HORTER INVESTMENT MANAGEMENT, LLC

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US-China trade war could cause a bear market, stress test shows

President Donald Trump's continued push to level the global playing field when it comes to trade has done little to disturb the relentless bull market in stocks.

But nothing lasts forever, and at some points investors will have to react if the tensions continue to escalate. By all indications, an acid test could come as early as week, with the administration poised to impose a range of new tariffs on $200 billion worth of Chinese goods.

Running a series of different scenarios in the U.S.-China conflict, experts at FactSet have come up with a worst-case trade war scenario, one in which most major economies would take a hit and the U.S., along with a few others, would see a bear market emerge.

"In the case of the escalating trade tensions between the U.S. and China, while financial markets still appear to be discounting the global impact of a trade war, our analysis shows that if/when the market does react, the effects will be widespread," Ian Hissey, vice president in FactSet's portfolio analytics group, said in a report last week.

Hissey modeled three scenarios: a base case where the dispute continues along its current path and tensions and tariffs gradually escalate; an optimistic result where the U.S. and China reach broad agreements on the future but the newly imposed tariffs remain, and a "conservative" case that involves "rapidly deteriorating" relations and a more profound impact.

Trade war stress test for stocks

Click to edit	Optimistic	Base case	Conservative
All countries	-8.34	-12.11	-16.97
5 Best			
Japan	4.44	6.61	7.46
Switzerland	-2.46	-2.27	-5.23
Denmark	-3.21	-2.73	-6.27
Portugal	-3.49	-3	-6.12
Netherlands	-3.68	-3.29	-7.04
5 Worst			
Hong Kong	-9.28	-15.7	-21.93
UK	-9.57	-12.84	-19.45
U.S.	-10.83	-16.45	-21.88
Canada	-10.97	-15.25	-21.94
Israel	-13.44	-19.05	-27.01

Source: FactSet

In determining impact, Hissey used the market's Brexit reaction, following the 2016 vote that allowed the UK to leave the European Union, as a template.

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JP Morgan Says Severe Crisis to Arrive in 2020

JP Morgan just published what could be the most well-documented financial crisis forecast ever written. The bank's quant team put out a 143-age report chronicling how the next crisis will unfold which features the opinions of almost 50 of Wall Street's top analysts and strategists. The consensus is that there will be a major "liquidity crisis" with huge selloffs in major asset classes, and no one to step in to buy. The losses will be exacerbated by the shift to passive management and the rise of algorithmic trading. JP Morgan says that the Fed and other central banks may even need to directly buy stocks, and there could even be negative income taxes. The bank thinks the crisis will hit sometime after the first half of 2019, most likely in 2020.

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The Next Crisis is Looming

As the ten-year anniversary of the last crisis has arrived this month, it is a fitting time to be thinking about what might cause the next one. In fact, many investors, professional and retail alike, are fairly obsessed with calling the next big blow up. But what might cause it? While trade war and political strife grab a lot of headlines, the real driver of the next crisis will be the Fed. The two big worries on that front are rising rates, but perhaps even more worryingly, its shrinking balance sheet. Crises have historically happened when money supply grew tighter, and that is what is occurring right now.

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QUOTE OF THE WEEK

"Rather fail with honor than succeed by fraud."

-Sophocles

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 September 14, 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 6 indices to get a better overall picture of the market. The combined average of all 6 indices is 5.22% year to date.

Index	Last Week		One Month	Year-to-Date
	Close	% Change	% Change	% Change
S&P 500 Index	2904.98	1.21%	2.51%	10.18%
Dow Jones Industrial Average Index	26135.38	0.94%	3.68%	7.59%
Nasdaq Composite Index	7941.26	1.39%	1.90%	16.92%
60/40 Portfolio (BAGPX)	13.47	0.82%	1.13%	2.90%
US Aggregate Bond Index	2015.54	-0.11%	-0.23%	-1.51%
20+ Year Treasury Bond (TLT)	118.74	-0.33%	-0.94%	-4.75%

Data Source: Investors FastTrack, Yahoo Finance, Investopedia

Term of the Week:

Beta

Beta is a measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole. Beta is used in the capital asset pricing model (CAPM), which calculates the expected return of an asset based on its beta and expected market returns. Beta is also known as the beta coefficient.

Dow Jones - Week Ending

WEEKLY MARKET SUMMARY

Global Equities: Reports of soaring optimism from small businesses and consumers combined with renewed confidence for a resolution in the Sino-US trade confrontation helped equities rebound nicely from the prior week's slump, with the Nasdaq Composite leading the major US equity indices with a nearly 1.4% increase. The S&P 500 and the Dow Jones Industrial Average also notched solid gains of 1.1% and .85%, respectively. The Energy sector and its SPDR Select ETF (XLE) edged out the Technology sector for the strongest weekly sector performance, with a 2% increase. The Financial sector, which had been showing some momentum, trailed all other major sectors, losing .35%. Ebbing trade worries helped International equities bounce back from 52-week lows, as the iShares MSCI Emerging Markets Index ETF (EEM) gained nearly 1.1%, and International Developed markets represented by the iShares MSCI EAFE Index Fund ETF (EFA) gained over 2% for the week.

Fixed Income: The yield on the 10 Year US Treasury continued marching higher until hitting resistance at the psychological 3% level, ending the week not far off at 2.99%. Yields on shorter-dated maturity Treasuries followed higher as well, with the notorious 10 Year versus 2 Year Treasury yield spread holding fairly steady at .21%. High yield spreads narrowed during the week, as the iShares iBoxx High Yield Corporate Bond ETF (HYG) gained .75% for the week. Lipper reported net inflows of $3.217 billion for corporate investment grade bond funds and outflows of $862 million for high yield bond funds for the week ended September 12th.

Commodities: Oil prices remain volatile with no shortage of catalysts affecting prices, including sanctions on Iran, Venezuelan chaos, infrastructure bottlenecks, and general emerging market fragility. Both major oil benchmarks ended the week higher, however, as the American West Texas Intermediate (WTI) gained nearly 1.8%, to $68.95 per barrel, while the International Brent crude benchmark gained over 1.6%, closing out near $78.10 per barrel. Natural gas prices were little changed after a volatile week, closing the week at $2.77/MMBtu.

WEEKLY ECONOMIC SUMMARY

Consumer Sentiment: The preliminary University of Michigan Consumer Confidence survey for this month, at 100.8, came in well above consensus expectations, and registers at its highest level since March. An increase in respondents' assessment of current conditions and expectations for future conditions should contribute directly to increased measures for consumption during the month of September. Also notable was the number of respondents mentioning concerns over tariffs, which increased period over period.

Consumer Price Index (CPI): The Bureau of Labor Statistics' inflation measure increased a less than expected .2% for the month of August thanks in-part to falling medical and apparel costs. The year-on-year (YoY) increase was also slightly lower than consensus expectations of 2.8%, at a 2.7% increase. Prices for shelter, airfare, and used cars were all factors for increasing prices for all of the CPI measures, including Core, which removes changes for food and energy. Though increasing, the rate of inflation is not sending any warning signs of an overheating economy and should allow the Federal Reserve some flexibility when it comes to the pace of raising interest rates.

US Job Market: Tuesday's release of the Labor Department's Jobs Openings and Labor Turnover Survey (JOLTS) report for July indicated a large jump in the amount of job openings versus the amount of new hiring, with openings up nearly 12% YoY, to 6.939 million, while hiring is only up 3.3%. The JOLTS report set the stage for the Thursday release of the weekly initial jobless claims, that came in well below the consensus estimate of 210,000, at 204,000, signaling continued strength in the labor market and an extremely favorable environment for job seekers. This is likely to persist as more of the large Baby Boomer generation retire from the workforce.

Current Model Allocations

Tactical Fixed Income Model Allocations

9/14/2018

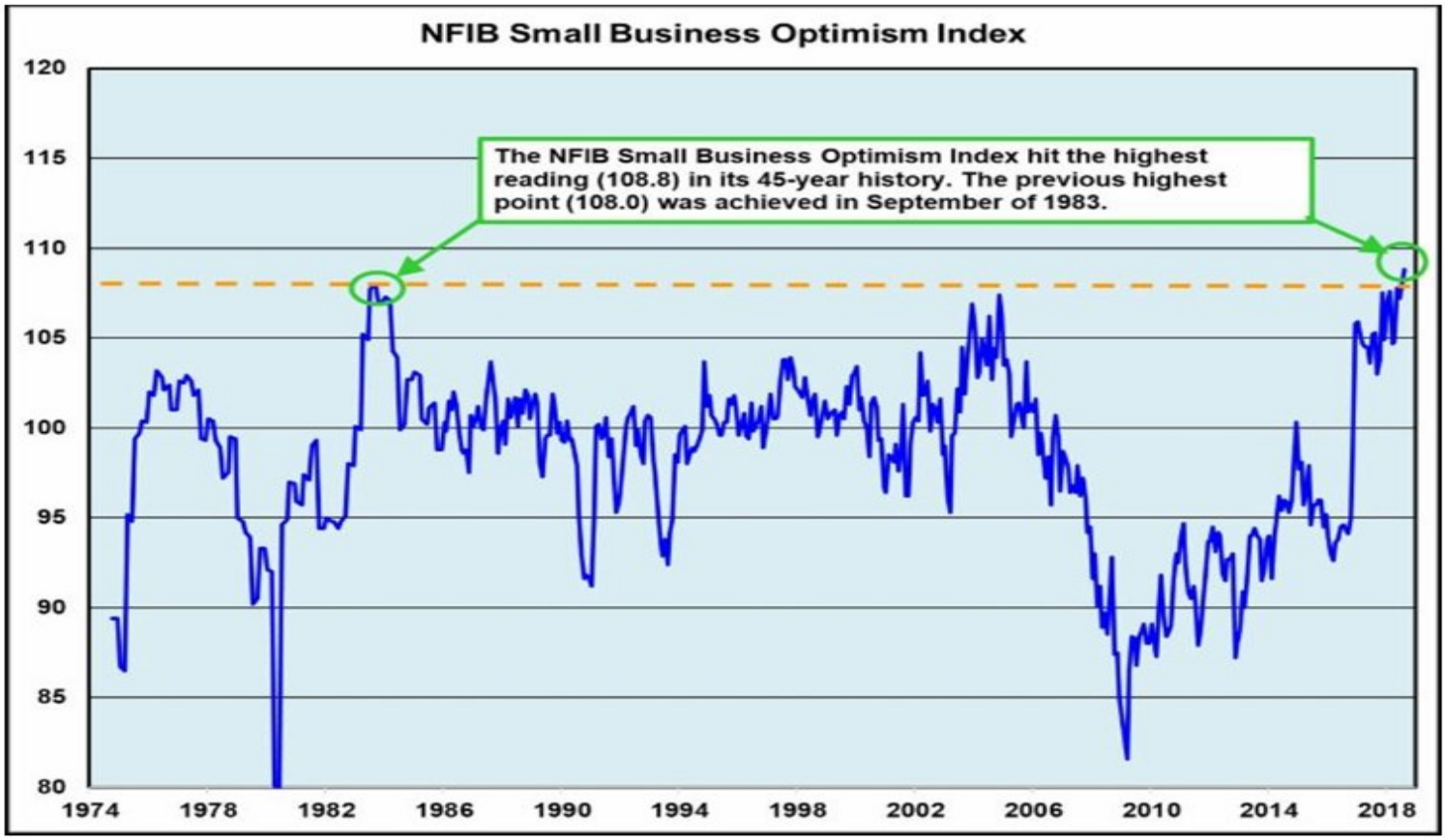
Cash—52%	EMB—15%	TIP—4%
PFF—4.00%	CWB—20%	AMJ—5%

Other Managers

Alpha Mid-Cap—	100% IEI
Anchor Alternative Equity—	100% ATESX
Anchor Hedged Fixed Income—	85% ATCSX/5% ABHIX/5% FHYTX/5% LAHYX
Anchor Dynamic Real Estate—	100% ARESX
Anchor Tactical MBS—	50% ARESX/50% CASH
Kensington Analytics—	41% PSHAX/30% SIGVX/20% MINT
EVO-1—	100% RYNVX
Preston Government Bond—	100% RRPIX
Preston Income—	14.3% CHI/14.3% PACIX/14.3% FISCX/14.3% PEY/14.3% DVY/14.2% RYU/14.3% CASH
Preston OTC—	100% QQQ
WST Capital Management—	17% HYG/17% JNK/ 15% FLOT/15% MINT/14% HYS/10% SHYG/10% SJNK/2% CASH
WEDCO Power Dividend Index—	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.



Data from Bloomberg. Chart, commentary, and opinions are those of Hanlon Investment Management.

Chart of the Week:

The Chart of the Week below shows the NFIB Small Business Optimism Index updated with August data released on Tuesday. The Small Business Optimism Index rose 0.9 points in August to 108.8, a new all-time record in the survey's 45-year history. Leading the index higher beyond not only consensus forecasts but also the range of analysts' expectations was a 6-point gain to a net 10 percent in plans to increase inventories, a 3-point increase to a net 33 percent in plans to make capital outlays, and once again, plans to increase employment, which also rose 3 points to a net 26 percent, a record high. This record optimism should help to keep the economy humming and bodes well for the markets.

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