HORTER INVESTMENT MANAGEMENT, LLC

Weekly Commentary http://horterinvestment.com/ March 25, 2019

The bond market is flashing its biggest recession sign since before the financial crisis

Federal Reserve Chairman Jerome Powell's assertion this week that the U.S. economy remains strong is facing a stern test from the bond market, which showed a classic recession sign Friday morning.

Short-term government fixed income yields are now ahead of the longer part of the curve, delivering a strong recession indication that hasn't happened since 2007.

The spread, or yield curve, between the 3-month and 10-year Treasury notes just broke the longest streak ever of being above 10 basis points, or 0.1 percentage point. The two maturities were last below that level in September 2007, a run of 3,009 trading days, according to Bespoke Investment Group. The two maturities inverted Friday morning, a near-perfect sign that a recession is coming. An inverted yield curve does not mean a recession is imminent but that one is likely over the next year or so.

The three-month note yielded 2.468 percent around 10 am, while the benchmark 10-year was around 2.44 percent.

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The US Yield Curve Just Inverted

It finally happened. After dangling on the edge of an inversion for months, the US yield curve has just officially crossed into one. The gap between 3-month and 10-year Treasury yields is now negative. 10-year yields have been falling, recently hitting a low of 2.439%. Yield curve inversions are seen as the most reliable indicator of forthcoming recessions. Yields have been falling as a reaction to a highly dovish Fed and weakening economic data.

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QUOTE OF THE WEEK

"Success is the sum of small efforts– repeated day in and day out."

- Robert Collier

Taking a comprehensive look at the overall current stock market

Taking a comprehensive look at the overall current stock market, you can see the chart below representing eight major indices and their returns through the week ending March 22, 2019. In a truly diversified portfolio, the portfolio's total return is determined by the performance of all of the individual positions in combination – not individually.

So, understanding the combined overall performance of the indices below, simply average the 12 indices to get a better overall picture of the market. The combined average of all 12 indices is 9.45% year to date.

Index	Last Week		One Month	Year-to-Date
	Close	% Change	% Change	% Change
Dow Jones Industrial Average Index	25,522.73	-1.34%	-1.83%	9.97%
S&P 500 Index	2,800.81	-0.75%	0.47%	12.26%
Nasdaq Composite Index	7,644.77	-0.58%	1.63%	15.48%
60/40 Portfolio (BAGPX)	12.43	0.16%	0.24%	8.18%
US Aggregate Bond Index	2,099.93	1.05%	1.38%	2.61%
20+ Year Treasury Bond (TLT)	124.86	2.55%	2.71%	2.76%
MSCI EAFE (EFA)	64.31	-1.40%	0.30%	9.41%
MSCI Emerging Markets (EEM)	42.43	-1.51%	-1.42%	8.63%
France CAC Index (EWQ)	29.19	-2.96%	0.48%	12.40%
Germany DAX Index (EWG)	26.74	-2.98%	-1.07%	5.48%
Italy Borsa Index (EWI)	27.57	0.11%	3.65%	13.88%
London FTSE (EWU)	32.96	-1.38%	1.54%	12.30%

Data Source: Investors FastTrack, Yahoo Finance, Investopedia

Term of the Week:

Real Rate of Return

A real rate of return is the annual percentage return realized on an investment, which is adjusted for changes in prices due to inflation or other external factors. This method expresses the nominal rate of return in real terms, which keeps the purchasing power of a given level of capital constant over time. Adjusting the nominal return to compensate for factors such as inflation allows you to determine how much of your nominal return is real return.

Dow Jones - Week Ending

WEEKLY MARKET SUMMARY

Global Equities: A head fake higher by equity markets, after an expected dovish Federal Reserve policy statement, was reversed after the Friday release of contractionary German manufacturing data. Weekly gains were wiped out, and then some, as the Dow Jones Industrial Average led to the downside, losing -1.34% on the week. The S&P 500 and the Nasdaq Composite indexes fared better, down -.75% and -.60% respectively. The Financial sector was hit particularly hard, moving lower with interest rates directly after the Fed announcement, with the SPDR Select Sector Financial ETF (XLF) down -4.84% on the week. International equities were hit harder than US indices, as Developed International stocks represented by the iShares MSCI EAFE Index Fund ETF (EFA) lost -1.40%, while Emerging Markets represented by the iShares MSCI Emerging Market Index ETF (EEM) fell -1.51% during the week.

Fixed Income: Yields collapsed after the Fed announcement and continued to do so as a flight-to-safety ensued on Friday, as the 10-year US Treasury Note yield dropped to 2.44% and the German 10-year yield fell to -.01%. The yield spread on the 10-year Treasury fell to .12% over the 2-year Note and fell into negative territory versus the 3-month Treasury Bill. High yield bond spreads widened back out to the level from the prior week, as the iShares IBoxx High Yield Corporate Bond ETF (HYG) squeaked out a .07% gain on the week. Lipper reported net inflows into high yield funds of $1.796 billion for the week ended 3/20.

Commodities: Oil prices seemed to be headed meaningfully higher on tighter supply conditions, but dropped late in the week thanks, again, to global economic worries stemming from the weak German data and the dovish pivot from the Fed. The West Texas Intermediate (WTI) benchmark, however, ended .60% higher on the week, to $58.87 per barrel, thanks to a surprising drawdown in US inventories, while the International Brent crude benchmark dipped by -.37%, to $66.91 per barrel. Natural gas prices pulled back by over 1%, to $2.75/MMBtu.

WEEKLY ECONOMIC SUMMARY

FOMC Announcement: As anticipated, the Federal Open Market Committee left its benchmark Federal Funds rate unchanged at 2.25-2.5% after its most recent meeting on Wednesday. This meeting included an update of the dot plot of the expected future path of its benchmark rate, which showed no more hikes in 2019 and one hike in 2020. The statement also laid out the plan for tapering the roll-off of balance sheet assets starting in May, while ending the roll-off all together in September of this year, thus ending this phase of quantitative tightening. The Fed balance sheet has been reduced by $450 billion from its high-water mark of over $4.2 trillion in October of 2017.

Existing Home Sales: The Existing Home Sales report released by the National Association of Realtors leaped 11.8%, to 5.51 million, for the month of February. Boosted by lower mortgage rates, single-family home buyers came back to the market after late-2018 slumps. Regionally, the west bounced by 16% after being largely depressed by wild fires, while the south also had a strong monthly increase of nearly 15%. The report added that the supply of homes had also risen by 2.5%, a number that is likely to rise thanks to the buyer enthusiasm displayed by the headline increase in sales.

Jobless Claims: Initial jobless claims, which are compiled as the number of individuals who filed for unemployment insurance for the first time, dropped to 221,000 for the most recent reading for the week ending March 16th. This was well below the 230,000 from the prior week, below the consensus estimate of 225,000, and may mean a March bounce back from the weak payroll increase from February. Continuing claims were down 27,000 to 1.75 million, displaying the continued tightness in the labor market and a contrast to other economic data that had been deteriorating.

Current Model Allocations

Tactical Fixed Income Model Allocations
3/22/2019

Exchange Traded Fund —11%	Exchange Traded Fund – 33.5%	Exchange Traded Fund – 3%	Exchange Traded Fund – 13%
Exchange Traded Fund —5%	Exchange Traded Fund – 8%	Exchange Traded Fund – 5%	Money Market—10.5%
Exchange Traded Fund —5%	Exchange Traded Fund – 2%	Cash –3%	

Data Source: Hanlon Investment Management

Other Managers

HIM #9—	100% fund
HIM #22—	67% Rydex Nova/ 33% Money Market
HIM #25—	100% Cash
HIM #8—	100% trust

Summary

In utilizing an approach that seeks to limit volatility, it is important to keep perspective of the activity in multiple asset classes. We seek to achieve superior risk-adjusted returns over a full market cycle to a traditional 60% equities / 40% bonds asset allocation. We do this by implementing global mandates of several tactical managers within different risk buckets. For those investors who are unwilling to stomach anything more than minimal downside risk, our goal is to provide a satisfying return over a full market cycle compared to the Barclays Aggregate Bond Index. At Horter Investment Management we realize how confusing the financial markets can be. It is important to keep our clients up to date on what it all means, especially with how it relates to our private wealth managers and their models. We are now in year nine of the most recent bull market, one of the longest bull markets in U.S. history. At this late stage of the market cycle, it is extremely common for hedged managers to underperform, as they are seeking to limit risk. While none of us know when a market correction will come, even though the movement and volatility sure are starting to act like a correction, our managers have been hired based on our belief that they can accomplish a satisfying return over a full market cycle, -- while limiting risk in comparison to a traditional asset allocation approach. At Horter we continue to monitor all of the markets and how our managers are actively managing their portfolios. We remind you there are opportunities to consider with all of our managers. Hopefully this recent market commentary is helpful and thanks for your continued trust and loyalty.

Data Source: Hanlon Investment Management

Chart of the Week:

Publicly-traded Real Estate Investment Trusts (REITs), represented below by the Vanguard Real Estate ETF (VNQ), have broken out above rising highs of 2017 and 2018 in this Chart of the Week. The interest-rate-sensitive sector has benefited from the Fed's decision to pause rate hikes due, in general, to its high dividend payouts. Currently included in Hanlon Tactical, and a staple in most Hanlon Strategic and All-Weather models, REITs serve to diversify from traditional investments and have returned around 15% year-to-date.

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