ASHDON

Investment Management

Global stocks rallied and ended the first quarter of 2019 near record highs. While the volatility has unnerving for many investors, it is volatility that creates opportunity for active managers and our client portfolios benefited over last two quarters. The S&P 500 index advanced +13.7% for the quarter. International markets also recovered, up +9.0% (MSCI EAFE Index – USD) for the same period. Bond price changes were also notable during the quarter as long bond yields fell back to 2016 levels and the yield curve flattened. The Barclay's Aggregate Bond Index was up for the quarter (+2.94%).

Key responsibilities of an investment advisor include initial construction and then ongoing maintenance of an appropriate portfolio. We liken the job of building a portfolio to a highway construction project. Surely a construction crew would prefer to have all traffic stopped and diverted until the job is completed. Instead, they do their jobs in the midst of moving (often quickly and densely) traffic. Over the last several quarters, there have been times when the market "traffic" was dense and fast. For example, in 2016, recession risks were rising, commodity prices were collapsing, and the stock market gave way. In short order, the passage of the Tax Cut and Jobs Act (TCJA) in late 2016 triggered a spike in GDP, followed by a strong stock market rally driven by tech companies (who were repatriating cash from overseas under the TCJA). More recently, a surprising change in US monetary policy in December put a floor under the market, leading to the strong Q1 rally. Through all this, we maintained overall conservative portfolio allocations and remained committed to active, fundamental investment strategies. Looking back, the objective data show that has been the right decision – our portfolios have obtained their goals with less volatility than the broad market.

Our work on improving portfolio construction and maintenance has been ongoing. To be sure, there have been days when we have felt the speeding traffic. We respect the barriers that keep value safe: company balance sheet quality, price purchased consistent strategy discipline, and diversification. And make every attempt to be disciplined and dispassionate in all investment operations. During 2017, we fully invested in finding the balance between quality and investment expense, implementing inexpensive equity portfolios across client accounts where possible. We estimate that these increments lowered the real cost of investing for our clients by about 0.6% annually – a cost savings that will continually accrue to client wealth. At the end of the year, the majority of our investors could directly see what they owned, we could efficiently control what was owned, and, we were in a better place to protect and grow our clients' wealth.

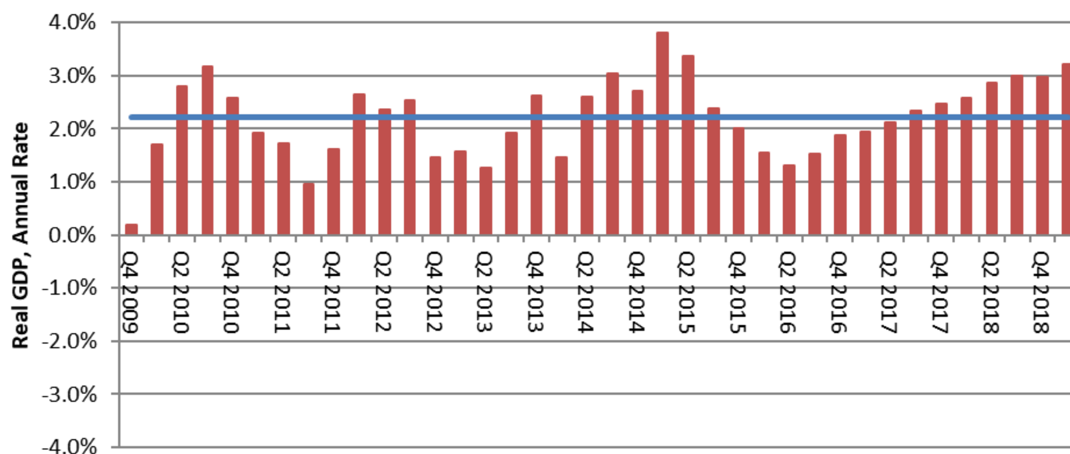
In 2018, under heavy market traffic, we continued our process improvement, further assuring that we will be able to dispassionately stick to our discipline going forward into a period we suspect will feature increased volatility. We focused our "construction" resources on refining the management tools that allow us to express our investing view across all client portfolios more quickly, without sacrificing portfolio customization or rising costs. This process has added value numerous times in 2019, making incremental equity investments in January – picking up lower cost positions for accounts that needed exposure, and in February and March as the rally progressed - trimming stock positions for clients who were overweight equity, or for whom we judged needed lower market exposure.

Our view is that the current environment is attractive for long term wealth building. We believe that our commitment to active management and to continuous process improvement will allow us to exploit a more volatile period for better compounding and our focus on fundamentally-driven strategies will keep asset value safe. We look forward to the future.

Thank you for your trust and confidence.

The US economy is in good shape. At the highest level, US real GDP continues to track in the 2.0% to 2.5% band (currently tracking at 2.2%). This level of GDP is consistent with our expectations for economic production in a mature, developed economy with headwinds from demographics, leverage, and over-supply of certain goods and services. While the long-term potential GDP for the US is likely higher, the overhanging excesses will take time to work out. In the medium term, this level of economic activity is highly sustainable, creating an attractive investing environment. Recent results have been somewhat higher, and the advanced Q1 data exceeded expectations at 3.2% (change from one year ago). The headline number was encouraging, but underlying details were less so. The good result was the result of an unsustainable inventory build, volatile export/import balance, and increased government spending while personal consumption and residential investment were disappointing. Forecasts for Q2 indicate softer results, but the economy continues to surprise many observers and the evidence of a growing economy can be found beyond GDP results.

REAL GDP



During Q1, the yield curve inversion and the implied "forecast" for an imminent recession was prominent in the news. It will pay investors to keep the yield curve in mind at all times, but interpretation of the signals from any economic data must be done in the context of all of the data. At this point, the data point to a stable and growing economy. Given the current data trends (growing production, wages, sales, corporate profits and jobs) all show that the economy over the last decade has had broad momentum. The US economy has been resilient in the face of several significant global events (euro crisis, EM weakness, etc.)

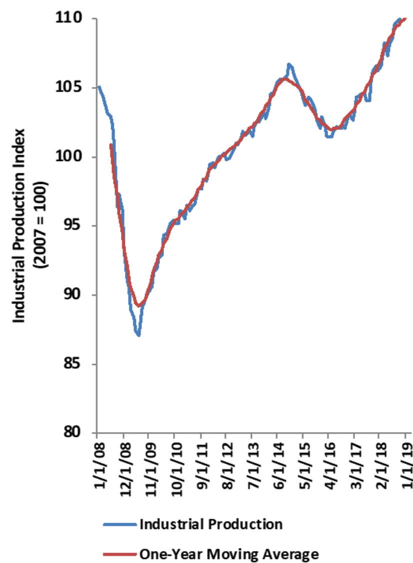
The durability of the US economy has been tested through this recovery cycle, for example during late 2015 and early 2016 when a significant decline in worldwide energy consumption and production pushed the economy to the edge. However, a combination of domestic stimulation in the US and external stimulation from Chinese policy, the economy recovered and has continued to grow.

This leads to consideration of the yield curve. The yield curve inversion came about as the FOMC continued to increase short term interest rates while long term interest rate stayed low. Short term rates are set by market conditions and monetary policy. However long-term rates are set by investor expectations of long-term growth and inflation. All through the recovery from the 2008 banking crisis, long term bond yields have stayed below historical levels. For us, the bond market is clearly communicating that the global economy continues to recover and rebalance. Yields on foreign government bonds remain well below US rates. For example, the German 10-year bund and the 10-year JGB yields are negative. Yields in countries with weak economies (e.g. Italy, Spain) are on par with that of the US with an objectively stronger economy. The yields on the bonds of these other countries are evidence that those economies continued to be supported by significant

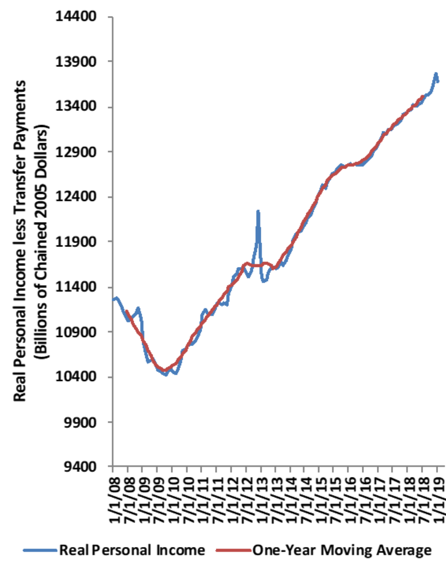
stimulus. This holds US yields down and provides an ongoing stimulus to the US economy. But even with this additional stimulus, the US economic growth remains muted. Central bankers and policy makers are forced to acknowledge the global context of the economy. So, the FOMC's change in policy last quarter – announcing that they would not raise rates further in 2018 and softening their stance on rate increase in 2019 – was not that surprising and we believe an appropriate response to the data.

Our view of the US and global economies is realistic, and we are sanguine. The slow growth path is stable and sustainable. The policy accommodation reduces the probability of calamity. And this situation creates and outstanding opportunity for long term investors.

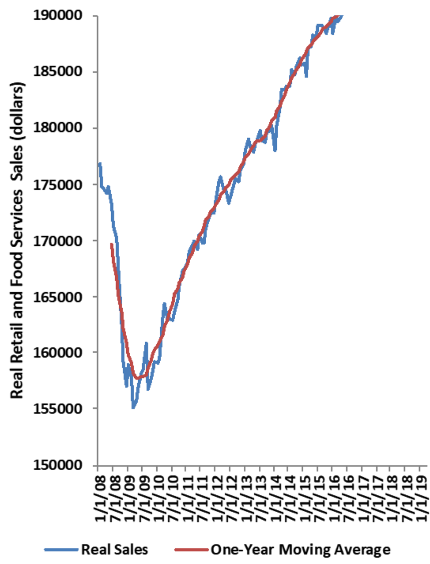
INDUSTRIAL PRODUCTION INDEX



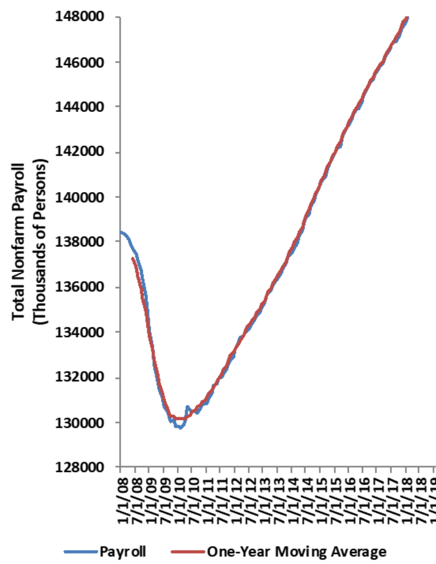
REAL PERSONAL INCOME



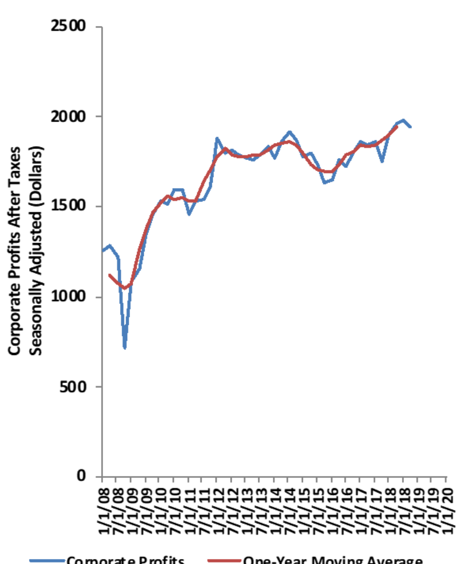
REAL RETAIL SALES



NONFARM PAYROLL



CORPORATE PROFITS



ISSUED BY

Ashdon Investment Management
214 East Grundy Street Tullahoma, TN 37388
Phone: 931 461-5733 Fax: 931 461-5735
INFO@ASHDON.COM

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