April 18, 2019
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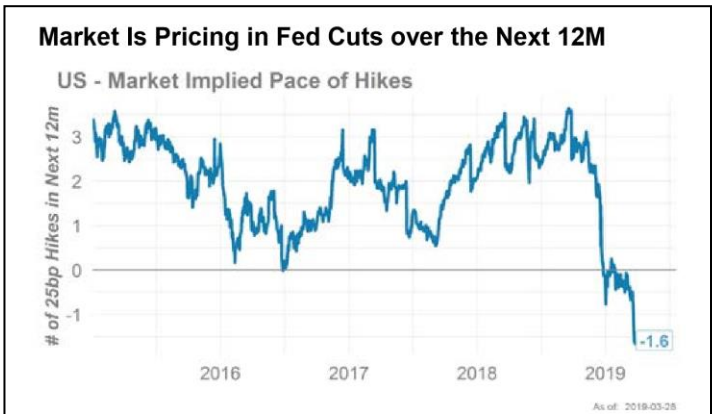
"Never Mind"

Todd Asset Management US Market Commentary

	1Q 2019	1 Year	3 Year*	5 Year*	7 Year*	10 Year*
S&P 500	13.7%	9.5%	13.5%	10.9%	12.8%	15.9%
Russell 1000 Value	11.9%	5.7%	10.5%	7.7%	11.1%	14.5%

* *Annualized Total Returns.*

First quarter market performance shows the power that a simple phrase like "Never Mind" can have, especially when it is the Fed Chairman invoking that sentiment. The S&P rose almost 14% in the first quarter posting a rebound of Biblical proportions from a fourth quarter that ended in tears. As you may recall, late last year the markets got spooked when the Federal Reserve statement from December 19 suggested they were going to persistently raise rates and sell bonds from their balance sheet in a nearly automatic fashion. In response to that, markets panicked, culminating in a Christmas Eve selling frenzy that was probably exaggerated by algorithms and automated programs. By early January, the Fed effectively said "Hey, remember that December statement we made? Never mind." and plotted a course to be patient in monetary policy. They went as far as to predict no rate increases in 2019. The market has gone a step further and seems to be anticipating the Fed actually lowers rates over the next 12 months. Taking the Fed out of play drove a large "risk on" rally in January, despite concerns that we would have expected to temper enthusiasm.



Source: Bloomberg, Morgan Stanley Research

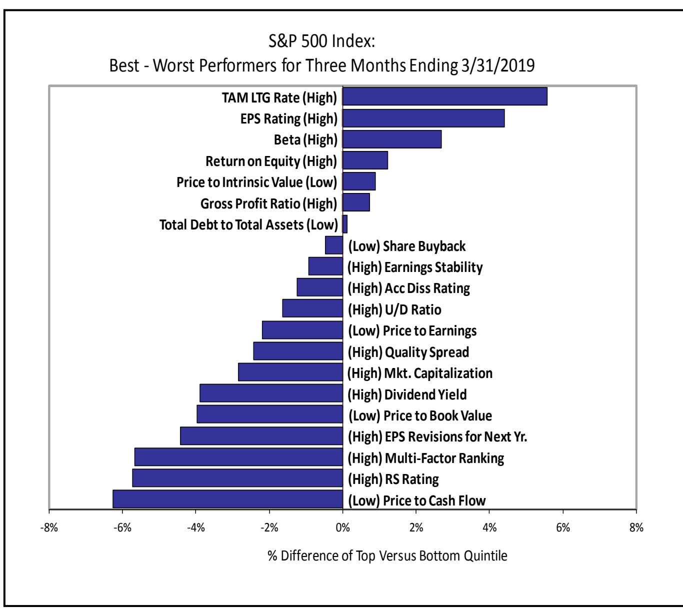
We remain bullish on the outlook for 2019. We do not anticipate a recession, though we saw GDP slow in Q4 2018 and probably Q1 2019. The US and China continue to tiptoe towards some resolution to their trade war. We believe the trade concerns drove much of the global economic sogginess last year, as business confidence evaporated and business investment plans undershot expectations. A trade deal would provide the impetus for an economic reacceleration we expect in 2019, as uncertainty about trade seems to be holding business confidence and investment back. We believe the reacceleration will resemble 2017 in that regard and that investors should begin anticipating a globally synchronized recovery again as international stimulus programs take hold.

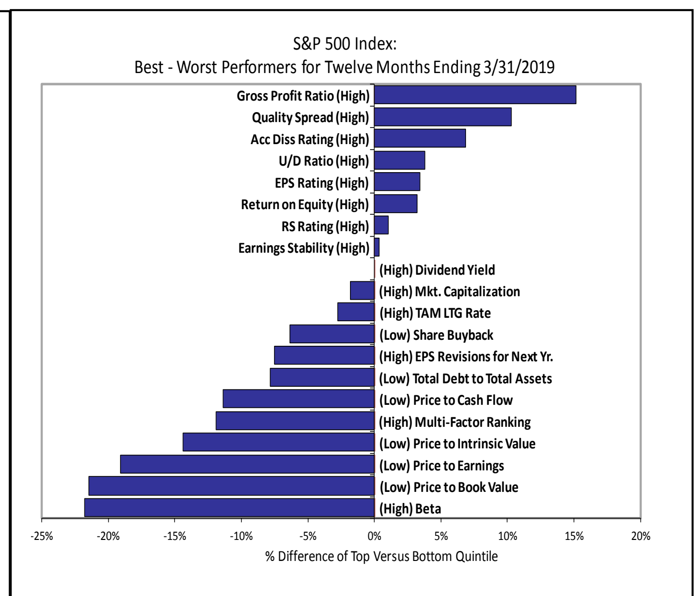
There are still concerns though, and the market seems to be anticipating a lot of good news. Our guess is that the market could bide time or fade a bit over the next few months and then get a stronger bid when the economic reacceleration/US-China deal becomes apparent. The concerns investors ignored over the first quarter included:

- An inverted yield curve briefly occurred at the end of the quarter, where the US 10 year Treasury yield declined below the three month rate. The rule of thumb is persistently inverted curves usually lead to recessions.
- Bond yields plummeted in the US and worldwide, usually a sign of recession fears.
- US Earnings estimates revisions have been negative after the tax induced positive surge last year.
- The China trade deal has not been reached yet.
- Brexit looks messier than ever.
- The EU is now under trade pressure from the US.
- The US government needs to get through a debt ceiling debate, replace spending lost to sequestration cuts and endure the beginning of the election season.

These concerns are all common knowledge, but the power of the Fed averting a policy mistake has prompted this rally. Avoiding this mistake should extend this economic cycle and allow for continued growth without a dramatic increase in inflation. The S&P is trading at the average price to earnings ratio it has enjoyed since 1990. Secular bull markets usually do not end until you see an above average valuations. We would not be surprised if the market stalled out and consolidated for a few months though, after a very robust first quarter.

Factor Analysis





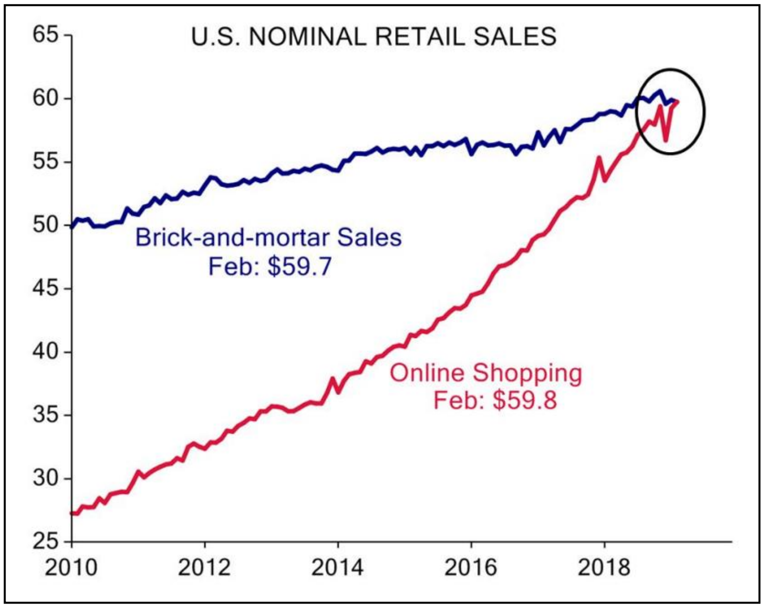
Source: Ford Equity Research, Bloomberg, & TAM estimates.

The customary analysis we use to identify which factors added or detracted value from portfolios over the past three months (left chart) and trailing year (right chart) are presented above. The growth rally continues. As value oriented investors, saying this gives us no joy. If you look at both the trailing three month and twelve month returns, traditional value factors are buried at the bottom of the list. Profitability measures, strong historic earnings growth rates and high accounting returns are the common factors that investors rewarded over the past quarter and year. Additionally, fundamentals generally did not help create performance last year as more factors detracted from performance than helped. For some years now, when stockholders worry about economic growth they default to growth stocks and shun value stocks. Market participants got edgy in the fourth quarter, and the S&P 500 declined nearly 20% through Christmas Eve as worries about intensifying trade wars and Central banks becoming tighter grew. A strong rebound followed in the first quarter as Central banks moved to a more neutral posture and progress on trade talks got baked into expectations. US stocks outperformed International stocks, and Growth stocks outperformed Value stocks over both the trailing year and quarter. Small Caps underperformed the S&P 500 over the past year, but outperformed over the first quarter.

This suggests to us that there are crosscurrents at work that have led investors to be risk averse, quality conscious and growth seeking over the past year, but those fears may be starting to ease up as they are becoming more interested in Small Cap stocks. This feels very much like how markets acted during the 2015-2016 growth scare. Back then, investors narrowed the factors that were rewarded and focused only on Dividend Yield. The number of factors in favor might be higher this time around, but, the sentiment is very similar.

As investors' concerns get resolved, i.e. China/US Trade negotiations yield an agreement, Brexit is completed or delayed, Central Banks become neutral after tightening and general late cycle fears ease up, there is likely to be a rotation towards some of the laggards that are value oriented stocks or offer good economic sensitivity. The dollar has been a beneficiary of rising tensions, and that could reverse as well offering better returns for US investors in overseas markets. We believe that is starting now, and expect 2019 to play out much like 2017 with International stocks outperforming the US and economically sensitive stocks outperforming the more defensive sectors.

Interesting Charts we saw this quarter



Source: Evercore ISI and the Commerce Department

For those of you thinking the internet is a fad, we have some bad news. According to the Commerce Department, online sales outpaced in-store sales for the first time ever (chart left). The strength in this clearly reflects the convenience of the medium. Overall strength in both measures points out that US consumers are in good shape. The Online shift puts downward pressure on prices, keeping inflation in check. It also depresses rents and commercial property prices.

Expect the spread of this through other services to have a disinflationary effect on the economy.

Indicators Do Not Suggest a Near Term Recession

Recession Dashboard

Recessionary indicators point to limited downside risk

Inflation and real estate trends are not yet problematic, but warrant greater scrutiny

Start of Recession	Yield Curve	Inflation Trends	Job Creation	Credit Perform	ISM Mfg.	Earnings Quality	Housing Market
Nov-73	↓	↓	↓	↓	↓	--	↓
Jan-80	↓	↓	↓	↓	↓	--	↓
Jul-81	↓	↑	↑	↓	↓	--	↓
Jul-90	↓	↓	↓	↓	↓	↓	↓
Mar-01	↓	↓	↓	↓	↓	↓	↔
Dec-07	↓	↓	↔	↓	↓	↓	↓
Present	↔	↔	↑	↑	↑	↑	↔

Key: ↓ Recessionary ↑ Expansionary ↔ Neutral

Source: Standard & Poor's, Federal Reserve, BLS, National Statistical Agencies, NBER, ISM, Census Bureau, Haver Analytics®, Credit Suisse

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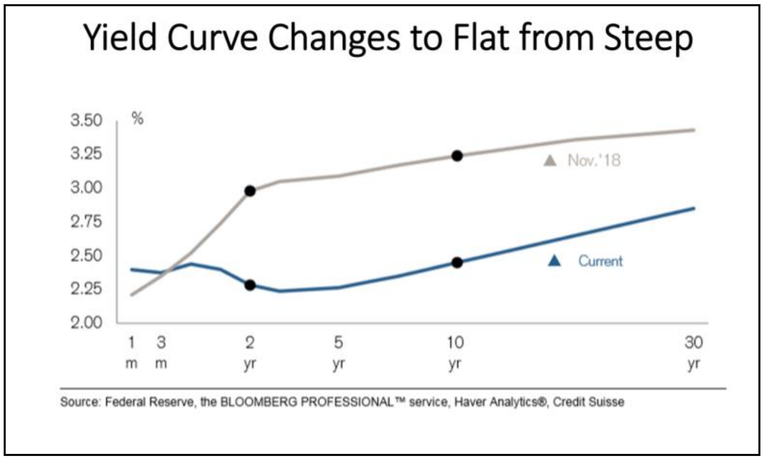
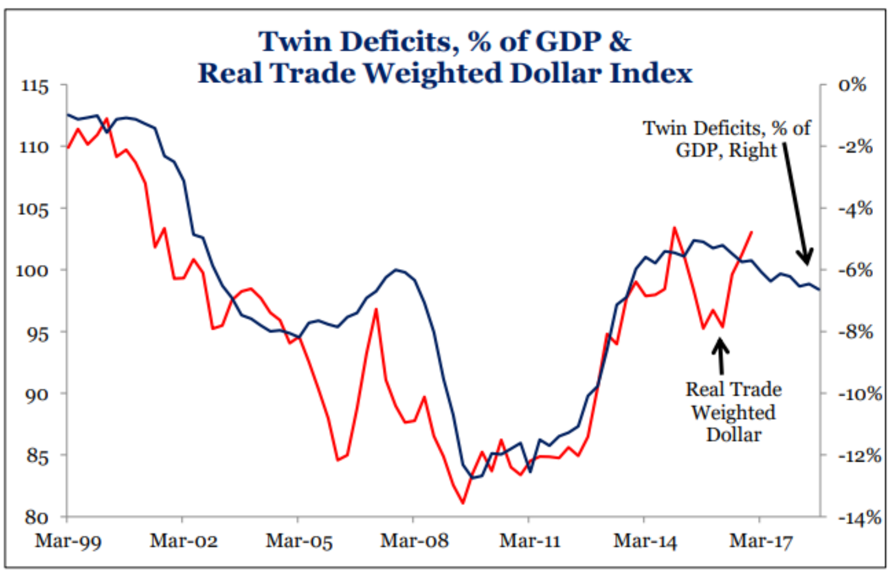


The Yield Curve illustrates how short term interest rates compare to longer term rates. Short term rates are set by policy makers while long term rates are set by the market. A positive slope indicates that the market expects higher rates in the future, presumably as the economy grows. In November of last year, longer term rates were comfortably higher than short term rates. Quarter end 3 month rates were nearly equal to the 10 year rates, indicating the market was concerned about a slowdown that drives rates lower in the future.



Source: Strategas

The recent strength of the dollar makes our exports less attractive draws foreign investors into our markets. As illustrated in the chart above, the combination of the budget and trade deficits leads movements in the dollar. The forecast for those deficits is to deteriorate as tax cuts impact the budget deficit and our trade deficit remains high. We would expect dollar weakness, which should be a support for our exports, especially if trade deals are struck with China and/or the EU. This weakness should get US investors more interested in foreign assets, like in 2017.

Surveys indicate small business interest in expanding has cooled over the past year, though it still remains near the peak of prior cycles. Tax cuts should have helped this measure. We would note that the recent decline coincided with the imposition of tariffs and general rise in uncertainty noted in our introduction. As those concerns are resolved that this measure should recover and improve. Employed consumers enjoying rising wages should set the stage for small businesses to expand.

<u>Summary</u>

We just wrapped up the best quarter of market performance since 2009, a liftoff period after the Great Recession. Much of this is a result of a rebound from the fourth quarter, which was the worst since 2011. We do not believe a recession is likely anytime in the next couple of years, but the market was very concerned that one was occurring during the fourth quarter as synchronized slowdowns in growth between China, Europe and the US concerned investors. These slowdowns arose from a number of different factors, but the major concerns, namely the US/Chinese trade dispute, Brexit Concerns and aggressive tightening from the US Fed are all in the process of being resolved. We believe a second half economic acceleration is likely as stimulative measures from China should bolster worldwide economies. We would not be surprised to see the S&P 500 bide some time and consolidate though until we get some formal agreement on the US/Chinese trade dispute or an economic reacceleration. We are still in a secular bull market that we think will last for many years to come.

As always, if you need any additional information, please feel free to contact any of us.

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04/18/19
S&P 500 – 2,905
Russell 1000 Value – 1,241

Refer to the following page for more information on the commentary presented. This is pertinent to this letter and should not be reproduced or duplicated without this disclosure.

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S&P 500 Index is a widely recognized index of market activity based on the aggregate performance of a selected portfolio of publicly traded common stocks. The performance data was supplied by Standard & Poor's. It is included to indicate the effect of general market conditions.

Russell 1000 Value Index is a widely recognized index of market activity based on the aggregate performance of common stocks from the Russell 1000 Index, with lower price-to-book ratios and lower forecasted growth values. The performance data was supplied by Frank Russell Trust Company.