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Dear Clients of MacDougall Financial, July 14, 2019

"Don't fight the Fed" is one of the oldest axioms in the investment world and today you can substitute "Central Banks" for "Fed". Since the Great Recession, economic growth has been powered by the zero interest rate policies (ZIRP) and Quantitative Easing (QE) policies of the global Central Banks. Years ago, Japan led the way into negative interest rate territory and was soon followed by Germany, Switzerland and now even France has issued negative rate 10 year bonds. America started the year with a 10 year T-bill rate of 2.7% and it is now trading around the 2% level. Globally there is around $13 trillion of negative rate debt proving that we are indeed riding on volcanic 'foam' while the credit cauldron boils beneath us! Interest rates supposedly reflect risk but how can Spain issue 10 year bonds at .4% when the US issues the same paper at 2%? Euphoria prevails in the credit markets and "nothing sedates rationality like large doses of effortless money" (Warren Buffet). You could call this "irrational exuberance" but in truth, there are valid statistics supporting the stock market's recent climb to record levels: wages are rising, inflation is quiescent, employment stands at record levels, low cost credit is readily available and most importantly, the Central Banks are "all aboard" the debt train. Few prognosticators see any signs of a recession in the near term so the default view is 12-18 months. The all-important consumer, responsible for 70% of GDP, is in ruddy health with incomes rising (albeit slowly after a long plateau), moderate debt to asset levels and confident in their employment. America has just surpassed its record for consecutive quarterly increases in GDP (40!) and even Europe has enjoyed 24 consecutive quarters of rising GDP. Remember, expansions don't die of old age, they are ended by the Central Bank, industry busts or financial crisis and these factors are currently absent….for now!

While the positives are evident, the prudent investor should recognize the limited upside and growing potential downside. Negative data includes declining orders for durable goods, over a year of declining freight volumes, the PMI readings are the lowest since Sept. 2009, the latest monthly CAPEX numbers show sharp declines and demand for oil and semi-conductors is down. Trade tensions are a major risk due to their corrosive effects on markets, business sentiment and consumers. Lastly, we have had an interest rate inversion for now 3+ months (short rates are higher than long rates) and this is considered a recessionary harbinger. These and other negative indicators are what lead Morgan Stanley to declare that we are already in a recession.

The stock market, however, is one area that is not in any recession for the S&P 500 rose 18.5% in the first half. Sector returns varied from a Tech high of 27.1% to a Utilities low of 14.7%! These exceptional double digit returns followed a decline of circa 18% in the 4th Qtr. 2018 and an overall calendar 2018 decline of -4.4%. In an odd reversal, cash went from being the best performing asset class in 2018 to the worst performing ytd. The lessons to draw from this potpourri of conflicting data is to reduce risk exposures to your 'comfort' level, diversify, focus on quality and overweight cash and fixed income provided that growth of principal is not a requirement. Supporting the market is the fact that forward PE ratios are in line with 25 year averages (16.7 vs 16.2), stock buybacks & M&A deals are at records, capital expenditures are up 10% year over year and business confidence remains good. Wide swings and heightened volatility are hardly unexpected and we can expect intra-year drops of 15-25% which wrenches everyone's stomach! The cure is to remind yourself that despite drops of this magnitude, the annual return of the S&P 500 has been positive in 30 of the last 40 years. Plus, the yield on the S&P 500 is 2% equaling the 10 year T-Bill rate and there are ample income options yielding in the 3-6% range available in both the equity and bond markets. High yield debt rose circa 9.9% ytd and this along with Preferred's, Transports &

MLP's sport 5-6% cash yields. In short, investment opportunities abound. Please do take a moment to reflect on your specific balance of risk & reward (aka indigestion vs Tums) and communicate your feelings to us. Our goal is simple – minimize your financial stress.

Our portfolios of equity and bond funds performed in line with the averages and our small cap funds did particularly well. Both growth and value equity fund ytd returns were solidly in the teens with some small caps approaching 30%. Bond funds showed positive returns across the spectrum of 2-6%. Even our perennial albatross, international funds, grew by 12-15% and this allowed a few of them (those focused on growth and/or Asia) to more than erase their 2018 losses. We are well aware of the underperformance of this sector and have been actively reducing its weight in our portfolios. Nevertheless, we have long investment memories and can point to years of outperformance and thus we are reluctant to reduce this to under 10% unless so directed by the client. Given the inherent fluctuations in the calendar year returns, we encourage you to look at the 3 & 5 year average annualized returns on your asset allocation spreadsheets. Excepting the 5 year international sector returns (anemic at 2-5%), the majority of the performance figures are comfortably in the teens! This is an uncommon event so take a moment to savor it.

Where do we go from here? Years ago, I told the joke of a stranger asking a local for directions and receiving the reply "if I wanted to go there, I would not start from here." This encapsulates our predicament today where we hope our politicians are responsible stewards but want them to keep the punch bowl full by adding debt at every turn. No one votes for austerity! However, if debt is indeed consumption brought forward, then we cannot continue to borrow our way to prosperity for penury is the more likely destination. The piper must be paid….but when? It is my personal belief that we can 'kick this can' down the road for quite a few more years principally because there is no constituency for reducing entitlements, defense or other discretionary public expenses and raising taxes is anathema. The politicians agree that "we need to spend more" but the debt markets are not stupid and the 'extend and pretend' bubble is getting long in the tooth. I take some consolation in the fact that other countries are well ahead of us in the debt queue and the failure of 1 or 2 highly indebted borrowers (corporate or government) might awaken the vigilante. Also, for America, the wolf is not yet at the door but the sooner we nibble on some of the solutions, the less pain will be felt. My crystal ball is no clearer than anyone else's and I will err on the conservative side in recommending the allocation of your assets. There could be years left in this rally or months, I really don't know, but rest assured we will do our best to protect your capital.

Best, Lanny