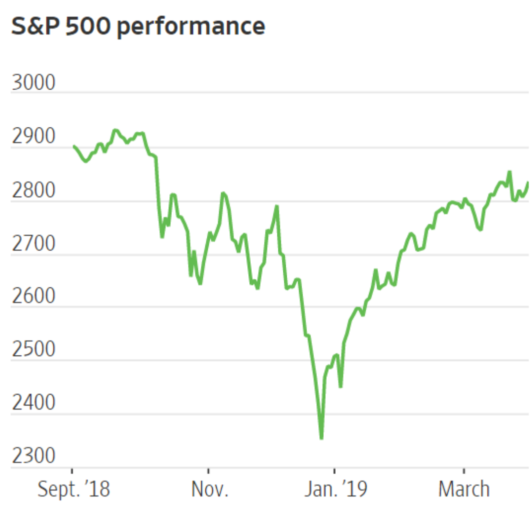
2019 First Quarter Review & Outlook

Market Review

Equities

Stock investors have been on a wild ride over the past six months. The S&P 500 Index has gone from a record high in September of last year, to the cusp of a bear market at year-end, to being back within striking distance of its recent peak watermark. No wonder equity investors have experienced nausea and vertigo with stocks' violent swings, leaving them pondering if the months ahead will be a sequel to the last two quarters.

With 2018's losses in the rearview mirror, 2019 began with strength as the S&P 500 Index posted its best quarter since September 2009, jumping 13.6%. The Dow Jones Industrial Average of 30 large stocks climbed 11.2%. Equity traders had tailwinds in the first quarter as the Federal Reserve did an about face by announcing a halt to rate hikes in the near future, instead of the two previously expected for 2019. Concerns over a trade war with China also eased. Finally, the U.S. economy looks to be on track for continued (albeit slower) growth.

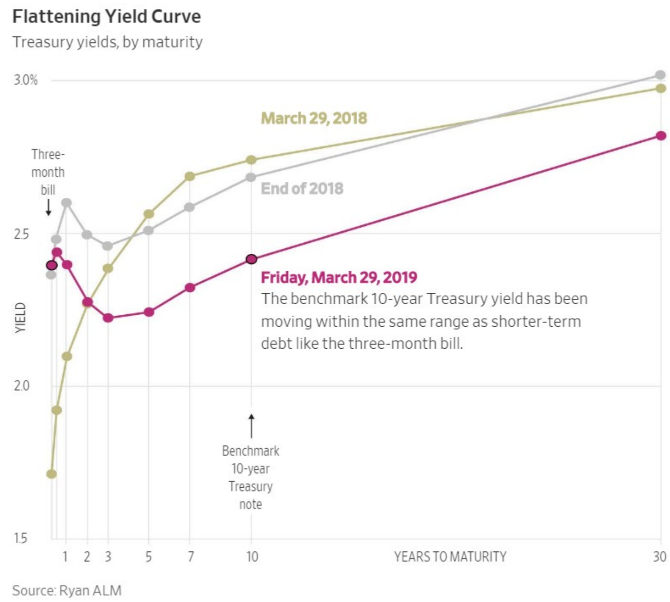


Source: SIX

Fixed Income

The combination of an accommodative Federal Reserve and tame inflation data helped U.S. government bond prices rise during the first quarter. (Climbing inflation is considered a threat to bond investors because it chips away at the value of their fixed dividend payments.) The yield on the benchmark 10-year Treasury—used as a reference for everything from commercial lending, home mortgages to student debt—settled at 2.42% by quarter end (a 15 month low); well below 2.68% where it ended 2018 and the high of over 3% last year. (Yields fall as bond prices rise.)

As yields fell in the past three months, bond traders became more optimistic that the Fed will have to keep rates at low levels as the economy showed signs of weakening and inflation in check. While bond investors have been pleased with recent gains, concerns of late that some Treasury yields fell below those of short-term debt spooked stock investors, if only temporarily.
(A development known as an "inverted yield curve" that often presages a recession.)

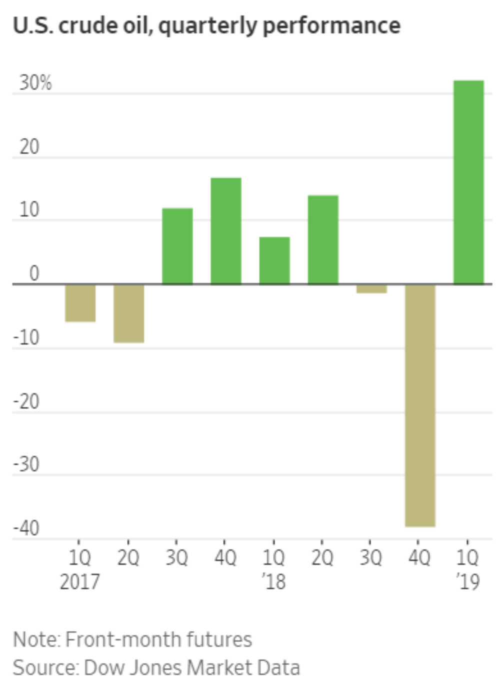


Global Market Performance

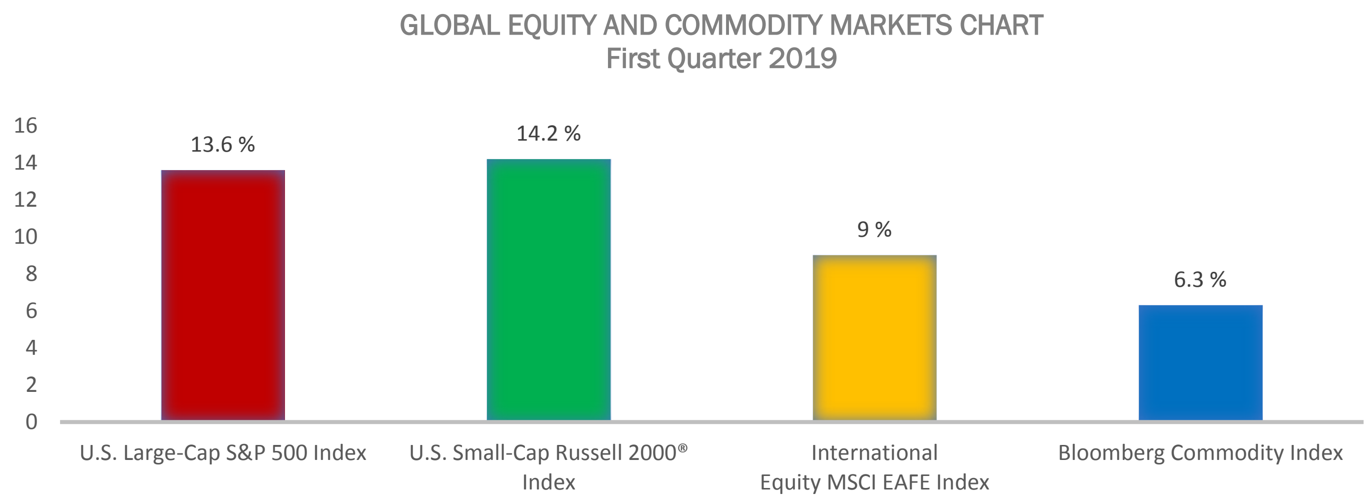
Stock investors headed into the New Year with a sense of wariness after contending with sharp reversals across all major global markets in the fourth quarter of 2018. As mentioned though, the S&P 500 Index surprised those investors with a strong 13.6% gain for the past quarter. Small company stocks climbed even higher by 14.2% over the last three months (as measured by the Russell 2000 Index) as these higher-risk equities were in favor during the stock market rally. The best performing major U.S. stock index was the tech-heavy Nasdaq Composite, which jumped 16.5% for the quarter. For the first three months of the year technology, real estate and industrials were the top performing sectors. Health care, financials and materials were lagging sectors; though all recorded solid gains.

Major foreign stock markets performed well for the quarter, but underperformed U.S. markets. Developed international stocks rose 9.0% in the past three months, as measured by the MSCI EAFE Index in U.S. dollars. Continuing concerns about slowing economic growth in Europe and Japan, and growing political disunity within the European Union (especially the unresolved Brexit divorce debacle) stunted otherwise solid returns for foreign developed countries.

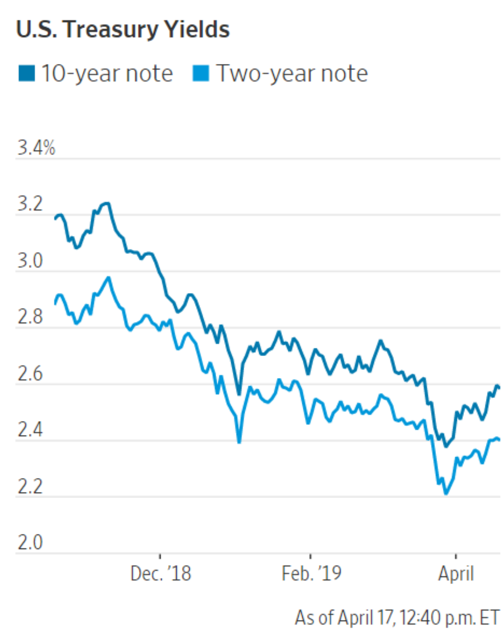
Emerging markets (EM) gained 10.0% for the first quarter as measured by the MSCI Emerging Markets Index, spurred by the highest growth rate of any major global economy (though also in a slow decline). China's stock market rebound of nearly 18% from last year's excessive losses was particularly impressive. Chinese state-controlled government authorities took pro-growth measures in attempts to shore up a weakening economy and local equity prices. A sharp rise in crude oil prices helped energy-producing EM countries like Russia to also record double-digit returns.



Natural resources and other commodities gained 6.3% for the year as measured by the Bloomberg Commodity Index. Crude oil closed above $60 for the first time since early November, up 32% from the lows, capping its best quarter since 2009. Much of the oil market's recovery has been attributed to aggressive output cuts from OPEC and its allies. Saudi Arabia (the de facto head of the coalition) and other oil-producing nations, led by Russia, struck a deal in December to withhold 1.2 million barrels of daily production from global markets. Also, U.S. sanctions have been choking off supplies from Venezuela and Iran. Gold and silver rose 8% for the past three months as investors continued to purchase these precious metals as a safe haven from global political instability and slowing economies. Investors aren't the only ones seeking out gold. Central banks bought the most gold by volume last year since 1967, according to the World Gold Council.



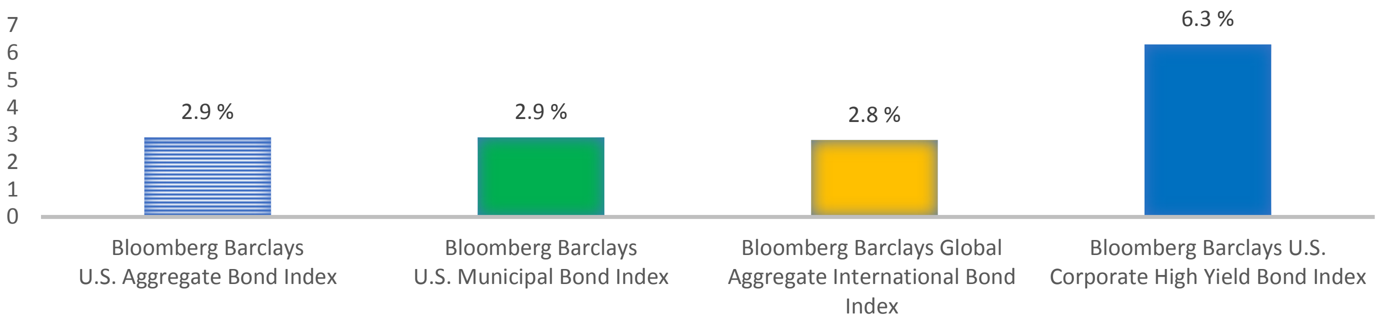
Investors piled into bonds in the first few months of 2019, buying everything from conservative U.S. Treasurys to riskier high-yield corporate debt, as a newly supportive Federal Reserve eased their concerns about rising interest rates and the potential for a near-term recession. Still, the sharp drop in Treasury yields since November has stirred a debate recently among fixed income investors about whether the Fed's pivot to stalling raising rates is a positive sign for bonds—or should they be wary of the potentially troubling reasons the Fed could envision, such as a slowing economy and a Treasury "inverted" yield curve, that may have prompted our central bank's shift in direction.



Source: Tullett Prebon Information

For the past three months the Bloomberg Barclays U.S. Aggregate Bond Index of high-quality government, mortgage and corporate bonds rose 2.9%. Non-investment grade or high-yield bonds climbed 6.3% for the quarter as investors were more optimistic about holding low credit-quality debt securities amid a soaring stock market. Tax-free state government municipal bonds gained 2.9% for the year, equaling high-quality taxable bonds but with the benefit of tax-free dividends. The Bloomberg Barclays Capital Global Bond Index of high-quality world debt, finished the quarter up 2.8%, nearly matching the U.S. bond index.

FIXED INCOME MARKETS CHART
First Quarter 2019



Portfolio Review

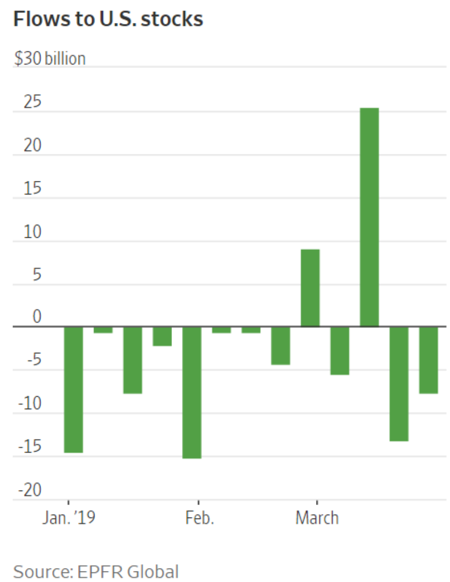
> *But as U.S. equities and nominal government bonds are not among the* (most) *appealing assets, we believe the portfolio you should own today looks more or less nothing like a traditional 60% stock/40% bond portfolio.*
>
> —GMO; *Liquid ALTS: Rising To the Occasion*, Quarterly Letter Q4 2018

Strategic Financial Concepts (SFC) Tactical Investment Strategies (TIS) model portfolios performed very well for the first quarter, along with the stock and bonds markets in general. SFC portfolios registered mid- to upper single-digit gains for Conservative to Moderate allocations, and high single to low double-digit returns for more aggressive portfolios. While we somewhat lagged our benchmarks over the past three months during the booming stock market, we are satisfied with our risk-adjusted portfolio returns since they have less risk than our comparable peers. Most importantly, SFC TIS model portfolios have outperformed over the past several years, and all but one (the Growth Model Portfolio) since inception more than 15 years ago.

We expect the U.S. economy and corporate profits to continue to grow in 2019, but at a slower pace than 2018. The Federal Reserve has recently halted its rate-raising policy. Trade negotiations with China seem to be coming to a conclusion. These trends usually bode well for stocks near term. Nevertheless, we are in the late stages of a 10-year bull market run and in the midst of a stagnating global economy so it's best to think ahead and be somewhat cautious with our portfolio positioning.

Market Outlook

There is little doubt that the best quarter for the S&P 500 Index since the third quarter of 2009 (and its best first quarter since 1998) caught investors by surprise. As did the very poor fourth quarter equity losses of last year. What may or may not be as shocking is that most investors (retail "mom & pops" as well as professional investors) who tried to "time" the stock market's highs and lows lately were dead wrong. It was an expensive mistake. Many investors began selling stocks in October 2018 with most sales executed in December after much of the damage of the near bear market was already done. As seen in this chart, most investors continued to sell stocks into the New Year and did not come back into the market until March, which was *after* the bulk of the hefty market gains in January and February. So in essence they sold low and bought high!



The basic Investing 101 and expensive lesson learned is that it's impossible to time the market in the short run. And while it makes sense to over- or under-weight different types of investments (stocks, bonds, real estate, gold etc.) during different market cycles, investors will never win in the long-run trying to correctly guess twice on multiple occasions—when exactly to get out of and then when to get back into the stock market.

> *In the next few months economic data will either confirm a bottoming out of recent economic weakness … or point to a further economic deceleration.*
>
> —Mark Haefele; Chief Investment Officer, UBS Wealth Management

So that's the lesson of the recent past. Now what is foreseen in the immediate future? What are the challenges and the opportunities? Although slowing from the impressive near 3% GDP (gross domestic product) growth in 2018, the U.S. economy and stock market so far this year have stood up well in the face of the slowdown abroad, political wrangling and trade disputes. What isn't clear yet is whether the U.S. can continue to sidestep widespread global weakness. First quarter GDP is expected to confirm a low number of 1% to 2%; affected by the federal government shut down and business-damaging cold weather. In the coming quarters, nevertheless, economists are expecting a rebound. Especially if a trade deal with China is struck, unemployment remains low, and U.S. industrial production and services continue in growth mode. Lately consumer confidence has climbed in the past two months since the lows of January, along with recent housing and auto sales.

Now that the stock market is back near record highs, analysts have noted with concern that U.S. equity valuations are again at the high end of historical averages. This has caused some investors to take a hard look at stock prices and earnings in determining how much room this renewed rally could run. Much depends on upcoming first quarter corporate earnings reports and forecasts, which are expected to be lower than the same time last year. It also will depend on interest rates, mostly controlled by the Federal Reserve. Low interest rates justify higher stock prices as investors are willing to pay up for higher-risk equities instead of holding safer low-dividend-paying bonds. The Fed is expected to keep borrowing rates low, which should help support stocks for the coming quarters.

So what is our outlook and how have we positioned portfolios in light of our research? While the start of the year has begun very well, the ride for investors is still expected to be turbulent for the rest of 2019 and perhaps into the election year of 2020. But it can potentially be made smoother and expectantly profitable for SFC TIS clients by our underweight of stocks and bonds, and using alternative investments (such as "hedged" investments that limit losses and natural resources) to help weather the storms. This strategy was proven to be effective last year and in other periods of volatile markets.

> *For me it's been realizing that what makes people happy is having options – doing what you want, with who you want, when you want, where you want. And options come from savings and assets …*
> —The Biggest Returns; The Collaborative Fund by Morgan Housel

We remind ourselves often why we are in the business of serving financial advisors' clients to grow and protect their wealth. The above quote by Morgan Housel sums it up eloquently. Accumulating money and other assets, by itself, is not the primary goal as we can't take our possessions to the grave. Money helps provide us with the pursuit of happiness envisioned by our founding fathers, and to have the freedom to live our lives the way we want—whether it's funding a child's or grandchild's education, enjoying a dream home and vacations, time for hobbies, activities with loved ones, a financially stress-free retirement, access to good health care, and improving the lives of heirs and those benefitted by our charitable bequests. As such, we are honored to serve you in reaching your goals; whatever they may be! And remember to pay it forward.

We appreciate your continued confidence in our services. Your inquiries are welcomed.

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Dedicated to Protecting and Growing Clients' Wealth

Sources: 361 Capital, *Must Reads of the Week*, January 30, 2019; Fidelity *Quarterly Market Update*, First Quarter 2019; First Trust Advisors Monday Morning Outlook, *Economy on Very Solid Ground*, April 8, 2019; GMO Quarterly Newsletter, *Liquid ALTS: Rising To the Occasion,* Q4 2018; The Houston Chronicle, *S&P 500 Caps Its Best Quarter Since 2009*, March 30, 2019; JP Morgan Asset Management, *Guide to the Markets*, Q2 2019; LPL Research, *Daily Market* Update, March 29, 2019; PIMCO Asset Allocation Outlook, *Late Cycle vs. End Cycle Investing*, January 2019; State Street Global Advisors, *SPDR ETFs Chart Pack*, March 2019 Edition; The Wall Street Journal (multiple publications).