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TAGStone CAPITAL INC

Second Quarter 2018

SECOND QUARTER MARKET OVERVIEW

Stocks were a mixed bag during the Second Quarter 2018 as the prospects of a prolonged trade war between the U.S. and China weighed on the stock markets throughout the world.

For the quarter, large, U.S. stocks, as measured by the S&P 500 index gained 3.43% as they struggled for direction. In contrast, the Russell 2000 index of small U.S. stocks gained 7.75% during the second quarter, enjoying a significant rebound from volatility in First Quarter 2018.

International stocks struggled more than their domestic counterparts with the MSCI EAFE index of large, foreign stocks declining 1.24% for the quarter.

Alternative asset classes were varied during the quarter too. Global real estate stocks, as measured by the S&P Global REIT Index gained 6.05%, while the MSCI Emerging Markets index fared worse among all major asset classes posting a decline of 7.96% for the quarter.

The prospects of rising interest rates continued to weigh on bonds. The Barclays U.S. Aggregate broad domestic bond index declined 0.16% in the second quarter.

The benefits of diversification shown through in the second quarter as the dispersion of returns between the best and worst performing major asset classes was almost 20%.

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E + R = O, a Formula for Success[1]:

Combining an enduring investment philosophy with a simple formula that helps maintain investment discipline can increase the odds of having a positive financial experience.

"The important thing about an investment philosophy is that you have one you can stick with."

David Booth
Founder and Executive Chairman
Dimensional Fund Advisors

An Enduring Investment Philosophy:

Investing is a long-term endeavor. Indeed, people will spend decades pursuing their financial goals. But being an investor can be complicated, challenging, frustrating, and sometimes frightening. This is exactly why, as David Booth says, it is important to have an investment philosophy you can stick with, one that can help you stay the course.

EQUITY INDICES	Jun. '18	2nd Qtr.	YTD
S&P 500 Total Return (Large-Cap Stocks)	0.62%	3.43%	2.65%
Russell 2000 Total Return (Small-Cap Stocks)	0.72%	7.75%	7.66%
MSCI EAFE (Developed International Stocks)	-1.22%	-1.24%	-2.75%
MSCI Emerging Markets (International Emerging Stocks)	-4.15%	-7.96%	-6.66%

FIXED INCOME INDICES	Jun. '18	2nd Qtr.	YTD
Barclays U.S. Aggregate (Broad Domestic Bonds)	-0.12%	-0.16%	-1.62%
Barclays 1-5 Yr. Credit (Short-Term Domestic Bonds)	-0.05%	0.26%	-0.44%
Barclays 5-10 Yr. Credit (Intermediate-Term Domestic Bonds)	-0.29%	-0.59%	-2.87%
Barclays U.S. TIPS (Treasury Inflation Protected Securities)	0.40%	0.77%	-0.02%
Citi World Gov't 1-5 Yr. Hedged (Short-Term Global Bonds)	0.24%	0.24%	0.41%

[1] Jack Canfield, The Success Principles: How to Get from Where You Are to Where You Want to Be (New York: HarperCollins Publishers, 2004).

This simple idea highlights an important question: How can investors maintain discipline through bull markets, bear markets, political strife, economic instability, or whatever crisis du jour threatens progress towards their investment goals?

Over their lifetimes, investors face many decisions, prompted by events that are both within and outside their control. Without an enduring philosophy to inform their choices, they can potentially suffer unnecessary anxiety, leading to poor decisions and outcomes that are damaging to their long-term financial well-being.

When they don't get the results they want, many investors blame things outside their control. They might point the finger at the government, central banks, markets, or the economy. Unfortunately, the majority will not do the things that might be more beneficial—evaluating and reflecting on their own responses to events and taking responsibility for their decisions.

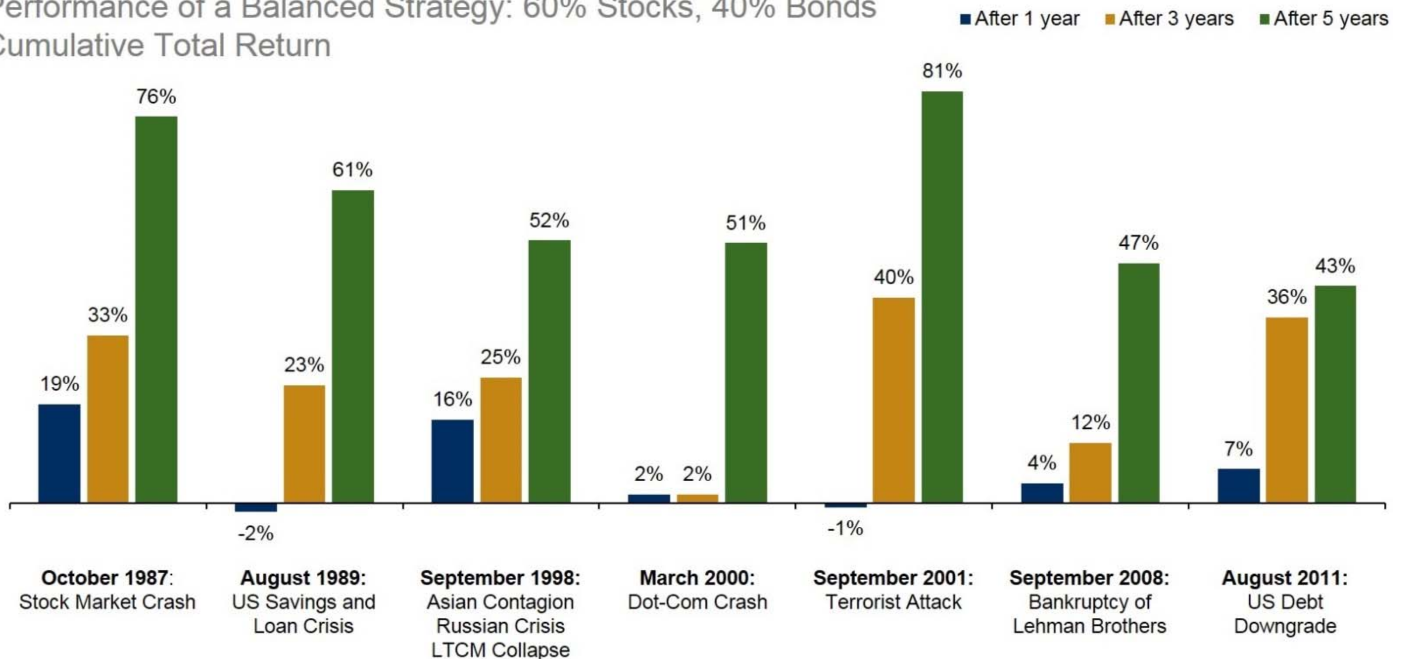
e + r = o :

Some people suggest that among the characteristics that separate highly successful people from the rest of us is a focus on influencing outcomes by controlling their reactions to events, rather than the events themselves. This relationship can be described in the following formula:

e + r = o (Event + Response = Outcome)

Simply put, this means an outcome—either positive or negative—is the result of how you respond to an event, not just the result of the event itself. Of course, events are important and influence outcomes, but not exclusively. If this were the case, everyone would have the same outcome regardless of their response.

Let's think about this concept in a hypothetical in-



In US dollars. Represents cumulative total returns of a balanced strategy invested on the first day of the following calendar month of the event noted. Balanced Strategy: 12% S&P 500 Index, 12% Dimensional US Large Cap Value Index, 6% Dow Jones US Select REIT Index, 6% Dimensional International Value Index, 6% Dimensional US Small Cap Index, 6% Dimensional US Small Cap Value Index, 3% Dimensional International Small Cap Index, 3% Dimensional International Small Cap Value Index, 2.4% Dimensional Emerging Markets Small Index, 1.8% Dimensional Emerging Markets Value Index, 1.8% Dimensional Emerging Markets Index, 10% Bloomberg Barclays Treasury Bond Index 1-5 Years, 10% FTSE World Government Bond Index 1-5 Years (hedged), 10% FTSE World Government Bond Index 1-3 Years (hedged), 10% ICE BofAML 1-Year US Treasury Note Index. Assumes monthly rebalancing. For illustrative purposes only. S&P and Dow Jones data copyright 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. ICE BofAML index data copyright 2018 ICE Data Indices, LLC. FTSE fixed income indices © 2018 FTSE Fixed Income LLC. All rights reserved. Bloomberg Barclays data provided by Bloomberg. Dimensional indices use CRSP and Compustat data.

Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Not to be construed as investment advice. Returns of model portfolios are based on back-tested model allocation mixes designed with the benefit of hindsight and do not represent actual investment performance. See "Balanced Strategy Disclosure and Index Descriptions" pages in the Appendix for additional information.

vestment context. Say a major political surprise, such as Brexit, causes a market to fall ("event'). In a panicked response, potentially fueled by gloomy media speculation of the resulting uncertainty, an investor sells some or all of his or her investment ("response"). Lacking a long-term perspective and reacting to the short-term news, our investor misses out on the subsequent market recovery and suffers anxiety about when, or if, to get back in, leading to suboptimal investment returns ("outcome").

To see the same hypothetical example from a different perspective, a surprise event causes markets to fall suddenly ("e"). Based on his or her understanding of the long-term nature of returns and the short-term nature of volatility spikes around news events, an investor is able to control his or her emotions ("r') and maintain investment discipline, leading to a higher chance of a successful long-term outcome ("o").

This example reveals why having an investment philosophy is so important. By understanding how markets work and maintaining a long-term perspective on past events, investors can focus on ensuring that their responses to events are consistent with their long-term plan.

The Foundation of an Enduring Philosophy:

An enduring investment philosophy is built on solid principles backed by decades of empirical academic evidence. Examples of such principles might be:

- trusting that prices are set to provide a fair expected return;
- recognizing the difference between investing and speculating;
- relying on the power of diversification to manage risk and increase the reliability of outcomes; and
- benchmarking your progress against your own realistic long-term investment goals.

Combined, these principles might help us react better to market events, even when those events are globally significant or when, as some might suggest, a paradigm shift has occurred, leading to claims that "it's different this time." Adhering to these principles can also help investors resist the siren calls of new investment fads or worse, outright scams.

The Guiding Hand of a Trusted Advisor:

Without education and training—sometimes gained from bitter experience—it is hard for non-investment professionals to develop a cogent investment philosophy. And even the most self-aware find it hard to manage their own responses to events. This is why a financial advisor can be so valuable—by providing the foundation of an investment philosophy and acting as an experienced counselor when responding to events.

Investing will always be both alluring and scary at times, but a view of how to approach investing combined with the guidance of a professional advisor can help people stay the course through challenging times. Advisors can provide an objective view and help investors separate emotions from investment decisions. Moreover, great advisors can educate, communicate, set realistic financial goals,

COULD STOCKS BE DUE FOR A PULLBACK THIS YEAR?

Midterm Years Can See Large Pullbacks, But Bounce Back

Year of Presidential Cycle	S&P 500 Average Intra-Year Pullback	S&P 500 Average Return a Year After Lows
First Year in Office	-14.0%	12.1%
Midterm Year	-16.9%	32.0%
Pre-Election Year	-11.5%	15.9%
Election Year	-11.8%	18.3%

Source: LPL Research, FactSet 01/25/18
Date: 1950-Present

and help their clients deal with their responses even to the most extreme market events.

In the spirit of the "e + r = o" formula, good advice, driven by a sound philosophy, can help increase the probability of having a successful financial outcome.[2]

Markets Have Rewarded Discipline:

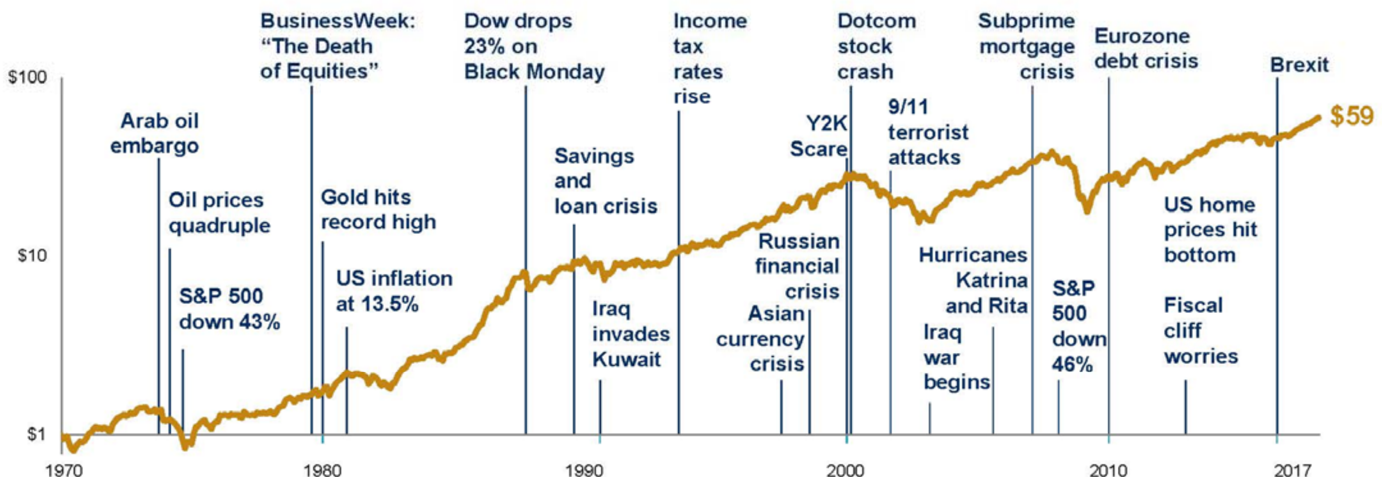
As we head into the election season, a look back at past-market crises can serve as an important reminder for investors today. As we have discussed before, the intra-year decline of the S&P 500 Index of large U.S. stocks has averaged 14.1% since 1980. That is the decline from the market high to the market low in any given 12-month calendar year.

However, as seen in the table on the previous page, the average intra-year decline of the S&P 500 Index during midterm election years, like 2018, is much higher. In midterm election years, the intra-year decline of the S&P 500 Index has averaged 16.9% since 1950.

For many, feelings of elation or despair can go with headlines leading up to and after controversial elections. We should remember that markets can be volatile and recognize that, in the moment, doing nothing may feel paralyzing. Throughout these ups and downs, however, if one had hypothetically invested $10,000 in a globally diversified portfolio of stocks in January 1970 and stayed invested, that investment would be worth about $590,000 at the end of 2017.

Markets Have Rewarded Discipline

Growth of a dollar—MSCI World Index (net dividends), 1970–2017



In US dollars. MSCI data © MSCI 2018, all rights reserved. **Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.**

A disciplined investor looks beyond the concerns of today to the long-term growth potential of markets.

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2. Adapted from "E+R=O, a Formula for Success," The Front Foot Adviser, by David Jones, Vice President and Head of Financial Adviser Services, EMEA.

Past performance does not guarantee future results. All investments include risk and have the potential for loss as well as gain.

Data sources for returns and standard statistical data are provided by the sources referenced and are based on data obtained from recognized statistical services or other sources we believe to be reliable. However, some or all information has not been verified prior to the analysis, and we do not make any representations as to its accuracy or completeness. Any analysis nonfactual in nature constitutes only current opinions, which are subject to change. Benchmarks or indices are included for information purposes only to reflect the current market environment; no index is a directly tradable investment. There may be instances when consultant opinions regarding any fundamental or quantitative analysis do not agree.

The commentary contained herein has been compiled by W. Reid Culp, III from sources provided by TAGStone Capital and Dimensional Fund Advisors, LP, as well as commentary provided by Mr. Culp, personally, and information independently obtained by Mr. Culp. The pronoun "we," as used herein, references collectively the sources noted above.

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