Shorepoint
Capital Partners LLC

Identifying Opportunity.
Navigating Risk.

Newsletter – October 2018

MARKET TRENDS 9/30/2018

US Stock Markets	Q3	YTD
S&P 500 Index	7.7%	10.6%
S&P MidCap 400 Index	3.9%	7.5%
Russell 2000 Index	3.6%	11.5%
Int'l Stock Markets		
EAFE Index	1.4%	-1.4%
Emerging Mkts Index	-1.1%	-7.7%
Fixed Income		
Barclays Intermediate Gov't/Credit Bond Index	0.2%	-0.8%
Barclays Capital Muni Bond 3 Year Index	-0.1%	0.6%
Commodities		
SPDR Gold Shares (NAV)	-5.2%	-8.7%
Goldman Sachs Commodities	1.3%	11.8%
Real Estate		
Dow Jones US REIT Index	0.7%	2.1%
Yields	**9/30/2018**	**12/31/2017**
6 Mo. US T-Bill	2.4%	1.5%
10 Yr UST	3.1%	2.4%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

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The Ignoring Market

The 3rd quarter of 2018 was the most remarkable one of the year thus far with a strong rally in large cap domestic stocks. It would seem that Wall Street has taken to ignoring policy developments in Washington D.C. The President deepened the beginnings of a trade war with China, which contributes a specific type of unpredictability we haven't seen in many administrations. This increasing uncertainty was not being reflected in the markets at the end of the third quarter as the rally continued into the end of September. However, in early October the market seemed to awaken to these concerns with equity markets declining.

The Federal Reserve ("Fed")

Another component of the wall of worry that stocks will have to climb is the Fed's monetary policy. Much to the President's dismay, Federal Reserve Chairman Jerome Powell has articulated a commitment to steadily raising rates to a "neutral level." The President had hoped he'd be an easy money banker, which is especially helpful in an election year! Expect the pressure to mount on Powell to skip raising rates at their next meeting. But we wouldn't necessarily expect the Chairman to bow to it.

The Psychology of Numbers

While interest rates still remain historically very low, a conventional 30 year mortgage hovered around 5% for the first time in many years. For many young homeowners, this threshold is a new and scary one. Despite inflation also remaining very tame, there will likely be adjustments and volatility in markets as consumers, business owners and operators, and investors deal with crossing certain psychological barriers and new "threshold" numbers. A couple numbers that remain very reasonable are the price of gas, still under $3, and inflation, still barely above 2% and well below the historic average of 2.9%.

A Strong Economy!

So what's the good news you might ask, rather than budding trade wars and Fed tightening? There are several points that underscore why the domestic market has had such a nice run recently:

- Corporate earnings for the quarter came in at record levels.
- Stock valuations remains around average to low and are not near bubble territory based on current earnings.
- Small cap and mid cap stocks have underperformed in the quarter versus the "biggies" of the S&P 500 Index, leaving them relatively cheap.

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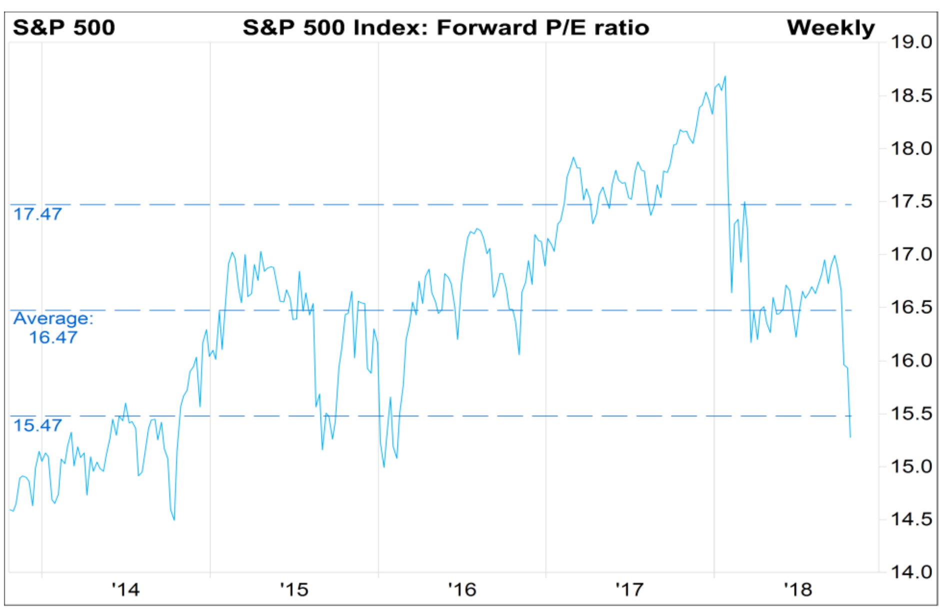
- International and emerging markets stocks particularly have performed abysmally, making them look very inexpensive.
- Unemployment is at lowest level since 1969.
- Inflation still remains low.
- Tax cuts added to strong corporate earnings and consumer spending.
- In addition, with so many people working, there is a nice foundation to our economy, which is now almost ten years into recovery following the Great Recession of 2007-2009.

Too Much Good News for Too Long?

In fact, one of the most pernicious concerns for investors going forward will likely be tied to the economy's recent success. Money managers and economists worry that we have already seen the best news we'll be seeing in this market cycle. Rarely do many facets of a modern economy work this well simultaneously. Company operating margins remain at all-time highs, but we are seeing pressures in the form of commodity inflation, labor inflation, and increased logistics/freight costs. Commodity costs remain elevated with steel, oil, and natural gas all up double digit levels compared to a year ago. Tim's grandfather aka Papou used to say, "after my laughter come my tears." Have we seen the peak of this economic cycle with these record earnings that were foretold by the climbing market? Does this 10 year period without a recession indicate an aging bull market with softer earnings and slower growth ahead? No one knows, but with the recent pullback in equities resulting in lower valuations, the market seems to be reflecting these concerns. According to the following chart, the S&P 500 Index has experienced a significant multiple compression (lower PEs = Price/Earnings per Share) which makes it more attractive on a valuation basis.



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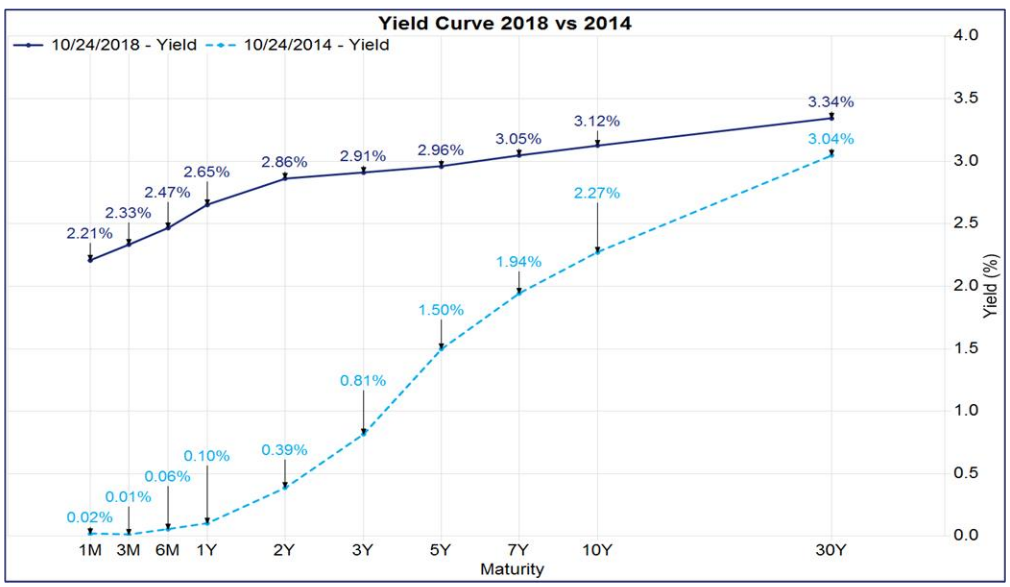
Mid Term Jitters and Bond Yields Rising

While we don't see a recession as being imminent, growth will likely be slower going forward after the market ebullience and sharp corporate execution we have enjoyed. Since September, the market continues to grapple with the prospects of higher interest rates, trade wars and slowing of international economic growth which has added to and increased market volatility. In addition, the upcoming mid-term elections are likely adding to investor concerns/fears after strong recent gains in stocks. Surely the increasing yields of bonds will also provide refuge to scared investors and asset allocators in search of stability and income. Another threshold recently breached was the 10 year Treasury yield, which went above 3% again! As the following chart shows, bonds with shorter maturities have experienced the largest movement in interest rates and the "flattish" yield curve indicates some caution on future economic growth.



Our Constructive View Remains – Looking Forward

While the trade wars and accompanying global tensions that follow such a policy are troubling, we are hopeful that the current administration is being political ahead of the mid-term elections and hoping to activate its base. A little softening in rhetoric and trade policy or better trade deals would go a long way to alleviating the troubling policy ramifications of picking fights with our economic partners. Given the history of the current President, it would seem likely that he would be "transactional" and give the markets what they want.

In addition, we would argue that growth is still growth, although the most significant gains of the cycle may be behind us. That does not mean that we can't find attractive opportunities for capital in both stocks and bonds and

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earn patient investors competitive returns in the months and years to come. We do NOT believe the domestic economy is headed for a recession in the near-term. Fiscal stimulus provided by tax reform should continue to fuel economic growth and enable companies to grow earnings in 2019. In addition to the domestic opportunities we see, the poor performance of international and emerging markets may produce long term vindication for those of us who have remained disciplined and diversified, despite the short term drag those positions have had on recent performance. We also remain positive on our outlook for dividend paying companies with defendable business models that are benefiting from secular growth and have the ability to generate strong cash flow.

The bond side of our portfolios was hurt by Fed rate increases but bonds should eventually settle in and provide a higher income level for more moderate and conservative investors. However, our clients continue to benefit from our use of a diversified approach to fixed income instead of investing just in U.S. treasuries. Other bond sectors, such as floating rate leveraged loans, actually produced positive returns and have higher yields than Treasuries with less volatility. Also, with money market yields increasing, we may utilize money market investments as an alternative to some of the bond allocation which will reduce portfolio risk and volatility.

As contrarians, we are adding to attractively valued international developed market equities, and emerging market equities/bonds which have not performed well in 2018. We continue to advocate a "buy the dips" approach and will add to high quality, attractively valued companies that have robust cash flow, strong earnings growth prospects and solid balance sheets.

Overall, Shorepoint's core philosophy is to manage diversified portfolios of quality, reasonably valued assets based on your investment objectives and risk tolerance. This has and will continue to be a successful investment strategy over the long-term. We seek to take advantage of opportunities as they arise and generate attractive long-term returns to help our clients reach their financial goals. As always, we are available to discuss your concerns and answer your questions.

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