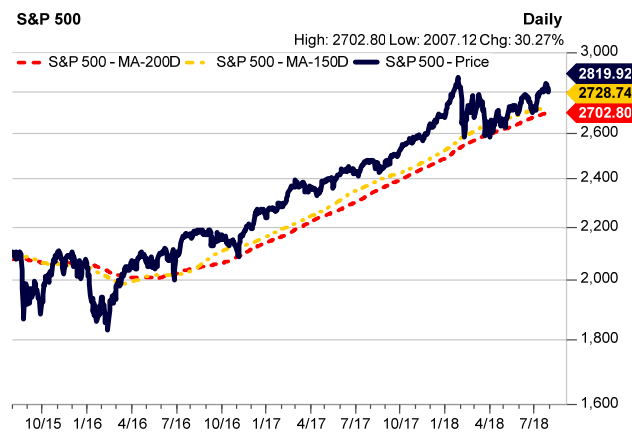


Observation Deck

Views from the Investment Policy Committee



3rd Quarter 2018

Purpose

- The Observation Deck is a series of pictures designed to communicate points of view and to generate discussion and debate, it is NOT a set of recommendations
- Our commentary is not the result of any single data point or graphic, it is a reflection of the weekly conversations within the Investment Policy Committee and a set of perspectives that are derived from many observations accumulated over varying time frames
- Slides that are included in the Observation Deck are a subset of the scores of data points and graphics that the Investment Policy Committee views each week in assessing the status of the business cycle and the health of financial markets
- We hope that you enjoy the Observation Deck and recognize that the views and opinions expressed are capturing a moment in time and are subject to change without notice

Macro TIP Chart

Tactical Investment Positioning

3rd Quarter 2018

Strength of Conviction	Chg	Negative	Neutral	Positive	Rationale
Business Cycle					Growth remains above trend across many geographies. Leading indicators are at peak levels and likely to soften from here
Financial Conditions	←				Monetary policy shifts toward tightening in many geographies. US rates starting to exert pressure. Fiscal stimulus complete.
Relative Preference	Chg	Neutral			Rationale
Asset Class		Bonds		Stocks	Positive trajectory for profit growth but stocks likely at peak valuation levels. Bond yields becoming more attractive.
Economic Sensitivity		Defensive		Cyclical	Profit cycle remains good for economically sensitive stocks. Valuations becoming more attractive for defensive stock sectors.
Credit Quality		Sovereign		Credit	Credit fundamentals remain mostly solid. However, spreads are very narrow and suggest valuations are full.
Duration Profile		Short Maturity		Long Maturity	Yields responding to higher inflation expectations and monetary policy actions. Business cycle reaching late stage.
Commodities		Below Weight		Above Weight	Late stage GDP strength pushing incremental demand against a mostly stable supply environment.
Cash		Below Weight		Above Weight	Rising cash yields offer competition to financial assets for the first time in over a decade.

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Observation #1

Protectionism Around the Globe

- Despite above trend global GDP growth and a world unemployment rate below 5.5%, the scars of the 2008 financial crisis, a globalization backlash, and the pace of technological change, have led to a high level of skepticism in the system and a rise of populist movements
- The push against globalization is widespread and the rhetoric of protectionism is not unique to the United States

Examples of Protectionism Around the Globe*

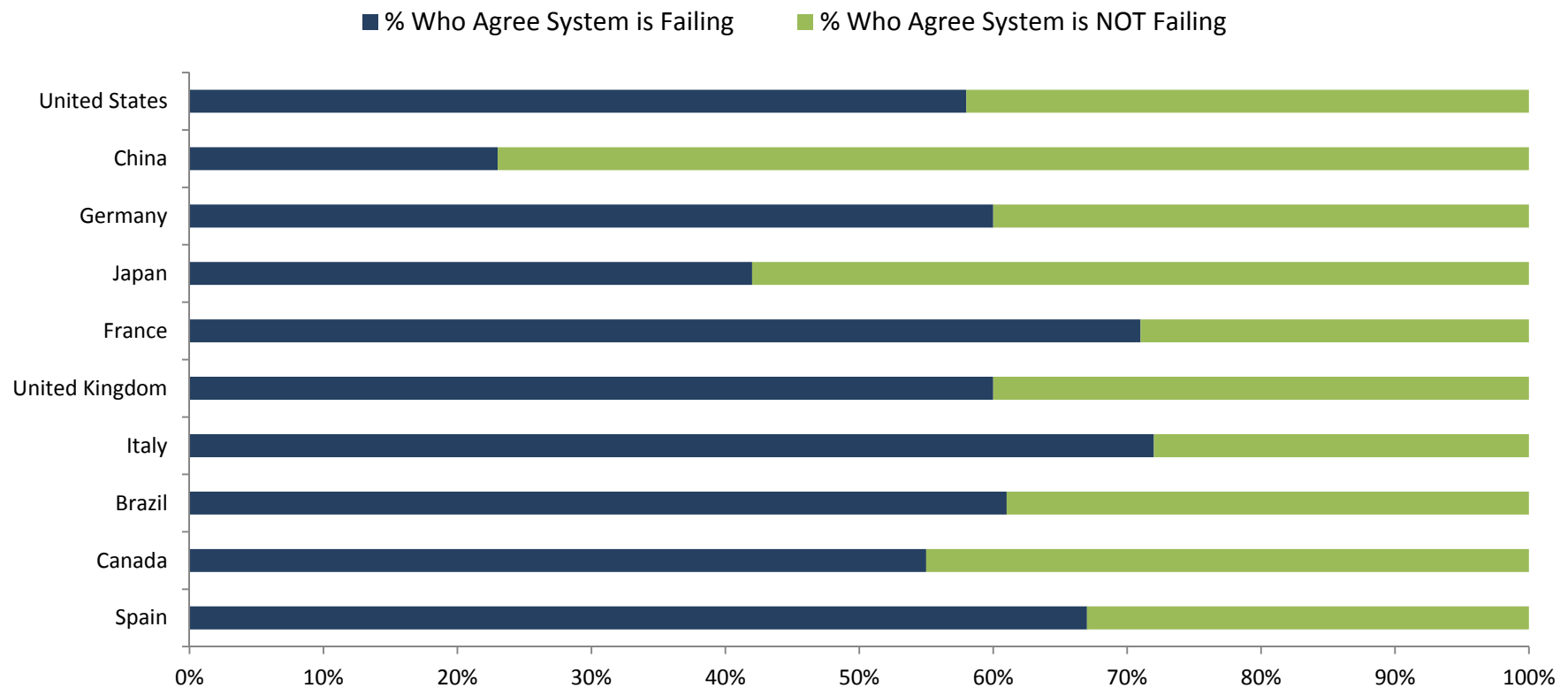
Country	Example	Implications
China	“China 2025”	Digital protectionism (forced joint ventures, onerous requirements on foreign firms) intended to undercut foreign competitors and boost Chinese companies’ competitive advantage
France	National Front Party	Le Pen gained support for raising nationalist views and an exit from the Eurozone. She vowed to defend France against “rampant globalization”.
India	Tariffs	Over the last year, imposed tariffs on various product groups, including auto parts, solar panels, footwear, and furniture, citing the need to “provide adequate protection to domestic industry”
Italy	League Party	Voter frustration with the political establishment and economy. Regions whose industries were impacted by imports and automation supported the League. Campaigned on a “robot tax”
United Kingdom	Brexit	Frustration by voters who feel they have been left behind due to globalization and free trade. The vote for Brexit were supported strongest by regions of the UK impacted by the flight of manufacturing
United States	Tariffs	President Trump believes the US trade deficit and trade deals are unfair and hurt US manufacturing. Implement tariffs to reduce the deficit and “bring the jobs home”.

*Source: Stifel Investment Strategy - July 2018

Observation #1

Protectionism Around the Globe

- The Edelman Trust Barometer of 2018 surveyed over 33,000 of the general population across 28 countries regarding confidence in public leaders, equality of the system, hope for the future, and desire for change
 - 63% of respondents stated that CEO's are not credible
 - 71% of respondents suggested government leaders are not credible
 - 82% of respondents don't trust the media



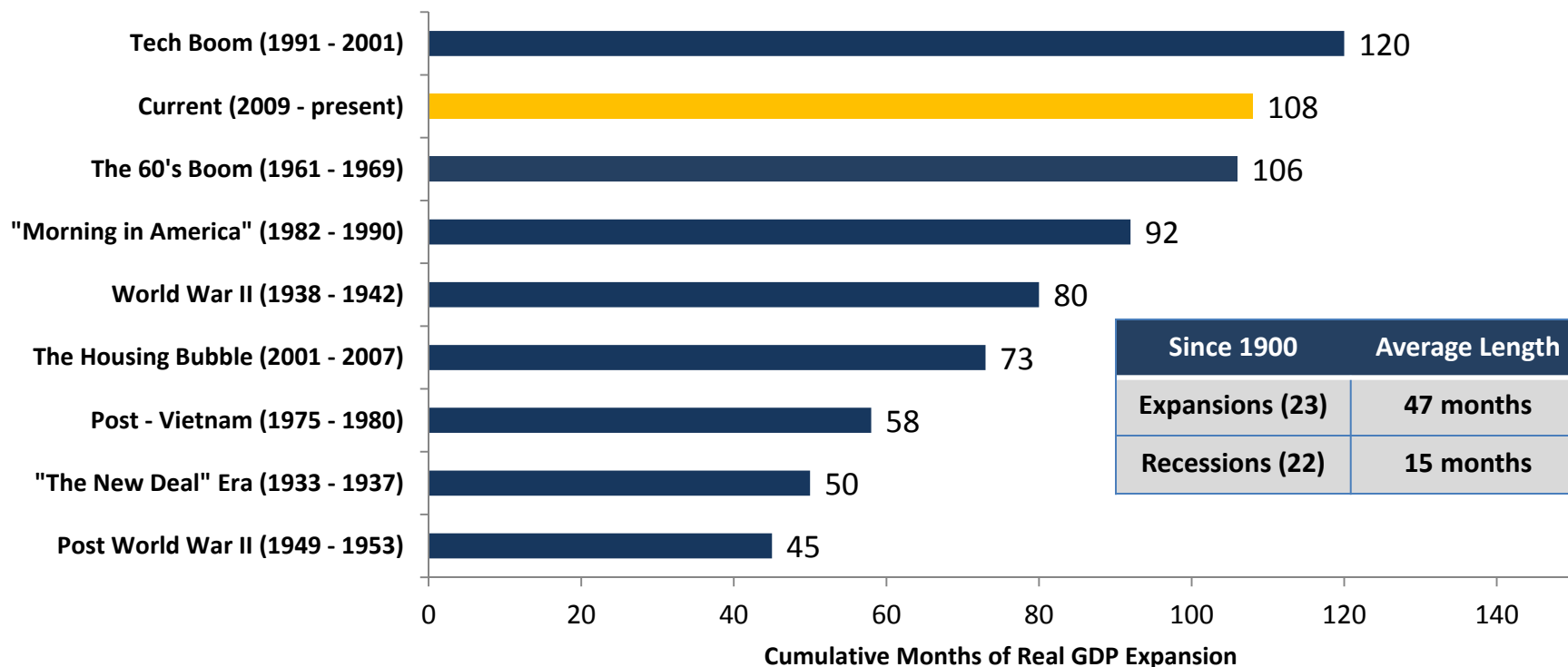
Source: Edelman Trust Barometer 2018

Observation #2

Long Live Goldilocks

- The current expansion has faced years of skepticism, but what this business cycle has lacked in strength it has made up for in its duration, now the second longest expansion of the past century
- The current expansion may rank 2nd in its duration, but its cumulative strength has lagged many of its predecessors – ranking this cycle only 5th by cumulative real GDP growth

DURATION of the Expansion Phase of the Business Cycle

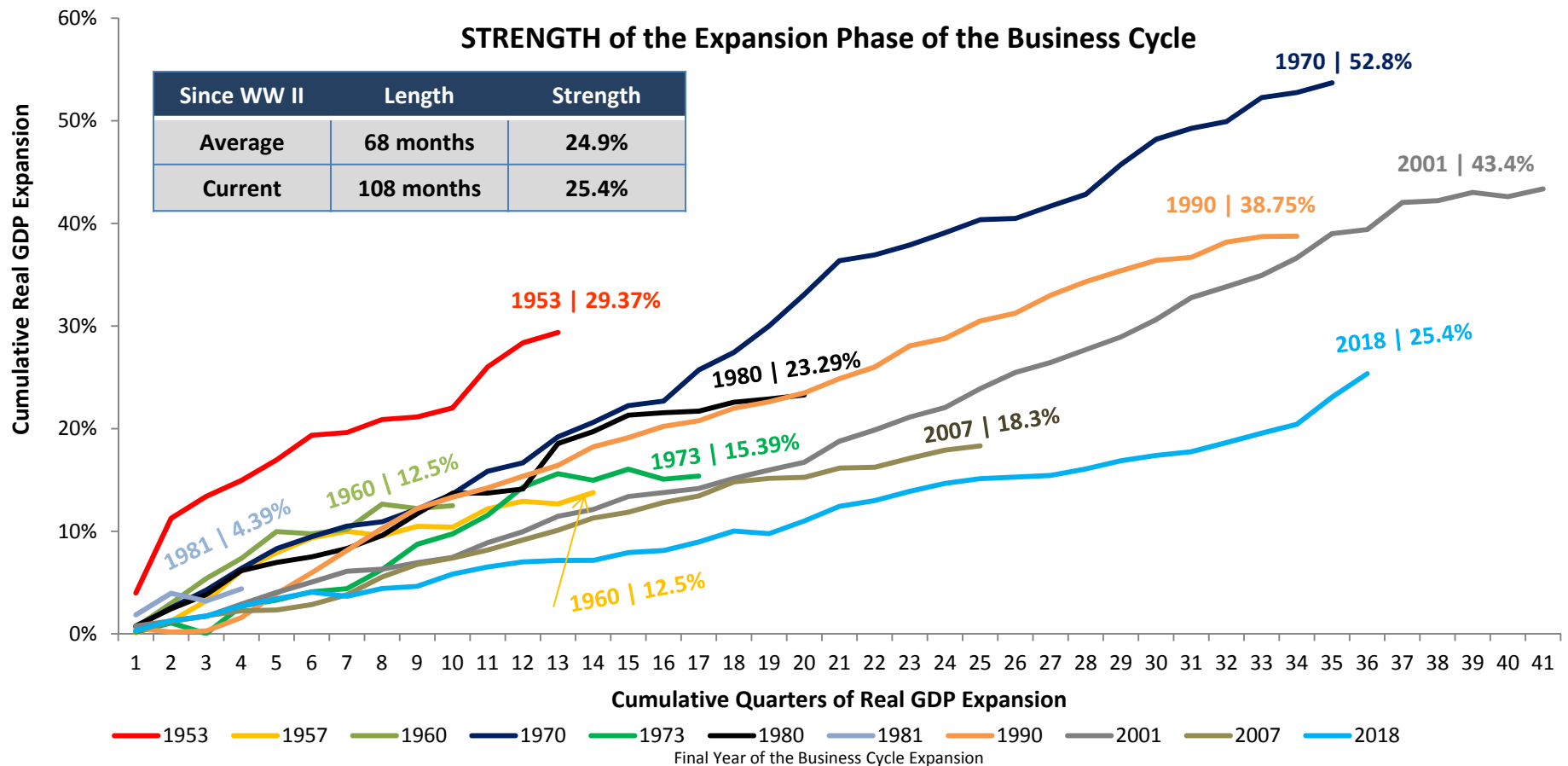


Source: NBER (National Bureau of Economic Research), As of June 30, 2018

Observation #2

Long Live Goldilocks

- The shallow trajectory of the current business expansion has allowed financial conditions to remain very accommodative without the risk of rising inflationary pressures
- Business cycles do not die of old age, their demise is more commonly affiliated with rising excesses that occur simultaneously with tighter financial conditions



Observation #3

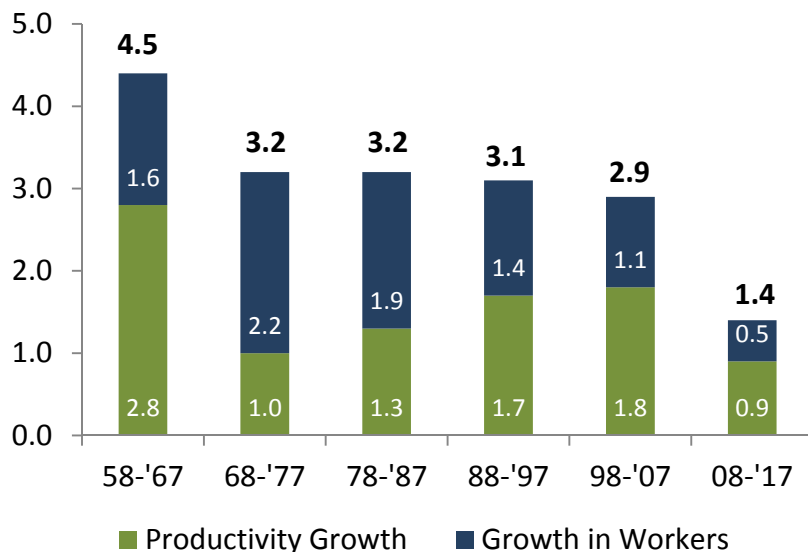
The Business Cycle and Trend Growth

- Business cycles have an ebb and flow, vacillating above and below trend growth from quarter to quarter
- Monetary and fiscal policies may influence economic strength or weakness temporarily, but trend growth for an economy is ultimately a reflection of working age population and changes in productivity

$$\frac{\text{Growth in Workers} + \text{Growth in real output per worker}}{\text{Growth in Real GDP}}$$

Drivers of U.S. Real GDP Growth, 1958 – 2017

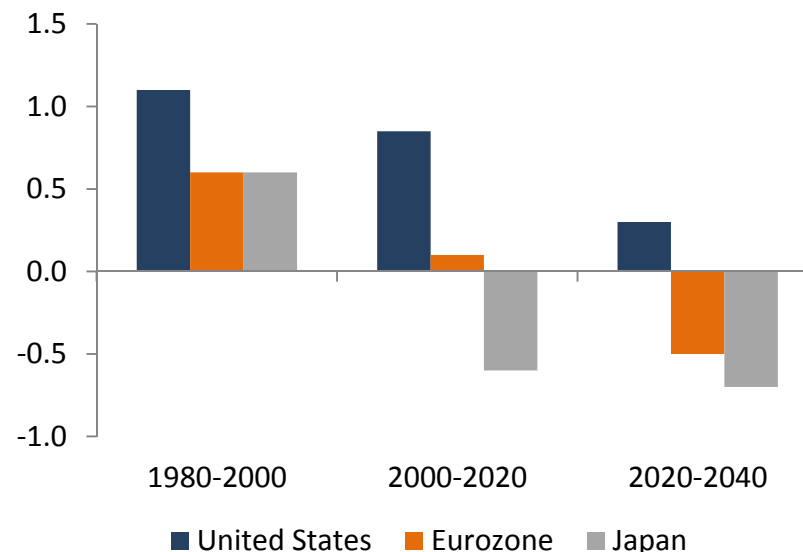
Average Year on Year % Change



Source: BEA, BLS, Federal Reserve Bank

Global Working Age Population Growth

Annualized % Change



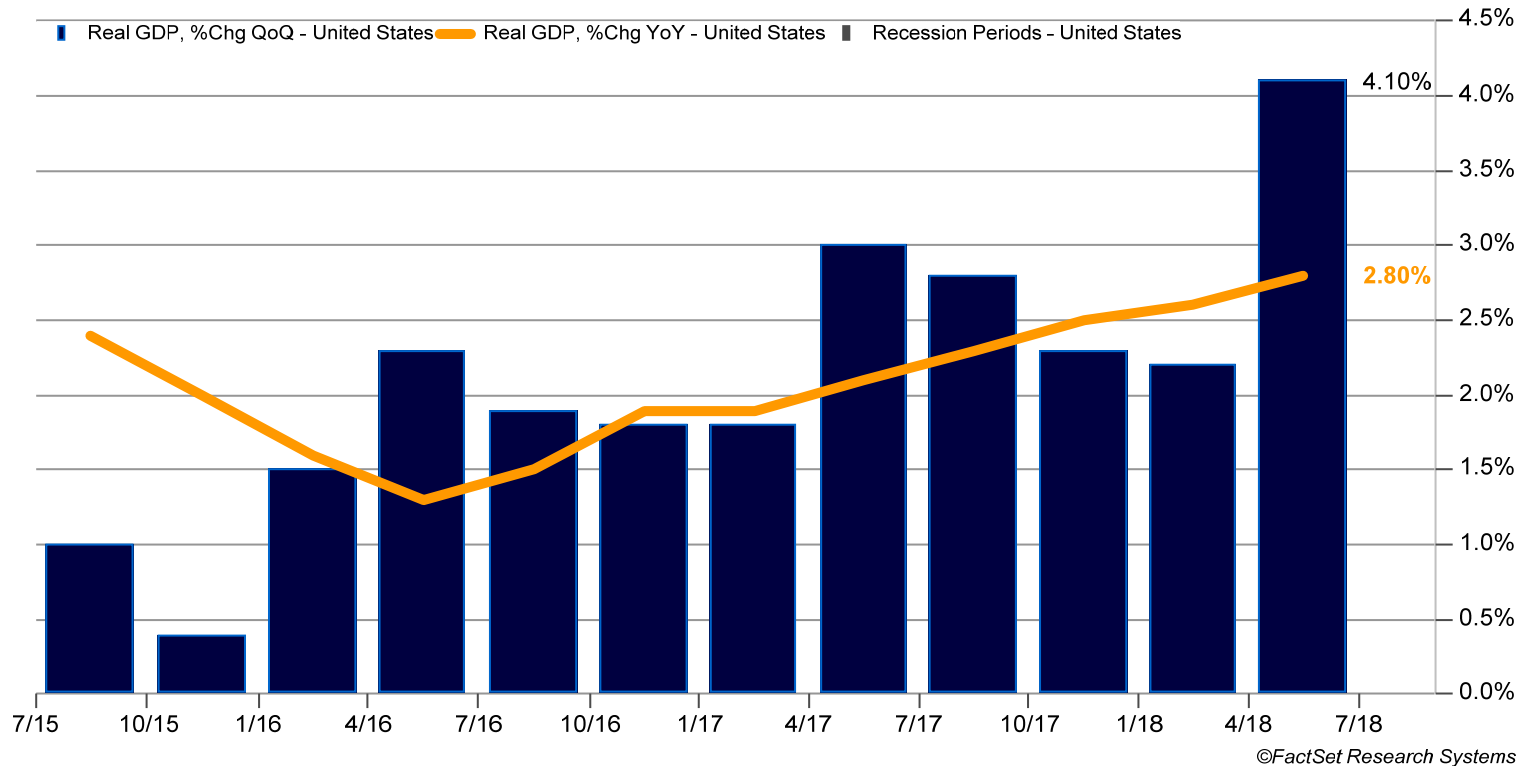
Source: United Nations Department of Economic & Social Affairs

Observation #3

The Business Cycle and Trend Growth

- After experiencing slower than trend growth as a result of the collapse in energy prices and subsequent infrastructure spending declines, the United States economy has accelerated above the 2% annualized rate of Real GDP growth that many economists (and the Federal Reserve) consider to be trend growth
- Fiscal stimulus added momentum to a cycle that was already experiencing nice strength and excellent breadth, but it is set to fade as the calendar turns toward 2019-20

USA Real GDP Growth



Observation #4

As Good As It Gets

- Most indicators of sentiment and confidence surrounding the economy are at or near all-time highs, which history would suggest is a good time to re-evaluate the sustainability of elevated expectations
- The direction of manufacturing activity can be a very valuable leading indicator of economic strength and the data suggests that global activity levels may have peaked earlier in the year

GLOBAL PURCHASING MANAGERS INDEX (PMI) FOR MANUFACTURING

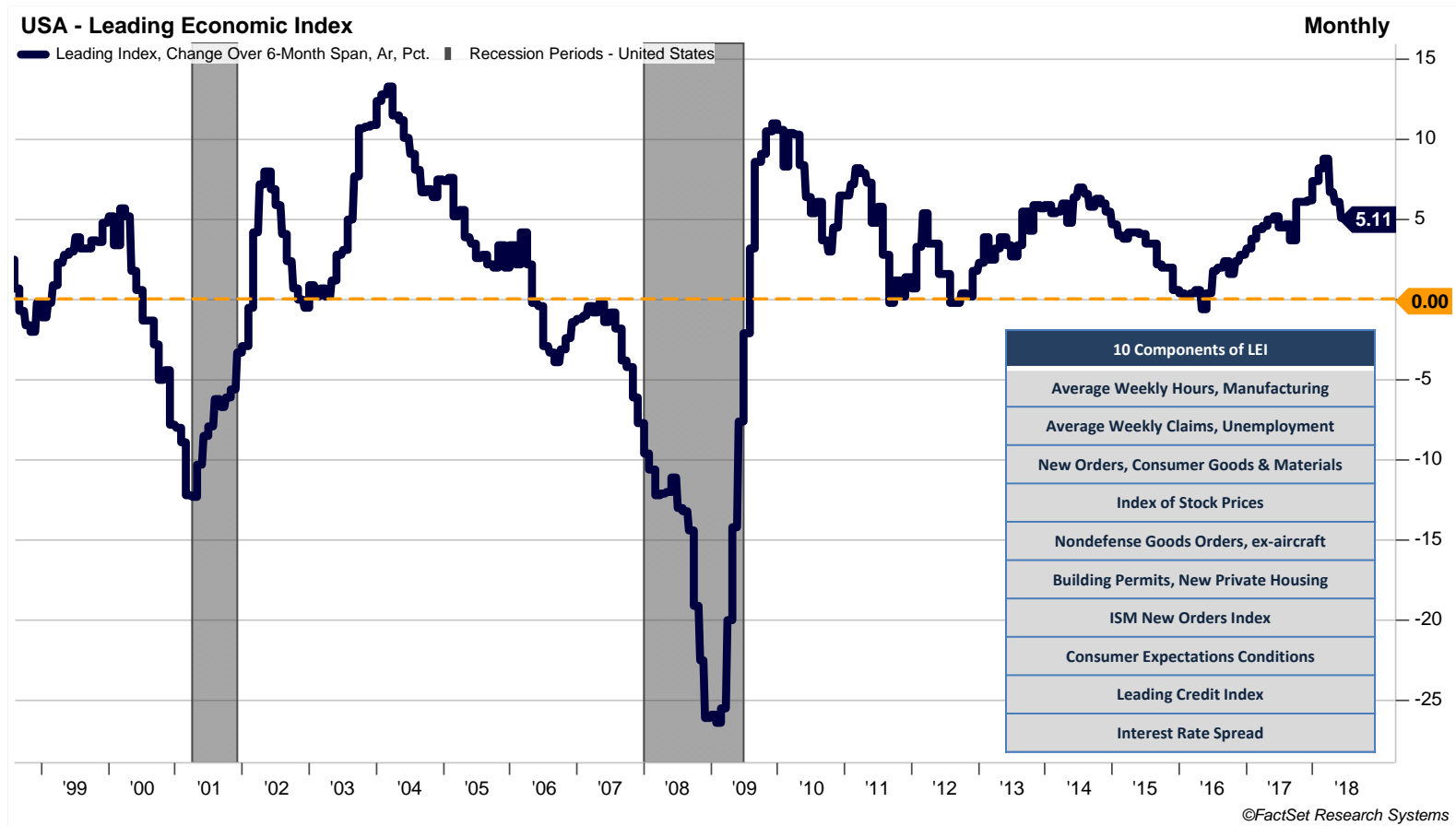
	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
World	51.0	50.8	51.1	52.0	52.0	52.6	52.7	52.9	52.9	52.7	52.6	52.6	52.7	53.1	53.2	53.4	54.0	54.5	54.4	54.1	53.3	53.5	53.1	53.0
Developed	51.4	51.2	51.5	52.6	52.9	53.7	54.1	54.1	53.9	54.1	54.1	53.9	53.9	54.2	54.6	55.2	55.8	56.2	56.3	55.7	54.9	55.1	54.7	54.4
Emerging	50.3	50.1	50.4	51.1	50.8	51.1	50.8	51.3	51.6	50.9	50.6	50.8	50.9	51.7	51.3	51.2	51.6	52.2	51.9	51.9	51.3	51.3	51.1	51.2
USA	52.9	52.0	51.5	53.4	54.1	54.3	55.0	54.2	53.3	52.8	52.7	52.0	53.3	52.8	53.1	54.6	53.9	55.1	55.5	55.3	55.6	56.5	56.4	55.4
UK	48.6	53.1	55.6	53.8	53.2	55.6	55.2	54.6	54.1	57.7	56.5	54.5	55.4	56.8	56.0	56.2	58.2	56.0	55.0	54.9	54.9	53.9	54.3	54.4
Canada	51.9	51.1	50.3	51.1	51.5	51.8	53.5	54.7	55.5	55.9	55.1	54.7	55.5	54.6	55.0	54.3	54.4	54.7	55.9	55.6	55.7	55.5	56.2	57.1
Australia	56.4	46.9	49.8	50.9	54.2	55.4	51.2	59.3	57.5	59.2	54.8	55.0	56.0	59.8	54.2	51.1	57.3	56.2	58.7	57.5	63.1	58.3	57.5	57.4
Euro Zone	52.0	51.7	52.6	53.5	53.7	54.9	55.2	55.4	56.2	56.7	57.0	57.4	56.6	57.4	58.1	58.5	60.1	60.6	59.6	58.6	56.6	56.2	55.5	54.9
Germany	53.8	53.6	54.3	55.0	54.3	55.6	56.4	56.8	58.3	58.2	59.5	59.6	58.1	59.3	60.6	60.6	62.5	63.3	61.1	60.6	58.2	58.1	56.9	55.9
Italy	51.2	49.8	51.0	50.9	52.2	53.2	53.0	55.0	55.7	56.2	55.1	55.2	55.1	56.3	56.3	57.8	58.3	57.4	59.0	56.8	55.1	53.5	52.7	53.3
France	48.6	48.3	49.7	51.8	51.7	53.5	53.6	52.2	53.3	55.1	53.8	54.8	54.9	55.8	56.1	56.1	57.7	58.8	58.4	55.9	53.7	53.8	54.4	52.5
Ireland	50.2	51.7	51.3	52.1	53.7	55.7	55.5	53.8	53.6	55.0	55.9	56.0	54.6	56.1	55.4	54.4	58.1	59.1	57.6	56.2	54.1	55.3	55.4	56.6
Greece	48.7	50.4	49.2	48.6	48.3	49.3	46.6	47.7	46.7	48.2	49.6	50.5	50.5	52.2	52.8	52.1	52.2	53.1	55.2	56.1	55.0	52.9	54.2	53.5
Spain	51.0	51.0	52.3	53.3	54.5	55.3	55.6	54.8	53.9	54.5	55.4	54.7	54.0	52.4	54.3	55.8	56.1	55.8	55.2	56.0	54.8	54.4	53.4	53.4
China	50.6	50.0	50.1	51.2	50.9	51.9	51.0	51.7	51.2	50.3	49.6	50.4	51.1	51.6	51.0	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0
India	51.8	52.6	52.1	54.4	52.3	49.6	50.4	50.7	52.5	52.5	51.6	50.9	47.9	51.2	51.2	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1
Japan	49.3	49.5	50.4	51.4	51.3	52.4	52.7	53.3	52.4	52.7	53.1	52.4	52.1	52.2	52.9	52.8	53.6	54.0	54.8	54.1	53.1	53.8	52.8	53.0
South Korea	50.1	48.6	47.6	48.0	48.0	49.4	49.0	49.2	48.4	49.4	49.2	50.1	49.1	49.9	50.6	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8
Taiwan	51.0	51.8	52.2	52.7	54.7	56.2	55.6	54.5	56.2	54.4	53.1	53.3	53.6	54.3	54.2	53.6	56.3	56.6	56.9	56.0	55.3	54.8	53.4	54.5
Indonesia	48.4	50.4	50.9	48.7	49.7	49.0	50.4	49.3	50.5	51.2	50.6	49.5	48.6	50.7	50.4	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3
Russia	49.5	50.8	51.1	52.4	53.6	53.7	54.7	52.5	52.4	50.8	52.4	50.3	52.7	51.6	51.9	51.1	51.5	52.0	52.1	50.2	50.6	51.3	49.8	49.5
Brazil	46.0	45.7	46.0	46.3	46.2	45.2	44.0	46.9	49.6	50.1	52.0	50.5	50.0	50.9	50.9	51.2	53.5	52.4	51.2	53.2	53.4	52.3	50.7	49.8
Mexico	50.6	50.9	51.9	51.8	51.1	50.2	50.8	50.6	51.5	50.7	51.2	52.3	51.2	52.2	52.8	49.2	52.4	51.7	52.6	51.6	52.4	51.6	51.0	52.1

Heat Map = Monthly manufacturing PMI activity indices (Markit Economics)
 Green = readings above 50 are indicative of manufacturing activity expanding
 Red = readings below 50 are indicative of manufacturing activity contracting
 Yellow = highest reading for that country during the 3 year time period

Observation #4

As Good As It Gets

- The Conference Board's Leading Economic Index (LEI) suggests that the United States economy will continue to expand in the months ahead, but that the pace of growth is likely to slow from here

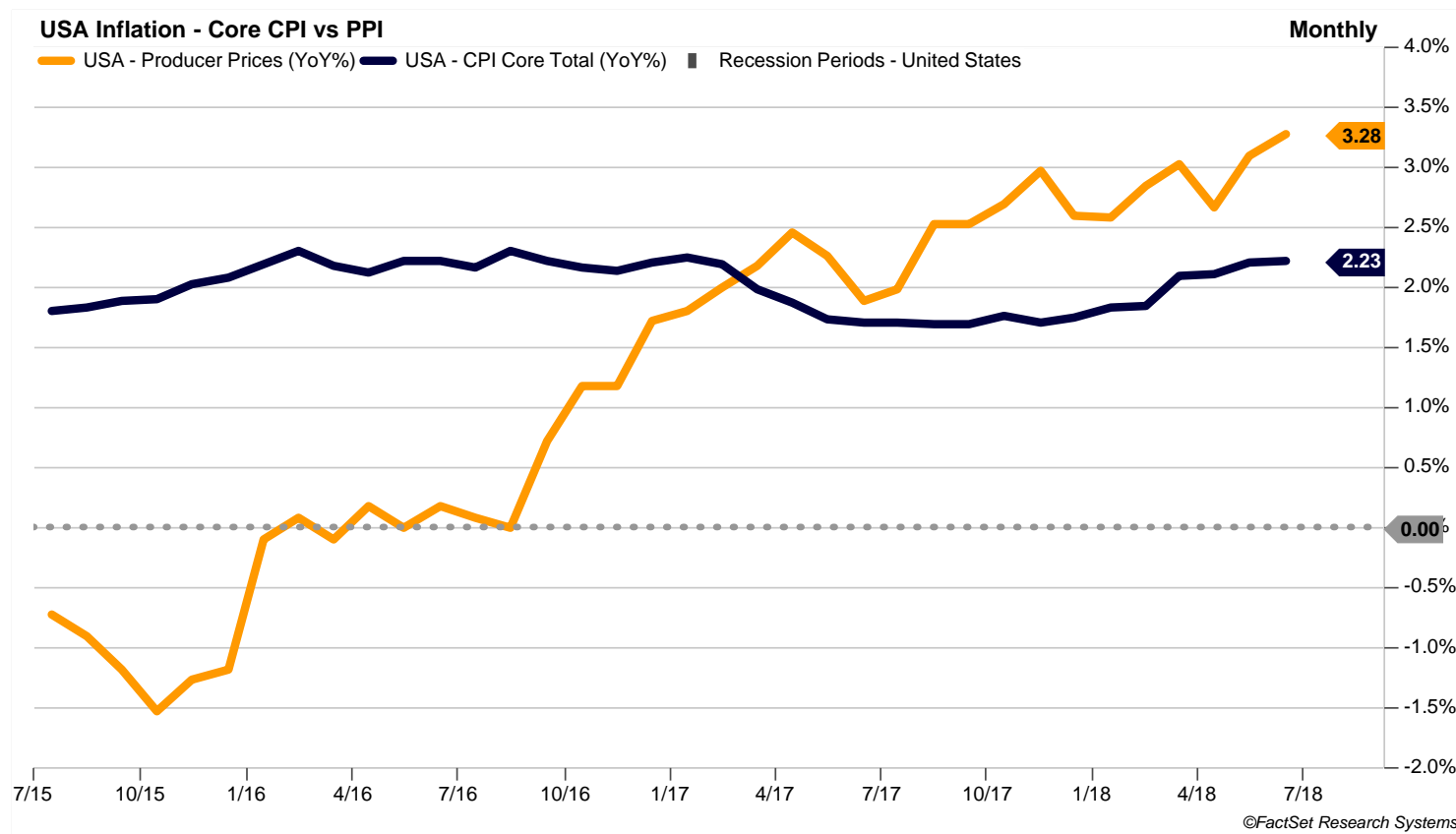


Conference Board U.S. Leading Index = Leading indicators include economic variables that tend to move before change in the overall economy. The LEI is comprised of 10 economic data sets. These indicators give a sense of the future state of an economy.

Observation #5

Inflation on the Doorstep

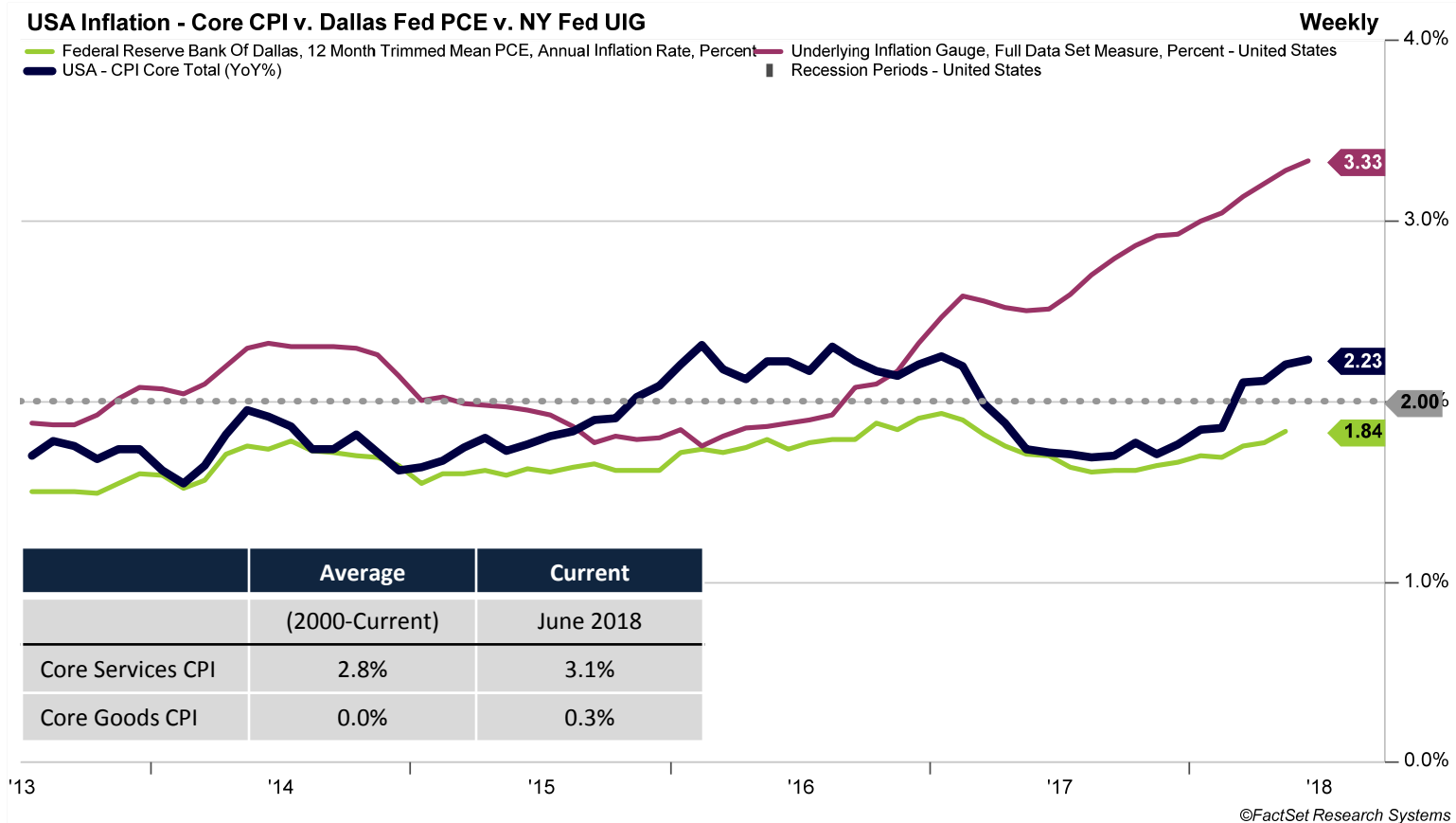
- Core Consumer Price Inflation (blue line) that backs out the volatile prices of food and energy, has remained low during recent years of modest economic growth
- As labor, materials and capacity slack is absorbed by increasing economic strength, the input prices for producers (orange line) is on the rise and companies will need to determine whether they are able to pass the higher costs of production along to consumers or accept the pressure on profit margins



Observation #5

Inflation on the Doorstep

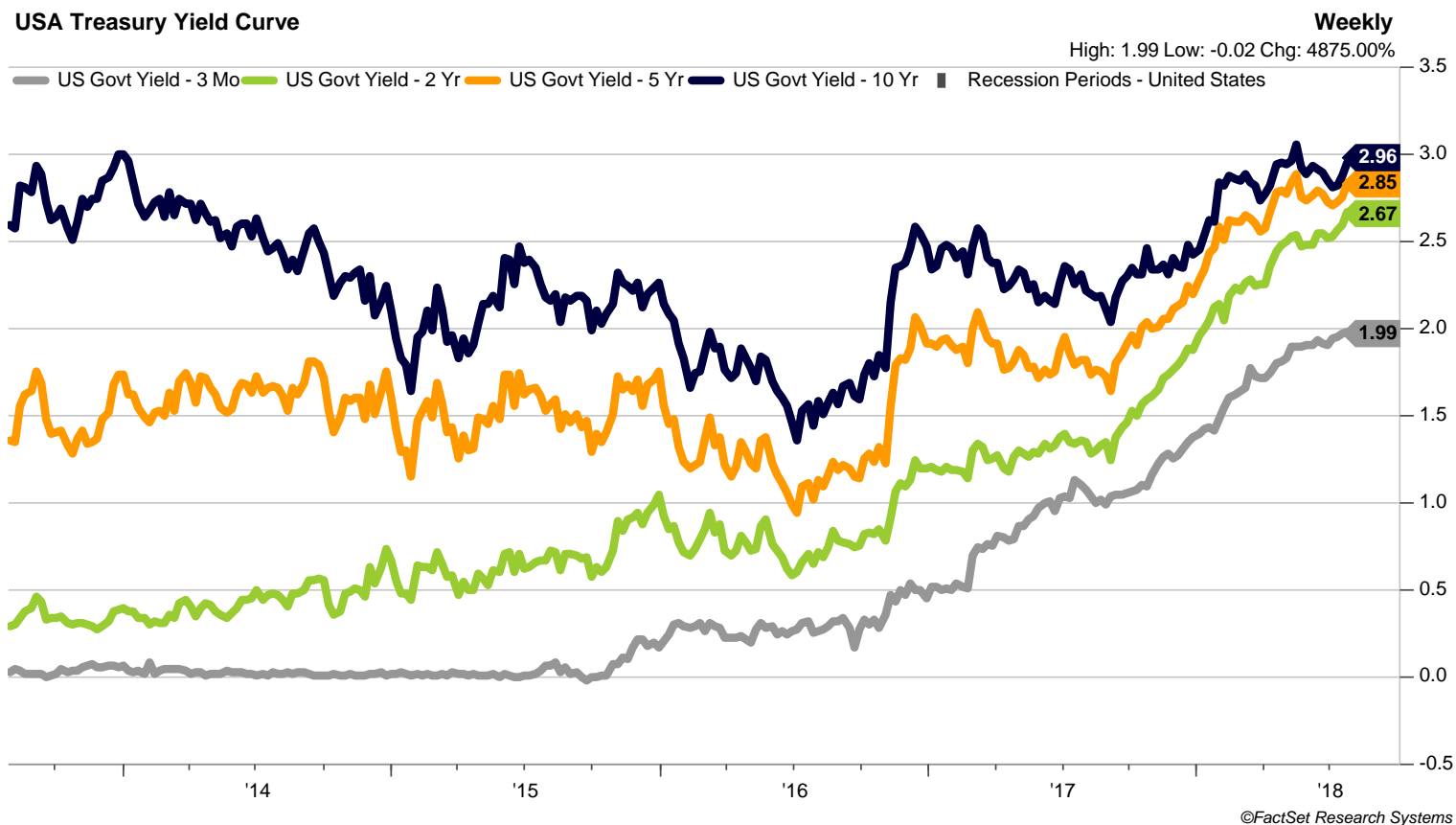
- There are many measures of inflation, the Core Consumer Price Index (CPI, blue line) and the Personal Consumption Expenditures (PCE, green line) are most common
- The NY Fed Underlying Inflation Gauge (UIG, purple line) is an alternative measure of inflation that is gaining an increasing amount of attention due to its leading indicator attributes and significant rise over the past year



Observation #6

Financial Conditions are Changing

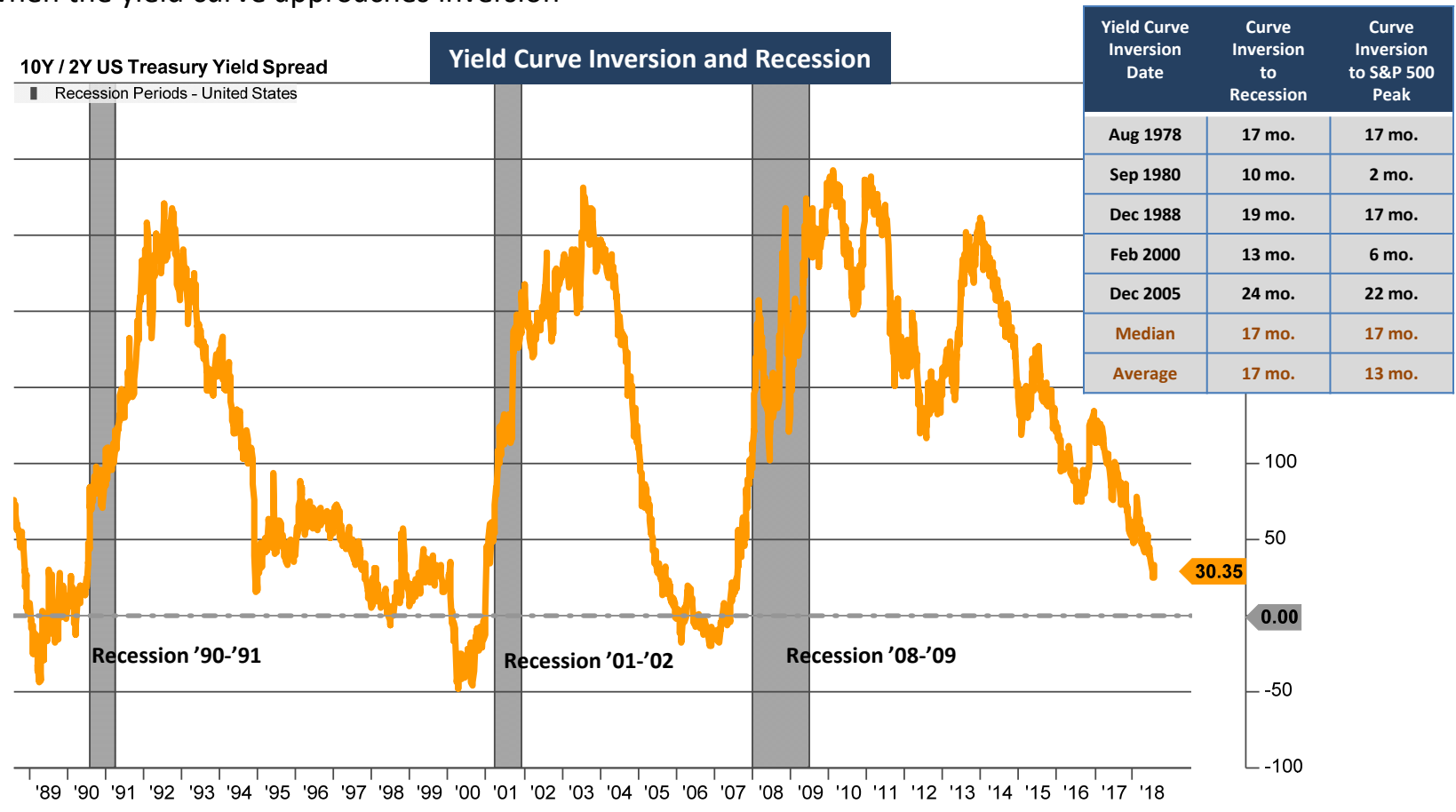
- Financial markets are uncanny in their ability to anticipate shifting economic strength and its impact on price stability (inflation) and corporate profits
- As the excess labor, materials and capacity is absorbed by a stronger economy, bond markets anticipate policy changes at the Federal Reserve and a “normalization” of interest rates



Observation #6

Financial Conditions are Changing

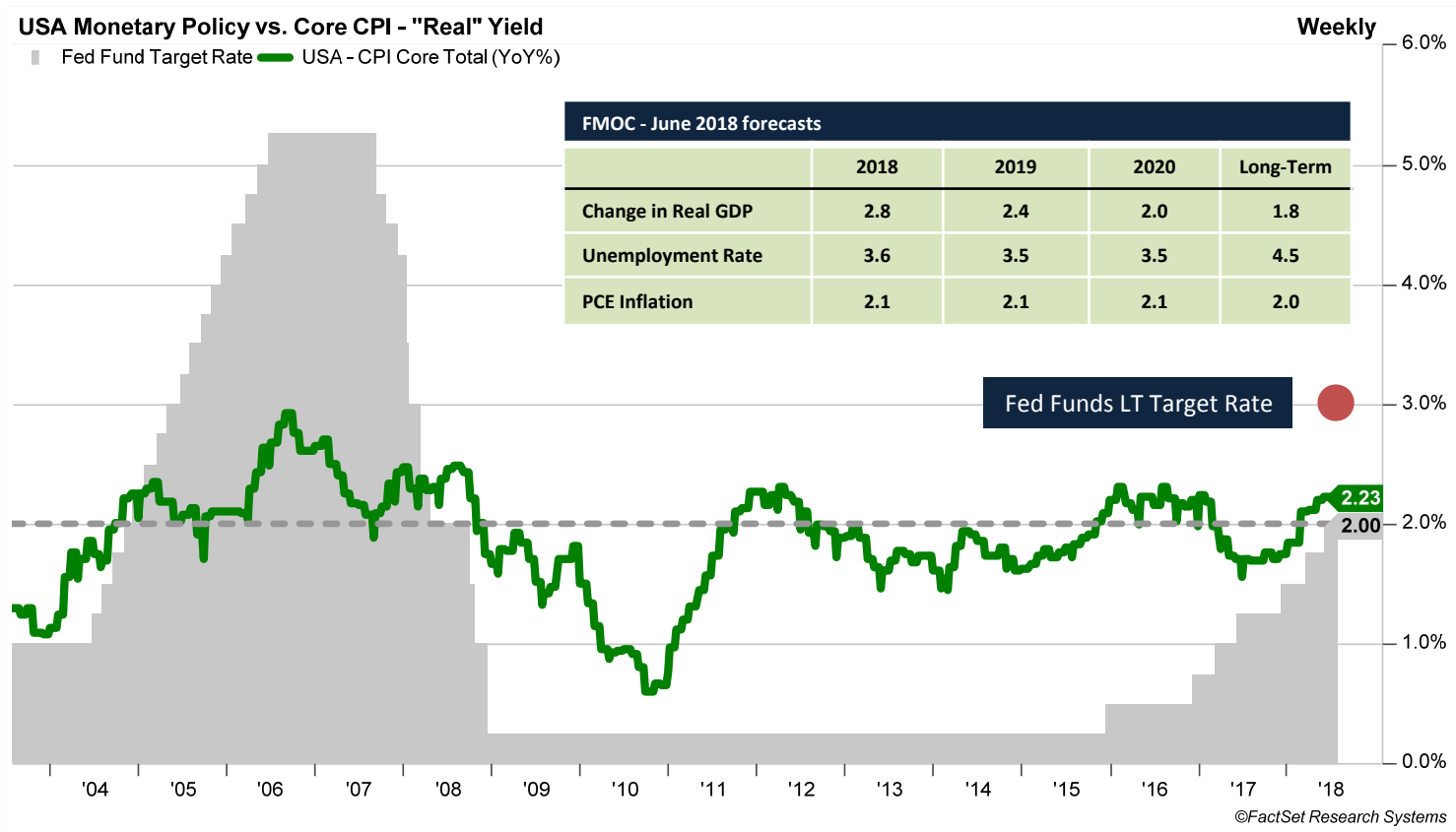
- Whenever Central Banks are raising short term interest rates, investors must evaluate the impact that higher rates may have on future economic growth, price stability and the path for corporate profits
- Yield curve flattening is typical within a maturing business cycle, but history suggests investors should take note when the yield curve approaches inversion



Observation #7

Don't Fight the Fed

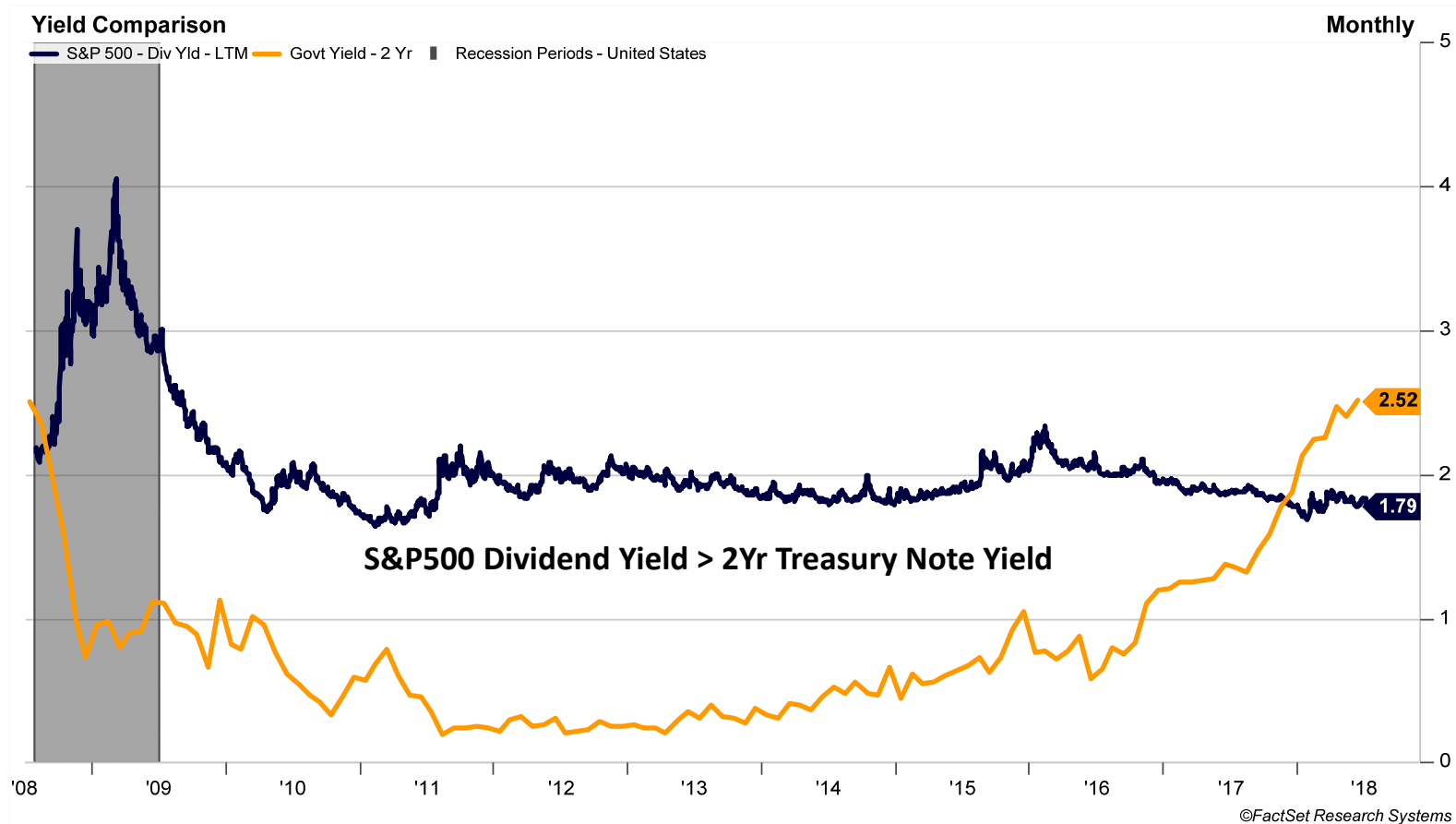
- The United States economy is stronger than the Federal Reserve believes is sustainable over the long-term as measured by Real GDP growth, the unemployment rate and the PCE measure of inflation
- As long as these conditions persist, the Federal Reserve has suggested that the path to “normalized” interest rates should be followed – a view that financial markets may not fully appreciate



Observation #7

Don't Fight the Fed

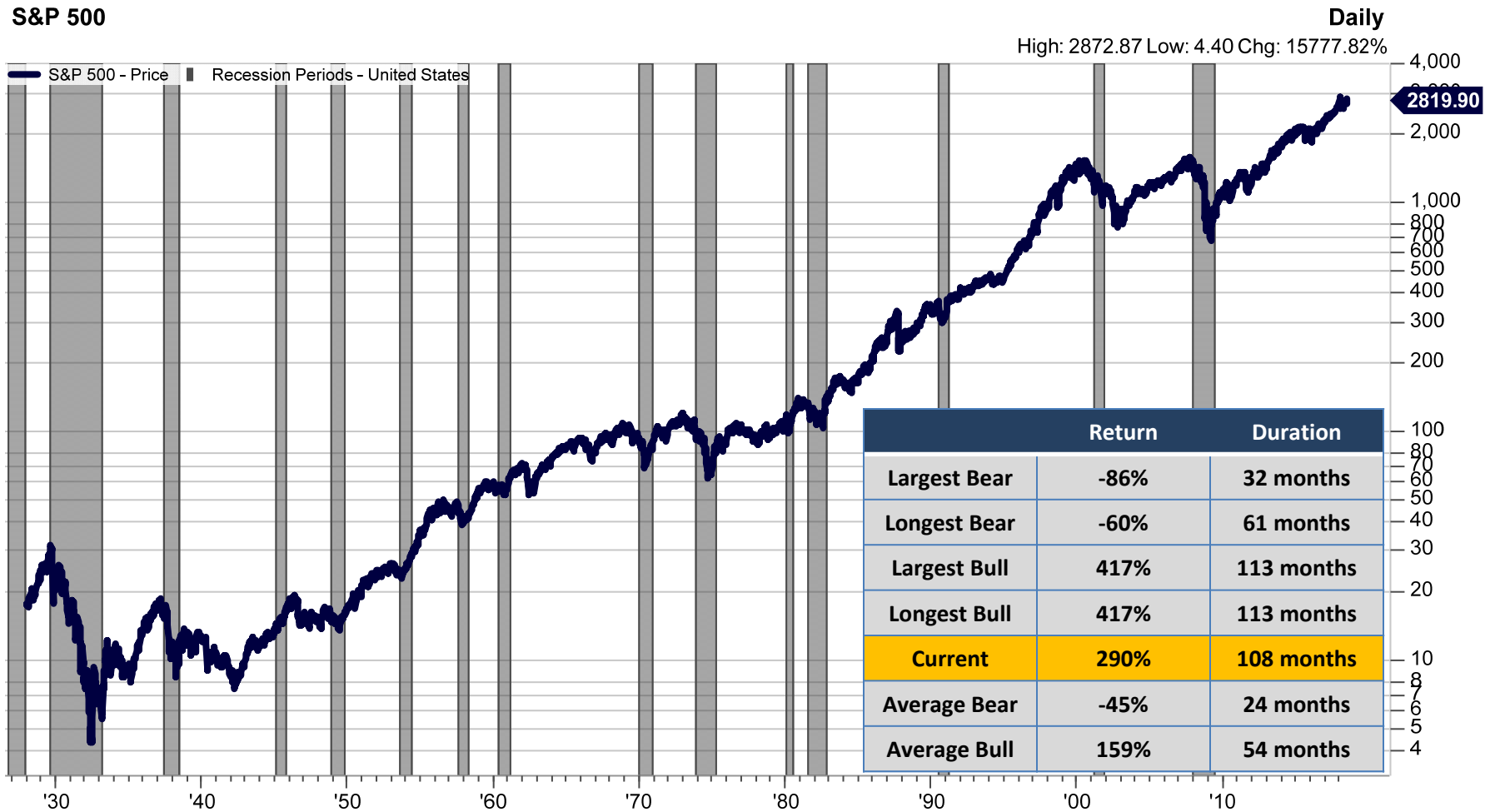
- Higher yields become enticing for investors and create competition for investment dollars that may have been allocated to riskier asset classes in the pursuit of yield
- The yield on the US Government 2Yr Treasury Note surpassed the dividend yield of the S&P 500 for the first time in nearly 10 years



Observation #8

Are Stocks Too Expensive?

Characteristics of Bull & Bear Markets (1926 – Present)

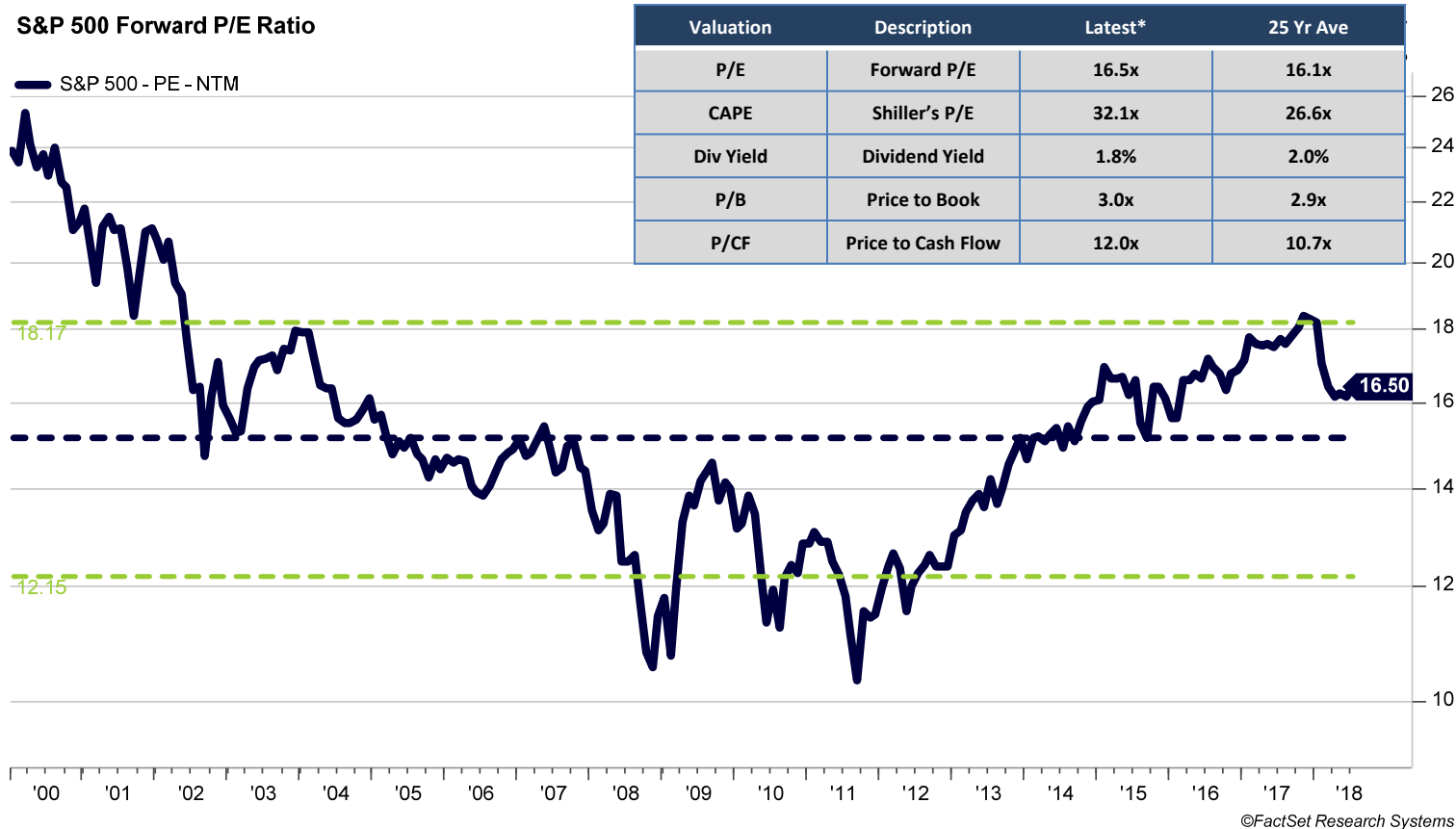


©FactSet Research Systems

Observation #8

Are Stocks Too Expensive?

- Stock prices almost always follow the general direction of corporate profit expectations – lower when profits are expected to decline, higher when profits are expected to expand
- How much investors are willing to pay for profits (earnings) can vary significantly, but many of the common valuation metrics suggest we are closer to long-term averages than we are to the extremes

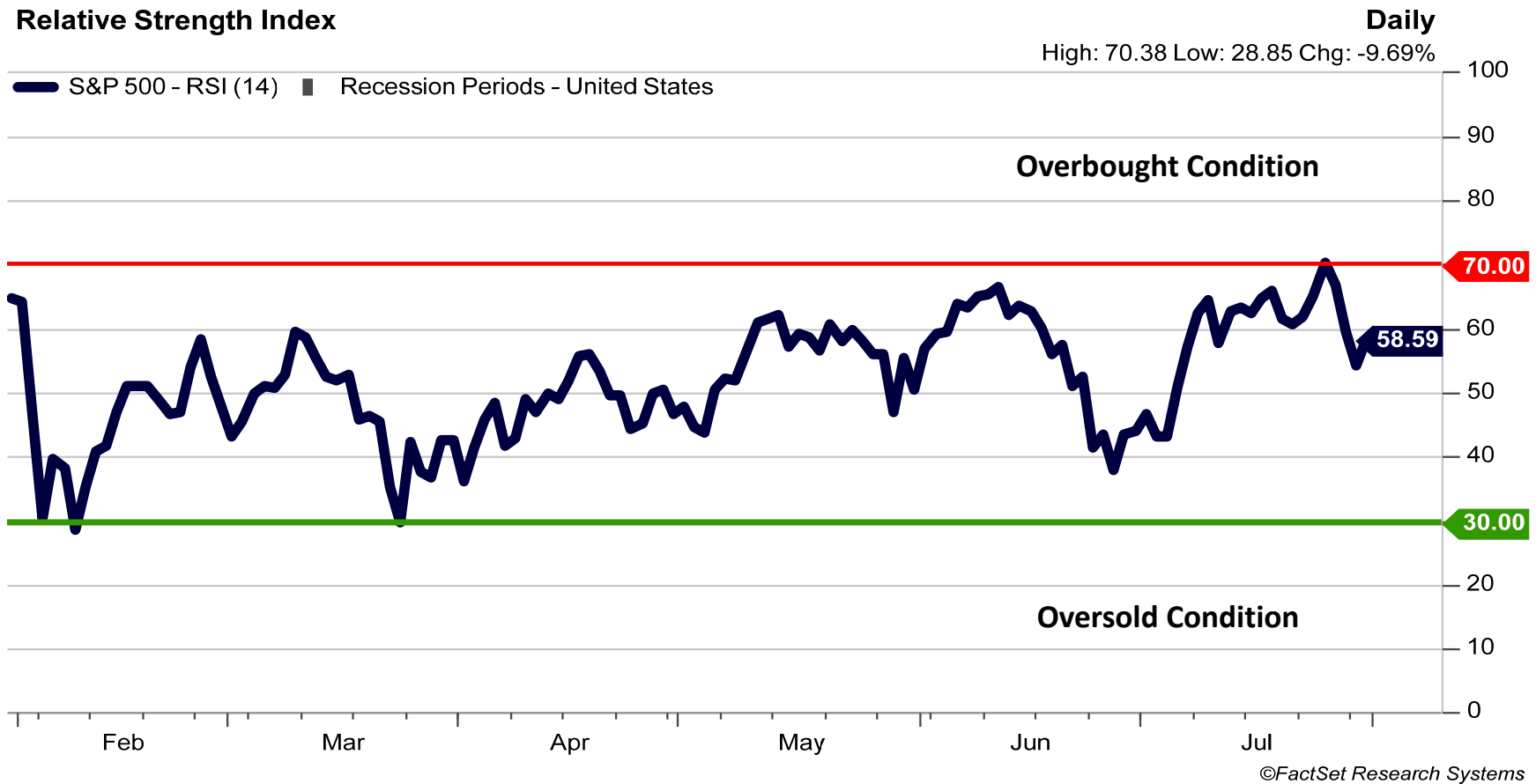


Observation #9

Volatility Can Create Opportunity

- We prefer to rely on fundamental analysis and valuation metrics for assessing a long-term investment opportunity, but observing various technical indicators may provide valuable near-term entry and exit signals

Relative Strength Index

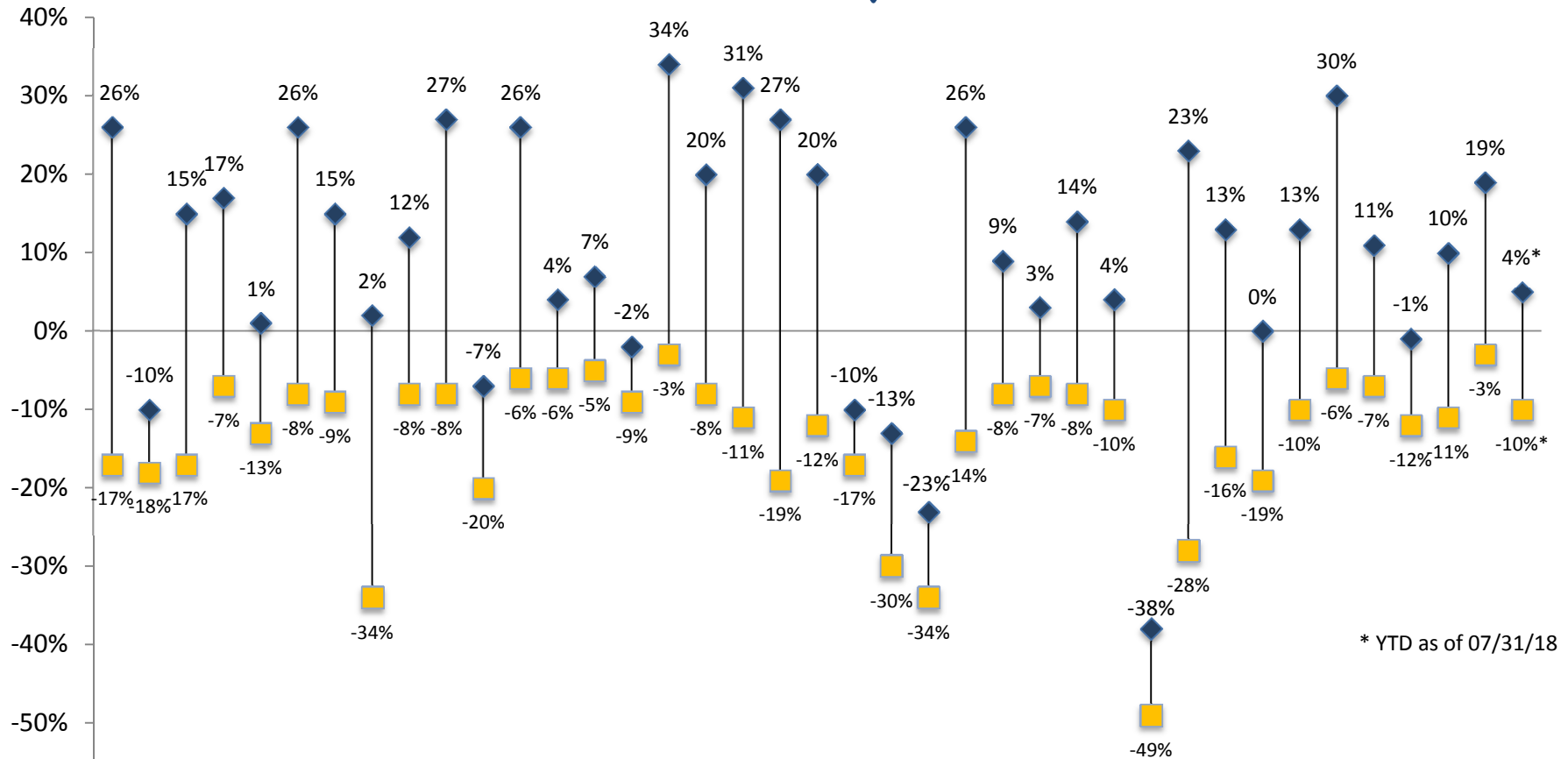


Observation #9

Volatility Can Create Opportunity

S&P 500 intra-year declines vs. calendar year returns (1980 – present)

■ = lowest point during the year ◆ = calendar year return

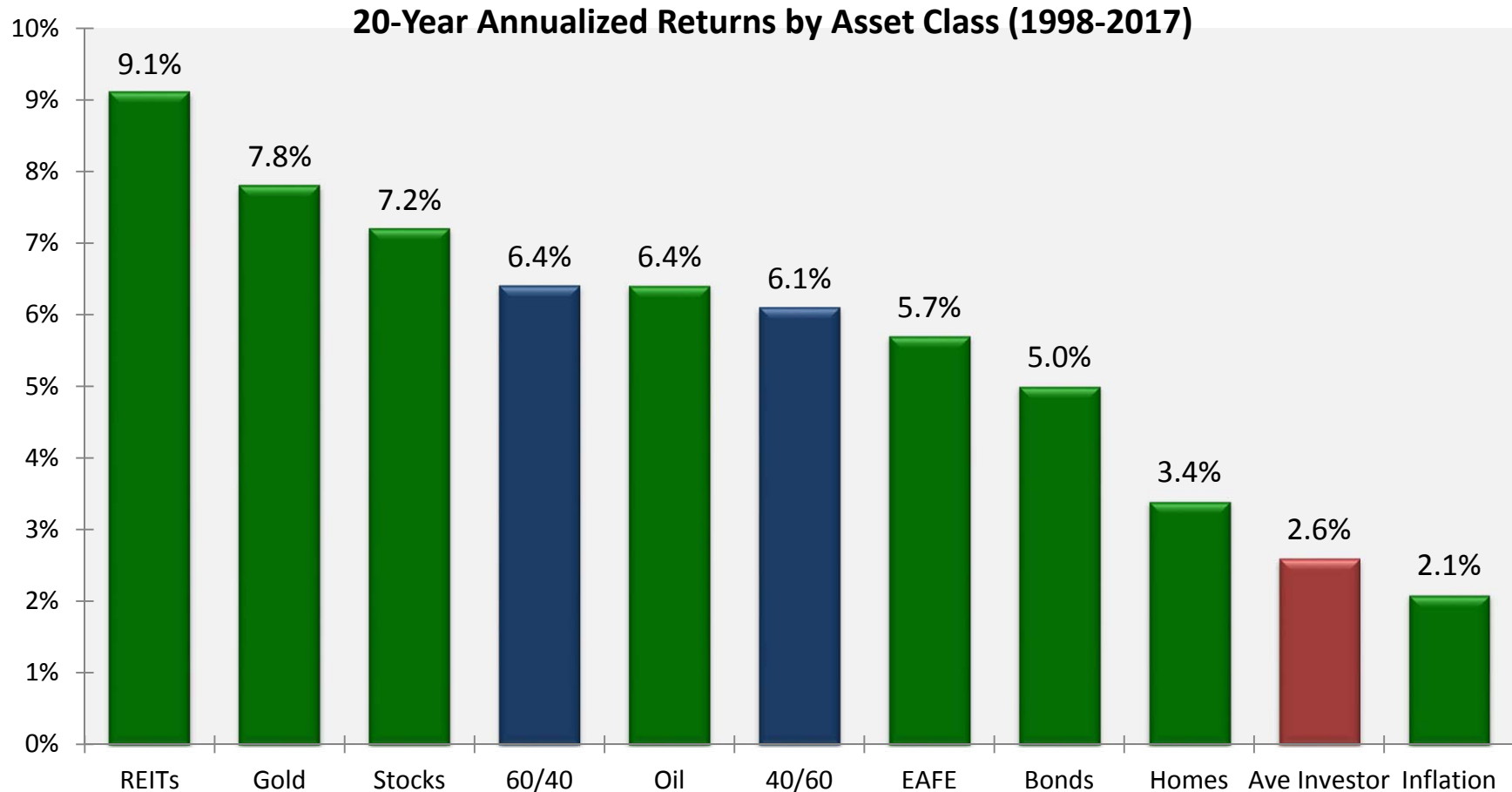


Despite average intra-year drops of -13.8%, annual returns positive in 29 of 38 years

* YTD as of 07/31/18

Observation #10

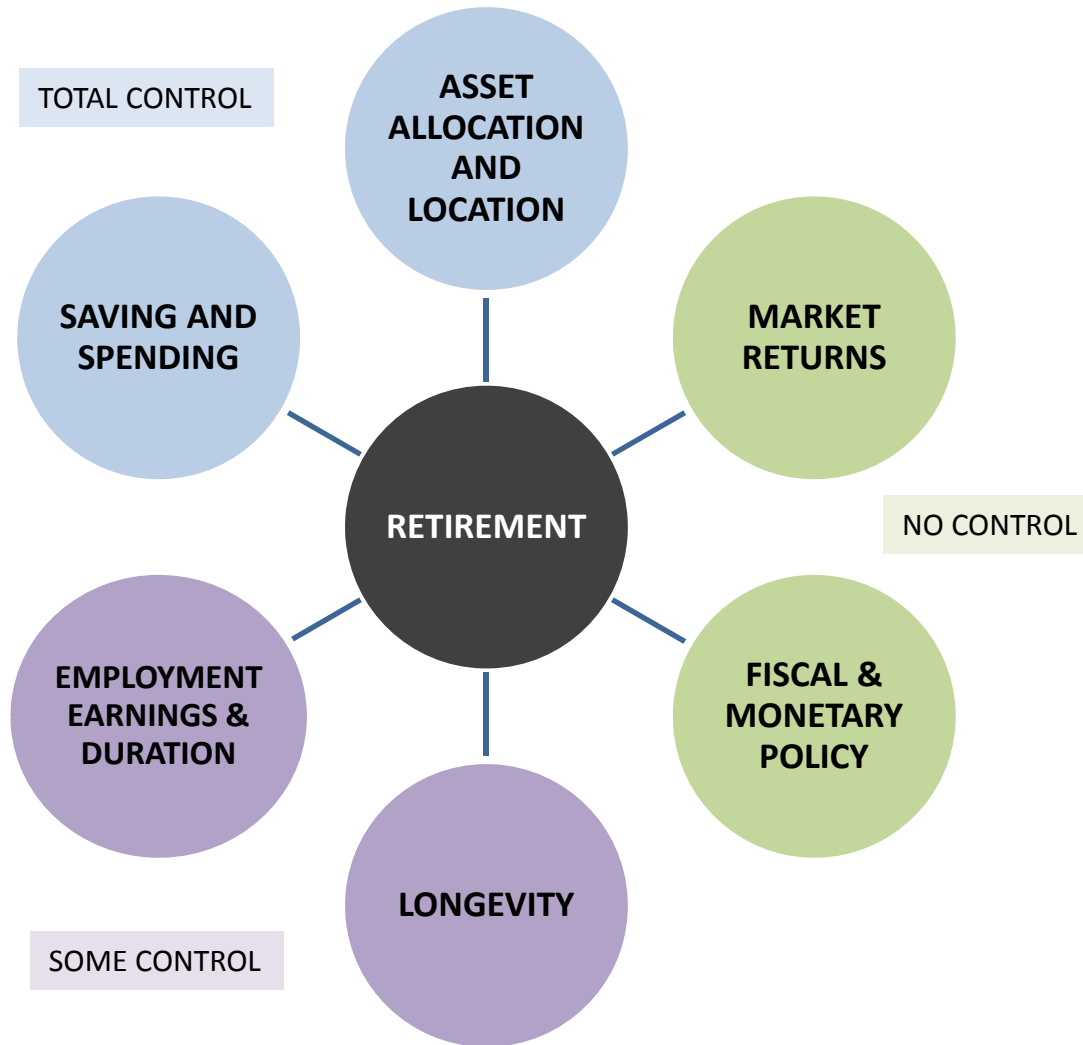
The Most Important Decision – Asset Allocation



- Source: JP Morgan Asset Management, 2017; NAREIT Equity REIT Index, S&P 500 Equity Index, Barclays Aggregate Bond Index, USD/Troy Oz. Gold, WTI Oil Index, MSCI EAFE Equity Index, Median Sale price of Existing Single Family Homes, Headline CPI.
- 60/40 Portfolio is 60% S&P 500 Index and 40% Barclays US Aggregate Bond Index : 40/60 Portfolio is 40% S&P 500 Index and 60% Barclays US Aggregate Bond Index
- Average Investor = Dalbar Inc. analysis of monthly mutual fund sales, redemptions and exchanges

Observation #10

The Most Important Decision - Asset Allocation



A SOUND RETIREMENT PLAN

Make the most of the things that you can control but be sure to evaluate factors that are somewhat or completely out of your control

JP Morgan Asset Management "Guide to Retirement"

Disclosure

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