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June 30, 2018

LARGE CAP CORE GROWTH COMMENTARY

The S&P 500's record-breaking post-election rally came to a sudden halt this February as volatility surged. For the second quarter, the markets settled down a bit and the S&P 500 scored a nice 3.43% gain for the period. Still, the index has a ways to go to get back to its January 26th high of 2873. At the quarter's end it sat about 5.4% below the January record high. Conversely, smaller-cap indexes have been strong with the Russell 2000 hitting a new high in June with the tech heavy NASDAQ following suit. The NYSE Advance/Decline line, a widely followed technical indicator, made a new high as well. Many market technicians consider this a very positive sign that points to more upside to come. The Russell 1000 Growth Index, with its heavy technology and FANG weighting, also hit a new all-time high in the quarter. It continues to outdo the S&P 500, gaining 5.76% for the period. Our Large Cap Core model, with its mixture of core and growth stocks, lagged the Russell 1000 Growth Index as core stocks continued to lag the growth index. The weakest stocks were overseas in the emerging markets which were hurt by the strong U.S. dollar. The emerging markets ETF (sym: EEM) fell almost 10% for the period. Despite talk of a trade war, the U.S. economy continues to hum along. Both the manufacturing and service PMIs remain well above 50, indicating that we are still in expansion mode. Additionally, the stock market is still above its important 200 day moving average where it has found support throughout this correction. A break below this average could signal a negative change in trend for stocks. Below that, the next major support is at the February low of 2533. We don't expect the S&P 500 to break this level. It is more likely that the index will follow the other indexes mentioned above to new highs. Conversely, the S&P 500 has yet to break out to a new high for 100 days as of the end of June and the longer it takes to move up the greater the risk becomes.

Turning our attention to our Large Cap Core Growth model, our top performing sector was energy, which rode a wave of rising oil prices. Oil prices jumped from the mid-$60s to the mid-$70s during the 3 month period and are up from the upper $40s a year ago. The sector gained 9.78% for the quarter. Number two in the performance derby was, not surprisingly, technology (up 7.54%), which has been on a tear of late. Strong performances by the FANG-type stocks have been driving performance. Telecom was also strong, gaining 6.53%. On the flip side, lagging sectors were led by the industrials, which fell 6.01% for the period on tariff-related fears. Also weak were the financials, down 3.02%, as interest rates fell and yield curve flattened. Consumer staples, an out-of-favor group this year, fell 1.12%. Top performing individual issue included Nike, which

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soared 20.26% on a good quarterly report and good news flow during the quarter. CDW Corp., provider of IT services, jumped 15.21% after a strong earnings report and positive forward guidance. Bringing up the rear were Thor Industries, down 12.48%, as tariff fears hurt the stock and Celgene, down 10.97% on setbacks on some pharmaceuticals under development. Adjustments to the model for the quarter included adding to our Baxter International position, the sale of Lennar due to rising mortgage rates, the sale of Dollar General due to an earnings disappointment, the initiation of a position in FLIR, a maker of monitoring products to commercial and government markets and initiation of a position in O'Reilly Automotive.

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As noted, the U.S. economy appears to be healthy. For June the Markit Service PMI posted a reading of 56.5, flat with the preliminary estimate. It fell slightly from the 56.8 reading in May, which was the highest reading since April of 2015. For the quarter, the average service PMI was 56, the strongest quarterly expansion reading in three years. The Manufacturing PMI report at 55.4 was revised up from its preliminary estimate of 54.6. However, this was down from the May reading of 56.4. Some of the internals also weakened, but 55.4 is a solid expansionary reading so both sectors of the economy look good. Gross Domestic Product was a slight disappointment in the first quarter, coming in at 2.0%, down from a preliminary estimate of 2.2%. For the just completed second quarter, GDP estimates are coming in around the 4.0% area with some estimates approaching 5.0%. Auto sales popped 3.2% in June as rising sales of SUVs and pickup trucks helped offset the continuing fall in passenger cars. The job environment is excellent. For the first time since record-keeping started, the number of jobs available exceeded the number of unemployed. Job openings rose to 6.7 million at the end of April (a record high), well above the 6.3 million Americans who were unemployed. The June non-farm payroll came in at a solid 213,000 versus expectations of 195,000 jobs added, and this was in spite of a tight labor market and fears of a trade war. Discouraged workers came back into the market causing the unemployment rate to rise from 3.8% to 4.0% which is a positive, in this case. The percentage of Americans in the labor force rose from 62.7% to 62.9%. We believe the unemployment rate will continue to trend down this year. With the economy this robust, we think the Fed will feel safe in raising rates two more times by year end. There are headwinds, however. First, the threatened trade war between Trump and seemingly the rest of the world can only hurt economic activity. Also, earnings growth appears to be peaking after getting a big boost from the tax cut enacted earlier this year. The flattening yield curve and tightening financial conditions could also throw a monkey wrench into the picture.

Positive Trends	Negative Trends
PMIs above 50	Trump Tariffs
Some Indexes Making New Highs	Fed Tightening
Advance/Decline Line New High	EPS Peaking
Strong Employment Statistics	Yield Curve Flattening
2Q GDP Expected in 4% Area	Strong Dollar
Stellar EPS Growth	
Business and Consumer Optimism High	

Turning our focus to corporate earnings, we expect the S&P 500 earnings growth rate to come in at 20% if not higher. Energy is expected to lead the other sectors with expected earnings growth of over 140%. The price of oil a year earlier was under $50 per barrel but has risen to around $75 currently giving the energy sector quite a shot in the arm. The technology sector also looks to post a good quarter with earnings expected to rise about 25.0% as the FANGS continue to lead the performance derby.

Quarterly Projected S&P 500 EPS Growth	
1Q 2018	24.8%
2Q 2018	20.0%
3Q 2018	21.7%
4Q 2018	17.8%
Full Year	20.5%

Source: FactSet

Of course, we expect the earnings growth rate to slow down as we move into 2019 and lose the growth rate impact from the tax cuts. The current expectation is for an increase in S&P 500 earnings in the 10% neighborhood for next year. One key will be how strong management guidance is this earnings season.

The dual impact of the continuing correction in the S&P 500, combined with strong earnings growth for 2018 means the stretched valuations we had been dealing with for the last year or two are no longer as big of an issue. The current 12 month forward PE for the S&P 500 is 16.1x on about $168-$169 in S&P 500 earnings, in line with the 5 year average PE. Recently, inflation has just ticked up slightly over 2% and history shows that inflation this low creates an environment that can support PE ratios that exceed 17x-18x or higher. If inflation starts to pick up noticeably, we would want to revisit the valuation scenario. Currently, we believe the weight of the evidence supports higher stock prices, particularly given that several indexes have already broken out to new highs and have been confirmed by the advance/decline line. Note that markets almost never peak until the advance/decline line has fallen for several months after making a new high.

We are now in the 10th year of this bull market. It is often said that bull markets don't die of old age. Instead, they are "murdered" by the Fed through a policy mistake. So, if the Fed can avoid an overtightening mistake, this bull may still have room to run.

Top 10 Model Holdings [1]	Weight
1. Microsoft Corp.	5.74%
2. Apple, Inc.	5.19%
3. Home Depot, Inc.	3.80%
4. JP Morgan Chase & Co.	3.43%
5. Texas Instruments, Inc.	3.25%
6. Unitedhealth Group, Inc.	3.22%
7. CDW Corp.	3.18%
8. Cisco Systems, Inc.	3.12%
9. Honeywell International, Inc.	2.89%
10. Alphabet, Inc.	2.76%
Total of Portfolio	36.58%

[1] Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model. As of 6/30/2018.

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.

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