Inside Views From an Investment Management Leader

UPDATE

January 2019

About our Company

Company Profile:

Mitchell Anthony Capital Management is a private, boutique investment firm who has helped our clients grow and protect their wealth since 1991.

Key Offerings:

- *Personal wealth management*
- *Proactive investment strategies*
- *Proprietary research*
- *A professional team*
- *Fee-only services*

Distinguishing Values:

- *Passion for excellence*
- *Strategic focus*
- *A disciplined process*
- *Prudent risk management*
- *Comprehensive client care*
- *Superior long-term performance*
- *Sound judgment*
- *Objective Analysis*

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In the News

Check out MACM's new website and blog!

If you have't already, be sure to visit the new website of Mitchell Anthony Capital Management at **www.MitchellAnthonyCapital.com**. In addition, Mitch and the team publish frequent market and economic updates on MACM's blog, which you can find at **www.MACMblog.com**.

Economic Review & Outlook

Is the Fear-Driven Selloff Over?

The equity markets retreated as selling begat more selling and fear begat more fear in the fourth quarter of 2018. This dramatic change of course for the equity markets in 2018 was reminiscent of similar market action in 2014 and 2015 when weakness in global economic conditions emerged. However this correction was sharper with most indices falling 20% or more, compared with 10% or more corrections in 2014 and 2015. Was this just a big bump in the road to much higher levels for US equity markets? Or has the path for equity markets already reached its summit because recession lies on the horizon? Most investors have found themselves asking these questions over and over recently. While none of us know with certainty what lies ahead, trends in economic data point to further growth for the US economy as the impact from the trade war becomes more of a distraction to economic conditions than a game changing event. Further this is all occurring while inflation and central-bank policy mostly remains benign. This environment of continued steady growth will ultimately lead to higher equity prices particularly those equities that are insulated from the problems in manufacturing and highly cyclical industries. As the equity market continues on its path of recovery the leadership in the equity market will likely to take on a different twist as investors avoid the US sectors and foreign markets that are directly impacted from the trade war that is likely to persist for the short to intermediate term. This is a difficult time to own deep cyclical industrial names but contrarily a great time to own companies experiencing organic growth occurring with innovation and development of great products.

We have had tremendous alpha for the last few years based upon our ability to identify where investors were going early. We owned the FAANG stocks long before most people knew what the FAANG was (Facebook, Amazon, Apple, Netflix, and Google). The acronym for the market leaders in 2019 will be a different version of FAANG, but will clearly be areas insulated from global trade and benefiting from organic or secular growth.

Mitchell Anthony
President
Chief Investment Officer

How did the US equity market and in particular the FAANG fall so far so fast if the environment is still benign and these companies are still experiencing great organic growth? The first thing to understand before I attempt to answer this question is that the leadership in the equity market in the first three quarters of 2018 was the FAANG and/or similar companies with strong organic growth that was insulated from the trade wars. Almost all other types of stocks whether domestic or foreign including Industrial names, financials, and deeply cyclical areas began their selloff in April 2018 when Trump first announced his plans to impose tariffs on foreign countries unfairly dumping their products in America. This was bad news for Europe and Asia as they are major manufacturing and industrial centers. As a result these areas of the market lost 20 to 30% in 2018 and were avoided by MACM clients. Most MACM portfolios were flat to down 3% in 2018. The S&P 500 lost about 5% in 2018. MACM finished the year with a modest 300 basis points of alpha over the S&P 500, after dominating the S&P 500 by over a thousand basis points at the end of Q3.

MACM sold all of its holdings in Europe and Asia quickly when the news of tariffs first unfolded in March and we reinvested the proceeds and increased our holdings in healthcare and the FAANG These areas did fantastic in the marketplace until the big short emerged.

So again, the question is - how did the equity market and in particularly the FAANG fall so far so fast? There are several answers. The first answer is that the environment became unfriendly for industrial names early in 2018 because of the trade war. The environment in Q4 became somewhat unfriendly for the FAANG as they were attacked

(continued on p. 2)

Economic Review & Outlook (continued)

by the politicians who seemed unreasonably angry about minor privacy issues involved with social media and the digitization of data, and likewise forgot how great our world has become as a result of digitization and social media. The third answer lies in the fact that this selloff appears to have had strong roots with program trading that was designed to short highly valued broadly owned names and create fear and then cover shorts once the cycle of fear had ran its course. The equity market appears to have been ripe for this type of interference by traders. America has become sharply divided and the political unrest is at all-time highs. The average investor is not well-equipped to evaluate the impact of political unrest on the economy and consumer confidence. This unrest combined with some real economic problems associated with Trumps attempts to change the global trading environment drove investors out of stocks and into cash as the initial shorts pushed market indices down 5 to 10%. The fear driven investors then started to capitulate and became sellers and their selling pushed the market down another 10%. Finally in December Washington and central banks clearly became alarmed and moved into action to ensure investors that all was still good in our economy. Chairman Jerome Powell backpedaled his previous hawkish position, and then we got somewhat different rhetoric from Trump about trade wars. These traders likely knew that Corporate America is scheduled to report some terrific earnings for 2018 beginning in January and February that would likely be a catalyst to push equity prices higher. All of this combined information I believe caused the program traders to decide it was time to cover their shorts and this selloff suddenly ended without any real change in economic data, political unrest, or real news on trade wars. Now clearly there is a bias to the upside. We are now seeing follow-through from investors who are wanting to get back into the markets and accepting the fact that they got whipsawed by the trader's gamesmanship. This will likely continue unless something new is added to the mix that spooks investors or brings the program traders to begin another position of shorts.

The American economy is clearly strong with consumer sentiment still near all-time highs and tax driven corporate spending still working. The impact from the weakening economy in China is difficult to assess. China is still growing at better than 6% but China is not happy with this and has announced plans to stimulate and seems motivated to settle the trade dispute with Trump as China is losing the trade war. China exports about 550 billion of goods and services to America each year while America exports about 175 billion of goods and services to China. (Pg. 4, Figs. 1,2). Not hard to see who's losing in that scenario.

How strong is the American economy and is this strength sustainable? There are lots of indicators to look at to measure the strength of an economy. Unemployment is always a go to indicator. Unemployment in America is close to all-time lows. Seemingly anyone who wants to work can get a job. Wages have been tilting upward for a few years now but still well under control. This seems to be what chairman Powell talks a lot about when he worries about inflation and economic conditions overheating. What seems missing in this economy that's typical of a strong economy is a great underlying consumption theme. What consumption theme is driving our economy? Every good cycle in the past has had a great theme. Quite frankly there is nothing that stands tall and strong. Housing has never become a great theme in this cycle and is on a plateau now. It may have a second run but there is no indication of that on the horizon. Autos have been quite strong and this has been a modest theme. Clearly the demand for digital devices is a theme but is not a big consumption engine in a $17 trillion economy. Healthcare spending is another modest theme. Without the tax cuts I suspect our economy would have never accelerated in 2018. It is unclear whether the above trend pace is sustainable and it seems more likely the economy will fall back to modest growth of 2½% GDP. This actually is Nirvana for equity markets and in particular growth stocks that have secular themes or innovative themes driving the growth.

We remain optimistic.

Table 1: Stock & Bond Market Returns — 12/31/18

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	-15.8%	-1.7%	Small Cap Value (IWN)	-18.7%	-13.0%
Large Cap Value (IWD)	-11.7%	-8.4%	Small Cap Growth (IWO)	-21.7%	-9.4%
Europe Asia Far East (EFA)	-12.6%	-13.8%	Emerging Markets (EEM)	-7.6%	-15.3%
Invest Grade Bonds (LQD)	-0.6%	-3.8%	High Yield Bonds (HYG)	-4.4%	-2.0%
Interm Treasurys (IEF)	3.9%	1.0%	Mortgage Bonds (MBB)	2.1%	0.8%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

Table 2: Real Estate & Commodity Returns — 12/31/18

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	-5.8%	-4.3%	DJ Commodity Index (DJP)	-10.7%	-13.1%
Int'l Real Estate (IFGL)	-4.6%	-6.4%	Goldman Commodity (GSG)	-22.6%	-13.9%
NAREIT Residential (REZ)	0.0%	3.9%	Gold (GLD)	7.5%	-1.9%

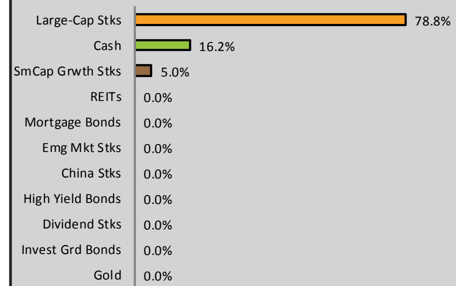
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

MACM Managed Accounts

Growth Portfolios

Dynamic Growth

A dynamic blend of stocks, bonds, commodities, REITs, and cash for growth investors with a bias toward timely asset classes.

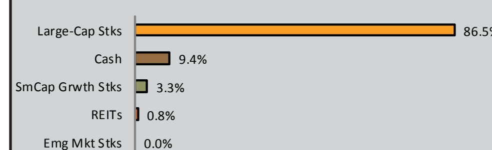


Growth

A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity

A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.



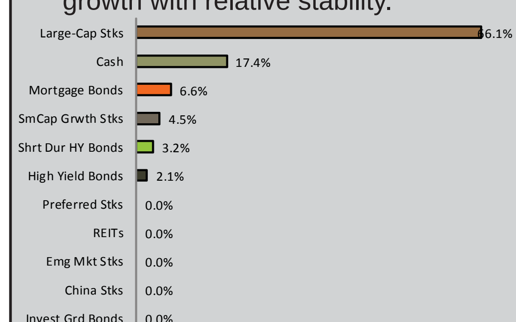
Focused REIT

A portfolio of companies whose primary business is owning and leasing real properties.

Balanced Portfolios

Asset Allocation for Income

A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.



Equity Markets: Consumption Drives Growth

Earnings growth drives leadership in the stock market, while consumption generally drives earnings. Every market cycle has consumption themes which are either secular or cyclical in nature. Here's what is active in this market cycle.

Secular Consumption Themes:

- **Theme:** Global demand for wireless devices, digital media and cloud computing power. Demand growth is a product of industry's ability to innovate. Sector: Technology
- **Theme:** Global demand from wealthier and growing emerging market populations for meat and poultry to support more "western-like" eating habits, as well as growing demand for technologies that provide greater agricultural yields.

  Sector: Materials
- **Theme:** Global demand for energy as population grows as well as increasing demand for the technologies that make it viable to extract natural resources from the farthest reaches of the earth. Sector: Energy
- **Theme:** Increasing demand for healthcare as population ages, as well as growing demand for new and better products provided by innovation in the development of life-saving drugs, devices, and services. Sector: Healthcare

Cyclical Consumption Themes:

- **Theme:** The return of mild consumer discretionary spending balanced against purchasing decisions based on need instead of want. Sector: Consumer Discretionary/Staples
- **Theme:** Pent-up demand within the enterprise upgrade cycle. Sector: Technology
- **Theme:** The re-surfacing of emerging market infrastructure spending. Sector: Industrials
- **Theme:** Credit market stabilization and a return of demand for investment banking products and services. Sector: Financials
- **Theme:** The return of demand for manufactured products.

  Sector: Industrials, Energy

Commentary: Equities Stumble

Equities retreated in Q4, as investors grappled with trade wars and hawkish Fed actions. Moreover, after a banner year for earnings growth on the back of Trump's tax cuts, investors now face broad earnings expectations showing a return to slower single-digit growth for the year ahead. As a result, safer-haven sectors lead in Q4, with Utilities posting the only positive return for the quarter. Prior leaders like Technology were hit hard, down over 17.0%. Secular growth stories nevertheless provided strength, leading the Technology sector to post positive performance for the year overall, up 3.3%. A slow growth and low-inflation environment still bodes well for stock performance, however, and equities have already begun swiftly retracing their losses.

Sector Performance Review *12/31/18*

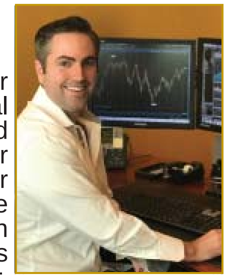
	Quarterly Change	Trailing 12-Months
Utilities	1.1%	4.6%
Real Estate	-5.2%	-3.6%
Consumer Staples	-5.3%	-8.5%
Healthcare	-9.5%	6.1%
Comm Services	-13.2%	-6.3%
Financials	-13.2%	-12.9%
Materials	-13.7%	-16.5%
Consumer Discretionary	-16.1%	-0.1%
Technology	-17.4%	3.3%
Industrials	-17.7%	-13.6%
Energy	-24.8%	-18.5%

Data based upon Russell 1000 Index and GICS sectors. Source: Bloomberg Financial

Fixed Income Review

By Kyle Aron

Rocky Finish to 2018



Kyle Aron
Senior Analyst

Markets were roiled in the fourth quarter of 2018 as fears over trade wars, a global slowdown, and an overly hawkish Fed overcame investors. The heated tug-of-war between President Trump and Fed Chair Powell also seemed to further exacerbate the sell-off. In an apparent flexing of its own power and wisdom, the Fed enacted its fourth rate hike for the year in December, deeply in the thick of the market sell-off, and decisively against the warnings of the President. While cooler heads ultimately prevailed, both with Fed Chair Powell and on the trade front amidst conflict with China's Xi Jinping, the markets were only beginning to retrace the ground they lost to close out 2018.

Ultimately, Fed Chair Powell softened his position in December and early January, indicating a reduced number of rate hikes forecast for 2019, as well as a more "patient" approach by the Fed under his watch. Notably, of the nine rate hikes that the Fed has undertaken since 2015, nearly half have occurred under Fed Chair Powell, who has yet to see his first anniversary as Fed Chair. On the trade front, Trump and China's Xi Jinping agreed in early December to delay the implementation of any new tariffs for 90 days in an attempt to reach equitable trade terms. These developments, along with still relatively strong economic fundamentals in the US, seemed to help markets find a bottom in late December.

Nevertheless, the major damage had already been done, and the S&P 500 ended the quarter down nearly 14.0%. The high-flying tech segments had an even harder fall, down nearly 17.0% (NASDAQ 100). However, these segments with strong secular growth still saw overall outperformance for the year, with the NASDAQ 100 essentially flat in 2018. Meanwhile the S&P 500 ended the year down over 4.0%. Notably, strong names like NFLX have already bounded back from the depths of the sell-off, as investors maintain confidence in these leading innovative companies. NFLX is up over 40.0% from the December lows. MACM's focus on these strong secular growth companies again helped it maintain an edge over the broader market throughout the year. REITs performed poorly in Q4, as rising interest rates and a plateau in the real estate market continued to be headwinds. Gold rallied in the fourth quarter, with fearful investors pushing the price up over 7.0% (GLD). This was not enough to overcome gold's poor performance for the year, however, as it contends with a low-inflation environment and strengthening dollar (-2.0% in 2018). Commodity funds were pummeled in Q4, mostly a result of poor oil performance (GSG -22.6%).

Fixed income results were as expected given the market tumult. After reaching a high of nearly 3.3% in early November, the yield on the 10-year Treasury had fallen to 2.7% by the end of the year, as investors gobbled up safe-haven securities. However, this strength was not enough to compensate for an otherwise lackluster year, with most Treasury funds ending the year flat to down. Long-dated Treasurys were down 1.7% (TLT) in 2018, and mid-dated Treasurys were up a mere 1.0% (IEF). Investment grade corporate bonds were essentially flat in Q4, and ended the year down nearly 4.0% (LQD). Riskier high-yield corporates traded down along with equities in the fourth quarter (HYG -4.4%), but ended the year with slightly better performance than their higher-quality counterparts (-2.0% in 2018). Overall, the outlook in this asset class remains relatively poor given the incoming economic data and the Fed's policy positioning.

Overall, equity markets may well have found a recent bottom, and could remain an asset of choice amid a slow but steadily growing US economy. Moreover, secular growth stories seem even more timely, and could prove resilient in a slowing growth environment. However, with trade wars still on the front of many investors' minds, it remains to be seen how they will play out. If the border-wall fight is any indication, President Trump is clearly willing to permit some short-term domestic suffering for the sake of the greater good.

MACM Investment Spotlight

Mitchell Anthony
President
Chief Investment Officer

Facebook – The F in the FAANG?

There is a reason why Facebook is the first name in the FAANG!

Facebook has become one of the most widely known companies in the world for many reasons. It has led the evolution of social media and its tools for sharing ideas, personal views, political views, pictures, and just about everything else has been widely used by Generation X, the millennials, and now the baby boomers. Facebook has learned how to monetize their products as their clients are highly sought after by anyone with something to sell. Facebook's revenue for advertising has been growing hyperbolically and the outlook remains fantastic. Facebook has also been monetizing information they gather about what their clients do on their platform, what they share with friends, and what sites they visit. All of this has been done legally and with authorization from the clients. However, what they are doing here has been widely misunderstood by regulatory bodies and the media and anyone seeking to make a story that will sell newspapers.

The media and members of Congress have attacked Facebook in a seemingly unfair manner for alleged breaches that may have occurred in their duty to safeguard their client's data and only share information they gather about their clients that is authorized. Thus far the regulatory body has not been able to identify any illegal conduct by Facebook based upon current laws and regulations. The hoopla has been all about whether or not the regulatory environment needs to be adjusted so what Facebook is doing with information they gather is fair and reasonable. The media and regulatory bodies seem to want to hold Facebook to a standard that is not realistic for a company whose stated objective is to build products and services to allow consumers to share information and data with friends and business associates. The key word is share. Facebook is not a bank that has been entrusted to hold cash or securities for clients. It is a social media company that people utilize to share information.

Facebook's strength is their team of innovative, creative professionals that have and continue to make social media products that are state-of-the-art and sought after by people around the globe. Undoubtedly they have taken their eye off the ball a bit regarding how to manage expectations in the political environment for what they do and the freedom they should have. I believe Congress will find other things more appropriate for their time as Facebook does a better job of setting expectations in 2019. The company has been distracted and their earnings growth in the year ahead will not meet initial targets but they are still on a tremendous secular growth path that is unaffected by tariffs or economic cycles.

Economic & Financial Market Charts

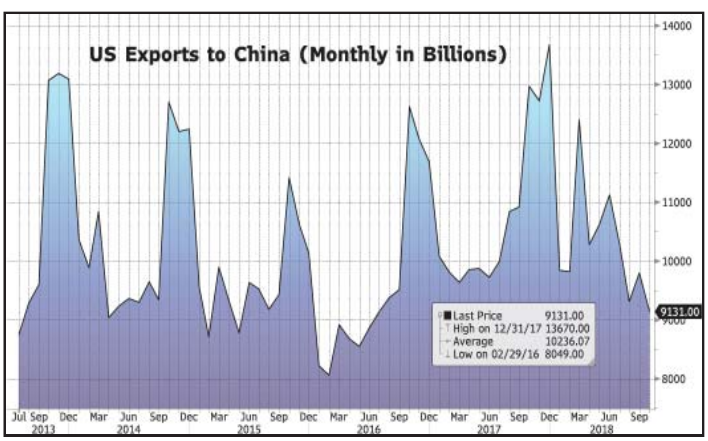


Figure 1 - Source: MACM / Bloomberg Financial
Graph of U.S. Exports to China

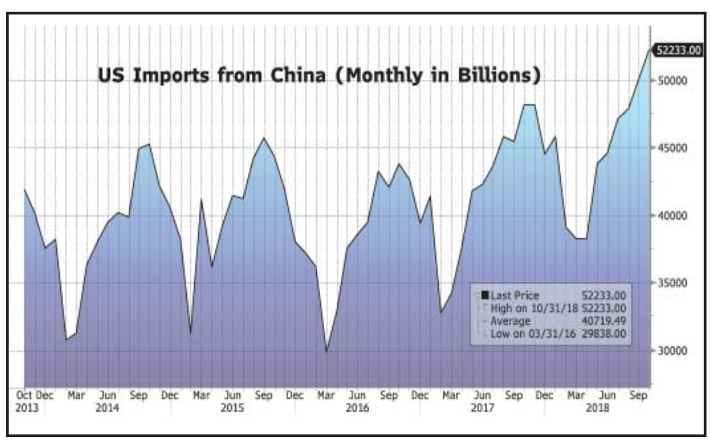


Figure 2 - Source: MACM / Bloomberg Financial
Graph of U.S. Imports from China