Peter Sorrentino, Chief Investment Officer, Comerica Asset Management Fourth Quarter 2018

Quarterly Commentary

2018 in Review

After a record-setting extended advance, the U.S. equity market entered a consolidation phase, initially as a market correction, defined by a decline of 10% from the high, and as the year ended, a broad decline came within twenty-four basis points of crossing the 20% decline threshold of a bear market. The advance that began in the second quarter of 2009 culminated in late September of this year with an annualized return of 17.13%, well more than the historic return on equities of 10%. Due to the length and homogenous nature of the advance, it would be well within the scope of history for the market (as defined by the S&P 500® Index) to decline to a level of 2245. This is based on historic price patterns and would also be supported by the underlying valuation metrics. As viewed through the lens of price-to-earnings, sales and cash flow in the market was in the ninetieth plus percentile. The afore mentioned 2245 level would put the market back at strong valuation support levels, making it a compelling alternative to fixed income assets.

The fading influence of global central bank intervention resulted in a return of market volatility to financial assets, as rising short-term interest rates forced investors to act upon unprofitable holdings. During much of the post-2009 advance, negative interest rates put little imperative on investors to deal with bad investments as they were effectively being paid to borrow. The recent equity market decline is somewhat unique in nature as its impact is, for the most part, ubiquitous, impacting companies of all sizes and lines of business. In past declines, while the overall direction of the market was down, some groups typically held up better than others, thus forming the leadership for the next advance. So far in this recent decline, that has not been the case. There are some exceptions, as both developed and emerging markets began to stabilize following the initial decline. International markets have begun to uncouple and did not fully participate in the subsequent selloffs that gripped the U.S. equity market in the waning days of 2018.

It was the dramatic decline of the monolithic stock market leadership that was perhaps the most notable event of the closing quarter, with technology shares more than erasing the 18.75% advance of the prior nine months to close 2018 with a 3% loss. Almost as noteworthy was the reversal of the health care sector's emerging leadership, all attributable to a Federal Court ruling calling into question the legality of the Affordable Care Act. On November 30th of 2018, that news sent health care stocks down 6.5%. In the days that followed, the group lost not only the balance of its 16% gain, but an additional 2.5%. The year ended with the group recovering to finish roughly where it started for the year. This was not the only leadership rotation to fall victim to the broad market decline, as the Russell 2000® Index outperformed the larger Russell 1000® Index from the beginning of the year until the end of the third quarter. However, once the selling began, it fell hardest upon the share prices of those smaller, less liquid companies. The year ended with the Russell 2000® Index off 12% to the Russell 1000® Index's decline of 6.6%. In the end, last year's equity market winners were not based upon valuation or momentum, but upon the strength of the U.S. consumer, as discretionary and utility shares were able to post gains.

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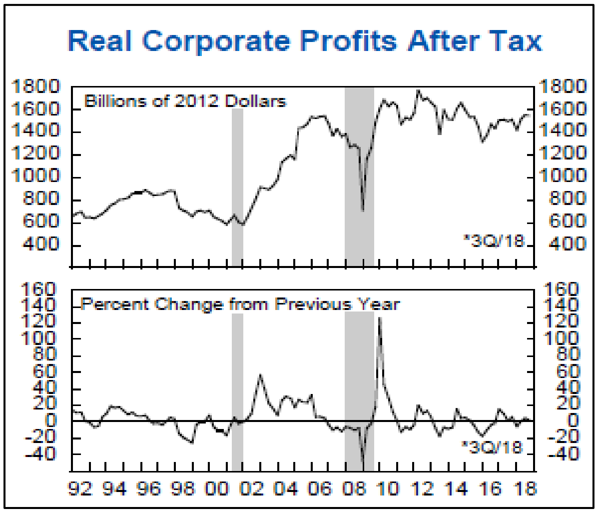
Looking Ahead to 2019

Based upon the current Comerica economic forecast for slightly slower GDP growth of 2.5% in 2019, and declining inflation with CPI dropping from 2.3% in 2018 to 1.8% in 2019, the underlying fundamentals are supportive for equities. Our outlook for corporate earnings calls for a deceleration in growth from the 15% increase of 2018, that was driven by both a 6% topline revenue improvement and profit margins returning to the 12% cycle peak, to a 4.4% earning advance in 2019 supported by a 1.94% topline revenue increase and an incremental 0.50% margin improvement.

Our view that the U.S. economy is in the late stage of the current economic advance leads us to favor investments in business, as opposed to consumer spending. The passage of the 2018 tax reform measures favors domestically-oriented companies versus the multinationals. The impact of the tax law changes is to enhance the return potential on reinvested profits, as each incremental dollar of revenue can potentially yield a greater level of profit to the business. Larger multinational enterprises can exploit tax rate differentials in numerous jurisdictions, effectively lowering the impact of higher tax rates in any particular country. Typically, the companies that will realize the greatest benefit are small to medium-sized businesses where the supply chain and customer base are principally domestic. This has the additional benefit of avoiding the impact of what we believe is a secular advance in the value of the U.S. dollar. The value of the dollar culminated a forty-year decline relative to other developed market currencies in June of 2011. Since that time, the composition of the U.S. trade balance has changed, as domestic energy production has largely displaced imports. The shift in the composition of the trade balance from consumables (in the form of crude oil) to hard assets, such as consumer and industrial goods, has fundamentally altered the dynamics of the global monetary composite. Further boosting the value of the dollar are the actions of the Federal Reserve Bank, as it not only raises the cost of credit but reduces the supply of dollars through the reduction of its holdings of government debt obligations.



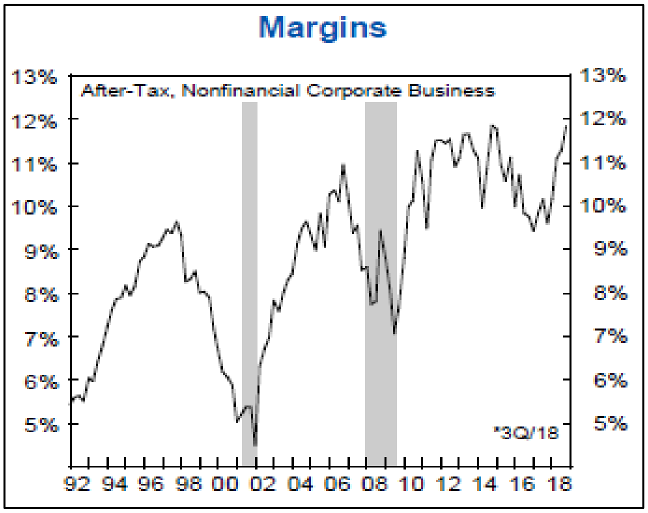


Exhibit 1 (Source: Crandall, Pierce & Company)

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With the prospect of a potential recession on the horizon, we recommend an exposure to global markets – a well-diversified emerging market representation. The distortions in global markets brought on by not only the Financial Crisis, but the policy response to it, have produced an outsized concentration in the developed markets relative to their share of global economic output. As policy makers move to return to historic policy norms, these imbalances will most likely begin to correct themselves. The faster-growing economies of emerging Asia and Europe are expected to attract capital investment as they forecast to deliver higher returns during the coming years. This does not portend the collapse of developed markets, rather, it is the likelihood that investment returns in the developed markets will lag those of the emerging markets. As such, we believe it prudent, where appropriate, to diversify equity exposure into these markets.

Our concern regarding the declining quality of corporate balance sheets has not abated, and the risk presented by the size of the high yield debt market remains one of our significant concerns for 2019. While the recent equity selloff resulted in a flight to the safety of U.S. Treasury securities, serving to reverse an evolving rise in the term structure of interest rates, we view this as temporary. The Treasury Department's own forecast calls for auctions of greater than $200 billion in 2019, at a time when international tensions have led many central banks to reduce or eschew ownership of U.S. Treasury debt. The result should be a gradual steepening of the domestic yield curve as the equity market stabilizes. Our emphasis in the taxable debt market is on high quality obligations biased to the short end of allowable maturity schedules. We continue to find value in municipal obligations as credit quality improves, thanks to states and municipalities addressing the funding of post retirement obligations. The positive nature of the term structure within the municipal bond market presents investors with a legitimate risk versus return proposition.

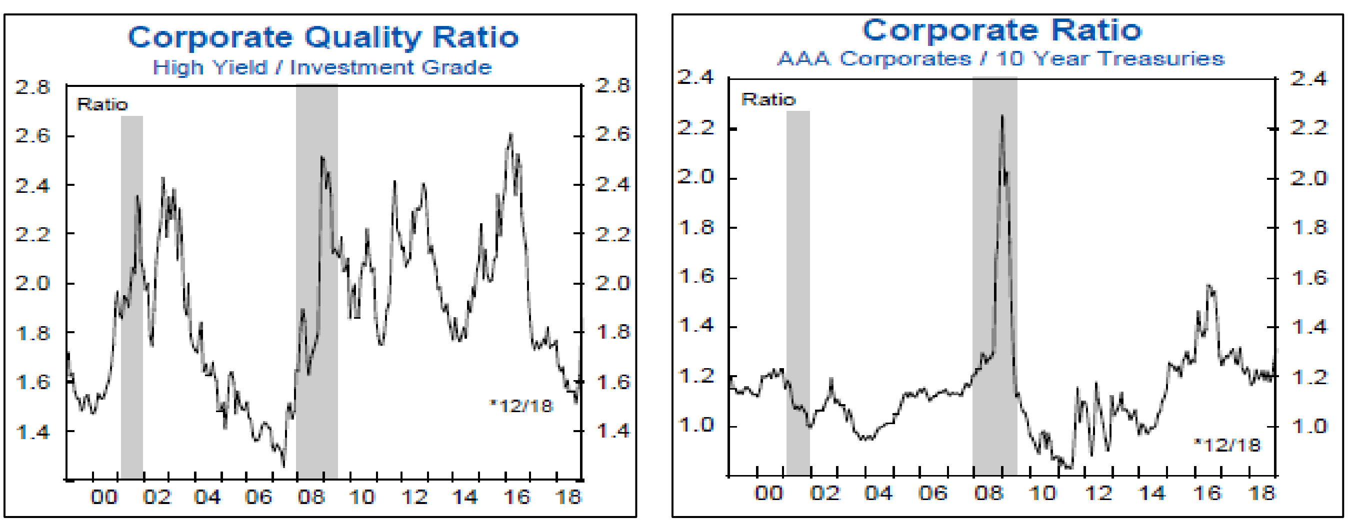

Exhibit 2 (Source: Crandall, Pierce & Company)

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