ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook — Second Quarter, 2019

Dear Client,

We are sending a much-abbreviated Quarterly Review and Outlook for the second quarter, not because there is any less to write about than usual, but because there have been several out of the ordinary (or as CEOs like to call them, "nonrecurring") projects over the last few weeks that have taken more time and have been more of a distraction than anticipated.

The most time-consuming distraction has been due to several upgrades to our suite that began July 1. As part of our lease renewal, we negotiated a number of improvements including new carpet in the common areas and some offices, new wall paper in the conference room off of the lobby and new ceiling tiles (including painting the tile grid). The improvements are happening in three phases. The first phase, which included my office, meant moving everything to another location while the work was being done (July 1 – July 12). While everyone expects snags along the way, almost every phase of the process has been mishandled by each organization involved in the project – the property management company, the architect, the contractor and some of the subcontractors resulting in far more downtime and involvement than we planned for. In the end though, phase one is complete and the improvements look good.

The second project involves transitioning to new investment management and reporting software. The process of preparing our existing data for conversion, "scrubbing" the data after being imported into the new software and the learning curve (videos, conference calls, trial and error, etc.) associated with mastering the new software, has been and continues to be quite time-consuming. With that said, we're excited about the upcoming benefits of the software to our clients including website reporting, a secure client portal and reporting via phone app.

So, there you have it, my excuses for the delay in distributing your quarterly reports and market commentary. Luckily, the financial markets delivered solid results during the second quarter albiet with a decent setback in May.

Best regards,
Brant

Benchmark Returns as of June 30, 2019

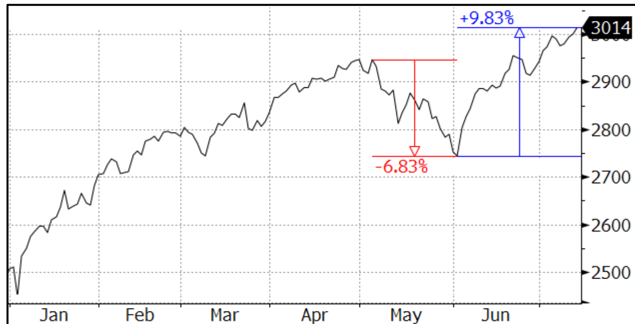
INDEX	3 Mo.	6 Mo.	12 Mo.
US STOCKS			
S&P 500 Index (large-cap stocks)	4.30	18.54	10.42
Russell 2000 Index (small-cap stocks)	2.10	16.98	(3.31)
FOREIGN STOCKS			
MSCI EAFE Net Total Return Index (US$)	3.68	14.03	1.08
S&P Europe 350 Index Net TR Index (US$)	4.28	15.47	1.92
MSCI Japan Net Total Return Index (US$)	1.02	7.75	(4.19)
MSCI Emerging Markets Net TR Index (US$)	0.61	10.58	1.21
COMMODITIES			
US Dollar	(1.09)	(0.04)	1.58
Euro	1.38	(0.82)	(2.66)
Gold	9.07	9.91	12.53
Oil (West Texas Intermediate)	(2.78)	28.76	(21.15)
Bitcoin	199.91	232.39	107.01
BONDS			
BBgBarc US Aggregate Bond (inv. grade)	3.08	6.11	7.87
BBgBarc US Treasury 20+ Year	6.11	11.14	12.30
BBgBarc US Treas. Inflation Protected Secs.	6.09	6.15	4.84
BbgBarc Municipal Bond	2.14	5.09	6.71
BBgBarc US Credit TR (corporate bonds)	4.27	9.35	10.34
BBgBarc US Corp. High Yield Bond	2.50	9.94	7.48
S&P International Sov Ex-US Bond US$	3.79	5.31	4.18

Goldilocks has entered the building. That appears to be the conclusion of equity investors as they've taken heart from the trade-war truce and look forward to basking in the warm pool of Fed accommodation once interest rate cuts come at the end of the month. Perhaps things will work out that way, but you know what they say about the best laid plans of mice and men. While the truce makes for some nice headlines, it doesn't actually change much; we are still far from a negotiated deal and a fresh tariff threat is always lurking 280 characters away. So, we enjoy the rally while it lasts, but recognize that economic uncertainty is likely to be hiding just in the shadows for some time to come.

On July 15, the closing value for the S&P 500 Index (SPX) of US large cap stocks was 3,014.30, another in a series of all-time highs that began on July 1. After declining 6.8% in May, stocks have rallied almost 10% (Chart 1) on hopes the Fed will aggressively cut interest rates this year thereby further stimulating the economy

and driving stock prices ever higher starting with its policy following its upcoming meeting at month-end.

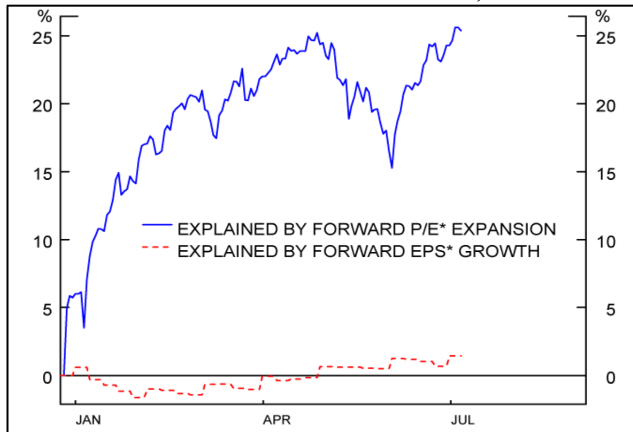
Chart 1: S&P 500 Year-To-Date



Source: Bloomberg Finance LP

As shown in Chart 2, since the Christmas Eve stock market lows, essentially all the 28% return in the SPX is explained by valuation expansion (stock prices have advanced while earnings estimates have stayed flat). The forward price to earnings (P/E) ratio has recovered from 13.5 to 17.2 (according to Thomson Reuters/IBES). As discussed in last quarter's *Letter*[i], lower interest rates support higher valuations and the market is performing as though it's expectations for significantly lower rates (four 0.25% Fed rate cuts over the next 12-months – Chart 3) are in the bag.

Chart 2: S&P 500 Return Since Dec. 24, 2018



Source: BCA Research & Thomson Reuters/IBES

Meanwhile, more than half of the SPX sectors are forecast to have contracted profits last quarter, and three sectors have experienced no revenue growth versus one year ago according to IBES data. Profit growth for the companies in the SPX is projected to be 1.8% overall for 2019 with three sectors (materials, energy and technology) turning in negative profit growth (Table 1).

Chart 3: Market Implied Projected One-Year Change in Fed Funds Rate*

**As discounted in the Eurodollar futures market*
Source: Bloomberg Finance LP

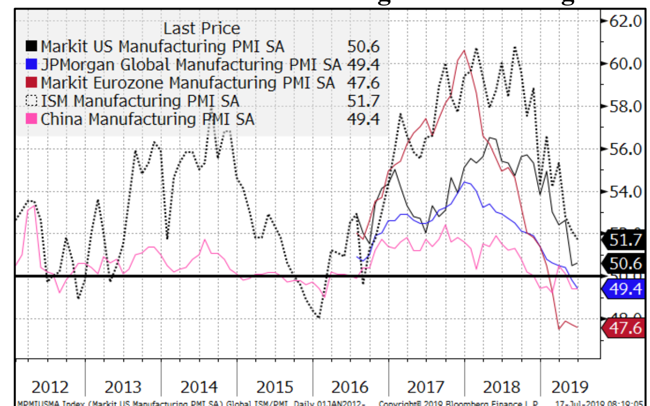
Table 1:S&P 500 Earnings Analysis

SECTOR	2018 Profit (MM)	2019 Profit (MM)	Profit Growth
MATERIALS	$ 39.5	$ 32.2	-18.5%
ENERGY	$ 76.4	$ 67.5	-11.6%
TECHNOLOGY	$ 264.4	$ 254.7	-3.7%
CONSUMER STAPLES	$ 88.9	$ 89.6	0.8%
SPX	$ 1,342.7	$ 1,367.0	1.8%
COMMUNICATION SERVICES	$ 128.6	$ 131.7	2.4%
INDUSTRIALS	$ 129.2	$ 134.2	3.9%
UTILITIES	$ 40.0	$ 41.8	4.5%
REAL ESTATE	$ 30.1	$ 31.6	5.0%
HEALTH CARE	$ 203.7	$ 215.6	5.8%
CONSUMER DISCRETIONARY	$ 103.4	$ 110.5	6.9%
FINANCIALS	$ 238.5	$ 257.6	8.0%

Source: BCA Research

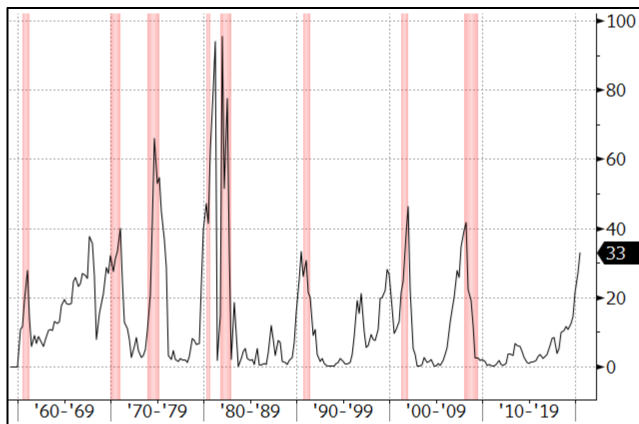
Global manufacturing indices are moving toward or are below 50 – the expansion/contraction level (Chart 4), the NY Fed's recession probability model continues to tick higher (Chart 5), and non-financial ex-tech corporate net debt-to-earnings (EBITDA[ii]) has hit all-time highs (Chart 6).

Chart 4: Global Manufacturing Indices Falling



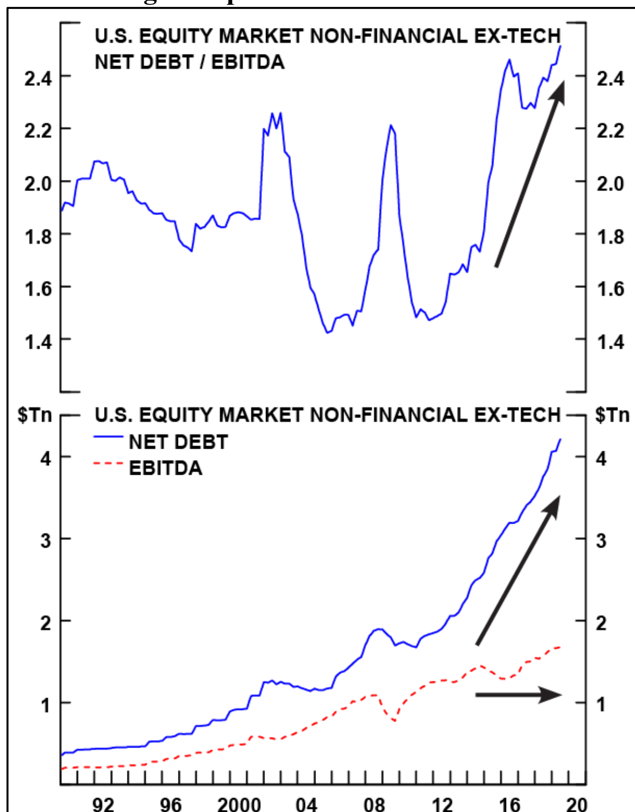
Source: Bloomberg Finance LP

Chart 5: NY Fed Probability of US Recession Twelve Months Ahead



Red shaded areas denote recessions; Source: Bloomberg Finance LP

Chart 6: High Corporate Debt Levels



Source: BCA Research & Thomson Reuters/IBES

While markets cheered the trade truce following the recent G20 meeting, odds are high that manufacturing will remain in the doldrums as the tariff rate on $200 billion of Chinese imports went up from 10% to 25% on May 10, and no tariff rollback was agreed. As a result, highly-cyclical global trade and manufacturing will likely continue to weigh on the economy for the remainder of the year.

We're at the point where bad news is actually good for stock prices because it reinforces the market's belief (certainty?) that the Fed will deliver on the interest rate cuts it expects. This is an asymmetric reaction function. In "normal" markets, where central bank interest rate policy is deemed as roughly appropriate for the economy, strong data is positive for stocks and weak data is negative.

When the economic outlook deteriorates sharply, central bank policy rates suddenly appear inappropriately high, leading to a risk-averse environment. This is what we saw in the US in May after the trade war escalated. As the consensus grows that Fed policy needs to be eased to counteract the slowdown, we enter a scenario where marginal bad data prints are good for stocks because they are seen accelerating the central bank's response. During this period, policy expectations become the primary driver of returns because the poor economic outlook is acknowledged. This makes the asymmetric reaction function for stocks biased more toward gains than losses because we know easing is coming and it's just a matter of how much, how quickly. This is the situation we've been in since early June.

This phase normally lasts until it either becomes clear the economy will pick up again, or that the Fed easing priced in won't be sufficient to prevent a severe slowdown. In the positive scenario, we return to the "normal" world of good news is good and bad news is bad. But in the negative scenario, where easing fails to boost the economy, then suddenly it becomes the worst possible world for equities. With policy makers perceived as impotent, bad news is very bad for stocks, while marginal data beats won't provide much uplift.

The jury is still out on which way we're going in 2019 and we remain cautious on the broad equity market over a cyclical 3 to 12-month time horizon.

Brant Kairies
952-885-2732

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[i] Available along with all previous Letters at: http://accessafs.com/useful-info/newsletter/

[ii] Earnings before interest, taxes, depreciation and amortization