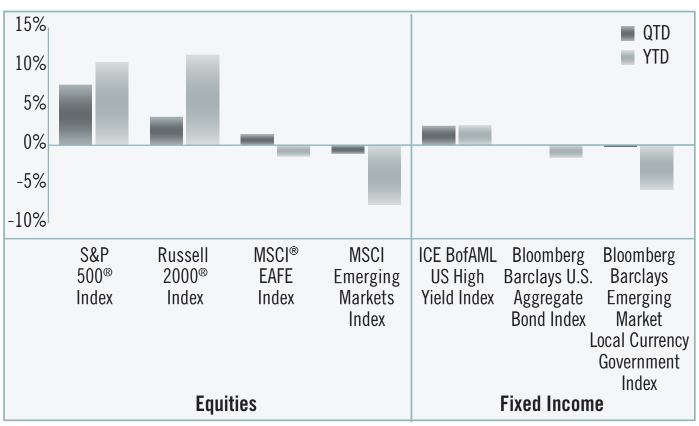
U.S. Stands Strong Amid Trade Tensions, Yield Curve Concerns

Domestic equities continued to march ahead in the third quarter with the S&P 500® Index gaining 7.71%, bringing the year-to-date return to 10.56%. Small-cap stocks, as measured by the Russell 2000® Index, lagged their larger counterparts, advancing 3.58%, but are ahead for the year with a return of 11.51%. Trade war concerns continued to mount during the quarter, which caused international and emerging market stocks to perform very poorly. The MSCI EAFE® Index managed a modest gain of 1.35% for the quarter, but is still down year to date, at -1.43%. Emerging market stocks have performed the poorest so far this year, with the MSCI Emerging Markets Index slipping 1.09% for the quarter, widening the year-to-date loss to -7.68%.

U.S. Treasury yields continued to rise modestly during the quarter, with the 10-year rate moving from 2.86% to 3.06%. The Bloomberg Barclays U.S. Aggregate Bond Index was essentially unchanged for the quarter, up 0.02%, with a year-to-date return of -1.60%. High-yield bonds continued to be among the best performers in fixed income; the ICE BofAML U.S. High Yield Index was up 2.44% for the quarter, helping boost the year-to-date return to 2.52%. Local currency emerging market debt continued to struggle, with the Bloomberg Barclays Emerging Market Local Currency Government Index falling 0.25% for the quarter to extend the year-to-date loss to -5.75%.

MAJOR INDEX RETURNS

Periods Ending September 30, 2018



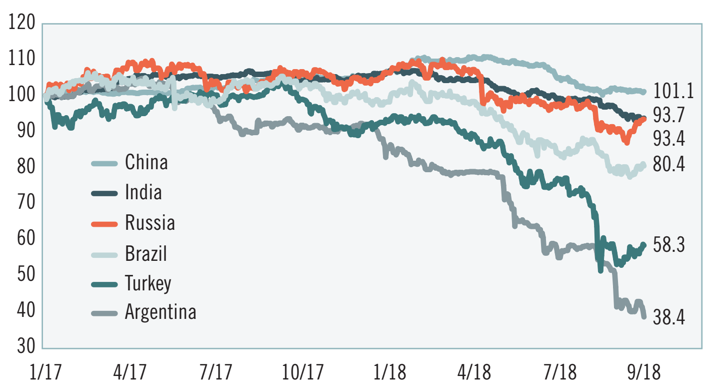
Past performance is no guarantee of future results.
Data is obtained from Bloomberg and assumed to be reliable.

TRADE SPAT WITH CHINA ESCALATES

China is arguably the most important emerging market country in the world, and U.S.-China trade tensions clearly escalated throughout the recent quarter. There was some easing of uncertainty in global trade relations, with the renegotiation of the North American Free Trade Agreement (NAFTA) between the U.S., Mexico, and Canada—which has been redubbed the U.S.-Mexico-Canada Agreement, or USMCA. Still, spats with China have become more prolonged, and it seems more time will be required to reach a solution. Both President Trump and the Chinese leadership appear to be "digging in their heels" for a more protracted trade battle. This has clearly cast a shadow over emerging market stocks and bonds given the importance of China. Economic problems in smaller countries, such as Turkey and Argentina, haven't helped sentiment, either. Strength in oil prices, a fairly strong U.S. dollar, and trade tensions have caused strong headwinds in emerging markets. Additionally, Europe has clearly slowed somewhat since the beginning of the year due to trade concerns and continued difficulties with Italian banks and the prospects of Brexit. It is fairly certain that although the global economy is still growing, a "global synchronized recovery" isn't being mentioned anymore by Wall Street strategists.

EMERGING MARKET CURRENCIES RELATIVE TO U.S. DOLLAR

Indexed to 100 from January 1, 2017 through September 30, 2018



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Data is obtained from Strategas and assumed to be reliable.

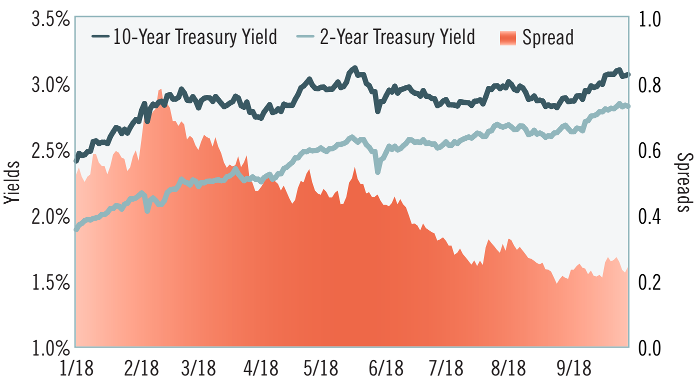
We still don't know how long negotiations with China will take to be resolved, but the market is starting to provide favorable longer-term prices on many well-positioned Chinese stocks. Valuation spreads between the U.S. and the rest of the world are fairly wide today due to this uncertainty.

YIELD CURVE CONCERNS

The Federal Reserve, in a widely expected move, raised short-term rates in September, and we fully expect another increase in December of this year. However, the U.S. yield curve has continued to flatten and started to attract debate from many Fed governors. Some Fed members believe the flattening, or potential inversion of the curve, is merely "technical" and not that meaningful. Other Fed members believe the central bank should respect the shape of the yield curve (particularly if it inverts) and potentially pause after December's rate hike. We believe full inversion is a clear negative for the economy and should be respected by the Fed regardless of the supposed reasons it is occurring. A flat curve can be tolerated for quite some time, but an inversion, not so likely. In terms of the sustainability of the U.S. expansion, Fed actions over the next six to 12 months will be important to watch.

TREASURY YIELDS COMPRESS

Period Ending September 30, 2018



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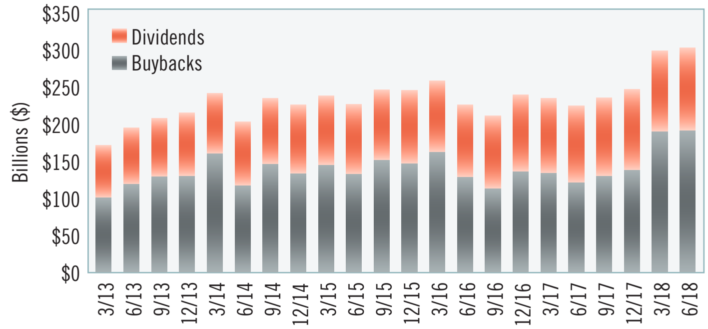
U.S.: PILLAR OF STRENGTH

In the global economy, the U.S. continues to be one of the pillars of strength. Current business conditions appear to be very solid, continuing from second-quarter business strength. For instance, the Institute for Supply Management's non-manufacturing index hit 61.6 in September, the highest reading in the index's 10-year history. A level above 50 suggests expansion in the U.S. service sector. In addition, unemployment numbers denote strength we haven't seen in decades, and corporate stock buybacks and dividends continue to grow. Stock buybacks for the S&P 500 Index were $190.6 billion during the second quarter, the highest level in history, and the 12-month repurchases through June 2018 were 29% higher than the year-earlier total. Stock dividends have grown meaningfully as well; the 12-month total through June among S&P 500 companies was $435.7 billion, up 7% year over year.

S&P 500® INDEX QUARTERLY DIVIDENDS AND STOCK BUYBACKS



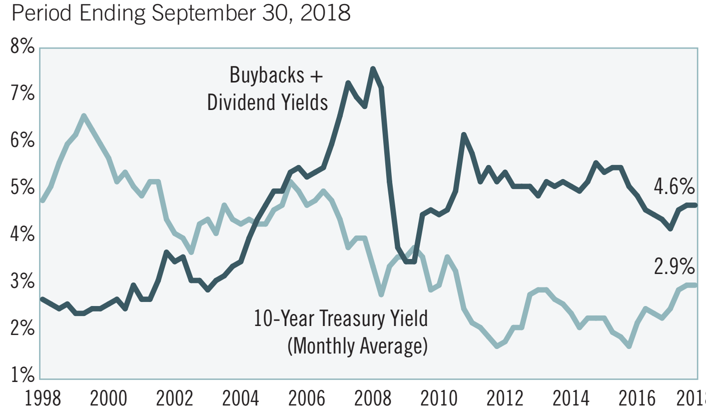
Past performance is no guarantee of future results.
Data is obtained from S&P Dow Jones and assumed to be reliable.

Furthermore, combining the yields of corporate buybacks and dividends among S&P 500 companies, the net effect has been yields greater than those provided by Treasuries.

Other areas of strength in the U.S. include corporate cash flow, which is benefiting from tax reform, as well as good operating results. So far, U.S. businesses have had enough domestic momentum that they have overcome most of the background noise on trade, but the longer this persists, it could eventually become a headwind for our markets as well.

S&P 500® STOCK BUYBACKS AND DIVIDENDS COMBINED YIELD VS. 10-YEAR TREASURY YIELD

Period Ending September 30, 2018



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As always, we invest in companies with a sustainable competitive edge and a sound balance sheet. We firmly believe this is the best long-term approach we can provide our clients in this period of heightened uncertainty. We thank you for your continued trust and confidence.

continued

Authored by:

Douglas S. Foreman, CFA,
Chief Investment Officer
Kayne Anderson Rudnick Investment Management, LLC

Kayne Anderson Rudnick believes that superior risk-adjusted returns may be achieved through investment in high-quality companies with market dominance, excellent management, financial strength, and consistent growth, purchased at reasonable prices.

The **S&P 500® Index** is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The **MSCI® EAFE Index** is a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. The **MSCI® Emerging Markets (EM) Index** is a free-float adjusted market capitalization index tracking the equity performance of global emerging markets. The **Bloomberg Barclays U.S. Aggregate Bond Index** is a market value weighted index that tracks the daily price, coupon, pay downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. The **Bloomberg Barclays Emerging Market Local Currency Government Index** is a flagship index that measures the performance of local currency Emerging Markets (EM) debt. Classification as an EM is rules-based and reviewed annually using World Bank income group, International Monetary Fund (IMF) country classification and additional considerations such as market size and investability. The **ICE BofAML U.S. High Yield Index** tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market.

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