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Quarterly

THE PACIFIC FINANCIAL GROUP INC.

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Outlook

The fourth quarter of 2018 began with strong momentum, with U.S. equity markets close to all-time highs and companies reporting record high earnings. However, in the weeks that followed, markets oscillated, followed by a sharp drawdown in late December. Overall, the S&P 500 finished down 4.38% for the year. International developed equities and emerging market stocks held up slightly better than U.S. stocks in the fourth quarter but suffered double digit losses for the year. This was the first calendar year with a negative return for the S&P 500 since 2008.

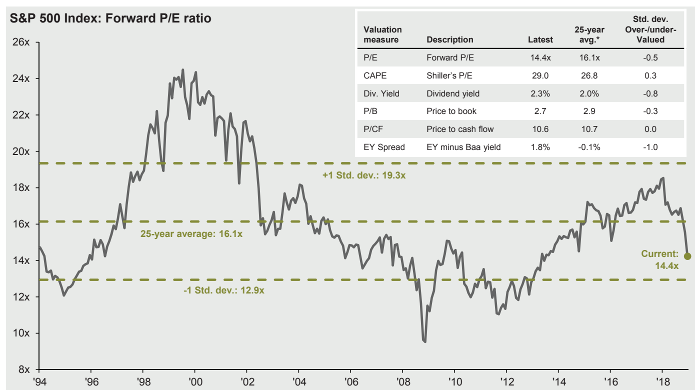
In fixed income, we saw yields move higher through the first three quarters, as the Federal Reserve increased interest rates. In the fourth quarter, investors favored safe assets and Treasury yields fell substantially, with the 10 Year Treasury finishing at 2.69%. Overall, the Bloomberg Barclays U.S. Aggregate Bond Index posted a return of 0.01%. Credit sectors finished in negative territory as spreads widened, while short term Treasuries and Municipals led performance.

There were several factors that contributed to the recent volatility. Domestically, investors showed concern for the flattening yield curve and the possibility of continued rate hikes by the Federal Reserve. In the past, this type of activity typically occurs later in the economic cycle. Global economies have benefited from the decades long trend of expanding trade, however recent tariffs and trade war talk has slowed this trend. Once the final numbers are in, earnings growth in 2018 for the S&P 500 is projected to be over 20%. There are concerns over slower growth in 2019, as the boost from tax cuts diminishes. Finally, growth has moderated in several parts of the world, including Europe and China.

We are monitoring all of these risks closely but there are also quite a few data points that show economic growth is stable. The most recent employment report showed 312,000 jobs added to the U.S. economy. We also saw the participation rate increase to 63.1%, indicating more people are coming back into the workforce. Several indicators point to robust retail sales in December. Wage growth continues to improve, while household debt remains at a manageable level. These data points indicate a robust consumer. Consumer spending represents about two-thirds of GDP and estimates for fourth quarter GDP growth are in excess of 2.5%.

In addition to consumer and employment indicators, which are widely followed, we analyze a wide range of data points. Many of these point to stable or strengthening conditions. The majority of goods in the U.S. are shipped via truck; the American Trucking Association Truck Tonnage Index is in a strong up-trend and posted a record high in November. Corporate bankruptcies continued to trend lower in the third quarter, posting the lowest level in over 10 years.

Market sell offs can present opportunities for investors. The recent volatility has improved valuations across markets. In the U.S., JPMorgan estimates the forward P/E for the S&P 500 to be 14.4, below the 25-year average. Valuations metrics declined throughout the year, with earnings growth outpacing price appreciation by a wide margin. With equity valuations reasonable and economic growth stable, we remain bullish on equities.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	14.4x	16.1x	-0.5
CAPE	Shiller's P/E	29.0	26.8	0.3
Div. Yield	Dividend yield	2.3%	2.0%	-0.8
P/B	Price to book	2.7	2.9	-0.3
P/CF	Price to cash flow	10.6	10.7	0.0
EY Spread	EY minus Baa yield	1.8%	-0.1%	-1.0

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management

As we look out into 2019, we recognize there are several risks to economic growth, including Fed rate hikes and trade issues. We will be monitoring these issues closely, but overall we believe U.S. growth will continue at a slower pace. GDP growth and earnings growth are likely to moderate off the strong pace in 2018, but we expect both of them to show positive results. In previous recessions, there are typically excesses in one or more cyclical sectors, such as housing or business investment. We don't see any excesses building at this time, with most indicators in-line with their historical averages.

In our equity strategies, we continue to favor multi-cap exposure. Smaller, domestically focused companies tend to be more insulated from trade issues and currency volatility. We also maintained our tilt toward growth due to strength in the consumer. We did add

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Strategy Commentary

Balanced Strategy

Asset class returns reversed course in the fourth quarter, with bonds taking the lead and stocks pulling back. During the first three quarters of 2018, stocks posted healthy gains off of strong economic data and earnings growth. Bonds struggled as yields moved higher and investment grade credit spreads widened. In the face of potential tariffs and additional rate hikes, investors shifted to less risky assets causing a pullback in equity prices and a rally in Treasuries. Overall, the S&P 500 Index fell 13.52% while the Bloomberg Barclays US Aggregate Bond Index rose 1.64% over the fourth quarter. Led by Utilities stocks, defensive sectors held up the best, while long term Treasuries led fixed income sectors.

In our portfolio construction process we first focus on the overall asset allocation. In the Balanced strategy, we retained a preference for equities. Despite the recent volatility, we believe stocks are poised to rebound in 2019. Attractive valuations and stable growth in the domestic economy should support equities in the near term. We then focus on exposure within each asset class. Our research shows that investors can benefit from exposure across large, mid and small cap stocks. We dedicate a portion of the equity exposure to low cost multi-cap ETFs. In an expanding economy, we look to tilt the portfolio to areas that can exhibit higher growth rates. In this strategy, we have a tilt towards growth stocks. This holding detracted modestly during the recent pullback. However, we believe a strong consumer should benefit faster growing companies. In fixed income, one sector that continues to provide strong risk adjusted returns, with low sensitivity to changes in interest rates, is non-agency mortgages. Overall, these securities posted solid results in 2018 but detracted slightly during the fourth quarter during the flight to quality. Modest consumer debt levels, strong employment and improving loan-to-value ratios should support the sector in the near term.

Equity Strategy

Domestic equities began the quarter with solid momentum. Major indexes were close to all-time highs. S&P 500 companies posted earnings growth of 26% and revenue growth of 9% for the third quarter, according to FactSet. However, investors began to grow concerned over future Fed policy and the impact of a trade war, sending stocks on a bumpy ride with a sharp drawdown in December. Overall, the S&P 500 fell 13.52% for the quarter, with mid and small caps faring worse. Value stocks, led by Utilities and Real Estate, outperformed growth stocks. The price of oil fell due to oversupply and potential slower global growth next year, pulling down Energy stocks. Despite the setback to equities, we remain optimistic on risk assets. There are strong trends in employment, wage growth and consumer spending. These factors should support GDP and earnings growth in 2019.

Our Equity strategy is structured to capture returns using several broad themes. We look to gain exposure to companies of various sizes. Over time we believe including smaller, faster growing, companies can enhance returns. These smaller companies are generally more domestically focused and better insulated from trade issues. During 2018, we saw strong performance from small caps in first half but as sentiment shifted, they suffered a drawdown in the fourth quarter. Investment style trends tend to persist through an economic cycle and we are currently overweight growth stocks. While value stocks had a slight edge over growth stocks in the fourth quarter, we believe the broader trend remains in place. We also look to overweight sector exposure to enhance returns. We increased Health Care exposure during the quarter, which contributed to performance, while Technology exposure detracted slightly.

Global Strategy

Global equities finished the fourth quarter down 12.75%, as measured by the MSCI ACWI NR Index. The ongoing tariff dispute between the US and China, along with the Fed rate hikes, put pressure on a number of markets. China, Germany and Japan all suffered double digit losses last quarter. Europe's economy is decelerating at a quicker pace than expected. We saw a contraction in Q3 German GDP as manufacturing output decreased. Japan's

economy is having a difficult time growing because China is a significant trading partner for their economy. Emerging markets, which underperformed developed markets in the first half of 2018, outperformed in the second half, with its strongest quarter in Q4. The standout performer in EM was Brazil, which rose 14% on optimism for a more business friendly government.

We begin the portfolio construction process by determining exposure across three broad regions, the U.S., developed markets outside the U.S. and emerging markets. We currently favor U.S. equities over developed markets outside the U.S. We believe growth rates, momentum and supportive fiscal policies favor U.S. companies. Our U.S. exposure covers large, mid and small cap companies. Mid and small cap exposure detracted in the fourth quarter but remain attractive due to valuations, growth rates and less exposure to trade war volatility. In foreign developed markets, we favor Japan over Europe, due to strong company balance sheets and continued monetary policy support. We maintain a neutral view on emerging markets with a benchmark weight in the portfolio, which contributed to performance.

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exposure to Health Care due to robust fundamentals, reasonable valuations and strong price momentum. We favor domestic stocks over international developed equities due to stronger economic fundamentals and earnings growth in the U.S. We maintain a benchmark weighting of emerging markets exposure in our global portfolio. We remain diligent in our analysis and research, continually looking to improve our portfolios while managing risk. The New Year brings optimism, which mirrors our investment views. We wish you good health and happiness in the coming year!

Has anything happened we should know about? If there are any changes in your financial situation, investment objectives or specific restrictions, please contact your Investment Advisor or The Pacific Financial Group, Inc. It is critical to the achievement of your investment goals and the success of our relationship to discuss any changes in your financial needs.

Our clients receive quarterly performance on their accounts. For performance on any of our strategies, please contact your Investment Advisor.

Multi-Mandate Approach

We believe that an effectively diversified portfolio should be built around three distinct mandates, with each mandate having its own unique objective, expectation, and contribution to the portfolio. It is through the combination of mandates that we believe a client can experience greater diversification, improved risk management, and enhanced returns.

Market Movements

The strategies offered in the market movement segments are designed to replicate the risk and return of the overall stock and bond market movements. Equity markets began the quarter on a strong note, posting a record high in late September, along with third quarter earnings growth of 26%, according to FactSet. However, concerns over Fed rate hikes and unproductive trade negotiations caused equity prices to lose momentum. The steep decline in December pushed S&P 500 returns negative for the year; the first time since 2008. Overall, the S&P 500 fell 4.38% for the year, with international developed and emerging markets faring worse. Small cap stocks saw strong performance in the first half but pulled back in the fourth quarter as sentiment shifted. Defensive sectors, led by Utilities and Real Estate, provided the strongest returns during the quarter. Energy stocks were among the worst performers as the price of oil fell over 25%. As expected, the Federal Reserve increased the Federal Funds rate four times in 2018. Yields on Treasury bonds drifted higher throughout the year, peaking in November, due to rate hikes and solid economic data. However, the risk-off sentiment prevailed late in the quarter, pushing yields substantially lower. The 10 YR Treasury finished the year at 2.69%, only marginally higher than where it began. Credit sectors finished in negative territory as spreads widened, while short term Treasuries and Municipals led performance.

Dynamic

Strategies in this mandate are designed to actively adjust asset class weightings to increase/decrease exposure to market movement. Defensive sectors like utilities, consumer staples, and REITs, outperformed cyclical sectors. Larger companies performed better than mid and small cap companies in the quarter. Value stocks outperformed growth in the fourth quarter, however growth stocks outperformed for the year. Short term Treasuries and Municipals led performance in fixed income. The Morningstar Tactical Allocation category was down 9.25% for the quarter, compared to the S&P 500 which was down 13.52%. Tactical allocation managers with a lower correlation to the Morningstar category led performance.

Active Alternatives

Strategies in this mandate are designed to provide a source of risk and return that is independent of overall stock and bond market movements. Throughout the quarter, volatility across asset classes increased, making some of the biggest moves in months. The CBOE Volatility Index (VIX) spiked to 36, and finished the quarter at 25.4. The Wilshire Liquid Alternative Index finished the quarter down 3.72% compared to the S&P which fell 13.52%. Market neutral managers delivered more consistent returns with low downside, while long-short equity managers reduced volatility by lowering equity exposure.

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