VANDERBILT Ave. ASSET MANAGEMENT

1st Quarter 2019

Whereas VAAM forecasted higher than consensus real GDP growth in 2018, our forecast for 2019 is weaker than consensus GDP growth. In addition, we are predicting higher than consensus inflation of 2.5%-2.75% for the core PCE, which is the Fed's preferred inflation gauge. There has been a recent softening in job growth. In the first three months of the year, the economy added 180,000 jobs on average, down from a monthly average of 223,000 for all of 2018. February 2019 jobs were at a 17-month low of 33,000. This recent weaker labor market data has translated into weaker retail sales. Retail sales unexpectedly fell in February after a steep December decline of 1.6%. This is the largest decline since September 2009. In the U. S. economy, consumer spending represents 70% of overall GDP. Despite tax incentives, business capital spending has been disappointing, as cash flow has been deployed to stock buybacks and dividend increases. Further, slowing global growth, trade policy uncertainties and the fading effects of the 2017 tax cuts are all playing a role in slowing economic momentum. Modest unpredictable incidents can cause economic downturns if they lead consumers and businesses to lose confidence. The overall trend in consumer confidence has been softening since last summer. Any issues that raise uncertainty (such as trade policy) could reduce confidence and negatively impact consumer spending and/or business investment.

There are several major headwinds to economic growth. Finding the labor needed for 3% economic growth (which the Trump administration is forecasting) could prove challenging. Over the past ten years, the prime population (age 25-54) has only grown at 0.1% annually. The last time the U.S. experienced consistently high economic growth was in the 1980's, when the prime population was expanding at 2.2% annually. Immigration restrictions will serve as an impediment to growth. In addition, productivity growth has been decreasing, reflecting weaker investment and innovation. Workers' output has been increasing by only 1.0% annually since 2010. A wave of baby boomer retirements will lower the labor force participation rate by 2.5% over the next 10 years. The Congressional Budget Office's baseline economic forecast over the next 10 years is for the U.S. workforce to expand by only 0.5% annually and productivity growth by 1.4% annually for a combined growth of 1.9%.

There are several uncertainties revolving around Federal Reserve policy. At their recent meeting, the Fed left interest rates unchanged, citing subdued inflation pressures and threats to U.S. growth from the global economic slowdown and trade policy uncertainty. Slower global growth has led numerous central banks to adopt less restrictive and more stimulative monetary policies. The Fed cited inflationary tradeoffs in their attempt to achieve their 2% inflation target. They indicated they are willing to let inflation run above the 2% rate in order to achieve a longer-term average of their 2% goal. The inherent danger with this approach is that inflation stays above 2%, the Fed is unable to bring it down and they are forced into a series of restrictive interest rate increases to bring inflation under control. Another monetary policy uncertainty is the transitioning of the Fed's balance sheet from quantitative tightening. The Fed has been reducing its balance sheet by $50 billion per month. The balance sheet was $4.5 trillion in October 2017 and is currently approximately $4 trillion. The Fed plans to slow the monthly reduction of U.S. Treasury securities from $30 billion per month to $15 billion beginning in May. They would end the entire balance sheet runoff in September of this year. Redemptions of mortgage-backed securities in September would be reinvested in Treasuries up to as much as $20 billion per month, moving the Fed generally towards a U.S. Treasury only approach to its' assets. In addition to the rate of balance sheet transitioning, an equally important question is the composition of the balance sheet. The mix of Treasury securities before the 2008 crisis was an average maturity of less than four years, whereas now it is around nine years. The Fed has not decided as to the ultimate objective for its' Treasury portfolio. The expectation is that the primary investment target will be the short end of the curve. The Fed could then provide monetary stimulus by moving from shorter duration to longer duration securities when it so desires. The Fed's balance sheet was approximately 6% of GDP prior to the financial crisis and will be about 17% of GDP when they are done transitioning.

We believe higher inflation is around the corner and will serve as another potential impediment to growth. The velocity of the M2 money stock is accelerating, which has often been associated with higher inflation. Longer-term job growth is the highest uninterrupted expansion on record and has been an important anchor to consumption. This has the potential to lead to demand pull inflation pressures. Capacity utilization has risen and, with less slack, could lead to inflation pressures. With little slack in the labor market, cost push inflation could result as the Phillips curve starts to respond. The Phillips curve depicts the inverse relationship between the unemployment rate and corresponding rates of increases in wages. Average hourly earnings are up 3.2% from a year earlier, near their largest gain in a decade. Previously mentioned sluggish long-term productivity trends will not help ease inflation pressures. In addition, the Fed's tendency to let inflation run above its 2% target risks inflation accelerating and the Fed struggling to bring it down.

Trade tariffs are inflationary and it is U.S. consumers, not China, that are paying for the tariff dispute. Price increases tend to extend beyond import prices to domestic prices. Tariffs increase the cost of imported goods, but also may raise world prices, thereby increasing the cost of domestic prices. These price increases pass through to other goods, putting upward pressure on the broader economy. Protectionism will result in lower GDP, as household losses surpass government and producer gains.

Another headwind to growth is the government's fiscal deficits and the resultant debt levels. The government's deficit is expected to be $1 trillion for the current fiscal year ending 9/30/19. The deficit totaled 4.5% of economic output last year, compared with an average of 2.9% over the previous 50 years. Debt-to-GDP has more than doubled from 35% at the end of 2007 to 78% at the end of 2018 and is on track to hit 93% by 2029. The areas where spending will rise sharply are Social Security, Medicare and interest on the debt. These expenditures are expected to outstrip revenue growth. The forecast does not include Trump's promise of $1 trillion in infrastructure spending, increased military spending and funding for the U.S./Mexico border wall. When the ratio of government debt-to-GDP exceeds 90%, the rate of median growth falls by 1%. Another potential negative ramification of higher debt levels is that it could limit the government's policy options to counter an economic downturn. Analyses show that countries with higher debt-to-GDP ratios heading into a recession have smaller fiscal responses and diminished growth outcomes. While some economists are downplaying the size of the national debt, it is an alarming growth pattern that does not seem to have fiscal reins within Washington.

The change in the yield curve during the first quarter is outlined below. The 2-year through the 30-year part of the curve saw a parallel decline in interest rates. The 2-year versus the 10-year part of the curve flattened by five basis points. Since money market rates (1-month and 3-month bills) did not change, the curve became inverted out to the 7-year note when compared to bills.

	12/31/18	3/31/19	Change
1-month Treasury Bills	2.43	2.42	-0.01
3-monthTreasury Bills	2.36	2.38	0.02
2-year Treasury Note	2.49	2.26	-0.23
5-year Treasury Note	2.51	2.23	-0.28
7-year Treasury Note	2.59	2.31	-0.28
10-year Treasury Note	2.68	2.40	-0.28
30-year Treasury Bond	3.02	2.81	-0.21
10-year vs. 2-year	19	14	-5

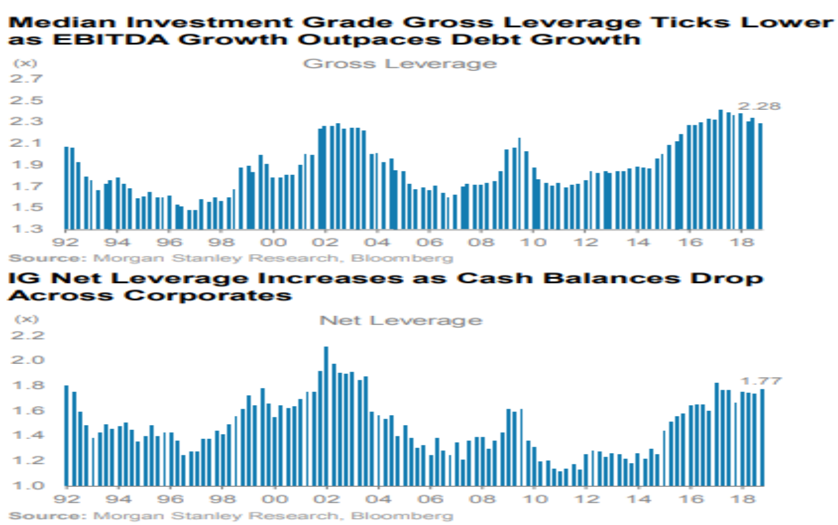
The yield curve has inverted before each of the last seven recessions-since the 1970's. However, there have also been occasions when the curve inverted and a resultant recession did not occur. An inversion must last on average at least three months before it can credibly be said to be sending a clear signal. Even when the yield curve inverts and provides a correct recession warning, it does not indicate how far in the future the recession will commence. One of the results of quantitative easing is to make the possibility of an inversion easier. Before quantitative easing, there was some extra yield, known as the "term premium", built into 10-year U.S. Treasury securities. This was compensation for extending out the yield curve. That meant to get an inversion, investors had to expect significant reductions in interest rates, which rarely happened without a recession. In recent years, the term premium has been nonexistent or negative. This meant the gap between the 3-month and 10-year yields was lower to start with. Therefore, even anticipation of small cuts in rates could make the curve invert.

Corporate, Asset-Backed, and Mortgage-Backed Securities

After a disappointing 2018, the corporate bond sector enjoyed a significant rebound during the first quarter of this year. For instance, as measured by ICE BofAML 1-10 Year Corporate Index ("1-10 Year Index"), the excess spread, the outperformance of corporate bonds as compared to comparable duration U.S. Treasury bonds, was an impressive 2.07%. This return easily offset last year's underperformance of -1.46%. The ICE BofAML 1-3 Year Corporate Index ("1-3 Year Index") outperformed by 0.87% during the same 3-month period. Performance was driven primarily by a decline in spreads from 1.39% at the beginning of the year to 1.03% for the 1-10 Year Index, and from 0.93% to 0.64% for the 1-3 Year Index. Corporate spreads reacted to the Federal Reserve pivot on interest rates, an improved outlook for a U.S.-China trade deal as the quarter progressed, a recovery in equity prices and fair to modestly cheap historical spreads at the beginning of the year. Spreads are once again overvalued. The current 1.03% spread of the 1-10 Year Index is 0.20% tighter than the historical median, while the 1-3 Year Index is at 0.64%, as compared to a historical median spread of 0.91%.

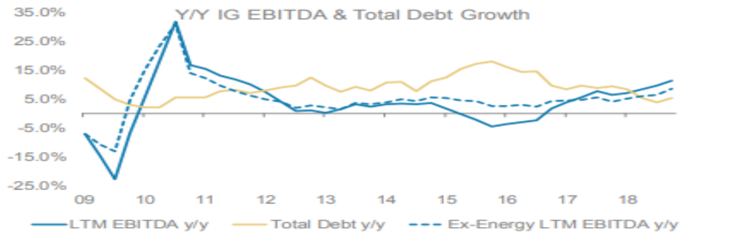
Your portfolio's exposure to the sector was reduced during the quarter as the group moved to overvalued. The portfolio's credit risk was also reduced as lower rated "BBB" issuers were sold. As of the end of the quarter, intermediate bond portfolios held less than 33% of total assets in corporate bonds as compared to 37.6% exposure to U.S. credit intermediate bonds for the Bloomberg Barclays U.S. Gov/Credit Intermediate Index. Shorter duration portfolios are now targeting 40% exposure to corporate bonds versus approximately 31% of credit securities in the ICE BofAML 1-3 Aggregate Index. In addition, lower rated "BBB" securities were sold and the duration is below the Index. Your portfolio is well positioned as the economy moves to the latter stages of the recovery cycle and spreads are no longer considered "cheap."

The financial fundamentals that we follow in security selection have not shown deterioration over the past quarters as shown in the following charts.



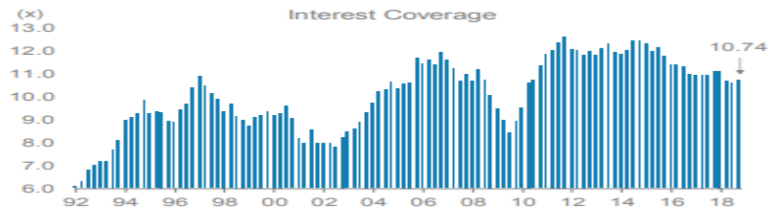
Both investment grade gross leverage (Gross Debt/EBITDA), and investment grade net leverage (Gross Debt-Cash/EBITDA) remain stable at 2.28 times and 1.77 times, though both remain elevated from prior economic expansions. EBITDA growth remains positive, but the continuing growth in debt has constrained improvement in leverage, while the combination of higher debt levels and higher interest cost on new debt has moved interest coverage (EBITDA/Interest Coverage) modestly lower as shown in the two tables below.

EBITDA Growth Has Exceeded Debt Growth for the Last Three Quarters, but Debt Growth Remains Positive



Source: Morgan Stanley Research, Bloomberg   Note: Constant universe

Interest Coverage Ticks Higher, Driven by Strong EBTIDA Growth



Source: Morgan Stanley Research, Bloomberg

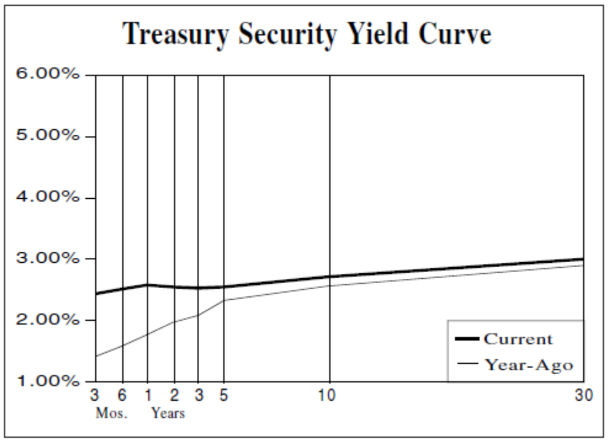
Fourth quarter 2018 earnings exceeded expectations during the quarter. 73% of the S&P 500 reported earnings that met or exceeded expectations and 61% exceeded sales expectations. The results are in line with historical results for earnings and better than historical for sales. Looking forward, however, is the near-term outlook for earnings, cash flow and debt issuance. Market expectations are for near-term weakness with recovery in the latter half of 2019 for these key fundamentals. With valuations at current levels, the market is exposed to disappointing results over the coming months and supports our modest underweight.

The reduction in our corporate exposure included issuers that experienced a significant negative earnings surprise, certain maturities in the shorter duration portfolios and the sale of certain "BBB" rated securities. Negative earnings surprises during the quarter included American Express, Duke, Gilead Sciences, JPMorgan Chase, Morgan Stanley and Toyota. Sales of other issuers included General Motors and Zimmer Biomet Holdings, both of which are lower rated "BBB" issuers that are highly sensitive to changes in economic momentum. A portion of the proceeds from sales and or maturities were reinvested in high quality issuers including Home Depot, the home improvement retailer. This "A" rated company has strong, stable financial fundamentals including 17x EBITDA/Interest, 1.65x Gross Leverage and 1.55x Net Leverage. Home Depot had a significant positive earnings surprise. Costco was also added to the portfolio during the most recent quarter. Costco operates membership warehouses that sell a large array of food, toys, electronics, apparel, etc. The company has low leverage of just 1.45x and cash that exceeds outstanding debt. Their interest coverage is over 35x for recent quarters. They also had a significant positive earnings surprise.

Where guidelines permit, asset backed securities ("ABS") and mortgage securities are held. The ABS portion of the portfolio remains highly rated at "AAA", short duration and highly liquid. Over time the investments are being transitioned to credit card issues with high quality receivables. The mortgage investments are all Agency guaranteed and, due to their seasoning and structure, are of shorter duration.

Selected Yields

	Recent (3/27/19)	3 Months Ago (12/26/18)	Year Ago (3/28/18)
TAXABLE			
Market Rates			
Discount Rate	3.00	3.00	2.25
Federal Funds	2.25-2.50	2.00-2.25	1.50-1.75
Prime Rate	5.50	5.50	4.75
30-day CP (A1/P1)	2.48	2.54	1.92
3-month Libor	2.60	2.81	2.30
U.S. Treasury Securities			
3-month	2.42	2.43	1.72
6-month	2.45	2.53	1.92
1-year	2.39	2.61	2.11
5-year	2.16	2.65	2.60
10-year	2.37	2.81	2.78
10-year (inflation-protected)	0.57	1.09	0.73
30-year	2.81	2.06	3.02
30-year Zero	2.87	3.10	3.06



Source: Value Line, Inc.

	Recent (3/27/19)	3 Months Ago (12/26/18)	Year Ago (3/28/18)
Mortgage-Backed Securities			
GNMA 5.5%	4.01	3.82	3.19
FHLMC 5.5% (Gold)	3.57	4.02	3.31
FHLMC 5.5%	3.49	3.90	3.32
Corporate Bonds			
Financial (10-year) A	3.33	4.04	3.84
Industrial (25/30-year) A	3.96	4.35	4.10
Utility (25/30-year) A	4.04	4.39	4.08
Utility (25/30-year) Baa/BBB	4.41	4.79	4.40
S&P 500 High Yield Corp. Bond Index	4.88	6.01	5.07
Foreign Bonds			
Canada	1.53	1.98	2.12
Germany	-0.08	0.25	0.50
Japan	-0.07	0.02	0.04
United Kingdom	1.01	1.26	1.37
Preferred Stocks			
Utility A	6.00	5.87	6.00
Financial A	5.46	6.15	5.91
Financial Adjustable A	5.46	5.46	5.46

Federal Reserve Data

BANK RESERVES

(Two-Week Period; in Millions, Not Seasonally Adjusted)

	Recent Levels			Average Levels Over the Last...		
	03/03/19	02/27/19	Change	12 Wks.	26 Wks.	52 Wks.
Excess Reserves	1582685	1504551	78144	1535231	1615012	1750732
Borrowed Reserves	12	21	-9	36	115	122
Net Free/Borrowed Reserves	1582673	1504520	78153	1535195	1614897	1750609

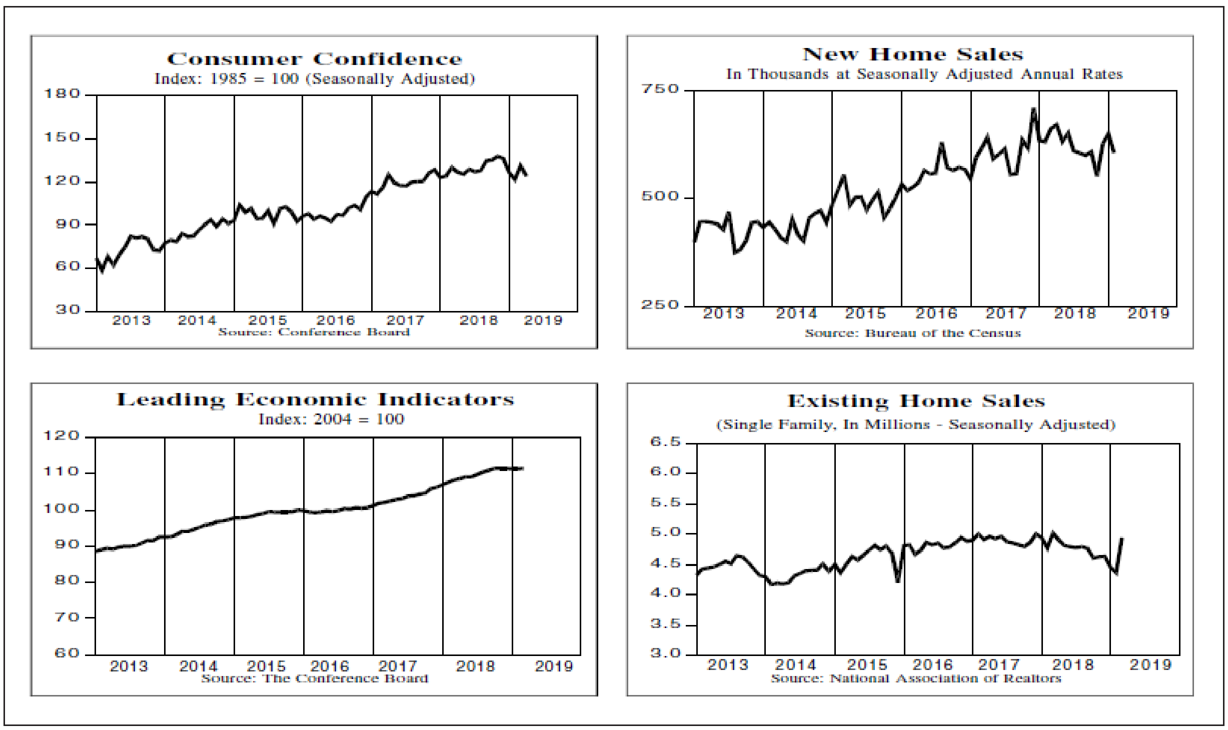
MONEY SUPPLY

(One-Week Period; in Billions, Not Seasonally Adjusted)

	Recent Levels			Ann'l Growth Rates Over the Last...		
	03/11/19	03/04/19	Change	3 Mos.	6 Mos.	12 Mos.
M1 (Currency+demand deposits)	3745.3	3758.0	-12.6	2.7%	2.3%	2.9%
M2 (M1+savings+small time deposits)	14499.8	14490.6	9.2	4.3%	4.3%	4.1%

Source: Unites States Federal Reserve Bank

Tracking the Economy



Source: Value Line, Inc.