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MARKET REVIEW

› 4TH QUARTER 2018

EXECUTIVE SUMMARY

- Global Stock Market underwhelms in 2018 with largest decline in the 4th Quarter since 2008
- Foreign Markets decline and go from cheap to cheaper in 2018
- Growth companies outperform Value companies as a collective group over the past 10 years
- 10-year and 30-year Treasury notes increased 0.29% and 0.28% respectively as interest rates steadily climb.

2018 Annual Market Review

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Overview:

2018 Annual Market Review

President's Message

William Wang

President, HFG Trust

It would be an understatement to call 2018 a tumultuous year for those keeping a close eye on their portfolio values. We published a series of 'Market Updates' throughout the month of December illustrating recent market events as well as the volatility that has existed in capital markets over a century for context. Unfortunately, market declines are unavoidable but what should give investors a sense of optimism is that market prices don't always reflect the true intrinsic value of the assets you own, so don't overreact to the dollar value on paper. In fact, it's far more effective to divert your attention to something that you can control, like the financial and cash flow plan you have so earnestly prepared with your advisor. That plan will get you through the most irrational of times and ultimately, if you yearn for peace of mind, should be your measurement for success.

Over the last 12 months, almost all major asset classes of the global stock market experienced negative results. US stocks were down -5.24%. International Developed Markets and Emerging Markets were down -14.20% and -14.58% respectively. Global Real Estate followed suit with -7.42%. The goal of this Annual Market Review is more than what the results have been the past 12 months, however. I want HFG investors to understand the belief system and process behind why their portfolios are allocated the way they are and the positives and negatives of investing such a way.

It would be safe to assume there are many investors around the globe questioning whether they should be invested in capital markets today or if their strategy is positioned correctly. I would be surprised if our clients weren't wondering and feeling the same thing and rightfully so. I have spent weeks thinking about how to remedy that emotion knowing full well what's a stake for every investor that has entrusted HFG with their financial well-being. Everyone knows an advisor can't guarantee results, it's the first thing they teach you in finance school. So I thought I would attempt to provide the next best thing: context and knowledge, which is what my college professor cultivated in me many years ago. In the following pages, you will see a clear outline of our investment philosophy and the relevance of each stage. I believe you hire an advisor to do two things for your portfolio:

1. Increase the probability of success
2. Illustrate some ability to forecast where returns will come from

Although no strategy or advisor can guarantee to outperform every year or every decade, they should be able to illustrate how they can increase the probability of your success. Investing is a combination of math and money, which means it is imperative a good investor uses applicable math to make decisions. Today, due to a noticeable overvaluation in US markets (even after last year's correction), you will see portfolios allocated a little heavier to International and Emerging Markets because that is where opportunistic returns exist looking out 7-10 years. You will also see holdings in your portfolio favoring Smaller, better Value and Profitable companies in your year-end holdings report.

2018 Annual Market Review

President's Message

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Investment Philosophy

"In the midst of movement and chaos, keep a stillness inside of you" – Deepak Chopra

Investing is one of the most complicated emotional journeys one can endure. Whether it is buying a business, a rental property or publicly traded securities, it is inevitable that you will be confronted with two emotions: fear and greed. Let's look at how we develop a strategy that is sustainable over a client's lifetime that centers around evidence and facts. It's the best chance we have at remaining still during times of chaos.

1 **Risk Model Allocation** – The most important and influential decision an investor can make regarding their portfolio is their risk model allocation. It is critical for two reasons. First, how you allocate your assets determines the downside risk of a portfolio. It is important for an investor to match their strategy with their tolerance for market declines. As hard as it is to resist, most investors know the most detrimental thing they can do for the long-term welfare of the portfolio is abandon ship in a bad investment market. Second, it dictates the possibility of portfolio returns because there is a large disparity between owning stocks vs. investment grade bonds. In fact, the benefit to owning stocks in the US vs. bonds is north of 8% dating back to 1928; we call this stock market premium. So if you choose the wrong risk model, there are significant return opportunities year to year that you are leaving on the table, that no amount of great advising or management will make up for.

2 **Global Investment Climate** – All investors have to make key calculations on their journey to building wealth. The first one being: what is the real value of the asset that I am buying? Once you know that, investing becomes very easy. Let's assume you have that information, the next question to ask yourself is, how do I apply it? We ask ourselves that question everyday often leaning on 100 years of data for reassurance. So how do we use this information to invest responsibly?

Simply put, the global stock market is divided into three major regions. United States makes up 52% of the global market capitalization. The International Developed Countries approx. 35% and Emerging Markets 13%. Historically, buying companies and regions at low prices has increased the probability of extracting good returns over a full market cycle. This hardly seems like rocket science, but you will be surprised how many professional and novice investors ignore this cardinal rule due to lack of understanding as to where investment returns derive. Every day we assess the value of all three major regions of the globe and determine what companies in the world are most attractive. The lower the price, the more we allocate towards that region within reason. The higher the price, the less exposure we want in our portfolios. Theoretically it is a simple concept, but in practice finding and forecasting these values can be complex for our investment committee as they balance fundamental analysis with our ever changing economic and political landscape.

3 **Factor Exposure** – At HFG, we have long embraced academic research and sought evidence to improve the construction of our clients' portfolios. Over the last decade, scholars have identified a strategy known as Factor Investing that aims to choose attributes of stocks that are associated with higher returns. We feel this research partners well with our regional assessment of value. These factors are referred to as:

Value – Value aims to capture return from companies that have low price relative to their fundamental value. (Price to Book Value, Price to Earnings)

Size – Historically, smaller companies have exhibited greater return potential than large companies as the stock market is separated by market capitalization of a stock.

Profitability – This strategy aims to capture higher returns from companies that are more profitable than its peers. Profitability is determined by gross profits to assets and historically has produced a noticeable premium over a 10-year period as compared to the rest of the stock market.

2018 Annual Market Review

Economic Update

When markets are volatile, pundits are not hesitant to highlight the negative. When market prices are going up, it seems like there are a million reasons why it should continue. The truth is always somewhere in between, and throughout every market cycle there are positives and negatives that have the “potential” to ignite investors fear or greed. Remember, short-term market results are not driven by fundamentals, but rather the behaviors of consumers and investors around the world. Here is an update on economic fundamentals:

Growth: GDP growth has been positive for the last 18 straight quarters ranging between 0.4% - 5.1% since 2011. This quarter it is estimated to be 3.4%, which is down 0.1% from Q3. This minor adjustment is due to perceived decrease in personal consumption expenditure and exports as a result of international trade tensions.

Jobs: Labor force has remained relatively unchanged over the last 12 months. In fact, over the last 8 years, reported unemployment rates in our country have declined steadily to 3.7% as of October 2018, which is the lowest since 1969. There is well-known debate as to the definition of being unemployed. The intention of this review is not to side one way or another, merely state the fact that the reported metric has looked promising.

Profits: Corporate profitability has been positive with tax reforms, spearheaded by our current administration, playing a factor. With over 465 companies making up 95% of our corporate economy, 78% or 362 companies have reported increases in earnings while half beat revenue estimates. As of 3rd quarter, year over year growth of corporate earnings was up 32.9% partly due to higher oil prices, robust corporate pricing power as well as positive consumer spending.

Inflation: Core Consumer Price Index (Inflation) continues to be stable and is estimated to remain near 2% in 2019. Headline CPI, which includes commodities and oil prices rose year over year by 2.2%.

Interest Rates: The Federal Reserve raised interest rate targets to 2.25%-2.50% during its December meeting, while the FOMC lowered expectations for GDP growth and Personal Consumption Expenditures in 2019. The expectation is that rates will be raised once or twice in 2019. Our CEO, Ty Haberling published a short piece in December about the Federal Reserve second guessing the economy’s ability to withstand too aggressive of interest rate hikes.

Economic Risks: The primary risks are not surprising to anyone following current events. In fact, they headline investors concerns and fears. Trade tensions continue to be the primary subject and has the potential to slow global economic growth, which would impact short-term International performance. The Federal Reserve is striving to tighten monetary policy but fear doing so too aggressively, which may slow US stock prices reverting to norms. Domestically, although our unemployment rate remains steady, there is a slowing in labor force growth which could hinder future economic growth. It will be interesting to keep a close eye on this in 2019

Global Valuations

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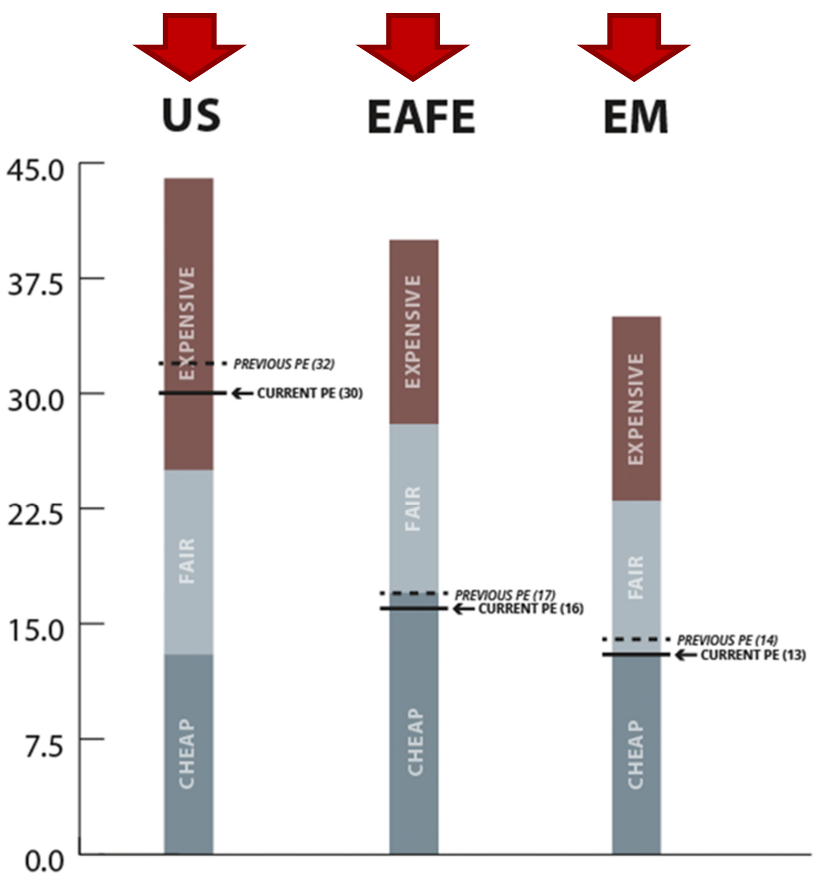
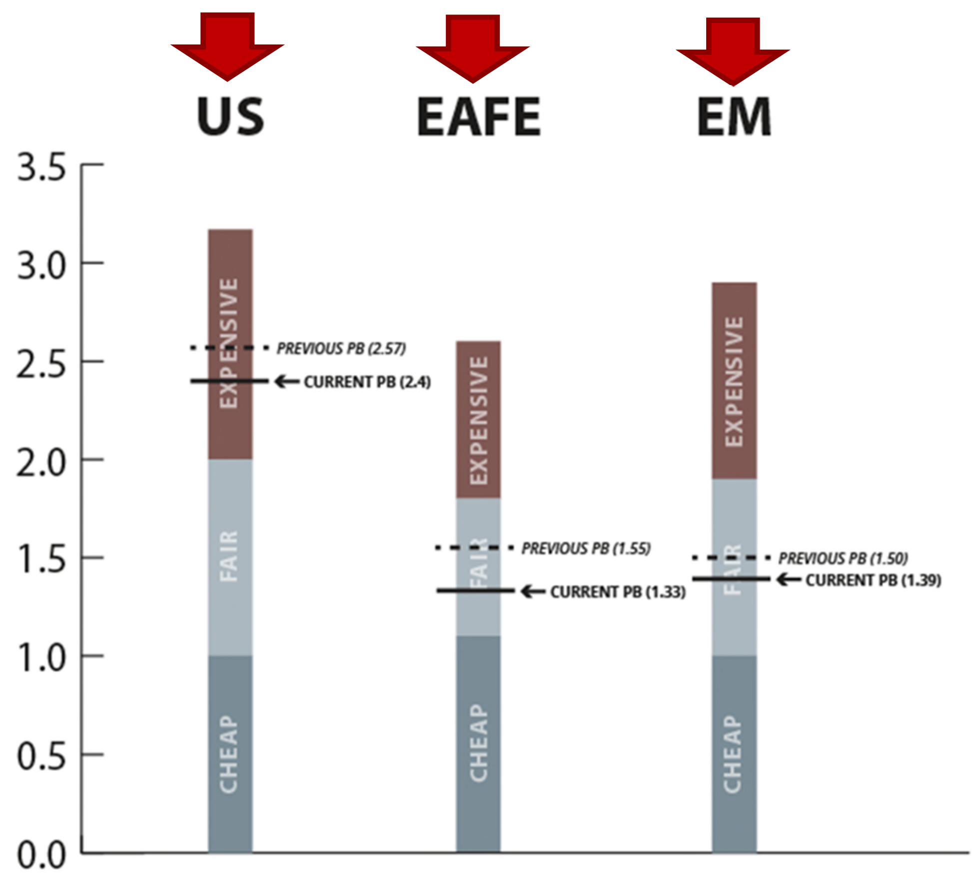
During times of market turbulence, we encourage investors to look at the comparative attractiveness of different markets across the globe for perspective. You will see two key metrics that will typically tell a similar story. We use at least two fundamental metrics to confirm we are making an accurate assessment. A Price to Earnings ratio looks at the value of a company from an income statement perspective while a Price to Book ratio utilizes the balance sheet. This year has seen US Markets fall from 32x Earnings to 30x, which is still a approximately ***70% above historical averages***. Book Value illustrates a similar story. International Developed Markets (EAFE) and Emerging Markets (EM) have both gone from cheap to cheaper over the past 12 months.

Price to Earnings (CAPE)



Price to Book Value



Factor Performance

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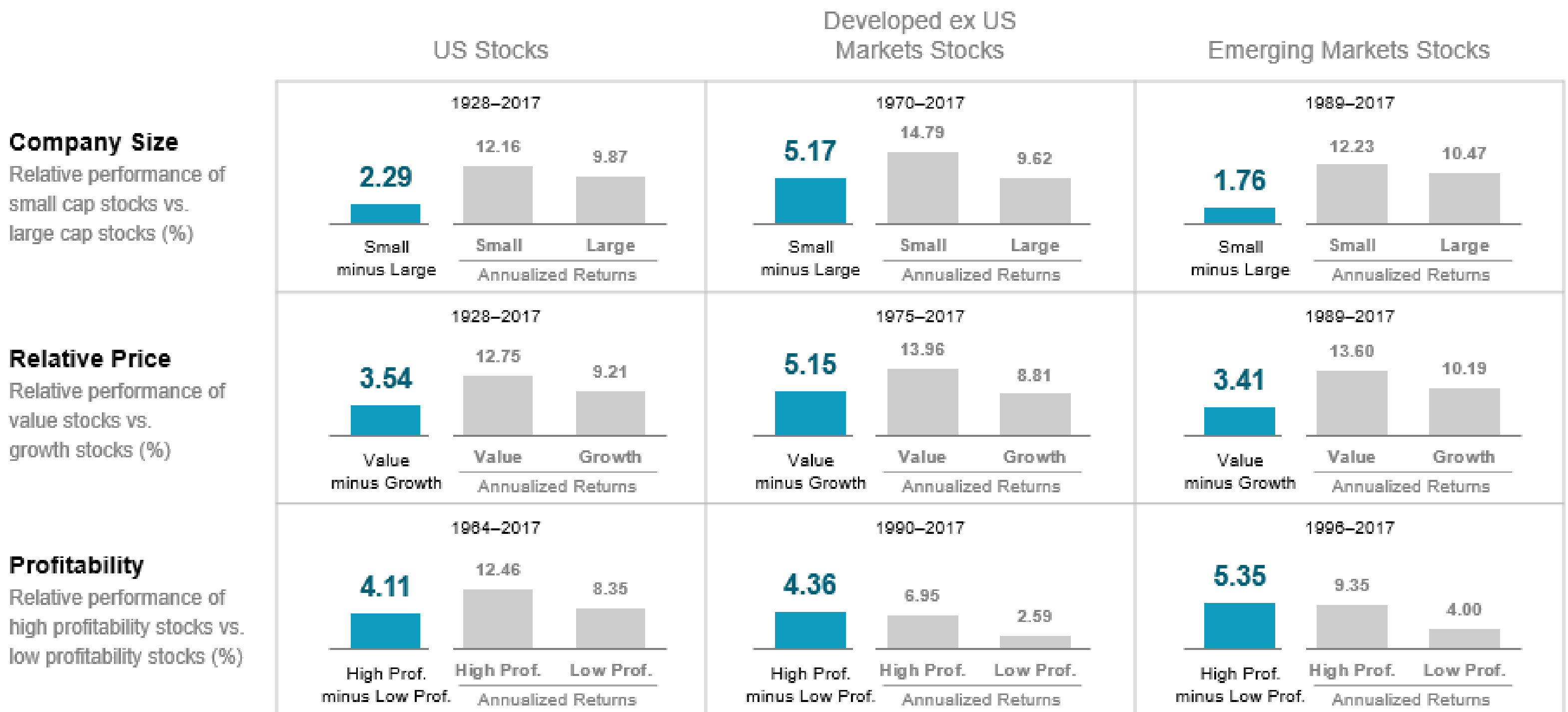

The chart above indicates the premiums that exist from owning smaller, better value and profitable companies across the globe. In the United States, small stocks outperformed large stocks by 2.29% between 1928 to 2017, while International Developed Markets produced a 5.17% premium between 1970 to 2017. These factors do not occur every year or every decade. In fact, over a 10-year period, each factor in every region has their respective probability of success:

	US	Int'l	EM
Small	84%	95%	86%
Value	72%	87%	86%
Profit	100%	100%	100%

Over the past decade, not all the factors have produced premiums. As of December 2017, Value has underperformed Growth in US Markets and Emerging Markets but the remaining seven regional factors performed as expected. Again, it is important to emphasize that no strategy will outperform every year or every decade, factor investing is no exception. What factor investing attempts to do is inform investors where enhanced returns have existed and how likely they are to occur again. The goal for any advisor is always to increase the probability that their clients maximize returns and ultimately, accomplish their long-term goals and objectives.

Market Summary

Index Returns

2018	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	-5.24%	-14.09%	-14.58%	-5.90%	0.01%	3.17%

Since Jan. 2001	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Avg. Annual Return	7.6%	5.8%	13.1%	10.1%	4.5%	4.4%
Best Year	33.6% **2013**	39.4% **2003**	78.5% **2009**	37.4% **2006**	10.3% **2002**	8.8% **2014**
Worst Year	-37.3% **2008**	-43.6% **2008**	-53.3% **2008**	-45.7% **2008**	-2.0% **2013**	1.2% **2013**

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 Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]). S&P data © 2019 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 2019, all rights reserved. Bloomberg Barclays data provided by Bloomberg.

World Asset Classes

2018 Index Returns (%)

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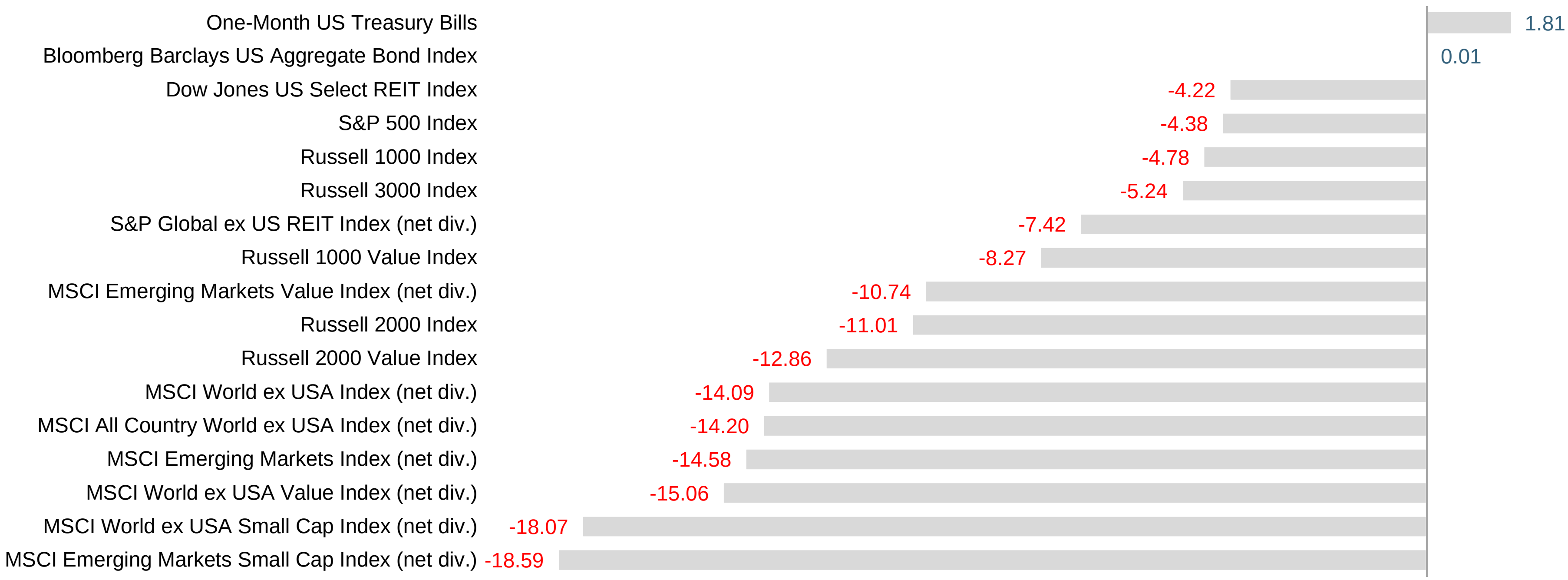
Equity markets around the world posted negative returns for 2018. Looking at broad market indices, the US outperformed non-US developed and emerging markets.

Value stocks were positive vs. growth stocks in emerging markets but negative in the US and non-US developed markets. Small caps underperformed large caps in the US, non-US developed, and emerging markets.

REIT indices outperformed equity market indices in both the US and non-US developed markets.



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US Stocks

2018 Index Returns

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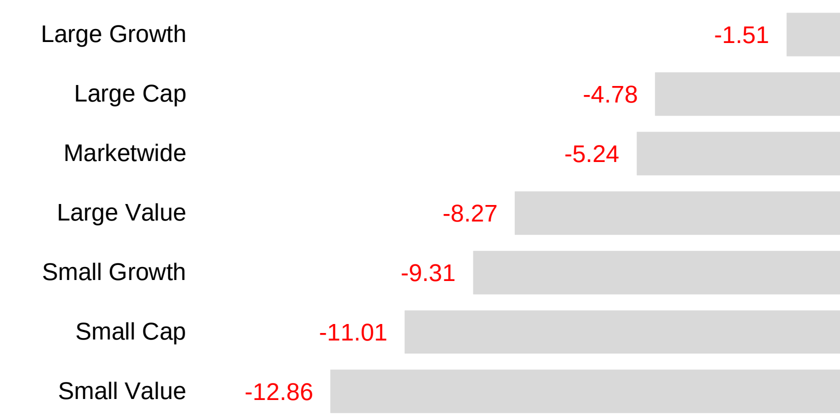
US equities outperformed both non-US developed and emerging markets.

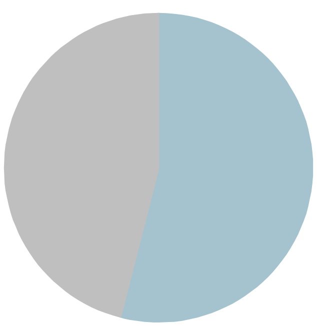
Value underperformed growth in the US across large and small cap stocks.

Small caps underperformed large caps in the US.

Ranked Returns for 2018 (%)



World Market Capitalization—US



54%

US Market

$25.1 trillion

Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Growth	-1.51	11.15	10.40	15.29
Large Cap	-4.78	9.09	8.21	13.28
Marketwide	-5.24	8.97	7.91	13.18
Large Value	-8.27	6.95	5.95	11.18
Small Growth	-9.31	7.24	5.13	13.52
Small Cap	-11.01	7.36	4.41	11.97
Small Value	-12.86	7.37	3.61	10.40

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International Developed Stocks

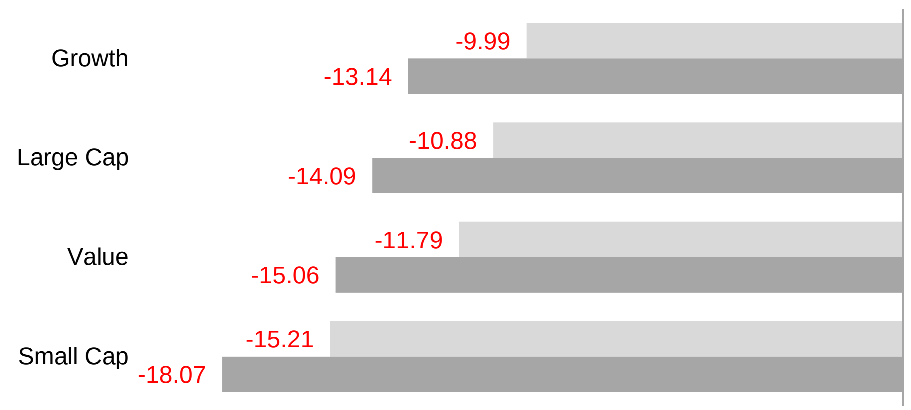
2018 Index Returns

In US dollar terms, developed markets outside the US outperformed emerging markets but underperformed the US during 2018.

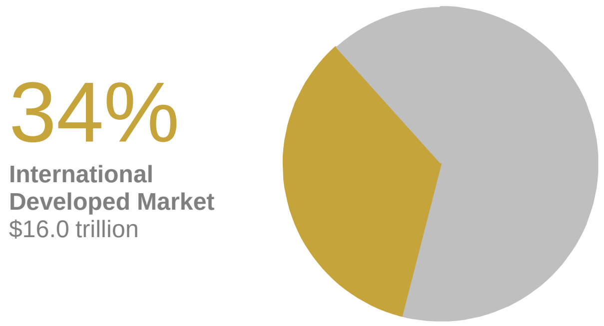
Value underperformed growth across large and small cap stocks in non-US developed markets.

Small caps underperformed large caps in non-US developed markets.

Ranked Returns for 2018 (%)



World Market Capitalization—International Developed



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Growth	-13.14	2.84	1.36	6.74
Large Cap	-14.09	3.11	0.34	6.24
Value	-15.06	3.36	-0.73	5.69
Small Cap	-18.07	3.85	2.25	10.06

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Emerging Markets Stocks

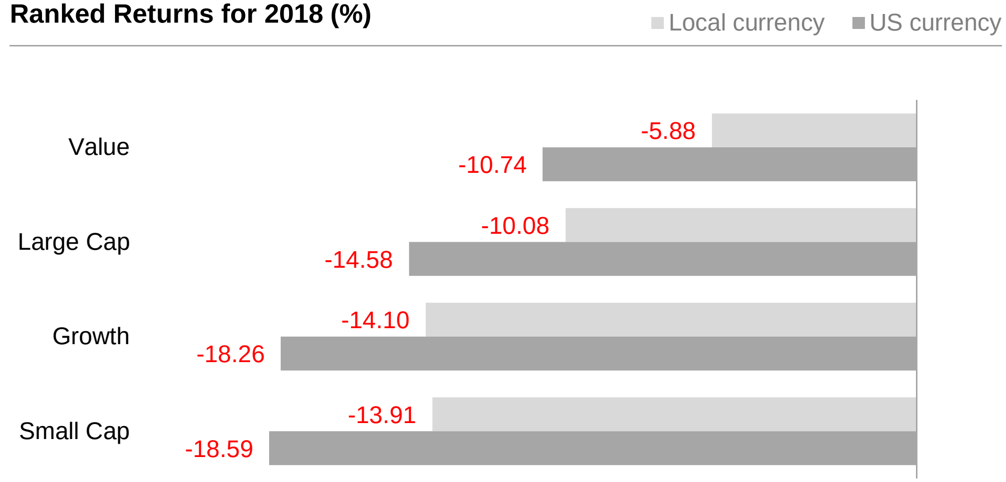
2018 Index Returns

In US dollar terms, emerging markets underperformed developed markets, including the US.

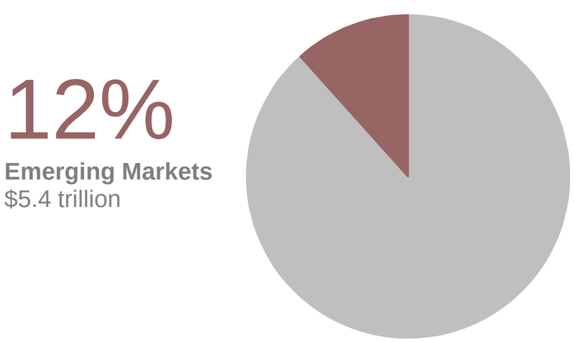
Value outperformed growth across large and small cap stocks in emerging markets.

Small caps underperformed large caps in emerging markets.

Ranked Returns for 2018 (%)



World Market Capitalization—Emerging Markets



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Value	-10.74	9.52	0.51	6.99
Large Cap	-14.58	9.25	1.65	8.02
Growth	-18.26	8.89	2.67	8.97
Small Cap	-18.59	3.68	0.95	9.87

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Real Estate Investment Trusts (REITs)

2018 Index Returns

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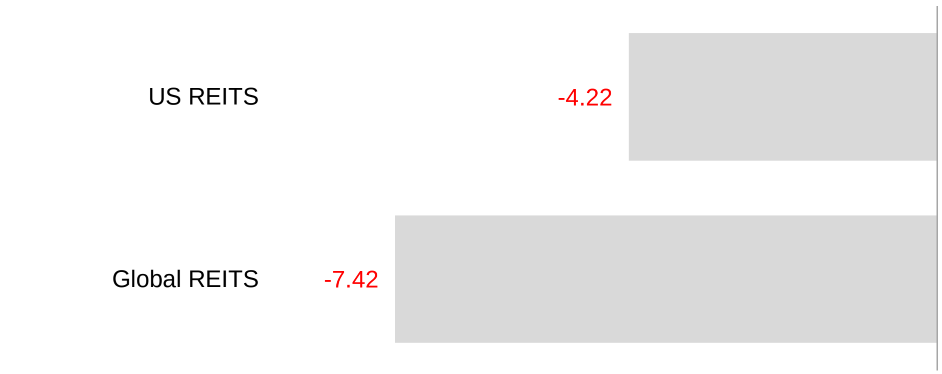
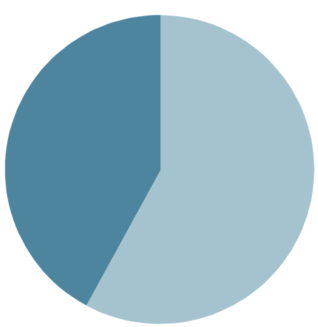
US real estate investment trusts outperformed non-US REITs in US dollar terms.

Ranked Returns for 2018 (%)



Total Value of REIT Stocks

42%
World ex US
$436 billion
245 REITs
(22 other countries)



58%
US
$601 billion
97 REITs

Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
US REITS	-4.22	1.97	7.89	12.05
Global REITS	-7.42	3.35	3.39	8.94

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 and S&P data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Fixed Income

2018 Index Returns

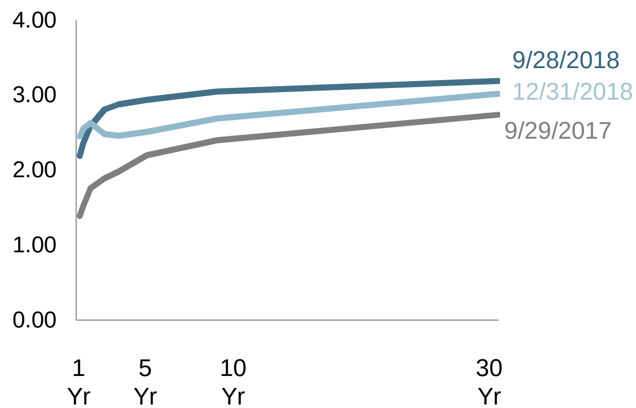
For 2018, yields on the 10-year Treasury note and 30-year Treasury bond increased 29 basis points (bps) and 28 bps, respectively.

The short end of the yield curve experienced the greatest increases. The yield on the 1-year Treasury bill increased 87 bps to end at 2.63%, while the 2-year Treasury note finished with a yield of 2.48% after an increase of 59 bps.

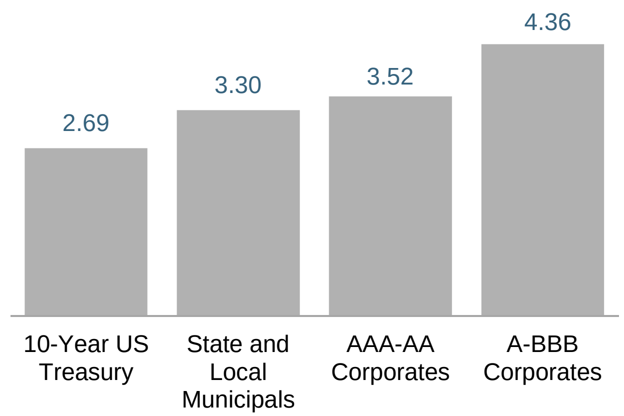
In terms of total returns, short-term corporate bonds increased 1.57% for the year. Intermediate-term corporate bonds declined 0.23%.

The total returns for short-term municipal bonds were 1.77%. Intermediate-term municipal bonds returned 1.57%. General obligation bonds outperformed revenue bonds.

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
FTSE World Government Bond Index 1-5 Years (hedged to USD)	2.12	1.58	1.53	1.69
ICE BofAML US 3-Month Treasury Bill Index	1.87	1.02	0.63	0.37
ICE BofAML 1-Year US Treasury Note Index	1.86	1.06	0.70	0.62
Bloomberg Barclays Municipal Bond Index	1.28	2.30	3.82	4.85
Bloomberg Barclays US Aggregate Bond Index	0.01	2.06	2.52	3.48
FTSE World Government Bond Index 1-5 Years	-0.76	1.56	-0.82	0.29
Bloomberg Barclays US TIPS Index	-1.26	2.11	1.69	3.64
Bloomberg Barclays US Government Bond Index Long	-1.79	2.63	5.90	4.15
Bloomberg Barclays US High Yield Corporate Bond Index	-2.08	7.23	3.83	11.12

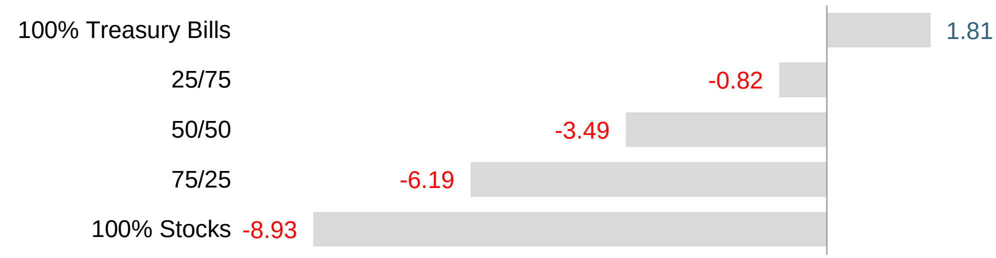
One basis point equals 0.01%. Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are 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 ICE BofAML 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. Sinquefield). FTSE fixed income indices © 2019 FTSE Fixed Income LLC, all rights reserved. ICE BofAML index data © 2019 ICE Data Indices, LLC. S&P data © 2019 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Impact of Diversification

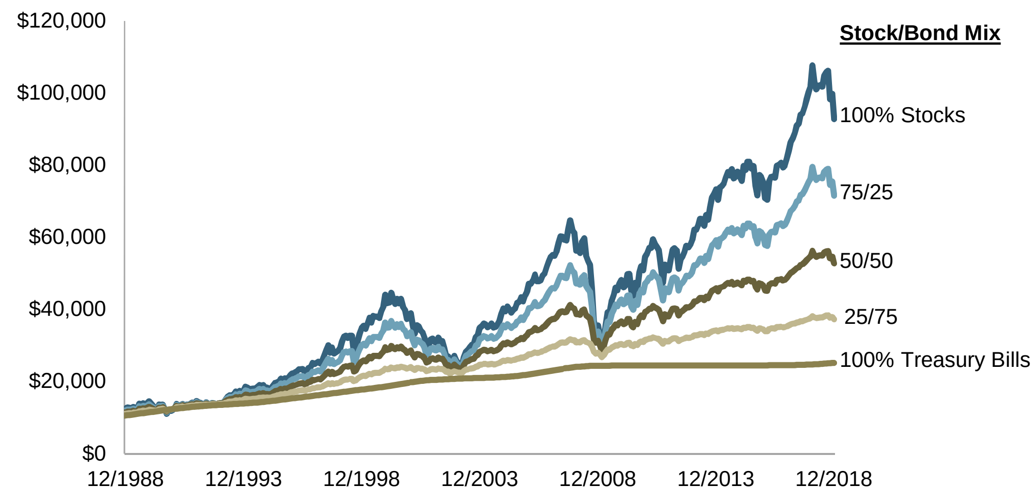
2018 Index Returns

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 for 2018 (%)



Growth of Wealth: The Relationship between Risk and Return



Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Treasury Bills	1.81	0.93	0.57	0.32	0.16
25/75	-0.82	2.57	1.73	2.88	3.65
50/50	-3.49	4.16	2.82	5.36	7.32
75/25	-6.19	5.70	3.86	7.75	10.98
100% Stocks	-8.93	7.18	4.82	10.05	14.65

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 2019, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).