MIDDLETON & COMPANY, INC.

Investment Update

October, 2018

2018 Third Quarter Update

Review: The S&P 500 continued to rally in the third quarter on the back of strong earnings growth and continued strength in the US economy. Fixed income and international equities lagged once again in Q3. The Federal Reserve raised the federal funds target rate to 2.00-2.25% at their September meeting, and they are expected to raise it again in December.

Period	3Q18	2Q18	1Q18	YTD
S&P 500	7.7%	3.4%	-0.8%	10.6%
MSCI EAFE[1,2]	1.4%	-1.0%	-1.5%	-1.0%
MSCI Emerging Markets[2]	-1.0%	-7.9%	1.3%	-7.5%
Barclays U.S. Aggregate Bond	0.0%	-0.2%	-1.5%	-1.6%
Barclays Municipal Bond	-0.2%	0.9%	-1.1%	-0.4%

[1]Europe, Australia, Far East
[2]MSCI returns are in U.S. Dollars

Outlook: Positives outweigh potential negatives for now

Third quarter S&P 500 earnings are expected to grow 28% vs. Q3 2017, an impressive result even if the benefit of the lower corporate tax rate (21% vs. the prior 35%) is removed. Additionally, US economic growth has surprised on the upside year to date. GDP growth accelerated to 4.2% in Q2, the fastest quarterly growth in 4 years. That said, there are a number of factors that we are watching as potential areas of caution:

- US earnings growth in 2019 is expected to still be positive albeit slower than 2018, even after accounting for the growth in 2018 driven by the lower tax rate.
- The Fed is likely to continue raising interest rates. As we have seen in prior economic cycles, higher interest rates eventually impact economic growth and equity valuations. The level at which those negative effects manifest themselves can vary each cycle, but we do know that certain members of the Fed are willing to reach a point of “mildly restrictive” monetary policy so that they are not late in preventing the economy from overheating.
- Global growth has shifted from a story of synchronization in 2017 to one of divergence in 2018. Unlike the US, Eurozone and Japan GDP growth estimates for 2018 have fallen and now imply deceleration vs. 2017. Emerging market growth is also expected to

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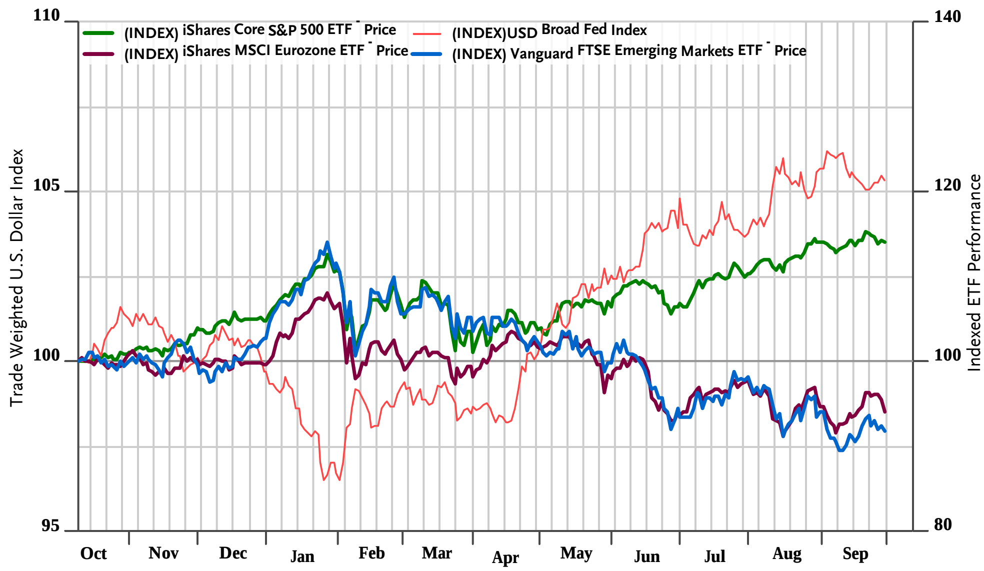
Be slower than 2017, as factors such as weaker local currencies, higher interest rates, and trade disruptions take their toll.

The chart below shows the 12 month performance of the S&P 500 (green) vs. the Eurozone (purple) and Emerging Market (blue) ETFs and the Broad U.S. Dollar Index (red). Beginning in April of this year one can see a strong upward move in the S&P 500 and the strengthening of the dollar while international markets have fallen. Accelerating growth and higher interest rates in the U.S. have been rewarded by investors, and the factors contributing to these trends may persist a while longer. Similarly, the challenges in international markets may be difficult to reverse quickly due to rising U.S. interest rates and potential trade disruptions.



Source: FactSet

In summary, the strong underlying fundamentals in the US have supported U.S. equity markets in 2018, and we believe the risk-reward in US equities may remain more positive than other major assets classes in the near term. In fixed income, we continue to see better value in shorter maturities in a rising rate environment and remain biased towards quality due to the extended economic cycle. As interest rates rise the gap in relative attractiveness between stocks and bonds continues to narrow, so we are watching trends in both interest rates and corporate earnings very closely. We also expect that rising interest rates could add pressure to other riskier asset classes that have benefited from the ultra-low rate environment.