ReDefine Wealth Management's Monthly Market Commentary

April 30, 2019

ReDefine Wealth Management

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Market Performance Roundup

As of 04-30-2019

ReDefine Wealth Management

WORLD MARKETS

		1 MO.	Q1 19	YTD	2018	1 YR.	3 YR.
Global Equities (USD, % chg.)	*MSCI All Country World (Total Return)*	3.43%	12.33%	16.18%	(8.93%)	5.63%	11.96%
	MSCI World (Total Return)	3.60%	12.65%	16.70%	(8.20%)	7.08%	12.02%
	MSCI EAFE (USD) (Total Return)	2.91%	10.13%	13.33%	(13.36%)	(2.73%)	7.77%
	MSCI Emerging Markets (Total Return)	2.12%	9.95%	12.29%	(14.24%)	(4.68%)	11.66%
Country Equities (Local, % chg.)	*Dow Jones Industrial Average (Total Return)*	2.66%	11.81%	14.79%	(3.48%)	12.63%	17.16%
	S&P 500 (Total Return)	4.05%	13.65%	18.25%	(4.38%)	13.49%	14.87%
	NASDAQ (Total Return)	4.77%	16.81%	22.38%	(2.84%)	15.82%	20.58%
	Russell 2000 (Total Return)	3.40%	14.58%	18.48%	(11.01%)	4.61%	13.60%
	Nikkei 225 Stock Average (JPY) (Total Return)	4.97%	6.89%	12.20%	(10.29%)	1.15%	12.30%
	STOXX Europe 600 Euro (Total Return)	3.91%	13.18%	17.61%	(10.22%)	5.13%	8.26%
	FTSE 100 (Total Return)	2.33%	9.49%	12.04%	(8.73%)	3.15%	10.33%
	DAX 30 (Total Return)	7.10%	9.16%	16.91%	(18.26%)	(2.13%)	7.13%
	Shanghai Composite	(0.40%)	23.93%	23.43%	(24.59%)	(0.13%)	1.56%
Global Fixed Income (USD, % chg.)	*Barclays Global Treasury (Total Return)*	(0.63%)	1.60%	0.96%	(0.38%)	(0.24%)	0.19%
	Barclays US Treasury (Total Return)	(0.28%)	2.11%	1.83%	0.86%	4.77%	0.98%
	Barclays Global Aggregate (Total Return)	(0.30%)	2.20%	1.90%	(1.20%)	0.94%	0.94%
	Barclays US Aggregate (Total Return)	0.03%	2.94%	2.97%	0.01%	5.29%	1.90%
	Barclays Global High Yield (Total Return)	0.84%	6.33%	7.23%	(4.06%)	3.48%	6.43%
	Barclays US Corporate High Yield (Total Return)	1.42%	7.26%	8.78%	(2.08%)	6.74%	7.69%
	S&P Leveraged Loan Index (Total Return)	1.67%	3.96%	5.70%	0.47%	4.22%	5.55%
	Barclays Emerging Markets (Total Return)	0.40%	5.43%	5.85%	(2.46%)	5.88%	4.88%
Real Assets (USD, % chg.)	*USD DXY*	0.20%	1.16%	1.36%	4.40%	6.14%	1.55%
	Dow Jones US Real Estate Index (Total Return)	(0.03%)	17.08%	17.04%	(4.03%)	19.06%	8.69%
	Bloomberg Commodity Index	(0.42%)	6.32%	5.88%	(11.25%)	(8.03%)	(0.66%)
	S&P GSCI Gold	(0.99%)	1.34%	0.34%	(2.14%)	(2.54%)	(0.12%)
	S&P GSCI Precious Metals (Total Return)	(0.82%)	0.55%	(0.27%)	(3.58%)	(3.79%)	(1.57%)

ReDefine Wealth Management

May 8, 2019 ***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. It is designed to illuminate the process behind the implementation of investment decisions within **ReDefine Wealth Management Global Thematic Active Asset Allocation Portfolios.***

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.*

In order to facilitate portfolio success, ReDefine Wealth Management employs a Global Thematic Active Asset Allocation approach to our investment portfolios.

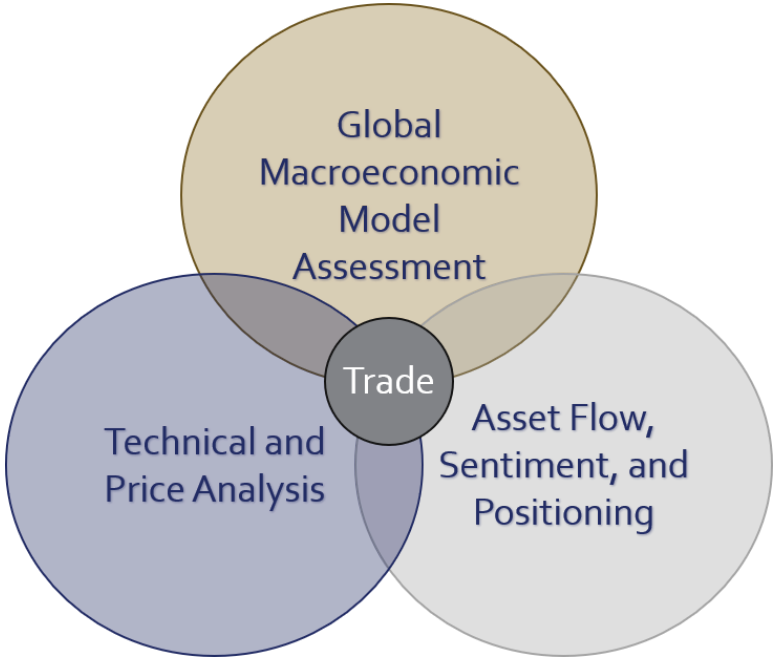
Our Global Macroeconomic Analysis provides the basis for attractive reward versus risk within global investment opportunities and helps to inform our Active Asset Allocation. We divide assets between the best opportunities that we can source within three primary portfolio components – *Global Equities, Fixed Income/Cash, and Real Assets.*

Like a traffic signal, Active Asset Allocation allows RWM to invest or overweight opportunities where we feel strongly (green light), avoid or underweight asset classes where we feel unconvinced or cautious (yellow light), and even take inverse positions when we feel strongly negative (red light).

Once the allocation is decided, we begin our investment selection to specifically choose the financial instruments we will use to implement our globally thematic strategic asset allocation. 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.

Global Thematic Active Asset Allocation



Fundamental Global Macroeconomic Backdrop

It is important to remember that the S&P 500 is sitting near the same levels it was in January 2018 and September 2018 - right before two quick and painful corrections. Earnings are close to the levels of those times as well, but the economic data is now weaker - both in the US and abroad. Exhibit 1.

The ever-evolving China Trade Deal.

This ongoing saga has led to some volatility and price declines recently, and quite frankly talk of a deal has taken on a life of its own, not unlike the Brexit fiasco. The China trade deal was originally forecasted to be settled six months ago. In the ensuing time period, news the trade deal has been used by President Trump seemingly as way to prop up the market and dampen volatility. President Trump has been promising the American people (as well as global trade partners) that any negative data points are temporary because a US/China trade deal will solve the world's economic problems and put the US in its proper place as the dictator of trade terms.

We tend to believe that a US/China trade deal will be done, and that Trump and Xi will trumpet the deal as a game changer, however several factors may make the deal potentially weaker than expected. Historically, China tends to set policy that is long-term in nature, whereas the US tends to set policy feverishly before an election cycle. This may aid China in negotiations as they have the wherewithal to "wait out" Trump in hopes he will be defeated in 2020, and potentially usher back in the era of sweetheart deals with democratic leaders. China has developed their global economic power on the backs of incredible and often one-side trade deals that take advantage of their status as a "developing" economy. It is difficult to believe that they will stray from their proven methods in order to strike a trade deal that would benefit the US in a significant way.

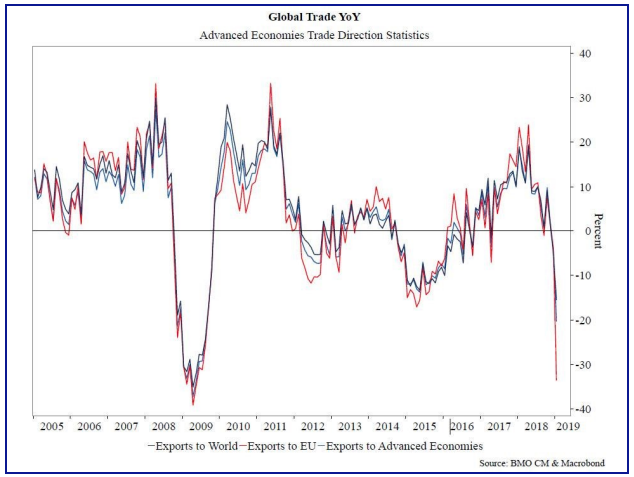


Exhibit 1. Source: BMO CM &Macrobond as of April 30, 2019

We tend to believe it is more likely that the deal will take more time and economic consequence than Trump is willing to endure this close to an election. A likely scenario is that of President Trump (or one of his many surrogates) rushing to a microphone touting an impending deal anytime the US markets show volatility or downward pressure. We remain under the assumption that a significant deal will not be made in the near future, yet we remain hopeful that Trump with defy the odds and use his current leverage to get a more mutually beneficial deal done.

In last month's letter, *De'ja Vue All Over Again?*, we wrote about how the markets seemed to be setting up in a similar way as they did twice last year - which ended in 12% and 20% declines respectively. We attempted to show the "setup" using a few charts that demonstrated the divergences in several key areas. These included the S&P 500 vs the 10-yr yield. The S&P 500 equity prices vs associated equity earnings. And multiple economic gauges, and company specific metrics (Apple stock specifically) vs the Semiconductor Index Price (SOX).

Our hope was that by examining stock earnings reports and key monthly economic data we would be able see these divergences come back together. Hopefully

Fundamental Global Macroeconomic Backdrop (cont.)

illuminating if the data warrant these high stock valuations. Unfortunately, the aforementioned divergences actually widened even more for each of the cases we shared. The problem is not that the data didn't provide the evidence we were hoping to see, but rather that markets did understand the evidence yet continued to ignore it.

The divergence between stock prices and the 10-year US Treasury yield has historically been a short-term phenomenon, as the 10-yr yield is typically a reflection of the underlying economic strength or weakness of the US economy. As mentioned, this divergence has continued to widen and thus we feel more confident that the yield is the more accurate gauge as of this writing. Exhibit 2.

For example, economic data is much weaker than what one would expect after the Q1 market run-up. Some market pundits point out that the GDP grew 3.2% in the first quarter, which was indeed much better than anticipated. And they would be correct. That said, closer examination of the components that make up the GDP number calls into question the number's validity. Specifically, inventories grew substantially over the last three quarters, which will work to inflate the number. Then when we mix-in other one-time factors, our calculations subtract roughly 2% off the 3.2% GDP calculation. Not overly impressive when considering the stock market added over 1% to the number with its >10% upward move.

GDP is the gauge used in determining economic recession.

When blending the GDP data with an economic statistic that we have a bit more faith in – the ISM Manufacturing Index (ISM) - a much clearer picture of the current economic environment emerges. The ISM recently reported its lowest number in two and half years. Rising inventories and decreasing sales have conspired to steer the ISM lower. *If these inventories don't (at least begin to) sell off soon, they may have a more visible adverse impact on future GDP numbers.* History shows us that stock prices tend to react very negatively once talk of "pricing in" a recession begins and considering the current price levels falling GDP numbers may prove especially painful for certain segments of the market.

Exhibit 2. Source Bloomberg as of April 30, 2019

Stock earnings have been deteriorating in the face of rising stock prices. According to a favorite unbiased data group, FactSet, with about 80% of first quarter 2019 earnings reported, quarter over quarter earnings will be negative. And considering the tailwind of record-breaking stock buybacks in Q1 this is somewhat alarming. Many companies have used buybacks over the last decade as a way of "propping up" stock prices and stockpiling inexpensive debt… and unfortunately, potentially hiding underlying weaknesses. When flat-to-declining earnings are combined with questionable economic data, that typically points to the potential of unstable economic footing. That is not certain, however we feel certain that the combination probably does not warrant a huge market bounce from the December lows.

Let's take a moment to consider Apple.

Apple bought back more shares in the first quarter than they did in the entirety of 2018. On January 3, 2019 Apple announced to analysts they were "slashing" their future earnings, revenues, and IPhone sales projections. Recently Apple reported Q1 earnings that were in line with the January estimates and the markets celebrated by pushing Apple shares up over $10 from the close (just 30 minutes prior). Apple's earnings, sales, and market share are significantly lower year-over-year. And to put a cherry on top, they lowered their second quarter forecast and announced revenues will drop another 5-6% in the next quarter.

Apple's revenue declined by 5% over the past year which equates to the exact level they were **4 years ago.** IPhone sales, the largest contributor to revenues, dropped 17% year-over-year and are estimated to decline into late 2020 or 2021. Their global market share in smartphones has dropped from roughly 23% four years ago, to 11.7%. Further, sales to China and their services business, were also down for the quarter with China sales down 22% over

Fundamental Global Macroeconomic Backdrop (cont.)

last 4 years, with the headwind of a negative underlying growth rate and corporate debt rising to over $100 billion.

It wasn't long ago bellwethers GE and IBM were experiencing similar headwinds. GE now trades under $10 and is grappling with paying down $111 billion in debt – which over $40 billion was incurred with stock buybacks. IBM has announced the cessation of their stock buyback program in order to attempt to pay down their debt. IBM's stock price has been on a steady decline (roughly 36%) over the last six years. As of this writing, we worry that Apple may be finding itself on a similar path as GE and IBM. Those three companies are simply behemoth examples of a pervasive corporate trend that has developed over the last decade - companies adding cheap debt to fund stock buybacks, and in some cases to give the appearance of earnings growth. We will have more on this subject later in the year.

The real question remains: How will this balance sheet jujitsu playout for the market as a whole?

We continue to closely monitor the semiconductor market, which tends to serve as a leading indicator of global market health and breadth. We were expecting to see a bounce in global semiconductor sales because the semiconductor index (SOX up ~26% YTD) was leading both the tech sector and markets higher thus far in 2019. However, the largest semiconductor companies such as Intel and Texas Instruments have been reporting weak

Exhibit 4. Source MI2 Partners, Bloomberg as of April 30, 2019

sales over the prior quarter. Exhibit 3. These weak global sales were confirmed by World Semiconductor Trade Statistics (WSTS) which showed semiconductor sales declined by 20% on a quarter-to-quarter basis (3-month moving average). This has happened two other times in the last 25 years.

And you may ask, what happened after those two occurrences?

From 2007-2008, the semiconductor index dropped roughly 70%. And 2001-2002 the index shed almost 85% from its highs in 2000. These drops in global semiconductor sales preceded the last two precipitous drops in the index and foreshadowed two recessions. We openly wonder if the recent rally in the SOX, against declining sales is going to end poorly for the global stock markets. We tend to believe markets are at extreme price levels and we question what could be the catalyst that may trigger a sudden and potentially large correction.

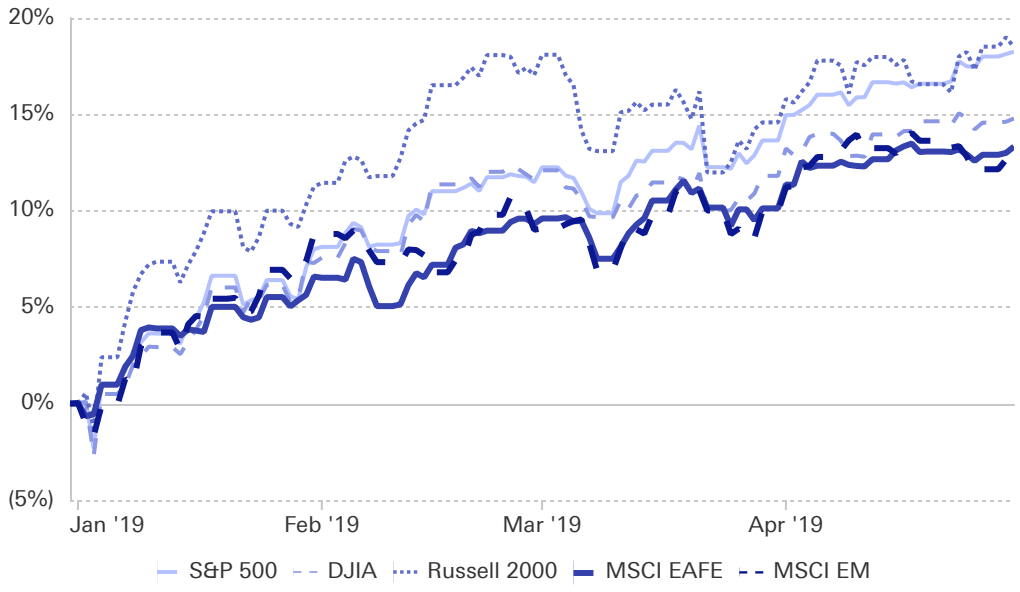
Our hope was that key economic and earnings data would decrease the aforementioned divergences and help place the markets on stable footing. However, the markets continue to ignore all the warning signs of potentially repeating sudden volatility shocks and lower prices.

Global Equities

As of this writing, the trend higher is in place and no matter how questionable the underlying fundamentals and technical factors may be, the market seems to want to continue higher. We believe the Fed's continued easy monetary policy comments - not actions - along with the nearly omnipresent jawboning from the White House have been the primary factors in the rally in stock prices since the late December 2018 lows. *We do question how long the markets will acquiesce to words and hollow gestures and continue to drive higher, despite very high valuations and weakening economic conditions.* We continue to seek out a potential catalyst for a sudden and potentially large correction. The US/China Trade Deal could be a factor in the near term if it looks like both sides are at an impasse and they openly back away from the table.

However, despite all of the questions and concerns we have for US markets, we are still of the opinion that we would rather be invested in the US then abroad. Europe, especially Germany of late, continues to print weak economic numbers, with a handful of countries either in or approaching recession territory. One large contributor to Europe's economic weakness is demand from emerging markets. Countries like Germany had become European giants by exporting goods to China and its neighbors. At this time, exporters like Germany are reporting weakening demand for their goods. Recently South Korea joined the list of powerful exporters that are reporting weakening demand for goods and weakening economic numbers. We continue to believe that foreign markets – specifically emerging markets - will remain relatively weak in the face of a strong or strengthening US dollar. So as long as the US dollar remains elevated or continues to move higher, we will continue to avoid emerging market equities and most international equities. However, we do believe that it is a "when" not an "if" that the US dollar will reverse its course and begin to weaken. Until then, we believe it prudent to remain on the sidelines outside of US equities.

Year-to-Date Global Equity Performance



	1 MO.	YTD	2018
S&P 500 Index (TR)	4.05%	18.25%	(4.38%)
Dow Jones Industrial Average (TR)	2.66%	14.79%	(3.48%)
Russell 2000 Index (TR)	3.40%	18.48%	(11.01%)
MSCI EAFE Index (TR)	2.91%	13.33%	(13.36%)
MSCI Emerging Market Equity Index (TR)	2.12%	12.29%	(14.24%)

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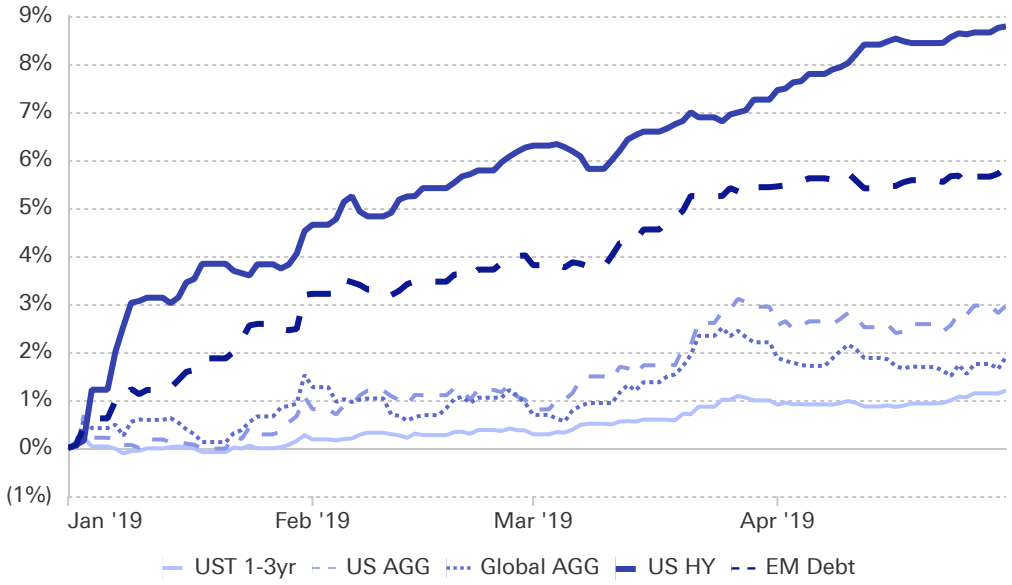
Global Fixed Income

If history is any guide and the underlying US economy is as strong as the US stock market would indicate, we should be experiencing rising yields. That is not the case currently. We continue to believe the US Federal Reserve Board (FED) is going to be forced to eventually cut short-term rates. When that occurs, we tend to believe that action will set-up a reflation trade that will eventually move longer rates higher. Interestingly, we continue to hear rumblings from the White House and some Fed officials attempting to justify significant rate cuts, while at the same time the same actors are crowing about the US economy's strength. Those two opinions are difficult to reconcile.

A strong economy would not require a 1% rate cut. In fact, that stimulus would serve to possibly cause a strong economy to overheat and lose stability. Perhaps the White House and the FED are actually worried about that the US economy is indeed weakening and desperately in need of preemptive stimulus. An early warning sign that we are watching for is another (and protracted) inversion of the yield curve.

Time will separate the winners from the losers; however, we remain of the belief that there is value in certain sectors of US fixed income.

Year-to-Date Global Fixed Income Performance



	1 MO.	YTD	2018
US 1-3 YR Treasury Index (TR)	0.20%	1.20%	1.56%
US Aggregate Bond Index (TR)	0.03%	2.97%	0.01%
Global Aggregate Bond Index (TR)	(0.30%)	1.90%	(1.20%)
US Corporate High Yield Bond Index (TR)	1.42%	8.78%	(2.08%)
Emerging Market Bond Index (TR)	0.40%	5.85%	(2.46%)

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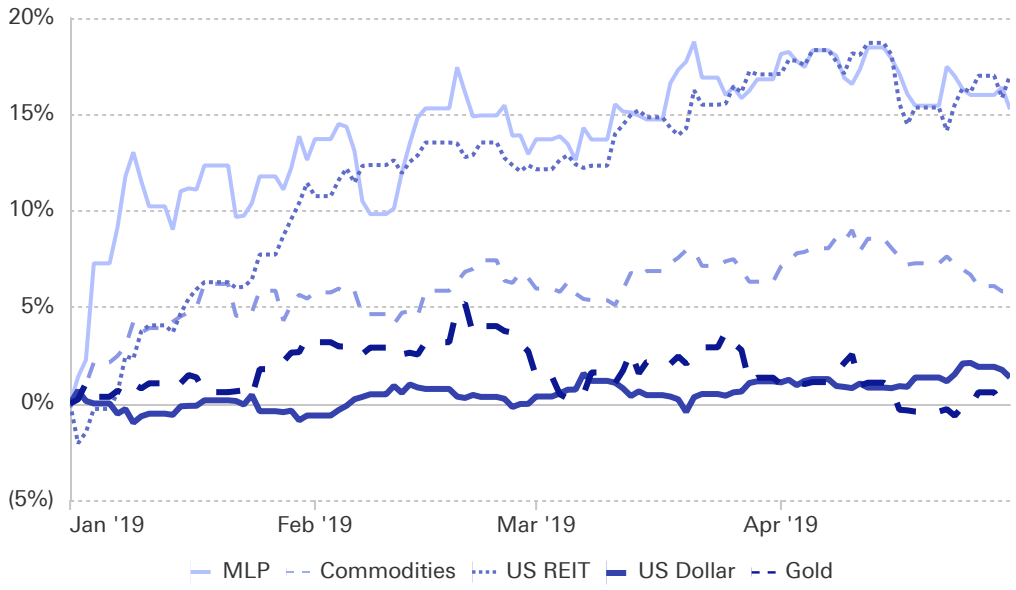
Global Real Assets

Commodities were mostly unchanged, but oil continued its upward march on strengthening bullish sentiment and had the strongest start to a year since 2002. Oil is also the best-performing asset so far in 2019 (followed by Chinese equities).

Commodities on the whole seem to be stuck in a range and will most likely continue this course until we see the US dollar begin to weaken and break below the $95-$96 range. As of this writing, the US dollar trades around $97.50.

We continue to build positions in precious metals. We believe gold, silver, and platinum stand to be significant beneficiaries of a secular trend of a weakening dollar (eventually), however *precious metals status as a "safety asset" could allow them to hold their own if the dollar rises due to a market correction, as they did in the 4Q of 2018.*

Year-to-Date Global Real Asset Performance



	1 MO.	YTD	2018
Alerian MLP Index (TR)	(1.33%)	15.27%	(12.42%)
Bloomberg Commodity Index (TR)	(0.42%)	5.88%	(11.25%)
Dow Jones US REIT Index (TR)	(0.03%)	17.04%	(4.03%)
US Dollar Index (TR)	0.20%	1.36%	4.40%
GSCI Gold Index (TR)	(0.99%)	0.34%	(2.14%)

Conclusion

It is important to remember that the S&P 500 is sitting near the same levels it was in January 2018 and September 2018 - right before two quick and painful corrections. Earnings are close to the levels of those times as well, but the economic data is now weaker - both in the US and abroad.

We tend to believe the equity markets are overvalued at these levels, especially when considering the underlying economic data. We continue to believe that the risk of the economic numbers not improving swiftly enough to justify the current valuations is very strong and the probability of another sharp equity correction is quickly becoming heightened. That said, we feel confident in our overall portfolio allocations - specifically our allocations to high quality, lower duration US fixed income - as well as our allocations to market volatility trades and increasing allocations to cash & cash equivalents.

Our 2019 Market Outlook favors high-quality equities and bonds, U.S. and EM equities, value over growth, active versus passive, and real asset strategies.

*Our four major **Global Investment Themes** and general market assumptions for 2019*

Volatility and Global Political Unrest Will Continue to Rise

Commodity Prices Will Rise and the US Dollar Will Begin to Decline

US Interest Rates and Global Inflation Will Move Sideways

Balance Sheets Matter Again - Value Over Growth, Quality Over Credit

Disclosures

INVESTMENT RETURNS PRESENTED IN THIS STATEMENT ARE NOT AUDITED RETURNS. INVESTOR PERFORMANCE MAY DIFFER DUE TO FACTORS SUCH AS THE TIMING OF INVESTMENTS, TIMING OF WITHDRAWALS, CUSTODIAL AND OTHER FEES.

Investment returns are compared to the performance of several indexes shown herein. Broad-based securities indices are unmanaged and are not subject to fees and expenses typically associated with managed accounts or investment funds. The number and types of securities found in the index can differ greatly from that of the accounts held in the strategy shown. Investments cannot be made directly in an index. Diversification does not guarantee a profit nor protect against loss. The investment portfolio does not seek to replicate or correlate with these indices. Market conditions vary between the investment portfolios and the indices, and the indices do not include reinvestment of capital as to the investment portfolios. Furthermore, investment portfolios invest in strategies and positions not included in these indices.

The standard deviations, information ratios and allocation targets may be higher or lower at any time. There is no guarantee that these measurements will be achieved. The information provided should not be considered a recommendation to purchase or sell a particular security. Any specific securities identified do not represent all of the securities purchased, sold or recommended for advisory clients, and may be only a small percentage of the entire portfolio and may not remain in the portfolio at the time you receive this report.

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