Investment Strategy Update

ASCENTIAL WEALTH ADVISORS
AN INDEPENDENT PRACTICE

Market Report

Quarter 2 • 2019

Markets Recover

Markets had a strong start in 2019, rebounding from the 2018 year-end correction and erasing most losses. The postponement of additional US tariffs on China and reassurance from the Federal Reserve that they would back off on raising interest rates gave investors the confidence needed to buy into an oversold equity market. This positive performance came in spite of relatively high political uncertainty, with the US in a prolonged government shutdown and the UK struggling to reach an agreement on Brexit. Markets also shrugged off indications of weaker economic data that have sparked recession fears.

All of the major equity indices both in the US and abroad gained for the quarter, with the US leading the pack. Notably within the US, growth outperformed value and the NASDAQ made an impressive recovery, gaining 16.49%. Outside of the US, the MSCI Emerging Markets index lagged a bit, up 9.92% for the quarter, in line with the performance for developed foreign stocks.

Globally there have been signs of a slowdown, and the current economic cycle which began ten years ago could be in deceleration mode. With the tax cut stimulus fading, US GDP growth is projected to slow to around 2% in 2019. However, inflation and unemployment remain low, which combined with accommodative monetary policy could help to push a recession further out. The potential for a trade deal with China and resolution to Brexit could be positive for extending this global growth cycle. Overall, the recovery since the Great Financial Crisis has been a slow upward grind that could also continue.

Bond yields fell with the ten-year US Treasury yield moving from 2.69% at the start of the year to 2.41% at the end of the quarter. The Federal Reserve ended its rate hike cycle and indicated it would stop reducing its balance sheet this year, shifting expectations from a potential rate hike this year to either no change in rates or a rate cut by year end. The yield curve remains relatively flat at this point, with yields on the 2-year US Treasury at 2.27% and the 30-year US Treasury at 2.81%.

Index	*2019 (through 03/31)*
S&P 500	+13.65
DJIA	+11.81
EAFE (Int'l)	+9.98
BC Ttl Bond	+2.49

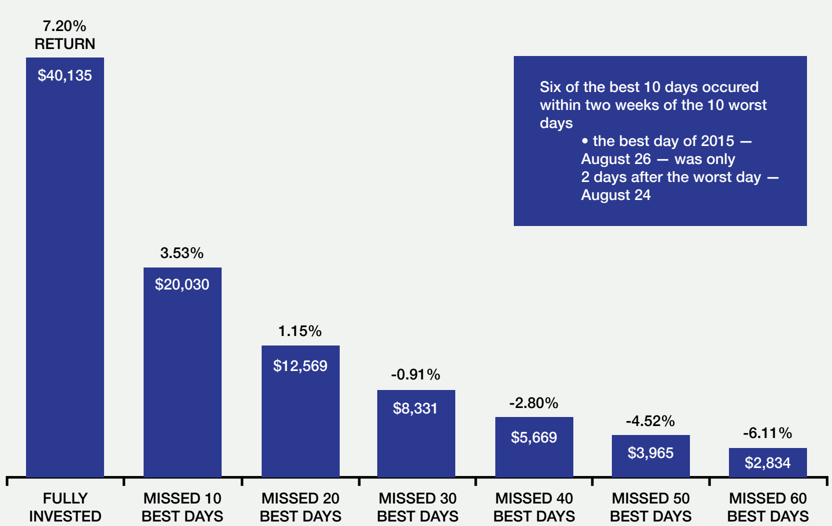
Dow Jones Relative Risk Benchmarks	
Conservative	+0.62
Moderate	+8.79
Aggressive	+13.71

"Fear of Missing Out"

When the economy experiences weakness or instability and investors get nervous, the natural inclination is to wonder if we should sell. Should we get out now before it gets worse? We frequently get this question, and typically will advise clients to stay the course. We are not market timers. Our philosophy is based on positioning portfolios in a disciplined, risk managed way so that investors may be able to remain invested through thick and thin, and in the end potentially achieve a better outcome than one that is dictated by fear or greed. This chart illustrates a risk of trying to time the market. Considering this history, we feel investors should be more focused on the fear of missing out rather than the fear of short-term volatility.

RETURNS OF THE S&P 500

Performance of a $10,000 investment between January 1, 1998 and December 29, 2017



Source: JP Morgan, "Principles for successful long-term investing," February 2018

2019 OUTLOOK

FIXED INCOME — After a year of gradually rising interest rates, it appears that they have topped out for the near term. Bonds gained for the quarter as demand increased alongside fears about slowing economic growth. Yields fell, and the yield curve became inverted for a time with short term rates moving above long-term rates. An inversion of the yield curve can be a warning sign for a recession, however there have been times where it has been a false alarm. For those times where it has been a precursor to a recession, on average it has been about 14 months before the recession began. (JP Morgan, Apr 2019) Given the mixed economic indicators and relatively flat yields on bonds, we are in favor of maintaining a shorter maturity bias at this time. We will be watching the economy and markets over the next quarter to determine if a shift to longer maturities is timely.

Our View — Maintain a shorter maturity bias, monitor for further signs of economic weakness

US EQUITIES — Stocks began the quarter "oversold" with the S&P 500 trading at 14.4 times forward earnings. After the rally this quarter, the S&P 500 is now at 16.4 times price to earnings, very near the 25-year average. Growth in earnings slowed in the 4th quarter to 3%, but is expected to pick up again in 2019, although it is not expected to be as strong as the first three quarters of 2018 due to the waning effects of tax cuts. We feel cautiously optimistic that the recession fears are overblown. Based on valuations, expectations for modest earnings growth, and the potential for a favorable trade dispute resolution, we recommend maintaining allocations to equities and not becoming too defensive yet. While growth outperformed value again for the quarter, we are still recommending a more equal weighting between growth and value. These trends are cyclical plus based on history, if the economy does weaken value stocks may outperform.

Our View — Maintain exposure to US equity, balance growth and value

INTERNATIONAL EQUITIES — Uncertainty surrounding trade negotiations has caused a drag on economic activity, which has been felt more heavily in foreign markets. We feel that markets are pessimistically discounting foreign equities, which are more reliant on exports than the US and therefore more exposed to potential tariffs. Resolution of either Brexit or US/China tariffs could be a very positive development, propelling foreign stocks significantly higher. While valuations in the US are average at this point, foreign stock valuations remain below average, which could offer additional opportunity. With 76% of the world's GDP generated outside of the US, and growth rates in emerging markets still double that of the US and other developed markets, we recommend patience and maintaining exposure to foreign stocks.

Our View — Maintain current position, monitor trade negotiations

> The individual investor should act consistently as an investor and not as a speculator
>
> – Benjamin Graham

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DISCLOSURES