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SEEKING THE TRUTH

Technology has made impressive strides with widespread benefits to productivity, communications, entertainment, drug development, surgical treatments, increased purchasing power, education, and many other areas of our lives. One of the most interesting developments from a retail perspective has been in the use of DNA technology to learn one's ancestry. For a nominal fee and a swab of the mouth, home test kits like Ancestry and 23andMe can help provide context on a person's genealogy, examples including how much of your family tree is from Europe, Scandinavia, the Middle East, South America, Africa, and American Indian. Alternative results of the test have included unintended and emotional consequences of learning of previously unknown siblings, whereabouts of children who were put up for adoption, or the shock of perhaps learning one's true biological father. Additionally, forensic DNA analysis through GEDmatch has been used to exonerate the previously accused and innocently imprisoned and the resolution of unsolved criminal activities, some dating back decades. Learning the truth can be hard to handle, especially when unexpected or contrary to one's expectations.

Washington D.C. politics and media attention were primarily focused on the final report of the Mueller's DOJ special counsel's two-year investigation into Russian collusion affecting the Presidential election. Despite the report's findings of no collusion, those opposed to the President and his administration reacted with distrust, having fully embraced the theory of collusion, but now the report's discrediting their entrenched beliefs. Those who support the administration, on the other hand, felt vindicated and with renewed enthusiasm. Despite the report, political rhetoric continues, with an effort to sway public perception leading up to the 2020 election. However, after the report's release, the financial markets showed signs of relief on the basis the administration had avoided a significant disruption and risk of impeachment, and with the hope Congress can move forward in addressing the needs of the country. In our opinion, this also produced a higher probability the more business friendly Republican economic policies would be furthered over the President's remaining term, and should his reelection occur, allow the economy to grow faster than the policies proposed by Democratic candidates.

IN THIS ISSUE

DNA Technology

DNA technology has revolutionized modern science in areas of ancestral research, forensics, and medical treatment developments.

The Mueller Report

Special Counsel, Robert Mueller, has been drawing to a close his two-year investigation into Russian interference in the 2016 US presidential election.

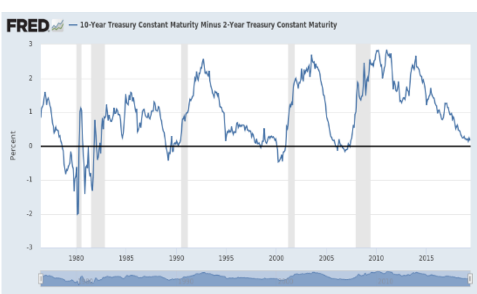
The Mueller report was not the only market moving news taking place in Washington, as the Federal Reserve's communications were the primary focus of Wall Street and main street investor attention. In our analysis, the markets sold off in the 4th quarter of 2018 primarily based on expectations of tighter monetary policy and a potential policy mistake. However, as the year began, investors reversed course and embraced the view the Federal Reserve was overly optimistic in their assessment of the near-term strength of the economy, and multiple increases in the Fed funds rate were unlikely to occur in 2019. With Fed Chairman Powell's communication of the Fed's willingness to be patient, traders took the news as a signal to unwind their cautious positions and increase portfolio risk.

April 23, 2019 FOMC Meeting: The Board of Governors discuss proposal to revise the Board's control rules. Photo courtesy of www.federalreserve.gov.

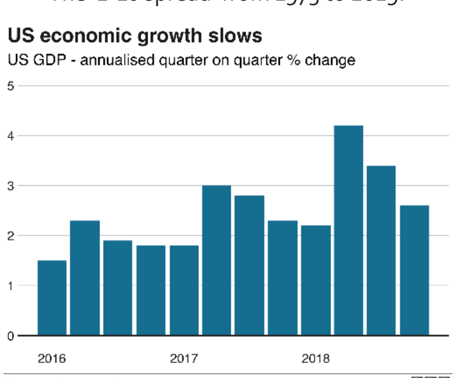
As a result, the broad domestic equity markets rebounded sharply from its 4th quarter test of support at the 200-week moving average, rising by 14% as measured by the Russell 3000 Index and recovering the vast majority of the 4th quarter decline. Fixed income investors also responded favorably by aggressively buying bonds and driving down yields, with the Treasury yield curve shifting downward by 0.20% to 0.30%. As an example, the 10-year Treasury yield fell from 2.68% to 2.40%.

FEDERAL OPEN MARKET COMMITTEE

The Federal Open Market Committee (FOMC) is the monetary policymaking body of the Federal Reserve System. Its 12 members are seven from the Board of Governors and five of the 12 Reserve Bank presidents.



The '2-10 spread' from 1975 to 2019.

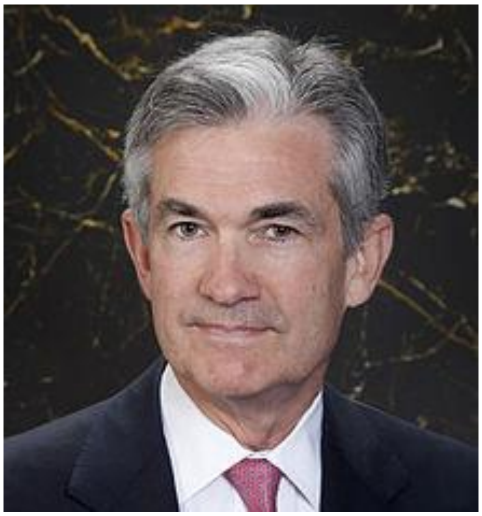


Due to their greater price sensitivity to changes in interest rates, longer dated bonds generated improved returns relative to shorter term bonds. This downward shift in intermediate and longer dated bonds, combined with a more muted move in shorter term bonds, anchored by the Fed funds target rate at 2.5%, caused 3-month T-bill yields to be above the 5-year yield. Many viewed this "inverted yield curve" as a cause for concern, a warning sign for a possible recession. While not a "normal" shape, in our opinion this isn't cause for near term concern as most investors focus on the spread between 2-year and 10-year yields as their recession predictor. This "2-10 spread" remains very narrow at roughly 0.15%, a level that needs to be monitored closely, but not a precursor for an impending recession. A wide "2-10 spread", usually peaking in the 2.5%-2.75% area, is associated with a robust economic backdrop, while a narrow spread is associated with a slower economic backdrop.

U.S. economic growth has indeed been on a longer-term gradual secular decline. This is primarily due to an aging population. However, on a shorter-term basis, U.S. growth has been slowed by ongoing trade negotiations, primarily with China, but also with major trading partners including the European Union and Japan. The U.S. is the largest economy in the world and is an especially important export market for foreign countries and companies. A resolution to the China trade war would provide a boost to domestic and international economic growth and remove an impediment to corporate spending plans. As discussed in past

EFFECTIVE FEDERAL FUNDS RATE

Federal Reserve Chairman Jerome Powell



FAST FACTS

PE Ratio

$$\text{Price/Earnings Ratio} = \frac{\text{Stock Price per Share}}{\text{Earnings per Share (EPS)}}$$

S&P 500

According to Investopedia, "The S&P 500 or Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. The index is widely regarded as the best gauge of large-cap U.S. equities."

commentaries, companies would like a higher degree of certainty before committing capital to long term investments. In the interim, companies continue to resort to shorter term shareholder friendly actions, including repurchasing stock and increasing dividends.

Given the economic backdrop, economists are now beginning to suggest the next change in the Fed funds rate will be a reduction. While we have no market "GDP Match" technology available to precisely validate, like the Fed, we also will need to be patient and see how the data flows. We don't believe the Federal Reserve will be cutting rates over the next several months, despite President Trump's efforts to sway Fed policy, and believe market interest rates are depressed relative to inflation. They remain low due to weak economic growth and interest rates overseas, and perhaps an overreaction to Chairman Powell's recent dovish comments. Resolution to the trade negotiations would likely cause an upward change to growth estimates, an upward shift in the yield curve, and widening of the "2-10 spread". Investors can make money by taking advantage of overreactions to short term market data, whether in the bond or stock markets.

With technology making vast inroads in our daily lives, it should be no surprise technology stocks have had a significant influence on market returns, with the tech sector outperforming the broad S&P500 by over 50% over the last decade. Leading gainers over that period have included many known names including Apple, Amazon, Netflix, Salesforce, and Adobe, that have created products and services of interest to both businesses and consumers. The growth style of investing, heavily weighted to the technology and consumer discretionary sectors has similarly dominated over this period, outperforming the S&P500 and Value styles by 19% and 40%, respectively. Investors unwilling to reassess future drivers of economic and market performance are missing out, as robust earnings have grown to support the prices of these stocks.

We don't subscribe to the theory that "value is dead", as investors theorized in the late 1990s during the technology bubble, nor believe growth is immune to periodic corrections. However, old economy industries and sectors must embrace technology to compete, whether through using productivity enhancing software and hardware, leveraging the internet for increased distribution, enhanced use of robotics, artificial intelligence, or new methods for finding oil, as examples. It is interesting to note over the same 10-year period, the energy sector was the worst performing sector by trailing the S&P500 by 75% on an absolute return basis. The use of fracking and horizontal drilling technology, along with the increased interest towards renewables, has been a drag on traditional energy stock performance.

Overall, we remain favorably biased to the equity market, but don't expect the remainder of the year to match returns witnessed over the first quarter, as these were a recovery from 4th quarter losses. On a valuation basis, the 10-year Treasury with a yield of 2.5%, which equates to P/E of 40x, is expensive relative to equities with a Price to Earnings (P/E) valuation multiple in line with their long-term historical median of a little over 15x, or an earnings yield of 6.5%.

Despite the criticism, the Federal Reserve has done an admirable job of steering the economy, and financial institutions are in a much better position to withstand an economic slowdown. Inflation remains low, wages are showing growth, unemployment is low and bringing workers back into the labor force, and consumer and CEO confidence remains solid. This type of economic environment has historically been favorable, potentially leading to a "melt-up" in prices. We believe there remain misperceptions on the underlying resiliency of the U.S. economy which has shifted towards companies with lower capital intensity, higher margins and returns on capital, and a higher growth rate. In this environment, old valuation metrics may not be appropriate. Our entrepreneurial spirit will continue to create inventions or innovations, whether a new app, discovery of a new drug or surgical technique, or some other solution. It's in our DNA.

Mark Teichner

TMI Market Trax is written by TMI Trust Company's Mark Teichner. Questions or comments on TMI Market Trax, TMI Agency portfolios or other investment services distributed by TMI Trust Company, contact Mark Teichner at mteichner@tmico.com. The material herein is based on data from sources considered to be reliable, but it is not guaranteed as to accuracy, does not purport to be complete and is subject to change without notice. This communication is for informational purposes only. Use by other than intended recipients is only allowed prior to TMI Trust Company's consent. Sender accepts no liability for any errors or omissions arising as a result of transmission. Any comments or statements made herein do not necessarily reflect those of TMI Trust Company or its affiliates.

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