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THE BIG PICTURE

For many investors the fourth quarter of 2018 was unnerving, as the ancient concept of risk resurfaced. For other investors, such uncertainty, turmoil and even panic brought back the equally old concept of opportunity, as prices of individual stocks began to disperse in different directions.

Investors want to know, who has caused the recent market turmoil? Is it President Trump's fault? Is it Fed Chair Jerome Powell's fault? Whoever's fault it is, why can't they fix it? In our view, the causes are many and have their roots years, and even decades, ago. Beginning in the late 1980s with then Fed chair Alan Greenspan, the Fed started providing Wall Street with more and more "supports" against downside risk in financial markets. First came lower interest rates and later ZIRP (Zero Interest Rate Policy), next came government bailouts of banks and non-bank financial businesses, the repeal of Glass-Steagall that allowed Goldman Sachs and other big investment banks to become members of both the FDIC and the Federal Reserve System, and so gain yet more federal government support. Later we saw suspension of the accounting rule requiring banks to mark their assets to market (which can result in "mark to fantasy" prices), and finally QE (Quantitative Easing), with massive purchases of financial assets by central banks. All of this created the now famous "Fed Put," where Wall Street investors trust the Fed to support financial asset prices in times of stress, and so protect investors against market risk. In short, Fed policies have distorted financial markets for decades. Wall Street was protected, Main Street was ignored, and debt burdens have soared. GDP growth has been stuck around 2% since the "recovery" started around 2010, which is half of the usual GDP growth in a recovery. Some investors are beginning to worry that the combination of weak economic growth and strong stock market gains can't go on forever, nor can the Fed Put.

The new Fed chair, Jerome Powell, reminds some of Paul Volcker. Volker was the Fed chair who had the courage to tame inflation in the late 1970s and early-to-mid 1980s. Volker's actions generated much turmoil in the financial markets, but it resulted in a stronger, more sustainable economy. Jerome Powell's recent actions are creating concerns on Wall Street, as he seems to be willing to raise short-term interest rates and reduce the Fed's ownership of financial assets, known as QT (Quantitative Tightening). People are beginning to worry that the Fed Put may be a thing of the past. Risk in risk assets may still exist.

Similar problems have become obvious in other countries. The ECB (European Central Bank) buys corporate bonds. The BOJ (Bank of Japan) buys equity ETFs. The SNB (Swiss National Bank) buys U.S. FAANG-type stocks. Without such permanent government buying, what are financial assets really worth? No one really knows, and the fear of governments not supporting asset prices results in less trust and more fear that market prices could go lower should government support be reduced or even removed. But for many the hope remains that the Fed Put still exists when greater market stress appears. We will have to wait to find out.

The recent market turmoil is neither shocking nor unexpected. While recently there has been a sharp market upturn, that does not tell us that "all is well" again. Our view of the current market turmoil is that, eventually, "this too shall pass," but not immediately. While it may take several years, the current turmoil is starting to uncover the fact that economic fundamentals, not central banks' monetary policies designed to support financial markets, ultimately are the basis for determining durable asset prices. It is our job to manage this potential return to "price discovery" in the markets, rather than having prices determined by massive central bank and government interventions.

We believe our clients' core investment goal is to build economic security. Because of our focus on building durable wealth through constant risk management, we believe we are well-positioned to manage equity portfolios in the current environment — to protect capital and so be able to take advantage of opportunities as they arise, one stock at a time, thereby coming closer to the core goal of building economic security.

THE ECONOMY AND INVESTMENT MARKETS

For the past decade we have seen steady, if modest, GDP growth, low unemployment, high consumer confidence, and record stock prices. But it appears all of that is now changing. The economy is slowly but steadily getting weaker. The size of the total debt burden is (not so) slowly but steadily getting bigger. The two are connected. As more taxes, profits and savings are devoted to debt payments, fewer assets are available for investments in economic growth. As we noted above, Fed monetary policy has played a major role in determining the path we currently are on. Recent tightening of monetary policy and record debt levels both burden hopes for economic growth. Fiscal policy, in the form of massive federal deficits and debt, are also a burden on future economic growth.

If U.S. economic data continues to slow, we likely are on a path to continuing low inflation, flat or lower interest rates, potential consumer and corporate debt defaults, lower consumer confidence and, at some point, even recession. Credit spreads (the difference between interest rates on investment grade vs. junk bonds) are widening, and European bank solvency is beginning to resurface as a real concern, with the ECB taking over Italy's Banca Carige on January 2, 2019 due to non-performing loans and inadequate capital.

Looking at the investment markets, broad stock market valuations are still high, market volatility has increased, future corporate earnings estimates

are beginning to decline, and stock buybacks appear to be on the wane. At the same time, diverging individual stock prices and sharp market movements in both directions are beginning to offer us better opportunities, one stock at a time. Overall, the risks are to the downside, but the opportunities are beginning to appear.

EQUITY STRATEGIES AND PORTFOLIO MANAGEMENT

How do we manage portfolios when market turmoil surfaces? Every downturn is different. The basic surprise in December was that stocks didn't follow their most common historical pattern. Normally, when growth expectations go down, as they recently have (embodied in the decline of the 10-year Treasury yield from a recent peak of 3.25% to around 2.70%) you will see defensive, safety stocks such as utilities, staples, and REITs doing wonderfully well. That pattern played out from October through early December. But then the historical pattern got weaker through the end of 2018 as the FAANG-type stocks rallied. Is the Fed Put alive? What to do?

The ZeroHedge website had a comment in a December 26, 2018 article that an incredible 85% of trading isn't by humans; it's generated by quantitative factor trading algorithms (e.g., momentum) and passive trading. Algorithm "investors" tend to use momentum a lot. Our judgment is that relying on momentum results in a low signal-to-noise ratio in the context of the recent market gyrations. Bottom line, we expect both the market and individual stocks to eventually go to where they're headed based on fundamental macroeconomic and individual stock data, but perhaps with a bit crazier path than we are used to seeing.

Momentum works the same way on the downside, with indiscriminate selling, as it does on the upside, with indiscriminate buying. For fundamental investors who are patient, that creates opportunities. When momentum reverses, consumer confidence falls and fear begins to surface. Investors begin to prefer safe investments over speculative investments. When fear shifts investors to a preference for safety, the Fed is hard-pressed to once again entice investors into speculatively priced financial assets. The idea of the Fed Put only works when investors are inclined to speculate. Fear can become an important headwind for the success of Fed interventions and Wall Street's constant optimism.

Managing equity investment strategies can be frustrating at times when the market doesn't immediately and consistently follow the data. But both discipline and patience are part of successful full market cycle investing. In October and November we saw the value of our forward-looking investment process that seeks to identify clouds on the horizon. Our defensive portfolios with a tilt toward utilities, staples and REITs benefited because we were proven right on economic data beginning to slow, on inflation moderating, and on interest rates not soaring. In December the market reversed course a bit, but the data didn't. We expect the recent lack of market response to data to change, but market intervals like most of December can try one's patience.

As always, we prefer to stick to our discipline of building durable wealth through risk management, rather than to start chasing headlines that market momentum is more important than individual stock fundamentals. For decades we have stuck to our discipline, and in our judgment it is still the way to go. We prefer to build portfolios based on fundamental data rather than temporary factors such as momentum. We prefer using fundamental economic and stock data in determining whether a stock is a desirable purchase.

CONCLUSION

With our largely defensive portfolios, Symons Capital is well prepared for the possibility of continued stock market volatility. We successfully navigated the prior market downturns in 2000 and 2008 because in seeking to build durable wealth we are willing to look forward and tilt portfolios away from where we see risk and towards where we see safer reward probabilities. We are willing to diverge from trying to stay close to the performance of benchmark indices when we see unattractive risk/reward scenarios.

Can the broad market continue to decline? Yes. Current market conditions make this a time for caution. The highest probability is that the market will struggle going forward, and we want to keep the odds on our side. But declines can bring individual stock opportunities. To some extent, the current market reminds us of 2000. That market got pretty bad for the favored Tech, Media, and Telecom sectors. But for the unloved sectors there were opportunities.

Today, as interest rates stay flat or decline, defensive, interest-sensitive sectors like utilities, REITs and even staples can become opportunities for those willing to stray from index sector weightings. We see this as the safest path to protecting capital and building long-term wealth. Helping our clients to accomplish the core goal of economic security requires constant diligence. We currently see the market as risk-averse and we expect that to continue for at least the next quarter or two. Economic slowing is clearly happening and it is likely to continue. We view this as a good time to own safe, quality, low volatility stocks. While you never know for sure what the future holds, we view this as the best path for a while. As markets have been scrambling since October, we appear to be increasingly well positioned. Perhaps it is now the turn of momentum and passive investors to worry, and our turn to enjoy a safer ride.

It is obvious that all may not be well in the world or in the markets. We begin 2019 with energy and excitement, because Symons Capital has an investment process designed to build durable wealth through constant risk management over full market cycles. Being successful over full market cycles is what wins out — what creates durable wealth and economic security.

Yours sincerely,

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Chairman & Founder	Chief Investment Officer

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