From the Desk of Bob Centrella, CFA ***July 8, 2019***

Q2-19 Summary and 2019 Outlook

I hope you all had a great 4th of July and weekend and a healthy and happy first half of 2019. Congrats to the US Women's World Cup team for their victory Sunday and 2nd straight WC! If you hold stocks or bonds you should also be a happy camper as both asset classes are having a great year so far. The second quarter saw a continuation of gains racked up in Q1. There were some bumps along the way based on the trade talk narrative, but as the Trump/Xi summit approached and then took place, markets breathed a sigh of relief as a truce was reached and talks between the 2 countries were put back on the front burner. Both equity and debt securities doing well also reflects the change from the Federal Reserve's stance from being Hawkish (raise rates) to Dovish (lowering rates). Investors now expect the Fed to cut rates later this month.

Below is a list of asset returns for the month, quarter and YTD. You must look hard to find a negative return YTD anywhere. Stocks in the US and all around the world are enjoying easy monetary policy by central banks. Now we just need their economies to perk up!

Asset Class Performance YTD, Q2, and June - Total Return (%)

US Related

ETF	Description	June	Q2	YTD
SPY	S&P 500	7.00	4.26	18.37
DIA	Dow 30	7.29	3.09	15.18
QQQ	Nasdaq 100	7.59	4.17	21.54
IJH	S&P Midcap 400	7.74	3.05	17.97
IJR	S&P Smallcap 600	7.34	1.80	13.68
IWB	Russell 1000	6.89	4.06	18.51
IWM	Russell 2000	6.98	1.92	16.84
IWV	Russell 3000	6.88	3.96	18.39
IVW	S&P 500 Growth	6.05	4.43	19.88
IJK	Midcap 400 Growth	7.11	3.55	18.97
IJT	Smallcap 600 Growth	7.16	2.49	13.59
IVE	S&P 500 Value	8.05	3.98	16.57
IJJ	Midcap 400 Value	7.89	2.04	16.24
IJS	Smallcap 600 Value	7.66	1.10	13.56
DVY	DJ Dividend	7.32	2.33	13.49
RSP	S&P 500 Equalweight	7.55	3.69	19.03
FXB	British Pound	0.44	-2.50	-0.41
FXE	Euro	1.72	1.17	-1.11
FXY	Yen	0.44	2.59	1.41
XLY	Cons Disc	7.82	5.06	21.22
XLP	Cons Stap	5.22	4.28	15.86
XLE	Energy	9.39	-2.77	12.98
XLF	Financials	6.66	7.90	17.05
XLV	Health Care	6.40	1.21	7.74
XLI	Industrials	7.83	3.54	21.31
XLB	Materials	11.57	6.04	16.99
XLK	Technology	9.05	5.94	26.89
XLC	Comm Services	4.77	5.49	--
XLU	Utilities	3.18	3.33	14.42

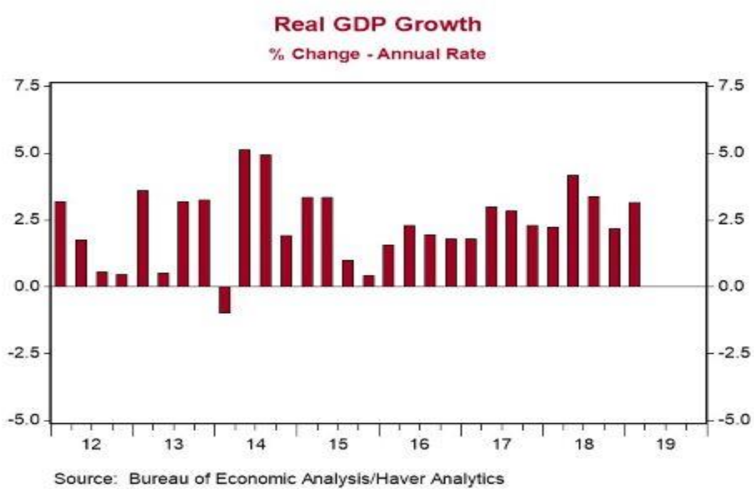
Global

ETF	Description	June	Q2	YTD
EWA	Australia	5.51	6.88	19.48
EWZ	Brazil	6.31	8.02	15.91
EWC	Canada	5.67	4.49	20.53
ASHR	China	7.81	-1.98	--
EWQ	France	8.31	6.58	18.44
EWG	Germany	7.05	7.05	13.68
EWH	Hong Kong	6.86	0.54	16.76
PIN	India	-1.44	-0.16	4.78
EWI	Italy	9.90	2.59	17.76
EWJ	Japan	4.47	0.65	8.65
EWW	Mexico	3.13	1.55	7.49
EWP	Spain	4.17	2.46	9.30
RSX	Russia	9.20	14.71	26.03
EWU	UK	4.61	0.42	12.95
EFA	EAFE	5.85	3.46	14.17
EEM	Emerging Mkts	6.18	0.71	10.67
IOO	Global 100	6.69	4.11	16.75
EEB	BRIC	6.42	1.01	15.74
DBC	Commodities	3.97	-1.07	8.56
USO	Oil	8.38	-3.76	24.53
UNG	Nat. Gas	-5.51	-15.29	-19.51
GLD	Gold	8.00	9.17	9.86
SLV	Silver	4.98	1.06	-1.31
SHY	1-3 Yr Treasuries	0.46	1.37	2.35
IEF	7-10 Yr Treasuries	1.22	3.76	6.65
TLT	20+ Yr Treasuries	0.95	5.71	10.48
AGG	Aggregate Bond	1.10	2.82	5.84
BND	Total Bond Market	1.25	3.07	6.14
TIP	T.I.P.S.	0.75	2.74	6.08

After slumping in May as trade talks faltered stocks rose in June as the S&P 500 gained 7% for its best June since 1955. That brings the total return to 4.26% for the quarter and 18.37% YTD for the best 1st half since 1997. Sounds great right? Let's not forget that we dropped 10% in December and 13.5% in Q4 of last year. So, in essence the S&P 500 just regained its old high reached last September. And since the beginning of 2018, the S&P has gained 10% in price and about 13% in total return. So, let's not get all crazy that stocks are boiling over and running away. We are basically in line to a few percentage points below the long run rate of return (9% annually) of stocks since the beginning of 2018 – it's just been a very bumpy road to get here. I bring this up because although some talk as if stocks are going too far and too fast, I disagree and argue that stocks are in line with long term growth rates once you widen the return period a bit.

ECONOMY

The final report for Real GDP in Q1 came in at 3.1% growth. The estimate for Q2 growth is about 2%.

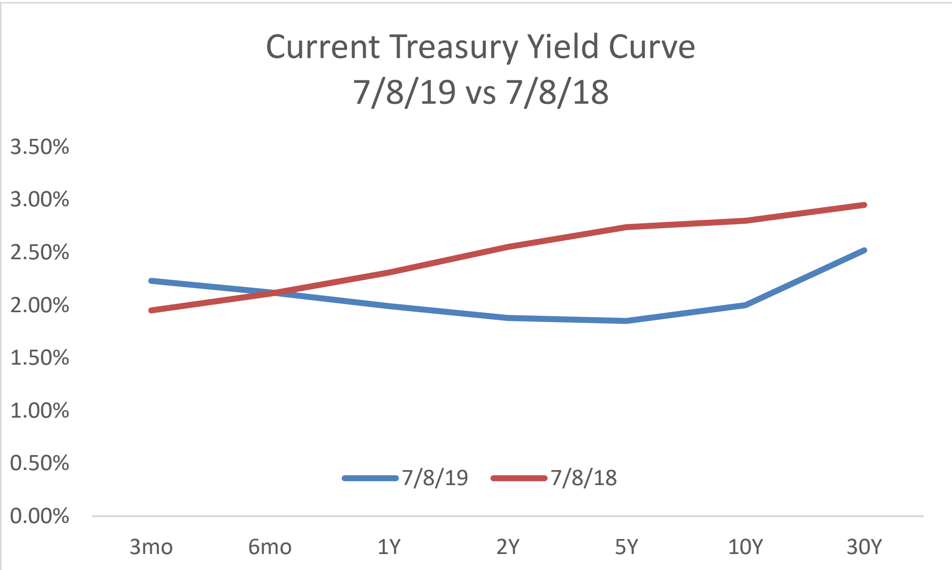


Given the slowdown in some economic numbers, low inflation, the effect of tariffs and the possibility of a trade war, the Fed has indicated they are more likely to decrease rates going forward. The Trump administration has been much more vocal than his predecessors at calling out the Fed for being too aggressive in raising rates and like him or not, he was correct this time. The Fed didn't need to raise rates the last hike and now are likely to at least reverse that in July. But with the unemployment rate still low at 3.8% and the latest jobs report showing an increase in hiring, the Fed might be one and done for a while as it watches the data.

BONDS

Longer-term Bonds rallied in Q2 and this rally in bonds has once again caused most of the yield curve to invert – where the short-term rates are higher than long-term rates. Presently, the curve is inverted totally from 3-mos to 5-Yrs and the 10Yr Bond and 3-mo Bill is inverted. In Q2 the yield on the 10-Yr US treasury dropped from 2.42% to 2.0% and the Barclays Bond Aggregate returned about 2.8%. The 3-mo yields 2.23%.

Normally, the shorter the maturity the lower the yield as investors are "rewarded" for holding longer maturities. As I've noted in the past, an inverted yield curve historically has signaled slowing economic growth and often precedes a recession. A yield inversion indicates that short-term rates need to decline. At the end of May the Fed began communicating that it was reversing its stance and felt rate cuts would likely be needed to stimulate the economy. It has become clear that the Fed did not need to raise rates the final time it did so earlier this year. If the Fed lowers rates, it will be the first cut since the crisis in 2008. The Fed has raised rates 9 times since December 2015.



The chart above shows the current Yield Curve vs one year ago. Notice how the 2018 curve is sloping upward from left to right – this is a normal curve. So, at this point, to achieve normalcy either short term rates must decline or long-term rates must rise. The former now seems more likely.

I started softening my stance on bonds last quarter and continue to feel that rates won't be moving higher, but you also can't get much yield on bonds. For fixed income investments I like a combination of individual bonds and ETF's in a barbell approach of short term and intermediate to longer term maturities. A mix of government, corporate, some high yield, preferred and convertible debt can bring a decent yield.

STOCKS

You know what seasoned investors say when the Fed starts easing -- Don't fight the Fed! Stocks around the world are flirting with highs. In the 2nd quarter US stocks performed better than the world index, Growth outperformed Value and Large-caps beat out mid- and small-caps. But all turned in positive returns. YTD, the S&P 500 has returned 18.3% while the All World (ex-US) returned 13.4%. The only markets outperforming the US are Russia +26%, Canada +20.5% and Australia +19.5%.

As we enter July and the beginning of Q3 many are debating whether stocks can continue their run. First, we get to hear from companies as earnings reporting season starts this week. As of now, earnings for the S&P 500 are expected to decline both this quarter (-2.6%) and next (-.5%). Earnings then begin to grow again in Q4 and into 2020, which can serve as a springboard for stocks to continue to move higher. On a valuation front, the forward P/E ratio is 16.9, which is slightly above the 5-yr average of 16.5x and a few points above the 10-yr of 14.8x. So, again I feel that stocks are fairly- valued but not over-valued. Given the level of interest rates and the fact that rates are likely to decline, I would argue that stocks are still relatively attractive.

So, as I ask every quarter - where to from here? A positive outcome in a trade deal with China is still pretty much built into the market. If a deal falls apart and Trump resorts to tariffs, this market will fall as we saw what happened in May.

As a backstop though, we have the "Fed Put". The "Fed Put" is the Fed's ability to lower rates to support the economy. As I started out by saying "Don't fight the Fed", when the Fed goes into a rate-lowering cycle, stocks have generally done well in the time frame following. But hopefully, with an election year coming up, Trump and his administration will work out a reasonable deal with China. With stocks already surpassing my <u>best-case</u> scenario I talked about in January of about 17% gains in 2019, I am moving my target higher for the remainder of 2019. With the S&P already around the 2975 level, I'm upping my <u>best-case</u> target to 3275, or a potential gain of 10% from here. Again, this is my best-case scenario with a base-case of about 5% higher at 3125 at year-end. Raising my target doesn't mean it is a straight line up or that there can't be a correction. Corrections come and go, and I still see downside risk of about 10% given a collapse in trade talks as the negative catalyst. But I see any correction as a buying opportunity unless the fundamentals change drastically.

We are entering July and August, 2 months when investors and traders are on vacation and often stocks move on small amounts of trading. We could see some consolidation of gains and stocks moving range-bound through the summer and await earnings reports starting the end of this week.

CONCLUSION

In summary, Forza's recommendation remains that we still prefer equities to bonds but with rates likely to be cut by the Fed, bonds should earn their coupon or a little better and offer some stability. We would maintain both in the overall allocation of assets for balanced portfolios. We are looking for stocks to consolidate recent gains and move in a range until we reach Q4. We are still optimistic on US stocks being higher from current levels by year-end as I stated earlier, but it will not be a straight line up. We still recommend overweighting US stocks and underweighting International but do recommend a slightly higher allocation to international than before. The new ECB chief, Christine LaGarde is a dove in favor of lower rates which will keep easy money in the European system. China is still a bit of a wildcard but if a trade deal is reached, they will pump money into their economy. If not reached, they will pump money into their economy! Bonds are likely return their coupon from here or a little better. I prefer the fixed income barbell I mentioned earlier. Let's read the tea leaves that companies give us as they report earnings.

Enjoy your vacations and Have a great Summer! ☺ -Bob