Quantitative Asset Management, LLC
Investment & Advisory Services

October 15, 2018

Quarter Ending September 30, 2018

Year to Date Performance	Last Full Quarter	YTD	Index Close
Dow Jones Industrial Average	9.01%	7.22%	25,535.06
NASDAQ Composite Price	7.14%	15.78%	7,578.66
Standard & Poor's Averages	7.20%	8.91%	2,786.27

Dear Clients,

On August 22, 2018, the equity bull market turned 3,453 days old. It is the longest period of uninterrupted gains in American history. (Although, as we write this letter the NASDAQ, S&P and Dow are down 5.5%, 2.5%, and 1.5% respectively from the end of the third quarter). Economic and consumer data, when compared with some company valuations, continue to be a positive catalyst pointing towards future growth. At Quantitative Asset Management, we tend to focus our quarterly letters on equities and stocks and what is going on in the broad economy. However, we thought it was an appropriate time to get "off track" and talk about a longer lasting "perceived" bull market… the bond and fixed income marketplace.

For the last 37 years (or 13,514 days to be exact), we have been in what investment professionals call a bond bull market. Throughout the duration of this bond market cycle, investors have observed positive rates of return and significant stability in the pricing of their bonds. In simplistic terms, interest rates and bond prices move in opposite directions. The reduction in rates from 1981 until today has provided the support for this market to run its course. In addition, due to the market performance of bonds and "bond like" investments, investor dollars continue to funnel into these types of investments at a record pace. However, if investors take a closer look at what they own, they may find all is not what it seems.

The most important "risk" for bond investors to understand - which is virtually never talked about - is what is called reinvestment risk. Most investors own bonds for two specific reasons: income and safety. The perceived bond bull market has been met with great fanfare, but if investors take a closer look, they will see the income from their bond portfolio has significantly **decreased** over the duration of this market cycle. For example, an investor who purchased a 10-year treasury in 1981 received an income of 16% per year. If that same investor chose to reinvest their proceeds upon maturity (1991), their reinvestment rate would have been 7.39%, a 50% reduction in income. If the same investor continued to reinvest their proceeds at maturity, their

2001 rate would have been 4.7% and they would currently be 7 years into their duration, collecting 2.08% per year until 2021. Stable, and in some cases increased bond prices, have hidden this income deterioration; however, over the last 37 years, some bond investors have seen their income decrease by close to 87%.

The next "risk" we want to focus on is what happens to your bond investments during a rising rate environment. For most investors, this is uncharted territory...they have not lived through a rising rate environment. Luckily, Jeffrey is someone who has. As stated above, interest rates and bond prices move in opposite directions. During a rising rate environment, some investors could see a significant impact on the pricing of their bonds. During the late 1970's and early 80's, it was not uncommon to see bond prices down 30% or more. It is important to note, if an individual investor holds their bonds to maturity, they will eventually receive their principal back; however, open-end mutual funds and exchange traded bond funds will be subject to more long-term volatility as they do not hold a majority of their bonds to maturity.

The point of this letter is not to predict an impending correction in the bond market. That said, much like evaluating the equity markets, it is important to understand the investment you own, the risks associated with it, why you own it, and how you are going to make money. Most importantly, "safe" or "riskless" investments do and can hold some significant risks. At QAM, we firmly believe the equity markets are the best place for superior long-term investment returns. As the equity and bond markets continue to capitulate, we will leave you with a quote from Peter Lynch in his book, "*One Up On Wall Street: How To Use What You Already Know To Make Money in the Market*":

> "If you can follow only one bit of data, follow the earnings – assuming the company in question has earnings. As you'll see from this text, I subscribe to the crusty notion that sooner or later earnings make or break and investment in equities. What the stock price does today, tomorrow, or next week is only a distraction."

On a side note, as we were discussing the topics for our 3rd quarter letter, we realized this topic (as it relates to the equity markets) deserves more attention. Therefore, we will be writing an additional letter to you during the 4th quarter… so stay tuned!

Jeffrey L. Farni, Sr. John C. Farni