SPECIAL MARKET UPDATE – DECEMBER 2018

Since the first of October it's mostly been all about the Federal Reserve. We were told that interest rates were nowhere near neutral. This strong talk from the Fed took the market by surprise and though the tone has subsided slightly it hasn't been enough. What the Federal Reserve will do throughout 2019 is anyone's guess. What we do know is the Fed increased rates in December, a ninth 0.25% fed funds increase since December 2015, to a new range of 2.25-2.50% and signaled they will continue to raise rates in the future. Raising rates often signals that the economy is extremely strong, but the current increase and harsh tone sent a message that the Federal Reserve wanted to slowdown the economy by raising rates in an aggressive manner. To be clear, the Fed certainly has the power to slowdown the economy and you seldom win fighting the Fed. As a result, the markets have reacted violently negative.

Couple the Fed's tone with a few additional (mainly political) items and markets have been skittish at best. When you have economists trying to predict what Trump will do and not what the economy will do, it creates uncertainty and volatile markets. Mix in the Secretary of Defense resigning and the possibility of a government shutdown next week and the situation can seem perplexing and certainly perpetuates greater uncertainty.

Due to these measures, some portions of the U.S. yield curve "inverted". An inverted yield curve can often be an early-warning indicator of a future recession. As a leading indicator, an inverted yield curve, on average, has proceeded a recession by 26 months. Extrapolating this out, that would signal that the market is predicting a recession in the Fall of 2020.

Because of these events, we began positioning all portfolios to be more conservative than our usual, prudent lower risk.

Comparatively speaking, the S&P 500 Index is down over 14% in the 4th quarter. This December is now the worse market decline since the Great Depression in 1929 (for the month of December). The NASDAQ is down more than the S&P. While the famous FAANG stocks have dropped more than 27% from their peaks (Facebook is down –39%, Apple is down –33%, Amazon down –29%, Netflix down –38% and Google down –21%) the VIX Index (a volatility fear-based index) has spiked over +90%. This market has thrown many very high-quality stocks out with the rest of the high risk and low-quality stocks. With this oversold condition certain high-quality stocks are becoming extremely attractive and SGI has and will continue to put some of our cash to work.

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2019 Key factors to watch

- U.S./China trade resolution? Or escalation?
- Federal reserve policy; pause or tighten further?
- Corporate earnings growth – will it slow but remain positive in the 7 to 8% range?
- U.S GDP growth. The past few months have been revised down. Will it stay above +2.5% over the next year?
- Inflation - will it remain below or near 2% ?(watch energy and how it affects inflation as energy prices have fallen –30% since Oct).
- U.S. tax policy – it's impact on consumers and on debt.

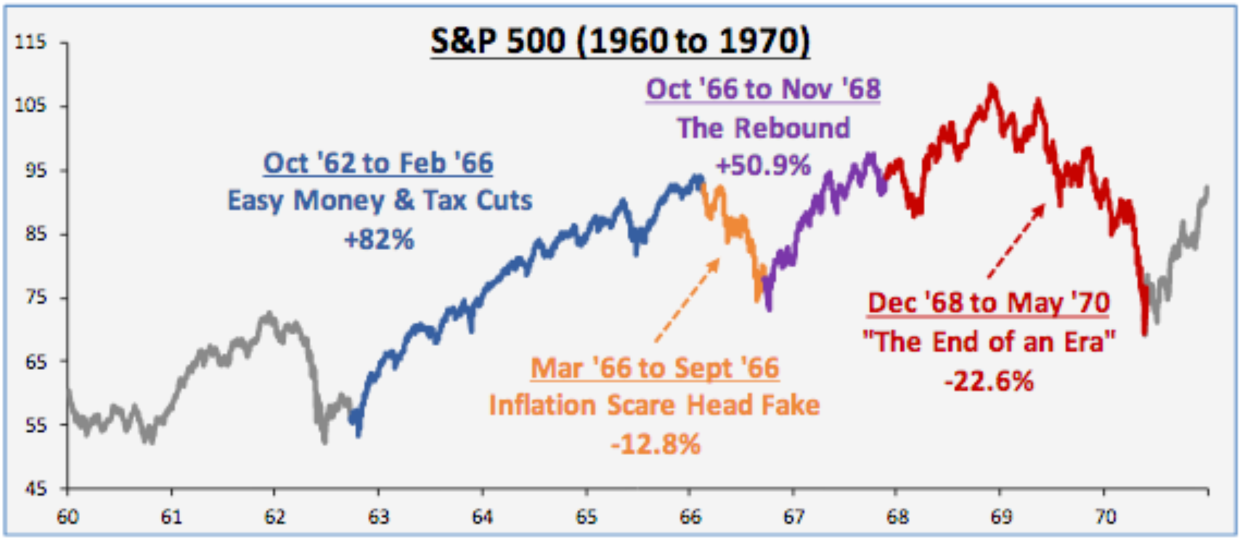
How SGI is positioning portfolios

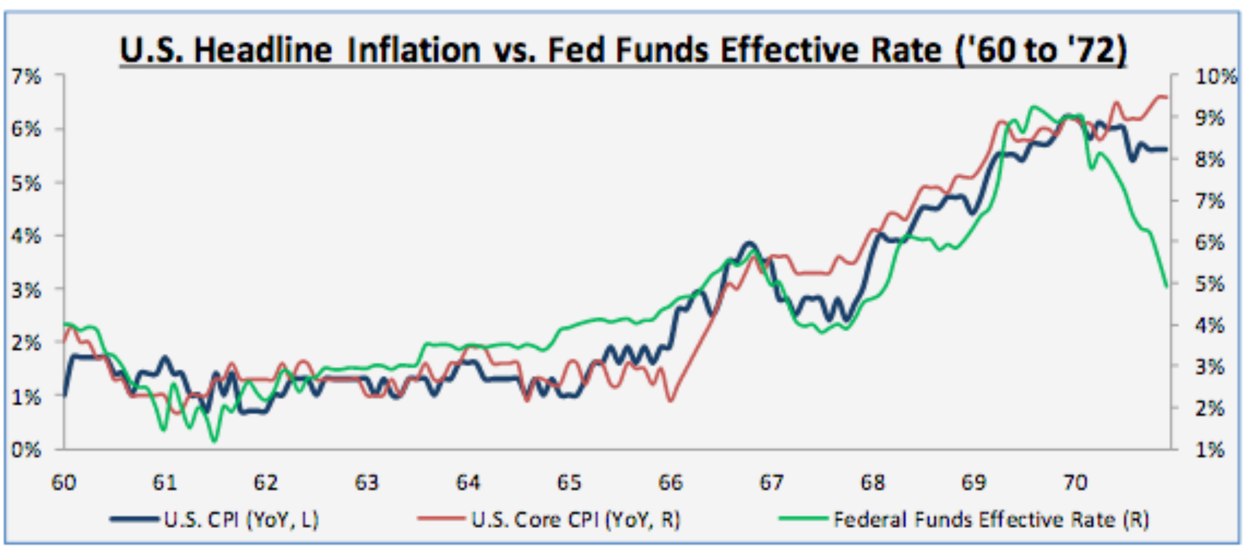
- We are cautiously optimistic on trade, and that interest rates will become more accommodative. No one knows what ultimate direction the market will head. But we do NOT expect anywhere close to a 2008. The economy and companies, employment and wages are nowhere near where they were in 2007 and 2008.
- SGI continues to rebalancing portfolios to reduce risk and buy high-quality low risk at attractive valuations. We have actively managed the portfolios in Oct., Nov. and Dec. And we will prudently continue to do so.
- All of the SGI portfolios characteristics such as risk, beta, and volatility metrics have and will remain lower than the S&P 500 Index (or comparative benchmarks).
- Performance remains strong relative to the broader benchmarks, the SGI US Low Volatility fund is outperforming the S&P 500, by over 400 basis point YTD. SGI's US Low Volatility fund ranked as the #1 performing fund (large blend by Morningstar) through the 3rd Quarter and is currently in the top decile over the past 1 and 5 years.

The Fed, Interest Rates and Market Turn-around?

There are many parallels between the current investment environment and the one that existed in the 1960's - the last time a big fiscal stimulus package was introduced in the middle of a solid economic cycle. Individual and corporate tax cuts enacted in 1964 led to GDP growth accelerating and a strong stock market in '64/'65 (sound familiar with 2017 and 2018). Then in late 1965, inflation picked-up and geopolitical risks began to simmer. At the same time, the Fed began to raise interest rates, which sparked a -13% stock market correction from February to October 1966. (Stocks are off about the same since the Fed spoke up the first of Oct.).

Notably, neither of these stock market headwinds caused a recession. Following the 1966 correction the market rebounded +51% in stock prices from Oct. '66 to Nov. '68. Financial, Healthcare, Industrial and Energy were the top performing sectors (in order).





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Markets tend to 'test' new Fed Chairs early in their tenure. While my hopes Wednesday were for more dovish commentary on the pace of the Fed's balance sheet reduction, there is still evidence that the efforts will not lead the U.S. into recession, given the significant fiscal stimulus still in the pipeline and inflation generally quiescent.

Though we are not predicting a 50%+ increase in the next two years, we are cautiously optimistic that the economy is stronger than the fear that is currently gripping the market.

If there is any way we may help provide you with SGI's insight or answer more specific questions, please don't hesitate to call us @ 888-251-4847.

Respectfully,
Dave Harden