viewpointe

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> “Never look back unless you are planning to go that way.” - *Henry David Thoreau*

The somber mood that prevailed during the fourth quarter of 2018 abruptly gave way to a much more pleasant atmosphere for investors during the first quarter of 2019. It was like someone flipped the "worry switch" off and investment performance kicked into high gear. This was a welcome change from what had been one of the weakest performance quarters in recent memory. In this edition of *Viewpointe,* we discuss the latest positive developments and provide our outlook as to what we believe lies ahead for the remainder of the year. We also highlight some changes that were made to our model portfolios. We conclude with a discussion regarding the benefit of deposit insurance.

Economic Review - A Positive Shift

Anxiety surrounding both an overzealous Federal Reserve (Fed) and trade tensions with China led to a material sell-off in asset classes pretty much across the board during the fourth quarter of 2018. Investors feared that escalations on either of these fronts would negatively impact economic conditions. Fortunately, pressure on both fronts subsided significantly as we moved into 2019.

Shortly after the Fed's December rate hike, Fed Governors began to soften their rhetoric. This resulted in a significant change in narrative versus what was projected at their December meeting. Suddenly, Fed Governors started referring to being patient and more data dependent. Several acknowledged negative drivers such as the government shutdown and slowing global growth. This more dovish stance was confirmed at their January meeting where they refrained from hiking the Fed Funds Rate, pointing to weakening financial conditions.

The Fed even took their dovish stance a few steps further at their March meeting. Once again the Fed chose to leave the Fed Funds Rate unchanged. More importantly they indicated that no hikes are likely in 2019. This drastic change in message came just three months after the Fed had indicated that two hikes were likely in 2019. In addition, the Fed announced it would end the drawdown of the Central Bank's balance sheet in September. This end to the Fed's balance sheet reduction initiative came much earlier than most market participants expected, signaling yet another shift to a more accommodative monetary policy.

So, why the drastic policy shift from December? Various economic data points had already softened prior to the December meeting. In addition, while the U.S. Government had not shut down prior to the Fed's December meeting, a shutdown appeared likely at the time they met. It is also important to note the equity markets had already significantly sold off and fixed income markets had indicated for quite some time they disagreed with the Fed's rate hike path. While we may never know the exact reasoning behind the Fed's drastic shift in direction, the important thing for investors is that Fed policy has become more dovish. We expect this to remain the case for some time to come, absent a significant increase in economic growth and/or inflation.

Switching to the topic of trade, while no definitive agreement has been reached with China, progress is being made. According to U.S. Trade Representative, Robert Lighthizer, trade negotiations are in the final stages. As a result, we are seeing a switch in conversations from "whether" there will be a deal to "what" will likely be included in the agreement. At the present time it is hard to say with any certainty what a deal may include. Safe to say, however, that President Trump will want to make sure the agreement has some significance in order to avoid alienating his constituents. The reason we say this is because trade is a key anchor amongst many of President Trump's supporters. If it is viewed that the President rolled over in the negotiations, his approval rating would

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be negatively impacted, greatly reducing his reelection prospects. In short, taking a hard stand on key issues and not reaching an agreement likely bodes better for his reelection prospects than settling for a watered down deal.

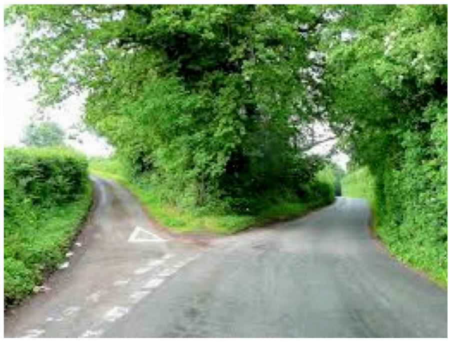
Assuming an agreement is reached, we anticipate it will include a reduction in the average Chinese tariff rate, an agreement on currency valuation and relaxation of the Chinese joint venture requirements. We also would expect to see provisions related to improved market access, better protection of intellectual property and Chinese commitments to purchase goods in key areas such as agriculture and energy. While some of these hoped for accomplishments are arguably already priced into projections, several still carry the potential for a significant positive surprise factor.

In the event a deal is reached that surprises on the upside, we would anticipate a positive boost on the economic growth front. From an economic growth perspective, we believe that progress on trade is key to prolong the current growth cycle. We feel that trade uncertainty has negatively impacted corporations willingness to spend on capital improvements. A deal that removes uncertainty and increases the competitive advantage of U.S. corporations should lead to an increase in capital expenditures. We believe such an increase is necessary to prolong the current economic expansion.

Fixed Income Commentary -

A Divergence on the Horizon

The once sleepy fixed income space has gotten much more exciting over the last two years. Drastic shifts in direction, large scale moves, talk of inversion and intrigue at the Fed have all led to an increased level of excitement. What had for many years lent itself to more of a buy and hold strategy has become an area of the portfolio that nowadays requires much more active management. As if things had not become exciting enough, we are anticipating a divergence in yields between U.S. Government Bonds and U.S. Corporate Bonds. So, what does that mean? Typically, when we think of interest rates going up, we expect the increase to occur in both government bond yields and corporate bond yields simultaneously.



Developing conditions make us question whether this pattern is going to change. To understand how such situations develop one must first grasp two fundamental concepts. The first concept deals with the primary drivers of interest rates. These drivers consist of the Fed Funds Rate and inflationary expectations. The Fed Funds rate directly impacts short-term interest rates while inflation expectations directly impact intermediate and long-term rates. These drivers impact the general direction of U.S. Government as well as corporate interest rates.

The second concept is where rates have a tendency to diverge. This concept deals with a security's risk profile. U.S. Government debt is backed by the full faith and credit of the U.S. Government. In other words, as long as the U.S. has printers and ink, its debt will be paid in full at maturity. Corporate debt on the other hand is dependent upon the financial solvency of the issuing corporation. Thus, if the corporation files bankruptcy you may lose some, if not all, of your investment. From a risk perspective it seems to makes sense why investors would require more return as the default risk increases.

We expect the Fed to remain on hold for the remainder of the year and for inflation to remain relatively tame. Looking at this factor alone, we would expect rates to remain rather range bound with a slight tendency to drift downward from current levels. When we factor in the risk profile, however, we come to an alternative conclusion when it comes to corporate yields. We expect corporate yields to actually increase as a result of increased default risk in the corporate space.

This expectation is based upon several factors. First off, corporate credit as a percentage of gross domestic product is just under 50%. From a historical perspective that is an elevated level that has historically been used as an indicator of increased default risk. Simply put, the more debt corporations hold, the harder it becomes to meet their financial obligations. Secondly, roughly 62% of corporate investment grade debt matures within the next five years. Most companies will have to issue new debt to pay off the old debt. This is significant since much of this new debt will be issued at higher interest rates than the debt that is maturing. This will result in a higher interest rate expense, which will negatively impact the financial condition of some of these corporations, in turn increasing their default risk. We are already seeing a sizeable increase in corporate credit rating cuts in anticipation of deteriorating financial conditions at several firms.

An increased level of default risk will lead investors to demand higher yields in order to be willing to invest in corporate bonds. If our predictions are correct, this should lead to an increase in corporate interest rates while U.S. bond rates either remain range bound or potentially drift down. It is important to note this downward drift could be exacerbated in the event the situation triggers a "flight to safety" trade where investors flood the government bond market to avoid the risk in the corporate space. This increased demand would in turn drive prices of government bonds up resulting in even lower yields than what we already anticipate.

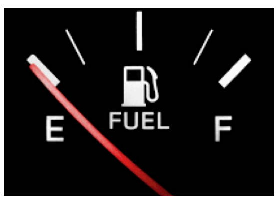
Equity Commentary -

Running out of Gas?

The Fed's shift to a much more dovish posture and progress on the trade front resulted in the strongest calendar start since 1991 for domestic equities. This strong start, coupled with recent improvements in some economic data, imply the consensus view has shifted back to "no imminent signs of a recession". The bull market for the S&P 500 reached ten years in length on March 8th. The S&P gained about 400% over that period resulting in an annualized return of roughly 17.5%. Not bad for a bull market that has received little fan fair in comparison to bull runs of the past.

While threats from an overly aggressive Fed and a trade war with China have subsided, we remain skeptical regarding additional gains in the short-term. Domestic equity valuations, while not stretched from a historical perspective, are in our opinion fairly valued. It is also important to note that earnings comparisons will be tougher in 2019, since we will be comparing future quarters to quarters that already include the benefits of a lower corporate tax rate.

In short, we need more gas to drive domestic equity prices materially higher. The additional fuel source that is most apparent at the present time deals with



a material agreement being reached on the China trade front. It is our opinion that such an agreement is necessary to boost corporate confidence to the point that management teams will be willing to increase capital expenditures. With that said, we are concerned the Fed may have already pushed short-term rates too far. With rates inverted at several points within the yield curve we are concerned fears of a recession may result in a self-fulfilling prophecy, unless we experience a positive surprise that diminishes the economic slowdown concerns. The area that holds the highest probability for a positive surprise at the present time is on the trade front. That is why we are monitoring developments on this front so closely.

Another potential driver that is gaining more steam in recent months deals with the Fed's recent shift toward a more accommodative monetary policy. It is important to not lose sight of the positive impact that accommodative monetary policy had on risk assets over the last ten years. The Fed quintupled its balance sheet following the Great Recession, creating a favorable environment for stocks. While the Fed has been reducing their balance sheet in recent years, they just announced their intention to end their balance sheet drawdown in September. That will leave the Fed's balance sheet at a much higher level than what had been anticipated just a few months back. These levels will provide support for risk assets and increase the odds the Fed may switch direction, and once again, increase the size of their balance sheet. Speculation regarding further accommodative policy is gaining traction based upon comments by some current and former Fed Governors. It is too early to say whether this comes to fruition, however, the possibility is increasing.

In conclusion, given the scale of the recent equity market increase it is reasonable to expect a pause in the upward trajectory of stocks. The next material move will likely be driven by developments on the trade front. If developments on the trade front are negative, stocks will react negatively. If developments on the trade front are positive, stocks will react positively. At the present time it appears the administration is making progress towards a deal. With that said, it is important to note that some sort of deal is already factored into current equity prices. As a result, the true question becomes whether we will see a deal that is better than what has already been factored in, or worse.

Asset Allocation -

Making Adjustments

We rebalanced both our Classic and Premier portfolios during the first quarter. We rebalanced our Classic portfolios in mid-January. This rebalance focused on bringing our portfolios back to target with an emphasis on placing some of the proceeds received from capital gains distributions back to work. We also implemented a strategy shift within the fixed income component of the Classic models. As previously mentioned in the fixed income commentary section, we expect a yield divergence to occur between U.S. Government debt and U.S. corporate bonds. Since corporate bond prices will be negatively impacted when their yields are pushed higher, we decided to reduce our exposure to corporate bonds. To implement this reduction we removed the Vanguard Short-Term bond fund from the models and replaced it with the Vanguard Short-Term Treasury fund. While the Vanguard Short-Term bond fund is primarily invested in corporate bonds, the Vanguard Treasury fund is primarily invested in U.S. Government bonds.

We rebalanced our Premier models during the latter half of February. Our Political Activism screen is run on a quarterly basis and the Senate database for the fourth quarter of 2018 was not sufficiently updated until mid-February. After running our screens, it was decided to remove three individual stocks from the portfolio and replace them with two new names and one that had been in the portfolio a few quarters back. Ultimately, this led to a reduction in our industrials exposure as we shed two names in the airline industry with a corresponding increase in our healthcare exposure. Overall, the moves proved timely given recent unexpected negative developments in the airline space.

On the individual fixed income security front we continue to favor certificates of deposit (CDs). It is, however, important to note that rates have pulled back significantly in recent weeks. Fortunately, we purchased a large number of CDs prior to and during the early stages of the pullback. We do believe that CD rates will stay at these new lower levels for the foreseeable future. While we are seeing some U.S. Government Agency Step Bonds that are looking more attractive, we have hesitated making purchases in this space until they offer slightly higher up front yields and/or a little more call protection.

Financial Planning -

The Benefit of Deposit Insurance

Over the last several years we invested a fair amount of client money in certificates of deposit. These certificates have directly been purchased from banks, savings and loans, and credit unions located throughout the United States. These instruments have provided attractive risk adjusted returns in comparison to many other fixed income options and are not available through many of our competitors. Given the increase in demand for these investments, we want to take this opportunity to review the legal protections available for deposits held by these institutions. After all, this added protection is what makes these investments so attractive to many of our clients.

Bank/Savings and Loan Deposit Accounts

The Federal Deposit Insurance Corporation (FDIC) is an independent federal agency that insures deposits in U.S. banks and savings and loans. The FDIC directly examines about 4,000 financial institutions for operational safety and soundness. The FDIC was created in 1933 to maintain public confidence and enhance stability in the financial system. Member institutions pay premiums to obtain insurance coverage. In the event a member institution fails, its depositors are insured for at least a portion of their loss. Generally, deposit accounts at banks and savings and loans insured by the FDIC are insured up to $250,000 per depositor per bank. FDIC insurance covers both demand deposits (those that provide immediate access to cash, such as checking, NOW, and savings accounts as well as money market deposit accounts) and time deposits, such as certificates of deposit (CDs). It covers both principal and any interest accrued as of the date that an insured bank closes.

FDIC insurance does not cover mutual funds, stocks, bonds, life insurance policies, annuities, or other securities, even if they were bought through an FDIC-insured bank. It also does not cover U.S. Treasury securities or safe deposit boxes.

You cannot increase your protection simply by opening more than one account in your name at the same bank. For example, splitting the money between a checking and a savings account, or opening accounts at different branches of the same bank, do not increase your coverage.

However, deposits that represent different categories of ownership may be independently insured. For example, a joint account qualifies for up to $250,000 of coverage for each person named as a joint owner. That coverage is in addition to the $250,000 maximum coverage for each person's aggregated single-owner accounts at that bank. For example, a married couple with three accounts at one bank – they each have $250,000 in an individual account, and they also have $200,000 in a joint account – would qualify for FDIC insurance on the entire $700,000.

The limit on the amount protected in one or more retirement accounts at one bank also is $250,000; this is separate from the $250,000 coverage of individual accounts. (Remember, however, that FDIC insurance applies only to deposit accounts, not to any securities held in an IRA or other retirement account.) In addition, it is important to note the FDIC treats valid irrevocable trusts as standalone legal entities which have their own separate insurance. When it comes to revocable trusts, the FDIC typically extends coverage to each of the beneficiaries designated.

You do not have to be a U.S. citizen or resident for your account to receive FDIC protection. According to the FDIC, no depositor has ever lost a penny of funds that were covered by FDIC insurance. An online calculator at the FDIC's website, www.fdic.gov, can help you estimate the total FDIC coverage on your deposit accounts.

Credit Unions

Member share accounts at most credit unions are insured by the National Credit Union Share Insurance Fund (NCUSIF). It is administered by the National Credit Union Administration (NCUA), which like the FDIC, is an independent agency of the federal government and is backed by the full faith and credit of the U.S. Treasury. (Some credit unions are not federally insured, but are overseen by state regulators; they typically have private credit insurance.)

NCUSIF insurance is similar to FDIC insurance; it covers share accounts, share certificates, and share draft accounts, but not investment products sold through a credit union. It covers single-owner accounts up to $250,000 per customer per institution. Retirement accounts such as IRAs and Keoghs have separate coverage up to $250,000. As with bank deposit accounts, independent coverage may be available for different categories of ownership. You can estimate your existing coverage by using the calculator at the NCUA's website www.ncua.gov.

In conclusion, it is our normal policy at Horizon to stay within the $250,000 insurance limits when purchasing certificates of deposit within client accounts. Our ability to utilize financial institutions across the United States enables us to do this while still obtaining competitive rates due to the number of financial institutions that we have access to. As a result, we have been able to lock in attractive interest rates with little to no chance of principal loss, assuming the security is held to maturity. This has provided many of our clients with additional peace of mind in a high anxiety investment environment.