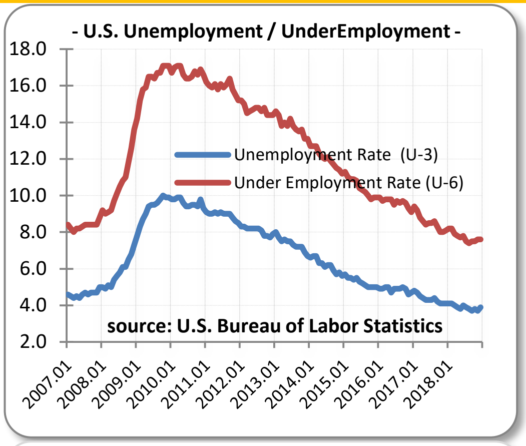
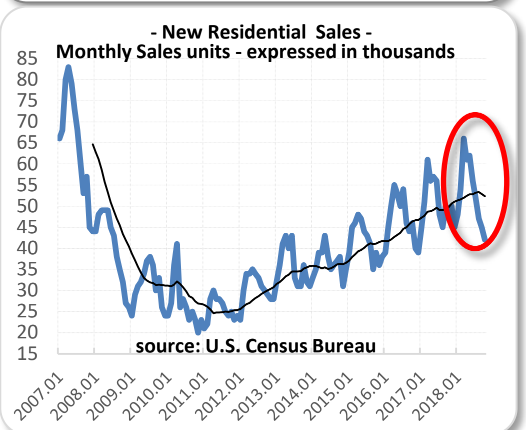
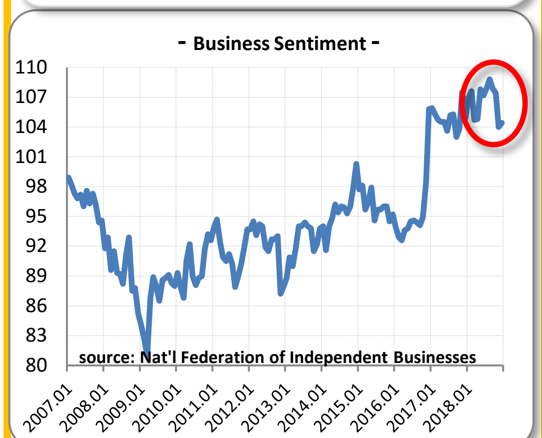
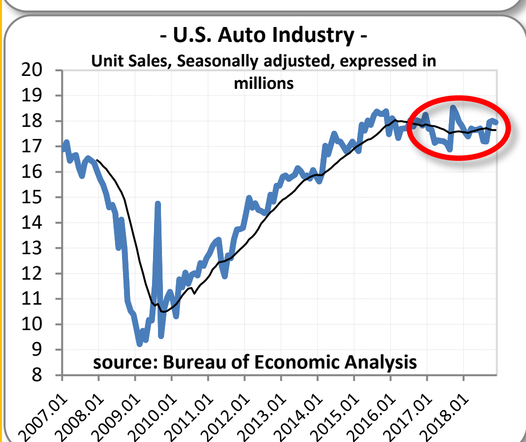
PRELIMINARY 2018 YEAR-END MACRO COMMENTARY









Report Contents

- *Macro-Economic Overview*

Overall pace of economic expansion continues, albeit at a modestly slower pace. The cycle, now into it's 10th year of expansion is showing signs of fatigue in Manufacturing, Auto & Housing sectors.

- *Equity Market Overview*

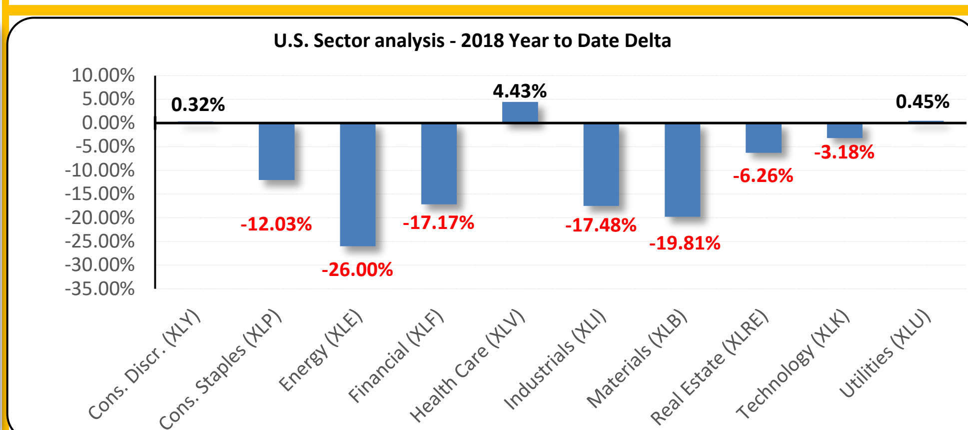
After a robust 2017, U.S. equity markets suffered their worst performance since the Financial Crisis of 2008-2009. 7 of 10 Sectors (as recorded by SSGA sector SPDRS) suffered losses.

- *Labor Market Overview*

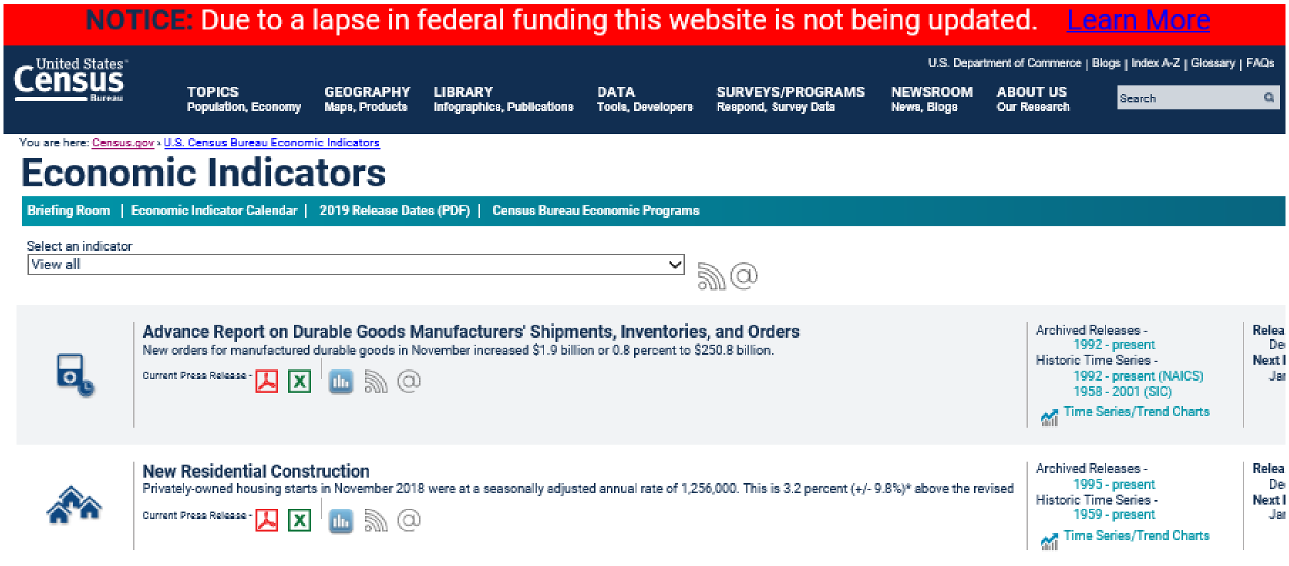
U.S. Job Market continues to show strength. However, despite 99 consecutive months of net job growth and 197 consecutive weeks of strong unemployment claims data, there are concerns.

2018 Year-End U.S. Sector Overview

Source: SSGA



Normally around this time I'm preparing my 2018 year-end/2019 outlook.
However, given the Government shutdown, now into its 27th day, I'm going to keep it relatively short principally because much of the data that I use is either unavailable or not current.
Federal web-sites like the Census Bureau, and Department of Labor, for ex., are posting messages similar to the below:



So with this in mind, some of the data on the following pages are going to be static, at least until the shutdown has officially ended. All that said, a formal year-end summary will be released once the shutdown has ended and data updated.
In the interim, below are some thoughts regarding the overall-macro-environment and Equity markets.

I. U.S. OVERVIEW:

On the plus side, and without looking at the data just yet, we have:

- A **Labor market** that by most accounts is strong still (99 consecutive months of net job growth).
- **Personal Income** data that's risen 32 consecutive months, and 58 of 60.
- An **Auto Sector** that posted its third consecutive year of 17+ million new sales.
- A **Manufacturing sector** that's now reflected expansion 28 consecutive months, and 107 of 113.

On the flip-side, we have:

- A **Housing market** that recorded its fifth straight month of declines in New Home Sales (through Oct).
- A **Federal Deficit** that's now increased 3 years in a row after improving the previous 5.
- A **National Debt** that's added $2 trillion USD in just over 24 months, now at roughly **$21.9 trillion**.
- A 29% increase in **Large-Scale lay-offs**, something one shouldn't see in an otherwise healthy economy.
- **NFIB** (National Federation of Independent Businesses) **Small Business Sector Sentiment** that's dropped in back-to-back years for the first time since **'07-'08**, or the beginning of the Financial Crisis. To be fair, the drops are small, but they **were** negative on a year-over-year basis, nonetheless.
- And, of course, a **Federal Shut-down** now officially the longest in U.S. History.
- In addition, we have a stock market that still hasn't entered Bear territory since 2008.

So that begs the question: Is this a healthy economy or not? And further, with respect to the markets, is the sell-off over and are we at what one might consider fair value?

First, the Economy:

This, for me, in all honesty, I think is much easier to address at this point.
The economy, the broader economy, **IS** healthy.
There are some very real warning signs, to be sure.
But it is healthy. The more important question I think, though, is **HOW** healthy?

Given all of the above data points, I feel that it's not as healthy as it once was or could be.

If your son/daughter, for example, follows up a B+ with a still respectable B or B-, you wouldn't be immediately concerned because it still indicates good performance on their part; **but** given the slight slip, you would more than likely keep an eye on it. And that's how I would describe the Economy, a **modest but discernible** slip on a broad scale and something that we should most definitely continue watching.

Second, U.S. Equity Markets:

Ok, to say that this past 4th quarter was unprecedented would be incorrect, but to more precisely say U.S. equity markets had their worst December since the **Great Depression** would not only be correct, I can't underscore enough how significant that is and something that should absolutely raise an eyebrow or two.

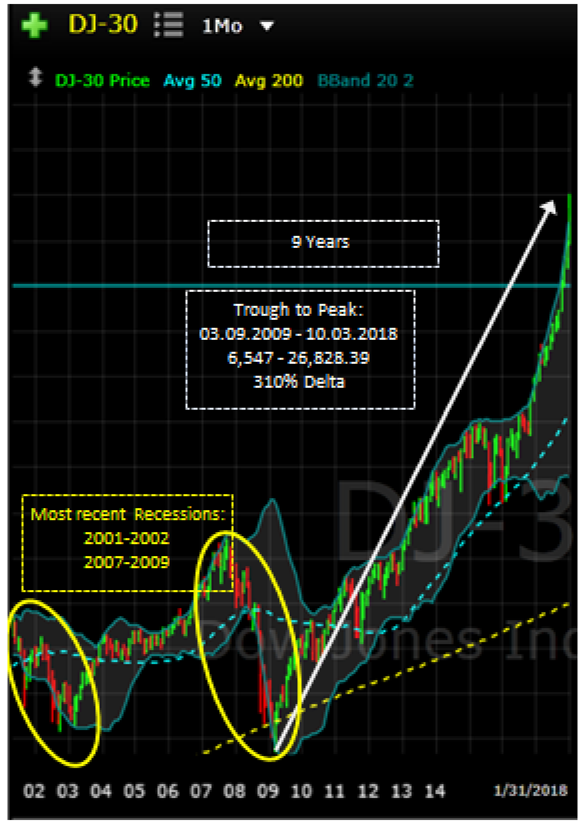
The **DOW**, with a closing value of 26,828.39 on Oct 3rd dropped slightly more than 5,000 points to 21,792.20, in just **under 3 months**.

As you know, I've not been constructive for nearly two years now and as a result have been largely defensive.
Those of you that have spoken to me at length understand my thesis.

The question for many, including myself, is this: What exactly do we make of this past quarter, and further, what should we construe as **"Fair value"** at this point?

I think that depends largely on whether you're using historical forward PE data, macro-economic data, Technical analysis, current corporate earnings data or a combination of all of the above, which I prefer.

Before this past quarter, we had an equity market that looked largely like this:



I've included the two prior Bear markets just to provide some perspective and to give you hopefully a much better sense as to the scope of this cycle, now officially the **longest in U.S. history**.

Clearly, we were (and still are) a long way from 2008, both on a literal and figurative sense.

But a 10-year, 300% move without a significant correction (let alone Bear market) is not something we should bank on.

You've heard me say this time and again:

Markets (any free market, pick one) **aren't** supposed to move in linear fashion. And yet, looking at the above graph, that's more or less what we've become accustomed to.

Eventually they correct, and they typically do so when no one expects it. And that is exactly why I've been so defensive these past couple of years.

Sure enough, along comes Q4 2018 (see below). **DOW** corrects by nearly **-19%**.

Since then (as of 12/24), we've now had an equal and almost opposite reaction, with the DOW bouncing back roughly **12%** (again, below).

Summary:

So we've gone from a market that was clearly in LONG-TERM OVERBOUGHT conditions (i.e., zero true corrections), to one that was SHORT-TERM OVERSOLD (excessive short-term correction), to now, one that's in my estimation in SHORT-TERM OVERBOUGHT counter-correction territory, manifested in a classic **V-shaped** recovery.

I feel strongly that this v-shaped bounce we've watched these past few weeks (bottom left) is temporary and a natural reaction to what we had seen during the 4th quarter.

My expectation is that:
We'll continue to see additional upward movement short-term.

However:

- Should data come in unusually strong, the Fed may be forced to introduce another rate hike, which the markets will not like.
- Should the Government shutdown continue, we'll begin to see a spike in the Initial Jobless Claims data, representing clear and Empirical proof as to its impact.
- Should conditions overseas worsen; trade tensions & China's slowing growth, or further Brexit drama within the European Union for ex., they **will** have an impact on our economy.
- And lastly, should the Mueller investigation yield any negative surprises for the administration, I think the impact should be obvious.

Given the entire body of work over these past 18 months, my initial instinct was to call for Recession for Q3-Q4 2019, at minimum a contraction in real GDP. The longer the shut-down, the more likely.

But given the short supply of some key economic metrics (again, due to the shutdown), I'm holding off on that call and going to reserve judgement until I have some additional data points available.

This past couples of years has been especially difficult. Unchartered waters, in many respects.

I've been defensive largely for all of the above, thus far resisting the temptation to chase a market that's essentially been **negative since last January**.

Summary (continued):

So in closing, unlike the modest correction we saw last January-February **(-9%)**, and despite this recent bounce back up, I think the odds are greater that what we're seeing represents less of a pause in the current bull market, and rather, the beginning of a larger correction.

A bit muddy given the shut-down, but as I write above, I'll publish one with more clarity once this mess has ended.

As always, I'll continue to do my best at keeping you apprised as to my thoughts and your portfolio.

As always, thanks for your trust.

God Bless,

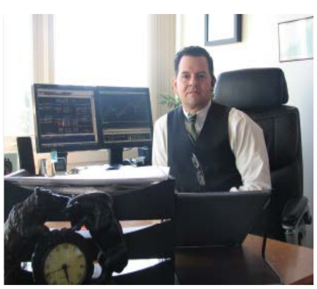
- Joe

Joseph E. Camargo, AAMS®, AWMA®

Founder / Portfolio Manager
Phoenix Investment Management

A **Registered Investment Advisory** firm
A **Better Business Bureau accredited organization**

350 Lincoln St., Suite 1103
Hingham, MA 02043
781.374.7585 (Office)
781.789.6686 (Cellular)
jcamargo@phoenixfinancial.co
http://www.phoenixfinancial.co



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