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Dear Monte:

Re: Q1 Investment Review

In the first quarter our ETF performance ran pretty much true to our approach. As shown on accompanying performance, you were pretty much right in line with our benchmark, the Lipper Balanced Fund Index.

The first quarter total returns from the markets are below.

Benchmark Index Returns	3 Months Ending 3/31/2019
Lipper Balanced Fund Index	8.5%
S&P 500 Stock Index	13.6%
Russell 1000 Value Index	11.9%
Money Fund Returns (Current annualized rate)	2.4%
S&P -7-10-Year-US Treas. Bond Index (TR)	2.4%
S&P- Twenty Year+ US Treas. Bond Index (TR)	4.7%

Back in September of last year the stock market hit its all time high. It then proceeded to decline just about 20% through December 24. From there we have since moved strongly higher so that we are rapidly approaching the September high, and it wouldn't be surprising if we go on to a new all-time high. Is this the restart of something old (the bull market continues) or the beginning of something new (the top of the market)? Of course, there is, as almost always, evidence to support either case.

On the positive side, the rally back has been very impressive in its strength as well as breadth as, this time around, more than technology was pushing the index values up. And fundamentally strong renewed job growth has just been announced for March along with a 3.8% unemployment rate. There appears to be a job available for anyone who wants one.

But on the other side, unbridled enthusiasm seems to have diminished somewhat and earnings estimates are being reduced. We are hard pressed to understand why projected 2019 earnings were so high to start with as the whole world knew that the special boost last year from tax cuts would not be repeated. It remains to be seen whether further earnings markdowns are ahead.

The economic expansion seems to be continuing, although, perhaps at a somewhat lower rate. Following soft numbers in February and the earnings markdowns, there is now much more conversation on a possible recession in 2020. Brexit, trade negotiations with China and the immigration dispute with Mexico are all wild cards for this year and next.

The Federal Reserve Bank has turned decidedly more dovish with respect to future rate hikes and there is now even some talk of a rate reduction. Today the Federal Funds Rate (the base interest rate from which all other U.S. rates are derived) is 2.5% or just about in line with last year's official inflation rate of 2.4%. This is generally considered a "neutral" stance implying that very short-term interest rates are just offsetting the economy's inflation.

The same, however, can't be said with respect to longer term rates as ten-year U.S. Treasury securities aren't yielding any more than Fed Funds, generally a factor of concern as it means that demand for longer term funds (for corporate expansion) is no greater than for shorter term funds. What we don't know is whether or not, in the current low interest rate environment, that this has the same meaning as it has had in the past when rates were generally higher. And we also don't know the real impact the unwinding of Quantitative Easing is having on "normal" longer term interest rates.

There are many extraneous forces now at work in the bond market, most a result of the so-called Quantitative Easing policy that, we believe, went on far too long. The result of the unwinding of this very stimulative monetary policy has been, among other things, a distortion in normal bond market behavior and relationships between long and short-term rates during economic expansion. QE remains very much an "experiment" in play, though the policy itself has been discontinued. No one really knows what, if anything, all this will lead to but the flat yield curve has been a major topic of discussion on the pundit circuit.

First Quarter Activity

There have been no changes to your portfolio since it was established at the end of last year. Equities represent about 65% of the total and we own no long-term bonds as we think, strategically, the next major move for the bond market will be toward higher rates. In addition, you are paid very little more income for taking on the extra risk associated with longer maturities.

Conclusion

In a "normal" market cycle we would expect that we are at the tail end of the great bull market, that by some definitions, began way back in 2009. But this market has broken so many precedents that we can't argue that point with any kind of conviction. We do know that the market is historically high and that many of the newer companies, particularly technology companies, are way overpriced unless very high earnings and sale growth rates are maintained for a long time. In the technology sector this extends to many large companies as well. Earnings growth and economic growth remain healthy but are likely to be slower than in the recent past.

Our approach to investment management has always contained a strong dose of risk avoidance but in a roaring market, risk is forgotten until it rears its ugly head again. Last fall, we did get a reminder of how quickly the good times can be interrupted and that was when our performance relative to the general stock market was at its best. Whenever the market does decide to move lower on a more sustained basis, our balanced accounts should hold up much better. We believe this approach is consistent with the expectations and objectives of most of our clients, but it can be very frustrating while the market is going up and we are lagging.

The SEC, as is often the case, is well behind in its oversight of the kind of more technically advanced logarithmic trading approaches in use and often leading the stock market today and the fact that it is not very well monitored or disclosed needs to change. The stock market is not there just to make money for speculators but is a critical part of the capital fund-raising mechanism by which both new and more mature companies have the ability to raise funds for expansion and future growth.

What none of us know is what role the Quantitative Easing policy implemented by the Federal Reserve Bank has had in pumping up the market in addition to supporting the economy. When more than enough money is available to fund real economic activity, the rest sits in the financial markets and some of that works its way into the stock market creating a market that rises more than it would if it were just capturing activity in the underlying economy. Now that Quantitative Easing has ended, how disruptive will this be to the "virtuous circle"? A rising economy spurs on the market creating a belief that it won't end and pushing the market even higher. It is just at these times we should be most suspicious. Our time will come when the economy slows, an over ebullient attitude is reigned in and as a result, the stock market levels off from the extraordinary returns seen over the past five years.

As always, we remain bullish on America and its stock market but a dose of realism in expectations is always useful from time to time to keep everything in perspective.

Sincerely,

Loudon Investment Management, LLC

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