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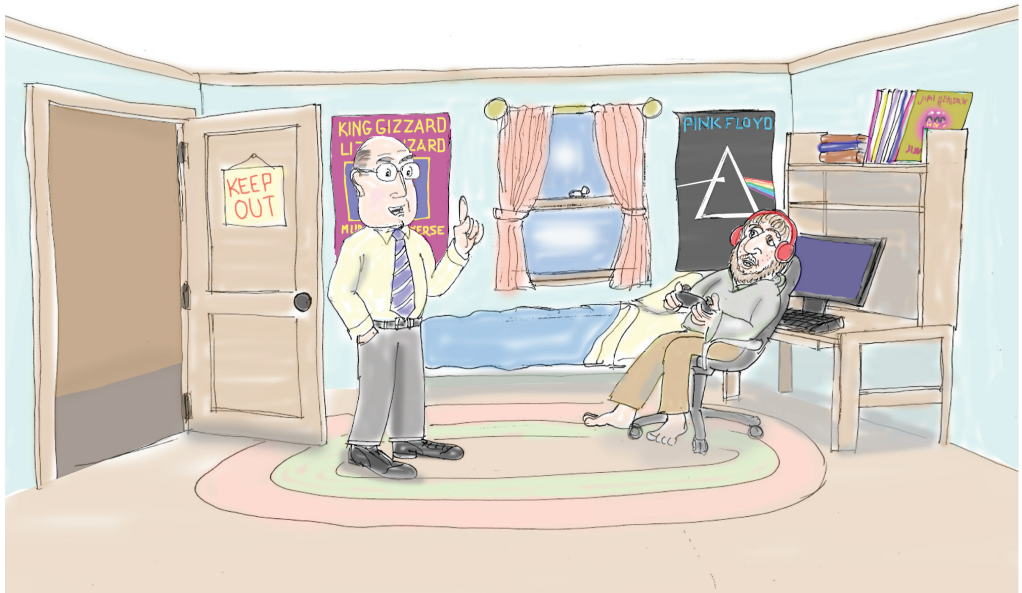
The Quarterly Commentary of Jurika, Mills & Keifer LLC



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"Son, it's time we have a talk about money... So, what exactly is a Bitcoin?"

THIRD QUARTER: JULY, 2018

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A Bumpy Ride

The bumpy ride in financial markets that marked the first quarter, continued into the second. A combination of mixed economic data, rising interest rates and a steady flow of political drama contributed to investor unease and ongoing volatility.

We also saw some important divergences develop between economies and markets. In the first quarter, much of the market volatility was centered around trade and the President's sweeping tariff proposals, and most markets reacted in lock step with one another. In the second quarter, while the trade

Summary:

- The markets continued their bumpy ride in the second quarter.
- We are starting to see divergences between economies and markets, with the U.S. again outperforming the rest of the world.
- The U.S. economy is running near full capacity, boosted in part by tax cuts. We expect growth to slow next year as the tax benefits run their course.
- Valuation levels are generally high, and markets are pricing in more good news than bad.
- Meanwhile, rising interest rates, inflation, trade, and politics, along with slowing global growth represent meaningful investment risks that are not adequately priced into markets.
- We therefore think it makes sense to maintain a more defensive allocation to risk assets.

rhetoric intensified, we began to see economies and markets behave differently.

Although it felt like a bumpy ride, the US stock market as measured by the S&P 500 index actually rose 3.4% in the quarter, and the technology-heavy NASDAQ 100 index rose 7.4%. Meanwhile, outside of the U.S., developed economy stocks declined 2.6% and Emerging Market stocks declined 7.9%. Bonds also had a tough quarter. The Barclays Aggregate Bond index declined 0.2%, and the Barclays Global Bond Index declined 2.8%.

While the U.S. economy continues to grow at a robust rate, economic growth outside the U.S. is showing some signs of slowing. In addition, most international economies are dependent on trade, especially with the U.S., and therefore sensitive to tariffs.

Some international economies are also sensitive to a rising dollar, especially if they have to purchase goods, such as oil, or service debt in dollars. Many emerging market economies fall into this category. They are heavily indebted and have large amounts of dollar-denominated debt, which becomes ever more difficult to service as the dollar rises.

The U.S., despite many challenges, remains in an economically enviable position: it has a highly diverse and innovative economy; it is almost self-sufficient in terms of food and energy production; it has a modest dependency on foreign trade (Imports are only 16% of GDP); it has the largest and most liquid capital markets; and it controls the world's reserve currency. The world economy may be highly integrated and interdependent, but economic problems outside of the U.S. tend to have limited impact inside the U.S., and conversely, economic problems inside the U.S. tend to impact economies outside the U.S. even more. Hence the saying, "when the U.S. economy catches a cold, the rest of the world economy gets a fever."

"When the symmetry of potential risk relative to potential return is unfavorable, as we think it is now, it makes sense to reduce risk."

But, the U.S. economy is not immune to its own economic maladies. Recessions are a normal occurrence here but are usually a result of our own making. Periods of growth ultimately run into natural limitations in the availability of labor, materials and capital; resulting in capacity constraints, inflation, rising interest rates, and periods of slower growth or recession.

Periods of excessive growth can result in the formation of economic bubbles, as they did in 2000 in technology and 2007 in housing. When these bubbles burst, the downside is more severe. At the moment, we do not see any major bubbles around the world, other than perhaps in sovereign debt.

Currently, the U.S. economy is benefitting from a sugar-rush of economic stimulus from the tax cuts enacted last year. This has put additional money into the pockets of companies and taxpayers, resulting in higher levels of spending and consumption, as well as lower levels of tax revenues. We expect the U.S. economy to grow at over 3% this year before slowing down again next year.

A good chunk of the stimulus results from the repatriation of offshore cash by companies and is one-time in nature. It is passing through the economy this year and next and should have run its course by 2020. The ongoing benefits of lower taxes will likely be more muted and are offset by increased borrowing by the Government to pay for them.

At present, the economy is running at near full capacity. Unemployment is now down to 4% and will likely decline further, well below the Federal Reserve's target employment rate. Baby boomers are retiring and there are fewer new people entering the workforce to replace them. A reduction in immigration - legal and otherwise - is contributing to stresses in the labor market.

As a result, we are starting to see upward pressure on wages, as well as bottlenecks in parts of the economy like construction, where it is increasingly difficult and expensive to find workers. So far, wage growth has been tepid, but we do believe that it will pick up later in the year if the economy continues to chug along at its present clip. Rising wages should result in higher prices for goods and services that use labor.

The Federal Reserve therefore should have little choice but to continue to raise interest rates to get ahead of price inflation. This is always a tricky process. Inflation, like a brush fire, has a way of spreading quickly once it is lit.

With a growing economy and rising interest rates, the U.S. Dollar should continue to appreciate relative to most other currencies.

The next recession:

As noted above, recessions are infrequent but normal occurrences. It is difficult to predict when a recession will occur, but it seems like the U.S. economy is in the late innings of the current period of expansion, and much of the recent boost in growth is temporal; the result of a tax cut that was financed by borrowing. This may be politically expedient, but it runs counter to conventional economic practice of building surpluses during periods of growth so that they may be used during periods of recession. When the next downturn occurs, there will no surplus to fall back on and additional stimulus will have to flow from additional borrowing.

Meanwhile, all of the talk related to trade and tariffs is adding a new level of uncertainty for companies and investors. While our expectation is that much of this is more political posturing than likely policy, it creates an air of uncertainty for all those who are affected and undermines the benefits achieved from fiscal stimulus and deregulation.

Trade, like many things, is not a simple or binary issue. Most goods that we produce or consume in this country are complex and are made up of many components made in many different places. Most company supply chains are global, complex, and take years to establish or change. A growing uncertainty about what rules and tariffs may or may not apply in what countries inhibits investment and capital creation.

While the U.S. may have legitimate gripes with China and other countries with respect to some trade policies and practices, the benefits to the U.S. economy of global trade far outweigh the costs. We therefore see the current focus on trade as misguided, and a negative factor in the economic balance that has the potential to do far more harm than good.

Investment Conclusions:

And so, in the U.S. we have an economy that is experiencing strong growth, benefitting from a large and temporary dose of fiscal stimulus. But it is also facing increasing headwinds from a rising dollar, rising inflation and interest rates, and the potential collateral damage of misguided trade policy.

Overseas, we see economies that are still growing, but where the rate of growth appears to be slowing, at least for the time being. Moreover, most of these economies are more vulnerable to whatever trade tariffs are enacted. Nobody wins a trade war, but some fare worse than others.

Looking at valuation levels, we continue to think that the valuation levels for most risk assets are moderately high and that expected returns from these levels are not very attractive.

Moreover, at current prices, markets are more vulnerable to negative surprises than positive ones. Besides unexpected increases in inflation and interest rates, trade disputes and tariffs and other potential geopolitical conflicts, there is also the ongoing Mueller investigation and the upcoming mid-term elections.

We do not try to time markets nor call recessions. We do however, pay attention to economic fundamentals, valuation levels, and indicators of risk and economic health, and adjust our long-term asset allocation accordingly. When the symmetry of potential risk relative to potential return is unfavorable, as we think it is now, it makes sense to reduce risk.

Therefore, despite the good current economic news in the U.S. economy, we are maintaining a more defensive asset allocation and a greater focus on U.S. over global and emerging economy equities.

Bonds, of most types and stripes, look pricey now, including longer duration Treasury bonds, as well as corporate and high yield bonds. We have tilted our bond allocation towards higher quality and shorter duration bond investments.

Over the long-term we continue to invest with a global focus; balancing investments targeted at areas of long-term growth and innovation - such as technology and biotechnology - with more defensive equity, alternative, and fixed income strategies aimed at mitigating volatility and risk.

As always, we welcome your comments, questions and referrals.

Jurika, Mills & Keifer, LLC
July, 2018

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Private Wealth Management

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Our firm is built on a core set of values and investment principles that have been central to our identity and success for over 30 years.

Our objective is to preserve and build the purchasing power of our clients' capital over time through forward-looking investment management and smart financial planning and counsel.

Our offices are in San Francisco, California. We welcome your inquiries.

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