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RICHARDSONGMP
Hunter
Wealth

Fall 2019

A Move to Consistency

A powerful market rebound took place over the first four months of this year. Much of this was simply unwinding the deep correction that happened at the end of 2018.

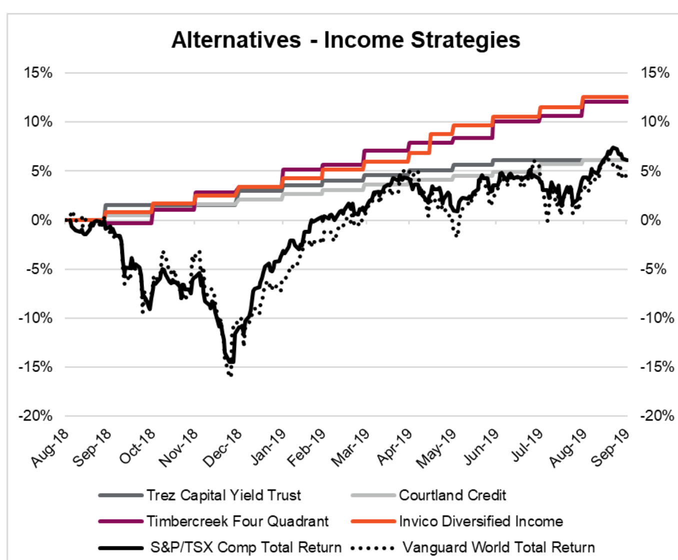
Since the spring, markets have lacked direction and become more uncertain. The American economy continues to grow, driven by employment and wage growth. Central banks have provided stimulation through low and falling interest rates. American homeowners are benefitting while also keeping household debt under control.

At the same time the American consumer is feeling more confident about his or her job and home affordability, global economies have been very weak. Interest rates in Germany have reached negative levels again in an attempt to stimulate.

US Corporate earnings have also slowed. Tax cuts created a spike in earnings last year making it inevitable that earnings growth would slow by comparison this year. However, absolute growth is still reasonable.

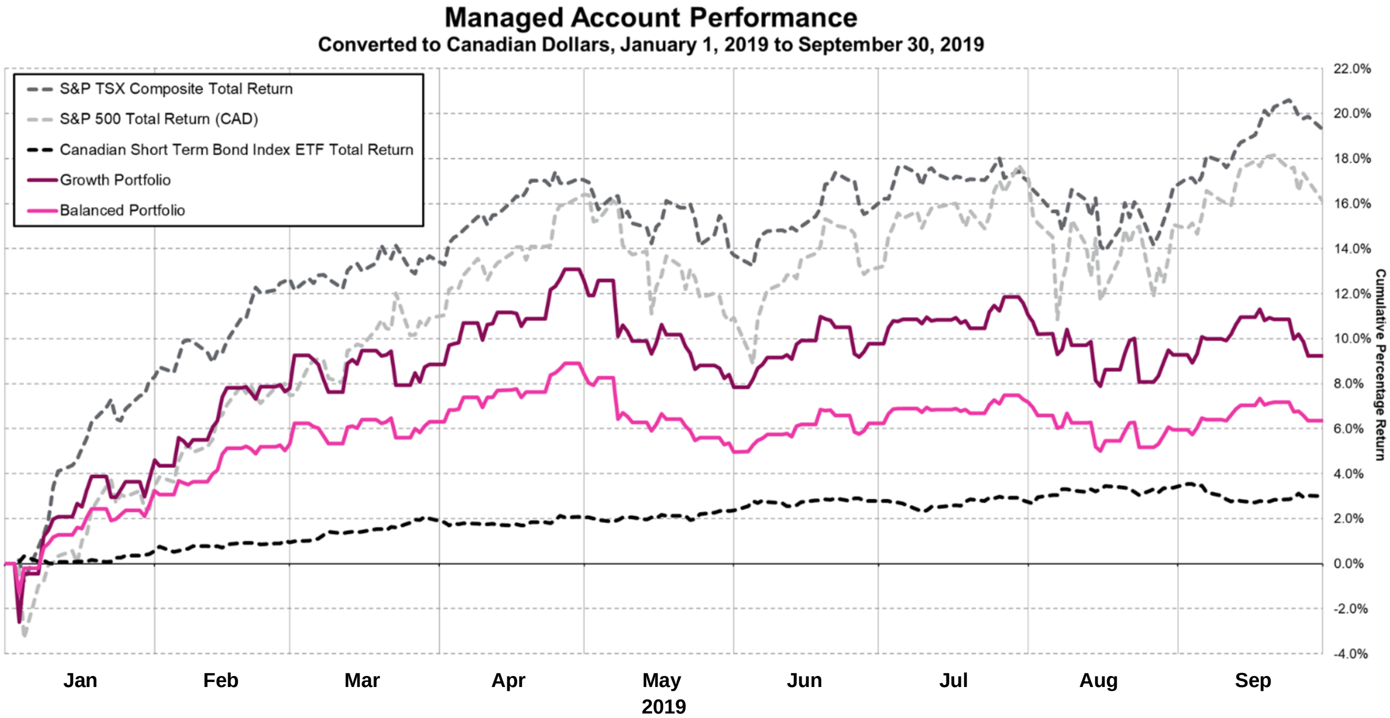
Business investment continues to be an area of weakness. Concerns over trade, impeachment, Brexit, and overall slowing growth have made it difficult for corporations to know what rules will be in effect and in what countries. They are holding back investing for the long-term.

We've increased exposure to Alternative Investments. Alternatives add diversification by using an expanded set of investment opportunities to enhance returns with reduced risk. Portfolios have been enjoying more consistent results with less correlation to public markets. Below are some of the income-focused alternatives we own in portfolios.



Source: Refinitiv Datastream and data from issuers

Managed Accounts



Source: Richardson GMP, net of fees, unaudited

Growth Portfolio is one specific growth-oriented managed account. The asset mix averaged approximately 75% equity, 5% fixed income, 18% alternatives, and 2% cash.

Balanced Portfolio is one specific balanced managed account. The asset mix averaged approximately 42% equity, 35% fixed income, 20% alternatives, and 3% cash.

Selected accounts are considered representative of growth and balanced portfolios across most managed client accounts. The level of cash varied throughout the quarter. Individual managed accounts vary in results due to customization. Deposits or withdrawals to portfolios, and the resulting implementation of changes in securities held represents the largest cause for differences in accounts. Client-directed and non-model securities held in managed accounts can also result in a significant performance difference from the average experience.

Managed portfolios had a great start to the year due to having above average levels of equity. Since May we have been cutting back equity exposure while shifting more funds to alternative investments.

Fixed Income has had a good year, benefiting from interest rates falling. Early in the year we added to fixed income as central bank policy became accommodative and rates started falling. However, the total allocation to fixed income remained between minimum and target fixed income levels in portfolios. At this point, there is still a positive bias for fixed income as rates are expected to continue falling. However, at such low current yields, the overall expected return is fairly low and the group remains vulnerable should currently very low rates rebound.

Equities have been reduced, particularly in our tactical model. Core, long-term companies remain integral to portfolios, especially growth ones. The exchange traded fund portion, which is owned based on relative strength and leadership, has moved from nearly exclusive representation in US sectors (especially technology-based ones), to less than one-third of the tactical model in equity. The long-held position in the ecommerce exchange traded fund "FDN", which contains Amazon, Google, Netflix, Facebook, PayPal and similar companies, has now been completely sold. This tactical change has reduced the variability of portfolios and lessened the correlation with markets. As cash from these sales may be held for the next several weeks, we've been parking funds in more yield-enhanced cash products.

Alternative investments has been the main asset class we've been adding to. A private real estate management fund and a second arbitrage hedge fund were two significant additions over the summer. Additional purchases of existing alternatives have also taken place. Read more information on alternative investments later in this publication.

Strong American consumer

There are two significant reasons to expect the US economy and stock market to continue to grow:

- **The American consumer is in great shape**
- **Low interest rate policy continues to stimulate.**

Americans are working and enjoying reasonable wage gains. There continues to be more jobs posted in the US than individuals looking for work. Unemployment claims are low, and unemployment itself continues at multi-decade lows.

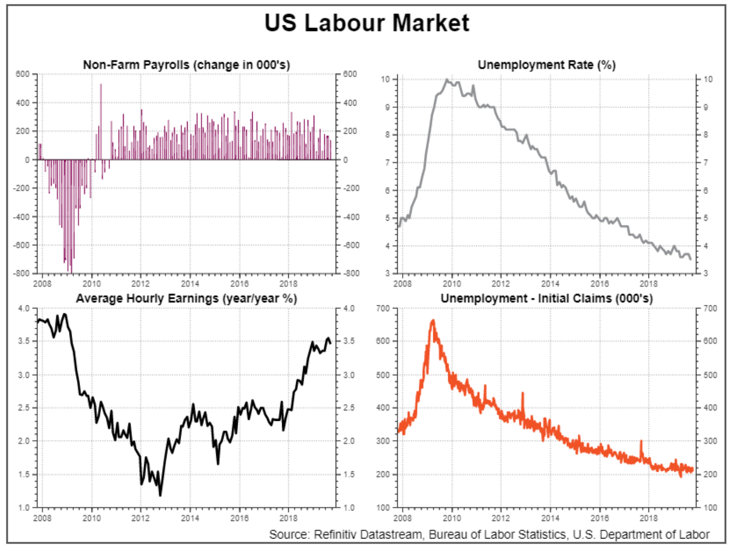
The US housing market is fairly stable. The rate of growth has slowed from the past few years and housing is still not as strong as it was previous to the 2008 financial crisis, but it is still growing. More importantly, American household debt as a percentage of disposable income continues to fall. The financial crisis in 2008 ushered in significant mortgage rule changes. They've worked. Americans now have more manageable debt levels on their homes, and interest rates continue to fall.

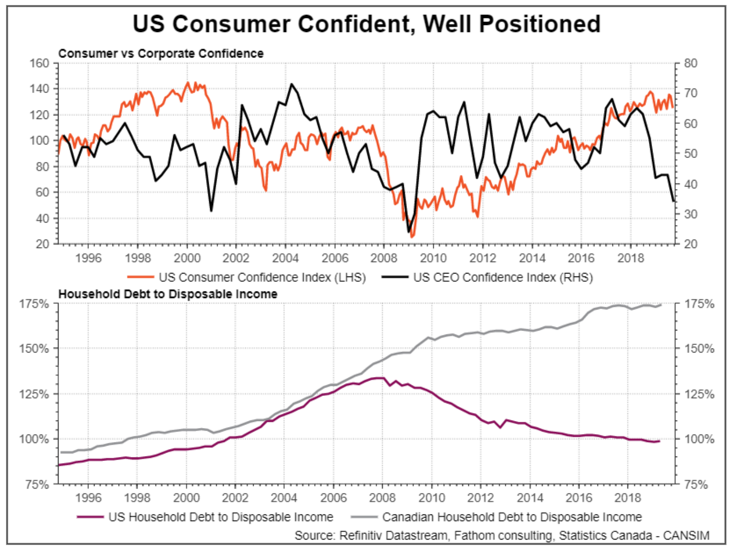
When people are comfortable with their mortgage payments and have ample work including increasing wages, the economy tends to do fairly well.

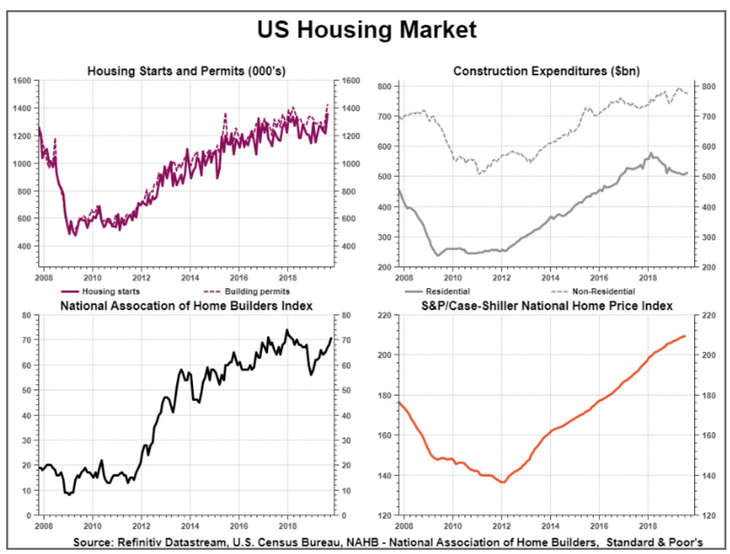
Why then does there seem to be so much fear about the economy and a potential looking recession?

Comparing *consumer* confidence with *corporate* confidence gives us a hint. CEOs and corporations themselves express a fear level approaching crisis levels seen shortly after 2008, and similar to post-2000 tech meltdown levels. Companies face uncertainties from a variety of political and trade issues around the world. They are reluctant to commit long-term capital.

Canadians were far less affected by the 2008 financial crisis. So, they've continued to pile debt onto their households. Government deficits have also ballooned. Recent Canadian government policy has made it tougher and more restrictive for resource industries while simultaneously increasing taxes. There are more challenges for risk-takers and job creators. Demand for more spending in nearly every facet of Canadian government continues, despite significant deficits. The Canadian consumer seems to be in a weaker position than his and her US counterparts.







Central banks to the rescue

Low interest rates provide more cash to households and allow more economic activity. As rates fall, investors pay more for stocks.

Interest rates are very low. Especially comparing them over the last few decades. Low rates create demand for goods. It makes expensive things more affordable by allowing payment for them over time, in manageable chunks. A low rate means that financing a purchase won't cost much more. It also means that less household income goes to paying interest. These savings provide more cash for further spending or investing.

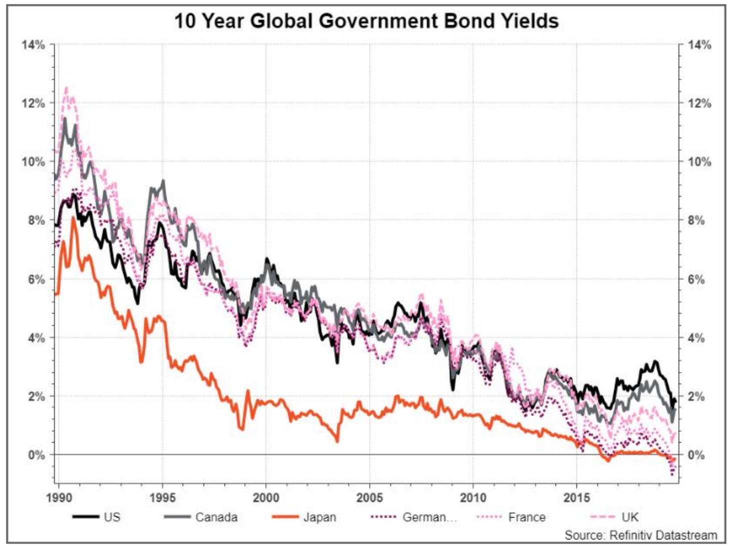
Last December, stock markets fell sharply. A significant contributor was Jerome Powell, chairman of the US Federal Reserve, guiding that interest rates might increase four times in 2019. Investors felt this policy was disconnected from a global slowdown and potential additional weakness from trade issues. They sold stocks in protest of this intention to continue raising interest rates, believing central banks were making a mistake.

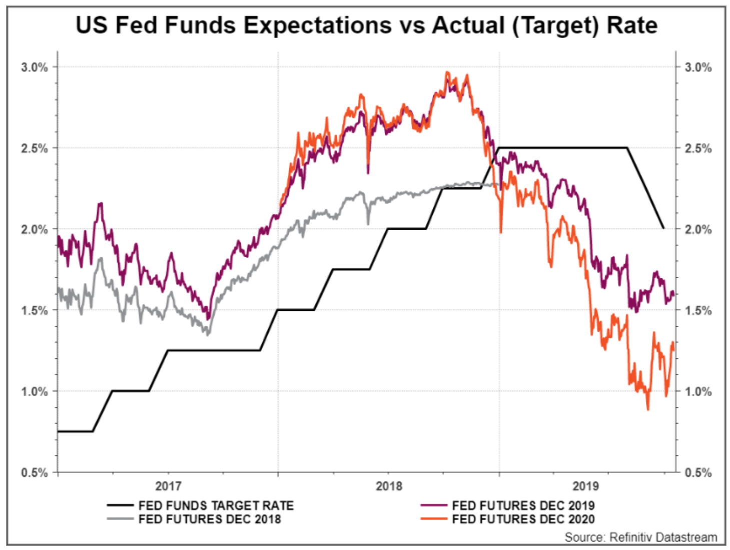
Shortly thereafter, economists and analysts of the Federal Reserve's policy target rate began to forecast it was going to fall. So far in 2019, two ¼% rate cuts already happened, and consensus estimates currently suggest two more might happen by year end. Consensus expectations a year ago predicted the fed funds rate today to be ~3%. And now, consensus estimates suggest the rate might drop to ~1¼% by the end of 2020. PIMCO, one of the fixed income specialists we use in portfolios, believes rate cut estimates are a little overdone and are positioning for a slight recovery. They feel the market expected too high of rates last year, and now the expectations may be too low.

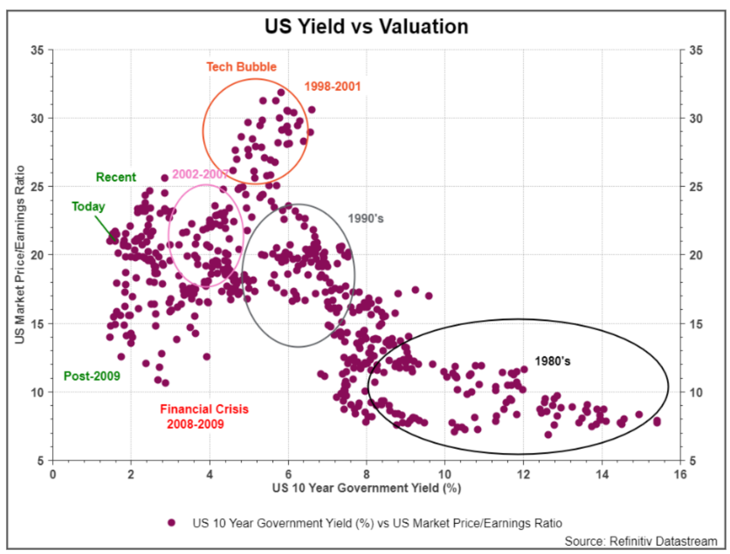
As the graph to the right illustrates, the lower interest rates are, the more investors will pay for future earnings.

Dividends also become more attractive as fixed income yields fall. Currently, a dividend-focused portfolio might yield close to 4%, while the benchmark Canada five-year bond yield is only 1¼%.

Simply put, low interest rates make stocks more attractive while stimulating the economy.



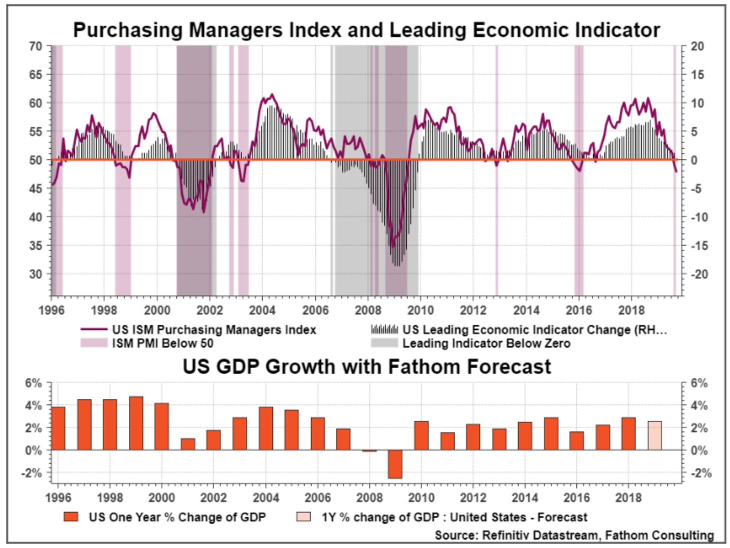




Warning Signs

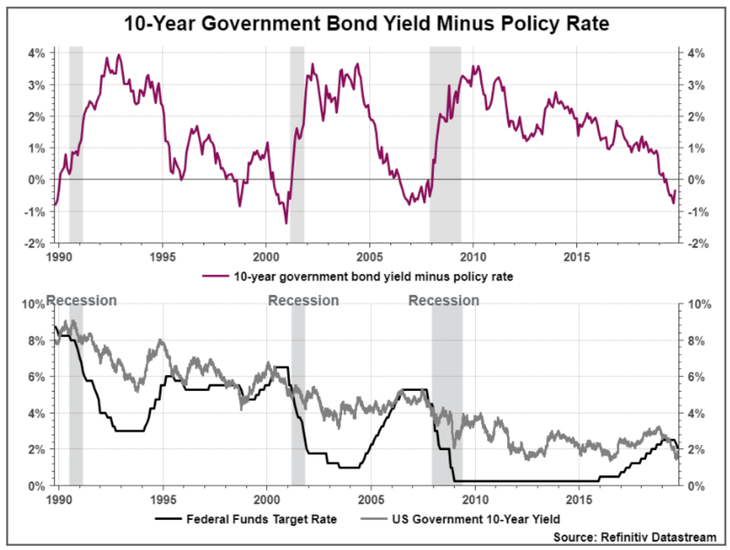
The strongest reasons for investors to be cautious about equities and the economy are:

- **Weakness in leading indicators**
- **Falling commodity prices such as copper and oil**
- **A flat yield curve.**



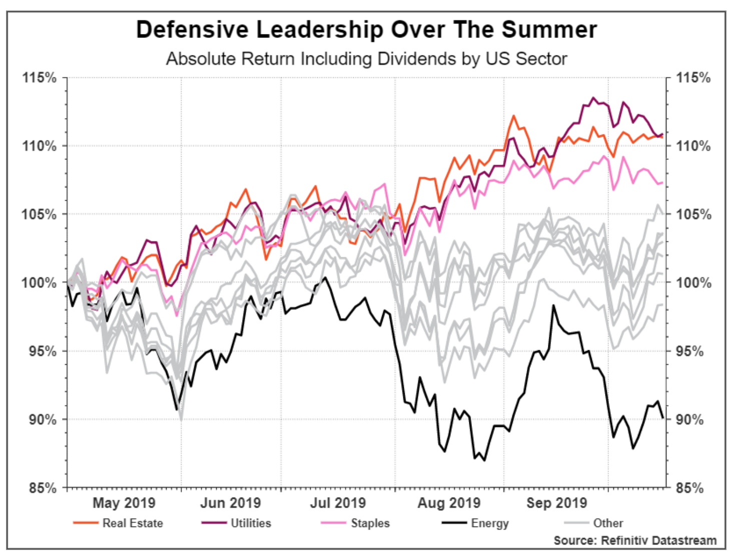
The Purchasing Managers Index (PMI) is a grouping of leading indicators that have done fairly well in predicting economic slowdown. Globally, Europe and China have had negative readings for months, and the US has now finally joined the pack.

After rising to over U$3/lb during 2017 and staying there into 2018, copper prices have fallen to $2.65/lb. At U$55/bbl Oil prices are at the lower end of their fifteen year range, and are well down from the low-U$70's/bbl they reached over the summer a year ago. Weak demand for materials and energy suggests slower economic growth ahead.



Recessions commonly follow flat yield curves (when short-term interest rates equal longer-term ones). Is this time different because the absolute level of both short and long rates is so low?

Political risks also loom. How much will global tariffs causing higher prices slow demand? Can a trade deal between such disparate ideologies as the US and China be struck? How will intellectual property and human rights issues be solved? What about potential US impeachment issues, and how much instability will Brexit cause? What will happen with protests in Hong Kong, and will the Chinese ever support the NBA again?



Despite a strong American consumer, accommodative central bank rate policy, and stable housing, investors have shifted portfolios into defensive sectors over the summer. This has been accompanied by flows into both bonds and cash. Many aren't waiting to see if everything works out. The challenge is whether to follow the defensive pack (and buy expensively valued utilities, food, and real estate stocks) or to own more cyclical and growth sectors that are struggling but are at discounted prices.

Investor hypersensitivity

The Richardson GMP Investment Strategy Committee manages a tactical model, and provides tactical guidance to its many portfolio managers. Tactical models try to adjust asset allocation by assessing opportunity and risk in financial markets.

Their 33-factor model shown to the right shows a more complete picture of the current situation. In summary, 20 of those factors are generally positive, which historically has been a reasonably good indicator to be invested in equity markets. Further, 10 of the factors are considered quite positive compared to only 4 of them considered very negative.

The current economic situation is a mixed bag, but with more positive indicators than negative. This is supportive of maintaining a core exposure to stocks and equities. There is never a time that every indicator is positive, providing certainty that the market can only go up. Reviewing multiple indicators helps determine the proportion of funds to commit to equities and growth. Portfolio management is about allocating more funds to opportunities when there is more potential for gains and less chance of losses. And similarly reducing investments in securities and asset classes showing increasing warnings.

There has been greater uncertainty about market direction and more volatility compared to a year ago. Combined with a meaningful number of cautionary economic signals, this suggests holding some cash in portfolios. Lower yields are generally very supportive of dividend stocks. The flow of capital into defensive sectors happened quickly last fall, but reversed at the beginning of 2019. Defensive sectors have again been outperforming since the spring. Investors should ensure they participate to some extent in this trend as it continues.

Market Momentum				
Canada				✓
US				✓
Consumer Model		✓		
HY Spreads			✓	
US Economy				
Leading Ind (3m)			✓	
Leading Ind (6m)			✓	
PMI			✓	
PMI New Orders			✓	
Cons Sentiment		✓		
Cars			✓	
Homes		✓		
Credit				✓
Chemical Activity		✓		
Rail		✓		
Energy Demand			✓	
Trucking		✓		
Phili Coinc				✓
US Unemployment			✓	
Rates				
Fed Funds				✓
Yield Curve	✓			
Yield Curve Change	✓			
Fundamentals				
Valuation Canada			✓	
Valuation US		✓		
Earnings Growth				✓
Sales Growth				✓
Margins				✓
Global Economy				
CRB		✓		
Oil			✓	
Copper	✓			
Baltic Freight				✓
KOSPI	✓			
Emerging Mkts		✓		
Global PMI			✓	
Total	**4**	**9**	**11**	**9**

Alternative investments are well suited as an asset class for periods of uncertainty and market slowdown. Hedge, arbitrage, private loans, and real estate are the primary alternatives held in our managed portfolios.

Consistency From Alternatives

Alternatives are attractive in portfolios because they are typically seeking an absolute return, independent of what is happening in financial markets. They can provide greater consistency. The lack of correlation with public markets makes them ideal for diversifying a portfolio.

Traditional portfolios only have two asset classes: stocks and bonds. A portfolio of entirely bonds provides the lowest return with the least variability in results. As stocks are added to the portfolio, annualized return expectations rise. At the same time, the volatility are variability of results also increases. The mapping of this efficient frontier in modern portfolio theory to the right shows this relationship.

Adding alternatives to a portfolio shifts the efficient frontier upward, suggesting potential for greater returns with equal or less volatility.

This is one of the reasons that pensions, endowments, and foundations are dedicating a significant portion of their assets to alternative investment strategies. The larger the size of endowment, the more that tends to be invested in alternatives.

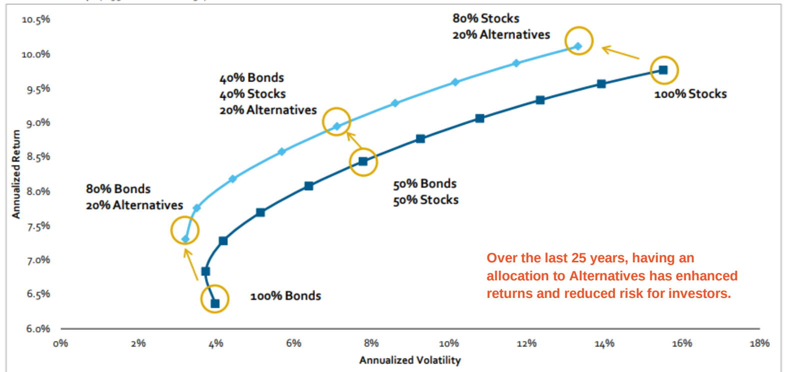
Strategies we like include:

- **Private credit strategies,** such as providing commercial loans for property or business development and holding real estate or other assets and covenants as collateral. Factoring, which is buying receivables of a business at a discount, is also an alternative lending strategy.
- **Equity long/short hedging strategies,** which own both long positions in stocks anticipated to appreciate and short positions in stocks expected to decline. Exposure to market fluctuations is reduced. The strategy seeks to be profitable on a net basis.
- **Event-driven arbitrage,** which takes advantage of the discount in public company takeovers. One security is converted to another at a set rate, yet it often trades at a discount to that conversion rate. Analysis focuses on understanding the legislative, regulatory, financing, management, and shareholder risks to a declared merger.

Adding Alternatives Exposure to a Portfolio May Reduce Volatility and Potentially Increase Returns

Risk and Return Trade-Off With and Without Alternatives

Data as of January 1, 1990 to December 30, 2016



Source: Bloomberg, Morgan Stanley Wealth Management GIC, Thomson ONE. Private equity index data sourced from Thomson ONE's Cambridge Associates benchmarking database and is represented by Buyout, Distressed, Growth Equity, Mezzanine, Private Equity Energy, Upstream Energy & Royalties and Venture Capital. Private Equity data subject to 5-month lag; therefore, all asset classes are depicted as of 1Qs016 for consistency. Private equity returns are net to limited partners. Stocks are represented by the S&P 599 Total Return Index. Bonds are represented by Barclays US Aggregate. Alternatives Investment are composed of 16.6% Equity Edge (HFRI Equity Hedge Index), 16.6% Equity Neutral (HFRI Equity Market Neutral Index), 33% Private Equity, and 33% Real Estate (National Council of Real Estate Investment Fiduciaries Property Index – NCREIF). Alternatives investments are not suitable for all investors.

Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

Asset Allocations for U.S. College and University Endowments and Affiliated Foundations

Fiscal Year 2018*

Size of Endowment	Short-Term Securities/ Cash/Other %	Fixed Income %	Domestic Equities %	Non-U.S. Equities %	Alternative Strategies %
Over $1 Billion	3	7	13	19	58
$501 Million to $1 Billion	5	10	22	22	41
$251 Million to $500 Million	4	12	24	22	38
$101 Million to $250 Million	5	15	31	22	27
$51 Million to $100 Million	3	19	34	22	22
$25 Million to $50 Million	5	22	39	18	16
Under $25 Million	5	24	45	15	11

Source: National Association of College and University Business Officers

* Average asset allocations as of June 30, 2018

Managed Account Alternative Investment Strategies

Private Credit/Equity & Real Estate	Long/Short Equity	Event-Driven Arbitrage
TREZ CAPITAL	FORGEFIRST	HGC INVESTMENT MANAGEMENT INC.
CORTLAND CREDIT	ehp FUNDS	UBS Asset Management
Timbercreek Asset Management	NEWGEN ASSET MANAGEMENT	**Equity Derivative Income**
Invico	WARATAH	Dynamic Funds Invest with advice.

Discretionary Management

Money is fuel. It allows you to either do the things you want to do, or prevents you from doing them when you don't have enough.

Financial management is matching your current investments and future earnings to the things you want to spend it on over your lifetime. A financial plan maps this out. It helps you confidently live your life, knowing you have planned out the "fuel" to do it.

A rate of return on the investments in the plan is key to making it work. Having a written Investment Policy Statement sets out the rules and strategies used to manage investments. Reporting allows comparison of portfolio results to the plan, giving you confidence you are on track.

With discretionary management, each family is placed into multiple securities models uniquely based on their goals and risk tolerance. When a security in a model changes, management software aggregates all the individual client purchases into one bulk trade. All clients get their proportionate share of the fill in any transactions that affect their portfolio. Fair and efficient. Non-discretionary Investment Advisors must call dozens or hundreds of clients to facilitate each transaction. Their time is spent simply calling clients for authority to transact.

Having the discretionary ability to enact trades proactively has significant benefits. It frees clients from having to make constant and numerous decisions. The relationship and communications between the Portfolio Manager and his or her clients focus on understanding the client's situation, designing solutions, and finding appropriate securities. It allows for consistent and simultaneous management across all portfolios.

The person with authority to trade bears responsibility for results. If you want advice from an Investment Advisor because you want to be involved, that's great. But the returns are yours, and management occurs when you, the decision maker, communicate with the Advisor. If you want to delegate managing your money then you need to give a Portfolio Manager the discretionary authority to do so. The decision maker is the manager.

I sincerely appreciate your business. I strive to earn your trust. I appreciate introductions to any family or friends that might benefit from our services.

Regards,

Your Wealth Team

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