Monthly Market Commentary

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ReDefine
Wealth Management

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September 5, 2018: ReDefine Wealth Management provides clients and business partners with a differentiated suite of services and products. This monthly commentary encapsulates how our team is looking at the world and the practical implications of our approach. This monthly commentary is designed to illuminate the process behind the implementation of investment decisions within ReDefine Wealth Management portfolios.

ReDefine Wealth Management Global Thematic Investment Strategy

Anecdotal and historical evidence suggest that mitigating portfolio draw-down has the greatest impact on portfolio success. ***Quite simply, it is more efficient to grow wealth by not losing wealth.***

Redefine Wealth Management employs a **Global Thematic** approach to our investment portfolios. Meaning that our ***Global Macroeconomic Analysis*** provides the basis for attractive reward versus risk within global investment opportunities. The findings of our macro analysis help to inform our ***Strategic Asset Allocation,*** wherein we divide assets between the best opportunities that we can source within three primary portfolio components – Global Equities, Fixed Income/Cash, and Real Assets.

We then work to further divide the primary components into sub-components, for example Global Equities may be divided between disparate geographies and various capitalization sizes. Once the general allocation is decided, we begin our ***Tactical Investment Selection*** to specifically choose the financial instruments we will use to implement our globally thematic strategic asset allocation. It is important to note that our tactical investments are also directional – i.e. Long and short.

Our disciplined processes allow us to handpick and tactically manage highly-liquid financial instruments, such as: ***ETFs, Mutual Funds, Stocks, Bonds, CEFs, and Options.*** So, while we may hold similar "investments" as traditional portfolios, it is our approach and flexibility that allows for asymmetric returns relative to risk.

Fundamental Global Macro Economic Backdrop

As a reminder, our *Global Investment Themes* and general assumptions at the beginning of 2018 were:

- **Stock Prices Will Stair-step Higher While Bond Prices Stair-step Down**
- **Global Inflation and US Interest Rates Will Rise**
- **US Dollar Will Strengthen and Global Political Unrest Will Increase**
- **Increasing Global Market Volatility**

As illustrated in the chart below, the broader US Equity Market as represented by the S&P 500 Index (white line) and the broader US Bond Market as represented by the Barclays Aggregate Bond Index (orange line) spent the first few months of 2018 trading relative strength. *In June, our "Stocks Outperform Bonds" theme truly hit stride as equities pushed higher and dramatically outperformed bonds.*

Source: Bloomberg

Fundamental Global Macro Economic Backdrop (cont.)

Interestingly, when the S&P 500 sold off at the end of January, bonds did a poor job of picking up the slack. Such a move is a telling, albeit brief, example of one of our *Burgeoning Investment Themes – Stock and Bond Correlations Will Turn Positive.* While this theme is considered burgeoning, i.e. "not yet ready for prime time," we are concerned that during the next market crisis (someday) stock and bond prices will move together. During this scenario, a traditional "diversified" portfolio will provide little to no real downside protection. But more on that in future Commentaries.
As discussed in last month's Commentary, geopolitical issues in Europe and midterm elections domestically cause us to have some reservations for Global Equity Markets in the 4th quarter. Fortunately, a temporary correction in the US Equity Markets caused by these forces is more than likely a buying opportunity - especially in individual stocks.

Our themes of *"Rising Inflation and Interest Rates," and "Increasing Political Unrest"* have proven accurate in 2018. Although those themes have not dictated a violent increase global volatility – as of this writing - after showing signs of impending drama in early 2018, our *"Increasing Global Market Volatility"* theme has largely been muted and benign this year. We continue to vigilantly monitor for increasing global volatility and all its manifestations, we are happy to have overestimated this theme, as Global Market Volatility tends to affect asset prices quickly and intensely.

Finally, *barring a thematic change in Central Bank Policy* we don't foresee a threat to our theme or the mounting near-term *"Strength of the US Dollar."*

In the US, the hotly contested mid-term election cycle, coupled with amazingly resilient and seemingly omnipresent (except on the football field) news of Colin Kaepernick will once again bombard the autumn airwaves with a healthy dose of gloom and doom. Most likely providing enough of a distraction to divert attention away from the real global macroeconomic issues we see bubbling under the surface.

Let's walk through our views on the three major strategic allocation components: Global Equities, Global Bonds & Cash, and Real Assets.

Global Equities

While there is always danger, barring a full-blown economic meltdown along the Emerging Markets and potential contagion to Global Equity Markets, *we continue to believe US Equity Markets provide the best risk/return opportunities globally.* The S&P 500 (Exhibit 2) has continued its upward trend and finally breached the previous high set in January. We believe this move will continue, but obstacles will be present (see the August Market Commentary for more specifics).

New highs continue to be set in the Nasdaq 100 and Russell 2000, representing the strength and breadth across US Equity Markets. Interestingly, the Dow Jones Industrial Average has yet to meet or exceed previous highs. *The Dow can serve as a barometer of foreign investment into the US,* so perhaps this relative "lag" points to a dearth of overseas investment.

Exhibit 2 ***Source: Bloomberg***

Exhibit 3 ***Source: Bloomberg***

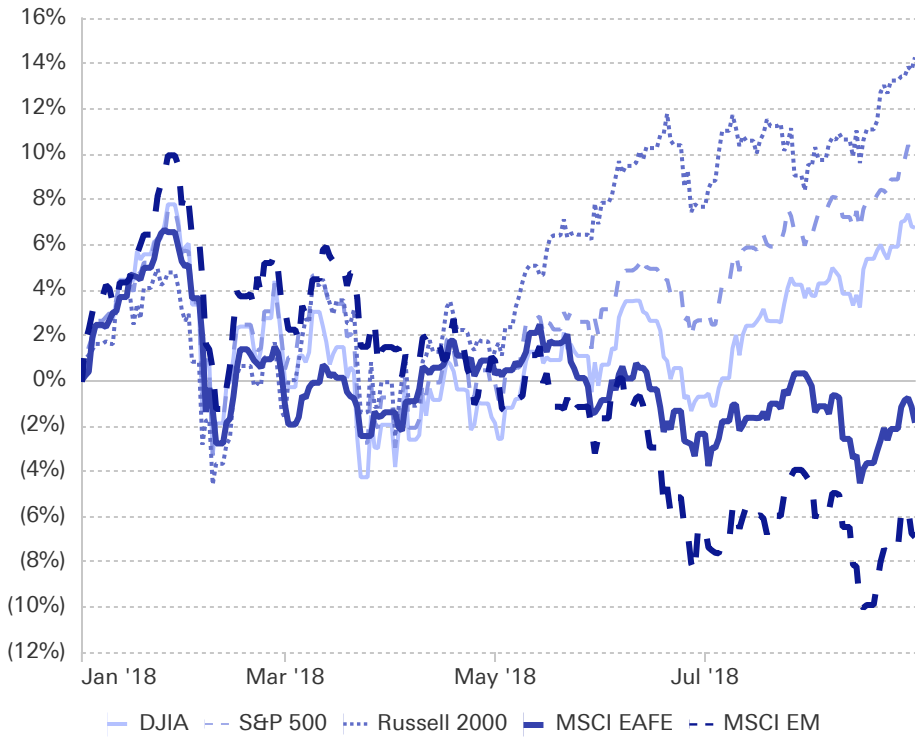
International Equities conversely continue to struggle, not only relative to US Equities but on absolute terms as well. Even considering that EFA - which represents a basket of foreign equities in developed countries - has held the 12-month support level it does not appear international stocks are poised to rebound anytime soon (Exhibit 3). Especially considering that geopolitical issues continue to surface in Europe.

While there have been brief rallies along the way, we still believe that *the strength of the US Dollar will continue to move Emerging Markets lower* (Exhibit 4). We maintain our net short position towards emerging markets. While we are prepared to change our minds, we believe it is more likely to increase that position rather than reduce.

Recently we increased our Global Equities sleeve of our portfolios to 60% of the overall Strategic Allocation, which represents a 10% near-term increase. That stated, our global equity target weight is 60% so we are now in line with our model.

Internationally, we exited our position in Developed Market equities and in harmony with our macro theme of a *Strengthening US Dollar,* we added to our short position in Emerging Market Equities that we established in June. Our core allocation to US Equities remains at 20% and is augmented by a 10% momentum allocation to high-dividend US Equities. Our 15% Sector Rotation allocation remains overweight US Small Cap Equities and

Year to Date Global Equity Performance



	CURRENT PERIOD	YTD
Dow Jones Industrial Average (TR)	2.89%	6.73%
S&P 500 (TR)	3.37%	9.94%
Russell 2000 (TR)	4.40%	14.26%
MSCI EAFE (TR)	(1.62%)	(1.87%)
MSCI Emerging Markets (TR)	(2.63%)	(6.93%)

Technology Equities, and *newly established positions within the Aerospace & Defense Sector.* Opportunistically, we maintain a small overweight to actively managed Small-Mid-Cap US Equities and we have *added a handful of positions in individual stocks within the Transportation and Consumer Discretionary Sectors.*

Another one of our Burgeoning Investment Themes is *Actively Managed Individual Stocks Will Outperform Passive Stock Indexes.* As with our other burgeoning, i.e. "not yet ready for prime time" themes, positions will be woven into our portfolios slowly and opportunistically. We will exercise caution acknowledging all-time highs in valuations and use short-term index corrections to weave in individual positions within the index.

Exhibit 4 ***Source: Bloomberg***

Global Fixed Income & Cash

Although there are opportunities within fixed income, the broad indicators continue to lack direction. While sideways can be considered a direction, it does not provide us much value. As shown by the Bloomberg Barclays Aggregate Bond Index (Exhibit 5) there has been little movement this year especially since February.

While we do expect bond prices to resume their downtrend, we would not be alarmed by a short-term spike in prices. Over the long-term however, we believe that stocks will continue to outperform bonds. We maintain our long-term view that there is a very high probability that the 30+ bull market in bonds may be nearing its end. As such, it is important to remain nimble.

Currently the Global Fixed Income & Cash sleeve of our portfolios has been reduced to roughly 32.5% of the overall Strategic Allocation, which represents a very slight overweight from our model target of 30%. Overall, we maintain a low-duration stance across our fixed income investments. Our allocation remains "bar-belled" between high quality bonds and higher-yielding, more credit-oriented bonds. We continue to overweight bonds backed by consumer credit within the credit end of the barbell.

Exhibit 5 *Source: Bloomberg*

Global Real Assets

At this point, it appears the US Dollar has resumed its uptrend after recent consolidation. This can be witnessed when compared to other currencies, especially in the emerging market space. The US Dollar Index (Exhibit 6) has bounced off of key support and advanced, which suggests strength versus major currencies such as the Euro and Yen.

We are not seeing attractive opportunities in the commodity space yet, *so we maintain our lowered Strategic Allocation weighting in our Real Assets sleeve at 5%.* This allocation is solely our strong dollar trade, and as mentioned in our last few Commentaries, we continue to monitor for a potential "risk off" environment and potential investments in this area.

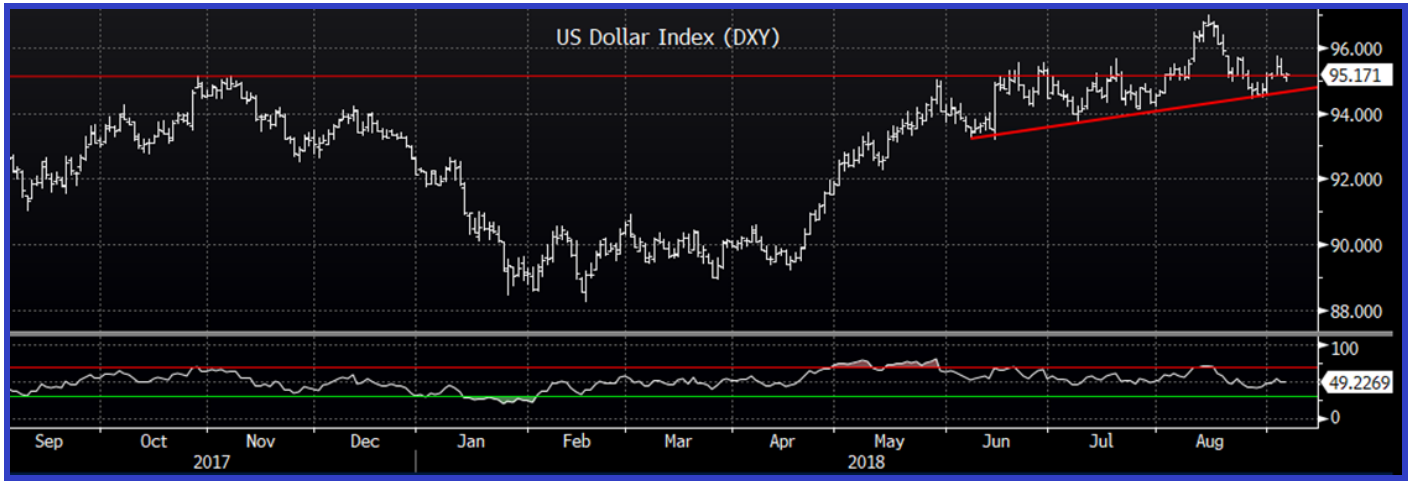


Exhibit 6 *Source: Bloomberg*

Conclusion

While it can be cathartic for us to look back at how our major themes have played out thus far in 2018, the more important question remains whether our themes will continue unabated. *Our research would suggest that our themes will continue to still be in play through the rest of the year and potentially much longer.* We continue to anticipate bouts of significant volatility toward the beginning of the fourth quarter. If it materializes, extreme volatility could affect our themes in the near-term. Even so, we remain cautiously confidant that our major themes will continue to provide our investors with the greatest opportunity to grow wealth by not losing wealth.