December 20, 2018

Re: Current Market Conditions and Next SFP Conference Call

Dear client,

I thought it might be a good idea to let you know my thoughts on the current stock market declines and the impact of the U.S. Federal Reserve's raising of interest rates. We will talk about this and other important items in our January conference call.

The U.S. Federal Reserve delivered another rate hike December 19, 2018, and judging by the market's reaction, the stock market was displeased. Early in the morning, before the Fed decision, the market was considerably up. However, by the market close, the market was significantly down and the decline continued into Thursday's session.

In my view and the views of my colleagues at BCA and Alpine Macro, this was a mistake. In the past, I had thought that the equilibrium rate or R* was when the 10-year Treasury reached 3.5%. It has never gotten there. In February of this year, the first market revolt, the 10-year Treasury climbed to 3.20%. This is what I now believe to be the equilibrium rate in which interest rates allow the economy to remain stable, not growing too fast or slowing down. In addition, there is a wealth of evidence pointing to a slowdown in the U.S. economy. For one, housing starts and residential real estate sales have slowed. Secondly, auto sales are also showing signs of stress.

Stocks took a hit on the news of the interest rate ticking up while bonds have rallied. This is another reason why we always have bonds in our managed portfolios. The Federal Reserve had a chance to reverse falling stock prices yesterday by not raising interest rates. However, the Fed is willing to play a game of chicken with financial markets. This could be a bad situation in which falling stock prices affect consumer confidence, triggering a recession.

Even though the Fed raised interest rates, the Chairman also talked about monitoring the situation and is willing to move interest rates up or down. I am of the opinion that further interest rates will either slow down or be curtailed. If that is the case, the stock market may stabilize. Yet, the path leading to the Fed's decision comes with increased volatility and risk.

The Fed rate hike is a negative for global equities. Markets grow with liquidity and die without it. The S&P 500 index has fallen approximately 17% from the top to the bottom since its October high, the bulk of the selloff may already been done and a selling climax could be near. The downdraft in prices has clearly cheapened stocks creating conditions for a possible rally in prices.

With all of this being said, we still are of the opinion that this is a plain vanilla correction and that the financial system, economy (although slowing) is in good shape. Unless consumer confidence really dips, there will be no recession until late 2019 or in 2020. At this point, we are still sticking to our plan and keeping the allocations where they currently are. We may sell a few stocks here and there and we may nibble on a few, but the end result will be the same allocation.

If things change where I assess that the environment is worse than a plain correction, I would certainly lower the exposure to stocks, but at this moment, I don't think we are there yet. It may be the case at some point where some courageous and brave investors would want to increase their stock exposure as bargains appear.

We are having a conference call on **<u>Tuesday, January 8, 2019 at 6:30 p.m</u>**. and invite you to tune in. To join the conference call, **<u>please dial the toll-free number: 1-800-914-8405.</u>** **<u>Once prompted, enter the access code: 5486434, followed by the # button</u>**.

On behalf of my entire crew, I wish you and your family a happy holiday and thank you for your continued confidence in us.

PS: I would like to remind you that you will drive yourself crazy if you look at your account each hour and every day. One secret to my success in investing is that I don't constantly look at my stocks. I pick them for a reason and I keep them unless I think that the operating conditions of the company have drastically changed. This is one of the keys to be a successful long term investor like we are.

Sincerely,

Steven L. Yamshon
Investment Counsel