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MACRO MUSINGS

July 24, 2019

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FIRST HALF 2019 REVIEW

SUMMARY

- **MACROCAST™ continues to indicate a low probability of a sustained, recessionary bear market.**
- **The biggest weakness within MACROCAST™ is in the valuation category. After a near 20% rally over the past 6 months, all signals within the category are neutral or negative. Other VITALS were mixed to positive.**
- **As in Q1 2019, stocks and bonds continued to perform well, and the rise in equities did not lead to a selloff in bonds. Gold also rose while other commodities struggled.**
- **Finishing with a strong rally in June, the S&P 500 notched one of the best, first 6 months in market history. Prior years that showed similar first half strength often saw gains through the rest of the year but temporary market pullbacks can be expected.**

THE MESSAGE FROM MACROCAST™

As a reminder, MACROCAST™ is Corbett Road's proprietary investment model. MACROCAST™ measures the appeal of risk assets by assessing the **VITALS** of the market—**V**aluation, **I**nflation, **T**echnical Analysis, **A**ggregate Economy, **L**iquidity, and **S**entiment. By looking at multiple factors, we can better gauge market conditions and the probability of a major market decline.

The most recent score for MACROCAST™ suggests a large, sustained market decline is unlikely.

VITALS Signs

Valuations: Negative to neutral (more on that below).
Inflation: The only category that showed all positive metrics. Inflation remains subdued, giving the Fed flexibility to cut rates when they meet next week.
Technicals: Mixed. The market is trading above its long-term average, but many individual stocks are lagging as the index hits all time highs.
Aggregate Economy: Mixed. Strong job growth and retail sales data is offset by weakness in housing and manufacturing.
Liquidity: Mixed to positive. The yield curve inverted, but the Fed (and several other central banks) is prepared to cut rates and add more liquidity to the economy.
Sentiment: Mixed. Investors continue to pull money out of equity funds in record numbers, but other surveys we follow are becoming increasingly optimistic—potentially limiting further upside.

Valuations remain the biggest detractor. All of our valuation measures are neutral or negative. The same conditions that were in place at the end of Q1 remain. We've had a strong market rally, and while earnings expectations have risen, the stock prices have risen much more, causing Price to Earnings ratios (P/E) to expand at an accelerated pace.

FIRST HALF ASSET CLASS REVIEW: (ALMOST) EVERYTHING IS UP

TOTAL RETURNS (%)

Through June 30, 2019. Asset classes ranked by 1 month % total return

Asset Class (index)	1 mo.	YTD	1 yr	3 yr▪
US Stocks (Russell 3000)	7.0	18.7	9.0	14.0
Emerging Market Stocks (MSCI EM)	6.2	10.6	1.3	10.6
Foreign Developed Mkt Stocks (MSCI EAFE)	5.9	14.0	1.1	9.1
Foreign High Yield Bonds (Markit Global exUS HY)	4.4	7.1	3.2	5.9
Foreign Inv. Grade Corp (FTSE Russell Non-$ Corp)	3.7	5.3	2.4	3.0
Foreign REITs (S&P Global exUS REIT)	3.4	13.5	5.7	8.0
Foreign Devlp'd Mkt Bonds (FTSE Russell WGBI ex-US)	3.2	5.5	4.6	0.8
Emg. Market Gov't Bonds (FTSE Russell EMGBI)	3.0	5.0	5.5	4.4
Commodities (Bloomberg Commodity)	2.7	5.1	-6.8	-2.2
US High Yield Bonds (iBoxx Liquid High Yield)	2.5	10.1	8.1	7.1
Foreign Gov't Inflation-Linked Bonds (FTSE Russell WILSI ex-US)	2.4	6.8	3.3	3.3
US REITs (MSCI REIT)	1.3	17.8	11.1	4.2
US Inv. Grade Bonds (Bloomberg US Agg. Bond)	1.3	6.1	7.9	2.3
TIPS (Bloomberg Treasury TIPS)	0.9	6.2	4.9	2.1
Cash (S&P US T-Bill 0-3 Month Index)	0.2	1.2	2.3	1.3
Global Market Index†	5.2	13.3	6.3	8.7
Global Market Index-Rebalanced *	4.9	12.2	5.9	7.9
S&P 500	7.1	18.5	10.4	14.2
60/40 US stock/bond (rebalanced) +	4.8	13.6	9.6	9.5
Crude Oil (West Texas Intermediate spot price)	9.2	28.6	-21.2	6.6
Gold (spot price)	8.0	9.9	12.5	2.2
US Dollar Index (spot price)	-1.7	0.0	1.6	0.0

Returns based on *month-end* total return prices, which may differ slightly from returns calculated with daily prices for specific time periods. MSCI EAFE and EM data are net total returns.

▪ annualized

† GMI is a passive, unmanaged, market-value weighted index of all the major global asset classes (excluding cash). Initial allocation based on 12/31/97 market values.

* Rebalanced version of GMI that's rebalanced to 12/31/97 weights every Dec. 31

+ Initially weighted 60% S&P 500 and 40% Bloomberg US Aggregate Bond, rebalanced to 60/40 every Dec. 31.

CapitalSpectator.com

Here is what we found most interesting about the first half of 2019 asset class performance:

1. ***Stocks and bonds both did well (again).*** Although stocks and bonds tend to rise together over the long run, it's rare that both are as strong as they've been thus far in 2019. In fact, it is the best start for the combination of both asset classes in 24 years (from *Financial Times*):

2. ***US large cap stocks outperformed international stocks (again).*** Stocks of all sizes and across all regions did well, but the S&P 500 continued to outperform international markets. This has been a consistent occurrence since 2012 but recall the decade before saw more muted returns for the S&P relative to international and small cap stocks. This outperformance may not last forever, but it can go on much longer than anyone anticipates.
3. ***Gold had a great second quarter (this is something new).*** Gold struggled after peaking in 2011, but this quarter's rally drove the precious metal's price up to a 5-year high. Whether or not this is the beginning of a secular, multi-year rally remains to be seen.

A GOOD FIRST HALF IS MOSTLY BULLISH FOR THE REST OF THE YEAR, BUT EXPECT MORE VOLATILITY

The first half of 2019 was one of the best starts in market history. What has that meant historically for the rest of the year? The table below from LPL Research shows all of the previous instances when the market was up at least 15% through June 30. Since 1950, the market has seen similar first half gains 9 times and stocks added to those gains in 5 of those 9 years. Most years saw decent sized pullbacks in the final 6 months, with a median drop of 9%.

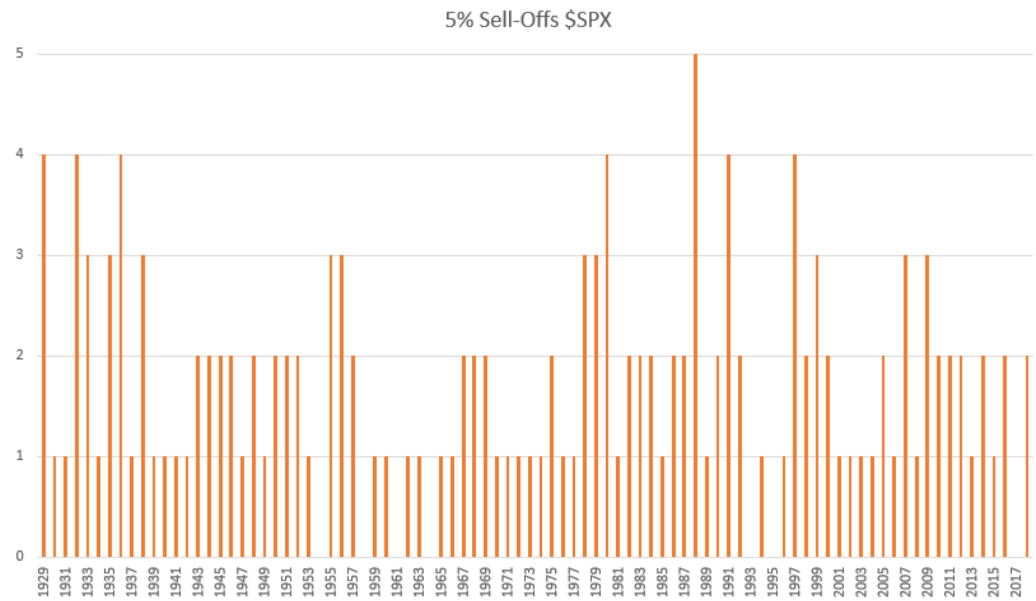
S&P 500 Index Returns After > 15% Year-to-Date Returns as of the End of June

Year	Yearly Return as of the End of June	Return for the Final 6 Months	Pullback for the Final 6 Months
1954	17.7%	23.2%	-4.4%
1975	38.8%	-5.3%	-14.1%
1976	15.6%	3.0%	-8.4%
1983	19.5%	-1.9%	-6.6%
1986	18.7%	-3.5%	-9.4%
1987	25.5%	-18.7%	-33.5%
1995	18.6%	13.1%	-2.5%
1997	19.5%	9.6%	-10.8%
1998	16.8%	8.4%	-19.3%
2019	17.4%	?	?
	Average	3.1%	-12.1%
	Median	3.0%	-9.4%
	Average Year (1950-Current)		
	Average	4.4%	-10.3%
	Median	4.9%	-7.7%

Source: LPL Research, FactSet 06/30/19

MULTIPLE 5% DECLINES IN A CALENDAR YEAR ARE COMMON

We have already witnessed one market decline of 6% this year, back in May. But it is common to see multiple 5%+ declines in a calendar year (from Alpha Architect):



Since the bear market bottom in 2009, 7 of the past 10 years have had multiple 5% corrections. Given the strength of the market and the history of second half declines, odds are we will see another one this year.

STILL POSITIVE ON THE REST OF 2019, BUT RAMP DOWN EXPECTATIONS

Despite our concerns, we still think a recessionary bear market between now and the end of the year is unlikely. MACROCAST™ remains positive, and, we believe the bull market is intact.

As always, thank you for your trust and confidence in Corbett Road.

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