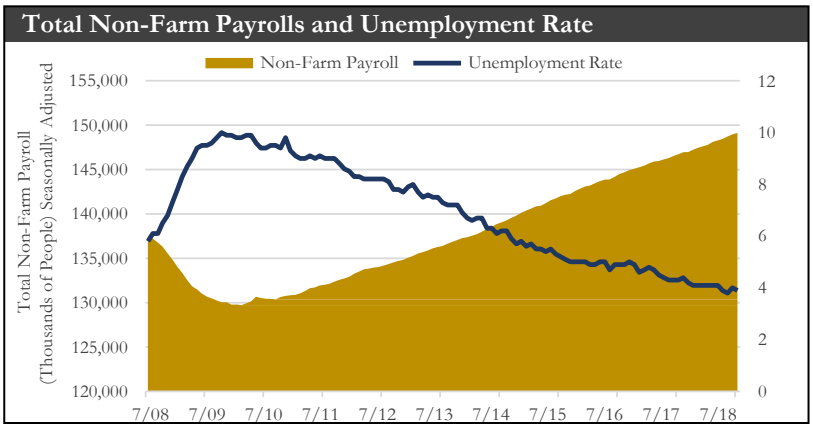
Colorado Capital
MANAGEMENT

FALL NEWSLETTER / OCTOBER 2018

Economic Review

GDP Growth: Evidence continued to mount that U.S. economic growth will remain solid in the second half of 2018. Real GDP grew 4.2% in the second quarter, and thanks to strong consumer spending and business investment, third quarter GDP is also expected to come in at close to this level. Although trade tensions have continued to escalate, job and income growth remained exceptionally strong, which kept consumers in good spirits and supported hearty gains in consumer spending.

Employment and Confidence: The labor market continued to improve and employers continued adding jobs across a wide array of industries. The unemployment rate remained below 4% while wage growth continued to trend higher. Initial jobless claims fell to the lowest level since 1969. Consumer confidence hit an 18-year high in September, a positive indicator for spending going into the holiday shopping season. Robust job growth and a strong economic outlook bolstered Americans' expectations for the future.



Source: U.S Bureau of Labor Statistics

Inflation and Interest Rates: While U.S. inflation picked up over the course of 2018, there were few signs of a breakout in price pressures. Year-over-year headline inflation in August was 2.7%, while the core rate was 2.2%. A strong U.S. dollar and a competitive retail sector clearly helped to keep a lid on core goods prices. Inflationary pressures should pick up slightly over the coming quarters. To contain inflation, the Fed is expected to continue nudging interest rates up a quarter point higher each quarter until the second half of 2019, when the funds rate would reach its neutral rate of 3%.

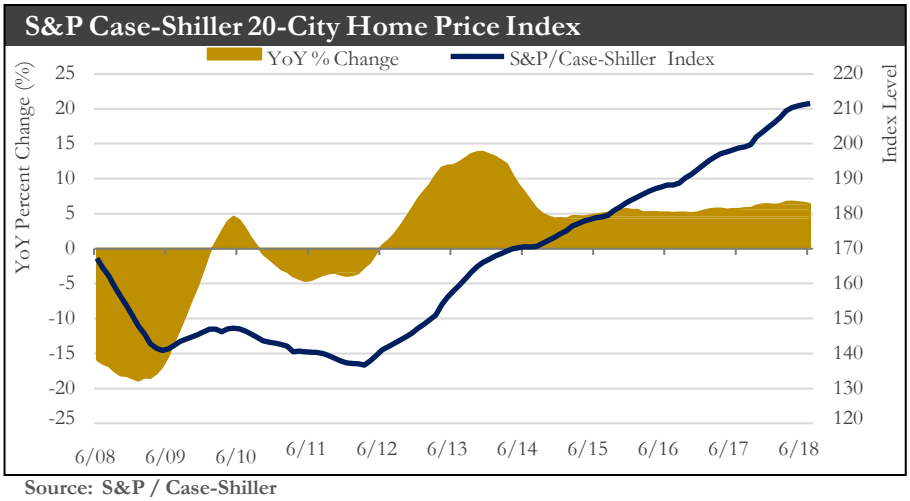
Key Economic Indicators			
Indicator	**Current (9/30/2018)**	**3 Months Ago (6/30/2018)**	**1 Year Ago (9/30/2017)**
US Economy			
Quarterly GDP (latest release)	4.2%	2.2%	3.0%
Unemployement Rate	3.7%	4.0%	4.2%
U.S. CPI (Core)	2.2%	2.3%	1.7%
Interest Rates			
Fed Funds Rate	2.25%	2.00%	1.25%
10-Year Treasury Rate	3.1%	2.9%	2.3%
Commodities			
Crude Oil (WTI)	$ 73.16	$ 74.13	$ 51.67
Gold Price	$ 1,192	$ 1,255	$ 1,229
Confidence & Currency			
Consumer Confidence Index	138.4	126.4	120.6
Trade Weighted Dollar Index	125.5	124.1	118.5
Stock Prices			
Dow Jones Industrial Average	26,458	24,271	22,405

Trade: Exports surged in the second quarter as some businesses rushed to get merchandise out the door ahead of retaliatory tariffs. This trend was reversed in the first two months of the third quarter, with the net trade deficit dragging down economic growth. The estimated impact of tariffs has so far been quite small. However, the tariffs in place have only been the tip of the iceberg relative to those under review or threatened. All told, an escalation in the trade spat with China and waning global demand could yet test the durability of the current expansion.

However, for now the U.S. economy has continued to boom with little reason for the Fed to alter its interest rate normalization plans that included a quarter percentage point raise in late September.

Colorado Capital Management contributors and editors: Steven Ellis, Monica Mielke, Lee Strongwater, and Julia Wentworth.

Housing: Pending home sales, a leading indicator of sales activity, fell in August. This marked the fourth decline in five months, suggesting that sales may continue to languish in the near-term. New home sales rebounded in August after trending lower in prior months. However, affordability remained a concern as home prices continued to rise and higher interest rates reinforced upward pressure on mortgage rates, giving little room to see much upside to home sales later this year.



Source: S&P / Case-Shiller

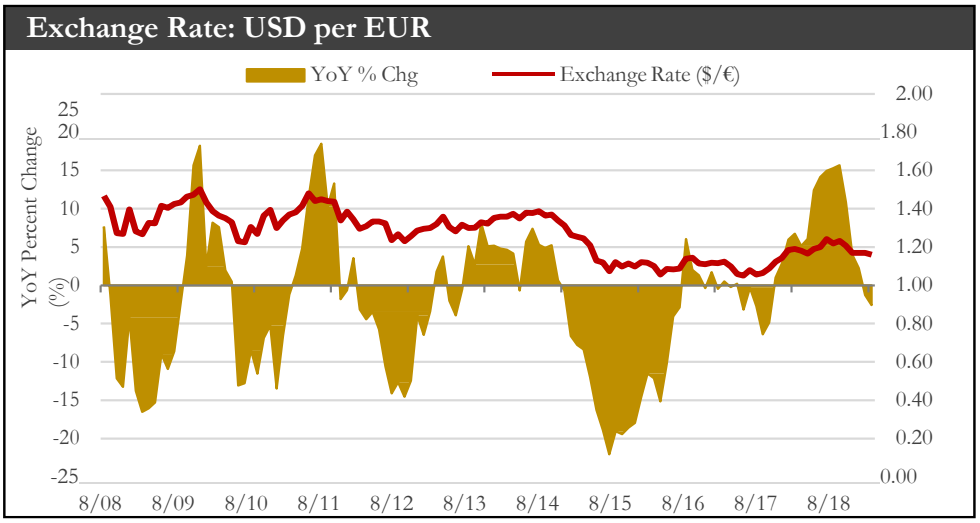
Oil Prices and Emerging Markets: Global oil prices in late September surged above $80 a barrel, their highest level in nearly four years after OPEC left production steady, fueling fresh bets that U.S. sanctions against Iran and outages in Venezuela could lead to supply shortages. Large developing nations like Turkey, India, the Philippines and South Africa import most or all of their oil, so rising prices have spurred higher inflation and expanded already large trade deficits, putting pressure on their currencies. The price of Brent crude has risen by 22% this year, but the cost has doubled if buying in Turkish lira. It is up 39% in Indian rupees and 34% in Indonesian rupiah.

U.S. Dollar: The U.S. dollar has been significantly stronger this year because the U.S. economy has been on a tax-cut- fueled bender; the gap between U.S. interest rates and those of other major economies has been the biggest in at least a decade, and the rest of the world has failed to live up to hopes for growth. Add in fears about emerging markets, Italian anti- European populism, and Brexit, and the dollar has been strong.

Global Outlook: Overall, global growth remains positive but less synchronized than a year ago. Central bankers in regions such as Europe and Japan have so far maintained very accommodative monetary policy, while policymakers in China have also taken measures to support growth. The U.S.-China trade conflict saga continues. With the two economic heavyweights on a hard-to-avoid collision course, this dispute is a key risk to growth. Tariffs in effect and those threatened could knock off up to 1% from U.S. and 0.3% from global economic growth.

U.S. Outlook: The U.S. economy continues to maintain strong momentum heading into Q4. From a bottom up perspective, the economy looks incredibly sound. Strong job growth, higher asset prices, and a relatively high saving rate should continue to support consumer spending. Business fixed investment also looks set to grow solidly, with an emphasis on productivity enhancing investment. Inventories are relatively low and government spending looks set to improve modestly in coming quarters.

Putting all the pieces together, the U.S. economy appears to remain on solid footing, with growth expected to continue at close to 3% through the end of 2019. Beyond that point, there is more uncertainty, as trade disputes pose significant downside risk to the economic outlook.



Source: Board of Governors of the Federal Reserve System

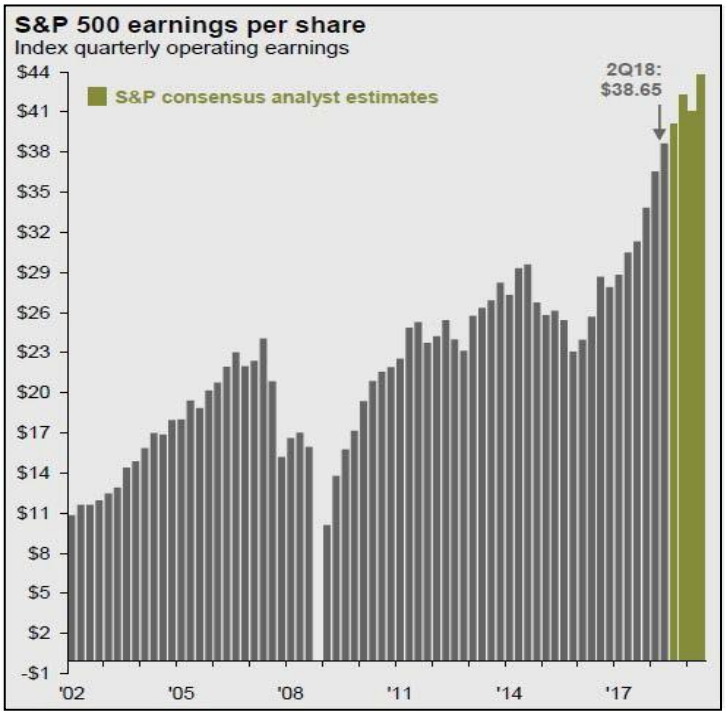
Market Commentary

During the third quarter of 2018, the S&P 500 index soared 7.7% while the Dow Jones Industrial Average gained over 2100 points, a 9.6% increase. Performance of growth stocks was particularly strong, with Amazon and Apple becoming the first companies valued in excess of $1 trillion.

Overseas, results were more muted. The MSCI EAFE index generated a 1.4% gain while emerging markets were negative for the quarter. Fixed income markets were uninspiring as the Barclays U.S. Aggregate Bond index was flat, and the Barclays Global Aggregate Ex-USD index slid 1.7%.

Domestic Equities: In the U.S., corporate earnings have been the star of the show, overshadowing a fairly consistent stream of negative headlines regarding both political factors (trade war, Washington dysfunction, North Korea, and Iran) and economic risks (rising interest rates, higher oil prices, and stretched valuations).

Despite these concerns, the growth in profits propelled the S&P 500 to new all time highs, and on August 22nd the current bull market officially became the longest one on record. Since the bull market began on March 9, 2009, the index has increased over 300%, and that's before adding in dividends.



Source: J.P. Morga Asset Management

On a year-over-year basis, earnings growth rate was 25% in the second quarter. This matches the first quarter's pace and represents the highest earnings growth rate since the third quarter of 2010. Both revenue growth and margin expansion have been key contributors to the surge in earnings. Sales growth came in at 10.1%, the fastest pace since 2011, while margins improved to their highest levels since 2000. In addition, 80% of S&P 500 companies reported a positive earnings surprise, the highest percentage since FactSet began tracking this metric in 2008.

International Equities: Following a strong 2017 and a good start to 2018, international equities have generally disappointed. Valuation multiples have contracted as investors attempt to account for a multitude of risks. Weaker currencies, relative to the dollar, and rising concerns about a trade war have been the primary drivers of poor returns. A strengthening U.S. dollar has been especially challenging for emerging markets. Troubles in Turkey and Argentina have stoked a sense of doom as fears of contagion have rattled emerging market investor confidence. Generally speaking, as the U.S. economy has boomed and risks overseas rise, investors and their capital have been lured back to the U.S. and away from the rest of the world.

There are positives to consider, however. Fundamentals are generally encouraging. Economic data in the Eurozone, Japan, and Emerging Markets have improved after disappointing early in the year. And earnings growth has been positive in 2018. Finally, the U.S.-Mexico-Canada Agreement (USMCA) has replaced the North American Free Trade Agreement (NAFTA) and provided evidence that compromise is possible without the pain of a full-fledged trade war.

Fixed Income: The third quarter was a positive one for investment grade and high yield corporates. But year-to-date, U.S. fixed income returns have been lackluster, with the Barclays U.S. Aggregate Bond index dropping 1.6%. Among the major fixed income sectors, U.S. high yield has been the clear winner while emerging market debt has struggled in the face of a strengthening U.S. dollar. Despite the weak results, it is probably fair to note that domestic bond returns have generally been better than expected given the backdrop of a strong economy and the accompanying concerns of rising inflation and rising interest rates.

Outlook: In the near term, we expect more positive news on the earnings front. FactSet is projecting a third quarter earnings growth rate of 19.3%. Double-digit earnings growth is also expected for the fourth quarter. Earnings growth should begin to normalize in 2019, however, as the benefits from tax reform begin to fade. Margins, currently at record levels, may begin to come under pressure as wages, interest rates, and raw

material costs all continue to increase. Highlighting the macro environment is the end of ultra-loose monetary policy, as central banks raise interest rates and trim balance sheets. These trends may lead investors to become more defensive. Given the late-cycle dynamics, those who are heavily weighted in favor of growth names may want to consider pursuing a more balanced approach.

In our view, international equities remain attractive. Recent weakness has been driven more by negative sentiment than by economic fundamentals. The good news is that valuations and currencies already reflect much of the risk that had been driving negative investor sentiment. When risks abate, investors may again focus on the positive economic and earnings stories abroad driving markets higher.

Fixed income investors face a challenging environment. The Fed is expected to continue to normalize policy by both raising short-term interest rates and reducing its balance sheet (selling Treasury bonds). Interest rates have risen considerably since the start of the year, and this trend is expected to continue. Adding to the challenge, the extended period of low interest rates has encouraged longer term borrowing, thus pushing the duration of the U.S. bond market to near record highs. We remain focused on short and intermediate term maturities, and are gradually leaning towards higher overall quality ratings.

CCM Update

Colorado Capital Management is excited to announce a new team member. Monica Mielke joined CCM in August as the new Client Service Associate. She has a 10- year background in office administration and will likely be the friendly voice picking up the phone when you call our office. Monica supports Andy Gilson on the operations team, where account opening, maintenance, distribution, and reporting are managed.

As a reminder, Zuzana Birova runs the portfolio management department, conducting buys, sells, rebalancing and investment research. The advisory team consists of Steve Ellis, Lee Strongwater, Kyle Schultz, and newly promoted (from client service) Julia Wentworth.

At CCM, we pride ourselves in having a strong team that works together to leverage our skills and provide our clients with the best investment strategy, client service, and comprehensive financial planning possible. We are all here to serve you, so please do not hesitate to reach out if/when questions or needs arise! To learn more about our team, please visit our website.

Left to right: Steve Ellis, Kyle Schultz, Monica Mielke, Lee Strongwater, Julia Wentworth, Andy Gilson, Zuzana Birova

Sources: Capital Market Consultants, Dept. of Labor, Dept. of Commerce, the Conference Board, Federal Reserve, National Federation of Independent Business.

INVESTMENTS / PLANNING / IMPACT

COLORADO CAPITAL MANAGEMENT provides investment management and financial planning to high-net-worth individuals and their families. As fee-only advisors, we place your interests first as we develop prudent and thoughtful financial strategies designed to both limit risk and meet specific long-term goals. We also offer sophisticated impact investing strategies for investors wishing to combine financial returns with positive social and environmental impact.

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