Fox-Smith Wealth Management Quarterly Commentary

1st Quarter - 2019

While it may be slower, expect another year of growth ahead.

(Hopefully, with a return to a logical connection between markets and economic conditions)

2019 Economic Outlook and Market Commentary – Gustin D. Fox-Smith AIF®, ChFC®

2018 – Year in Review

Before going into my outlook for 2019, I must address the extraordinary market conditions we have just been through in the last 90 days of 2018. We have heard the markets described as "Irrational", "Crazy", "Nonsensical" and many other things recently for good reason. Beginning in October, the market seemed to completely detach itself from the reality of economic conditions. We continue to experience data reports from nearly every sector of the US economy that are better than I have seen since the 80's and 90's, yet stocks are down, way down, in fact, to correction territory – how is that possible? And why is the market so extremely volatile all of a sudden?

First, we did return to volatility earlier in the year and after 2 years of next to zero volatility; 2018 just appeared to be wild with huge swings up and down with no explanation. However, it is important to note that since we entered the long, low volatility stretch before 2018, the market has climbed quite a bit. You see, one measure of volatility is to count the number of

Chart 1

Return to Historical Volatility

Risk Metric	2018	2017	2008	Avg. From 1990-2017
Avg. Daily Trading Range	1.1%	0.5%	2.8%	1.3%
1% or More Down Days	26	4	75	31
2% or More Down Days	12	0	41	9
Plus/Minus 1% Days	56	8	134	63
Max Drawdown	-10%	-3%	-49%	-14%

Source: Cetera Investment Management, Yahoo Finance, and JPMorgan. Data is based on S&P 500 Index as of 12/13/2018.

trading days with market changes of more than 1%. With the Dow Jones Index now sitting near 24,000 it takes a 240 point move to qualify, whereas it seems like just yesterday that a 100 -150 point day was a big deal. In percentage terms, the volatility we are seeing today is normal, in fact it is a bit below the average if you can believe that *(See chart 1)* Then, the volatility began to choose a direction, and it was decisively down.

Typically, as market behavior is displayed, we are able to discern in the data a number of things including the cause of the market action, estimates of its duration and magnitude, and often ways we can protect and/or find opportunities in it. Not so with this market. Coming on the heels of a long bull trend, this negative year saw many investors and large institutions executing tax loss harvesting strategies and capital gain avoidance trades. It is impossible to read market trading reports and find anything useful when large institutional managers are dumping billions in stocks and funds on various days for tax

Financial Trivia

Be sure to read your quarterly updates because each issue will include a financial trivia question and a chance to win a prize. The first 3 people who submit the correct answer by e-mail or phone to Erin; erin@fswealth.biz, will receive a prize. Prizes will vary from issue to issue but will be announced with each new question. Try your financial guru hat on to see if you can answer some of these questions before anyone else!

In this issue we are offering a $10 Starbucks gift card to each of the first 3 correct answers to the following question:

Who was the first U.S. billionaire?

savings, those trades blow out any patterns we might be able to see. This tax work is valuable, which is why we did the same for our clients. It is often the only silver lining we can deliver in a down market. But when we trade our $5-$10 million at a time it doesn't whipsaw the market the way it does when a large pension fund dumps $5-$6 billion on the market in a single day.

This action caused moves that contradicted positive economic data that would normally inspire a large up day. In fact, in December we saw a day where we received a retail sales report before the open that showed we not only beat, but doubled the expected number, yet stocks dropped hundreds of points anyway. These big tax moves explain a lot. The groups that were selling that day were selling no matter what because it was the day they chose. The great sales data didn't matter, their sale orders were going in regardless. But, once the tax selling subsided, we continued to see weakness in the markets and broad days of decline in response to nothing but good news. It was as if there was an unseen character directing the market lower without our knowledge. In the face of great data, exuberant holiday shopping, and full employment, the market kept dropping. Why?

It is said by several of the economists and analysts that I respect the most that it is an act of suicide for the FED to hike interest rates and perform quantitative tightening at the same time. This is exactly what they were doing, regardless of market conditions, and it is what was causing the market to go down for no apparent reason. You see, nearly a decade ago when the Government and the FED were trying to avoid a financial collapse the FED continually created funny money to engage in quantitative easing, which is the act of buying treasuries at the auctions in order to keep interest rates low and increase the money supply thereby stimulating the economy and the stock market. By the time they were done in early 2011, they had acquired over 4 trillion dollars in treasuries on their balance sheet, which was never a part of the expected mission of the FED. We knew that eventually they would need to unravel this, which would have the exact opposite effect that the quantitative easing had. (see chart 2)

Source: *The Gartman Letter*

I think It is good news that they are decreasing their balance sheet while all the other nations in the world that printed so much money have simply stopped, but are keeping their balance sheets loaded with created capital. Being the only central bank doing this gives us more ammunition and a more stable economy if we can get this off the books without it creating too large a drain on the market. This is how you can have the best economic data in 20 to 30 years, while simultaneously having a market correction. Mystery solved, the unseen character killing the markets was the FED.

2019 Market Outlook

At the start of this year the FED commented that they were going to pause on the interest rate hikes

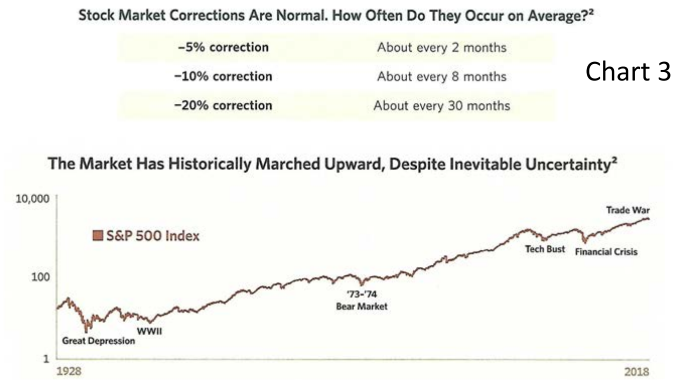
Ask an Advisor

In this section of each quarterly market update we will highlight a question or two that our clients send in and provide answers from our advisors. Please, if there's anything that comes to mind that you'd like to know more about, especially if it's a question you think others would be curious about as well, send your question to erin@fswealth.biz. Maybe we will highlight your question in a following issue. Rest assured, even if your question doesn't make it into print, it will be answered as I will be sure to address it in our monthly webcast.

for the time being and were also going to take a holiday from quantitative tightening in order to assess its effects on the market and find a way to continue this necessary action but in a more judicious fashion. The moment they stopped flooding the market with excess Treasury capital and reeling in the money supply, the market immediately responded with 9 straight days of huge gains. If they stay out of the market for a few more months we could have a really great start to the year. My hope is that as they begin to execute tightening activities again, that they will choose day-by-day when and how much to do based on conditions. On a positive market day with good economic data they can sell a solid supply and on the days with bad news and a down market, they may choose not to sell any. In doing it this way, more rationally and intelligently, it may allow the market to continue to perform even in the face of this pressure.

As I look ahead to this year to try to determine where things might head, we now have numerous sectors of the market that are well below average prices, giving us an opportunity and a greater likelihood of ending the year in positive territory. Stocks are no longer overpriced. In fact, after 3 quarters of near record earnings performance with no positive response from the market, we are undervalued by a fair margin and could have a nice run up of several thousand points on the Dow without getting to fair value. I remain very positive about the economic conditions for the next 5 to 10 years as well as the markets due to the broad cycle we've all discussed, but as I've said, that doesn't mean it comes without market corrections and without recessions. The economic cycle still occurs, but the difference between this part of the cycle and the one we just exited is the amount of capital in the system. There is so much free capital in the private sector yet to come in that will allow for a lot of growth and a lot of rapid change. Corrections in this part of the market cycle can be the same magnitude as we saw during the slow phase of the market. The difference is that the velocity of money is tremendously high with this much cash, making things happen much faster. For instance, a roughly 50% decline in 2008 - 2009 required almost 5 years for the market to recover. (see chart3)

Chart 3



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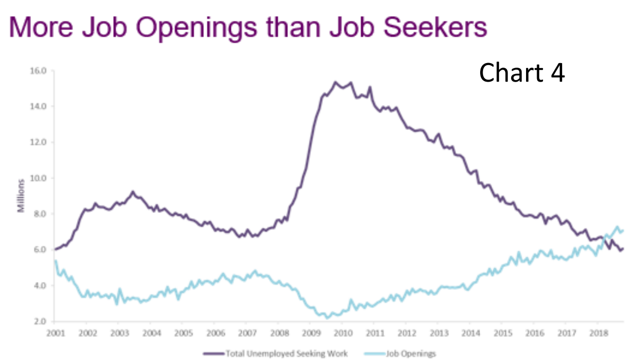
But a very similar correction in 1987 required only 5 months. That's the velocity of money in action. Things can just move a lot more quickly. That means when we're getting these swings down, we shouldn't assume we've lost 5 years. Just be patient and if economic conditions aren't melting down to justify the decline in stocks, it should recover quickly.

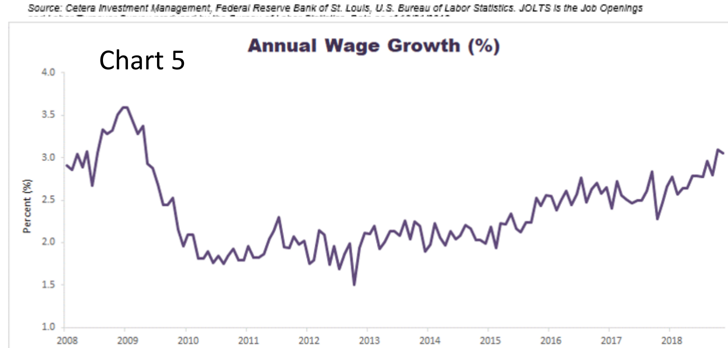
I remain tremendously bullish about the economy. We continue to see growing labor shortages spurring wage growth at a healthy clip, (see charts 4 and 5) solid job growth, and the average consumer still has very low debt and quite a bit of money on the sidelines at the bank; they are able to spend and borrow if they choose.

Chart 4



Source: Cetera Investment Management, Federal Reserve Bank of St. Louis, U.S. Bureau of Labor Statistics. JOLTS is the Job Openings

Chart 5



Source: Cetera Investment Management, Federal Reserve Bank of St. Louis, U.S. Bureau of Labor Statistics. Data as of 11/30/2018.

Our corporations made a decision a number of years ago, due to low interest rates, to borrow rather than spend their cash because it was cheaper to do so. They continue to sit on record levels of cash. The S&P 500 companies currently average 30% of their book value in cash, which is a record. These are all fuel for the engine of growth and will continue to drive growth for many years to come.

A strong job market, solid consumer spending, and low inflation are all positives that will help provide a framework for continued growth. The market's primary potential challenge can be summed up in one word, FED. Should they raise rates too far, or even worse, unravel their balance sheet too quickly, they could choke off any growth potential. That remains to be seen

Monthly Webcasts

You have probably already received your announcement of this new offering in the mail, but I want to remind everyone through this issue about our webcasts that are beginning this month. We intend to host a webcast every month through October and then break for the November and December holiday months, starting up again in the new year. The next 3 webcasts will be held on the following dates and times:

Dates of Upcoming Webinars:

(2:00pm MT/1:00pm PT/3:00pm CT/ 4:00pm ET)

- Tuesday, Jan 29th at 2:00pm MT
- Tuesday, Feb 19th at 2:00pm MT
- Tuesday, March 26th at 2:00pm MT
- Tuesday, April 30th at 2:00pm MT

To participate, just send an email to Erin erin@fswealth.biz) and a link will be sent to you so you can join the discussion. Please do not be shy during the webcasts. Our goal is to host more of discussion than a presentation so we need your feedback and questions.

The Dow Jones Industrial Average is a widely followed market indicator based on a price-weighted average of 30 blue-chip stocks that trade on the New York Stock Exchange which are selected by editor of The Wall Street Journal.

The S&P 500 Index is a capitalization-weighted index made up of 5000 widely held large-cap U.S. stocks in the Industrials, Transportation, Utilities and Financial sectors.

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