Fund Commentary Q4 2018

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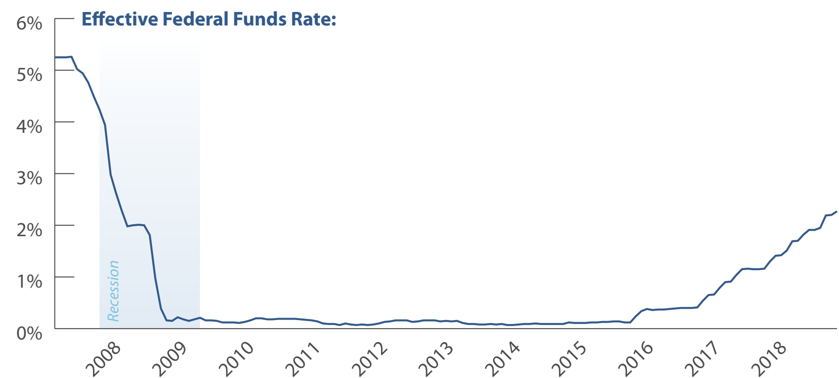
Environment

Just when 2018 was shaping up to be the third consecutive year of excellent stock market performance, the fourth quarter arrived, volatility reappeared, and major indices surrendered their gains for the year. The S&P 500 Index, which had been up over 9% through September, plummeted -13.52% in the fourth quarter, leading to a full year loss of -4.38%. While certainly not pleasant, US investors fared better than those overseas, as most European and Asian markets registered double-digit declines for the year. Why the reversal in sentiment? Any number of potential culprits have been mentioned but let's examine three: rising interest rates, rising debt levels, and rising trade friction between the US and China.

The US Federal Reserve started raising rates in December 2015 and accelerated the process last year with four consecutive hikes. By the time the December meeting arrived, the conversation had evolved from "policy normalization" to determining the appropriate rate level for current economic conditions. Many believed that a December "pause" would be appropriate, but political commentary infringing on Fed independence made that impossible and the final hike of 2018 was adopted. With historically low unemployment, rising wages, a buoyant consumer, and inflation hovering around the 2% target rate, the move seemed reasonable, although the stock market reacted badly. Whether that reflected valid concern over choking off economic growth or behavioral overreaction remains to be seen.

Despite the Fed's actions over the past year, historically low interest rates persist to this day, encouraging corporations to further leverage their balance sheets, despite the higher interest costs. One could argue US corporations have acted rationally, if not entirely prudently, by raising debt levels when presented with a low interest rate environment. The argument would be more convincing if the debt had been used to invest in productive assets rather than to buy back stock. Most troubling, however, is that corporate debt to GDP, which usually peaks during recessions, has jumped to record highs during a period of solid economic growth.[1]

Fed Funds Rate on the Rise….Will it Continue?



Source: Federal Reserve Bank of St. Louis Economic Research (FRED)

This obviously begs the question, what happens to debt levels when the US enters a recession? Historical evidence predicts sharp increases. Furthermore, what happens to earnings when previously digestible interest payments suddenly balloon in the face of reduced sales and margins? Were such developments to occur, we certainly do not need to ask what happens to stock prices. As of today, various measures of recession risk in 2019 remain low, although the market consensus of no further federal funds rate hikes in 2019 belies the Fed's more aggressive take, which projects two increases.

One potential monkey wrench increasing the odds of economic distress, would be a deterioration in the state of the US-China trade relations leading to the imposition of President Trump's threatened 25% tariffs. To an extent, the tariffs address an issue that was already being tackled by the market as a stagnant labor pool and rising costs in China have pushed lower value-added activities out to Vietnam, Bangladesh, and others. The stakes, however, are much larger than the import into the US of some Chinese-made consumer goods. China has not opened its market nearly to the extent of the US and employs multiple barriers to effective investment such as foreign ownership restrictions and technology transfer requirements. Of course, China's respect for intellectual property has been problematic for decades. Several have argued, however, that the stakes are even greater still and encompass the emergence of a great power rivalry between China and the United States and a possible re-ordering of the entire global trade system.

Outlook

In 2016, the National Football League's Cleveland Browns compiled a record of one and fifteen, an exercise in futility exceeded only by their winless campaign the following year. Under returning coach Hue Jackson, 2018 started with promise, but nosedived before management fired Jackson, replacing him with Defensive Coordinator Gregg Williams. Subsequently, the Browns compiled a five and three record, finishing the season with seven wins, eight losses, and one tie, and coming within a whisker of notching their first winning season since 2007 before losing their final game 24-26.

We mention this bit of sports trivia to illustrate the point that leadership matters, and a change at the top can make a meaningful difference to organizational success, be it in sports, the corporate world, or government. Examples abound, including the sea change in fortunes at Microsoft following Steve Ballmer's replacement by Satya Nadella. In the nearly five years since Mr. Nadella was appointed, Microsoft stock has appreciated 175%, compared to a 20% decline during the 14 years of Mr. Ballmer's reign. In fairness, Steve stepped in during the peak of the dot-com bubble and led the company through the Global Financial Crisis, but the numbers are what they are. More recently, the shares of Lowe's experienced a surge when Marvin Ellison, a long-time Home Depot executive, replaced Robert Niblock as CEO and quickly began a major renovation of the executive suite. Of course, General Electric's travails illustrate that if the wrong coach roams the sidelines for too long, the damage may require more than a change of leadership to overcome.

In the political arena we see the same phenomenon. It's difficult to deny that a major chunk of Turkey's problems can be traced to President Reycep Tayyip Erdogan having overstayed his welcome. David Cameron will likely go down as the one of the worst Prime Ministers in the history of the United Kingdom due to his unnecessary and pandering decision to hold a referendum on the UK's membership in the EU. Meanwhile, Theresa May's attempts to negotiate the exit have been clumsy and, in the event of a no-deal Brexit, she will stand alongside Mr. Cameron, as the UK economy will surely suffer greatly under such a development.[2]

Of course, the United States currently seems cursed with a surfeit of poor leadership, and we take no sides in making that statement. Donald Trump meet Nancy Pelosi. Mitch McConnell allow me to introduce you to Chuck Schumer. As of writing, the government is into its third week of shutdown, with no end in sight. On the international front, nobody knows how the aforementioned trading relations with China – arguably the most significant economic issue of 2019 – will develop. Although it may seem easy to pin both on the President, the shutdown is a failure of the entire political class and a strong argument can be made that China has been treated too leniently ever since its ascension to the World Trade Organization in 2001.

Indeed, country-level governance generates the most angst as we look ahead to 2019. Apart from the US and the UK, we see weakening leadership in Germany as Angela Merkel nears retirement, while the glow has definitely come off Emmanuel Macron in France courtesy of the Yellow Vest movement and his own hubris. Italy has reached agreement with the EU regarding its budget, but the issue will surely arise again. Turkey, Hungary, and Poland have become decidedly less democratic in recent years, while Brazil's newly-installed president seems eager to follow the same path toward "illiberalism." In China, President Xi Jinping must be feeling economic pressure based on his decision to make a New Year speech calling for the reunification of Taiwan with the Motherland, a reliable topic for fanning nationalist fervor and distracting attention from domestic issues.

The political calculus will become more challenging if the fourth quarter stock market malaise accurately predicts a downturn in future economic and corporate performance. The jury on that count remains decidedly out. The final US jobs report of the year showed "…one of the strongest months of job gains in the last decade, with employers adding 312,000 to payrolls in December."[3] After years of lackluster growth, wages also rose a solid 3.2%; the unemployment rate ticked up to 3.9% but that was primarily due to a surge of workers entering the labor force.[4] Less buoyant harbingers include the decline in the US 10-Year Government Bond Yield from 3.23% last November to 2.66% on January 4 and concomitant flattening of the yield curve, the December Chinese Caixin Manufacturing PMI dropping below 50 (the dividing line between growth and contraction),[5] a weakening US housing market, and indications that European growth may be rolling over. The more pessimistic indicators, as well as negative pre-announcements from market bellwethers such as FedEx, have led to a sharp reduction in earnings estimates, according to FactSet. To be sure, estimate reductions are the normal state of affairs but after positive tax reform-driven revisions in the first and second quarters of 2018, estimates were downgraded by 1.1% in the third quarter and a further 3.8% in the fourth quarter.[6]

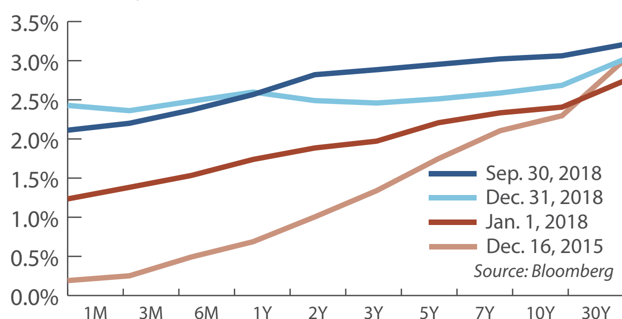
Taking all of the above into account, our sense heading into 2019 is one of cautious optimism, recognizing that conditions are balanced on a knife-edge. We believe the Saturna Sustainable Funds are well-positioned for positive or negative economic developments given our focus on low-debt, cash-generative, high-quality companies led by excellent management teams. Such characteristics are defensive in the event of a downturn, while the low debt focus will also be an advantage in the event economies regain momentum and the Fed continues with its rate normalization policy.

Saturna Sustainable Bond Fund

The fourth quarter of 2018 marked a potential change in US Federal Reserve policy and collective outlook on inflation. The US central bank raised rates in December, moving the target rate up 25 basis points to 2.25% - 2.50%, marking their fourth increase in as many quarters. However, the tone of the Fed changed as they decreased the number of projected rate increases next year from three to two. This change reflects the volatile markets, sharp decrease in oil prices, and slower than expected growth due to trade tensions with China. Inflation, which originally was expected to trend higher in the fourth quarter, surprised to the downside. The outlook was revised from 2.1% down to 1.9%.[7]

The market's reaction to the change in outlook for Fed policy drove the first US Treasury yield curve inversion since 2008. The lackluster economic growth and lower inflation expectations pushed the long end downward closer to levels seen in 2015. However, the short-end yields rose due to expected additional rate hikes and a lackluster economic outlook. We would expect the inversion to intensify should we see continued economic weakness, or corporate financial stress.[8]

US Treasury Yield Curves



Our top three worst performers were all floating rate securities, with the majority of negative returns starting mid-November, and prices leveling out starting the beginning of December. Floating Rate Notes (FRNs) are sensitive to future expectations of interest rates as our holdings have longer final maturities with interest rates that reset quarterly. The price declines occurred immediately after Fed Chairman Jerome Powell's November remarks about growth challenges in 2019, which included slowing demand abroad, fading fiscal stimulus at home, and lagging economic impact of the Fed's past rate increases. The expectations for potentially fewer rate hikes, along with an extended lower interest rate environment, drove the price volatility. However, despite recent headwinds, we ultimately believe there is room for price correction, especially with the surprising recent jobs report which showed that employers added 312,000 new jobs last month versus the consensus of 177,000. Average hourly earnings also rose 3.2%.[9] Potential trade talks with China could also ease some of the expected headwinds on growth originally forecast. FRNs provide upside protection with rising interest rates, without adding duration. The three holdings are detailed below.

- Hartford Financial – HIG Float 02/12/47 416515BC7 returned -12.58%. The coupon resets quarterly to LIBOR +2.125%. Currently the coupon is 4.74%, up from 3.54% last year.

Continued on page 11

As of December 31, 2018

Top 10 Holdings	Portfolio Weight
Bank of Nova Scotia	4.22%
Iron Mountain	4.18%
NextEra Energy Capital (FPL Group)	4.01%
Telecom Italia	3.96%
Lincoln National	3.92%
Novartis Capital	3.89%
First Abu Dhabi Bank	3.81%
Nokia OYJ	3.71%
Koninklijke DSM NV	3.62%
Telus	3.46%

Bond Quality Diversification	
AAA	6.81%
AA	11.97%
A	12.14%
BBB	35.55%
BB	15.61%
B	4.18%
Not rated	10.34%
Cash and equivalents	3.40%

Credit ratings are the lesser of S&P Global Ratings or Moody's Investors Service. If neither S&P nor Moody's rate a particular security, that security is categorized as not rated (except for US Treasury securities and securities issued or backed by US agencies which inherit the credit rating for the US government). Ratings range from AAA (highest) to D (lowest). Bonds rated BBB or above are considered investment grade. Credit ratings BB and below are lower-rated securities (junk bonds). Ratings apply to the creditworthiness of the issuers of the underlying securities and not the Fund or its shares. Ratings may be subject to change.

Saturna Sustainable Equity Fund

The Saturna Sustainable Equity Fund declined -11.81% in the fourth quarter, outperforming the S&P Global 1200 Index, which declined by -12.91%, and the Morningstar World Large Stock Category average, which slipped -12.94%. Of the Fund's 10 largest contributors, half showed double-digit returns, but not nearly to the extent seen in the first three quarters of 2018. Randgold Resources (17.49%), Starbucks (13.91%), and Vestas Wind Systems (11.44%) were the strongest holdings in the fourth quarter, but only Starbucks has been among the 10 largest contributors to the Fund year-to-date.

Randgold Resources, formerly based in Jersey, Channel Islands, was primarily engaged in gold mining and exploration operations in Africa before merging with the Canadian Barrick Gold Corporation in December 2018. Though the mining industry exerts heavy stress on the environment, Randgold has been a true leader in ESG performance, demonstrating a deep commitment to acting responsibly. They understand that financial sustainability is directly tied to environmental and community stewardship.

The merger of Randgold and Barrick will create the largest gold mining company in the world.[11] In a September 2018 article about the coming merger, Barron's noted that "while Barrick arguably paid up to buy Randgold, the benefits to the company from Randgold's management team, balance sheet, and strong record should help Barrick as it navigates a difficult industry and seeks to bolster investor confidence." Early signs indicate that Barrick will employ the same focus on sustainability and ESG criteria; Randgold fostered respectful community relations within the locations it operated mines, and Barrick cites the three pillars of "managing impacts, sharing benefits, and acting with respect" as the keys to strong relationships with their communities. Where Randgold traditionally scored highly in the areas of energy and climate change policies, environmental policies and report, and its board of directors, Barrick Gold currently rates less highly on energy and climate change policies but much higher in the area of diversity and labor rights. Barrick's 2018 Priorities include "zero severe incidents involving local communities" and achieving "at least 70% stakeholder support from our local communities as measured by independent perception surveys."[12] A portion of Barrick employees' annual incentive compensation (15%) was tied to sustainability performance in 2017.

As of December 31, 2018

10 Largest Contributors YTD	Return	Contribution
Adobe Systems	29.10%	0.97
Church & Dwight	33.23%	0.70
Mastercard, Class A	25.32%	0.58
Microsoft	20.80%	0.46
TJX Companies	18.95%	0.38
Nike, Class B	20.44%	0.37
Dassault Systemes ADR	11.22%	0.37
Hartalega Holdings	14.15%	0.26
Starbucks	14.75%	0.24
Ecolab	11.09%	0.19

10 Largest Detractors YTD	Return	Contribution
Valeo	-60.09%	-1.08
NXP Semiconductors	-37.04%	-1.00
Naspers ADR	-29.80%	-0.70
Ramsay Health Care	-24.01%	-0.54
STMicroelectronics	-35.64%	-0.54
3M	-16.91%	-0.52
Aviva ADR	-27.31%	-0.43
Toronto-Dominion Bank	-12.46%	-0.35
BIMB Holdings	-17.36%	-0.33
Samsonite International	-15.49%	-0.31

Top 10 Holdings	Portfolio Weight
Adobe Systems	4.33%
Dassault Systemes ADR	3.38%
Church & Dwight	3.02%
Apple	3.02%
Mastercard, Class A	2.98%
Microsoft	2.80%
Home Depot	2.80%
Unilever	2.78%
Toronto-Dominion Bank	2.66%
Murata Manufacturing	2.58%

Though Vestas Wind Systems was a considerable underperformer in the fourth quarter of 2017, its expansion in recent years – overtaking General Electric in 2016 as the top installer of wind turbines in the US[13] – encouraged an optimistic view of its opportunities for long-term growth. As of the third quarter 2018, Vestas reported slightly higher revenue than in the third quarter of 2017, and an order increase of 25% year-over-year, leading to an all-time high order backlog.

Continued on page 11

Performance Summary

As of December 31, 2018

Average Annual Total Returns *(Before Taxes)*	**1 Year**	**3 Year**	**Since Inception**[B]	**Expense Ratio**[A] *Gross*	*Net*
Sustainable Equity Fund (SEEFX)	-5.76% ▼	4.76% ▲	2.60% ▲	1.37%	0.75%
S&P Global 1200 Index	-8.17% ▼	7.38% ▲	4.96% ▲	n/a	
S&P 500 Index	-4.38% ▼	9.25% ▲	7.45% ▲	n/a	
Sustainable Bond Fund (SEBFX)	-3.17% ▼	1.46% ▲	0.64% ▲	0.84%	0.65%
FTSE WorldBIG Index	-1.32% ▼	2.62% ▲	1.69% ▲	n/a	
MSCI All Country World Index	-8.93% ▼	7.17% ▲	4.48% ▲	n/a	

Morningstar Sustainability Ratings™

Saturna Sustainable Equity Fund (SEEFX)

Percent Rank in Category: 5

Among 732 World Large Stock Funds

[A] *By regulation, expense ratios shown are as stated in a Fund's most recent prospectus or summary prospectus, dated March 28, 2018, and incorporate results from the fiscal year ended November 30, 2017. Expense ratios are restated to reflect the ending of the Distribution (12b-1) Fees, as approved by the Board of Trustees on March 14, 2017. Saturna Capital, the Funds' investment adviser, has voluntarily capped actual expenses of the Sustainable Equity Fund at 0.75% and actual expenses of the Sustainable Bond Fund at 0.65% through March 31, 2019.*

[B] *Saturna Sustainable Equity Fund and Saturna Sustainable Bond Fund began operations on March 27, 2015.*

Performance data quoted herein represents past performance, which is no guarantee of future results. *Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance data quoted herein. Performance current to the most recent month-end can be obtained by visiting www.saturnasustainable.com or calling toll-free 1-800-728-8762.*

A Fund's 30-Day Yield, sometimes referred to as "standardized yield" or "SEC yield," is expressed as an annual percentage rate using a method of calculation adopted by the Securities and Exchange Commission (SEC). The 30-Day Yield provides an estimate of a Fund's investment income rate, but may not equal the actual income distribution rate. Without the voluntary expense cap, the 30-Day Yield for Saturna Sustainable Bond Fund would have been 3.80%. Unsubsidized yield does not adjust for any fee waivers and/or expense reimbursements in effect. Although the expense cap remains in effect, for the 30 days ended December 31, 2018, due to expense resets at the Fund's fiscal year end, the Fund's expenses were not subsidized by the adviser resulting in a 30-Day Yield equal to the Unsubsidized Yield for that period.

The S&P 500 is an index comprised of 500 widely held common stocks considered to be representative of the US stock market in general. The S&P Global 1200 Index is a global stock market index covering nearly 70% of the world's equity markets. The FTSE WorldBIG Bond Index is a multi-asset, multi-currency benchmark, which provides a broad-based measure of the global fixed income markets. The MSCI ACWI covers approximately 85% of the global investable universe, with large- and mid-cap representation across 23 developed market and 23 emerging market countries. The MSCI ACWI Ex-US Index, produced by Morgan Stanley Capital International, measures equity market performance throughout the world excluding US-based companies. The MSCI Emerging Markets Index measures equity market performance in over 20 emerging market countries. Investors cannot invest directly in the indices.

The Morningstar Sustainability Rating is not based on fund performance and is not equivalent to the Morningstar Rating ("Star Rating").

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Morningstar Sustainability Ratings are as of November 30, 2018. The Morningstar Sustainability Rating™ is intended to measure how well the issuing companies of the securities within a fund's portfolio are managing their environmental, social, and governance ("ESG") risks and opportunities relative to the fund's Morningstar category peers. The Morningstar Sustainability Rating calculation is a two-step process. First, each fund with at least 50% of assets covered by a company-level ESG score from Sustainalytics receives a Morningstar Portfolio Sustainability Score™. The Morningstar Portfolio Sustainability Score is an asset-weighted average of normalized company-level ESG scores with deductions made for controversial incidents by the issuing companies, such as environmental accidents, fraud, or discriminatory behavior. The Morningstar Sustainability Rating is then assigned to all scored funds within Morningstar Categories in which at least ten (10) funds receive a Portfolio Sustainability Score and is determined by each fund's rank within the following distribution: High (highest 10%), Above Average (next 22.5%), Average (next 35%), Below Average (next 22.5%), and Low (lowest 10%). The Morningstar Sustainability Rating is depicted by globe icons where High equals 5 globes and Low equals 1 globe. A Sustainability Rating is assigned to any fund that has more than half of its underlying assets rated by Sustainalytics and is within a Morningstar Category with at least 10 scored funds; therefore, the rating it is not limited to funds with explicit sustainable or responsible investment mandates. Morningstar updates its Sustainability Ratings monthly. Portfolios receive a Morningstar Portfolio Sustainability Score and Sustainability Rating one month and six business days after their reported as-of date based on the most recent portfolio. As part of the evaluation process, Morningstar uses Sustainalytics' ESG scores from the same month as the portfolio as-of date.

The Fund's portfolios are actively managed and are subject to change, which may result in a different Morningstar Sustainability Score and Rating each month.

The Saturna Sustainable Equity Fund was rated on 90% of Assets Under Management and the Saturna Sustainable Bond Fund was not rated.

Percent Rank in Category is the fund's percentile rank for the specified time period relative to all funds that have the same Morningstar category. The highest (or most favorable) percentile rank is 1 and the lowest (or least favorable) percentile rank is 100. The top-performing fund in a category will always receive a rank of 1. Percentile ranks within categories are most useful in those categories that have a large number of funds.

Footnotes to commentary:

[1] *Goldfard, Sam and Ensign, Rachel Louise. Corporate Debt Is Reaching Record Levels, The Wall Street Journal, December 29, 2018. https://www.wsj.com/articles/corporatedebtisreachingrecordlevels11546099201*

[2] *Perhaps we should be gentler with Ms. May. As we were recently told during corporate meetings in London, "Half the people voted for Brexit, half voted against and 75% oppose any deal that may be struck."*

[3] *Kitroeff, Natalie. Strong Hiring and Fed Chief's Reassurance on Rates Delight Investors, The New York Times, January 3, 2019. https://www.nytimes.com/2019/01/04/business/economy/jobs-report.html*

[4] *The Employment Situation – December 2018, US Bureau of Labor Statistics. https://www.bls.gov/news.release/archives/empsit_01042019.htm*

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[7] *Kinahan, JJ. Hawkish Now, Dovish Later: Fed Hikes, But Lowers Projected 2019 Rate Projections, Forbes, December 18, 2018. https://www.forbes.com/sites/jjkinahan/2018/12/19/hawkish-now-dovish-later-fed-hikes-but-lowers-projected-2019-rate-projections/#30fb51a93a94*

[8] *Barrett, Emily. Aggressive Change in Market's Fed Outlook Drives Inversions in Yield Curve, Bloomberg, January 3, 2019. https://www.bloomberg.com/news/articles/2019-01-03/aggressive-repricing-of-fed-outlook-drives-u-s-curve-inversions*

[9] *Chandra, Sho. Standout Job Report Shows U.S. Economy Stronger Than Thought, Bloomberg Quint, January 4, 2019. https://www.bloombergquint.com/global-economics/jobs-blowout-shows-u-s-economy-on-stronger-footing-than-thought#gs.5OvDfFyp*

[10] *Bary, Andrew. In Deal for Randgold, Barrick Gets a Top CEO and a Stronger Balance Sheet, Barron's, September 24, 2018. https://www.barrons.com/articles/in-deal-for-randgold-barrick-gets-a-top-ceo-operator-and-a-stronger-balance-sheet-1537809626*

[11] *Community Relations, Barrick. https://www.barrick.com/sustainability/society/community-relations/default.aspx*

[12] *Gronholt-Pedersen, Jacob. Vestas Leaps to Top Spot in U.S. Wind Market, February 10, 2017. https://www.reuters.com/article/us-usa-wind-vestas-wind/vestas-leaps-to-top-spot-in-u-s-wind-market-idUSKBN15P12U*

[13] *Third Quarter 2018 Interim Financial Report, Vestas. https://www.vestas.com/en/investor/financial_reports/2018/q3#!*

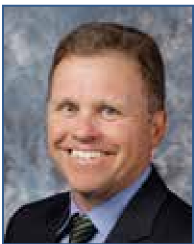
About The Authors

Jane Carten MBA
President and **Saturna Sustainable Equity Fund** Portfolio Manager

Jane Carten, President and Director, joined Saturna Capital in June 1997. Ms. Carten graduated from Western Washington University with an MBA and undergraduate degree in Computer Science and Business. As President, Ms. Carten oversees Saturna's daily operations and directs Saturna's internal and external information systems, managing the technology and marketing activities. She also directs Saturna's continuing education program and the philanthropic efforts of the firm. Ms. Carten is active in the Bellingham Bay Rotary and is a member of the Young Presidents' Organization; she is a former member of the Whatcom Museum Children's Advisory Board. She is a founder and former director of the nonprofit OpenAccess Internet Services and is a Bellingham Sister Cities member and contributor.

Patrick Drum MBA, CFA®, CFP®
Research Analyst and **Saturna Sustainable Bond Fund** Portfolio Manager

Patrick T. Drum, Research Analyst and Portfolio Manager, joined Saturna Capital in October 2014. He is a select member of the United Nations Principles for Responsible Investment (UNPRI) Fixed Income Outreach Subcommittee and an adjunct professor of finance at Pinchot University, formerly known as Bainbridge Graduate Institute (BGI). Mr. Drum has nearly 10 years of experience integrating ESG considerations into fixed income portfolio management. He holds a BA in economics from Western Washington University and an MBA from Seattle University Albers School of Business. He is a Chartered Financial Analyst Charterholder (CFA) and a Certified Financial Planner®. Mr. Drum has more than 20 years of investment experience in serving institutions and private clients.



Scott Klimo CFA®
Chief Investment Officer

Scott Klimo, Chief Investment Officer and Portfolio Manager, joined Saturna Capital in May 2012. He received his BA in Asian Studies from Hamilton College in Clinton, NY and also attended the Chinese University of Hong Kong and the Mandarin Training Center in Taipei, Taiwan. Mr. Klimo has over 30 years experience in the financial industry with the first several years of his career spent living and working in a variety of Asian countries and the past 20 years working as a senior analyst, research director, and portfolio manager covering global equities. Mr. Klimo is a chartered financial analyst (CFA) charterholder. He is a supporter of various environmental organizations and served for several years on the Board of Directors of the Marin County Bicycle Coalition.

Elizabeth Alm CFA®
Investment Analyst

Elizabeth Alm CFA, Investment Analyst, joined Saturna Capital in April of 2018. Originally from Connecticut, she graduated from New York University with degrees in Economics and Anthropology including field work completed in Luxor, Egypt. Prior to joining Saturna, Elizabeth spent 11 years at Wells Fargo Asset Management as a senior research analyst focusing on high-yield municipal bonds. As part of her previous role, she also worked on the management of several municipal SMA strategies. Elizabeth is a Chartered Financial Analyst® (CFA®) charterholder.

Stephanie Ashton
Manager of Corporate Social Responsibility

Stephanie Ashton joined Saturna Capital in 2012. As Manager of Corporate Social Responsibility she develops Saturna's internal sustainability initiatives, manages sustainability reporting, and contributes to overall sustainability strategy.

Ms. Ashton graduated from Western Washington University in 2006, majoring in English (Creative Writing emphasis) and minoring in French. Her professional background includes eight years in legal support as well as non-profit experience. She is passionate about a number of sustainability issues—notably sustainable agriculture and local food—and currently serves on the Board of Directors for the Bellingham Food Bank.

Saturna Sustainable Bond Fund

Continued from page 6

- Lincoln National – LNC Float 04/20/67 534187AU returned -13.40% for the fourth quarter. The coupon resets quarterly, with the next coupon reset end of January at LIBOR + 2.040%. Currently, the coupon is 4.50% as of October 22, up from 3.40% last October.
- NextEra Energy – NEE Float 06/15/67 302570AX returned -12.86%. The coupon also resets quarterly at LIBOR +2.125%. Currently, the coupon is at 4.90%, increasing from 3.71% last December.

The best performing holdings in the Fund this quarter were all banks or financial institutions. The highest returning security was Emirates NBD Bank (EBIUH 6 10/08/19) with a total return of 2.16%. The security is denominated in the New Zealand dollar, and returns were primarily driven by the appreciation of the NZD against the US dollar. Our US dollar-denominated green bond for Kreditanstalt Fur Wiederaufabau (KFW 2 11/30/21) also had a strong return at 1.99%. KFW is a Supranational Bank with direct backing from the German government. It's status as an AAA rated liquid name provided price support in the risk-off market in the last quarter of the year. HomeStreet, a local community bank (HMST 6 ½ 06/01/26) provided a strong return of 1.97% for the quarter.

2018 has continued to be a challenging investment environment as foreign bond markets have experienced substantial volatility. This can be observed in notable emerging market debt indices, many of which have experienced significant downward movement. For example, the MSCI Emerging Markets Index declined -14.58% year to date, including a -7.47% movement just in the last quarter.

The Sustainable Bond Fund saw a total return of -3.05% for the fourth quarter, bringing the one-year total return to -3.17%, with the majority of the declines due to the Fund's position in FRNs. The Fund's benchmark, the FTSE World BIG Bond Index returned 1.11% for the quarter, bringing the benchmark's one-year performance to -1.32%. We anticipate outperformance in a rising rate environment. However, the Fund has taken on two longer US Treasury positions with higher coupons: a 20-year position with a 5.25% coupon (T 5 ¼ 11/15/28) and a 30-year US Treasury position, with a 4.5% coupon (T 4 ½ 05/15/38). This provides a hedge should the US Treasury Curve continue to invert, and global growth continue to be slow. In this scenario, the longer-end yields would remain stable to declining (meaning price improvement), and the Treasurys would provide excellent exposure to the long end without credit risk or price volatility related to widening corporate spreads. The higher coupons reduce the price volatility and overall sensitivity to interest rate movements.

The portfolio was invested in 36 different issuers (excluding Treasurys) among 41 separate positions. The Fund posted an effective duration of 1.88 years and a 30-day SEC yield of 3.80%, up from 3.54% last quarter. As of quarter-end, the Fund had a 5.43% exposure to Mexican peso-denominated securities; the currency recovered 6.35% against the dollar in the third quarter but fell 4.72% in the fourth quarter. Peso-denominated securities returned -4.08% driven by the currency movement. New Zealand dollar-denominated securities account for 1.63% of the portfolio and showed the highest return at 2.09% driven by the 1.80% appreciation of the currency against the dollar over the fourth quarter. Other currency exposures include 6.19% of the portfolio in the Canadian dollar, 3.64% in the euro, 1.56% in the Australian dollar, and 1.87% in the Norwegian krone.

Saturna Sustainable Equity Fund

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Major detractors in the fourth quarter included many of the Fund's mainstays such as Apple (-29.88%), Koninklijke Philips (-22.85%), Dassault Systems (-21.32%), and Adobe (-16.19%). As noted previously, our sense heading into 2019 is one of cautious optimism but we believe the Sustainable Equity Fund is well positioned for either positive or negative developments in 2019, given the focus on low-debt, cash-generative, high-quality companies that are led by excellent management teams.

While TJX Companies and and Koninklijke Philips previously held spots in the portfolio's top 10 holdings, they were replaced this quarter with Church & Dwight and Unilever – two powerhouses in consumer goods. The remaining top eight holdings are consistent with those of the previous quarter.

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Investing involves risk, including possible loss of principal. Generally, an investment that offers a higher potential return will have a higher risk of loss. Stock prices fluctuate, sometimes quickly and significantly, for a broad range of reasons that may affect individual companies, industries, or sectors. When interest rates rise, bond prices fall. When interest rates fall, bond prices go up. A bond fund's price will typically follow the same pattern. Investments in high-yield securities can be speculative in nature. High-yield bonds may have low or no ratings, and may be considered "junk bonds." Investing in foreign securities involves risks not typically associated directly with investing in US securities. These risks include currency and market fluctuations, and political or social instability. The risks of foreign investing are generally magnified in the smaller and more volatile securities markets of the developing world.

Effective maturity *and* ***modified duration*** *are measures of a fund's sensitivity to changes in interest rates and the markets. A fund's effective maturity is a dollar-weighted average length of time until principal payments must be paid. Longer maturities typically indicate greater sensitivity to interest rate changes than shorter maturities. Modified duration differs from effective maturity in that it accounts for interest payments in addition to the length of time until principal payments must be paid. Longer durations tend to indicate greater sensitivity to interest rate changes than shorter durations. Call options and other security specific covenants may be used when calculating effective maturity and modified duration.*

Forward price-to-earnings *is a quantification of the ratio of price-to-earnings (PE) using forecasted earnings for the PE calculation. While the earnings used are estimates and are not as reliable as current earnings data, the benefit in using estimated PE is that the forecasted earnings can either be for the next 12 months or for the next full-year fiscal period.*