MACRO MUSINGS

April 24, 2019

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FIRST QUARTER 2019 REVIEW

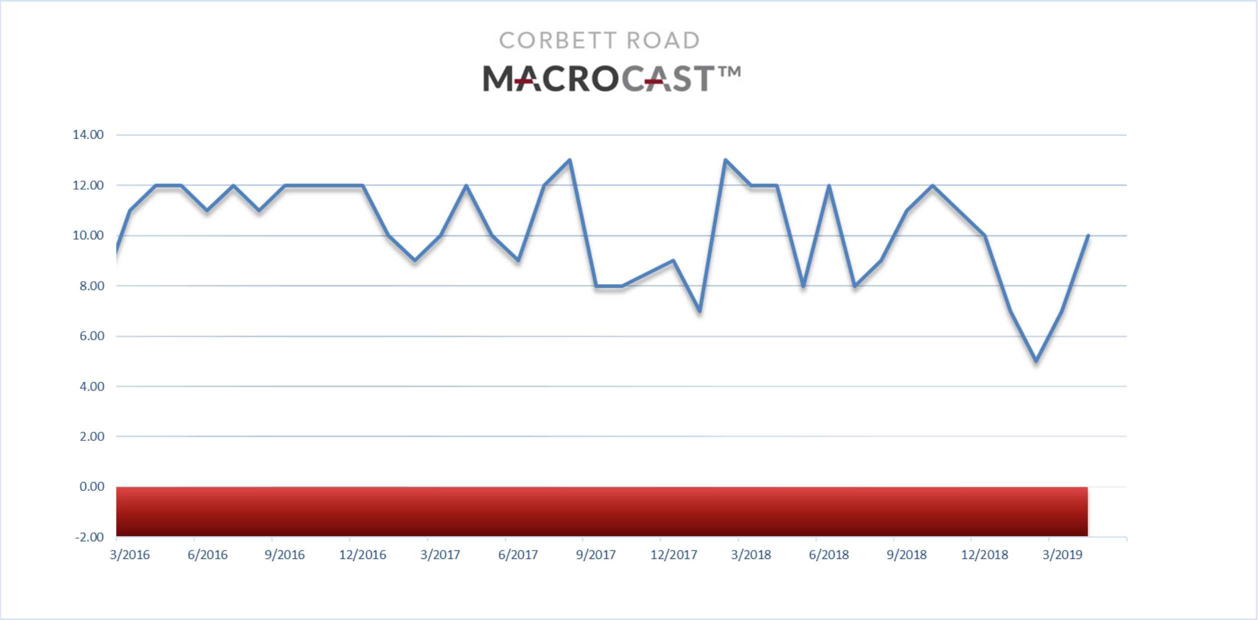
SUMMARY

- **The rebound in the MACROCAST™ score is led by improvements in our Technical indicators, while the Valuation category is a headwind.**
- **It was a big quarter for all major asset classes. A rebound in risk appetite combined with a less aggressive Fed led to both higher stock and bond returns. Commodities also rose, led by gains in oil prices.**
- **Strong starts to the year have historically been a positive indicator for the rest of the year. When the market registered double digit gains in Q1, returns for the final 9 months were positive in all but one instance.**

THE MESSAGE FROM MACROCAST™

As a reminder, MACROCAST™ is Corbett Road's proprietary investment model. MACROCAST™ measures the appeal of risk assets by assessing the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. By looking at multiple factors, we can better gauge market conditions and the probability of a major market decline.

The most recent score for MACROCAST™ is +10, up 3 points from last month and 5 points above the multi-year low registered in February. The current score suggests a large, sustained market decline is unlikely.



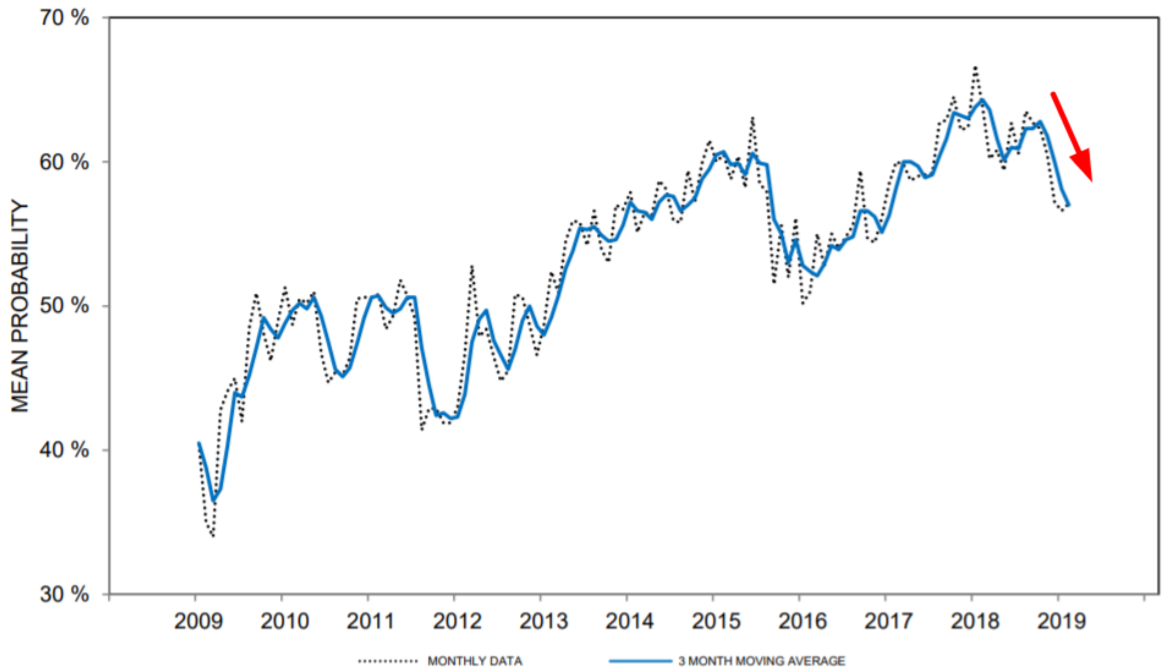
Technical indicators saw the biggest improvement. All major stock markets are back above their 200-day moving averages, or long-term trendline. The market is considered in an uptrend if it trades above the trendline and in a downtrend if it is below. On April 23, 2019, the S&P 500 reached a new all-time high, surpassing the previous high recorded on September 20, 2018.

Valuations were the biggest detractor. This is not a surprise; the S&P 500 is up 16% since the start of the year and almost 24% since the Christmas Eve bottom. Although earnings estimates for S&P 500 companies have risen since hitting a low in February, the market is up a lot more, causing the Price to Earnings ratio (P/E) of the market to expand.

Despite the rally**, Sentiment** indicators are mostly neutral. Both survey data and investor activities suggest skepticism of the rally.

The monthly University of Michigan sentiment survey indicates declining confidence that the market will continue to rally over the next year (from bullmarkets.co):

CHART 20: PROBABILITY OF AN INCREASE IN STOCK MARKET PRICE IN THE NEXT YEAR



This drop is unusual, as expectations typically follow market moves. The latest data does not include March, but the market was higher in both January and February and expectations still fell.

Investors have also been reluctant to put money back into the market. According to the Investment Company Institute, which tracks fund flows for mutual funds and ETFs, investors have *sold* equities since the beginning of the year. A reversal of this trend could drive stock prices higher.

TOTAL RETURNS (%)

Through March 31, 2019. Asset classes ranked by 1 month % total return

Asset Class (index)	1 mo.	YTD	1 yr	3 yr▪
Foreign REITs (S&P Global exUS REIT)	4.6	13.4	2.9	8.4
US REITs (MSCI REIT)	3.3	16.3	20.7	6.0
Foreign Gov't Inflation-Linked Bonds (FTSE Russell WILSI ex-US)	2.1	4.4	-5.2	2.9
US Inv. Grade Bonds (Bloomberg US Agg. Bond)	1.9	2.9	4.5	2.0
TIPS (Bloomberg Treasury TIPS)	1.8	3.2	2.7	1.7
US Stocks (Russell 3000)	1.5	14.0	8.8	13.5
US High Yield Bonds (iBoxx Liquid High Yield)	1.0	7.5	7.0	7.9
Foreign Devlp'd Mkt Bonds (FTSE Russell WGBI ex-US)	0.9	1.5	-4.6	0.9
Emerging Market Stocks (MSCI EM)	0.8	9.9	-7.4	10.7
Foreign Developed Mkt Stocks (MSCI EAFE)	0.6	10.0	-3.7	7.3
Cash (S&P US T-Bill 0-3 Month Index)	0.2	0.6	2.1	1.2
Foreign Inv. Grade Corp (FTSE Russell Non-$ Corp)	0.2	2.0	-6.0	1.5
Commodities (Bloomberg Commodity)	-0.2	6.3	-5.3	2.2
Emg. Market Gov't Bonds (FTSE Russell EMGBI)	-0.4	3.6	-2.6	4.6
Foreign High Yield Bonds (Markit Global exUS HY)	-0.4	3.6	-6.1	4.2
Global Market Index†	1.3	9.3	3.0	8.0
Global Market Index-Rebalanced *	1.2	8.3	2.0	7.2
S&P 500	1.9	13.7	9.5	13.5
60/40 US stock/bond (rebalanced) +	1.9	9.4	7.6	9.0
Crude Oil (West Texas Intermediate spot price)	5.2	32.4	-7.3	16.3
Gold (spot price)	-1.6	0.8	-2.5	1.6
US Dollar Index (spot price)	1.2	1.2	7.9	0.9

Returns based on *month-end* total return prices, which may differ slightly from returns calculated with daily prices for specific time periods. MSCI EAFE and EM data are net total returns.

▪ annualized

† GMI is a passive, unmanaged, market-value weighted index of all the major global asset classes (excluding cash). Initial allocation based on 12/31/97 market values.

* Rebalanced version of GMI that's rebalanced to 12/31/97 weights every Dec. 31

+ Initially weighted 60% S&P 500 and 40% Bloomberg US Aggregate Bond, rebalanced to 60/40 every Dec. 31.

CapitalSpectator.com

Here is what we found most interesting about Q1 results:

1. ***Everything went up.*** After a poorly timed December rate hike, the Fed signaled to the world that it was taking a break from raising rates. This helped trigger two things in the market: 1) it renewed risk appetite, as the possibility the Fed would send us straight into recession dropped and 2) the pause in rate increases contributed to the fall in interest rates, which pushed up bond prices and interest rate sensitive sectors like REITs (more on that below).
2. ***Among stocks, the US led the way.*** The US was the worst performing major stock market in the 4th quarter of 2018, so it is not surprising that it has rebounded the most. It outperformed both developed and emerging markets by 4%. Both international developed and emerging markets held up better than the US in Q4 but still rallied double digits to start the year.
3. ***REITs surprised with the best performance.*** Real Estate Investment Trusts were up even more than the market in Q1. REITs don't usually outperform the broader market during a big rally, but they pay good dividends and act as a bond proxy. Lower interest rates helped drive them higher (since 3/31, they have pulled back a little).

A START THIS STRONG IS HISTORICALLY BULLISH

Since 1960, strong starts have led to further gains, not losses. When the market gained 10% in Q1, it continued to rise nine out of ten times in the final three quarters. 1987 was the one down year, and even then, you saw further gains of 21% before the crash in October (table from LPL):

A GOOD START TO THE YEAR CAN HAVE BULLS SMILING

S&P 500 Index Returns When Q1 Gains >10% (1950 – Current)

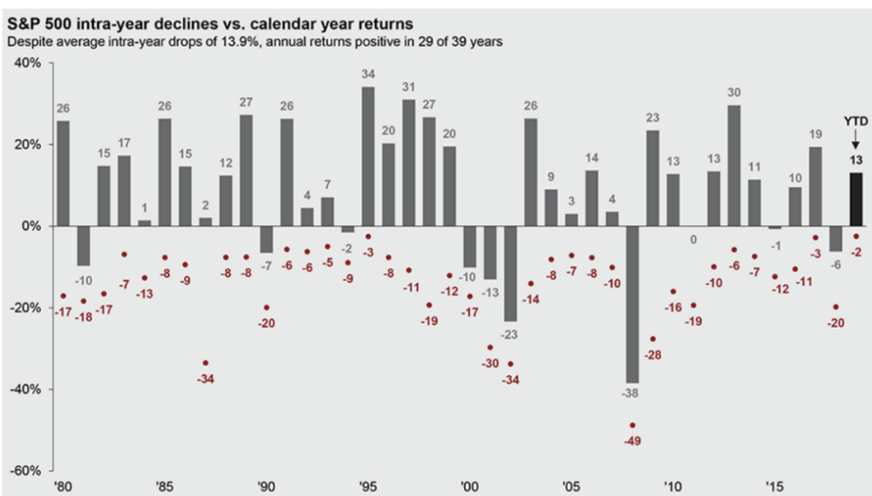
Year	S&P 500 Index	Q1 Return	Final Three Quarters	Full Year Return	Max Gain Final Three Quarters	Max Pullback Final Three Quarters
1961	65.06	12.0%	10.0%	23.1%	12.8%	-4.4%
1967	90.20	12.3%	7.0%	20.1%	10.6%	-6.6%
1975	83.36	21.6%	8.2%	31.5%	19.0%	-14.1%
1976	102.77	13.9%	4.6%	19.1%	9.3%	-8.4%
1986	238.90	13.1%	1.4%	14.6%	11.1%	-9.4%
1987	291.70	20.5%	-15.3%	2.0%	21.0%	-33.5%
1991	375.22	13.6%	11.2%	26.3%	13.2%	-5.6%
1998	1,101.75	13.5%	11.6%	26.7%	29.7%	-19.3%
2012	1,408.47	12.0%	1.3%	13.4%	14.7%	-9.9%
2013	1,569.19	10.0%	17.8%	29.6%	19.9%	-5.6%
2019	2815.44	12.3%*	?	?	?	?
	Average		5.8%	20.7%	16.1%	-11.7%
	Mean		7.6%	21.6%	14.0%	-8.9%
	Count		10	10		
	Higher		9	10		

Average Year For S&P 500 Index (1950 – 2018)

	Final Three Quarters	Full Year Return	Max Gain Final Three Quarters	Max Pullback Final Three Quarters
Average	6.3%	8.8%	17.5%	-12.1%
Median	7.3%	11.4%	14.3%	-9.6%
% Higher	72.5%	71.0%		

Source: LPL Research, FactSet 03/28/19
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.
* Note Q1 return as of 3/28/19

Corrections still occurred after strong starts. Each year saw a pullback of at least 4.4% and median decline of 9%. So far in 2019, the market's drawdown is 2% (chart from JPM):



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2018, over which time period the average annual return was 8.4%.
Guide to the Markets – U.S. Data are as of March 31, 2019.

J.P.Morgan Asset Management

We've shared the above chart many times, but it is an important reminder that even in good market years, a decline of *at least* 5% is the base case scenario.

BUT BIG GAINS MIGHT LEAD TO LOWER VOLATILITY

There seem to be signs that large gains at the start of the year lead to lower than average volatility. As shown in the following table, when returns through Easter are up 10%, the market resolved higher each time. The sample size is small, but the most interesting statistic is the standard deviation, or volatility of future returns (Table from Schaffer's Investment Research):

S&P 500 Returns Rest of Year After Easter

Last 30 Easters	Up 10% + Through Easter	Up < 10% Through Easter	Negative Through Easter
No. of Results	5	14	11
Average Return	12.52%	10.51%	-1.91%
Median Return	11.16%	10.21%	-2.99%
Percent Positive	100%	86%	45%
Std Deviation	7.33%	9.32%	16.53%

When the market was up over 10% through Easter Sunday, it exhibited lower volatility than if the market was positive but had lower returns. This is counterintuitive because you would think bigger returns lead to more volatility (like they often do with individual stocks), but that has not been the case.

POSITIVE ON THE REST OF 2019

An improving MACROCAST™ score and strong momentum in the market leaves us with a constructive outlook on the rest of 2019. We expect a market drawdown greater than the 2% we've seen so far, but if MACROCAST™ remains positive, we think a recessionary bear market between now and the end of the year is unlikely.

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