

# QUARTERLY OUTLOOK

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Q3 2019 | F3 Investment Management

Advisory services offered through F3Logic, LLC, a registered investment advisor.  
WealthShield and F3Logic, LLC are separate and unrelated entities.

# ARE WE HEADING INTO A RECESSION?

## Q3 2019 Quarterly Outlook

Most people believe that a recession is defined as two consecutive quarters of negative GDP. That is not how the National Bureau of Economic Research (NBER), the party responsible for determining when we enter and exit a recession, defines it.

The NBER defines a recession as: "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales".

What is also interesting about recessions is that the moment the economy is declared to be in a recession, we are typically closer to the end. The start date is realized in hindsight. Therefore, we do not think it is wise to base investment decisions on whether or not we are in a recession.

The important thing, and our central belief, is that we should invest based on where we are in the business cycle now. Not where we think we will be or where we were, but where we are today. We are never going to attempt to pinpoint the start or end of a recession. Rather, our aim is to identify when growth is accelerating or slowing.

Since the global economy began to slow in the third and fourth quarters, broad markets have been on quite the ride. Volatility has picked up meaningfully and economic data has continued to deteriorate. This deterioration caused stock markets to fall meaningfully in the fourth quarter of 2018, causing a move to a more accommodative stance by the Federal Reserve and global central banks. Markets responded positively to the change in tune by central banks (in particular the Federal Reserve) and have rallied through the first two quarters of 2019, with the S&P 500 hitting all-time highs.

Nothing has changed from a growth perspective. Growth and inflation are still slowing and that means a portfolio should be concentrated in high quality assets regardless of the asset class. As valuations remain in the top decile of historical observations, we believe risk management should be a top priority and alternative investments (risk mitigating and lower volatility strategies) should probably play a greater role in a portfolio.

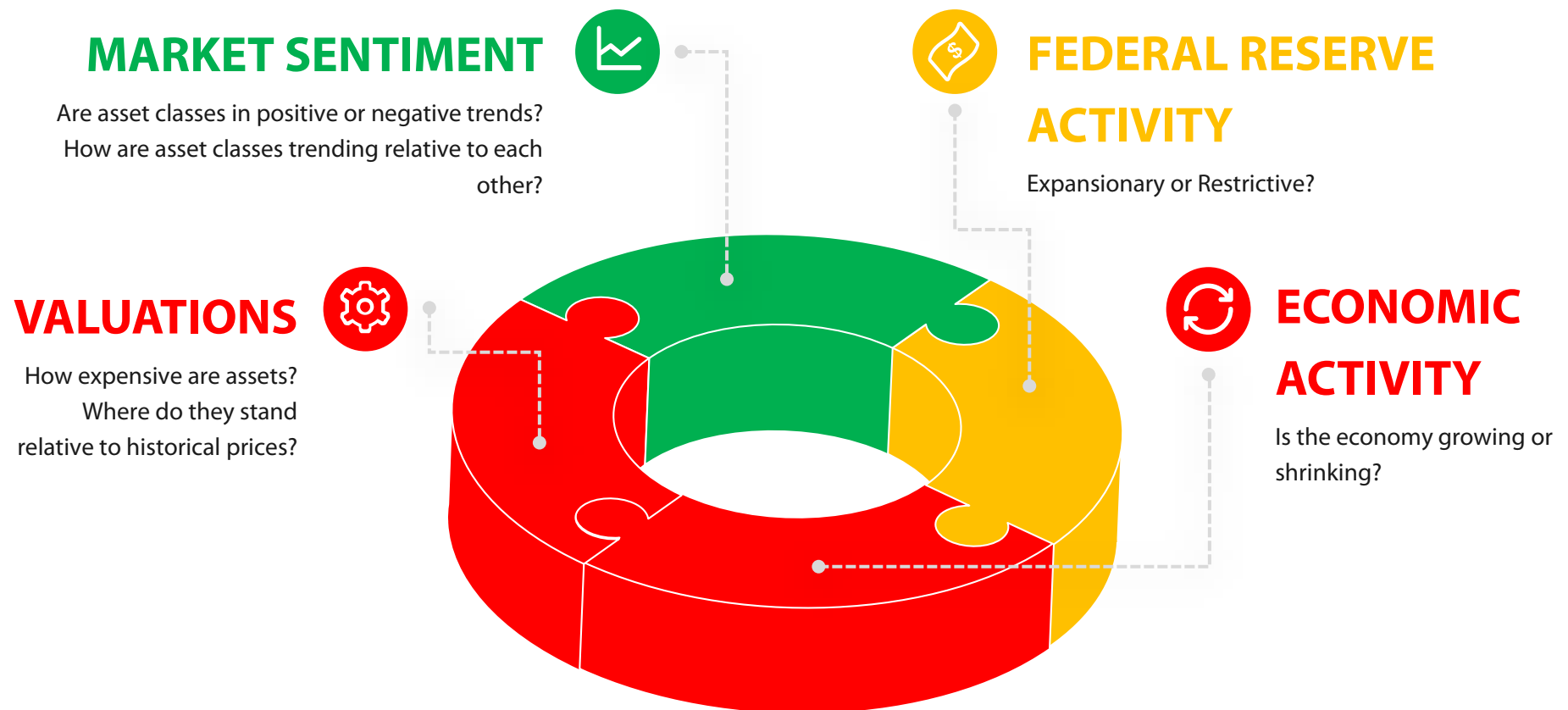
Market psychology is positive still, so growth slowing does not mean equity markets have to fall. However, market psychology can turn on a dime, so managing risk is paramount at this stage of the cycle.

It is our opinion that we are entering a difficult quarter that will bring to bear more slowing data. Particularly, we anticipate earnings growth to decline substantially in the near term. The Fed will most likely move to cut rates by the end of July in response to slowing growth and inflation. Without any known catalysts that could reignite growth, we are not so sure it will be the only cut or accommodative action by the Federal Reserve.

# ARE WE HEADING INTO A RECESSION?

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Currently our investment framework is signaling red for Valuations and Economic Growth, yellow for Federal Reserve Activity, and green for Market Sentiment. Will we enter a recession? We have no idea. However, growth is slowing now, so we plan to stay in high quality assets, manage risk, and enjoy the ride.

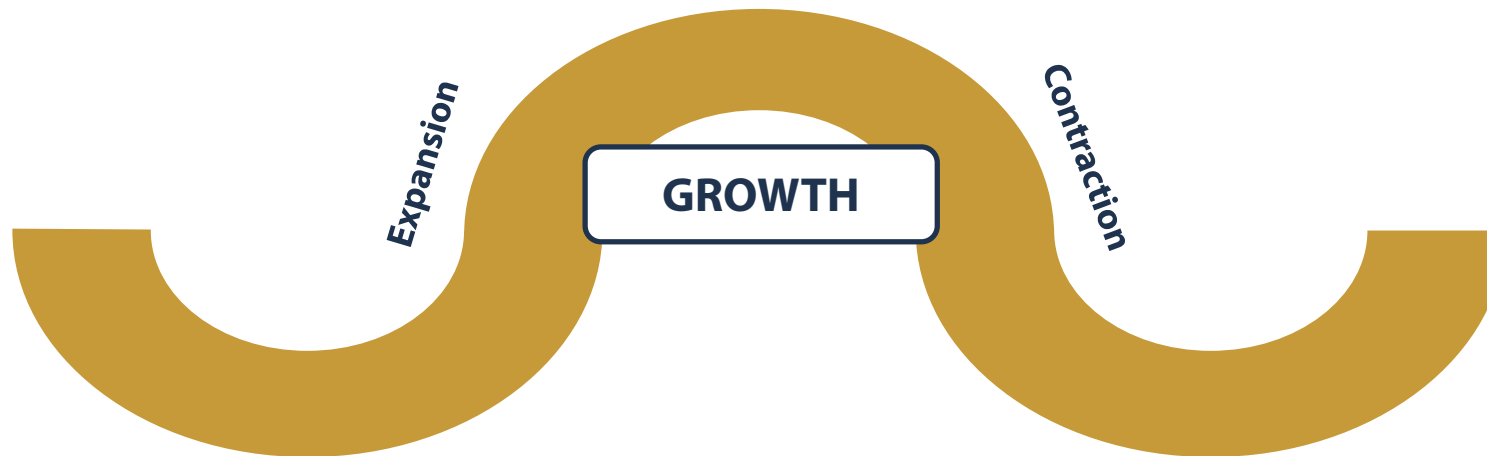


# BUSINESS CYCLE INVESTING

Q3 2019 Quarterly Outlook

## THE IMPORTANCE OF A VALUE-DRIVEN APPROACH

The contraction phase typically starts with high valuations and low credit spreads. “Risk off” assets, such as bonds and some alternative investments tend to out-perform.

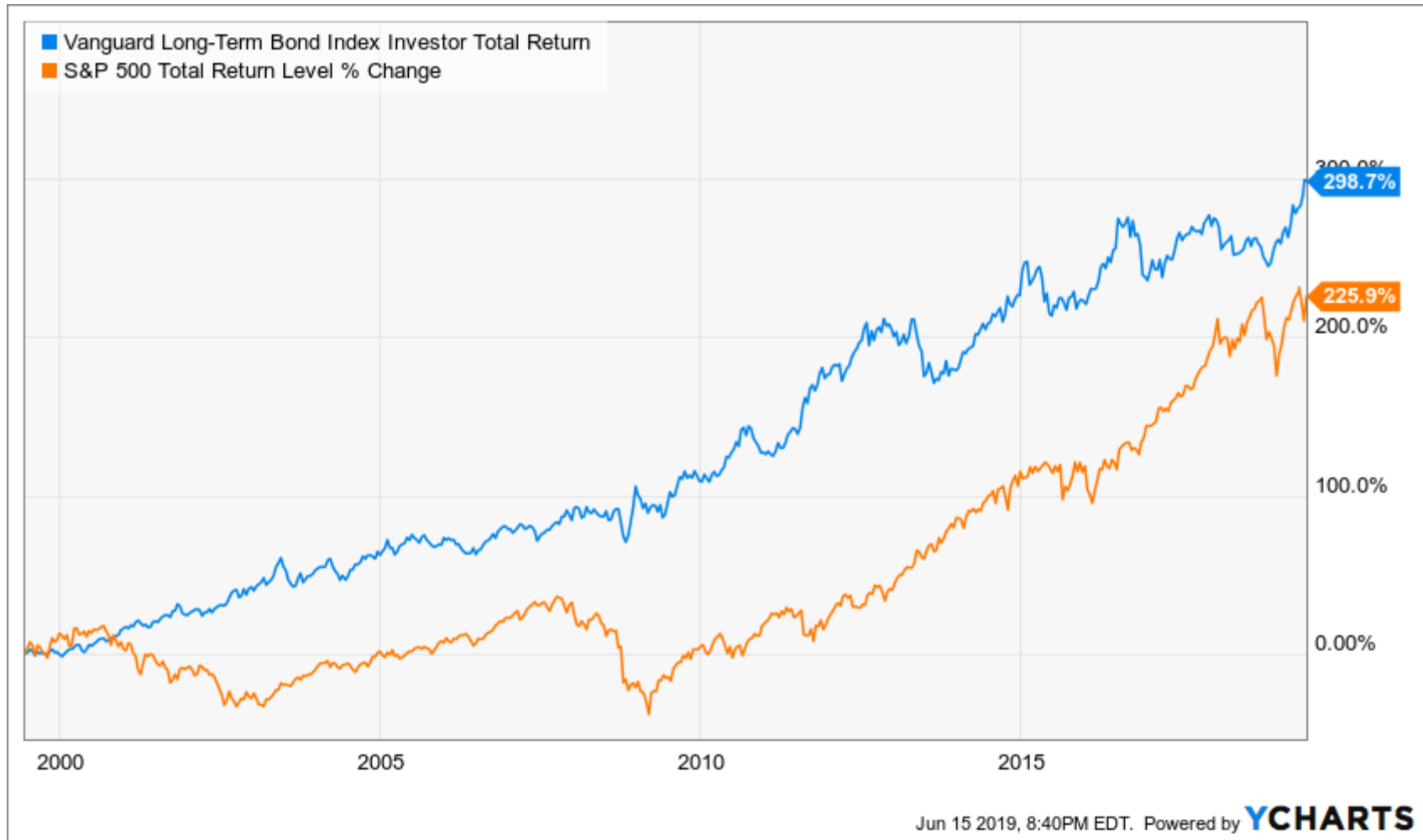


The expansion phase usually begins with low valuations and high credit spreads. “Risk-on” assets such as global stocks would be favored and economic growth increases .

Monitoring valuations and credit spreads help balance procyclical and countercyclical assets for an informed investment approach.

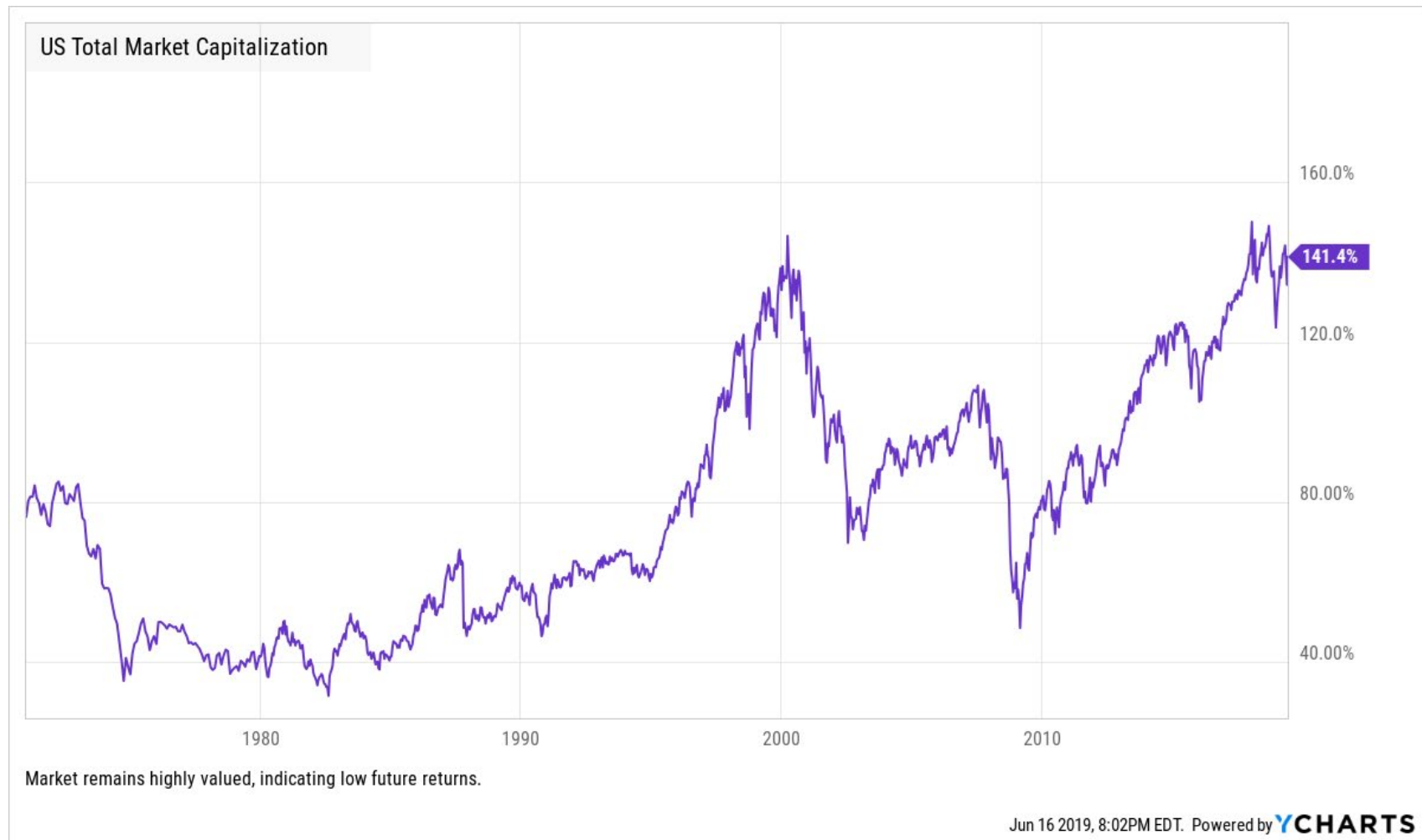
# VALUE MATTERS

## Q3 2019 Quarterly Outlook



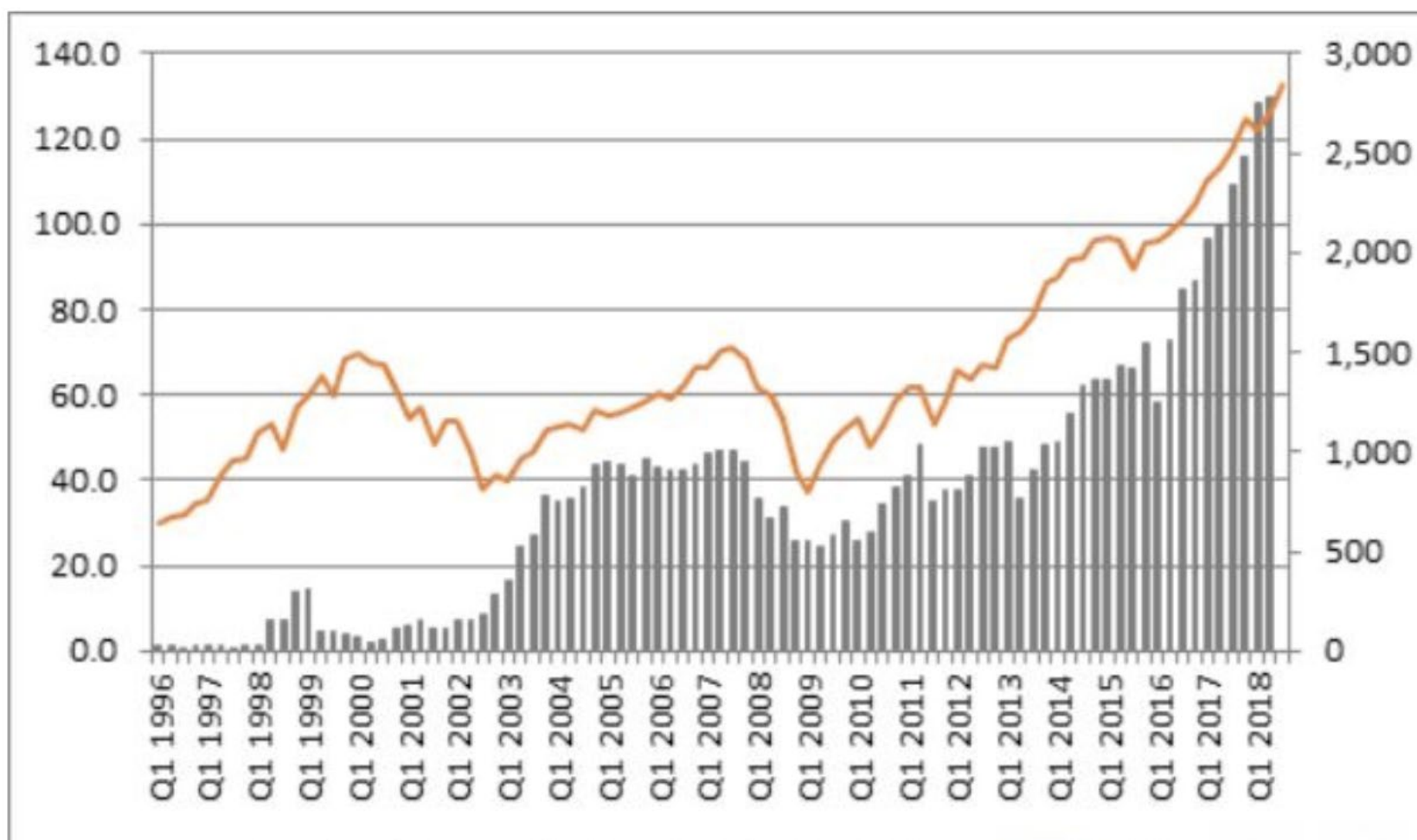
# VALUE MATTERS

## Q3 2019 Quarterly Outlook



# HISTORICAL ACCURACY MATTERS

## Q3 2019 Quarterly Outlook

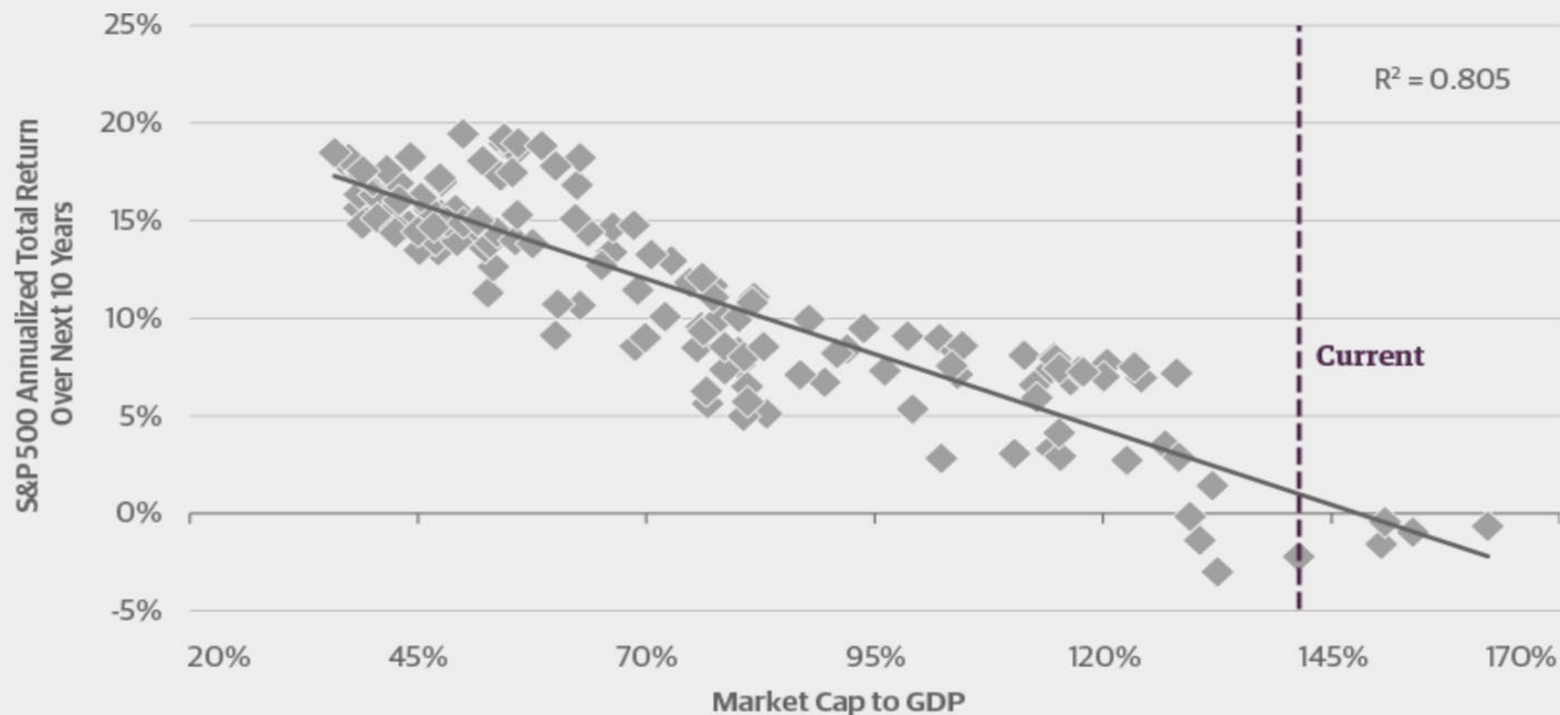


# HISTORICAL ACCURACY MATTERS

## Q3 2019 Quarterly Outlook

### Market Cap to GDP Has Been a Strong Predictor of Future Equity Returns

Data Since 1970



Source: Haver Analytics, Bloomberg, Guggenheim Investments. Data as of 9.22.2017.  $R^2$  is a statistical measure of how close the data are to the fitted regression line. Past performance is no guarantee of future returns.



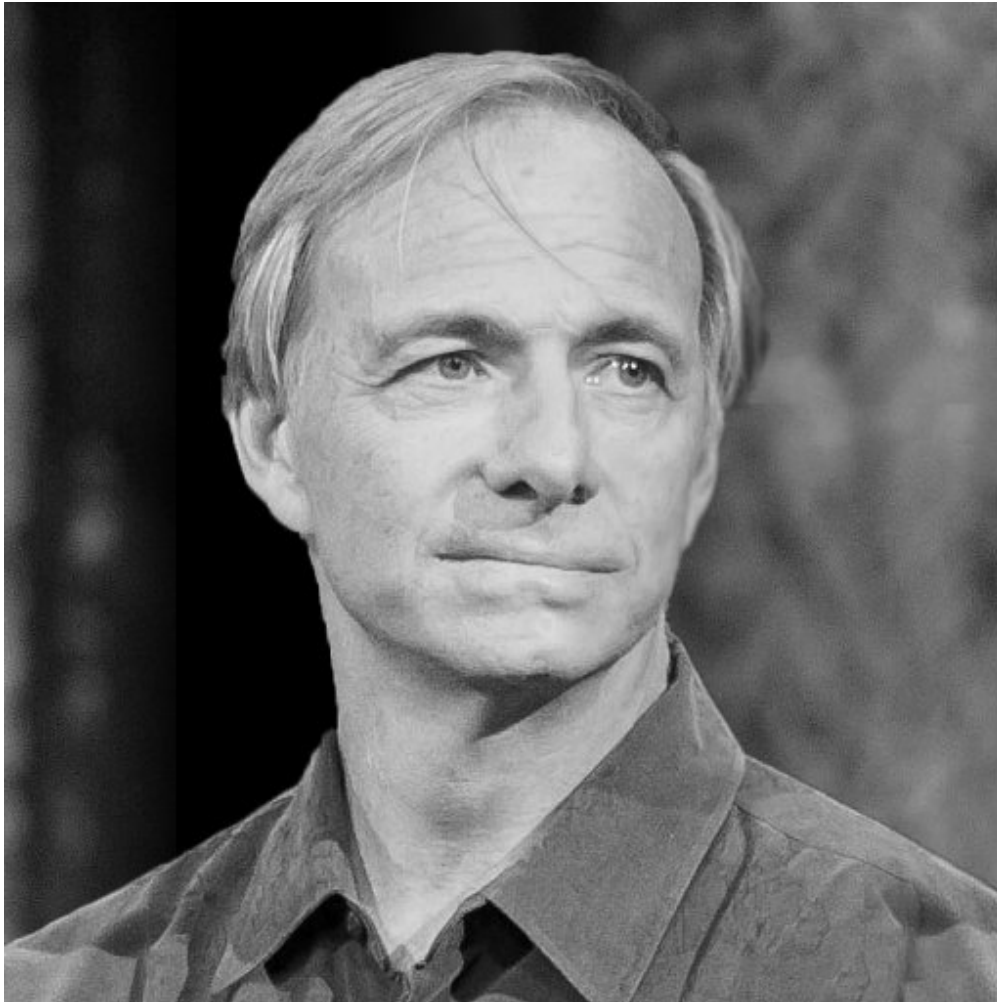
# HISTORICAL ACCURACY MATTERS

## Q3 2019 Quarterly Outlook

Correlation of log valuation ratios with actual subsequent S&P 500 total returns: 1950-2017		
Metric	10-year	12-year
Nonfinancial market cap/ Corporate gross value-added (Hussman 5/18/15)	-0.91	-0.93
Nonfinancial enterprise value/ Corporate gross value-added	-0.89	-0.91
Nonfinancial market cap/ Nominal GDP	-0.89	-0.90
Price/Revenue	-0.89	-0.90
Margin-adjusted CAPE (Hussman 5/5/14)	-0.89	-0.90
Price/normalized forward earn (Hussman 8/2/10)	-0.88	-0.89
Tobin's Q	-0.86	-0.88
Shiller CAPE	-0.83	-0.86
Price/prior record earnings (Hussman 6/22/98 Barron's)	-0.83	-0.83
Price/Book value	-0.77	-0.79
Price/Forward operating earn (imputed prior to 1980)	-0.78	-0.77
Price/Dividend	-0.77	-0.75
Price/Earnings (trailing 12-mo)	-0.76	-0.75
Enterprise value/Cash flow	-0.70	-0.72
Fed Model (FOE yield-10yr UST)	0.33	0.30

# ECONOMIC GROWTH & INFLATION

Q3 2019 Quarterly Outlook

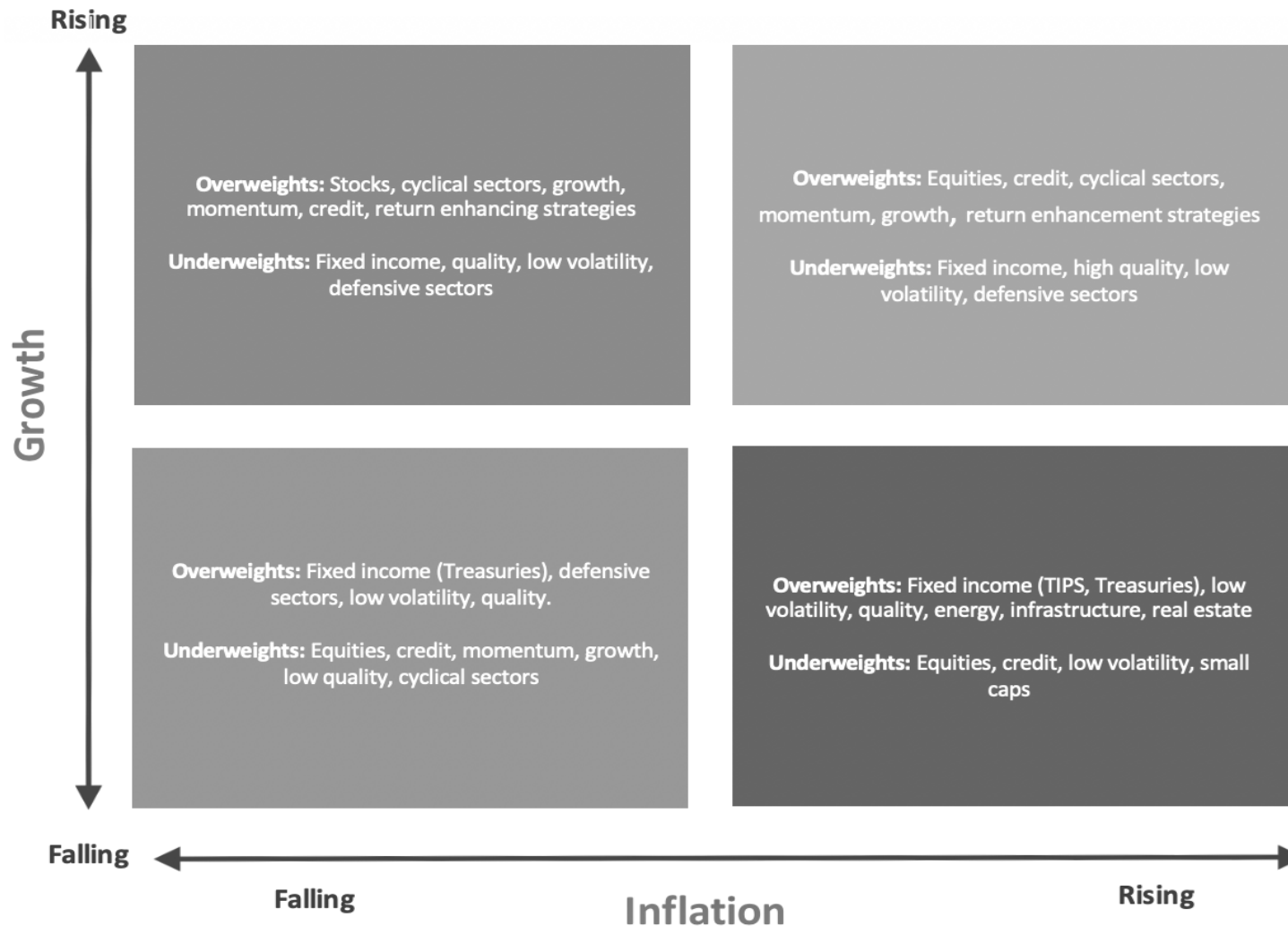


"There are two main drivers of asset class returns — inflation and growth."

- Ray Dalio

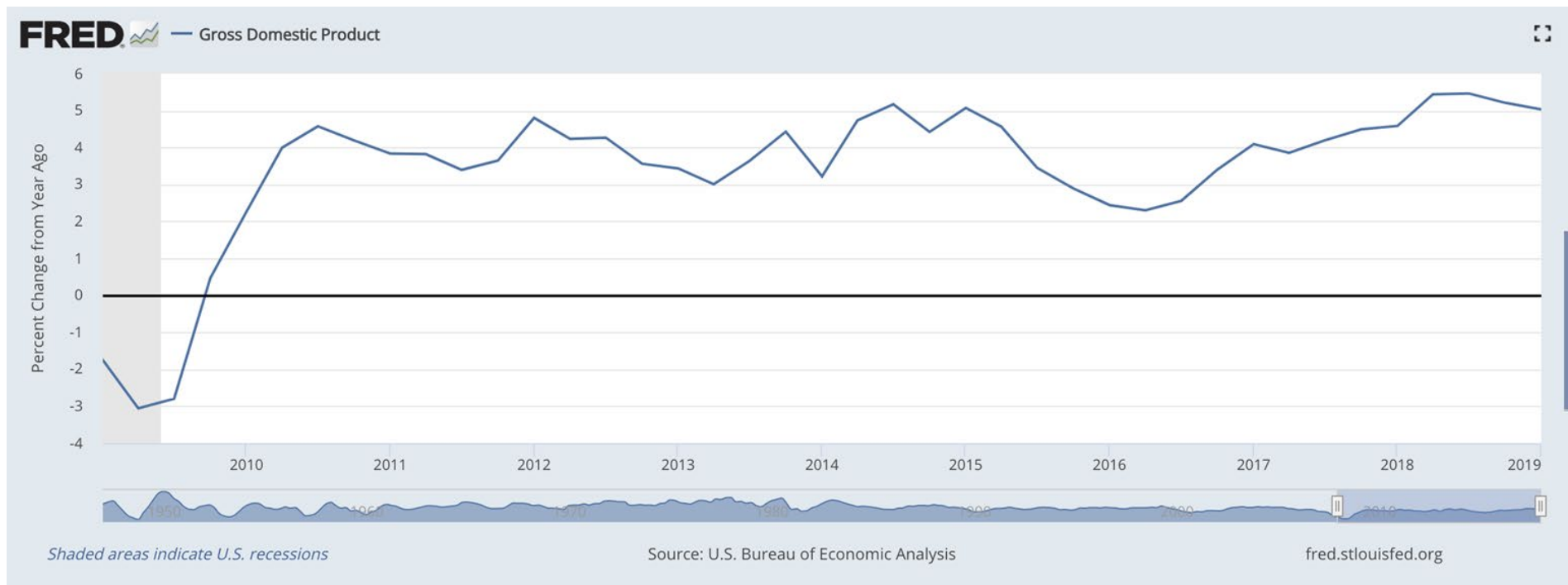
# ECONOMIC GROWTH & INFLATION

## Q3 2019 Quarterly Outlook



# ECONOMIC GROWTH & INFLATION

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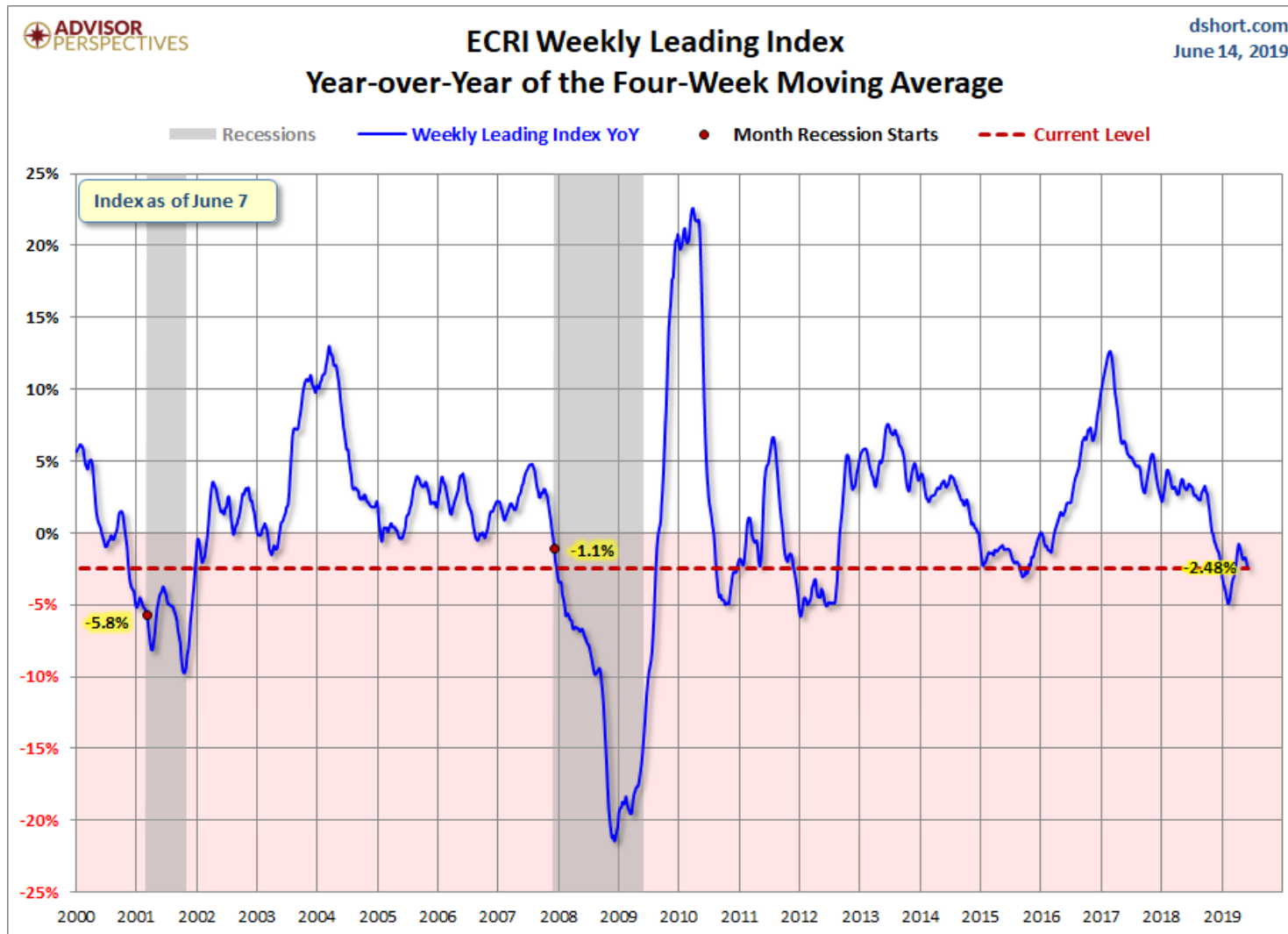
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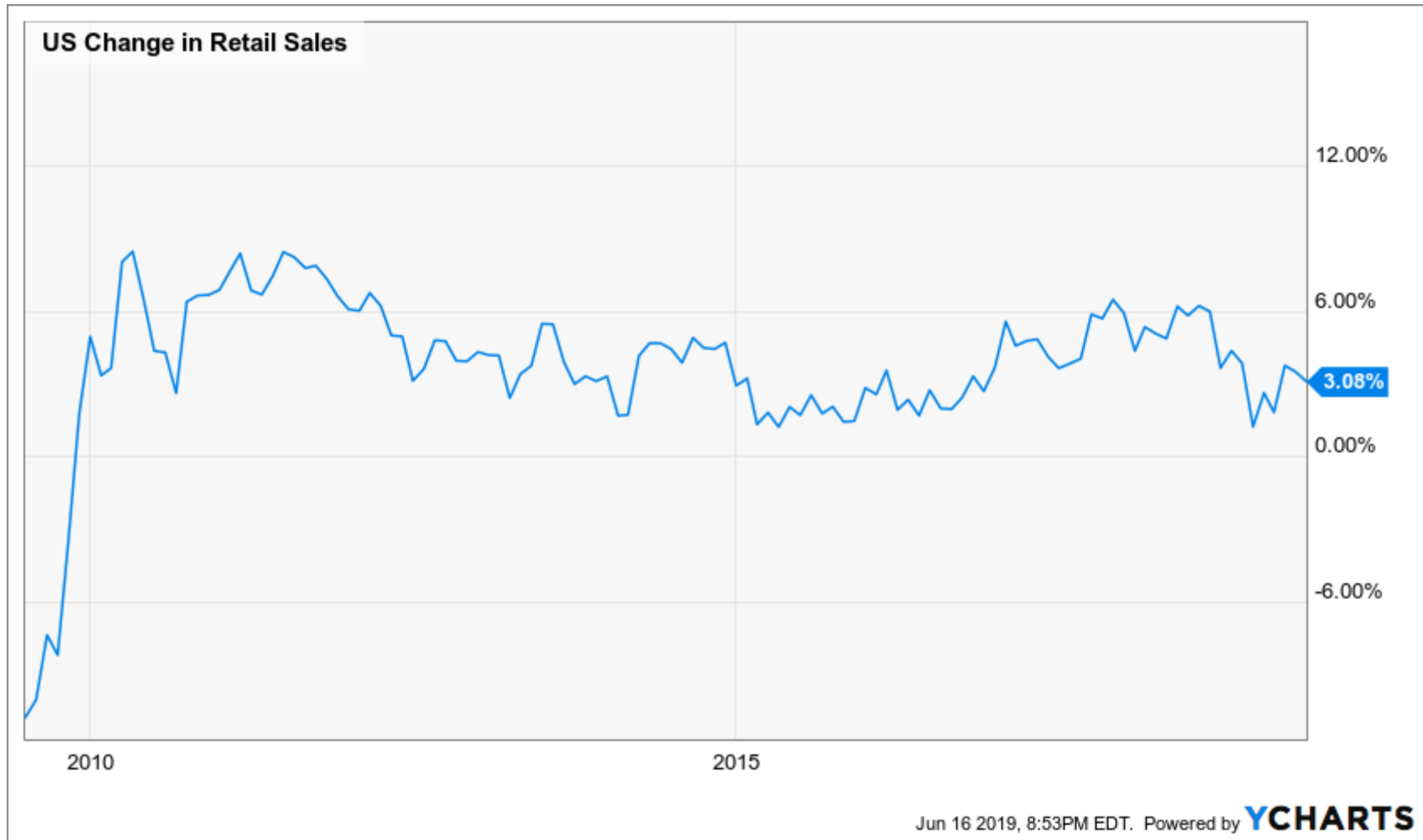
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## Q3 2019 Quarterly Outlook



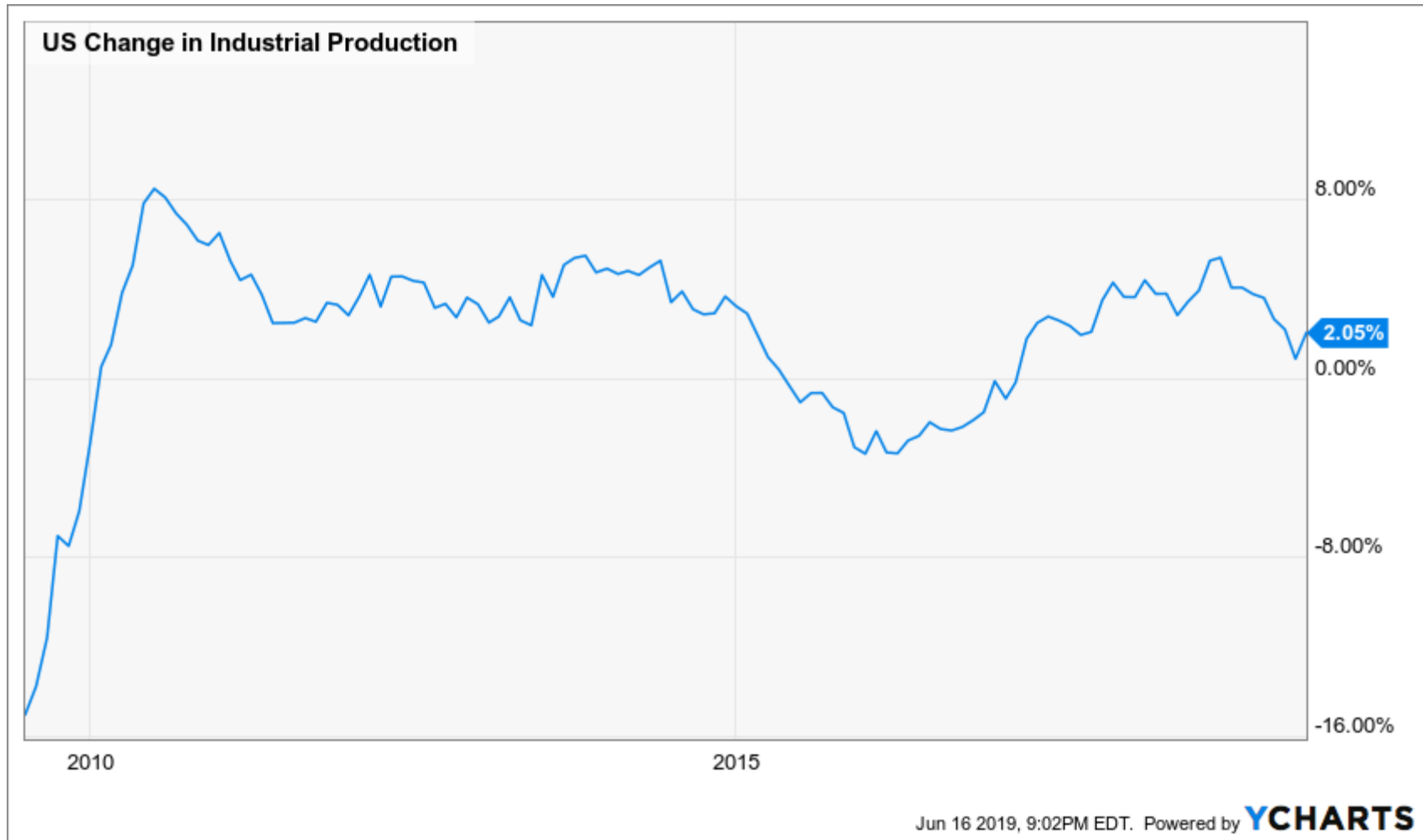
# ECONOMIC GROWTH & INFLATION

## Q3 2019 Quarterly Outlook



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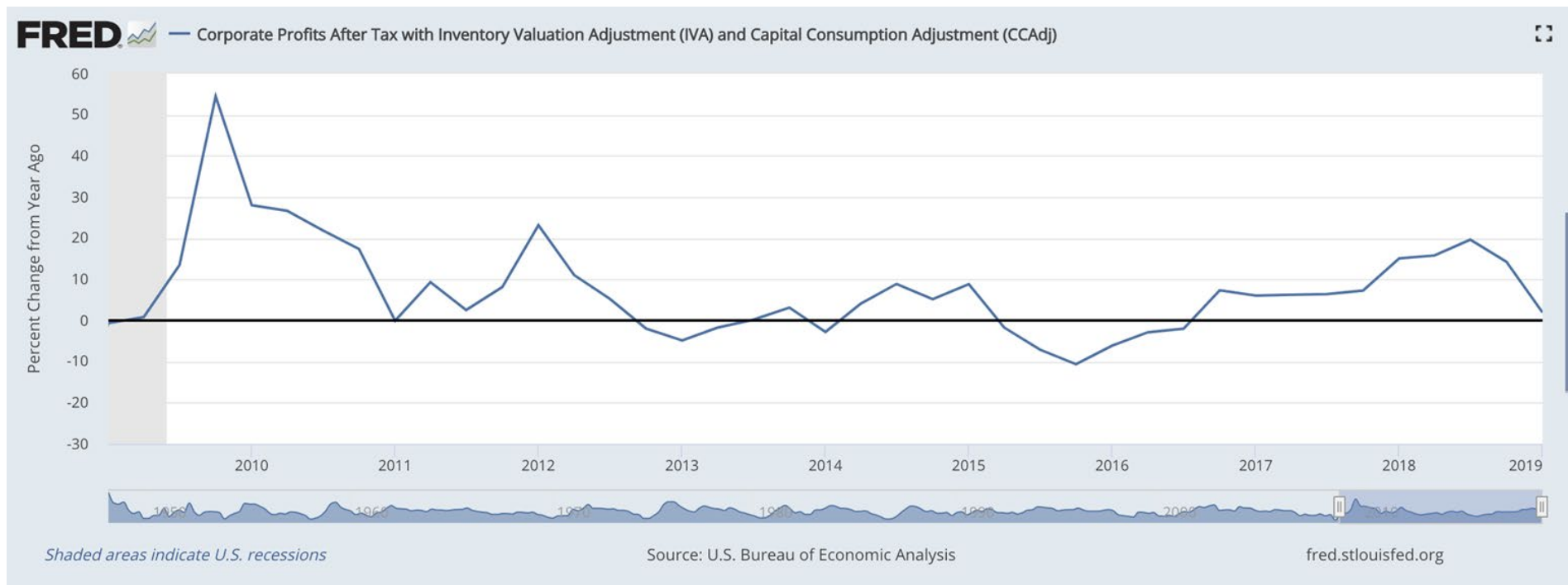
## Q3 2019 Quarterly Outlook





# ECONOMIC GROWTH & INFLATION

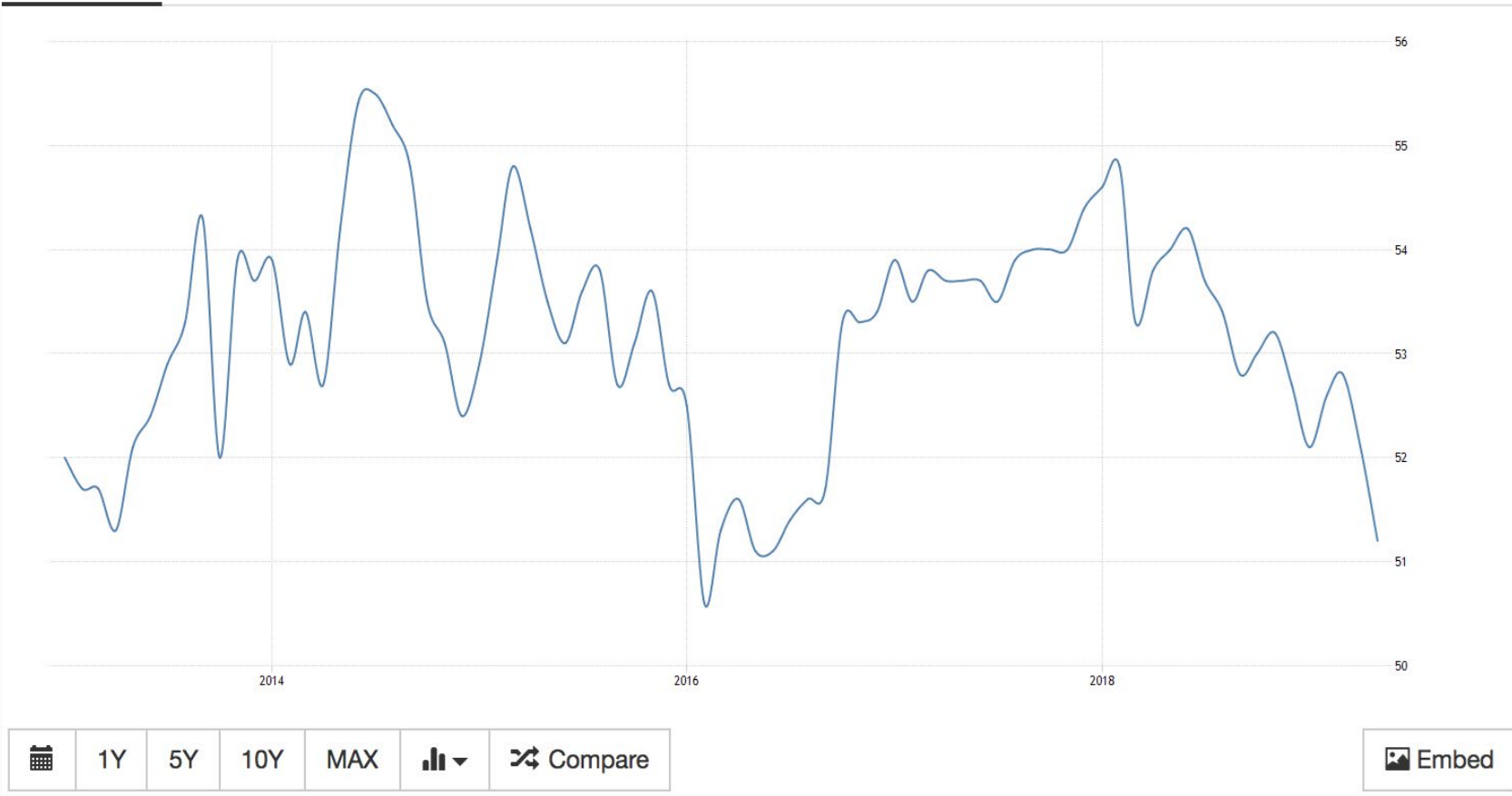
## Q3 2019 Quarterly Outlook



# ECONOMIC GROWTH & INFLATION

## Q3 2019 Quarterly Outlook

### Historical



# ECONOMIC GROWTH & INFLATION

Q3 2019 Quarterly Outlook



"By far the best economic predictor I've ever met is inside the stock market."

- Stanley Druckenmiller

# SMALL CAPS GOING THE WRONG WAY

## Q3 2019 Quarterly Outlook

IJR:IVV iShares Core S&P Small-Cap ETF/iShares Core S&P 500 ETF NYSE

14-Jun-2019

IJR:IVV (Daily) 0.2611

Open 0.2632 High 0.2633 Low 0.2611 Close 0.2611 Volume 1 Chg -0.0022 (-0.85%)

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# LUMBER HAS BEEN WEAK

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**\$LUMBER:\$GOLD** Lumber (Random Length) - Continuous Contract (EOD)/Gold - Continuous Contract (EOD) CME

14-Jun-2019

— \$LUMBER:\$GOLD (Daily) 0.287



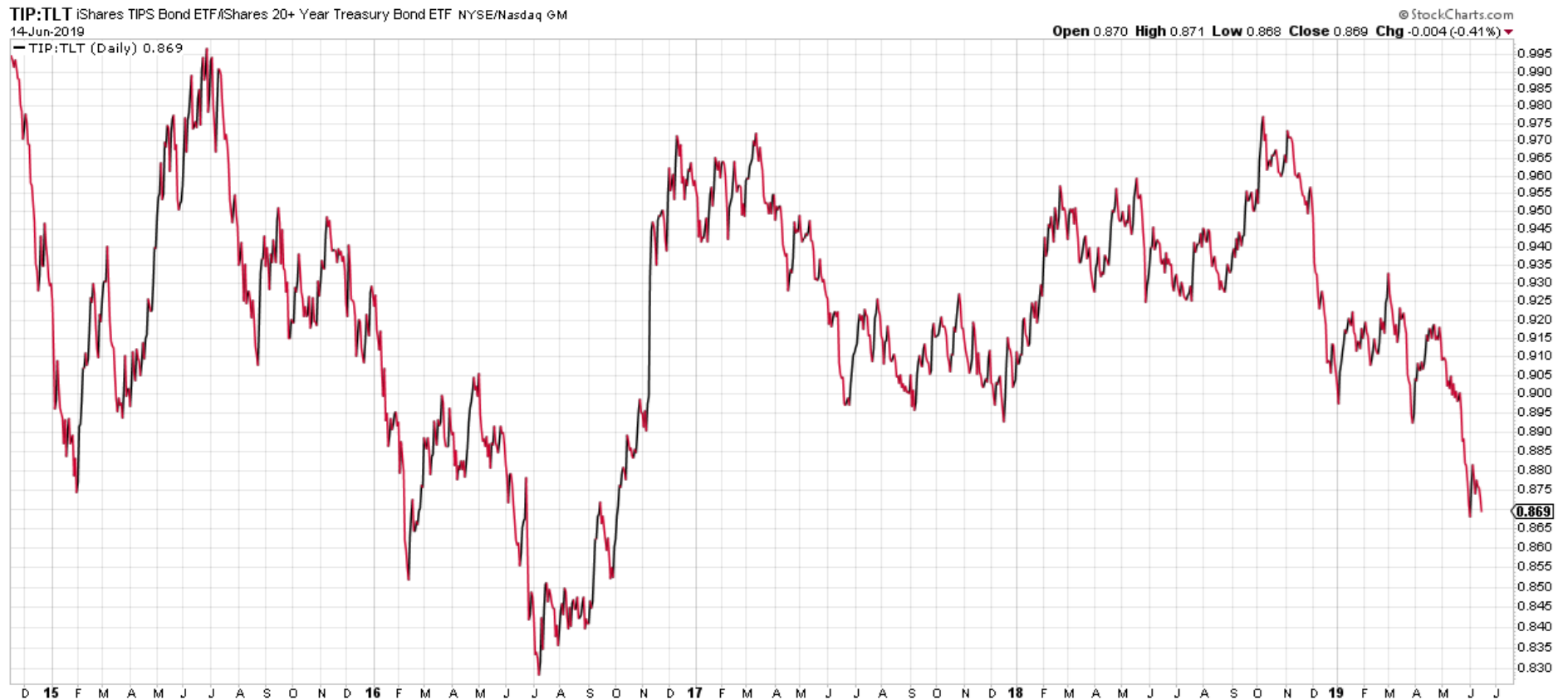
# DR. COPPER LOOKS SICK

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# NO INFLATION IN INFLATION EXPECTATIONS

## Q3 2019 Quarterly Outlook



# CYCLICALS STRUGGLING

## Q3 2019 Quarterly Outlook

XRT:SPY SPDR S&P Retail ETF/SPDR S&P 500 ETF NYSE

14-Jun-2019

XRT:SPY (Daily) 0.146

Open 0.146 High 0.146 Low 0.145 Close 0.146 Chg -0.000 (-0.13%)

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# TRANSPORTS SINKING

## Q3 2019 Quarterly Outlook

IYT:SPY iShares Transportation Average ETF/SPDR S&P 500 ETF NYSE

14-Jun-2019

IYT:SPY (Daily) 0.643

Open 0.644 High 0.645 Low 0.638 Close 0.643 Chg -0.002 (-0.30%)

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# CREDIT RISK RISING

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clint0033 published on TradingView.com, June 17, 2019 01:24:28 UTC

QUANDL:ML/HYOAS, 1D 4.24 ▲ +0.02 (+0.47%) O:4.24 H:4.24 L:4.24 C:4.24



Created with TradingView

# LOW VOLATILITY IS STRONG

## Q3 2019 Quarterly Outlook

**SPLV:SPY** Invesco S&P 500 Low Volatility ETF/SPDR S&P 500 ETF NYSE

14-Jun-2019

— SPLV:SPY (Daily) 0.192

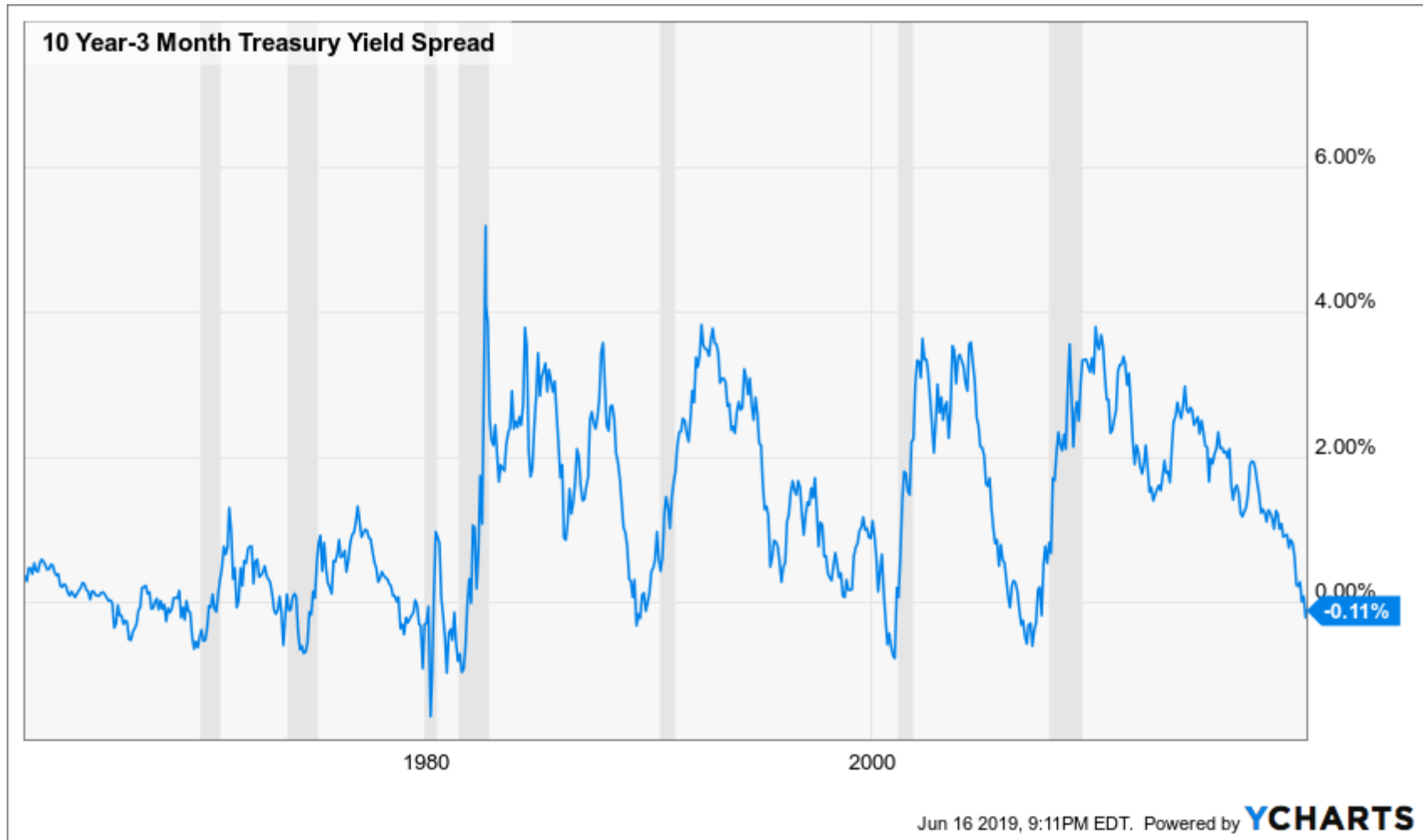
Open 0.191 High 0.193 Low 0.191 Close 0.192 Chg +0.001 (+0.62%)

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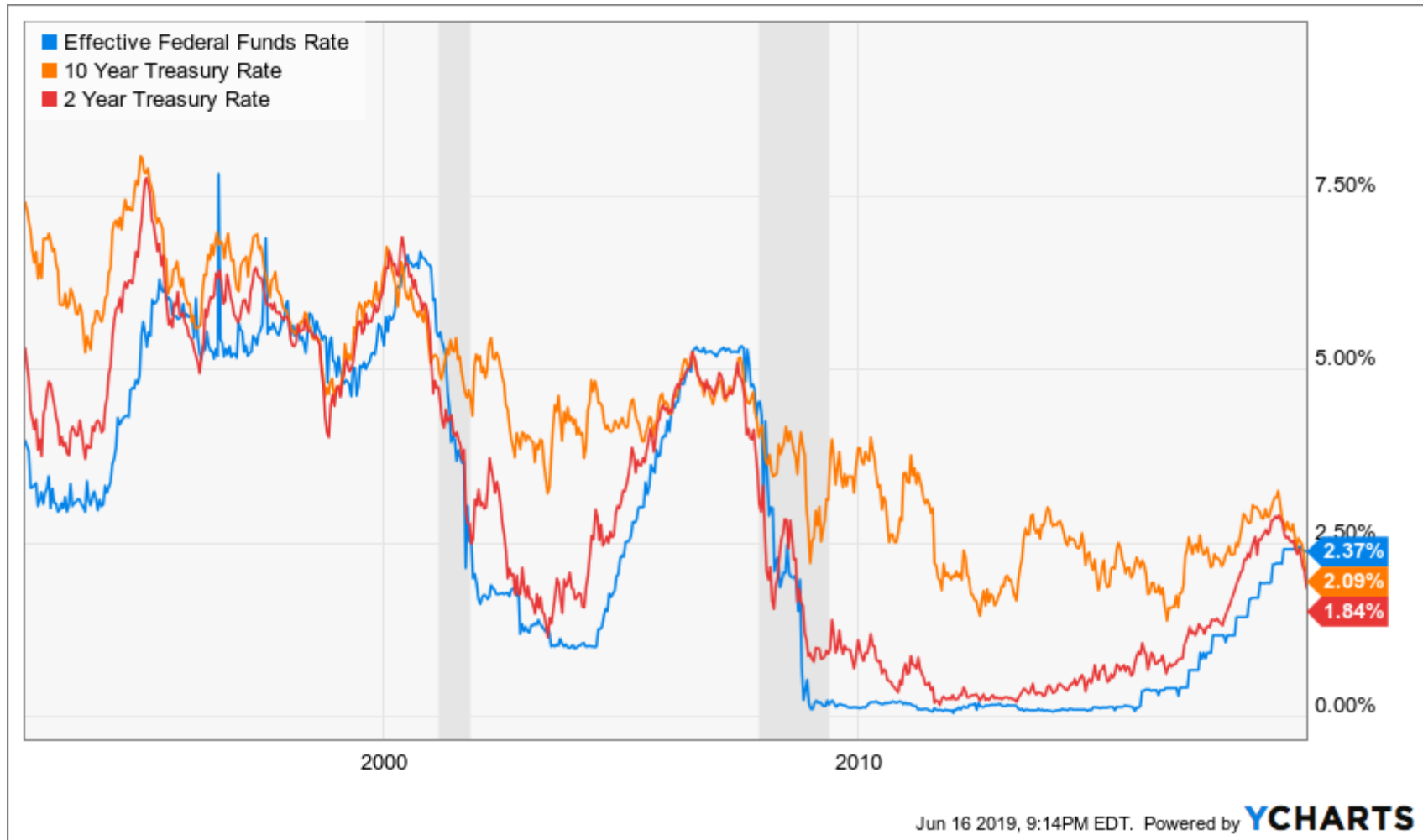
# WHAT ABOUT THE FED?

## Q3 2019 Quarterly Outlook



# BEHIND THE CURVE?

## Q3 2019 Quarterly Outlook

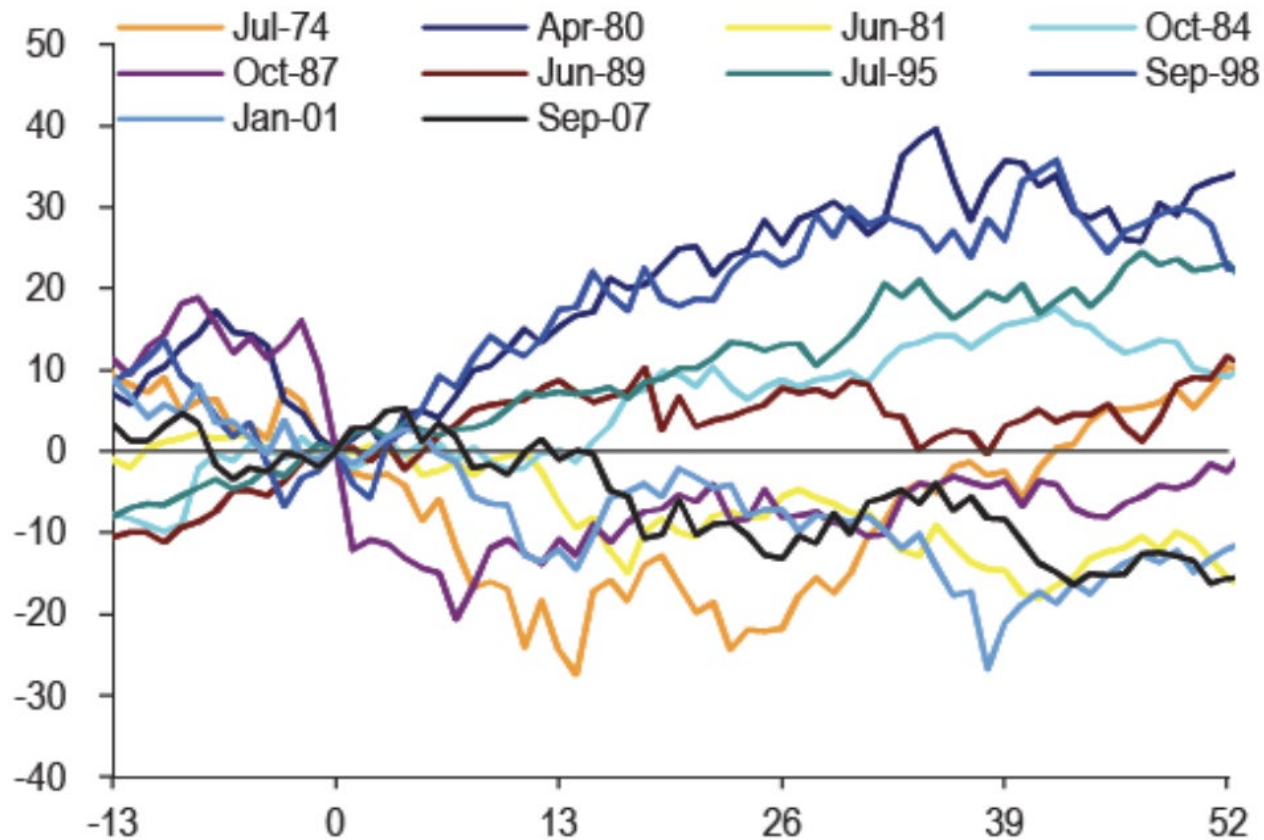


# WHAT COULD HAPPEN?

Q3 2019 Quarterly Outlook

## The trajectory of the S&P500 index before and after the first Fed rate cut

% change from indicated date, number of weeks in x axis

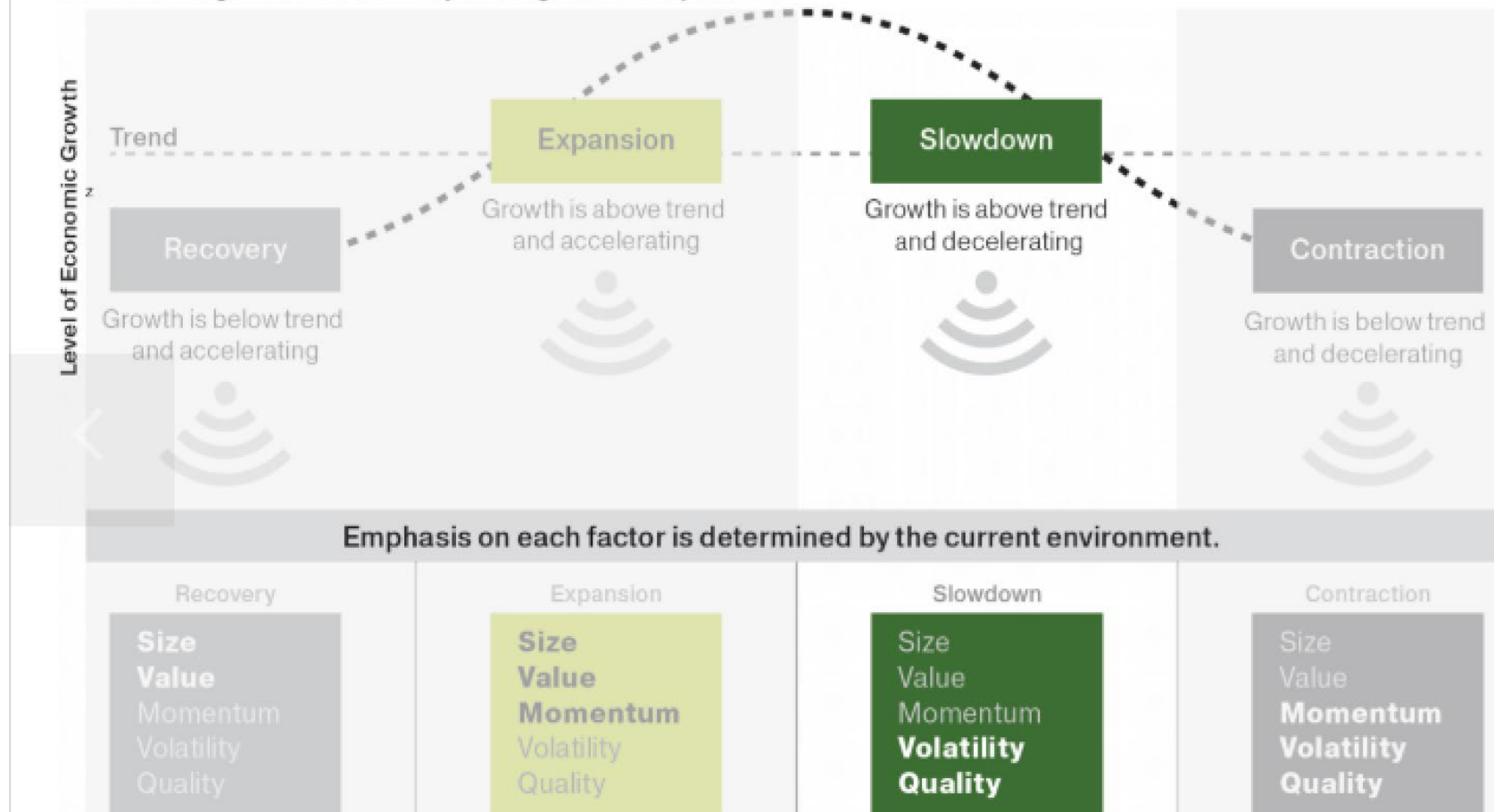


Source: J.P. Morgan

# WHAT TO DO?

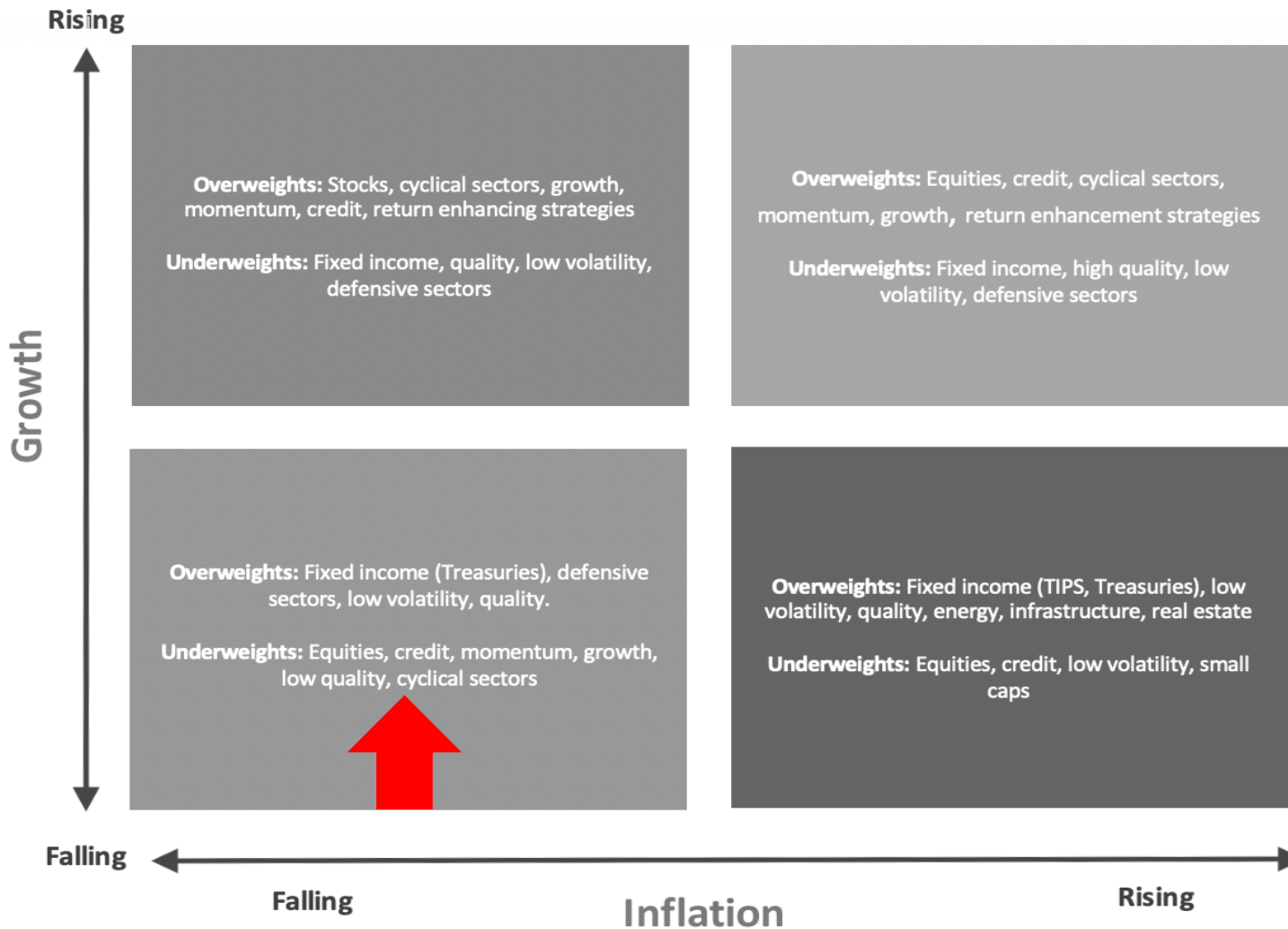
## Q3 2019 Quarterly Outlook

### Our Four Regimes and Corresponding Factor Exposures



# ECONOMIC GROWTH & INFLATION

## Q3 2019 Quarterly Outlook





# DISCLOSURES

## Appendix

Past performance is no guarantee of future returns. This is F3 Investment Management's current assessment of the market and may be changed without notice. The visuals shown are for illustrative purposes only and do not guarantee success or certain level of performance. This material contains projections, forecasts, estimates, beliefs and similar information ("forward looking information"). Forward looking information is subject to inherent uncertainties and qualifications and is based on numerous assumptions, in each case whether or not identified herein.

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Benchmarks: The index / indices used by F3 Investment Management have not been selected to represent an appropriate benchmark to compare an investor's performance, but rather are disclosed for informational purposes. Detailed information regarding the indices is available upon request. The volatility of the indices may be materially different than that of the portfolio.

F3 Investment Management is a registered investment adviser. Registration does not imply a certain level of skill or training. More information about F3 Investment Management including its advisory services and fee schedule can be found in Form ADV Part 2 which is available upon request.

Proxies include but are not limited to:

### Asset Class

Large Cap Value Equity  
Large Cap Growth Equity  
Small Cap Equity  
International Developed Equity  
International Emerging Equity  
Intermediate/Aggregate Bond  
International Bond

### Proxy

S&P 500 Dividend Aristocrats TR USD  
DJ US TSM Large Cap Growth TR USD  
Russell 2000 TR USD  
MSCI EAFE NR USD  
FTSE Emerging TR USD  
BBgBarc US Agg Bond TR USD  
BBgBarc Gbl Agg Ex USD TR Hdg USD

### Asset Class

Short Bond  
Pacer Wealthshield Index  
Managed Futures  
Dividend Growth Strategies  
M&A  
Commodities  
REITs

### Proxy

BBgBarc US Aggregate 1-3 Yr TR USD  
WealthShield Sector TR USD  
SG Trend Index  
S&P 500 Dividend Aristocrats TR USD  
Credit Suisse Merg Arbtrg Liquid TR USD  
Bloomberg Commodity TR USD  
S&P United States REIT TR USD

