HORTER INVESTMENT MANAGEMENT, LLC

Weekly Commentary http://horterinvestment.com/ October 29, 2018

A Stock Market Correction is Unlikely to Stop the Fed From Hiking Rates

Markets are in a frenzy, the rest of the global economy is slowing down and there are little signs of inflationary pressures building in the system. Everybody knows this is a terrible time for the Federal Reserve to be raising interest rates, right?

Not so fast.

While the number of fists banging on the table to get the Fed to re-examine its current policy arc seems to be growing by the day, central bank officials don't appear to be listening.

That's because it's not the Fed's job to react every time stocks correct or yields rise or economic forecasts nudge lower. Instead, policymakers are best off to stay resolute in the face of transitory shifts in financial conditions.

Even if deep down they're just as nervous as everyone else.

"The Fed has to do the opposite of the old adage, 'walk softly and carry a big stick.' They have to walk loudly and carry a small stick," said Gary Pollack, head of the private clients fixed income desk at Deutsche Bank Wealth Management. "They have to portray an image before the financial markets as the adult in the room."

That's been a little harder to do lately.

Click here to read more.

Fed's Kaplan: 'We no longer need to be stimulating the US economy'

Dallas Federal Reserve President Robert Kaplan on Wednesday became the latest central banker to say it's time to let the economy run on its own.

At a time when the Fed is undergoing criticism from President Donald Trump and some notable market voices, Kaplan said policymakers are on the right track with their gradual approach to raising interest rates.

The unemployment rate is running at 3.7 percent and inflation is just above the Fed's 2 percent target. Believing that the Fed has met its dual mandate, the Federal Open Market Committee has hiked its benchmark rate three times this year and is on track for a fourth increase in December.

Kaplan said that remains the right strategy.

"As we reach our dual-mandate objectives, I believe that the Federal Reserve should be gradually easing off the accelerator — we no longer need to be stimulating the U.S. economy," he said in an essay. "As such, I believe we should be gradually and patiently moving toward a neutral policy stance."

The comments come a day after Atlanta Fed President Raphael Bostic said the Fed doesn't need " to keep our foot on the gas pedal."

Click here to read more.

QUOTE OF THE WEEK

"Quality is everyone's responsibility."

- W. Edwards Deming

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 October 26, 2018. 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 6 indices is -8.20% year to date.

Index	Last Week		One Month	Year-to-Date
	Close	% Change	% Change	% Change
S&P 500 Index	2658.69	-3.93%	-8.40%	0.98%
Dow Jones Industrial Average Index	24688.31	-2.97%	-6.34%	1.56%
Nasdaq Composite Index	7167.21	-3.78%	-10.26%	4.67%
60/40 Portfolio (BAGPX)	12.63	-2.38%	-6.31%	-3.51%
US Aggregate Bond Index	1995.99	-0.37%	-0.53%	-2.46%
20+ Year Treasury Bond (TLT)	114.99	0.68%	-2.14%	-8.98%
MSCI EAFE (EFA)	61.43	-3.76%	-10.57%	-12.63%
MSCI Emerging Markets (EEM)	38.67	-2.59%	-10.07%	-17.93%
France CAC Index (EWQ)	28.05	-3.28%	-11.93%	-10.15%
Germany DAX Index (EWG)	26.78	-3.96%	-11.79%	-18.90%
Italy Borsa Index (EWI)	24.93	-2.33%	-14.80%	-18.10%
London FTSE (EWU)	31.2	-3.27%	-9.36%	-12.90%

Data Source: Investors FastTrack, Yahoo Finance, Investopedia

Term of the Week:

Business Cycle

The business cycle describes the rise and fall in production output of goods and services in an economy. Business cycles are generally measured using rise and fall in real – inflation-adjusted – gross domestic product (GDP), which includes output from the household and nonprofit sector and the government sector, as well as business output. "Output cycle" is therefore a better description of what is measured. The business or output cycle should not be confused with market cycles, measured using broad stock market indices; or the debt cycle, referring to the rise and fall in household and government debt.

Dow Jones - Week Ending

WEEKLY MARKET SUMMARY

Global Equities: Mostly positive 3rd quarter earnings releases and a solid US GDP print were not enough to quell equity market volatility stemming from worries over global growth. Fear from European and Chinese markets finally spread to the US, with the Nasdaq Composite Index leading the major US indices lower, down -4.15% on the week. The Dow Jones Industrial Average lost nearly 3%, while the S&P 500 finished down almost 4%. The Real Estate sector was spared for the better part of the week, but it too, was included in the Friday sell-off which caused the Select Sector Real Estate SPDR ETF (XLRE) to finish down slightly over -1%. Energy lagged all sectors, with its Select Sector SPDR ETF (XLE) closing down a whopping 7% for the week. Emerging Market (EM) equities fared better than the US and their Developed Market brethren, with the iShares MSCI Emerging Markets Index Fund ETF (EEM) down -2.5%.

Fixed Income: A global flight to safety saw US Treasuries and German Bunds furiously bought, with the 10-Year US Treasury Bond yield closing below technical support levels at 3.08% and its German counterpart yield falling from .47% to .36%. The global risk-off event caused high yield bond spreads over equivalent Treasury securities to widen near 2018 highs, while the iShares IBoxx High Yield Corporate Bond ETF was down -.80% for the week. Lipper reported large outflows of $2.364 billion out of high yield bond funds, and inflows of $415 million into investment grade corporate bond funds, for the week ending October 24th.

Commodities: Increased supply from OPEC, namely Saudi Arabia because of international scrutiny surrounding the murder of journalist Jamal Khashoggi, have combined with demand concerns of a potential global growth slowdown to create a perfect storm for crude oil prices. Oil looks to be more highly correlated with the stock market due to demand concerns, but should remain volatile based on political news. The American West Texas Intermediate (WTI) benchmark fell another -2.4% on the week, to $67.66 per barrel, while the International Brent crude benchmark fell over 2.8% to $77.74 per barrel. Natural gas prices finished the week slightly lower, to $3.20/MMBtu.

WEEKLY ECONOMIC SUMMARY

Gross Domestic Product (GDP): The initial estimate for 3rd quarter (Q3) US GDP has likely confirmed expectations that the pace of growth has slowed since the 4%+ growth of the 2nd quarter. However, at an annualized quarter-on-quarter (QoQ) growth rate of 3.5%, growth in the US economy is still robust and seemingly at a sweet-spot between a harmful slump and an overheating. Consumer spending was the clear standout at an encouraging 4% growth rate and helped offset a deficit in net exports that subtracted -1.8% from Q3 GDP growth rate. Residential investment continues to be a problem sector, contracting 4% for the quarter, while inflation was more subdued than expected at 1.7%

Durable Goods Orders: September orders for durable goods, items that are meant to last for three years or more such as appliances and aircraft, were reported higher than expected thanks to a large increase in orders for defense aircraft. The .8% month-on-month (MoM) increase versus the -1.5% expected masked the weakness in business investment that appears to be leveling off from the strong first half of 2018. This is more evident in the Core capital goods reading that excludes aircraft, which was down -.1% MoM. September's positive contributors included rising inventories and unfilled orders.

3rd Quarter Earnings: Amazon.com Inc (AMZN) reported earnings after the market closed on Thursday. The online retail giant reported record earnings, but reported revenue of $56.6B, that missed even the low end of analyst estimates of $66.5B for the quarter. AMZN's newer yet considerably smaller segments that include Amazon Web Services and its advertising business continue to grow at a rapid pace but were unable to prevent market participants already nervous about a macro slow-down from punishing AMZN stock by over -8%. The revenue miss combined with the company lowering guidance for the 4th quarter holiday season may have helped lead to the resumption of the broader market sell-off on Friday.

Current Model Allocations

Tactical Fixed Income Model Allocations
10/26/2018

Cash—60%	Energy Limited Partnership—5%	Exchange Traded Fund —5%
Treasury Bond—10%	Convertible Bonds —10%	Exchange Traded Fund —10%

Other Managers

HIM #12—	100% CASH
HIM #9—	100% fund
HIM #1—	85% fund 5% high yield fund 5% high yield 5% high yield fund
HIM #21—	100% real estate mutual fund
HIM #19—	50% real estate mutual fund /50% CASH
HIM #23—	33.33% fund/ 33.33% fund/ 33.34% fund
HIM #22—	100% fund
HIM #25—	100% fund
HIM #3—	14.3% fund/14.3% fund/14.3% fund/14.3% high yield/14.3% dividend/14.2% utilities/14.3% CASH
HIM #8—	100% trust
HIM #20—	2% Cash 10% short term high yield 10% high yield 14% high yield corporate bond 15% ultra short bond 15% floating rate bond 17% high yield bond 17% high yield corporate bond
HIM #10—	99.84% equities (48)/.16% CASH

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.

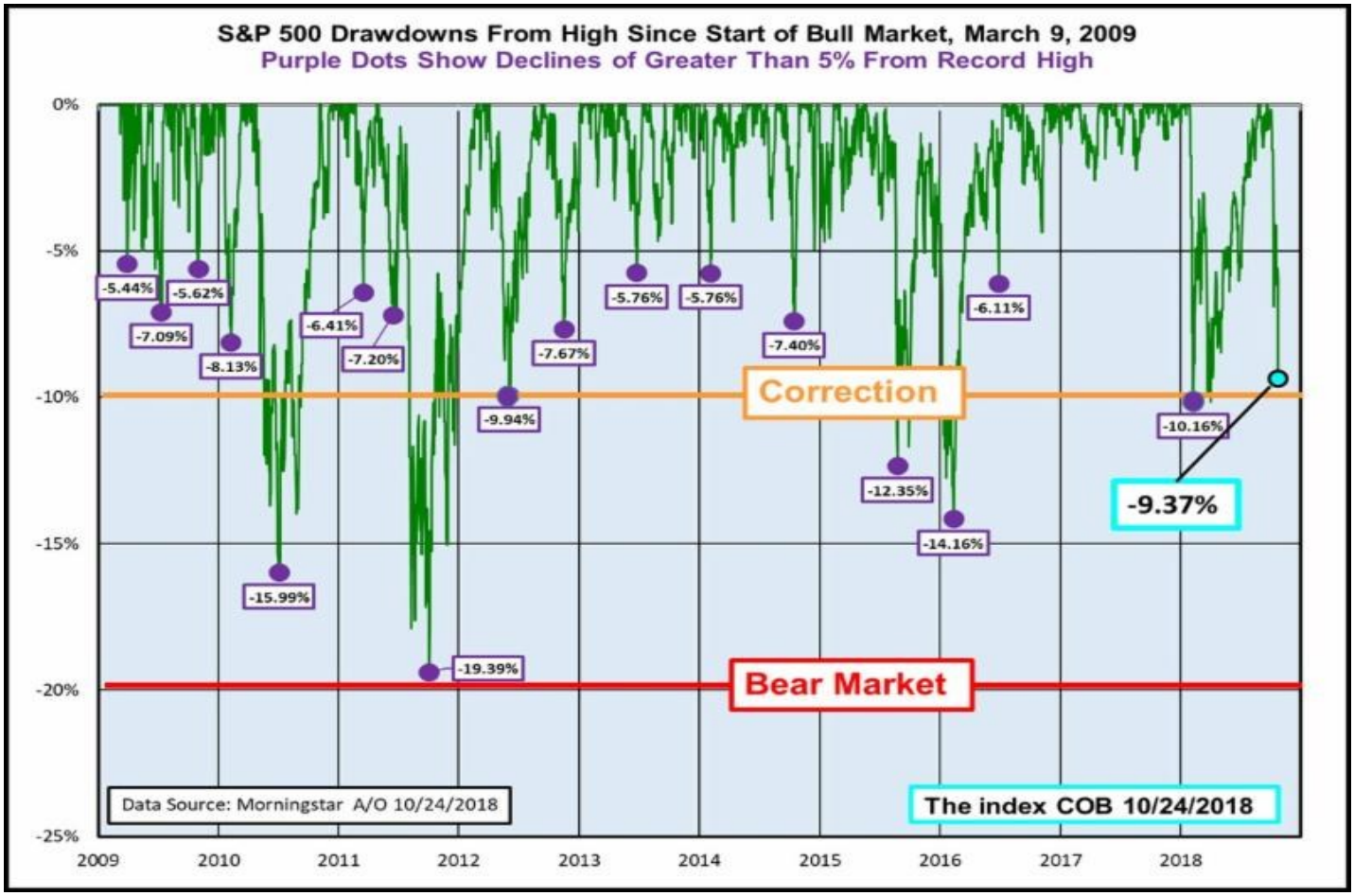

Chart of the Week:

The Chart of the Week shows the drawdowns of the S&P 500 index since the start of the bull market back on March 9, 2009. Despite increased volatility, and the recent sharp sell-off in the S&P 500, it is down 9.37% from its recent all-time closing high on September 20th, not out of line with other "normal" market corrections since the start of the Bull Market. While the current sell-off has happened over a short span, it has not yet reached correction proportions (10% down) and the economy and fundamentals remain sound.

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