NEWSLETTER – OCTOBER 2019

MARKET TRENDS 9.30.19

Asset Class	QTD	YTD
US Stocks		
Large Cap	1.78%	20.44%
Mid Cap	-0.09%	17.86%
Small Cap	-2.33%	14.13%
International Stocks		
Developed Markets	-0.79%	13.33%
Emerging Markets	-4.75%	5.43%
Fixed Income		
Taxable Bonds	1.41%	6.26%
International Bonds	2.96%	9.25%
Municipal Bonds	1.49%	6.40%
Alternatives		
Emerging Markets Bonds	1.17%	12.60%
Energy MLPs	-6.93%	4.56%
Floating Rate	1.29%	11.33%
Preferred	3.19%	13.76%
Gold	4.26%	14.53%
Real Estate	7.90%	27.57%

Source: Factset

TREADING WATER AT HIGH TIDE

To start July, the S&P 500 Index ("S&P") was at its all-time high. By the end of the third quarter with some sudden bumps and sell-offs along the way, the S&P eked out a 1% gain and 20% year-to-date for 2019. It was only up 4.3% for the previous twelve months which included the brutal sell-off in equities last December. The advance in equities this year comes alongside rallies in bonds and commodities.

Gross Domestic Product ("GDP"), inflation, corporate earnings, credit spreads and unemployment remained at levels normally associated with a healthy economy during the third quarter. That said, there were signs of lower consumer and business confidence and slowing manufacturing data. We think that the domestic economy is still solid, but slowing, and worries about a recession may continue to prove too pessimistic. Financial conditions are pointing toward improvement and the clear pickup in the housing indicators over the past few months provides confirmation that the effects of lower rates are flowing through to the real economy.

U.S. markets continued to outperform broad measures of both developed international and emerging markets stocks. US-centric stock allocations have been outperforming foreign investments for over a decade now. Given that most U.S. investment firms tend to overweight domestic holdings, ourselves included, it has been a rewarding period for those who don't follow modern portfolio theory assiduously. We remain watchful for reversions to the mean, however, and opportunities to take advantage of under-performing asset classes overseas.

POLITICS MORE VOLATILE THAN EQUITIES-SO FAR

The start of the third quarter was marked by far more activity (rancor, not bipartisan policy) in Washington. Within the Democratic Party, the debates heated up with attacks by Kamala Harris and Julian Castro (and other also-rans like DeBlasio) on front runner former VP Joe Biden.

In addition, U.S. Rep Alexandria Ocasio-Cortez came out strongly for impeaching the President. Speaker Nancy Pelosi, seemingly taken aback by her junior Congresswoman's temerity, spoke more cautiously, calling for more measured attention and patience with a process of examining the various details and facts surrounding President Trump's actions. Over the next several weeks, Speaker

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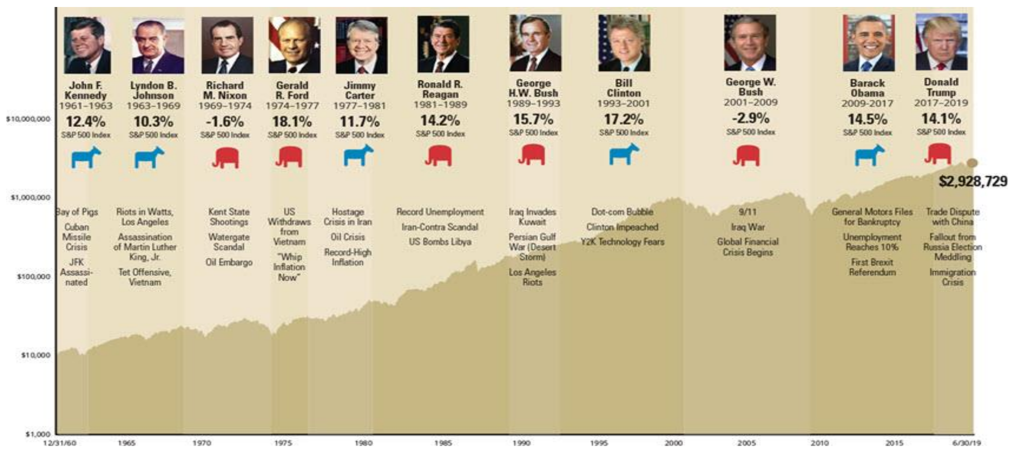
Pelosi seemed to regain the podium and limelight. By quarter-end, the impeachment proceedings had evolved into a more likely possibility, especially over the President's troublesome interactions with Ukraine.

As for political concerns, we will restate our previous newsletter statement, "….major policy changes still require a coordination between the Administration and Congress. …there is usually little to do as investors because there are too many variables to consider and frankly the long term timeframe we follow tends to wash away the significance of short term politics, even for the ultimate job in the country, if not the world." See the following chart:



PAST AS PARTIAL PROLOGUE

While many clients see the 2007-2009 Great Recession as the analog to what is to come, we think the next recession will likely be much less severe. After having decreased equity exposure another 2.5% this quarter (about 7.5% in the last 8-9 months) Shorepoint has returned most portfolios to a neutral weighting of stocks based on their long-term objectives, and we are holding a higher percentage than usual in cash/money markets.

TWEETER IN CHIEF

President Trump's policy-by-tweets grew ever more frenzied over the third quarter. It has become hard to follow what tariffs are actually in place and to determine what businesses they effect as retractions and list exceptions vary from moment to moment.

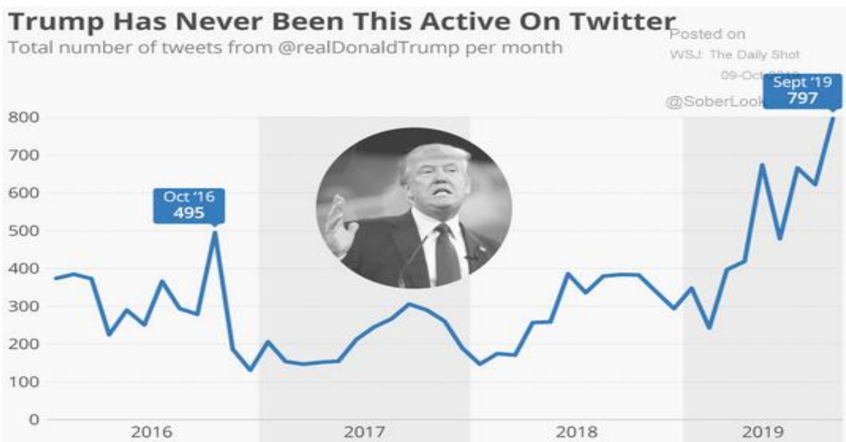
The Fed has been dealing with the inverted yield curve (short-term rates higher than long), which has often been a precursor to a recession. As discussed in recent newsletters, while a yield curve inversion has been a solid indicator of a recession, it is imprecise at best.

"…the domestic economy is still solid, but slowing, and worries about a recession may continue to prove too pessimistic"

"…takes several quarters for bad policies like tariffs to measurably affect the economy"

We remain in a world of remarkably low interest rates but where the U.S. is not close to the lowest. Much of the world has fallen into negative rates territory. Treasury bonds and relatively high rates continue to attract capital and investment to the U.S., making our dollar stronger, which hurts our multi-national companies by making our goods more expensive. The President's trade war threatens to leak further into a currency war by the day with China, which would be very negative should hostilities heighten.

Another negotiation tactic-the test balloon tweet by the President-rocked the market by calling for limiting access to investors in Chinese companies. That cratered Chinese stocks like Baidu for a few days. Though stocks tend to rally back after threats like these subside, they struggle to regain their previous highs.



As long term investors we are still learning how this frenetic communication style, and a news cycle as fast as a lightning strike, affect our view and approach. Thus far the President and Washington have not derailed a strong economy, but we know this may not last. Words matter. Tariffs can hurt. Political arguments can become so contentious and protracted that the basic needs of the people and the economy are not met.

It often takes several quarters for bad policies like tariffs to measurably affect the economy. The President wants the Fed to cut rates to ameliorate the brunt of his tariffs. The Fed won't likely comply fully. And even if they do, it won't likely solve that self-created problem. Either way these changes will take time to wind themselves through the economy before being revealed in numbers and accounting statements. But, as in our personal and political lives, there is no free lunch!

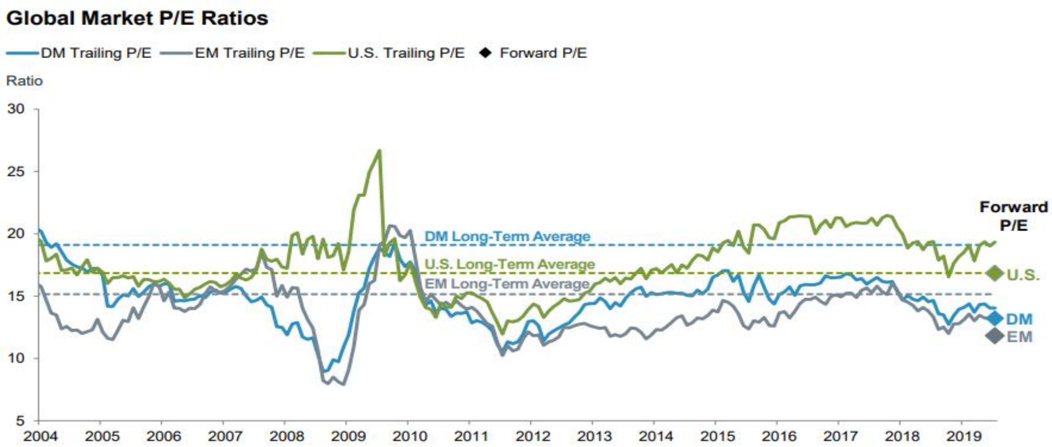
SHOREPOINT'S VIEW

We don't have a dour view of stocks. Rather than try and call the economic cycle, we continue to invest in companies with strong free cash flow, strong business models, and conservative balance sheets. While we think there may be an earnings lull, and we worry about trade wars and Washington missteps or non-steps, the historically low unemployment rate around 3.5% with modest wage growth, should provide a

"…use generalized market weakness and sell-offs to buy or upgrade to high-quality…"

"…10 year Treasuries yielding 1.5-1.75% and S&P 500 stocks yielding 2%, …favor equities" ballast for the overall domestic economy. Furthermore, the weakness in manufacturing is relatively small compared to the strong consumer segment of economy which accounts for two-thirds of economic activity. In many economies, and in the U.S. in particular, households are enjoying low unemployment, rising wages, and savings from refinanced mortgages. With household wealth and incomes in relatively good shape, we believe the risks to the broader economy have fallen.

We continue to monitor valuation in foreign stocks and are watchful for a long-awaited, but not yet nascent, global recovery. Valuation of foreign equities and foreign bonds look cheap (see below), however, we need to see macro conditions improve and policy concerns fade before increasing our foreign allocation.



We will continue to use generalized market weakness and sell-offs to buy or upgrade to high-quality names that become cheaper. A good example is when we recently replaced Blue Hills Bancorp (BHBK) with U.S. Bancorp (USB) in our Dividend Growth portfolios. Despite a challenging interest rate backdrop, USB is growing faster than the industry and improving operating leverage for strong free cash flow growth. This has allowed USB's management to shift more capital returns to dividends in the form of our projected 10% dividend per share growth for the foreseeable future. We also try to counter-punch sell-offs by picking up stocks with the ability to grow their dividends at an attractive rate and harvest tax losses through the year. With 10 year Treasuries yielding 1.5-1.75% and S&P 500 stocks yielding 2%, we still favor equities.

We also like private equity, private debt, and directly held real estate (not publicly traded REITs generally) as well; companies are staying private longer, which shifts some rewards to private markets in addition to dampening some of the portfolio volatility we experience in our holdings that are traded on the public exchanges.

As a firm we have lowered our return expectations across stocks and bonds. Our dimmer capital market assumptions will result in clients' target returns being slightly lower going forward. We are carefully reviewing how these changes affect clients' financial plans, and we will be reviewing these results in detail with you in our meetings and calls over the next 6-12 months. We will continue to reflect—to be thoughtful and flexible as we deal with interest rates and political conditions we have not seen in our careers. As ever, we remain focused on navigating risks and identifying opportunities.