CIO REPORTS

Q3 Market Outlook

Period Ending September 31, 2018

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Market Commentary

To understand the Trump administration, we think it's important to recognize President Trump's two major policy priorities: (1) trade and (2) immigration. He, along with his advisors Peter Navarro and Stephen Miller, see it as their responsibility to return the country back to a dominant manufacturing power, complete with U.S.-only supply chains and the demographics of decades ago. For them, stock market and immigration disruption are byproducts.

We trace most of this year's market volatility back to Trump's view of how the U.S. should look. The national security reviews (e.g. steel, aluminum, and autos), NAFTA negotiation, and China Section 301 study advance his goal of returning the country to a prior era. In pursuing his vision, Trump tends to govern by instinct, often using unpredictability and changing views to keep his negotiating opponents off-guard. The results bring volatility and uncertainty. We strive to look this through the volatility and noise to understand how policy is impacting the markets.

Q3 Outlook

Trade: Trade continues to be the biggest potential headwind to the market. As a result, we expect headline volatility to linger as markets attempt to decipher if Trump is bluffing on tariffs. While negotiations play out, we prefer to hold U.S. focused companies with minimal foreign currency exposure.

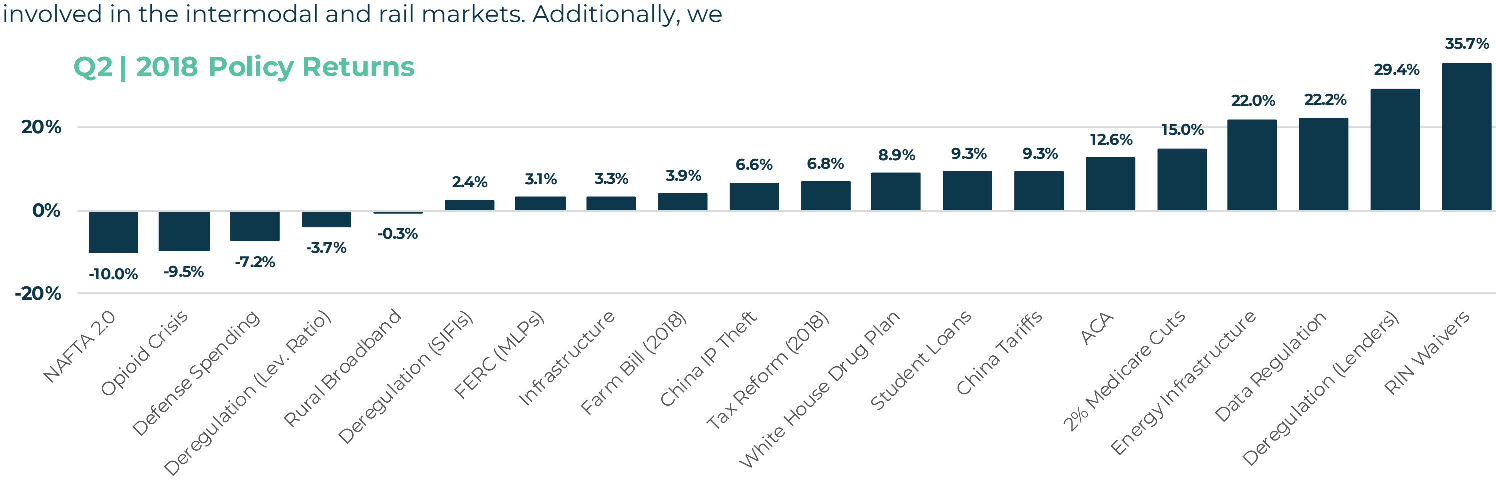
Immigration: Border arrests trended down in 2017 after Trump assumed office pledging an immigration crackdown. However, 2018 border arrests are increasing as the administration doubles down on its agenda and strengthens border enforcement. We expect this to impact U.S.-Mexico relations and be a defining issue in the midterm elections.

Trucking: Electronic logging devices (ELDs) continue to be implemented, which we believe will slow trucker productivity. In our view, ELDs are compounding a driver shortage, which will force trucking companies to increase compensation and turn down freight. In the transportation segment, we prefer to own asset-light companies with exposure to the spot freight market, as well as companies involved in the intermodal and rail markets. Additionally, we believe wage increases in the trucking segment may push inflation through the economy.

Defense: The FY 2019 appropriations process is underway in Washington D.C. We continue to expect companies involved in the defense industry to grow their revenues over the upcoming years due to the long lead time of defense contracts and the added tailwind from foreign demand. In our view, aircraft manufacturers and shipbuilders are best positioned to benefit from increased spending.

Refining Spreads: Drilling companies in the Permian Basin are extracting record amounts of oil, but pipeline capacity issues mean not all of it is moving out of the area. Trucking shortages (see above) are exacerbating the issue, allowing some refiners to purchase crude at the local spot price, which decreases their input costs, in the Permian Basin. After cracking the crude, the refining companies may then be able to capture the spread by selling the refined oil products at the market rate.

Q2 | 2018 Policy Returns



This chart tracks the performance of policies by measuring the performance of separate baskets of stocks. The adviser selects stocks for each basket based on what it believes will be impacted by each policy. See the disclosure section at the bottom of page 2 for a complete list of the stocks included in each policy and the calculation methodology.

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Policies Evolve.
Companies Change.
Markets React.

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Financial Deregulation: The Trump administration continues to focus efforts on dismantling the Consumer Financial Protection Bureau (CFPB), which is responsible for consumer protection in the financial sector. In our view, this will continue to benefit specialty finance companies, non-traditional lenders, and select regional banks.

Healthcare: The Affordable Care Act (ACA) continues to be a long-tail policy. After years of fighting the ACA, Republicans appear slightly more willing to expand Medicaid and Medicare, but only under their terms. Additionally, we don't believe risk reduction payments will be stopped under the ACA, despite headlines stemming from a recent New Mexico court ruling. In our view, these two items will help stabilize the insurance exchanges and insurer business models.

The Trump administration also released its drug pricing plan during Q2 2018. In our view, the plan does little to impact drug prices or pharmaceutical company business models.

Midterm Volatility: Campaign season will kick into high gear during Q3 2018. We expect the political environment to be highly charged. In our view, it's too early to call midterms as control over the recent Supreme Court vacancy and immigration will be contentious items. Plus, Donald Trump is a master campaigner who gets his base.

Outlook Summary

All of this is occurring against the backdrop of a solid U.S. economy. Unemployment is hitting record lows, GDP is approaching 3% annually, and lower tax rates are increasing profits. In our view, the market is looking through Trump's trade negotiations and governing style because of this strength. However, we are more cautious on the trade overhang and think headline risk, both to the upside and downside, will remain high. **We believe handicapping Trump is a fool's errand. Instead, we're continuing to monitor the above policies that we think will impact individual companies and sectors.**

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Important Information & Disclosures

The 2Q 2018 Policy Returns (on page 1) are calculated by averaging the performance of a group of stocks that AWA considers to impacted by each respective policy for the dates of 4/1/2018 to 6/30/2018. The following includes the tickers used for each policy—Defense Spending: LMT, RTN, NOC, BA, HII, GD, HXL, FLIR; RIN Waivers: ANDV, CVRR, HFC, PSX, VLO; Energy Infrastructure: LNG; FERC (MLPs): WPZ, SEP, EEP, SHLX, EQM, TCP, ETP; Student Loans: CECO, ATGE, CPLA, LAUR, LOPE, GHC, CHGG, NNI, NAVI, SLM; ACA: HCA, UHS, LPNT, EHC, MOH, CNC, WCG, HUM, CERN, TDOC, ASGN; White House Drug Plan: AGN, MMK, TEVA, MYL; 2% Medicare Cuts: LHCG, AMED, KND, CHE, SEM, MDT, ISRG, SYK, TFX; Opioid Crisis: MCK, CAH, ABC; Tax Reform (2018): CAL, COST, FISV, GPK, STAY, FIZZ; Farm Bill (2018): WMT, TGT, KR, DLTR, DG; NAFTA 2.0: DLPH, BWA, CMI, KSU; China Tariffs: EXPD, MATX, AAWW, CAT, DE, DG; Data Regulation: FB, TWTR, AMZN, GOOGL, ACXM, CLGX, EFX, TRU; China IP Theft: INTC, QCOM, NVDA, MU, IBM, AMD, TXN; Infrastructure: FLR, KBR, GVA, MLM, VMC; Rural Broadband: AMT, GLU; Deregulation (Lev. Ratio): BAC, GS, C, JPM, MS, WFC, STT, BK, NTRS; Deregulation (Lenders): ENVA, CURO, FCFS, GDOT, OMF; Deregulation (SIFIs): ASB, PACW, ZION, KEY.

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