EUBEL BRADY & SUTTMAN
ASSET MANAGEMENT

MARKET REPORT
THIRD QUARTER 2018

Key Takeaways

- U.S. economic growth and stock markets performed well during the quarter, but non-U.S. economies and stock markets experienced more turbulence.

- We prefer short-term bonds over long-term bonds as the yield curve flattens. In general, we feel short-term bonds can achieve a good portion of the returns of longer term bonds while preserving our option to reinvest the eventual proceeds of short-term bonds in better yielding bonds in the future.

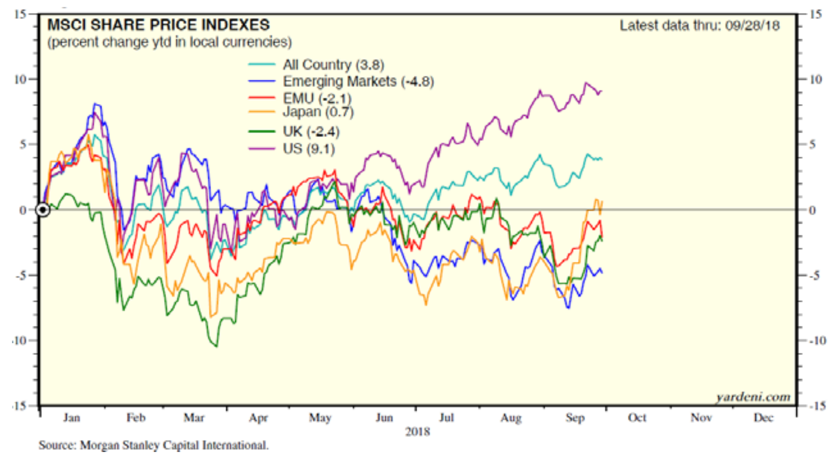
- We maintain a defensive positioning in a current environment characterized by less attractive asset prices.

Total Return as of September 30, 2018						
				Annualized		
	QTD	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**
S&P 500	7.7%	10.6%	17.9%	17.3%	14.0%	12.0%
NASDAQ	7.4%	17.5%	25.2%	21.8%	17.8%	15.8%
Russell 3000						
Index	7.1%	10.6%	17.6%	17.1%	13.5%	12.0%
Value	5.4%	4.2%	9.5%	13.8%	10.7%	9.8%
Growth	8.9%	17.0%	25.9%	20.4%	16.2%	14.2%
Russell Mid Cap						
Index	5.0%	7.5%	14.0%	14.5%	11.7%	12.3%
Value	3.3%	3.1%	8.8%	13.1%	10.7%	11.3%
Growth	7.6%	13.4%	21.1%	16.7%	13.0%	13.5%
Russell 2000 (Small Cap)						
Index	3.6%	11.5%	15.2%	17.1%	11.1%	11.1%
Value	1.6%	7.1%	9.3%	16.1%	9.9%	9.5%
Growth	5.5%	15.8%	21.1%	18.0%	12.1%	12.7%

Economic Overview

During the third quarter, many reported U.S. economic factors moved in a positive direction such as: economic growth, U.S. stock markets, corporate profits, employment, and consumer sentiment. At the same time, the Federal Reserve increased the federal funds target rate for the third time this year to 2.00% - 2.25%, a level not seen since 2008.

Global uncertainties were perhaps more abundant than typical during the quarter and year-to-date, but U.S. economies and stock markets appear to have largely avoided negative effects...so far. However, they may have been more of an exception as many countries and stock markets outside the U.S. were increasingly challenged



by factors such as slowing global growth, trade conflicts, political and geopolitical issues, rising U.S. interest rates, and a stronger U.S. dollar. The data from investment consulting firm Yardeni Research shown in the nearby graphs highlight the underperformance of non-U.S. stocks year-to-date.

The U.S. is not immune to global problems. But what is most concerning to us from an investor perspective was the continued lack of inexpensive securities across asset classes, which we have discussed at length in previous letters. This led us to maintain defensive positioning in client portfolios.

A Bloomberg article published just after quarter-end highlighted subprime mortgage bonds that traded for cents on the dollar after the financial crisis but now trade above 90 cents. From an investor's perspective, we look forward to the days when we may have the opportunity to capitalize on more attractive situations like these for your benefit.

U.S. Equities

The S&P 500 rose 7.7% for the quarter (including dividends), and is up 10.6% year-to-date. The healthcare sector outperformed during the quarter as earnings grew and healthcare companies may have been perceived as a relatively safe haven less susceptible to increases in interest rates than other types of firms. The technology and consumer discretionary sectors are outperforming year-to-date as the former continues disrupting many businesses while the latter benefitted from healthy consumer demand. All sectors posted positive returns for the quarter, but the materials sector posted the lowest return as tariffs may be adversely impacting some of these firms. The consumer staples sector has underperformed year-to-date on challenged growth and perhaps being viewed with less excitement from investors as bond alternatives.

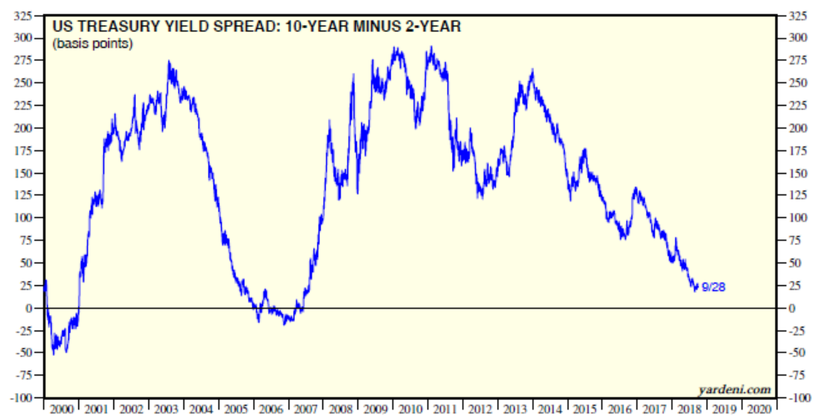
During the quarter, there was some reshuffling of companies between sectors. As a result, a newly created sector, communications services, replaced the telecommunication services sector. The telecommunications sector was running low on companies as mergers and acquisitions over time contributed toward reducing the number of companies in the sector to only three! That issue was alleviated as the new communications services sector combined the few companies remaining in the telecommunications sector with a number of companies from the consumer discretionary sector (e.g. Netflix, Comcast, Walt Disney) and the technology sector (e.g. Facebook, Alphabet). As many of these and other companies have increasingly competed in different industries, we think it has become more difficult to categorize them...but that hasn't stopped S&P from trying.

Large caps outperformed small caps during the quarter but small caps are leading year-to-date. Statistically inexpensive stocks underperformed their expensive counterparts during both time periods.

Fixed Income

Corporate bonds, as measured by the BofAML 1-to-10 Year Index, increased 0.8% during the quarter and returned -0.8% year-to-date. U.S. Treasuries and Agencies, as measured by a similar index, returned -0.1% for the quarter and -0.8% year-to-date. The 10-Year Treasury bond's yield increased to 3.1% from 2.9% at the end of the second quarter and 2.4% at the end of 2017. While some longer term bond yields (such as the 10-Year Treasury bond's yield) have moved up this year, we do not view many of them as particularly high enough to adequately protect your capital and purchasing power from inflation risk and interest rate risk. Hence, we generally remain focused on shorter maturities – on average.

Source: Haver Analytics.



Source: Haver Analytics.

As you can see in the graphs to the right from Yardeni Research, the difference between yields of the 2-year and 10-year U.S. Government Treasury bonds has been small in 2018 and has continued to narrow. This dynamic is called a flattening yield curve. The bottom graph shows that subtracting the yield of the 2-year Treasury bond from the 10-year Treasury bond has resulted in a very small number by quarter-end. Note that a "basis point" is a fraction of a percentage point such that 100 basis points are equal to 1 percent. Therefore, it is probably little surprise that we continue to find long-term bonds less attractive than short-term bonds, which give us a good portion of the yields from long-term bonds as well as the chance to reinvest the funds at interest rates that we think may be higher in the future.

Commodities

Commodities, as measured by the Bloomberg Commodity Index, returned -2.5% during the quarter and -3.4% year to date.

West Texas Intermediate oil prices were up a strong 21.2% for the year but edged down 1.2% to $73.25/barrel during the third quarter. Global oil suppliers recently decided against additional increases in oil output, and Iranian sanctions, which go into effect in November, could further restrict oil supply.

Copper declined 5.4% during the quarter and is down 15% for the year. Some perceive copper to be a barometer of global economic growth and therefore view these movements as potentially bearish for the future. Interestingly, gold has declined for six straight months, its longest monthly stretch of decreases since 1997.