CROSSMARK GLOBAL INVESTMENTS

CROSSMARKGLOBAL.COM

March 31, 2018

LARGE CAP CORE GROWTH COMMENTARY

The record-breaking post-election stock market rally finally ended with a bang! In February the S&P 500 dropped just over 10% on a closing basis and the Dow Jones Industrials actually fell over 3,000 during the carnage. Fortunately, the markets settled down and volatility returned to less explosive readings. For the quarter, the S&P 500 lost 0.76% on a total return basis while the Russell 1000 Growth Index, our benchmark, actually gained 1.41% with help from the "FANGs" and other technology stocks. Volatility, which had been so low in 2017, skyrocketed to over 50 from a recent low of 12.50. It settled back to 20 at the end of the quarter. Higher interest rates, political fights and talk of a trade war completely changed the character of the markets as if somebody had flipped a switch in early February. For the quarter, our Large Cap Core Growth model outperformed the S&P 500 but lagged the tech-heavy Russell 1000 Growth Index. Despite the pullback in stocks, the U.S. economy is still looking healthy with both manufacturing and service sector PMIs well above 50, signaling expansion. Additionally, we still appear to be in a global synchronized expansion, and that is generally positive for equity performance. Valuation, on the other hand, has been stretched over the last year or so. With interest rates rising and the U.S. 10 year yield heading towards the key 2.90% level, perhaps it was time for a correction to allow corporate earnings to catch up to valuations. The ten year finally peaked at about 2.95% before giving up ground into the end of the quarter.

Turning to our Large Cap Core Growth model, our best performing sectors were all cyclical. Technology won the day, up 3.94%, followed by Materials which gained 2.46% and then Financials (which benefit from higher interest rates), up 2.34% On the other side of the ledger, lagging sectors were Telecommunications, Energy and Consumer Staples. Note that Telecom and Staples are less economically sensitive areas of the economy. As for individual equities the story was earnings. Top performers included Harris Corp., a player in the strong defense sector that also benefitted from strong quarterly results. Cisco Systems, a networking company, also gained from strong tech sector performance and better than expected earnings. Tapestry, a new holding, also did well. Tapestry is a combination of Coach, Inc. and Kate Spade. Bringing up the rear were Thor Industries which, after more than doubling over the last couple of years, gave in to some profit taking on reports of slowing motorhome demand. Proctor & Gamble, along with much of the staples group, continued to decline despite posting decent earnings. Celgene also lost ground after reporting weaker than expected results.

- The record-breaking post-election stock market rally finally ended in February.
- Higher interest rates, political fights and talk of a trade war instantly changed the character of the markets in early February.
- The U.S. economy is hitting on eight cylinders.

Adjustments to the portfolio included initiating a position in Dollar General, trimming our Thor Industries position again and initiating a position in Tapestry. We also sold our Proctor & Gamble position in the weak Staples sector and used the proceeds to add to our Nike holdings.

For the quarter, the S&P 500 lost 0.76% on a total return basis while the Russell 1000 Growth Index, our benchmark, actually gained 1.41% with help from the "FANGs" and other technology stocks.

Taking a closer look at the economy, it looks as if the U.S. is hitting on eight cylinders. First, the Markit Manufacturing PMI covering March came in at 55.6, a three-year high. Optimism about the next twelve months also registered a three-year high. The three-month performance indicated the best quarterly results since the third quarter of 2014. One negative however, the talk of tariffs led to an increase in costs and stockpiling of goods. The Markit Service PMI also indicated a strong expansion of service sector business, posting a reading of 54.0 For March. While down from the previous month, it still points to strong growth. Looking overseas, the Eurozone Manufacturing PMI for March came in at 56.6 while key emerging markets registered expansions as well, so the global synchronized expansion continues, albeit at a slightly moderated pace. This correlates well with positive returns for equities. Auto sales for March also cast a positive light on the economy. U.S. light vehicle deliveries, driven by a surge in truck demand, jumped 6.4% for the best gain since February 2016. The seasonally-adjusted annualized sales figure came in at 17.49 million for the seventh straight month of over 17 million units. A volatile stock market, higher interest rates and higher gas prices were not enough to dissuade car buyers in March. The employment outlook is also healthy. The February employment results indicated that the U.S. economy added 313,000 jobs, the most since July 2016. Data for December and January were also revised upwards by 54,000. The unemployment rate held steady at 4.1% for the fifth consecutive month as over 800,000 entered the workforce due to improved conditions. Economists expect the good news to continue with unemployment possibly falling as low as 3.5% over the next few months. On the flip side, it looks as if gross domestic product for the first quarter may dip a bit from the last couple of quarters. Analysts are looking at something in the 2.0%-2.5% area, down from 2.9% in the fourth quarter of 2017. However, with the strong auto sales bolstering numbers, GDP may come in a bit better than anticipated. Also, much has been said about the negative impact of Trump's proposed tariffs. As Strategas Research notes, the tariffs currently total about $81.5 billion. The fiscal stimulus the U.S. should experience from tax cuts, spending and repatriation of overseas profits is estimated to total about $800 billion, which should overwhelm the negative tariff impact. Lastly, we would note that while the yield curve has flattened some recently, it is still positively-sloped, and this remains a positive for the economic outlook.

If the U.S. economy is hitting on eight cylinders, corporate profit growth seems to be hitting on twelve cylinders. For the first quarter of 2018, the S&P 500 is expected to report earnings growth of 17.3%, a nice way to kick off the New Year. If achieved, that would be the highest growth rate since the first quarter of 2011. The expected growth on December 31 was "only" 11.4% but analysts raised estimates significantly in January as the impact of tax reform worked its way into the mix. Higher oil prices also helped and the upward earnings revisions were led by the energy sector. Typically, estimates decline from the beginning of a quarter to the end of the quarter by several percent, so to see it increase by six percentage points shows a lot of bullishness.

S&P 500 Quarterly EPS Growth	
1Q 2018	17.3%
2Q 2018	19.1%
3Q 2018	20.9%
4Q 2018	17.1%
Full Year	18.5%

Source: FactSet

Coming into the New Year, the market had been on a tear ever since the 2016 election, posting positive total returns for 14 months in a row with January making it fifteen. All this in spite of the failure of Congress' new healthcare plan, the failure the new tax plan until late December, continued gridlock in Washington, D.C. and all manner of serious weather calamities including hurricanes, floods and fires. After adding another 5.73% in January, the S&P 500 was stretched

out on a valuation basis, especially with the Federal Reserve planning several rate hikes for 2018. A pickup in inflation was evident, as well. After losing over 10% in February the S&P 500 PE ratio dropped from about 18.0x to 16.1x, relieving some of the valuation pressure on stocks. Still, the 10 year average PE is about 14.3x so we could see some more PE compression and this could offset some of the double digit earnings growth we are expecting. The keys are (1.) do we make a successful retest of the S&P 500 lows around 2533 or (2.) does the 200 day moving average provide solid support and then form a "W" pattern (double bottom) and resume the uptrend as we have in the last several corrections? The next couple of months should tell the tale.

Top 10 Model Holdings [2]	Weight
1. Microsoft Corp.	5.45%
2. Apple, Inc.	4.83%
3. JP Morgan Chase & Co.	3.71%
4. Home Depot, Inc.	3.57%
5. Cisco Systems, Inc.	3.19%
6. Harris Corp.	3.15%
7. Texas Instruments, Inc.	3.14%
8. Honeywell International, Inc.	2.98%
9. Unitedhealth Group, Inc.	2.88%
10. CDW Corp.	2.84%
Total of Portfolio	35.73%

[1] Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model.

About Crossmark's 30 Year History

Crossmark Global Investments is an innovative investment management firm. The firm provides a full suite of investment management solutions to institutional investors, financial advisors and the clients they serve. We have a multi-decade legacy of specializing in responsible investment strategies for clients. Founded in 1987, the firm is headquartered in Houston, Texas.

For more information contact our
Advisor Solutions Group:
advisorsolutions@crossmarkglobal.com
888-845-6910

Crossmark Global Investments, Inc.
3700 W. Sam Houston Parkway S., Suite 250, Houston, Texas 77042
800.262.6631 info@crossmarkglobal.com
crossmarkglobal.com