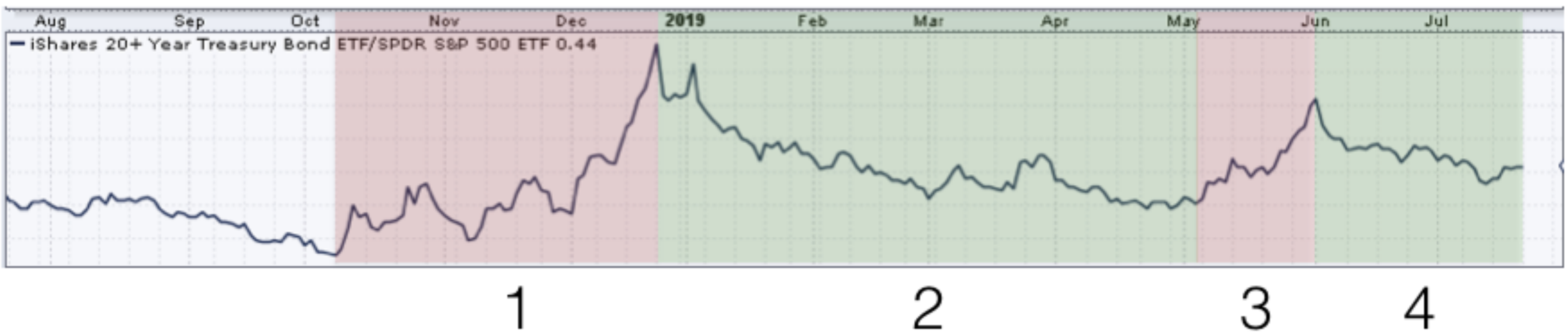
by Russell Redenbaugh & James Juliano

Monday, July 22, 2019

RISK ON / RISK OFF

An excellent way for investors to gauge if we are in a risk-on (own growth assets) versus risk-off (own safe-haven assets) environment is to follow the relative performance of stocks versus bonds. When capital flows into bonds relative to stocks it's a signal that there is a threat to future economic growth, and we must assess if a durable policy shift is occurring that hurts growth. Oppositely, when capital flows into stocks relative to bonds it's a signal higher growth is expected, and we must assess if a durable policy shifts is occurring that helps growth. The chart below outlines four periods of relative performance for U.S. Treasury bonds versus the S&P 500.



1. From Oct 4, 2018 through Dec 24, 2018 there was a huge risk-off shift in global capital markets caused by the threat of a deflationary monetary policy mistake. As we have continuously written since last Fall, in late September Jerome Powell began arrogantly telegraphing a monetary policy that was overly tight. In Fed meetings and press conferences he dogmatically described a series of future interest rate hikes that could overshoot the Fed's targeted "neutral rate" within the near future. Capital fled risk-on assets for the safety of bonds.
2. From Christmas Eve through the first week of January chairman Powell reversed the arrogant rate hike language that was causing panic in capital markets. He reframed the Fed's approach to monetary policy as that of a more "wait and see, data dependent" approach. With the dangerous deflationary policy mismatch

off the table, capital markets immediately repriced future growth expectations. Risk-on stocks began outperforming risk-off bonds, and the pattern continued for five months sending the S&P500 near new nominal highs.

3. During the month of May there was a pause in the risk-on trade, as trade concerns with China took a more serious tone ahead of the G-20 meeting.
4. While a trade deal has not yet been completed, the risk-on trade resumed by June as it appeared that Trump and Xi would not yet cross the brink into an official trade war. At the G-20 summit during late June both leaders agreed to pause looming tariffs and return to the negotiating table. With a trade deal hopeful but not assured, the Federal Reserve has maintained its language of leaning towards more accommodative monetary policy. A 25 basis point interest rate cut at the July 31 meetings is now fully priced into markets.

Despite all the political and economic headwinds being reported, markets remain in risk-on mode. While a trade or monetary policy error could tilt us back into a risk-off environment at any moment, it seems both policy domains are trending pro-growth for now. We remain cautiously optimistic and favor risk-on asset classes like U.S. stocks over safe-haven asset classes like U.S. Treasury bonds.

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ALLOCATOR

Fixed Income

Bonds are an asset class that does well in a deflationary policy environment (Low Growth & Strong Currency)

We have long said the Treasury bond bubble will pop again as it did from May2013-Jan2014 when long term Treasury bonds fell 18%. With voters choosing Trump's pro-growth agenda to ignite growth, we believe the this is even more likely. Treasury bond prices are at risk to fall 30-50%, and we expect any moves higher in bond prices (lower in yields) to be short-lived. Since most other bonds price off of Treasury yields, fixed income in general is a risky asset class.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Investment Grade	LQD	9/9/2016	$119.00	$123.77	4.0%	
Aggregate Bond	AGG	9/9/2016	$109.00	$111.17	2.0%	
Municipal	MUB	9/9/2016	$111.00	$113.44	2.2%	
TIPS	TIP	9/9/2016	$114.00	$115.23	1.1%	
Extended Duration	EDV	9/9/2016	$128.00	$125.65	-1.8%	
US Treasury 3-7 yr	IEI	9/9/2016	$124.00	$125.39	1.1%	
US Treasury 7-10 yr	IEF	9/9/2016	$109.00	$109.62	0.6%	
US Treasury 20+ yr	TLT	9/9/2016	$133.00	$131.69	-1.0%	
International Total Bond	BNDX	9/9/2016	$54.40	$57.68	6.0%	
High Yield	HYG	4/12/2016	$77.00	$86.59	12.5%	Act more like equities than bonds, benefit from improving growth

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Commodities

A change in the price of gold is a change in the value of the currency. When gold rises, the currency's value falls and vice versa. Commodities are an asset class that does well when the currency is weak.

If growth is slowing while the currency weakens, there is stagflation. Own precious metals.

If growth is accelerating while the currency weakens, there is an inflationary expansion. Own agriculture, industrial and energy commodities.

Commodities suffered heavy losses in the strong US Dollar environment 2012-2015. In 2016 Dollar weakness was caused by election uncertainty and commodities rallied. That weak Dollar trend was reversed by Election2016. The demand for transactional and asset based Dollars will rise if Trump's pro-growth policies are implemented and fall if his policy agenda fails. Gold's recent decline back below $1,300/oz is a confirmation of better policy and rising growth rates. Capital is beginning to leave safe haven asset classes as policy uncertainty diminishes.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Gold	GLD	10/2/2017	$120.77	$134.47	11.3%	
Silver	SLV	10/2/2017	$15.67	$15.17	-3.2%	
Energy	DBE	8/13/2014	$28.97	$13.95	-51.8%	
Oil	USO	7/30/2014	$37.00	$11.67	-68.5%	
Agriculture	DBA	9/13/2011	$32.50	$16.60	-48.9%	
Broad Comm. Index	GSG	8/5/2011	$33.00	$15.52	-53.0%	
Base Metals	DBB	6/17/2011	$23.00	$15.51	-32.6%	

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Real Estate

Real Estate is an asset class that performs well when growth is accelerating. When rising growth is coupled with a strong currency, own real estate tied to business activity (like commercial REITS). When rising growth is coupled with a weak currency, own real estate tied to commodities (farmland).

Commercial RE will be helped by improving real economic growth. RE properties leveraged to businesses & economic growth are preferred under pro-growth US policies.

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/ Loss	Policy Notes
Residential	REZ	12/21/2016	$61.00	$73.63	20.7%	Real estate assets have declined as higher interest rates expectations lower the perceived attractiveness of housing demand and real estate's dividend yield.
Building/Construction	ITB	12/21/2016	$28.00	$38.52	37.6%	
Mortgage REIT	REM	4/1/2016	$35.00	$42.80	22.3%	
REIT	VNQ	3/7/2016	$75.50	$87.43	15.8%	

ALLOCATOR

US Equity

We have been waiting for a 1980s/90s type of policy driven equity bull market for sixteen years. The 2014 midterm House/Senate/gubernatorial election shifts put us on the path as pro-growth candidates propelled the GOP to majorities. It was a repudiation of anti-growth economic policies and a big step toward a Reagan/Clinton type of equity bull market. Despite the voters' growth signal, Obama doubled down on his tax/spend/regulatory (EPA) agendas in 2015 causing stocks to be range bound and volatile. As 2016 began, policy uncertainty ahead of November's elections became the biggest threat to equities. The ebb and flow of the presidential political season moved markets in both directions as investors waited to learn which policy theme would prevail in November – growth vs. redistribution. Voters decisively made their choice in Election2016, and growth won. Trump's pro-growth policy agenda beat Hillary's anti-growth policy agenda in landslide fashion. Republicans retained control of the Senate, House and increased their control of governorships by three. The policy stage is now set for Trump and Congress to keep delivering pro-growth tax, regulatory and monetary policies. As they do, a bull market in U.S. equities will ignite to rival the 1980s/90s

US Equity - Cap Size

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Micro	IWC	7/11/2016	$72.00	$91.15	26.6%	Most tied to domestic policy / growth
Total Market	IWV	5/19/2016	$117.00	$174.53	49.2%	
Large	IWB	5/19/2016	$111.00	$165.18	48.8%	Large caps should underperform smaller caps as domestic economic growth accelerates
Small Cap	IJR	5/19/2016	$54.00	$77.28	43.1%	Most tied to domestic policy / growth
Mid Cap	IWR	4/6/2016	$38.57	$56.42	46.3%	More tied to domestic policy / growth

US Equity - Style

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Large Growth	IWF	7/11/2016	$101.00	$161.00	59.4%	Growth outperformed value in 2017 across all cap sizes. Trend will continue as tax cuts get implemented.
Small Growth	IWO	7/11/2016	$140.00	$200.53	43.2%	
Small Value	IWN	5/19/2016	$92.00	$118.64	29.0%	
Mid Growth	IWP	5/9/2016	$90.00	$145.68	61.9%	
Large Value	IWD	4/6/2016	$95.00	$128.24	35.0%	
Mid Value	IWS	4/6/2016	$68.00	$89.20	31.2%	

US Equity - Sector

Asset	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Staples	XLP	6/5/2017	$57.00	$59.94	5.2%	Defensive sector hurt by rising growth
Utilities	XLU	6/5/2017	$54.00	$60.37	11.8%	Defensive sector hurt by rising growth
Metals/Mining	XME	5/8/2017	$29.00	$28.52	-1.7%	Tied to commodity prices, hurt by strong Dollar
Energy	XLE	3/13/2017	$69.00	$62.76	-9.0%	Tied to commodity prices, hurt by strong Dollar
Healthcare	XLV	2/8/2017	$71.00	$91.76	29.2%	
Discretionary	XLY	11/14/2016	$79.00	$122.16	54.6%	Consumer strong w/ rising growth expectations
Financial	XLF	7/18/2016	$19.00	$27.94	47.1%	Helped by Trump deregulation (Dodd Frank) & rising interest rates
Materials	XLB	4/6/2016	$44.00	$58.41	32.8%	Global growth
Industrial	XLI	3/14/2016	$52.00	$77.45	48.9%	Global growth
Technology	XLK	3/7/2016	$41.00	$80.69	96.8%	Repatriation tax reform huge plus for tech companies

POLICY BASED INVESTING

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Foreign Equity

Country	ETF	Action Date Red Sell/Green Buy		Current Price	% Gain/Loss	Policy Notes
Mexico	EWW	10/1/2018	$51.23	$42.46	-17.12%	Freer and fairer trade agreements are pro-growth for all parties involved
Canada	EWC	10/1/2018	$28.78	$28.83	0.17%	
Denmark	EDEN	7/2/2018	$63.89	$61.26	-4.12%	European polices not improvng despite anti-austerity movements across the Euro Zone. Capital is fleeing. A zero trariff trade deal with the U.S. would reverse course and be very pro-growth for European economies.
Switzerland	EWL	7/2/2018	$32.58	$37.52	15.16%	
Netherlands	EWN	7/2/2018	$30.51	$31.09	1.90%	
Sweden	EWD	7/2/2018	$30.51	$30.32	-0.62%	
Eurozone	EZU	7/2/2018	$41.01	$39.13	-4.58%	
Spain	EWP	7/2/2018	$30.35	$28.49	-6.13%	
Poland	EPOL	7/2/2018	$21.78	$23.54	8.08%	
France	EWQ	7/2/2018	$30.52	$30.41	-0.36%	
Germany	EWG	7/2/2018	$29.98	$27.28	-9.01%	
Italy	EWI	7/2/2018	$28.89	$27.61	-4.43%	
Austria	EWO	7/2/2018	$22.65	$19.43	-14.22%	
Israel	EIS	2/26/2018	$52.41	$54.43	3.85%	
Vietnam	VNM	10/9/2017	$14.99	$16.37	9.21%	Demographic leverage to US economic growth policies
Indonesia	EIDO	7/24/2017	$26.78	$26.43	-1.31%	Demographic leverage to US economic growth policies
Ireland	EIRL	1/26/2017	$39.00	$41.90	7.44%	
Singapore	EWS	1/11/2017	$21.00	$24.70	17.62%	
China	FXI	1/6/2017	$35.50	$42.47	19.63%	Strong Dollar emerging market, tied to US growth
World Ex US	VEU	11/15/2016	$43.50	$50.97	17.17%	Global growth reset higher after US Election2016
Norway	ENOR	8/20/2016	$20.00	$24.31	21.55%	
UK	EWU	8/4/2016	$30.50	$32.11	5.28%	Brexit was a vote for growth
Finland	EFNL	7/26/2016	$33.00	$36.72	11.27%	

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Japan	EWJ	7/15/2016	$47.00	$54.67	16.32%	
South Korea	EWY	7/13/2016	$52.00	$57.72	11.00%	
Hong Kong	EWH	7/6/2016	$19.00	$26.43	39.11%	
Frontier Mkts	FRN	7/5/2016	$10.50	$14.60	39.05%	Highly levered to Eurozone growth movement
Peru	EPU	6/29/2016	$30.50	$37.80	23.93%	
South Africa	EZA	6/29/2016	$51.00	$54.91	7.67%	
India	EPI	6/27/2016	$19.00	$25.14	32.32%	Strong Dollar emerging market, tied to US growth
Taiwan	EWT	6/21/2016	$27.00	$35.74	32.37%	
Thailand	THD	5/20/2016	$64.00	$93.99	46.86%	
Belgium	EWK	3/16/2016	$16.50	$18.80	13.94%	
New Zealand	ENZL	3/5/2016	$36.00	$55.37	53.81%	
Philippines	EPHE	8/5/2015	$37.00	$36.36	-1.73%	
Qatar	QAT	12/1/2014	$24.00	$17.70	-26.25%	
Malysia	EWM	10/3/2014	$41.00	$29.56	-27.90%	
Australia	EWA	9/16/2014	$22.50	$22.75	1.11%	
Greece	GREK	7/14/2014	$20.00	$9.50	-52.50%	
Portugal	PGAL	6/4/2014	$15.00	$10.50	-30.00%	
Columbia	ICOL	6/27/2013	$21.00	$13.59	-35.29%	
Turkey	TUR	6/1/2013	$58.00	$25.69	-55.71%	
UAE	UAE	5/20/2013	$23.00	$14.16	-38.43%	
Russia	RSX	8/7/2011	$30.00	$19.97	-33.43%	Weak Dollar emerging market
Brazil	EWZ	7/14/2011	$60.00	$46.02	-23.30%	Weak Dollar emerging market
Chile	ECH	3/1/2011	$61.00	$39.90	-34.59%	
Egypt	EGPT	2/23/2004	$64.00	$29.99	-53.14%	

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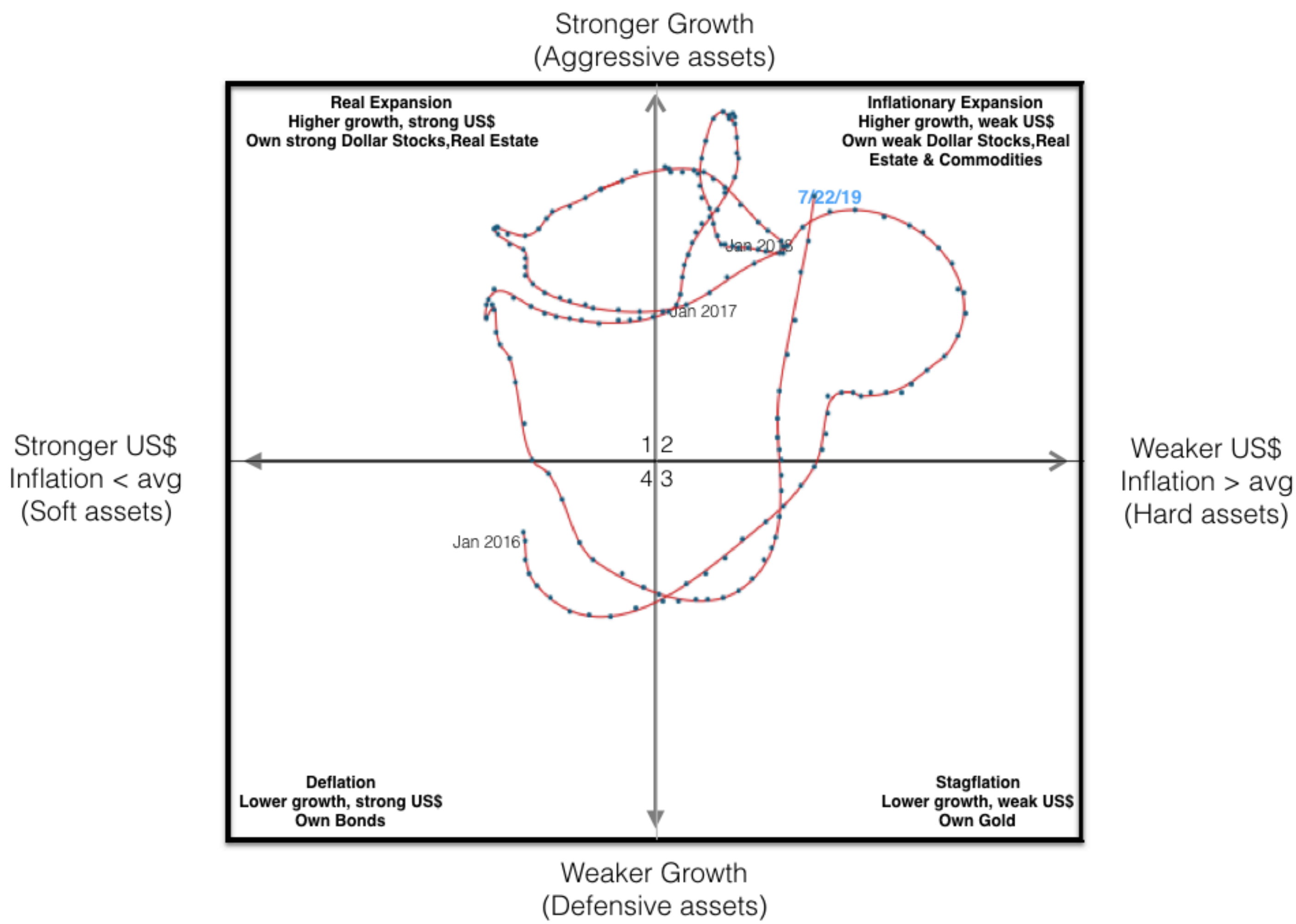
POLICY MAP

Growth increased versus last week (1.28 to 1.54): Despite pro-growth tax and regulatory policy improvements since 2016, growth has tipped into negative territory over fears of a 2008-style, deflationary monetary policy mistake.

Value of US$ was decreased versus last week (0.78 to 0.81): Dollar had been stable between gold $1,300-$1,375/oz, and strengthened to $1,230/oz. giving the Fed a strong Dollar signal to pause rate hikes until economic and market data calm down. Recent Dollar weakness above $1,400 is concerning but likely has some temporary geopolitical causes like Iran.



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BOND YIELD COMPONENT ANALYSIS

Nominal Yield: 2.05% (-3%) **Inflation Expectation Component: 1.80%** (+2%) **Real Growth Component: 0.25%** (-29%)

Real growth exited the range of .30-.70 to the upside after 2017 tax cuts. In recent weeks growth expectations embedded in bond market have dislocated from equity markets. The collapse in real growth so far seems caused caused by global bond market dynamics, not a significant deterioration in U.S. policy outlook. Trade policy uncertainty is easing, and the Fed has avoided making a a Q42018 deflationary policy mistake.