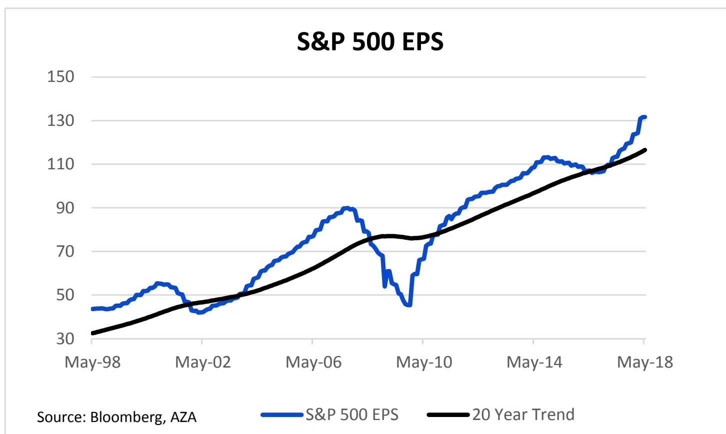
Market Recap[1]

May 2018

- Large cap equity markets advanced in May while investment-grade bonds declined. For the month, the S&P 500 Index returned +2.41%, the international EAFE Index dropped -2.19%, and the MSCI Emerging Markets Index declined -3.52%. U.S. small caps, represented by the Russell 2000 Index, increased +6.07%. The Barclays U.S. Aggregate Bond Index was up +0.71%. Additional information on index performance and risk measures can be viewed on page 7.
- **Market Indicators**: The bond yield curve has flattened as the difference in rates between short and long durations continues to shrink. However, comparison of 3-Month T-Bills to 10-Year Treasuries still indicates a friendly environment for growth. Stock market valuations are supported by strong earnings growth and are showing reasonable risk premiums. Financial conditions are favorable and credit spreads are tight. Oil prices have been range bound.
- **Economic Indicators**: Housing starts, auto sales, and energy investment are conducive to continued growth. Employment growth is steady. Manufacturing and leading economic indicators are at positive levels. Fiscal policy is expansionary.
- **Risk/Fear Measures**: The VIX Index, a measure of market volatility, traded between 12 and 17, ending the month near 15. The SKEW Index, a measure of crash "insurance" cost, spiked and subsequently increased substantially as concerns around European financial stability appeared. The term structure of volatility is pricing historically average systemic risk in the near term.

Earnings season for U.S. companies was a bright spot in equity markets and, on average, better than analysts expected. On a year over year basis, sales for S&P 500 companies were up over 8% and earnings increased over 23% according to Bloomberg. Tax cuts and global economic growth drove results. Despite Fed tightening, nearly all indicators point to growth for the remainder of the year.



In Europe, the Italian President proved an obstacle to the formation of premier-designate Gusieppe Conti, as the newly proposed finance minister had an anti-EU history. Fears of an Italian departure from the Euro increased, causing international and emerging markets to sell off and the U.S. Dollar to strengthen as a safe-haven. Courtesy of Business Insider, "Article 75 of the Italian constitution forbids referendums dealing with international treaties." This means the Italian constitution

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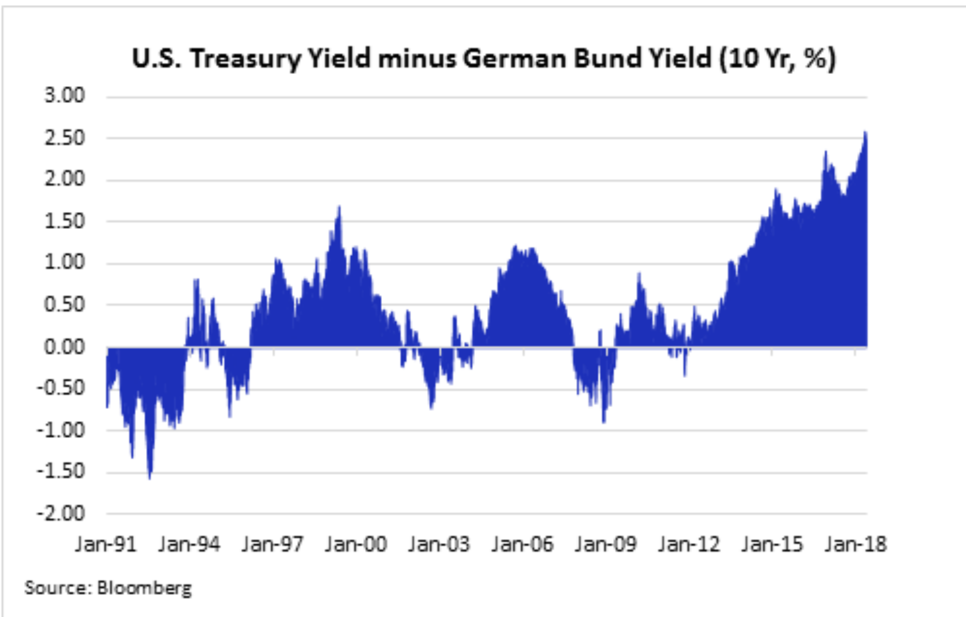
would have to be changed before a referendum could be held on Italy's membership in the EU and the Euro. Changing the constitution requires a two-thirds majority vote in Italy's lower house where the ruling coalition is nowhere close to this number of seats. In other words, the threat remains low.

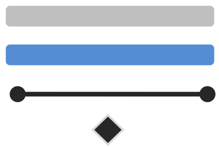
Regardless, U.S. yield divergence with the rest of the world continues. The spread between the 10 year UST's and equivalent German Bunds is at a multi-decade high. Germany is a massive creditor to the debtor EU nations so the financial situation on the EU periphery is a German problem as much as an Italian or Spanish issue. As of this writing, Conti's coalition was allowed to form a government whose language has been moderate toward the Euro. Next for Europe is a determination by the European Central Bank on its quantitative easing policy, the end of which could cause the interest rate spread between the U.S. and Europe to tighten. An analysis of the chart below suggests that peaks in this spread preceded U.S. equity market tops by a few years. This could coincide with a tight Fed policy in 2020 and the U.S. presidential election cycle. It is something to be cognizant of, while realizing that near term earnings growth and Fed policy will be the primary drivers of the market.



As always, we'll continue to monitor factors affecting financial markets and our clients. Please do not hesitate to contact us.

Review of indicator charts to follow…

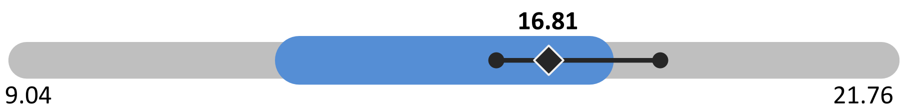
The following charts highlight a sampling of the indicators that we observe.



Historical Range
Typical Range (+/- 1 std deviation)
Trailing 12-Month Range
Last Observation

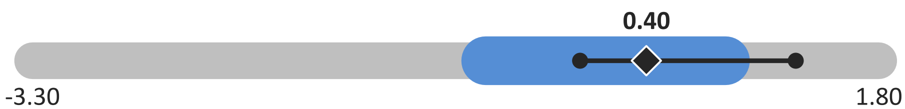
Economic Indicators

US Auto Sales
9/30/90 to 5/31/18 | Freq: Monthly | Units: In Millions | Ref: 1



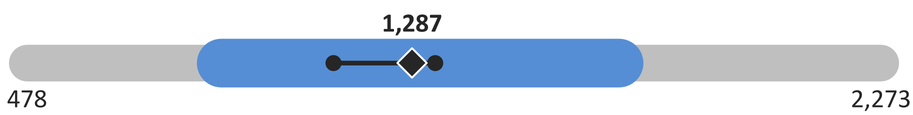
Trailing 12-Months

Leading Economic Indicators
9/30/90 to 4/30/18 | Freq: Monthly | Units: % Change | Ref: 2



Trailing 12-Months

Housing Starts
9/30/90 to 4/30/18 | Freq: Monthly | Units: Thousands | Ref: 3

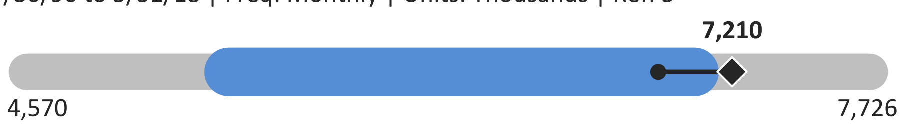


Trailing 12-Months

Home Prices
1/31/00 to 3/31/18 | Freq: Monthly | Units: Index Level | Ref: 4

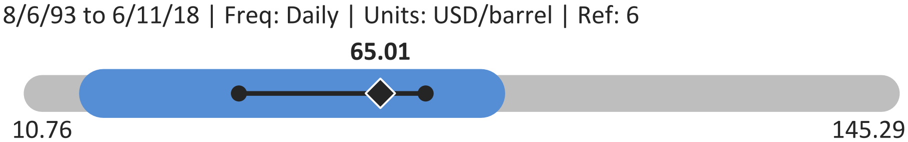
Trailing 12-Months

Construction Employment
9/30/90 to 5/31/18 | Freq: Monthly | Units: Thousands | Ref: 5



Trailing 12-Months

WTI Oil Spot Price
8/6/93 to 6/11/18 | Freq: Daily | Units: USD/barrel | Ref: 6

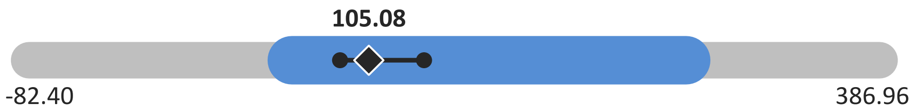


Trailing 12-Months

Risk/Fear Measures

US Treasury Yield Curve, 10-Yr to 3-Mo Spread

4/26/94 to 6/11/18 | Freq: Daily | Units: Basis Points | Ref: 7



Trailing 12-Months

High Yield Spread

7/18/94 to 6/8/18 | Freq: Daily | Units: % | Ref: 8

Trailing 12-Months

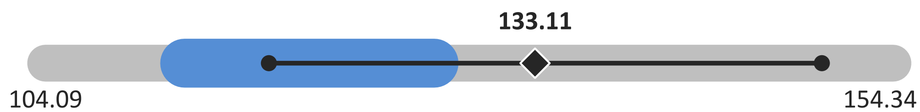
VIX Index: Volatilty

9/3/93 to 6/11/18 | Freq: Daily | Units: Index Level | Ref: 9

Trailing 12-Months

SKEW Index: "Crash Protection"

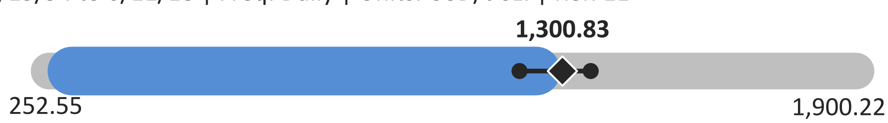
8/18/93 to 6/8/18 | Freq: Daily | Units: Index Level | Ref: 10



Trailing 12-Months

Gold Spot Price

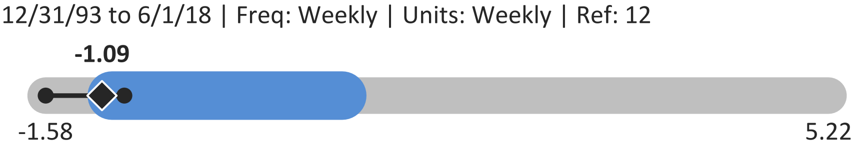
7/15/94 to 6/11/18 | Freq: Daily | Units: USD/t oz. | Ref: 11



Trailing 12-Months

St. Louis Fed Financial Stress Index

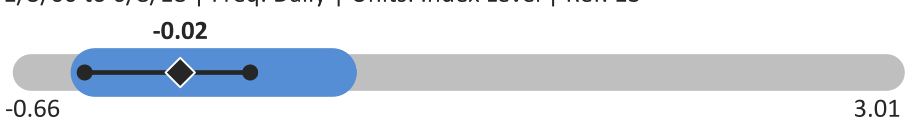
12/31/93 to 6/1/18 | Freq: Weekly | Units: Weekly | Ref: 12



Trailing 12-Months

BofA Global Financial Stress Index

1/3/00 to 6/8/18 | Freq: Daily | Units: Index Level | Ref: 13



Trailing 12-Months

Valuation Indicators

Major Markets

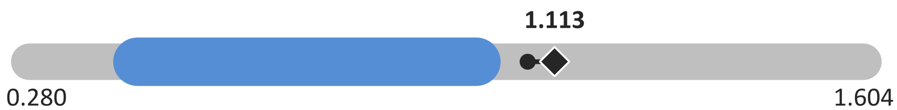
U.S. Stocks: Enterprise Value-to-EBITDA Ratio

1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 14

Trailing 12-Months

U.S. Stocks: Tobin's Q Ratio

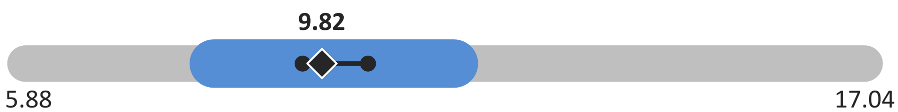
1/1/52 to 10/1/17 | Freq: Quarterly | Units: Ratio | Ref: 23



Trailing 36-Months

International: Enterprise Value-to-EBITDA Ratio

1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 15



Trailing 12-Months

Emerging Markets: Enterprise Value-to-EBITDA Ratio

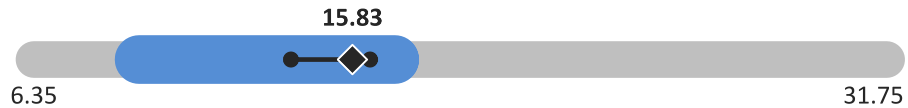
8/1/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 16

Trailing 12-Months

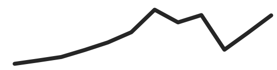
U.S. Style / Capitalization Segments

Large Growth: Enterprise Value-to-EBITDA Ratio

1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 17



Trailing 12-Months



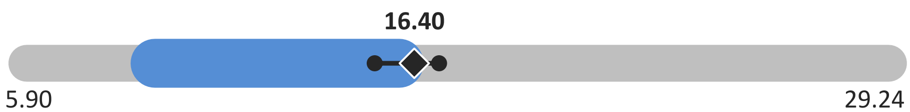
Large Value: Enterprise Value-to-EBITDA Ratio

3/20/00 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 18

Trailing 12-Months

Mid Growth: Enterprise Value-to-EBITDA Ratio

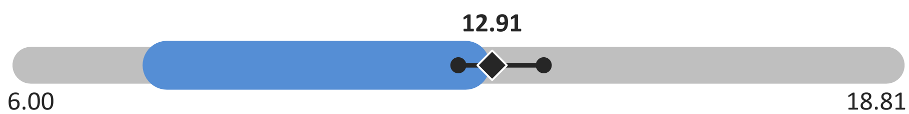
1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 19



Trailing 12-Months

Mid Value: Enterprise Value-to-EBITDA Ratio

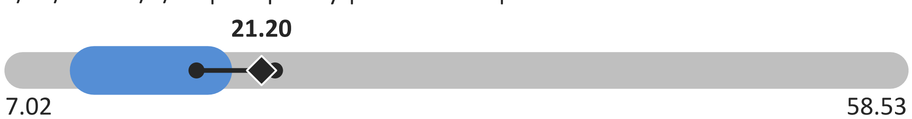
3/20/00 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 20



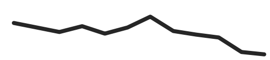
Trailing 12-Months

Small Growth: Enterprise Value-to-EBITDA Ratio

1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 21

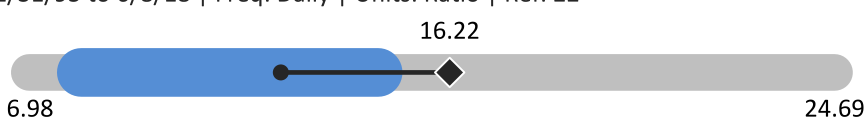


Trailing 12-Months



Small Value: Enterprise Value-to-EBITDA Ratio

1/31/95 to 6/8/18 | Freq: Daily | Units: Ratio | Ref: 22



Trailing 12-Months

Index Returns

As of 5/31/2018

U.S. Stocks

Index	Classification	1-Month	YTD	1-Year	3-Year	5-year	10-Year	Volatility[1]	Worst Loss[2]
				Average Annual Returns					
S&P 500 Total Return	Large Cap	2.4%	2.0%	14.4%	11.0%	13.0%	9.1%	13.2%	-51.0%
Dow Jones Indu Avg	Large Cap	1.4%	-0.2%	18.9%	13.5%	12.8%	9.7%	12.7%	-47.2%
NASDAQ Composite	Multi Cap/Tech	5.5%	8.3%	21.4%	15.1%	18.1%	12.8%	16.2%	-51.2%
Russell 1000	Large Cap	2.6%	2.2%	14.6%	10.7%	12.9%	9.2%	13.4%	-51.1%
Russell Midcap	Mid Cap	2.3%	1.6%	12.7%	8.6%	11.8%	9.2%	15.6%	-54.2%
Russell 2000	Small Cap	6.1%	6.9%	20.8%	11.0%	12.2%	9.6%	18.0%	-52.9%
Russell 3000	Multi Cap	2.8%	2.5%	15.0%	10.7%	12.8%	9.2%	13.6%	-51.2%

International Stocks

Index	Classification	1-Month	YTD	1-Year	3-Year	5-year	10-Year	Volatility[1]	Worst Loss[2]
				Average Annual Returns					
MSCI EAFE	International	-2.2%	-1.2%	8.5%	4.9%	6.5%	2.7%	16.3%	-56.3%
MSCI MXEF	Emerging	-3.5%	-2.6%	14.4%	6.6%	4.9%	2.0%	21.4%	-61.4%

U.S. Bonds

Index	Classification	1-Month	YTD	1-Year	3-Year	5-year	10-Year	Volatility[1]	Worst Loss[2]
				Average Annual Returns					
Barclays US Aggregate	Total Market	0.7%	-1.5%	-0.4%	1.4%	2.0%	3.7%	3.4%	-3.8%
BofA Merrill HY Master II	High Yield	0.5%	0.2%	2.8%	5.1%	5.0%	7.8%	9.0%	-33.2%

Alternatives

Index	Classification	1-Month	YTD	1-Year	3-Year	5-year	10-Year	Volatility[1]	Worst Loss[2]
				Average Annual Returns					
CBOE S&P500 BuyWrite	Option writing	2.1%	1.8%	7.7%	7.6%	7.9%	5.1%	9.7%	-35.8%
CBOE S&P500 PutWrite	Option writing	2.0%	1.4%	6.2%	7.6%	8.0%	6.2%	9.8%	-32.7%
HFRX Global Hedge Fund	Global HFs	0.3%	-0.7%	2.9%	0.5%	1.1%	-0.5%	5.3%	-25.2%
HFRX Hedged Equity	Hedged Equity	0.3%	0.9%	7.9%	1.7%	2.8%	-0.5%	7.0%	-29.5%

Blended Benchmarks[3]

% Stocks / % Bonds	Classification	1-Month	YTD	1-Year	3-Year	5-year	10-Year	Volatility[1]	Worst Loss[2]
				Average Annual Returns					
80/20 Allocation	Blend	2.1%	1.4%	11.3%	9.1%	10.8%	8.2%	10.6%	-42.4%
70/30 Allocation	Blend	1.9%	1.0%	9.8%	8.1%	9.7%	7.8%	9.3%	-37.6%
60/40 Allocation	Blend	1.7%	0.7%	8.4%	7.2%	8.6%	7.2%	8.0%	-32.5%
50/50 Allocation	Blend	1.6%	0.3%	6.9%	6.2%	7.5%	6.7%	6.8%	-27.1%
40/60 Allocation	Blend	1.4%	0.0%	5.4%	5.3%	6.4%	6.2%	5.6%	-21.3%
30/70 Allocation	Blend	1.2%	-0.4%	3.9%	4.3%	5.3%	5.6%	4.6%	-15.1%
20/80 Allocation	Blend	1.1%	-0.7%	2.5%	3.3%	4.2%	5.0%	3.8%	-9.6%

Notes

(1) Volatility represented as the annualized standard deviation of monthly returns over a trailing 15 year period.

(2) Worst loss represented as the maximum drawdown using monthly returns over a trailing 15 year period. Maximum drawdown measures the largest single drop in value from peak to trough.

(3) Blended benchmarks represent a hypothetical allocation between the S&P 500 TR Index and the Barclays US Aggregate Bond Index. The allocations are re-weighted monthly.

References

Sources: Bloomberg L.P.; Federal Reserve Bank of St. Louis; AZA Capital Management

1. US Auto Sales Total Annualized, SA. 9/30/90 to 5/31/18. Bloomberg: SAARTOTL Index.
2. The Conference Board Leading Economic Index. 9/30/90 to 4/30/18. Bloomberg: LEI CHNG Index.
3. US New Privately Owned Housing Units Started by Structure Total SAAR. 9/30/90 to 4/30/18. Bloomberg: NHSPSTOT Index.
4. S&P/Case-Schiller Composite-20 Home Price Index, NSA. 1/31/00 to 3/31/18. Bloomberg: SPCS20SA Index.
5. US Total Construction Employement. 9/30/90 to 5/31/18. Bloomberg: USECTOT Index.
6. West Texas Intermediate Oil Spot Price. 8/6/93 to 6/11/18. Bloomberg: USCRWTIC Index.
7. US Treasury Yield Curve, 10-Yr to 3-Mo Spread. 4/26/94 to 6/11/18. Bloomberg: USYC3M10 Index.
8. High Yield Spread. 7/18/94 to 6/8/18. Bloomberg: CSI BARC Index.
9. CBOE Volatility Index (VIX). 9/3/93 to 6/11/18. Bloomberg: VIX Index.
10. CBOE SKEW Index. 8/18/93 to 6/8/18. Bloomberg: SKEW Index.
11. Gold Spot Price. 7/15/94 to 6/11/18. Bloomberg: GOLDS COMDTY.
12. St. Louis Fed Financial Stress Index. 12/31/93 to 6/1/18. Bloomberg: SLF FSI Index.
13. BofA Merrill Global Financial Stress Index. 1/3/00 to 6/8/18. Bloomberg: GFSI Index.
14. Russell 3000 Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: RAY Index.
15. MSCI EAFE Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: EAFE Index.
16. MSCI MXEF Index Enterprise Value-to-EBITDA Ratio. 8/1/95 to 6/8/18. Bloomberg: MXEF Index.
17. Russell Top 200 Growth Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: R200G Index.
18. Russell Top 200 Value Index Enterprise Value-to-EBITDA Ratio. 3/20/00 to 6/8/18. Bloomberg: R200V Index.
19. Russell MidCap Growth Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: RDG Index.
20. Russell MidCap Value Index Enterprise Value-to-EBITDA Ratio. 3/20/00 to 6/8/18. Bloomberg: RMV Index.
21. Russell 2000 Growth Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: RUO Index.
22. Russell 2000 Value Index Enterprise Value-to-EBITDA Ratio. 1/31/95 to 6/8/18. Bloomberg: RUJ Index.
23. Tobin's Q Ratio. 1/1/52 to 10/1/17. Data from Federal Reserve Bank of St. Louis.

About Us

AZA Capital Management is an independent, federally registered investment advisor that provides asset management and investment consulting services. Our team focuses on providing innovative and objective portfolio management and consulting for institutions and high net-worth families.

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