Quarterly Investment Report
September 30, 2018

Dear Investor:

The market, as measured by the S&P 500, put in a solid third quarter price return of 7.2%, bringing the year's price gain to 9.0%. We are probably in the late innings of this business cycle, this expansion is aging, but our economy today is in a good place. This is thanks to very low interest rates, modest inflation, high business and consumer confidence readings, tax cuts, a world still awash in money, and a government that has gotten out of the regulatory way for many industries.

Our Gross Domestic Product (GDP) clocked in at 4.2% annualized growth for the second quarter. That number isn't sustainable going into the third quarter since the second quarter got extra oomph from higher exports ahead of potential tariffs. But expectations for the third quarter are still for a healthy 2.5% - 3.0%. Car and home sales are weakening a little and higher mortgage and loan rates will add to the slowdown.

The job market is really tight. We've had three consecutive weeks of the lowest unemployment numbers since 1969. The latest report was 3.9% and we could even see it drop to as low as 3.7% or 3.8%. Though we are seeing some upwards movement on wage growth, the balance of power between businesses and labor still favors companies.

The questions and uncertainties swirling around tariffs have yet to play out and any negative affects on future company earnings are premature to discern, so we should appreciate the fantastic earnings numbers that have come through for the second quarter. In fact, the first two quarters of the year have been stellar quarters for earnings growth, and If analysts are correct in estimating earnings growth for the third quarter, that will make three consecutive quarters where earnings growth has exceeded twenty percent. As has been the case historically, earnings benefit from cost cutting and stock buybacks, but in the first two quarters of 2018 revenue growth has doubled to about 8% from 2017's 4% levels. Revenue growth will undoubtedly slow down in the last two quarters of the year though remain higher than 2017.

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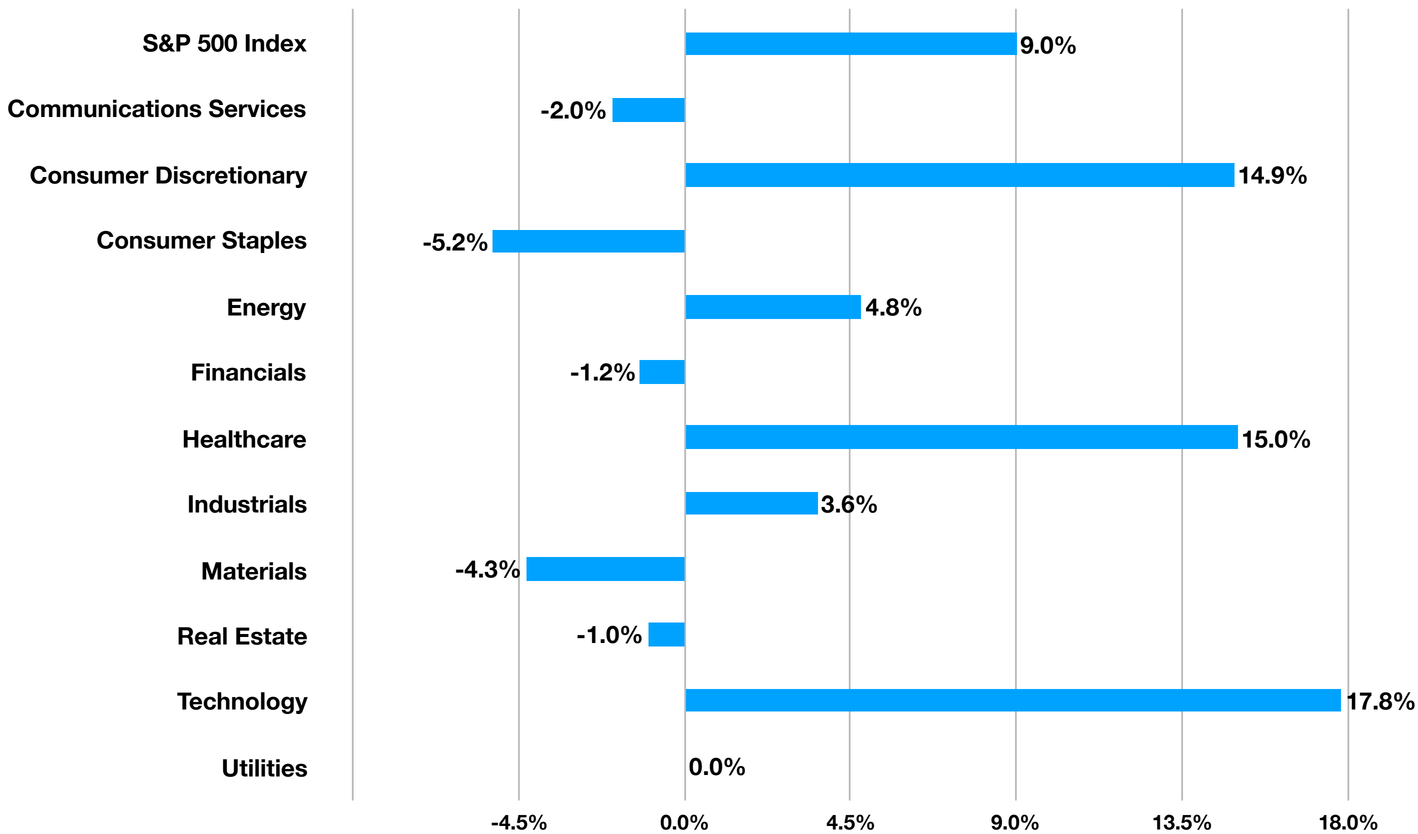
Corporate Earnings!

Here we show a chart of company year-to-date stock price performance for the eleven sectors of our economy so far this year. The three standout sectors, Consumer Discretionary, Technology, and Healthcare bring out a couple of points that inspire us to think that while the bull may someday soon take a mini rest, he's nowhere yet ready to retire into a full out deep slumber.

2018 Year-To-Date Price Performance S&P 500



Consumers account for 70% of economic spending and the consumer experience just keeps getting better and better. Consumer confidence is at an eighteen year high. At the push of a button we can order most anything from the comfort of our home. The last time the consumer felt this good was back in 2000 just before the DotCom crash. That should give us pause to not be complacent as high consumer confidence certainly doesn't guarantee that the bull market will continue. But, for now consumers are appropriately reacting to a growing economy with modest inflation, a strong dollar, and, for now, contained debt excesses.

The technology revolution is still young, it's only about 60 years old beginning with the integrated circuit in 1960. It will go on from here for many decades. Computer processing gains are huge and offer tremendous growth opportunities for companies in cloud computing, artificial intelligence, blockchain and social networking. Also, technology developments extends favorably to many industries as they can benefit from gains in productivity.

In healthcare we are relentless in our pursuit to understand the human genome and diseases. It took $3 billion to map the first human genome. Now we do it for under $1,000. Our biotech industry is just on the doorstep of innovation. If only the structure of our healthcare costs and insurance could catch up to the improving efficiencies of biology and engineering sciences.

A Less "Accomodative" Federal Reserve

As widely anticipated, the Federal Reserve raised the benchmark fed funds rate by a quarter percentage point to 2.25% at its meeting on September 26, 2018. This is the eighth rate increase since December 2015 and the third rate hike this year. The Fed signaled that it will probably raise rates in December and potentially three more times in 2019.

But, it all depends on the path of inflation. If inflation remains at around 2%, they will reassess how the economy has responded to raises since 2015. And if inflation heats up they are ready to move faster on rates.

There wasn't much earth shaking in the Fed's statements, but pundits zeroed in on the removed reference to "accomodative" Fed policy. That simply means that they believe rates are getting closer to the neutral level needed to balance inflation and employment goals.

The Elephant in the Room - Tariffs

The recent imposition by President Trump of tariffs on $200 billion of Chinese goods brings the total tariffs on China to $250 billion. This is punishment for China's theft of intellectual property through counterfeiting famous brands, stealing trade secrets, pressuring companies to share technology to gain access to China's markets, and alleged cyber attacks on U.S. companies to get trade secrets. China has retaliated with new taxes on about $60 billion of U.S. imports. Americans bought $375 billion more goods from China than the Chinese bought from the U.S. last year, which means the U.S. has a lot more to punish than China does.

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China can retaliate in ways beyond tariffs such as reducing or selling its considerable holding of U.S. debt. China holds about $1.2 trillion of our debt, which is about a fifth of the total held by foreign countries. We could withstand it if China changed its policy, but it would certainly drive up the costs of many of the products we buy every day. Realistically though, if China did pull back on U.S. debt, their Yuan currency would strengthen and cause their products to be more expensive for foreigners, which is not an attractive option for the Chinese. Another retaliatory tactic China could employ, may be to make it harder for Trump to get a nuclear deal with North Korea.

If we ignore for a moment the unethical acts of stealing intellectual property, and focus instead on the trade imbalance itself, the reported import-export trade imbalance between the U.S. and China isn't accurate. The problem is that the reported trade numbers assume that each product has a single country of origin and that the declared value of that product goes to that country.

So, for example, every time an iPhone rolls off the factory floor of Foxconn (Apple's largest contractor in China) and travels to a port in California, it's counted as an import from China. When actually about a dozen companies from five different countries supply parts for the iPhone. After decades of building a globalized version of free trade it's pretty darn difficult to assign an 18th century method of accounting for trade. The truth is that the traditional comparative advantage argument for trade should be expanded to include the notion of mobile capital. Mobile capital can borrow billions of dollars in one country at low rates of interest and then use that money to outbid domestic capital for assets in another country with fewer sources of credit.

Late Cycle Caution

While we can't yet know the outcome of tariff wars, we do know that both the U.S. and China will continue to dig in their heels and likely affect changes in global trade. Though global growth is set to remain above trend for now, changes to U.S. trade policy and rising interest rates are reasons to be cautious with our investments. In fact, we have been managing our portfolios at Ascend in anticipation of a market downturn by choosing those companies that can best withstand prolonged revenue and profit decline; companies that lead in their industry and have ample cash and manageable debt.

We don't anticipate a recession until at least well into 2019 but we recognize that stocks typically fall months ahead of economic decline. As we have said many times before, we will never try to time market declines as that is a losing game. Our strategy is to forfeit some of today's upside gains by modestly cutting back our long-term allocations to stocks, but remaining invested in stocks overall. Of course, every individual has a different asset allocation strategy largely determined by risk tolerances, age (time horizon), earning power and budgetary constraints. Our mantra for investing is to always choose quality growth assets at a reasonable price and prudently do our best to protect individual portfolios through all business cycles.

Sincerely,

Enjoy the changing season!

Ellen P. Le

Ellen P. Le, CFA
President