Morris Capital Advisors, LLC

Investment Commentary
September 30, 2018

Riding in the West

We had the great fortune of spending our vacation on a week-long bike tour in the western portion of South Dakota. Together with my wife, Anne, we rode our tandem bicycle through Badlands National Park, the Black Hills Forest to Mt. Rushmore, and northward to Devil's Tower in Wyoming. We covered a lot of ground, and struggled up more than a few long climbs, but our efforts always seemed to be rewarded with another magnificent view of the amazing western landscape.

After subjecting investors to some ups and downs during the first half of the year, the stock market rewarded us with strong performance in the 3rd Quarter. The S&P 500 generated a total return of 7.7%, the best 3rd quarter performance since 2010. With year-to-date return for the index at 10.5%, most of the return this year occurred in just one quarter. But this strong performance was not distributed evenly, as growth stocks once again outperformed value stocks, and large-cap stocks outperformed small-caps. This divergence is a continuation of market action in the first half of the year when market returns were driven by a small group of high-valuation stocks in the technology sector, a topic that we covered in our previous market commentary.

A number of factors contributed to the market rally. The domestic economy continued to show signs of improvement as GDP growth accelerated from 3% to over 4%, the strongest growth in a number of years. The labor market strengthened, pushing the unemployment down and wages up, and, as a result, consumer confidence rose and consumer spending increased. The virtuous circle of a stronger economy, better labor conditions, and higher consumer spending was apparent when companies announced quarterly results. Strong demand and the positive impact of tax reform measures contributed higher revenues, higher profit margins, and strong earnings growth. Encouraged by the strong results many companies increased revenue and earnings guidance.

The market rally was not without its cautionary signs. Valuations remained high, although somewhat lower than early in the year. Volatility in the major indices was unusually low as the S&P 500 index did not register a move of more than 1%, up or down on any day, a possible indication of investor complacency. Typically, a quarter as strong as this would have generated a strong up move and some sort of pullback. In addition, underlying measures of market strength were weak as the number of stocks hitting new highs declined and stocks hitting new lows increased.

But the economy and stock market face a significant headwind as the Fed gradually tightened policy. For almost 10 years the Fed has pursued a very accommodative policy to spur economic growth. They pushed interest rates to almost zero and held them there for an extended period of time. They also aggressively purchased government and mortgage debt, expanding the Fed balance sheet by more than $1 trillion, a policy known as "quantitative easing". Now, as economic growth has begun to accelerate, the Fed is beginning to slowly reverse those policy actions. The initial step in this process has been a gradual increase in short term interest rates in an effort to "normalize" rates. Recently, the Fed initiated the second step of this process to reverse quantitative easing, by not reinvesting the proceeds of bonds on their balance sheet as they mature.

Despite the somewhat effortless rise of the markets during this past quarter, investors need to balance their return expectations with the risk of a steep descent that might lie beyond the next curve. Global economic and political events could unsettle our markets. As the European Union struggles with Brexit and tense negotiations with Italy, the European central bank may find its policy options limited. Tense trade negotiations between the US and China or the European Union could raise uncertainty for both multinational corporations and investors. In addition, the threat of higher inflation, which has been well contained to this point, could add another measure of risk for bond investors, and the withdrawal of liquidity by the Fed could impact the markets negatively.

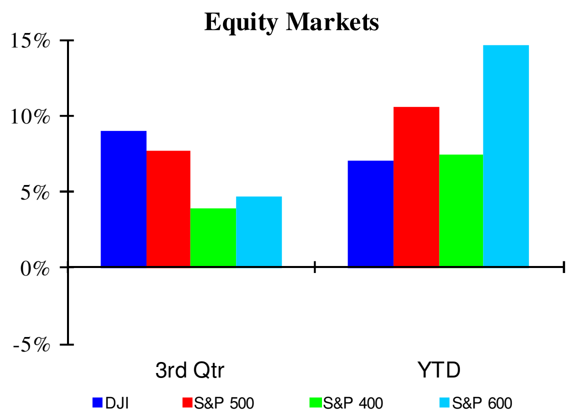
While these macro factors can impact investor expectations, and by extension the market itself, we recognize that they are clearly beyond our control. If fact, while we may be able to anticipate investor reactions to any of these potential events, we find it difficult to convert any of it into actionable portfolio decisions. Instead, we believe that the best foundation for an investment portfolio is to manage risk on an individual stock by stock basis. We focus our search for stocks that trade at attractive valuations based on their earnings potential and financial strength relative to their peers and the market in general. We manage risk by building a diversified portfolio among industry sectors with a long-term investment horizon to ride out the inevitable ups and downs of investor emotions.

Sincerely,
Daniel A. Morris

Market summaries on reverse page

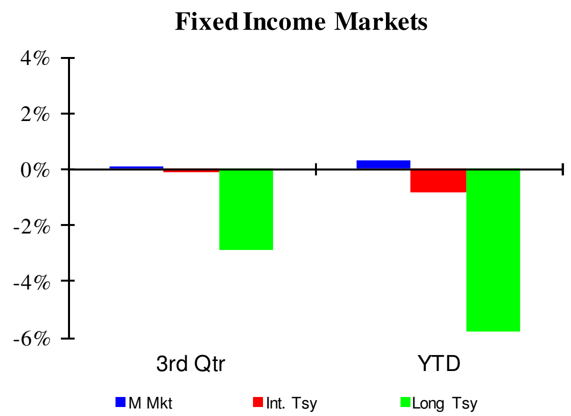
Morris Capital Advisors, LLC

Market Summary
September 30, 2018



Equity markets generally trended higher during the third quarter of 2018, powering over a few speed bumps. Mega-cap growth stocks briefly succumbed to profit taking following a high profile earnings miss by Facebook in late July, but quickly resumed the uptrend they have enjoyed all year long. Large cap stocks were also surprisingly resistant to rising interest rates, especially late in the quarter, when the ten year yield broke decisively through the 3.0% level in late September. Most stocks responded well to evidence that economic growth continued to be robust. Moreover, when trade negotiators achieved a surprise breakthrough in discussions to replace NAFTA, investors began to worry less about the impact on international revenues of a ruinous trade war and bid up the shares of larger companies, who tend to have more business exposure overseas..

Small company stocks did not fare so well in late September, and retraced about half their gains for the quarter. Interest rate sensitive stocks also performed relatively poorly. As a result, large company shares outperformed small cap stocks, and growth sectors sharply outperformed value names.



Interest rates traded in a fairly narrow range for much of 2018's third quarter, as worries about international weakness traded places with continued evidence of domestic strength and rising inflationary pressures. By late September, however, the sentiment scales had tipped decisively in favor of continued strong U.S. growth, and the yield on the critical ten year Treasury surpassed the 3.0% level for the second time thus year.

Federal Reserve policy continues to be supportive of rising interest rates. At its September meeting the Fed raised rates as expected, indicated it was likely both to raise rates again in December and to continue that pattern into 2019. For the quarter interest rates rose along the yield curve, putting continued pressure on the prices of longer-maturity bonds.