ELITE WEALTH MANAGEMENT

Monthly Newsletter **June 2019**

IN THIS ISSUE

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Market Performance

June was a strong month for risk assets globally as they mean reverted out of the very bearish performance in May on the back of positive trade rhetoric and increasingly dovish policy momentum emanating from the US. Federal Reserve. This month capped the S&P 500's best June since 1955 and its best first-half year performance since 1997 along with the best June for the Dow since 1938. The S&P 500 Total Return Index, Dow Jones Industrial Average and NASDAQ performed +7.05%, +7.19% and +7.42% respectively. This brings their respective YTD performances to +18.54%, +14.03% and +20.66%. International stocks also posted a strong positive return with the MSCI EAFE Index up +5.66% bringing its first half YTD performance to 11.78%, lagging the U.S. indices by a wide margin.

Market participants were generally in consensus that the markets strongly oversold in May from a technical standpoint, similar to their behavior during Q4 of last year. This provided a supportive tailwind to the markets stabilizing in early June. Earlier in the month, commentary from Fed members hinted at a loosening Fed policy in order to continue to support economic growth. On the political front, all eyes were pointed toward the G20 Summit at the end of June that would define the course of trade discussions in the coming months. President Trump initially hinted at and then dropped the threat of tariffs on Mexico as the two sides quickly came together to mitigate trade escalation on the continent.

Over this past weekend, the G20 meeting concluded with it's likely best possible outcome with Trump and China's Xi agreeing to a trade truce, holding off on putting into effect the latest round of proposed tariffs tin order o restart negotiations. Our expectation is that the markets will be cautiously optimistic as it continues to weigh the discussions. Although continued positive trade developments will likely carry markets higher, economic expansion will have increasing headwinds as the current bull market gets closer to the end of its cycle. Our investment committee will continue to monitor these developments as we position our portfolio's exposure conservatively in preparation for a higher volatility landscape.

Monetary Policy

Federal Funds Futures provide a unique insight into market participants expectations of future rate hikes based on the most current available data. These expectations have shifted dramatically through the month of June and especially following the Fed's latest meeting in June. At the end of May, market participants were pricing in a 69.5% chance of the Fed keeping rates steady at the July meeting. As of 07/01, the market is pricing in a 100% chance that the Fed will cut at the July meeting. The current Fed rate is at 225-250 basis points. The market is currently pricing in a 52.6% chance that the Fed will cut rates to 150-175 bps by the end of the December 2019 meeting, implying three rate cuts over the next six months.[1]

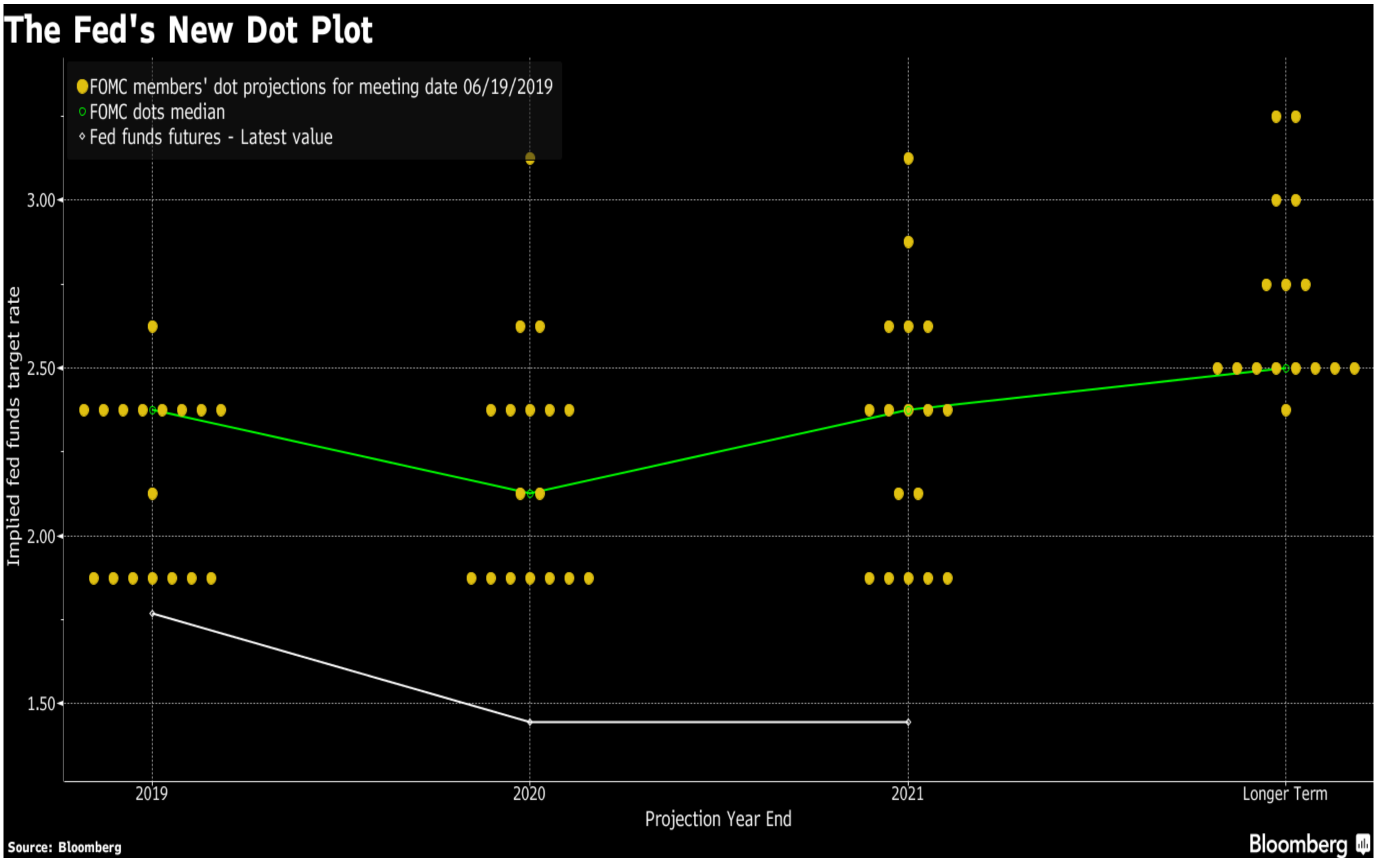
In the latest Fed meeting, which concluded June 19th, the Fed downgraded in the statement from the previous meeting its assessment of economic activity to a "moderate" pace from a "solid" pace. Back in January 2012, the Fed set an inflation target of 2% which they are continuing to undershoot. Whether they are immune to market and political pressure is become more debatable, but they indicated the need to monitor upcoming developments in trade discussions and upcoming economic releases over the next two months. There was a clear division amongst the members with eight out of seventeen expecting a rate reduction by the end of the year, another eight expecting no change and one expecting a hike.

History has shown that Fed Funds Futures are not typically accurate leading indicators for the FOMC's final decisions. Our investment committee's expectation is that up to two rate cuts are warranted, but three would be considered extreme and could send the wrong signal to market participants that the Fed is seeing greater weakness in the economy.

Global Outlook

The global macro picture for the month largely revolved around the G20 Summit outcome at the end of June. President Trump and China's President Xi agreed to a trade truce that involved Trump agreeing to delay plans for tariffs on an additional $300B of Chinese imports and allow Huawei Technologies to resume some of its business with U.S. companies. Market participants largely expected this outcome but caution that a final agreement still has a challenging road ahead.

The Eurozone's Markit manufacturing PMI continued on its weak trend, falling to 47.6 vs. 47.8 forecast and May's 47.7. Economic Sentiment declined to 103.3 from the previous month's 105.2. The European Central Bank (ECB) has indicated similarly to the U.S. Fed that it's willing to provide additional stimulus to prop up the economy and mitigate trade concerns between the U.S., Eurozone and China. China's Caixin manufacturing PMI declined to 49.4 for June vs. 49.6 estimates and May's 50.2 reading. The trade discussions are a binary overhang on the global outlook which we're monitoring closely.



Earnings Season

According to FactSet's latest earnings analysis as of 06/28, there is a notable positive in that of only 20 S&P 500 companies that have reported Q2 2019 earnings, 17 companies have reported a positive EPS surprise and 14 companies have reported a positive revenue surprise. On the negative side, the estimated earnings decline for the S&P 500 is -2.6%, much lower than the Q2 estimated decline of -0.5% at the end of March. Of the 113 S&P 500 companies that have issued guidance for Q2, 87 have issued negative EPS guidance which is the second highest number of S&P 500 companies issuing negative EPS guidance since 2006, behind Q1 2016. The Information Technology and Health Care sectors are contributing most to the increase in negative guidance, which isn't entirely surprising given the sectors relative performance over the last two years. The estimated revenue growth rate for Q2 is +3.8% which marks the lowest revenue growth rate since Q3 2016.[2]

The forward 12-month P/E ratio for the S&P 500 is 16.6 which is marginally higher than the 5-year average of 16.5 and a bit higher than the 10-year average of 14.8. The current Shiller PE ratio is 30.3, roughly the same level as the Black Tuesday peak. It's clear that earnings growth is continuing but showing deceleration/weakness which is typical at this point in the economic cycle and given the more recent earnings outperformance over the past several quarters. This doesn't necessarily imply a pending economic contraction which is also dependent on the trade negotiations and the Fed's response.

Portfolios Recap

Tactical Long/Short Strategy: +10.48% YTD 2019

The Tactical Long/Short Strategy gained +3.00% net of fees for the month of June. The S&P 500 Total Return gained +7.05% for the month. The Tactical Long Short Strategy underperformed as we kept the cash weighting of the strategy higher at the start of the month coming out of the bearish May in order to keep the portfolio's beta low. We increased the cash weighting as the markets rebounded strongly in June in order to provide a larger hedge to downside volatility. Despite the G20 outcome, a trade agreement is still elusive and we'll continue to keep equity exposure lower until the political environment softens and the longer term macroeconomic direction becomes more clear.

Core All Cap Strategy: +16.82% YTD 2019
Core Select Strategy: +14.42% YTD 2019
Global Strategy: +12.80% YTD 2019

For the month of June, the Core All Cap Strategy and Core Select Strategy gained +4.37% and +2.85% respectively net of fees. The S&P 500 Total Return gained +7.05% for the month. Both strategies underperformed the broad market as we maintain a higher cash weighting and defensive posture which helped them soundly outperform the previous month during elevated market volatility. The investment committee has a higher conviction in large cap technology stocks outperforming over the longer term and is focused on a more fundamental picture with a stronger conviction that the current components and defensive stance will outperform over a longer time horizon.

The Global Strategy gained +4.72% net of fees underperforming the MSCI ACWI Global Benchmark. The MSCI ACWI Global Index gained +6.73% for the month of June.

For the above three equity strategies, the investment committee is maintaining lower equity exposure from the previous month and increased exposure in short term US treasuries as the market pushes higher. It is our belief that the market is positioning for another round of volatility as experienced during May and Q4 of last year. The investment committee is continuing to focus closely on market valuations, market conditions and broad macroeconomic indicators in determining exposure adjustments. The Core All Cap Strategy, Core Select Strategy and Global Strategy invest excess cash into short-term U.S. treasuries which currently have an annualized yield of approximately 2.11%.

Dynamic ETF Option Strategy (DEOS): +3.94% YTD 2019

For the month of June DEOS gained +0.62% net of fees. The benchmark CBOE S&P 500 PutWrite Index (PUT) gained +4.77% for the month. The strategy performed in-line in a decreasing volatility environment as the Volatility Index (VIX) declined +19.40% for the month. We are continuing to leg further into short term traditional SPY credit put spreads with a conservative stance as we continue to monitor the political/trade landscape following the G20 meeting and as the market positions ahead of the Fed meeting at the end of July.

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References: