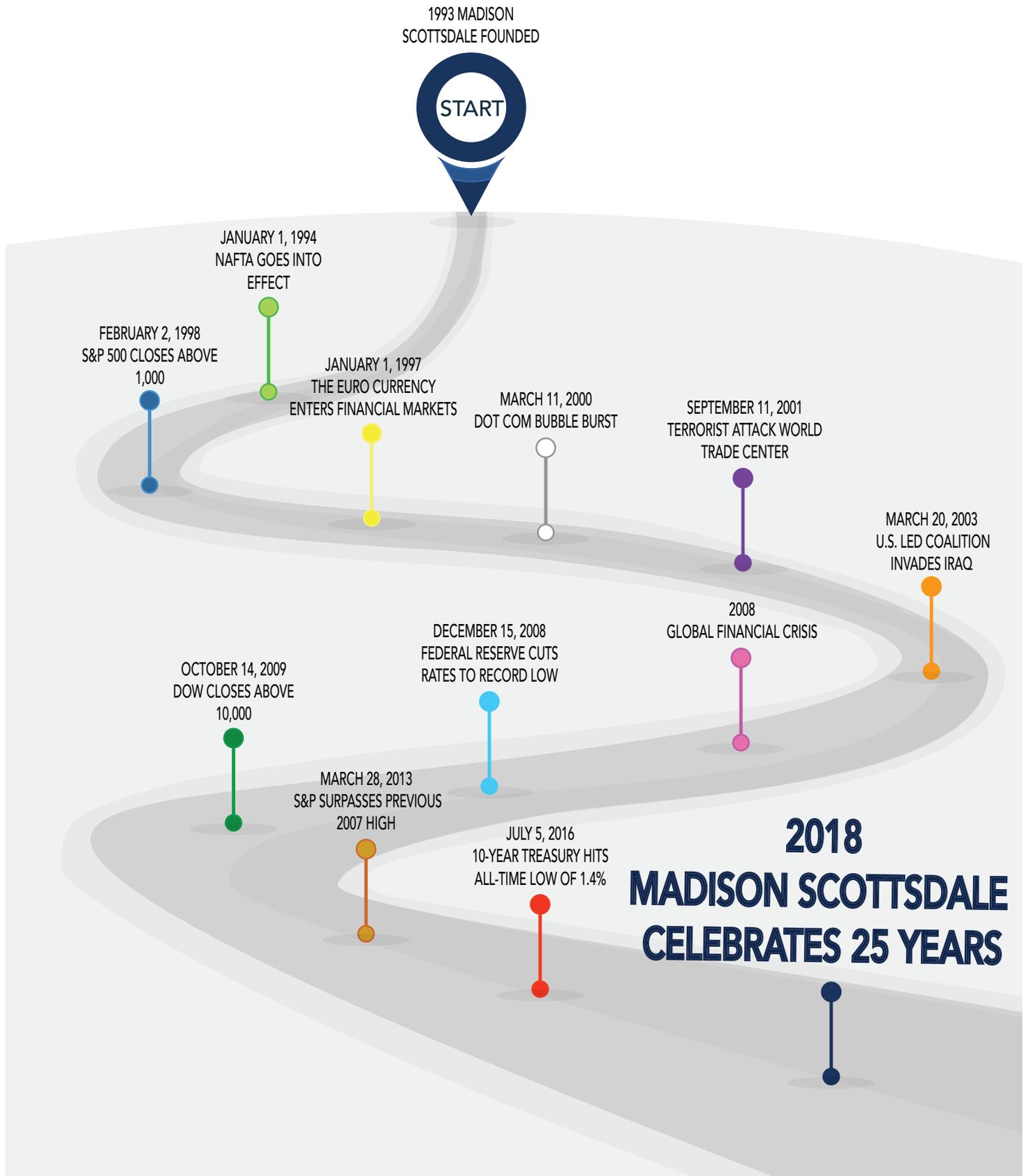


# The Long and Winding Road



# Market Update

## The Return to Normal?

In addition to ongoing short-term rate increases as the Fed strives to return to a normalized yield curve, we are reminded that the Fed continues to reduce its' balance sheet at a time when federal borrowing is rising. The European Central Bank (ECB) is also positioning itself for a less accommodative monetary policy. With the ECB's bond buying program ending in December and President Mario Draghi's term ending next year, it is widely believed that the ECB will begin raising its short-term overnight funding rate in 2019. This should continue to set the backdrop for a gradual increase in global interest rates. U.S. Treasury yields continued to ratchet higher during the third quarter and into Q4, with 2-year Treasury reaching a near decade high level of 2.86% by mid-November. Longer-term yields also rose as the benchmark 10-year Treasury Note, which began the quarter at 2.86%, rose above the elusive 3.25% level early in the 4th quarter, only to retreat and bounce back-up again, settling into its current 3.15% level.

After impressive economic growth of 4.2% annualized in the second quarter, the Blue Chip economic consensus expects a solid rate of 3% to be reported for the third quarter. Continued gains in the labor market and steady consumer spending support this projection. The Federal Reserve Bank's (Fed) estimate for growth was revised slightly higher at the September Federal Open Market Committee (FOMC) meeting from 2.8% to 3.1% for 2018. FOMC growth estimates for 2019, 2020 and 2021 are 2.5%, 2.0% and 1.8% respectively. As Fed Chairman Powell likes to remind us, longer-term projections are nebulous at best, but it is noteworthy that the Fed currently sees no signs of recession on the forecasting horizon.

Wage growth continues to grind higher as average hourly earnings rose to an annual 2.9% rate of increase in August. Overall inflation measures remain well-grounded, with the Fed's preferred core Personal Consumption Expenditure Index (PCE) remaining at their 2.0% target and the Consumer Price Index (CPI) slowing to 2.7% annually in their August readings. The Fed's outlook for inflation

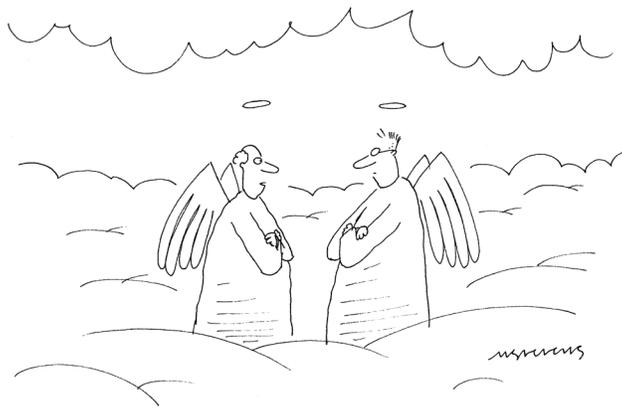
remains tame as well, with the PCE's rate of advance at about 2% over the next three years. Based on the Fed's current growth outlook, inflation forecast and updated dot plot, another Fed Funds Rate increase in December with an additional three moves in 2019 is the general consensus. This would bring the Fed Funds rate to 3.00%-3.25% by the end of 2019, a level that is higher than most current estimates of the neutral (neither restrictive nor accommodative) rate.

No doubt there are plenty of forces that could slow global growth. While the economy has thus far weathered the initial effects of tariffs, the full impact has likely not yet been felt. The threat of additional tariffs and sustained protectionist policies remain

a potential headwind. New concerns about Italy's defiant budget approach to European Union guidelines and worries over some emerging markets, while contained thus far, could morph into periodic bouts of risk-off trading pressures. The aftermath and political realities of mid-term election results have yet to unfold, but they could eventually weigh on confidence as the economy absorbs higher interest rates and their impact on the rate sensitive consumer and housing sectors.

While we are closer to the end of the interest rate cycle than

the beginning, we still see economic momentum taking yields higher. In our view, the Fed has more work to do and we expect the yield curve to shift higher and become a little flatter. As the boost from last year's tax reform measures fades, the status of trade negotiations and tightening of financial conditions will become key influences on the resilience of the current business cycle. We remain selective about the credit risk as rising rates create headwinds for corporations in the way of cost of capital and earnings growth potential. We believe a shorter maturity positioning, particularly in a flat yield curve environment where little additional yield is available by lengthening maturities, is key to protecting capital in this "return to normal."



**"I'm just glad we got out before interest rates went up again."**

# A Conversation with Madison Scottsdale Managing Director Anjanette Fowler



Anjanette Fowler was one of the early members of Madison Scottsdale's staff, joining the firm just a little over a year after its founding. As a result, she's seen almost all of the company's twenty-five years and has a powerful perspective on the evolution of insurance asset management over that time, since her industry experience predates her career with Madison Scottsdale. She earned her finance degree from Arizona State University, and as is the case in many

career stories, found a connection between her avocational interests and her career direction.

**Q. How did you begin your career in insurance asset management?**

**A.** Looking back, it really was a matter of chance. Soon after graduating I coincidentally ran into an old high school softball acquaintance from where I grew up in New Mexico. She was working in Phoenix for an insurance company and encouraged me to apply for an opening in their finance and investment accounting area and I landed my first "real" job. The fact that the company had an enthusiastic and competitive co-ed softball team was definitely a plus for all involved.

**Q. How did you make the shift to Madison Scottsdale?**

**A.** One thing that hasn't changed in the insurance business is the realities of mergers and acquisition. I went through a couple of these during my tenure with the insurance company and the second iteration put me back on the job market. We had done some investment consulting work with Stein Roe, where the co-founder of Madison Scottsdale had worked, so I had a connection. It was a small company, just four of us when I was asked to join. It was something of a risk, but also something of an attraction. Unlike life in a large corporation, there's a lot more variety in a start-up in terms of your responsibilities and opportunities to make an impact. From the beginning I liked the variety and really felt a part of the steady growth over the years.

**Q. What was the key to Madison Scottsdale's growth from the \$500 million of assets under management when you started to today's \$3-plus billion?**

**A.** It all starts with a solid investment process and philosophy. We were always highly risk-conscious, a good match for our industry. But our key differentiators were our relationships and focus on each of our insurance company partner's unique needs. I believe we've done a good job in adapting to changes over the years. For instance, beyond our core primary investment management responsibilities, we now spend considerably more energy in not only dealing with regulatory oversight, but in helping our clients deal with it. Our insurance company partner's investment committees and boards have serious fiduciary responsibilities that have grown exponentially over the years and we take seriously the task of making sure they understand how these are reflected in their asset management.

**Q. How has technology changed your work over the past twenty-five years?**

**A.** When I think about the changes, many of them will be familiar to anyone who's been in the workforce over this period. For instance, when I started we didn't have email. Of course, you don't need a lot of technology to communicate amongst four people – you just have to call out a name. Websites were somewhat science fiction and although we had desktop computers, we didn't have anything close to the software tools that we have now. So many processes that were manual are now automated and that's made us much more productive. Technology allows us to stay more closely attuned to our partner's business metrics, which in turn gives us a better handle on how to manage their assets and risks.

**Q. Given your perspective, what would you expect to be the major shifts in the industry in the years ahead?**

**A.** Technological change is bound to be the leading factor. We're already seeing the impact of Artificial Intelligence on the underwriting side of the business and we can expect to see that it will eventually influence all aspects of the insurance enterprise, including asset management -- it already has to some degree. I suspect that this will have the effect of tightening the distribution of investment results. As a result, our business partners will be looking to us to provide value beyond pure investment management, a trend which we're very much on top of. We already embrace the responsibility of being a part of the overall business planning and Enterprise Risk Management alongside our partners, as we all strive to align the investment goals and results, with the operational goals and results. In the end, it always comes back to strong relationships and open communication. I see those factors becoming ever more important in the years to come.

# Madison Scottsdale wins U.S. Captive Insurance Industry Award for Investment Management



Madison Scottsdale, a specialized investment management division of Madison Investments®, has been honored with the captive insurance industry's 2018 Investment Management Award for its record of risk-managed service to the U.S. insurance industry.

The U.S. Captive Service Awards are awarded annually by the industry-trade publication, Captive Review, to recognize excellence in the delivery and management of captive insurance assets and celebrate innovation, commitment, and expertise in the captive insurance field.

A pure captive insurance company is a privately held entity that insures the risks of its parent company by issuing policies, collecting premiums, and paying claims similar to a conventional

insurer. Countless firms entered the only series of awards dedicated to the captive insurance industry, vying for recognition in categories designed to specifically identify excellence and professional distinction in various captive insurance-related disciplines.

"It's a great honor to be recognized for the twenty-five years of Madison Scottsdale's dedication to providing the best possible asset management solutions for the insurance industry," said Anjanette Fowler, Managing Director. "Not only does the industry have special needs and regulatory concerns, but each insurance company has its own unique risk profile and investment requirements. We feel that this award recognizes how well we've met those various needs."



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The Captive Review awards were independently determined and awarded by one of Captive's Captive Owner Panels. Madison Scottsdale did not pay a fee in exchange for these awards. The Investment Management Award is open to asset managers and investment advisors and is presented to the firm that best exhibits unrivaled customer care and innovation.

Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index of U.S. fixed income securities. The U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities. The index includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS sectors.

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