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SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Andrew Slimmon November 2019 Equity Market Commentary

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1) As we expected, the S&P 500 has finally broken out of its year and a half trading range to the upside.
   a. Historically when the S&P 500 is up over 20% year-to-date through October, as it is now, the market has continued higher with a joyful Santa rally into year-end.[1]
   b. We think the S&P 500 could near 3,200 before year-end.
   c. However, on the surface, the market appears overbought and due for some pullback before its end-of-the-year surge. What leads me to question whether that will actually occur is a quote I read earlier this week from a European bank strategist:

      This rally caught everyone by surprise. Our clients have been defensive……they're waiting for some sort of a pullback or opportunity to deploy cash at a better time.[2]

      As I wrote in July, and I still believe today:

      My experience is that the market rarely gives you what you want when you want it. In essence, how can we have a pullback with so many wanting one? [3]

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment.
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2) A theme we have embraced all year has been that 2019 is a "post-pause year", as were 2012 and 2016.
   a. The US economy experienced growth scares in 2011 and 2015, just as it did in 2018, resulting in lackluster return years. That set up 2012 and 2016 to be good years – just as has happened this year.
   b. What's important to understand is in those previous "post-pause years", the market did not rally for only one year. *The better returns continued into 2013 and 2017. We do not think 2020 will be different.* More on this in our 2020 outlook piece.

3) Value stocks have dramatically outperformed growth stocks since the end of August. As we articulated last month, the rotation started as the market rejected the recessionary outlook scare.
   a. We think this is consistent with the value rallies the market experienced in 2012 and 2016, also periods when the recessionary calls proved wrong.
   b. In those periods, value's outperformance was much more significant than what we have seen so far.[4] We think value will continue to shine.
   c. Due to our flexible investment approach, Applied Equity Advisors has significantly increased its exposure to US value stocks since this summer.

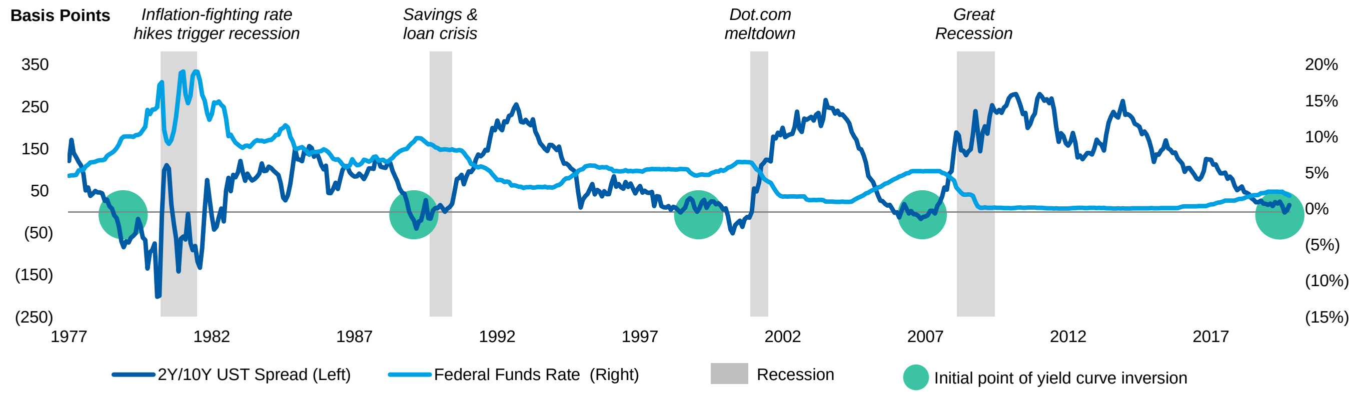
4) On the other hand, big growth stocks (i.e. the high flyers) have, as a group, been taken to the shed. They have been creamed since the end of August.[5] With so much crowding into the same technology names, I say AMEN to the market for punishing those who have irrationally chased returns without noticing either the extreme valuations or extreme enthusiasm.
   a. My view is that most of the damage has been done, and I doubt that growth will underperform further from here.

5) Alternatively, interest rate sensitive stocks (i.e. the defensives) remain quite vulnerable. I continue to believe these will lag as the economy recovers and investors chase back into the market.

6) I will end with the yield curve inversion and what I believe to be its historical relationship to the Presidential cycle.
   a. Presidents get re-elected when the economy is doing well in the quarter prior to the re-election. They get thrown out when it's not.
   b. There tends to be a lag between when the Fed changes policy and when that policy adjustment impacts the economy. The Fed cut rates this fall, and if consistent with history, this should positively impact the economy by the middle of next year.
   c. A China trade deal would add fuel to the economy next year.
   d. If the economy were to run hot in the second half of next year, on a year-over-year basis that will make the GDP bar more difficult for the *second half of 2021*.
   e. What does that have to do with the yield curve? See **Display 1** below showing the 2/10 year curve inverting in August. As you can see, the past four yield curve inversions have preceded market peaks in front of recessions by about two years. This would be consistent with difficult GDP comparisons for the second half of 2021.
   f. If history is a precedent, what you can also see is that we are early in this current inversion cycle, with plenty of upside still to go in the market.
   g. My conclusion is that in the near future, we should see a "hot" economy and pretty good returns for the stock market. And then additional worries down the road.

Andrew

DISPLAY 1



Initial Inversion	Stock Market Peak	Time Difference	S&P 500 Gain From Inversion To Peak
8/17/1978	11/28/1980	834 days	51.57%
12/14/1988	7/16/1990	579 days	41.46%
4/24/1998	9/1/2000	861 days	41.60%
12/27/2005	10/9/2007	651 days	28.80%
AVERAGE:		**731 days**	**40.86%**
8/22/2019	?	81 days so far	6.04%

1. Bloomberg as of November 8, 2019.

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[1] In the 7 times since 1950 the market is up over 20% through October, the market was higher by year-end all 7 times with an average return in November/December of 6.22%. Tony Dwyer. CNBC. November 4th, 2019

[2] Bloomberg. November 11th, 2019

[3] Isn’t The Stock Market a Forward Predictor?. July Commentary

[4] Factset data.

[5] According to Factset, the secular growth factor has underperformed the S&P 500 by -11.43% since the end of August.