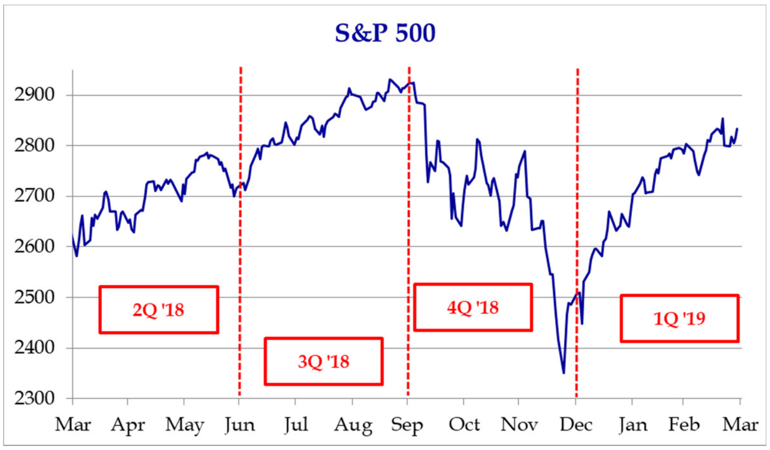
QUARTERLY REVIEW AND OUTLOOK
DID THE FED PUT HUMPTY DUMPTY TOGETHER AGAIN?

CHART I



Source: Strategas

We continue to be amazed, amused and a little flabbergasted at the recent gyrations in the U.S. stock market (Chart I). The last six months capture the change in economic expectations, induced in large part by the change in view by the Federal Reserve on the direction of U.S. interest rates. In September 2018, the Fed was arguing the need to increase interest rates. Indeed, many economists predicted three or four interest rate hikes in 2019! However, by the end of last year, the Fed's view changed to a decidedly neutral stance on the outlook for rates this year. This reflected their concern that global economic growth was slowing. Now most economists expect one, or perhaps no rate increases this year!

As interested observers, we are caught between scratching our heads in wonderment and chuckling a bit as well. We look back at the last few months and wonder what really has changed? Inflation remains benign. Corporate profits are still expected to grow modestly to moderately this year. GDP growth should continue to hold within the 2.0–3.0% range. To be sure, the China trade talks do seem to be moving in a positive direction.

But the real game changer in our opinion was the large decline in interest rates. As of this writing, the 10-year U.S. government bond yields about 2.5%, down from over 3% just six months ago. This decline probably reflects a global growth slowdown in the first quarter of 2019 and declining interest rates in Europe. The lower rates have helped push valuations in the equity market near

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levels reached prior to the fourth quarter correction (in reality a mini bear market). Based on the current consensus forecast of $175 a share for the S&P 500 in 2019, the market is reasonably priced at about 16-17 times estimated earnings. Most economists and market forecasters are still expecting a rising market, even from this point, by year end.

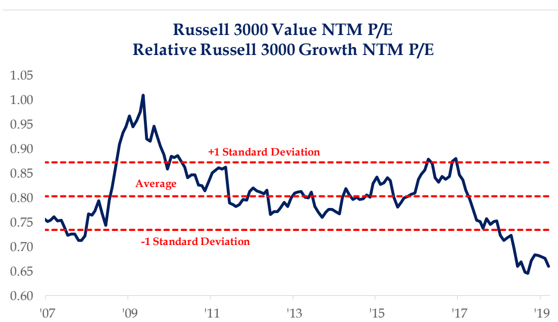
At this juncture, we tend to be a bit more conservative unless general economic trends continue to be stable or improve as the year progresses. Conversely, if economic trends soften, the gains of the first quarter may prove difficult to sustain.

To remain bullish, we need to see an accelerating recovery in the Asian markets, stable or lower oil prices, stable economic growth in Europe (including the United Kingdom) and the U.S. generating +2% GDP growth with stable to modestly rising interest rates. These are not high hurdles. As of this writing, first quarter corporate profits and expectations of continued growth would suggest that these positive trends should continue.

THE GROWTH VS. VALUE TRADEOFF MAY BE REVERSING

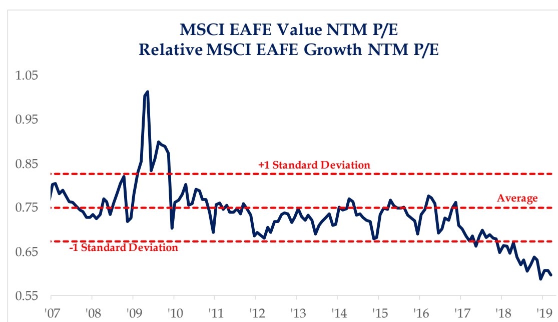
One interesting trend is beginning to catch our interest. Since the bull market began in 2009, the market leader has been growth stocks led by the technology sector. Indeed, value stocks are almost at an all-time low relative to growth. This is not only true in the U.S. market, but also in most foreign equity markets (Charts II & III).

CHART II



Source: Strategas

CHART III



Source: Strategas

Experts like to point to this relative disparity but come up short explaining why it has occurred. We fall back to our constant refrain that the biggest change has been the introduction of quantitative easing on a global scale. This has had an impact on global economic reaction far greater than most imagine. We list some of the less obvious factors that resulted from quantitative easing.

- Exacerbated the gap between the wealthy and lower income families by inflating assets such as real estate and financial assets. These assets are generally owned by the wealthy rather than the lower income strata.

- Reduced the cost of capital where financial engineering, such as stock buyback, mergers and a focus on cost reduction became more important than capital investment in productive assets.

- Emphasized growth stocks given their scarcity in a low inflation, low GDP growth environment. This reinforced technology (and particularly low capital-intensive industries, such as software) as the superior growth model versus the (growth-constrained) value industries, such as staple goods, industrials, energy, retail and other "non-digital" industries.

- Focused activist investor efforts on cost cutting rather than reinvesting in growth in the more traditional slower growth industries. This widened the gap between high growth and low growth equities.

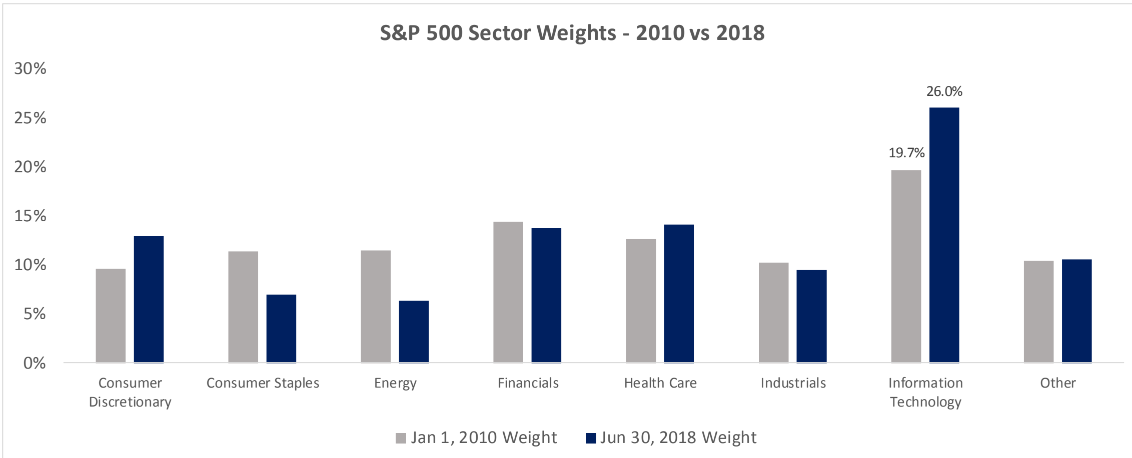
While the factors that have fueled growth over value are still in place, the charts suggest that the valuation disparity may have reached a point where reversion to the mean could occur. We believe that there are early signs of this occurring.

- First, many "value" defined companies are beginning to invest in growth versus cutting and consolidating. The food industry and other staple good sectors are a good example of this trend.
- Secondly, slower growth companies are transforming their business models to accelerate into the new digital world. Traditional media companies, retailers and other "value sectors" are in the early stages of redefining their future business models.

Nevertheless, we believe that the next recession (whenever that occurs) will pull down growth valuations to the point where the current spread between growth and value multiples are likely to narrow materially.

PORTFOLIO POSITIONING FOR 2019 AND BEYOND

CHART IV



Other includes Materials, Real Estate, Communication Services/Telecom. and Utilities

Source: Bloomberg

We have been focused on companies with an orientation to expanding their business in the digital world. This theme is reflected by investment in companies such as Alphabet (Google), Amazon and Activision Blizzard. Alternatively, we have also invested in companies where it's less obvious. A good example would be AON, a global insurance conglomerate that is rapidly expanding its online data and analytics business. Also, the media giant, Walt Disney, is moving rapidly into the online entertainment market using their very valuable content. Even McDonalds and Nike have embraced the digital world with online food orders and retail sales.

This orientation toward the digital world reflects the emergence of the internet in the last ten years. The technology sector jumped to 26% of the S&P 500 by mid-2018 from 19.7% at the start of 2010. The consumer discretionary sector jumped to almost 15% from about 10% in the same timeframe (Chart IV). The changes reflect the significant increase in market value of Amazon, Google, Netflix, Apple, Facebook and Microsoft among other internet beneficiaries. Indeed, we believe that we are still in the early innings of the digital world expansion. As 5G speeds are rolled out (benefiting our positions in tower stocks among other investments), the digital experience will expand at an even faster rate than the preceding ten years.

As we add new names to our investment portfolios, our focus will remain on finding companies that are in the forefront of the digital world of the future.

Above all, we continue to avoid owning companies with uniquely high valuations that don't meet our investment criteria of return on investment capital and free cash flow among other financial disciplines. We remain focused on capital preservation, as well as growth, in achieving our long-term goals for our client base.

KEN LYNN JOINS KPCM

KPCM is pleased to announce that Ken Lynn has joined our firm as a Vice President and Financial Advisor in our Great Neck office. Prior to joining Kings Point Capital Management, Ken served as Vice President and Senior Financial Consultant at Charles Schwab & Company. He served in Schwab's high net worth group. During his two decades of experience, he received numerous recognitions as a top Schwab advisor. We are extremely pleased to have Ken join our firm.

We have attached a copy of our annual ADV brochure and privacy statement for your records. As always, please contact our office if you have any questions.

Jack L. Salzman
Senior Managing Partner

Jeffrey P. Bates
Managing Partner

John A. Marshall, IV CFA, CFP®
Partner

Jason D. Beaird, CFA
Director

Ken Lynn
VP, Financial Advisor

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