Q4

First Republic Private Wealth Management

QUARTERLY UPDATE

Fourth Quarter / 2018

HIGHLIGHTS

- **Volatility increased during Q4 as investors faced a turbulent environment riddled with trade wars, geopolitical risks, rising interest rates, and weaker economic growth stemming from Europe and Asia**
- **Despite the swoon in financial markets seen during the closing months of the year, U.S. economic data remained on solid footing supported by a historically tight labor market and a robust U.S. consumer**
- **Global growth remained U.S.-driven as emerging markets faced currency and interest rate headwinds. A stronger U.S. dollar dampened corporate gains abroad while increasing the burden for foreign borrowers**

OVERVIEW

As we turn the page and welcome the new year, global stocks faced a turbulent environment during Q4. A combination of headwinds shifted investor sentiment to "risk-off" mode, and pushed markets sharply lower, despite a late rally on the day following Christmas. Investors witnessed an increase in volatility as escalating trade tensions between the U.S. and China raised fears that a prolonged trade dispute between the world's two largest economies could slow down global growth. The Federal Reserve (the Fed) raised interest rates at their December meeting, further dampening investor risk appetite even though domestic economic data through the quarter showcased signs of sustained economic growth, while recession probabilities in the near-term remained relatively low. Furthermore, the U.S. unemployment rate continued at multi-decade low levels, while wages showed an uptick in growth, highlighting the resiliency and tightness of the labor market.

U.S. EQUITIES RETREATED AS UNCERTAINTY RATTLED INVESTORS

Investors struggled to grasp the uncertainty surrounding the major headlines of the quarter, including concerns over the U.S. government shutdown, evidence of slowing economic growth in China, and the ongoing trade quarrel between the U.S. and China. Meanwhile, the Federal Reserve continued its path of monetary policy tightening and rate normalization, raising interest rates for a fourth time in December. Despite reports of strong macroeconomic data and signs of rising inflationary pressures, the Fed's hawkish stance reverberated across financial markets as investors grew concerned that the Fed could be raising rates too fast and too soon, and could unintentionally tip the balance of economic growth.

In addition, geopolitical tensions stemming from Europe, including worries of a hard Brexit and Italy's dispute with the European Union over the nation's budget deficit, coupled with reports of economic deceleration in China, further contributed to the gloomy investment environment, which saw investors gravitate towards safe haven investments.

THE CONTINUED STRENGTH OF THE U.S. DOLLAR HAS DRAGGED EMERGING MARKETS

Across international markets, borrowing costs were a trending topic throughout the year, as higher interest rates driven by the Fed's rate hikes, coupled with robust domestic economic data, led to the strengthening of the U.S. dollar against most international currencies. As a result, those countries which benefited from ultra-low U.S. dollar borrowing costs in past years as a source of relatively cheap financing are facing repayment hardships as interest payments ballooned and became increasingly difficult to service. Furthermore, dollar debt in the private sector has also increased, eroding corporate profits.

Emerging market equities slid into bear market territory as news of economic deterioration in countries ranging from Argentina to Turkey fueled worries that a global contagion would eventually drag developed markets down causing the global economy to stagnate. Doubts over the ability of the Chinese government to propel economic growth resurfaced after economic data signaled lukewarm growth. The trade war and tariffs further intensified the downturn in Chinese markets, which faced additional secular pressures including shifting demographics, slowing cyclical growth, amid other debt, environmental and real estate issues. In response, China is expected to continue on a path toward monetary policy easing.

WIDENING CREDIT SPREADS AND FLATTENING YIELD CURVES CONTRIBUTED TO MARKET VOLATILITY

The credit cycle continued on a bumpy path as credit spreads moved wider during the quarter, adding volatility to financial markets. The significant increase in corporate leverage during recent years of cheap financing remained a leading concern across credit markets, as interest rates are expected to continue moving higher and evidence of deterioration in the credit quality of debt issuers grows. Investors also remained vigilant of the flattening U.S. Treasury yield curve, which saw short-term rates move closer to long-term rates during the quarter. As the yield curve continued flattening, worries that an inversion is looming also added uncertainty to the market, which has used this phenomenon in the past as an indicator and early warning of an upcoming recession. However, despite all the recent attention the yield curve has received, we believe that these concerns could be overstated given the relative health of the U.S. economy, which continues to benefit from a resilient labor market, robust U.S. consumers, and the decaying effects of past fiscal stimulus.

CONCLUSION

Looking back at 2018, investors closed the year facing a series of challenges which led to dismal performance in Q4: ongoing trade disputes, economic and corporate growth expected to moderate, and the uncertainty surrounding the Fed's future interest hikes, were some of the headwinds that spiked volatility. Despite all these crosscurrents, economic data remained at healthy levels, as the unemployment rate continued at decade lows while wage growth climbed. Emerging market countries navigated choppy waters as a strong U.S. dollar weighed on those countries with large current-account deficits. Meanwhile, corporations with large U.S. dollar financing saw profits crippled by foreign exchange rates. International anxiety over Brexit and Italy's budget tussle with the European Union also weighed on performance in the Eurozone.

The recent market downturn and beginning of the New Year provides an opportunity for investors to reposition their portfolios and focus on risk management. As volatility increases and lingers, investors should manage future expectations and be aware that the bumpy ride experienced in the latter months of 2018 will take time before getting better. Broadly speaking, our asset allocation views still favor a proper balance between stocks, bonds, and cash.

FINANCIAL MARKET RETURNS

U.S. Equity	Q4 2018	1 Year*	ANNUALIZED 3 Year*	5 Year*	10 Year*
DJ Industrial Average	-11.3%	-3.5%	12.9%	9.7%	13.2%
NASDAQ Composite	-17.3%	-2.8%	11.1%	11.0%	16.8%
S&P 500 TR Index	-13.5%	-4.4%	9.3%	8.5%	13.1%
Russell 1000 Index	-13.8%	-4.8%	9.1%	8.2%	13.3%
Russell 1000 Growth Index	-15.9%	-1.5%	11.1%	10.4%	15.3%
Russell 1000 Value Index	-11.7%	-8.3%	7.0%	5.9%	11.2%
Russell Mid Cap Index	-15.4%	-9.1%	7.0%	6.3%	14.0%
Russell Mid Cap Growth Index	-16.0%	-4.8%	8.6%	7.4%	15.1%
Russell Mid Cap Value Index	-15.0%	-12.3%	6.1%	5.4%	13.0%
Russell 2000 Index	-20.2%	-11.0%	7.4%	4.4%	12.0%
Russell 2000 Growth Index	-21.7%	-9.3%	7.2%	5.1%	13.5%
Russell 2000 Value Index	-18.7%	-12.9%	7.4%	3.6%	10.4%

International Equity	Q4 2018	1 Year*	ANNUALIZED 3 Year*	5 Year*	10 Year*
MSCI EAFE Index (USD, net)	-12.5%	-13.8%	2.9%	0.5%	6.3%
MSCI AC World Index (USD, net)	-12.8%	-9.4%	6.6%	4.3%	9.5%
MSCI AC World Ex U.S. Index (USD, net)	-11.5%	-14.2%	4.5%	0.7%	6.6%
MSCI Emerging Markets Index (USD, net)	-7.5%	-14.6%	9.2%	1.6%	8.0%
MSCI BRIC Index (USD, net)	-5.3%	-13.4%	11.2%	3.0%	7.6%

Fixed Income	Q4 2018	1 Year*	ANNUALIZED 3 Year*	5 Year*	10 Year*
Bloomberg Barclays U.S. Treasury 1-3 Year Index	1.3%	1.6%	0.9%	0.8%	1.0%
Bloomberg Barclays U.S. Treasury 5-10 Year Index	3.4%	1.2%	1.5%	2.5%	2.8%
Bloomberg Barclays U.S. Long Treasury Index	4.2%	-1.8%	2.6%	5.9%	4.1%
Bloomberg Barclays U.S. Treasury U.S. TIPS Index	-0.4%	-1.3%	2.1%	1.7%	3.6%
Bloomberg Barclays U.S. Govt/Credit Intermediate Index	1.7%	0.9%	1.7%	1.9%	2.9%
ICE BofAML Municipals 1-10 Year A-AAA Index	1.5%	1.6%	1.4%	1.9%	2.8%
Bloomberg Barclays U.S. Corporate High Yield Index	-4.5%	-2.1%	7.2%	3.8%	11.1%
ICE BofAML Preferred Stock Fixed Rate Index	-4.6%	-4.3%	2.7%	6.1%	7.7%
JPMorgan GBI EM Global Diversified Index	2.1%	-6.2%	5.9%	-1.0%	3.5%

** All returns for the period ending on December 31, 2018.*
Source: Bloomberg, Morgan Stanley Capital International, Russell®, Standard and Poor's and Barclays.

INDEX DEFINITIONS

U.S. EQUITY

Dow Jones Industrial Average: is a price-weighted average of 30 actively traded blue-chip U.S. stocks

NASDAQ Composite Index: is a market capitalization index of approximately 3,000 common equities listed on the NASDAQ exchange

S&P 500 TR Index: is a type of equity index that tracks both the capital gains of the equities in the S&P 500 and assumes any cash distributions (dividends) are reinvested back into the index

Russell 1000 Index®: measures the performance of the 1,000 largest companies in the Russell 3000

Russell 1000 Growth Index®: measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values

Russell 1000 Value Index®: measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values

Russell Mid Cap Index®: measures the performance of the 800 smallest companies in the Russell 1000 index

Russell Mid Cap Growth Index®: measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. The stocks are also members of the Russell 1000 Growth index

Russell Mid Cap Value Index®: measures the performance of those Russell Midcap companies with lower price-to-book and lower forecasted growth values. The stocks are also members of the Russell 1000 Value index

Russell 2000 Index®: measures the performance of the 2,000 smallest companies in the Russell 3000 index

Russell 2000 Growth Index®: measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values

Russell 2000 Value Index®: measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values

INTERNATIONAL EQUITY

MSCI EAFE Index: is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada

MSCI AC World Index: is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets

MSCI AC World Ex US Index: captures large and midcap representation across 22 of 23 developed marketing countries (excluding the US) and 23 Emerging Markets countries

MSCI Emerging Markets Index: is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets

MSCI BRIC Index: is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance across the following 4 emerging market country indexes: Brazil, Russia, India and China

FIXED INCOME

Bloomberg Barclays US Treasury 1–3 Year Index: measures the performance of U.S. Treasury securities that have a remaining maturity of at least one year and less than three years

Bloomberg Barclays US Treasury 5–10 Year Index: measures the performance of U.S. Treasury securities that have a remaining maturing of at least five years and less than 10 years

Bloomberg Barclays US Long Treasury Index: includes all publicly issued, U.S. Treasury securities that have a remaining maturity of 10 or more years, are rated investment grade, and have $250 million or more of outstanding face value

Bloomberg Barclays US Treasury US TIPS Index: the index includes all publicly issued U.S. Treasury inflation-protected securities that have at least one year remaining to maturity, are rated investment grade, and have $250 million or more of outstanding face value

Bloomberg Barclays US Govt/Credit Intermediate Index: the index measures the performance of the USD-denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years

Bloomberg Barclays US Corporate High Yield Index: measures the USD-denominated, high-yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issues with an emerging markets country of risk, based on Barclay's EM country definition, are excluded

ICE BofAML 1–10 Year AAA–A Municipal Securities Index: is a subset of the BofAML U.S. Municipal Securities Index and includes all securities with a remaining term to final maturity less than 10 years and rated AAA through A3, inclusive.

ICE BofAML Preferred Stock Fixed Rate Index: this index is designed to replicate the total return of a diversified group of investment-grade preferred securities

JPMorgan GBI EM Global Diversified Index: is an investable benchmark that includes only those countries that are directly accessible by most of the international investor base. This index exclude countries with explicit capital controls, but does not factor in regulatory / tax hurdles in assessing eligibility

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