

Q1 2018

HFG | TRUST

QUARTERLY MARKET REVIEW

FIRST QUARTER 2018



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MARKET REVIEW

First Quarter 2018

The first month of the year, global stocks came out of the gate strong; however, February and March gave back January's return. For the quarter, returns were generally flat to negative. US growth stocks, both small and large, had moderate returns of 1-2%. On the other hand, US Value stocks had declines of 2-3%. International Markets offered mixed results as Developed Markets had losses of 1-3%, but Emerging Markets had modest gains of 1-3%.

This quarter's volatility may appear to be unusual with 400-500-point daily changes in the Dow. However, this volatility must be put into perspective. When I started in the early 1980's, the Dow was hovering around 1,000. Today, it floats between 24,000-26,000. A 500-point change today is no different than a 20-point change back in the 80's. In summary, what appears to be abnormal volatility with large down days followed by strong up days, is just normal market behavior.

How do we develop a strategy around this volatility? First, we start by understanding your financial goals. Next, we build a plan for your journey. In the plan, we have contingencies for risk and opportunity. We use time as our core risk mitigator. For example, if our client is twenty years from retirement, they should have more than two-thirds of their wealth in global equities because rarely have stocks underperformed bonds over this period of time. If our client is indeed retired today, we need to have predictable cash flow for their lifestyle. Ideally, we want the equivalent of 10 years of cash flow in fixed income / bonds to provide predictable income. The remaining part of the portfolio is unlikely to be needed for 10-15 years, and thus should be allocated to global stocks to offset inflation.

OVERVIEW

Market Summary

World Stock Market Performance

US Stocks

International Developed Stocks

Emerging Market Stocks

Real Estate Investment Trusts (REITs)

Fixed Income

Impact of Diversification

MARKET REVIEW - CONTINUED

First Quarter 2018







Another important consideration is how we use evidence to build our equity strategy. We are firm believers in the work of Dr. Fama and Dr. French. In 1993, they published a paper on how to increase returns on diversified stock portfolios. They are the origin of the concept known as “factor-based” investing. In their paper, they determined there were two factors that provided better returns for diversified stock portfolios over time. The first factor was called the “size” factor. Their research determined that small stocks had better returns than large stocks over time. The second factor was called the “relative value” factor. They found that value stocks had higher returns over time than growth stocks. They defined value stocks as companies with low stock prices compared to their stated book value (net worth), while growth stocks had high stock prices to their stated book value. Since then, they have found a third factor called the “profitability” factor. They have discovered stocks with higher profit margins have had higher returns than stocks with lower profit margins. Thus, we use mutual funds that combine these three factors to develop our client’s equity strategy.

As we use this “Evidence-Based” approach, it is important to understand what the limitations are to this or any other proven strategy. The first limitation is that the strategy won’t have positive returns when global stocks are down. If equity markets are universally down, there is no predictable or repeatable strategy to generate positive returns. Thus, investors aren’t getting a free-lunch. Second, the historically higher returns of size, relative value, and profitability haven’t had better returns every year. Returns were superior over long-time periods and the historical odds of these factors having higher returns than indexing were about 65-80% over 5 year rolling periods. Thus, there are periods where larger companies, growth companies, and lower profitable companies have had better returns. There are no absolutes in investing. The important point is that you need to be comfortable with the idea that uncertainty is inherent to the investment journey.

As you proceed through our Quarterly Market summary, I encourage you to view the information as just news. It may help you understand why your portfolio behaved a certain way; however, there is no “informative” information to use to predict the next quarter or the remainder of the year. The evidence suggests investors are best served by embracing diversification, tilting equity strategies to the three factors we discussed above, and giving their portfolio time to grow. At HFG Trust, we can assure you we are doing our part in diversifying your portfolio and building equity strategies around these three factors. In turn, we ask for patience and a long-term philosophy in order to provide your plan and journey the highest probability of success.

MARKET SUMMARY

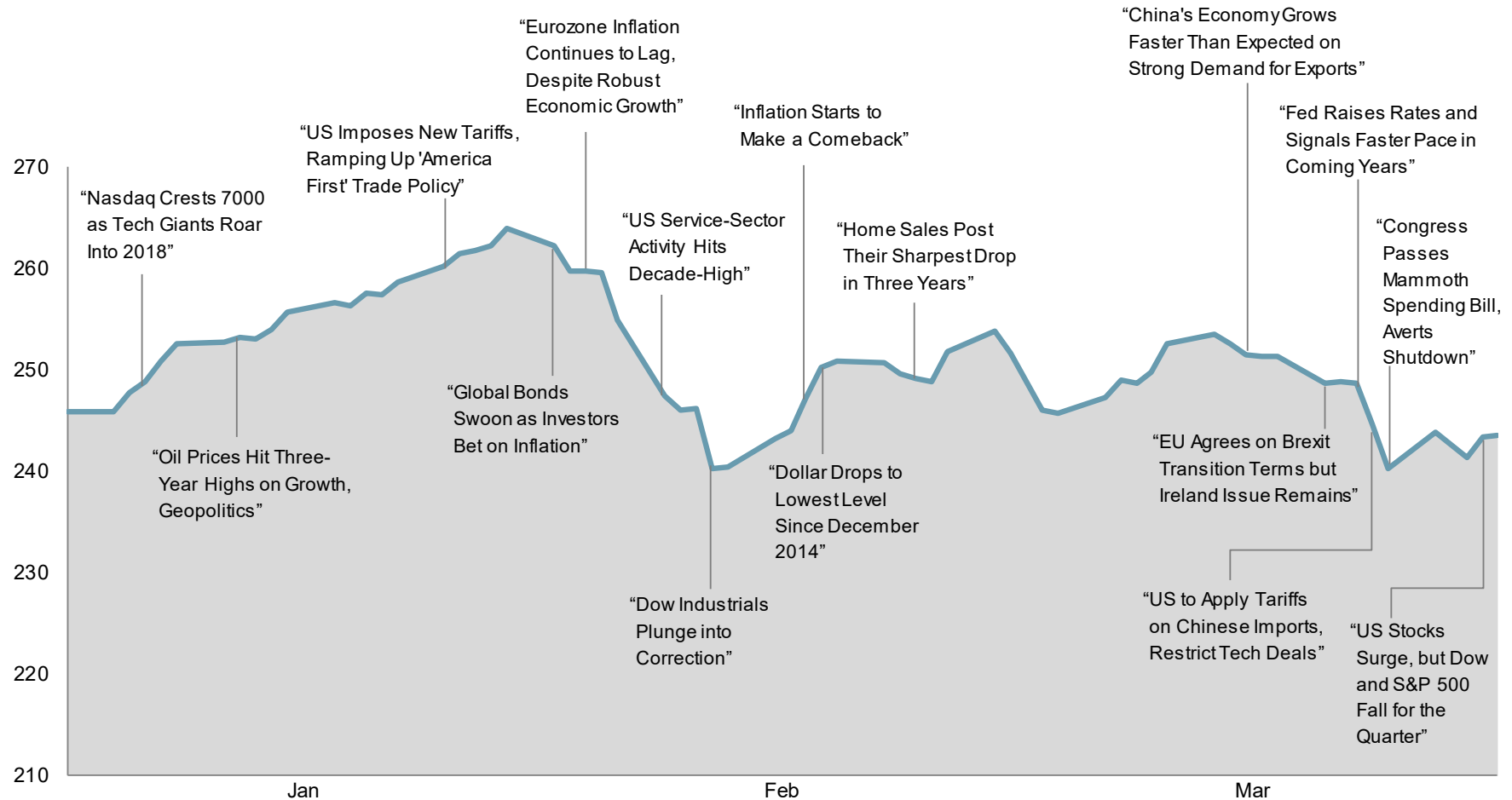
Index Returns

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Q1 2018	STOCKS				BONDS	
	-0.64%	-2.04%	1.42%	-5.79%	-1.46%	0.94%
						
Since Jan. 2001						
Avg. Quarterly Return	1.9%	1.5%	3.2%	2.5%	1.1%	1.1%
Best Quarter	16.8%	25.9%	34.7%	32.3%	4.6%	4.6%
	Q2 2009	Q2 2009	Q2 2009	Q3 2009	Q3 2001	Q4 2008
Worst Quarter	-22.8%	-21.2%	-27.6%	-36.1%	-3.0%	-2.7%
	Q4 2008	Q4 2008	Q4 2008	Q4 2008	Q4 2016	Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (FTSE WGBI ex USA 1-30 Years [hedged to USD]). S&P data copyright 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2018, all rights reserved. Bloomberg Barclays data provided by Bloomberg. FTSE fixed income © 2018 FTSE Fixed Income LLC, all rights reserved.

WORLD STOCK MARKET PERFORMANCE

MSCI All Country World Index with selected headlines from Q1 2018



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the current news.

Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

WORLD STOCK MARKET PERFORMANCE

MSCI All Country World Index with selected headlines from past 12 months

Short Term (Q2 2017–Q1 2018)



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news. Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2018, all rights reserved.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

US STOCKS

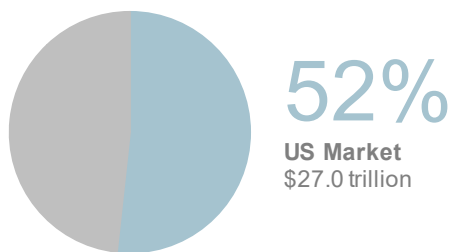
First Quarter 2018 Index Returns

The US equity market posted a negative return for the quarter.

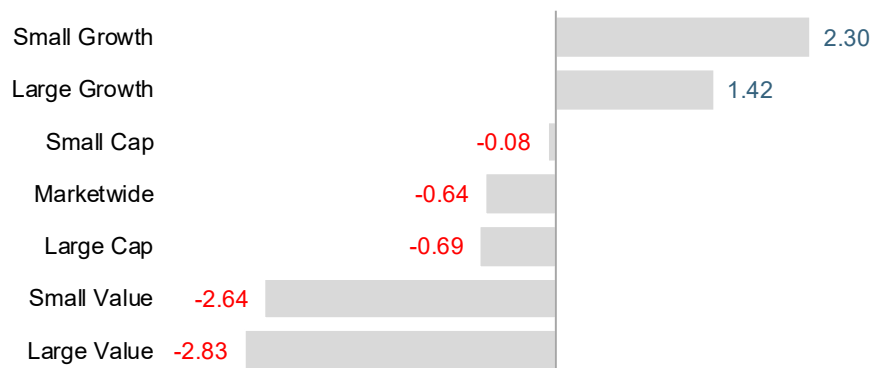
Value underperformed growth across large and small cap indices.

Small caps outperformed large caps.

World Market Capitalization—US



Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	* Annualized			
	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	13.81	10.22	13.03	9.62
Large Cap	13.98	10.39	13.17	9.61
Large Value	6.95	7.88	10.78	7.78
Large Growth	21.25	12.90	15.53	11.34
Small Cap	11.79	8.39	11.47	9.84
Small Value	5.13	7.87	9.96	8.61
Small Growth	18.63	8.77	12.90	10.95

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INTERNATIONAL DEVELOPED STOCKS

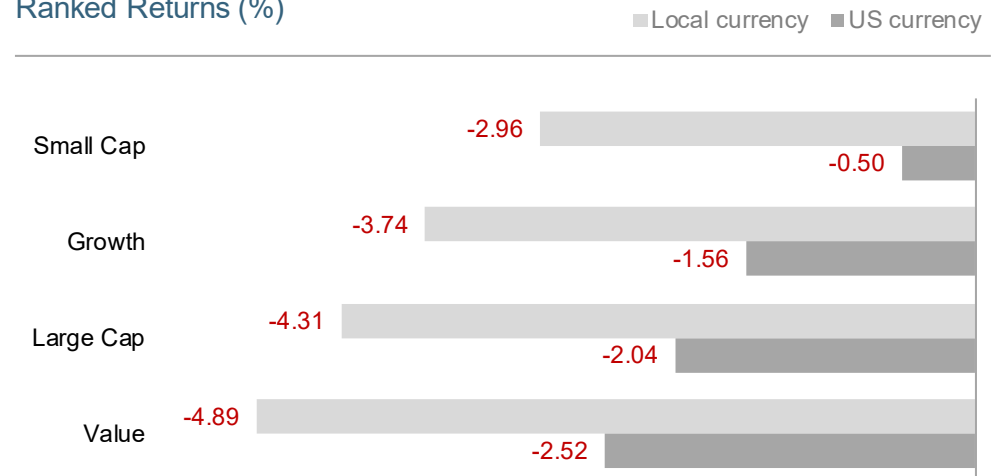
First Quarter 2018 Index Returns

In US dollar terms, Developed Markets outside the US underperformed the US and Emerging Markets during the quarter.

Value underperformed growth in non-US Developed Markets across large and small cap indices.

Small caps outperformed large caps in non-US Developed Markets.

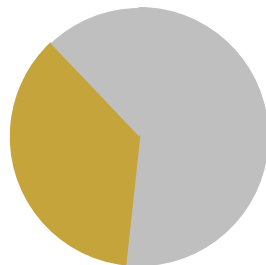
Ranked Returns (%)



World Market Capitalization—International Developed

36%

International Developed Market
\$18.9 trillion



Period Returns (%)

* Annualized

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	13.92	5.30	6.04	2.59
Small Cap	21.16	11.30	9.71	5.81
Value	11.66	4.46	5.44	2.08
Growth	16.28	6.06	6.58	3.03

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EMERGING MARKETS STOCKS

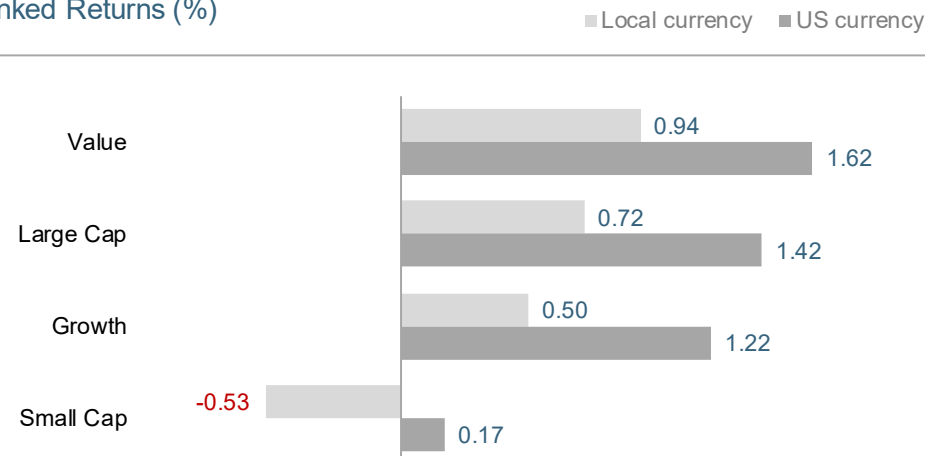
First Quarter 2018 Index Returns

In US dollar terms, Emerging Markets outperformed Developed Markets, including the US, during the quarter.

The value effect was positive in large cap indices, but negative in small cap indices within Emerging Markets.

Small caps underperformed large caps in Emerging Markets.

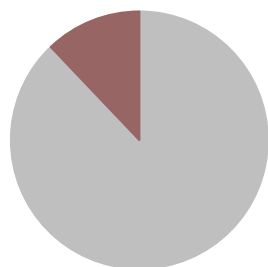
Ranked Returns (%)



World Market Capitalization—Emerging Markets

12%

Emerging Markets
\$6.3 trillion



Period Returns (%)

* Annualized

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	24.93	8.81	4.99	3.02
Small Cap	18.62	7.23	4.58	4.36
Value	18.14	6.65	2.57	2.07
Growth	31.73	10.89	7.30	3.87

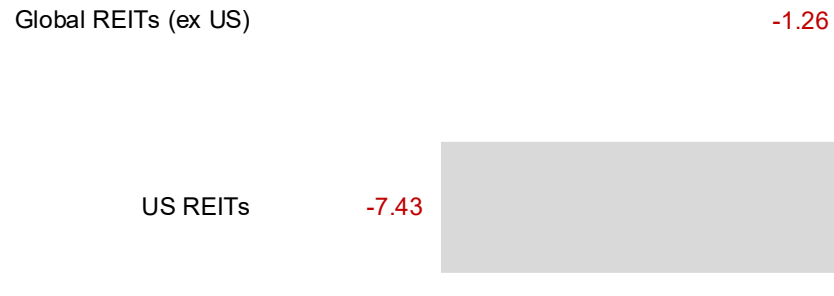
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REAL ESTATE INVESTMENT TRUSTS (REITs)

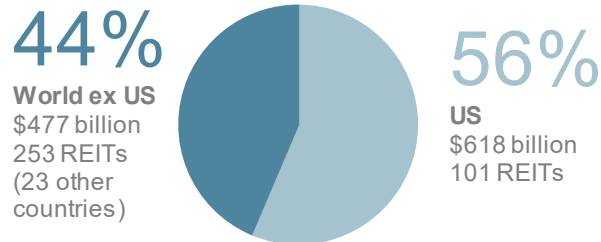
First Quarter 2018 Index Returns

Non-US real estate investment trusts outperformed US REITs in the first quarter.

Ranked Returns (%)



Total Value of REIT Stocks



Period Returns (%)

Asset Class	* Annualized			
	1 Year	3 Years*	5 Years*	10 Years*
Dow Jones US Select REIT Index	-3.68	0.74	5.97	6.02
S&P Global ex US REIT Index (net div.)	10.20	3.59	3.73	2.51

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2018.

FIXED INCOME

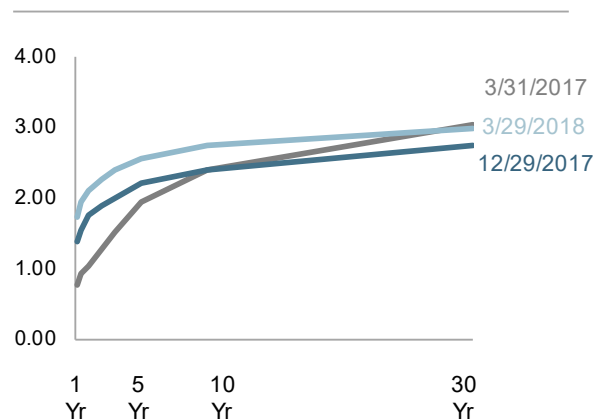
First Quarter 2018 Index Returns

Interest rates increased in the US during the first quarter. The yield on the 5-year Treasury note rose 36 basis points (bps), ending at 2.56%. The yield on the 10-year Treasury note increased 34 bps to 2.74%. The 30-year Treasury bond yield rose 23 bps to finish at 2.97%.

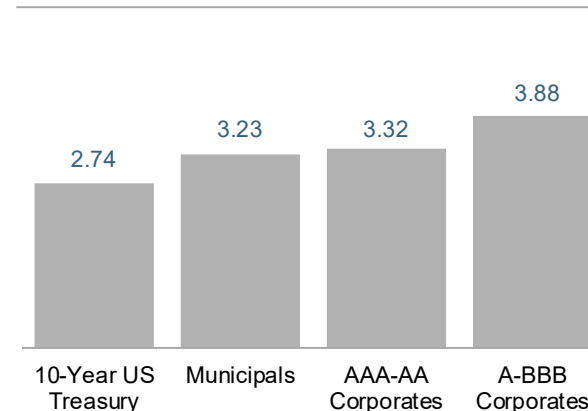
On the short end of the yield curve, the 1-month Treasury bill yield increased 35 bps to 1.63%, while the 1-year Treasury bill yield rose 33 bps to 2.09%. The 2-year Treasury note finished at 2.27% after a yield increase of 38 bps.

In terms of total return, the increase in rates pushed bond prices slightly down as short-term corporate bonds dipped 0.38% and intermediate corporates fell 1.50%. Short-term municipal bonds advanced 0.10%, while intermediate municipals declined 1.29%.

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



Period Returns (%)

Asset Class	* Annualized			
	1 Year	3 Years*	5 Years*	10 Years*
Bloomberg Barclays Municipal Bond Index	2.66	2.25	2.73	4.40
Bloomberg Barclays US Aggregate Bond Index	1.20	1.20	1.82	3.63
Bloomberg Barclays US Government Bond Index Long	3.53	0.45	3.28	5.75
Bloomberg Barclays US High Yield Corporate Bond Index	3.78	5.17	4.99	8.27
Bloomberg Barclays US TIPS Index	0.92	1.30	0.05	2.93
FTSE World Government Bond Index 1-5 Years	5.77	2.36	-0.37	0.57
FTSE World Government Bond Index 1-5 Years (hedged to USD)	1.01	1.06	1.21	1.93
ICE BofAML 1-Year US Treasury Note Index	0.66	0.54	0.42	0.71
ICE BofAML 3-Month US Treasury Bill Index	1.11	0.53	0.34	0.34

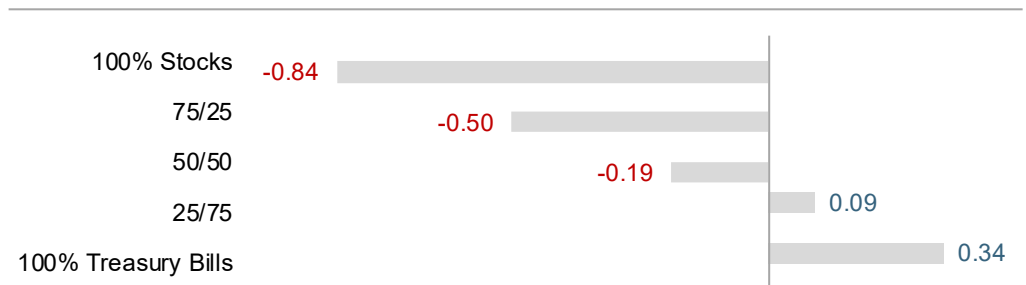
One basis point equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). FTSE fixed income indices © 2018 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2018 ICE Data Indices, LLC.

IMPACT OF DIVERSIFICATION

First Quarter 2018 Index Returns

These portfolios illustrate the performance of different global stock / bond mixes. Mixes with larger allocations to stocks are considered riskier, but have higher expected returns over time.

Ranked Returns (%)

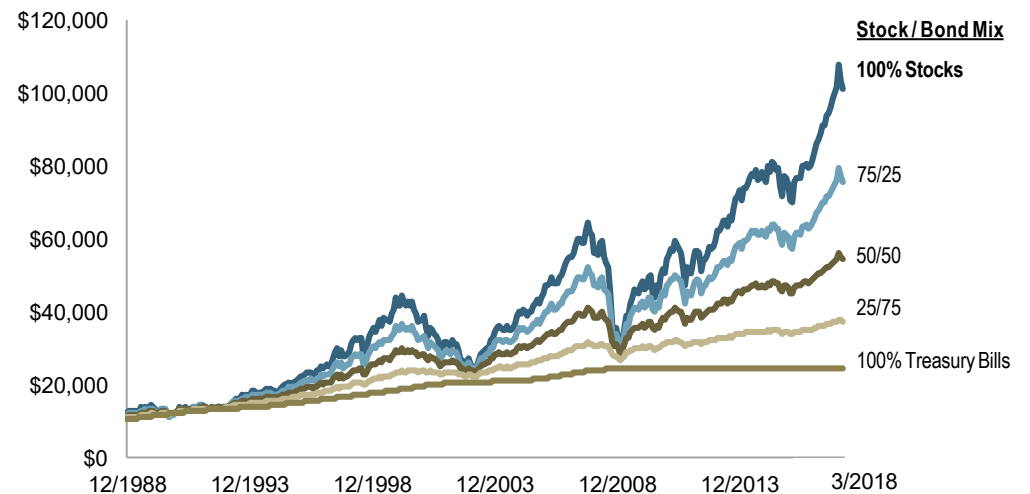


Period Returns (%)

* Annualized

Asset Class	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV ¹
100% Stocks	15.44	8.71	9.79	6.15	16.72
75/25	11.74	6.70	7.44	4.94	12.54
50/50	8.11	4.65	5.07	3.55	8.35
25/75	4.54	2.57	2.68	1.99	4.16
100% Treasury Bills	1.03	0.45	0.28	0.28	0.14

Growth of Wealth: The Relationship between Risk and Return



1.STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio. Diversification does not eliminate the risk of market loss. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2018, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).