Goodman FINANCIAL
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Q3 2018
MARKET & ECONOMIC REVIEW

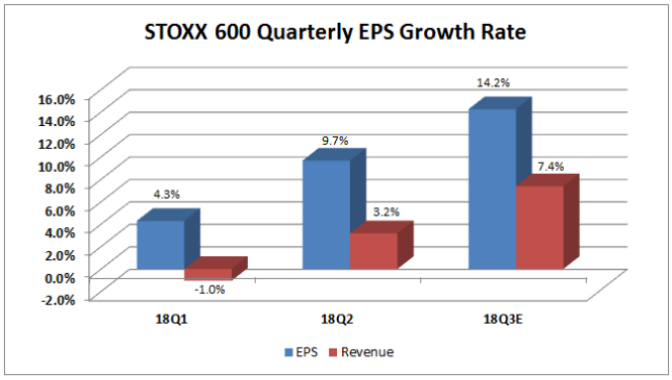
MAJOR EQUITY MARKET INDICES

INDEX	DESCRIPTION	6/30/18	LOW CLOSE	HIGH CLOSE	9/30/18	QTD RETURN*
S&P 500	A market-capitalization weighted index of 500 large U.S companies.	2,718.37	2 ,713.22	2,930.75	2,913.98	↑ 7.2%
DJIA	Dow Jones Industrial Average or "The Dow"; A price-weighted average of 30 major U.S. companies.	24,271.41	24,174.82	26,743.50	26,458.31	↑ 9.0%
Nasdaq Composite Index	A market-capitalization weighted index comprised of over 3,000 companies, mostly in the technology and biotech industries.	7,510.30	7,502.67	8,109.69	8,046.35	↑ 7.1%
Russell 2000	A market-capitalization weighted index tracking U.S. small-cap stocks.	1,643.07	1 ,643.07	1,740.75	1,696.57	↑ 3.3%
NIKKEI 225	A price-weighted index comprised of Japan's top 225 most established companies.	22,304.51	21,546.99	24,120.04	24,120.04	↑ 8.1%
MSCI Emerging Markets	An index comprised of 23 MSCI indices from emerging economies including Brazil, China, India, Mexico, Russia, South Africa, and the UAE.	1,069.52	1 ,003.33	1,092.36	1,047.91	↓ -2.0%
Stoxx Europe 600	An index comprised of 600 companies based in one of 18 EU countries including Austria, Belgium, Denmark, France, Germany, Ireland, Spain, and the United Kingdom.	379.93	373.47	392.08	383.18	↑ 0.9%

*** Excludes effects of dividends** **Sources: FactSet**

EQUITY MARKETS COMMENTARY

- Major U.S. stock indices posted gains during the third quarter of 2018, with the Dow Jones up 9.0%, the S&P 500 up 7.2%, and the NASDAQ Composite up 7.1%. Small-cap stocks lagged meaningfully, with the Russell 2000 small-cap stock index only up 3.3%.
- As seen on the chart below, small-cap stocks as represented by the Russell 2000 struggled vs. their large cap peers, as represented by the S&P 500 index. This was a reversal of fortunes from Q2 when small-caps outperformed them. As seen below, most of the shortfall occurred in September.
- Most S&P 500 sectors were positive for Q3. The Healthcare sector led the way, up 14.0% in Q3, followed by strong gains in the Consumer Discretionary, Industrials, Information Technology and Telecom sectors. The Energy and Materials sectors were both down 0.1% in Q3.
- The MSCI Emerging Markets Index once again lagged, down another 2.0% in Q3 and is now down 11.0% so far in 2018. Significant declines in the Turkish Lira and Argentine Peso gave emerging market investors cause for concern. These markets also continue to suffer from concerns about fallout from global trading wars, especially since mainland China and Hong Kong combined comprise a significant part of the index.
- European stocks as represented by the STOXX Europe 600 managed a small gain of 0.9% in Q3. Despite an expected 14% earnings growth rate for Q3 (as seen in the chart below), the STOXX Europe 600 has been struggling with investor concerns over Brexit and political uncertainties in several of its countries, Italy being front and center. We believe this disconnect creates an attractive investment opportunity.
- Japanese stocks as represented by the Nikkei 225 index had a strong quarter, up 8.1% as investors there are feeling more confident that the country's "Abenomics" is working and gaining traction.



Source: Thomson Reuters I/B/E/S

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FIXED INCOME RATES

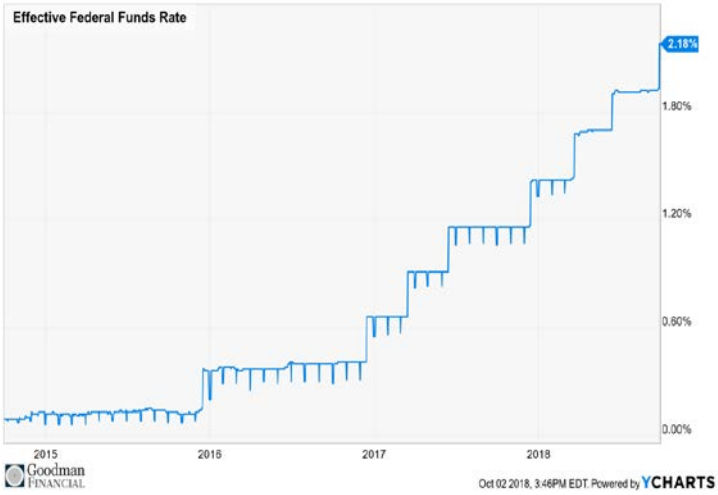
DESCRIPTION	6/30/18	9/30/18	QTD CHANGE IN BASIS POINTS	DESCRIPTION	6/30/18	9/30/18	QTD CHANGE IN BASIS POINTS
90 Day Treasury Bill	1.93%	2.19%	↑ 26	Federal Funds Rate Target	1.75%-2.00%	2.00%-2.25%	↑ 25
10 Yr. Treasury Note	2.85%	3.05%	↑ 20	Prime Rate (U.S.)	5.00%	5.25%	↑ 25
30 Yr. Treasury Bond	2.98%	3.19%	↑ 21	LIBOR (3 month)	2.34%	2.40%	↑ 6
15 Yr. Mortgage Rate	3.99%	4.14%	↑ 15	5-Year CD	1.74%	1.88%	↑ 14
30 Yr. Mortgage Rate	4.53%	4.74%	↑ 21	New-car Loan (48 month)	3.74%	3.93%	↑ 19

***One basis point is equal to 1/100th of 1% or 0.01%**

Sources: FactSet, Wall Street Journal, U.S. Treasury

FIXED INCOME MARKETS COMMENTARY

- Bonds posted mixed results in Q3 as interest rates rose in the quarter. The yield on the 10-year Treasury increased from 2.85% to 3.05%. With this rise in interest rates, the widely followed Barclay's Aggregate Bond Index Composite had a 0.0% return for Q3.
- As seen on the attached chart, the benchmark 10-year Treasury rate closed above 3.0% for the first time since May 2018. Prior to May of this year, one had to go all the way back to January 2014 to see the rate above 3.0%. It will be interesting to see if rates find a new floor at 3.0% rather than such a level being the ceiling they have been for so long. Logically, further increases in the Federal Funds rate will likely keep upward pressure on the 10-year rate.
- The Federal Open Markets Committee of the U.S. Federal Reserve (the Fed) voted during its September meeting to raise the Fed Funds Target Rate range by 25 bps to a range of 2.00% to 2.25%, a move that was widely expected. As seen in the chart below, this is the eighth rate hike since the Fed started raising the Fed Funds rates in late 2015 and the third rate increase this year. The Fed has indicated there is a high probability for another rate hike when it meets in December. By the Fed's own projections, further rate increases are expected in 2019 and into 2020. In fact, the Fed's most recent median projection for the Federal Funds rate in 2020 is 3.4% - a rate much higher than the current 10-year Treasury rate, as discussed above.
- Borrowing rates continue to rise for both businesses (as represented by the Prime Rate and LIBOR) and for consumers. Normally, higher borrowing rates would have a chilling effect on spending. In fact, auto and existing home sales have slowed down recently, but not materially so. This is something we will be watching closely as further rate hikes may begin to slow down an otherwise healthy and strong economy.



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U.S. ECONOMIC HEALTH

INDICATOR	DESCRIPTION	6/30/18	9/30/18	QTD CHANGE
Average Weekly Initial Claims for Unemployment Insurance (Thousands)	The number of new filings for unemployment insurance benefits. **Claims stayed low for another quarter, reflecting strength in the labor market.** *Most economists believe claims below 300,000 indicate a healthy labor market environment.*	224.50	207.00	↓ -7.8%
Unemployment Rate*	The percentage of total labor force that is unemployed but actively seeking employment. **The unemployment rate remains near low levels last seen in late 2000.** *The U.S. Federal Reserve targets a long-run unemployment rate of between 4.5% and 5%.*	4.0%	3.7%	↓ -30 bps
Average Weekly Earnings	The average weekly salary earned by private, nonfarm employees. **Wages rose during the quarter, likely a result of a tightening labor market. This suggests more disposable income for consumers and may attract more workers to join the labor force.**	$930.81	$939.78	↑ +0.96%
Index of Consumer Sentiment	This index reflects consumer attitudes towards the state of the economy. **Consumer sentiment increased since June and stays near post-recession highs.**	98.2	100.1	↑ +1.9%
Manufacturers' New Orders for Consumer Goods and Materials (Millions) *	The number of new orders placed for consumer goods. **New orders increased, indicating higher demand for U.S.-produced consumer goods and validating still-high consumer confidence and low unemployment.**	$208,729	$213,304	↑ +2.5%
Manufacturers' New Orders for Nondefense Capital Goods, Excluding Aircraft (Millions) *	This index is the producer's counterpart of new orders of consumer goods and materials. **New orders for nondefense capital goods increased during the quarter suggesting increased business confidence in the economy**.	$68,069	$68,692	↑ +0.9%
US Capacity Utilization: Manufacturing *	The ratio of production capacity being used to produce finished products compared to the total capacity available. **Utilization increased modestly and remains within the mid-70% range it has been in since 2012.**	76.1%	76.4%	↑ +30 bps

***These items are as of 8/31/18, the date of the most recently published statistics**

Sources: Federal Reserve Bank of St. Louis, The University of Michigan, U.S. Census Bureau, U.S Department of Labor

U.S. ECONOMIC HEALTH

- Initial Claims for Unemployment Insurance continued their downward trend, once again making post-recession lows during Q3 and reaching the lowest level since December 1969, when amazingly, the U.S. population was nearly one-third lower than it is today. Several other labor market indicators all point to a very tight labor market that is causing upward pressure on wages that may begin to show up in higher core inflation rates.
- As seen below, the Conference Board's *Consumer Confidence Index®* reached an 18 year high in September, a rather remarkable feat. With a strong economy that leads to low unemployment and rising real wages, consumers are feeling flush.
- U.S. Real GDP (i.e. adjusted for inflation) grew at a 4.2% rate for Q2 2018, the last reported data. This is the highest rate since Q3 2014 and has averaged 2.9% for the prior four quarters.
- One area of recent weakness in the economy is in housing. After recovering nicely since the recession, both existing home sales and new home sales (see chart below) have seen mild declines in 2018. This is likely due to slightly higher mortgage rates and lessening home affordability, as home prices have increased the past few years. While not yet concerning, this is an area we are watching closely.