MARKET ORIENTED STRATEGY & OUTLOOK

STRATEGY ASSET MANAGERS

STRATEGY

The Market Oriented Core Strategy did not escape the market carnage that occurred in the 4th Qtr. of 2018. The total return in the quarter was -16.6% compared with the S&P 500 benchmark return of -13.5%. For the calendar year, the performance for the 4th quarter pushed us below our calendar year benchmark. For 2018, the MO Core return was -8.2% in comparison with the S&P 500 return of -4.4%.

The question on the table is what happened? After outperforming the S&P 500 in 2017 by 4.5%, (26.3% vs. 21.8% for the calendar year), the very same sectors that contributed to the outperformance were hit hard in the 4th quarter of 2018. The overweight sectors, Information Technology, (inclusive of the new Communications sector), Healthcare, Industrials and Financials accounted for over 75% of the portfolio. The companies we owned in the Communication, Information Technology and Healthcare sectors underperformed the S&P 500 sector return by an average of 7.7% in the quarter. China's economy slowing and concerns about trade wars were big contributing factors to the Information Technology sector being hit hard in the quarter. Also, the tariff dialogue impacted that sector as well as Industrials, although our industrial stocks held up better than the S&P 500 Industrial sector in the quarter.

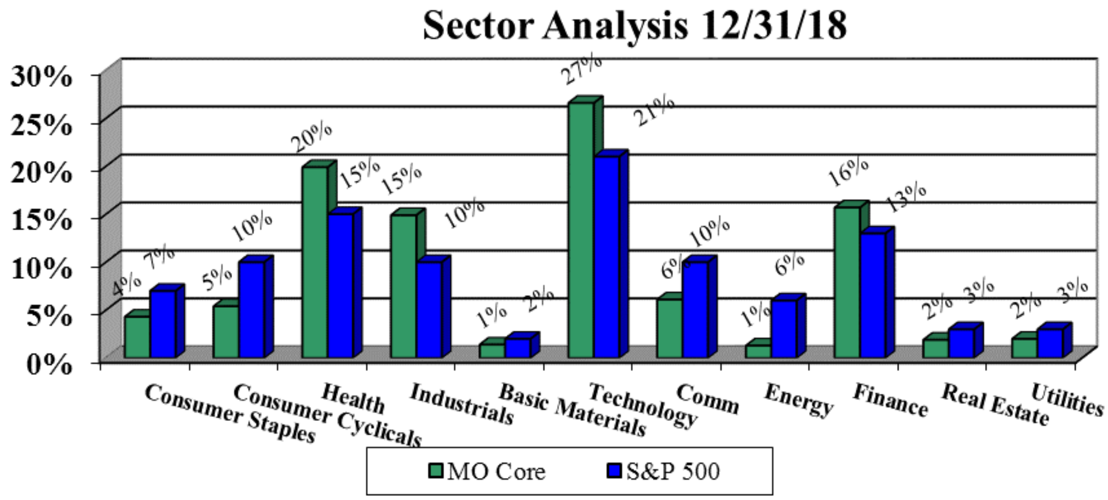
Our stock selectivity was not rewarded. The Financial and Industrial companies we owned did marginally better than the S&P 500 sector returns, but were far short of making a significant difference in the quarter's outcome.

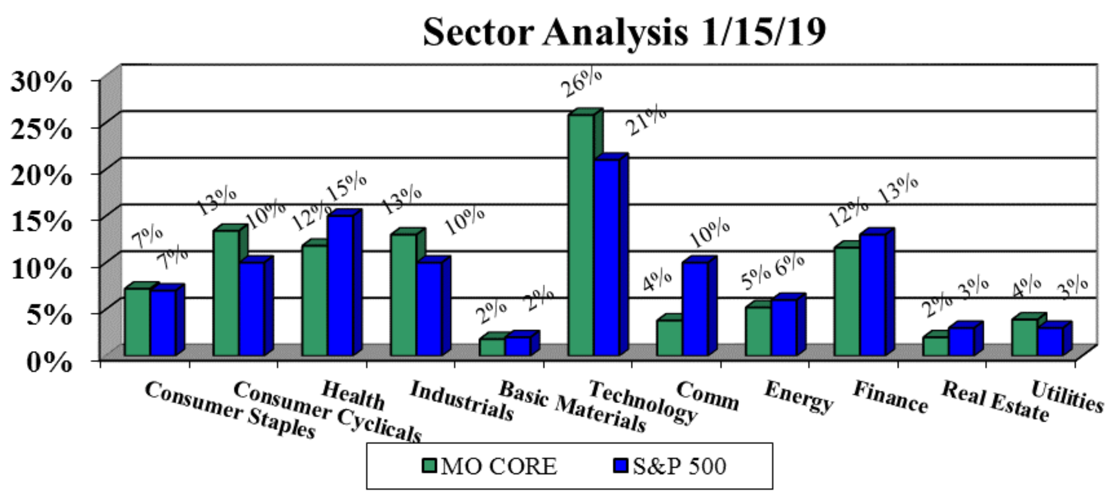
After the fact, from a portfolio contribution standpoint, all 5 overweight sectors were the biggest contributors to the 4th quarter's underperformance.

Following the January upgrade, significant reductions were made in the weightings in Healthcare, Information Technology, Communication and Financials. What our data is indicating is that the market has partially rotated away from these sectors that have dominated over the last 15-18 months, but these sectors are still the drivers of the capitalization-weighted S&P 500. Stock selectivity is going to be critical in 2019. We believe we are positioned to participate.

Past performance is no guarantee of future returns. The Market Oriented Strategy & Outlook reflects the views of the Investment Advisor only through the date of this report, and should not be considered investment advice. The Investment Advisor's views are subject to change at any time without notice based on market and other conditions. Portfolio characteristics are subject to change, and shown for illustrative purposes only. Please refer to the disclosure at the end of this report. December 31, 2018

The chart below shows the sector weightings as of December 31, 2018 and for comparison purposes the weightings after the most recent upgrade that occurred in the first week in January.





Shown below are the top 5 contributors and detractors for the quarter.

Top 5 Performers in the Quarter		Bottom 5 Performers in the Quarter	
CME Group Inc.	12.0%	Nvidia Corp.	-52.4%
Nextera Energy	4.4%	Align Technology	-46.5%
Twitter	1.0%	Activision Blizzard	-44.0%
SBA Communications	0.8%	PVH Corp.	-35.6%
Republic Services	-0.3%	Valero Energy	-33.4%

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OUTLOOK

Remarkably, Fed Chairman Powell speaking after the Fed raised the fed funds rate by a quarter percent (to 2.5%) on December 19th stated "Where we are right now is the lower end of neutral."- a mere 2 ½ months and only one interest rate rise after his "a long way from neutral" comment. Concerns about China trade/tariffs, and visibly slowing China and European economic growth and possibly in the US as well, were apparently enough to change the Chairman's mind to a more flexible stance. In subsequent comments, he stated rates could be lowered and/or other tools could be used to stimulate growth if need be.

We bore you with these details because we believe the change in the Fed stance is an important change in conditions that may lead us back to the "Goldilocks" scenario as economic growth slows back towards 2% in the US in 2019 (current estimates center around 2.5%), unemployment remains stable (which at 3.9% is basically full employment) and the Fed's favorite inflation gauge remains around 2% (currently 1.9%). Quite frankly, we wondered at times what war the Fed was fighting (by consistently raising the funds rate by 2% over the last 2 years) as their mandate from Congress is full employment with stable low inflation (generally considered 2%). Of note, over the last month the change in the probability for fed funds in 2019 has gone from 39% for one 0.25% hike to a 24% chance that the Fed will lower once by 0.25%. Wow.

With the Fed going to the sidelines, the China trade negotiations have moved to the forefront of investor worries and the situation continues to hurt many international companies as well as investor sentiment. According to FactSet, earnings revisions for Q4 2018 during the course of the 4th quarter have lowered the earnings growth rate from +16.7% to 11.4%. In addition, the American Association of Individual Investors (AAII) Sentiment Survey (12/27/2018) showed bearish sentiment exceeding 50% for the first time since 2013.

With the approximately 20% drop in the S&P 500 index from its high during the quarter to the low, stock valuations have moved to the "cheaper side" of average at approximately 15x forward earnings. Additionally, the extreme bearish sentiment in the AAII survey has often preceded strong rallies as evidenced by the 2 year rally in the S&P 500 index from the Spring of 2013 until Spring 2015. We also believe that a return to a Goldilocks economic environment will provide a solid foundation for the stock market as earnings continue to grow, but will keep the Fed from murdering the economic expansion (to paraphrase former Fed Chairman Bernanke).

Unfortunately, the China situation remains hard to handicap. Meetings continue between the two sides and pronounced slowing in Chinese economic activity may well force a faster settlement. News about the negotiations are certain to add volatility to the market, but without a settlement we believe the market can produce positive returns based on current valuations, a gentler Fed and earnings growth. A positive China trade result could significantly add to returns. Stay tuned.

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