viewpointe

A Horizon Trust & Investment Management Publication

HORIZON

ISSUE NO. 57, THIRD QUARTER 2017

> *"For the rich, the world is their oyster; for the poor, the world is their competitor..."*
>
> ***- Jay Ogilvy***

We spent much of the second quarter monitoring the progress of the Trump Administration's pro-growth agenda. Unfortunately, progress remains disappointing on the tax-reform, health-care reform and tax repatriation fronts. Thus far, the administration has been unable to get anything accomplished on the legislative front due to roadblocks in Congress. This in turn has led some investors to temper their 2017 growth expectations. While this lack of progress has weighed heavily on the fixed income markets, the equity markets have remained resilient and continue to forge ahead. In this edition of Viewpointe, we discuss these divergent market responses. We also discuss some changes implemented in our model portfolios during the second quarter. We conclude with a few pointers on disaster preparedness.

Economic Review -
Political Drama

The early post-election surge in a multitude of confidence indices has moderated recently. This should not come as a surprise due to the fact the euphoria was predominantly fueled by promises of economic growth that have yet to come to fruition. Out of the gate such an agenda seemed within grasp to many due to the combination of a Republican President and Congress. Unfortunately, reality has proved quite different, with the Trump administration spending vast quantities of political capital on reforming healthcare policy, but so far proving unable to unify sufficient support to seal the deal. In the meantime, market friendly policies, such as tax reform and infrastructure programs, have largely been sidelined potentially delaying any material positive economic impact into late 2017 or, more likely, 2018.

Doubts that the Trump administration will deliver on the economic front gained steam during the second quarter following the firing of FBI director James Comey. Speculation soon surfaced the firing resulted from Comey's unwillingness to succumb to Trump's pressure to stop pursuing the investigation into Russia's impact on the presidential election. It did not take very long after news broke that Trump's adversaries began to start talking about the possibility of obstruction of justice charges and perhaps even impeachment. While things have cooled off for the time being, we are confident the drama is far from over.

Needless to say all of this political drama distracted the Trump administration and impeded their ability to focus on the much needed fiscal policy that so many Americans are anxiously awaiting and many voted for. This legislative delay tempered the euphoric confidence levels that followed the election. As we discussed in the last edition of Viewpointe, we are concerned confidence levels have become overly optimistic. We are of the opinion that it is best to just sit back and wait for more details and to see more progress before becoming overly enthusiastic. It looks like more investors are deciding to take this approach now.

Continued on Page 2

We are not writing off the Trump Administration just yet. Say what you want about this administration, one thing is for sure, they are resilient. We still believe there is a strong likelihood they will accomplish some positive inroads on the economic front. It is, however, still too early to assess the scale and timing of their progress. It appears at the present time expectations may have to continue to be ratcheted down and time frames may have to be pushed further out than what many had originally anticipated.

In conclusion, while many economists are rushing to lower their 2017 economic growth projections, we continue to stick with our initial forecast of more muddle through growth around 2% for 2017. It is important to note we expect legislative progress to be made during the latter half of the year. The primary logic behind this belief is the simple fact that U.S. voters have removed the party in power in five of the past six federal elections. In short, using history as our guide, the Republicans may have a small window of opportunity to get things done. We do believe this may force the various factions to reach a consensus rather than squander their time in power. We will continue to optimistically monitor the situation for progress on this front and will adjust our forecasts and portfolios accordingly.

Fixed Income Commentary - The Glass is Half Empty

Recent fixed income market trading patterns indicate many fixed income investors have grown pessimistic as to economic growth prospects. This is in contrast to what we are seeing on the equity front, which continues to remain highly optimistic. So, why the mixed signals? Well in short, it all seems to come down to which data points one focuses on. To a large degree it comes back to the old saying of how some see the glass as half empty while others see the glass as half full.

Fixed income investors are extremely focused on economic data that provides indications of whether prices are going up or going down (i.e. inflation/deflation). The reason for this is fixed income investors demand more yield if they believe prices are going up in order to protect their purchasing power. So, what pushes prices up? Simply put, it all comes down to supply and demand, and demand increases when economic conditions improve.

Fixed income investors are on guard due to the fact many inflation focused indicators are showing little sign of prices going up any time soon. Of utmost importance perhaps are the recent readings of the core personal consumption expenditures (PCE) index. The PCE is the Feds' preferred measure of inflation and is utilized as an indication of whether interest rates are likely to go up or down. In short, higher inflation readings act as a justification for higher rates and vice versa. Fixed income investors are concerned that the PCE index has fallen from 1.8% on an annualized basis to 1.6% in February and 1.5% in March. Both of these readings are well below the Fed's 2% inflation target.

Moreover, the trends on core readings for retail inflation have also been weak. The core nominal retail consumer price index (CPI), which strips out food and energy prices, slipped to a 1.9% increase in April, from 2.3% in January. In summary, inflation data is not currently signaling that rates need to go up anytime soon.

Ultimately, this situation has led to a flattening of the yield curve. A flattening occurs when the difference between short-term and longer-term interest rates contract. Recently, we have seen short-term rates rise as a result of the recent hikes in the Fed Funds rate, while longer-term rates have actually fallen as a result of indications of weakening inflationary pressures. Historically, a flattening of the yield curve has acted as a signal that fixed income investors expect economic growth to slow. In conclusion, recent shifts in the yield curve are indicating that fixed income investors view the glass as half empty.

Equity Commentary - The Glass is Half Full

Equity markets on the other hand are telegraphing a much more optimistic outlook. The S&P 500, as of mid-June is up a staggering 15% from the U.S. election in

November. Some international equity markets have even registered better results. So, why are the equity markets so bullish while the fixed income markets are signaling lackluster economic growth? As mentioned in the fixed income commentary, it seems to come down to what factors one focuses on.

Thus far, equity markets have remained patient with the Trump administrations lack of legislative success. Some of the analysts we follow have pointed out that legislation usually takes at least 15 months to get passed after a change in administration. In the meantime, they point out the importance of regulatory implementation which is easier to accomplish. On this front they focus on the potential positive economic impacts from anticipated bank deregulation and looser restrictions on energy infrastructure development.

Perhaps the most persuasive justifications for the equity investor's optimism are recent developments on the earnings front. Corporate profits in the first quarter were the best in five years in the U.S. and the best in eight years in Europe. This put an end to seven consecutive negative year-over-year earnings quarters. Revenues and earnings per share in the first quarter rose 8% and 15% year-over-year, respectively, with 76% of the companies beating by an average of about 5%.

Additional factors that support a bullish equity forecast include the following:

1) Monetary policy remains accommodative
2) There are few signs of speculative excess
3) Large companies are sitting on large sums of cash
4) Business and consumer confidence remains elevated from a historical perspective
5) Signs of strength overseas (i.e. China, Japan, Eurozone)
6) Jobs picture remains solid
7) Recent uptick in mortgage equity withdrawal rate

While all of these factors support positive equity market performance full valuations remain a concern for us. We fear that current valuations offer investors little cushion should equity investors reduce their economic growth expectations. In addition, we question how much of the proposed Trump agenda is already baked into the cake and what will be needed to drive equities to higher levels. Ultimately, we are concerned that unless we see more implementation on the legislative front, growth expectations will go down and equity markets will be sure to follow.

Asset Allocation - Trimming and Shifting

We implemented some changes to both our Lakepointe Classic and Lakepointe Premier model portfolios during the second quarter of the year. These changes can be broken down into three major themes. First we decided to trim our equity position in order to bring it back down to target weight. In most instances we saw ourselves reducing our equity weight by 2-3%. During this process we also brought our equity asset class weightings back in-line with target weights.

Secondly, we changed our weightings in the large-cap equity fund space. As mentioned in the previous edition of Viewpointe, at the beginning of the year we moved to an index fund approach in the large-cap equity mutual fund space. When we originally implemented this strategy we weighted 70% of our large-cap fund position in the Vanguard S&P 500 index fund and 30% in the DoubleLine CAPE index fund. Outperformance of the DoubleLine fund led us to increase our position in that fund to 40% of our large-cap fund position during the second quarter.

Lastly, we implemented a significant change on the fixed income fund front. While we lengthened our portfolio duration at the beginning of the year to take advantage of falling interest rates, we decided to shorten our duration during the second quarter. The reasoning behind this move was based upon our belief rates are approaching a bottom and will either stay put or begin to drift back up. We decided to implement a strategy designed to hold up well under both of these potential outcomes. The way we accomplished this is through a combination of the DoubeLine Core Fixed Income fund and the Vanguard Short-Term bond fund. While the DoubleLine fund allowed us to maintain similar overall portfolio yield characteristics the Vanguard fund allowed us to reduce our portfolio duration. We believe both of these funds in conjunction with the Scout Unconstrained bond fund leave us well positioned to navigate what we view as the most likely fixed income scenarios.

Financial Planning -
Better Safe Than Sorry

If a disaster strikes in your community, you might not have access to food, water or electricity for several days. While you may think that you will have enough time to run to the grocery store, they quickly sell out of important supplies following emergency warnings. According to the Center for Disease Control (CDC), about half of adults in the United States do not have the resources and plans in place for a possible emergency. Preparing emergency kits and having a plan are important steps in keeping you and your family safe and healthy during a disaster.

Determining what to include in an emergency kit is really a two-step process. The first step is to determine the necessary items that you use on a routine basis. The second step is to determine what additional supplies would be required in the event that food, water and electricity are no longer readily accessible. The CDC makes the following recommendations:

FOOD & WATER (minimum 3-day supply)
- Water - one gallon per person, per day
- Food – Foods that are easy to make and will not spoil, like canned soup, dry pasta and powdered milk
- Manual can opener
- Basic utensils

HEALTH SUPPLIES
- Medicines (minimum 3-day supply)
- Medical supplies like syringes, cane and hearing aids

PERSONAL CARE ITEMS
- Soap
- Toothbrush and toothpaste
- Sanitizing wipes
- Contact lenses or glasses

SAFETY SUPPLIES
- First Aid Kit
- Emergency blanket
- Multipurpose tool (knife, file, pliers, screw driver etc.)
- Whistle

ELECTRONICS
- Flashlight
- Emergency Radio (battery, solar or hand-crank)
- Cell phone with alternative charging source
- Extra batteries

DOCUMENTS
- Important documents such as social security card, insurance cards and immunization records
- Paperwork regarding any serious medical conditions
- Emergency contact list

ADDITIONAL ITEMS
- Extra cash
- Maps of the area
- Dust masks
- Duct tape
- Extra set of car and house keys

Please note that these are to be used as general guidelines and that every family is unique. You may have personal emergency needs beyond what is included on this list. You also need to remember to update your kit in accordance with the changing needs of your family.

Be sure that your kit is centralized in a known location such as a sealed tote. Remember an emergency may force you to leave your home in a hurry and therefore you may have to grab your kit and move to an alternative location. It is also important to regularly monitor the expiration dates on food, water, medicines and batteries.

Devise an emergency plan that is communicated to the whole family. After all, if you are the only one that has a plan it does little good in the event you are not home or are seriously injured. It is also important to make sure that you know how to shut-off the gas, electricity or water at your home.

While nobody wants to think of being in an emergency situation it is important to make plans that lay out what you need to do in the event disaster strikes. By having an emergency plan in place, and the necessary supplies at hand, you can at least make a bad situation a little more comfortable for you and your family.