Investor Quarterly

Central Banks to the Rescue?

ROCKINGSTONE ADVISORS LLC

More Accommodative Monetary Policy Drives Asset Values Higher

In the face of deteriorating economic data, escalating trade disputes and political discord, most asset prices nevertheless jumped in 2Q19 as central banks across the globe became more dovish. As a result, yields plummeted and equities jumped. We find ourselves perplexed and marginally more cautious, as it is unlikely both markets (i.e. stocks and bonds) are correctly discounting the future.

S&P500 Forecast & Other Key Indicators

Based on the latest central bank moves and asset price changes during 2Q19, we make the following adjustments: EPS (2019: $164 to $162, 2020: $176 to $174), S&P500 (3,000 to 3,105), GDP (2.2% to 1.6%), Gold ($1,250/oz to $1,500/oz), Oil (unch = $60), 10-yr US Bond Yield (2.8% to 2.2%), Inflation (1.9% to 1.5%).

2Q19 in Review

April's earnings season was decent enough to spur stocks higher. Yet the breakdown in trade negotiations in May, combined with fears over an inverted yield curve, drove equities lower. June, however, saw a jump in asset prices as global monetary policy turned decidedly easier.

Asset Class Performance (Total Return: 2Q19[i] and 1H19)

We highlight the following: S&P500 (+3.1% and +18.5%), Gold (+9.6% and +9.9%), Bonds (+3.3% and +5.8%), Commodities (-2.0% and +8.6%). Global equity markets (except EM) were higher, fixed income broadly outperformed while commodity markets were mixed.

Rockingstone Performance

Our performance was respectable in 2Q19 (+3.2%) fueled by strong returns in defensives (MKC, PEP, CVGW, EL) and technology (MSFT, FLT, APPN, AAPL), helping to offset poor performance in select small caps (EVH, RRR), energy, and our bond underweight. During 2Q19 we reduced exposure to EM while adding ANTM to most portfolios.

About Us

Rockingstone Advisors LLC is a boutique asset management and corporate advisory firm co-managed by Brandt Sakakeeny and Eric Katzman, CFA.

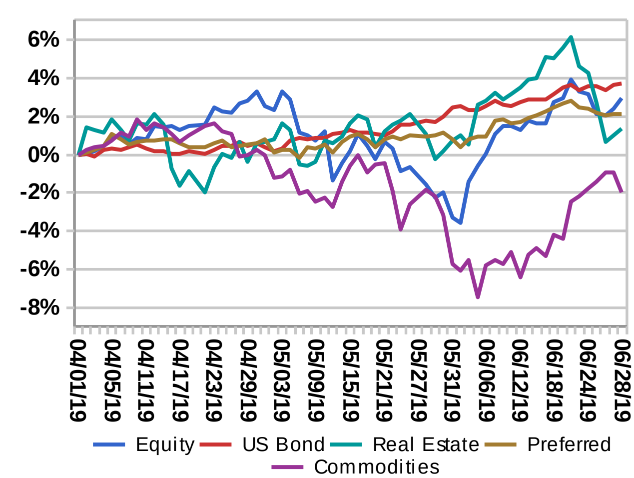
As an SEC-registered investment advisor, we provide multi-asset investment strategies to individuals, families and small institutions through separate accounts.

Our investment strategies attempt to capitalize on pricing inefficiencies across broad asset classes and then across individual securities, with a strong emphasis on fundamental research and analysis.

Thank you for your interest. You can find more information (and some interesting articles) at:

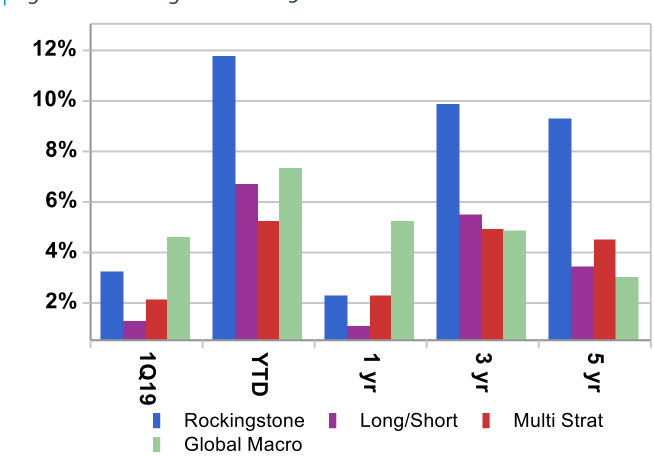
www.rockingstoneadvisors.com

Figure 1: 2Q19 Asset Class Performance[i]



Source: FactSet

Figure 2: Rockingstone: 2Q19 & Historical Returns[ii]



Source: Rockingstone Advisors, Morningstar, DJ Credit Suisse Indices

Please see our End Notes and Disclosures (pages 27-28 of this Investor Quarterly) for important information regarding performance measures. Form ADV available upon request.

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Asset Class Performance Review

Central Banks to the Rescue?

The technically-driven price declines witnessed in almost every asset class during 4Q18 were partly offset by a rebound in the 1Q19. The recovery continued into April, yet equity markets started to struggle in May given weakening global economic indicators, bearish sentiment over trade tariffs and political skirmishes in both the US and Europe. During this period, however, fixed income markets jumped as global bond yields declined. By early June equity markets reacted to both the decline in yields (later confirmed by the Fed and ECB that rates would be lowered if necessary) and initial signs of trade progress at the G20 meeting.

For those who have been close observers of financial markets over the last decade, central banks' outsized role in the global economy has been controversial and unprecedented. During the depths of the global financial crisis (GFC), central banks aggressively expanded their balance sheets by purchasing assets while also dramatically reducing interest rates. While many financial experts continue to debate the efficacy of such moves, the pace of the economic recovery in the United States since the GFC has been sufficient that in late 2015 the FOMC decided to begin to raise interest rates, unwind its balance sheet through the maturation of its bond holdings, and in general, try to return to a period of normalcy. This era of post-GFC tightening appears to have peaked September 2018, during which the Fed was forecasting as many as three interest rate increases in 2019 alone.

After just nine months, the Fed is now expected to cut interest rates 25-50 basis points at its July meeting, while the balance sheet wind down has been suspended. To justify its 180-degree turn, the Fed has highlighted the lack of inflation (expectations continue to decline), slowing industrial production, as well as uncertainty surrounding tariffs and trade, which the Fed believes is depressing economic activity.

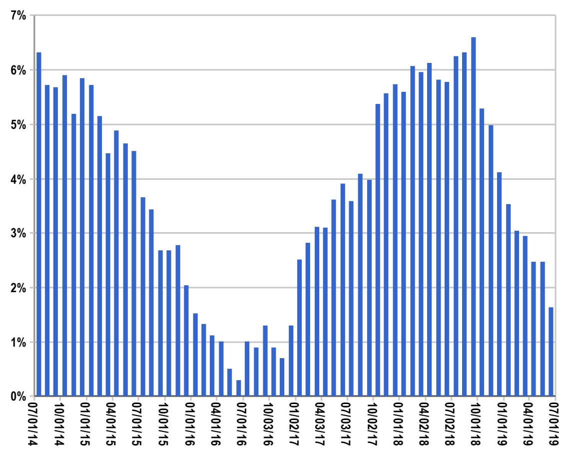
Not too surprisingly the ECB has essentially mimicked the Fed, albeit operating from a more tenuous position given Europe's political woes and its weaker economy. With key central banks around the globe now easing instead of tightening, investors must decide whether the factors slowing growth in the developing world are temporary in nature and hence with resolution to trade disputes global growth rates will accelerate, or whether a further slowdown is in the offing with the risk of one quarter of negative growth or a potential recession.

Ironically, we believe that asset prices currently reflect both potential outcomes. Equity prices have rallied, with global markets rising. Yet within the equity rally, defensive equities have outperformed cyclical equities. Fixed Income markets have also been driven higher, with the 10-year falling as low as 2.03% to levels not seen since 2016, indicating economic strain, or potentially deflationary pressure. Echoing moves in the fixed income markets, commodity prices, especially oil and industrial commodities continue to be weak, while precious metal prices have risen.

Overall, we were somewhat surprised by the degree of the moves in financial markets during the quarter and in 1H19. We had been forecasting mid-2% GDP growth for 2019, and with the Atlanta Fed's GDPNow pointing to growth of just 1.5%, would have countenanced slightly lower yields on bonds and a little pressure on commodities, especially as numerous economic indicators were slowing as the 1H19 progressed. These include (see full charts in the appendix): (1) Index of Leading Economic Indicators, (2) ISM

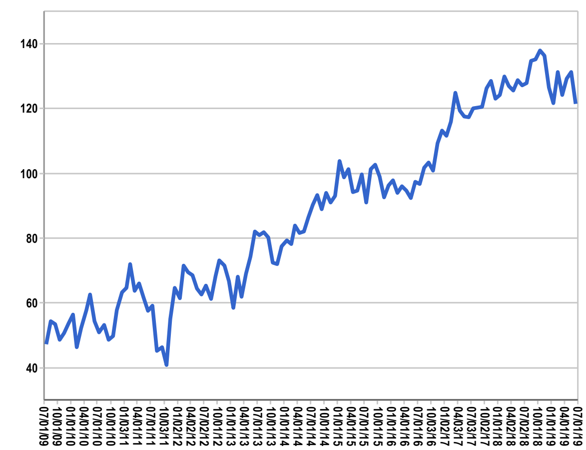
New Orders, (3) Industrial Production, (4) Inventory-to-Shipment Ratio, and (5) Architectural Billings Index. In contrast to the slowdown in several business-to-business indicators, the consumer remained quite robust amid high US consumer confidence levels, employment and decent retail sales. Thus, the strength of the consumer side of the economy led us to a more sanguine view of bond yields and commodity prices than we might otherwise have had.

Figure 3: US Leading Economic Indicators have weakened…



Source: FactSet

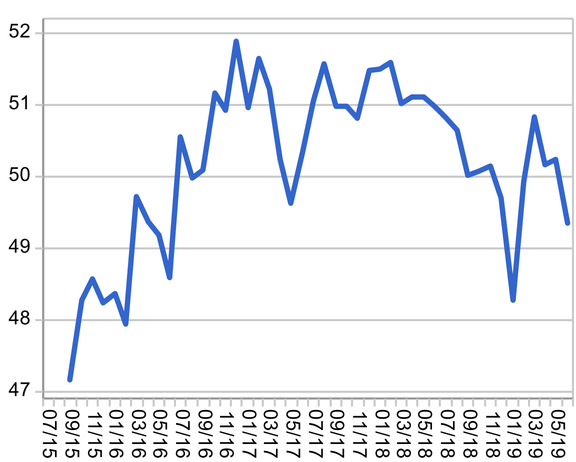
Figure 4: …but US Consumer Confidence remains high



Source: University of Michigan

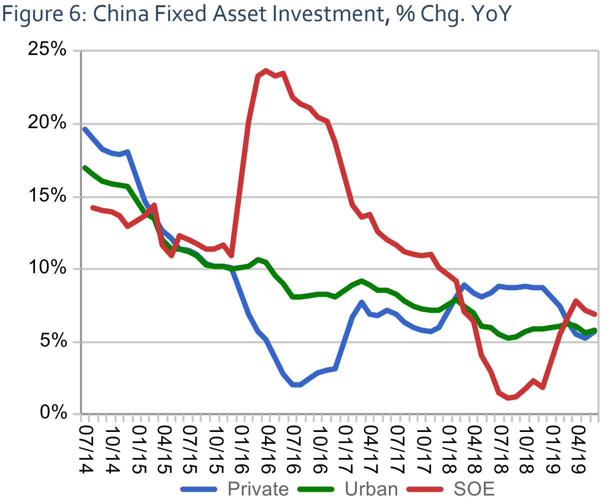
While the US economy is sending mixed signals, so too are China and the EU, the other two major markets. In our *1Q19 Quarterly Newsletter*, we noted that China's economic data appeared to re-accelerate given the expectation of a resolution of trade frictions with the US. But when both parties walked away from negotiations amid mutual recriminations, China's growth has clearly slowed again.

Figure 5: China Caixin PMI



Source: FactSet.

Figure 6: China Fixed Asset Investment, % Chg. YoY



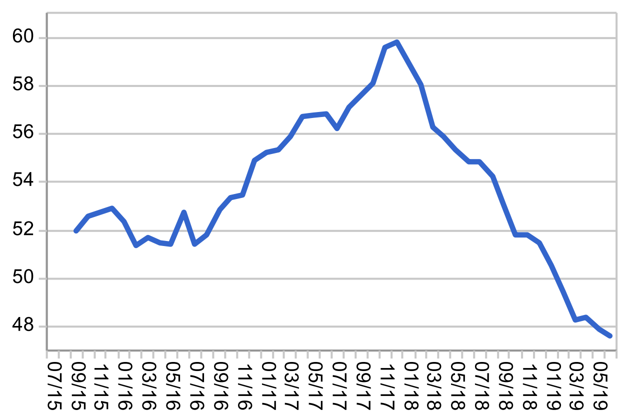
Source: FactSet.

This is due in part to recent US tariffs and the concomitant shifting of production to non-tariff countries like Vietnam, but also to secular factors, including tightening of credit, an aging population and the law of large numbers. And while China's recent GDP print of 6.2% would be the envy of every developed country, there remains deep skepticism around

China's official statistics, especially in light of the Communist Party's recent attempts to inflate economic statistics to improve its negotiating position.

The European economy is more closely tied to China than is the US, so the prospects of reaccelerating growth out of China would be a strong positive for Europe. Improving trends there would be a welcome relief: unlike the S&P, which peaked in September of 2018, global developed markets peaked in January of 2018 and spent the entire year of 2018 recording lower lows. And while European markets have joined their American counterparts in the 2019 equity rally, price performance has lagged that of the US indices as GDP and corporate profitability for the EU continue to be weak due to a combination of poor demographics, political challenges, excessive regulatory constraints, a weak banking sector and high government spending on social welfare programs across the region. Moreover, and as noted previously, the fact that select EU interest rates remain negative sends a disconcerting signal of the region's growth potential. That said, we've consistently noted that European stocks are relatively inexpensive (both historically and relative to the US) and it is possible that growth from China and the US can eventually stir production and exports from the EU.

Figure 7: European Union Manufacturing PMI



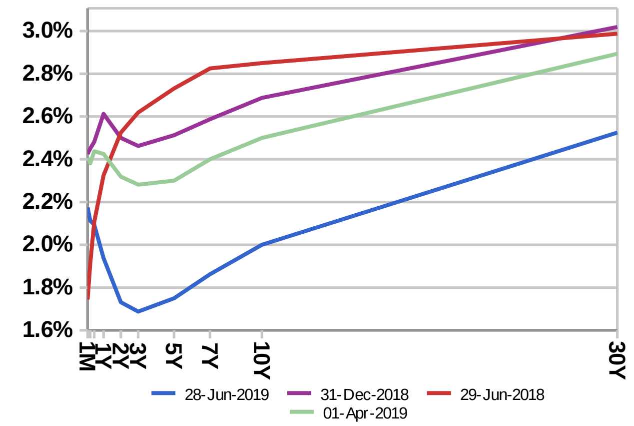
Source: FactSet.

Figure 8: EU Industrial Production, % Chg. YoY

Source: FactSet.

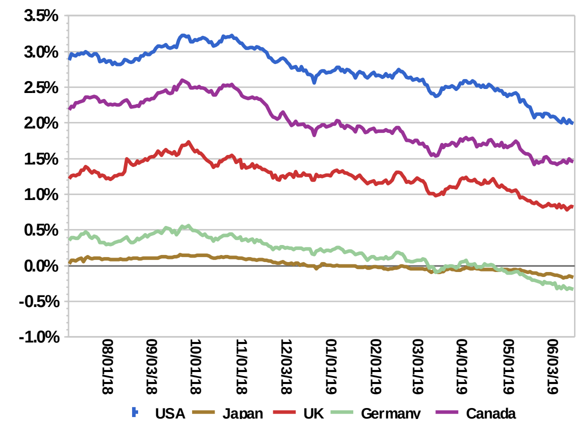
Slower global growth fueled in part by weakness out of China and Europe has forced the Fed into a major reversal in policy from just about nine months ago. Investors need only to look closely at both the changes in and shape of the curve to get a sense as to how the current environment differs from the norm (see Figure 9).

Figure 9: U.S. Government Yield Curve



Source: Factset

Figure 10: Global Sovereign Yields

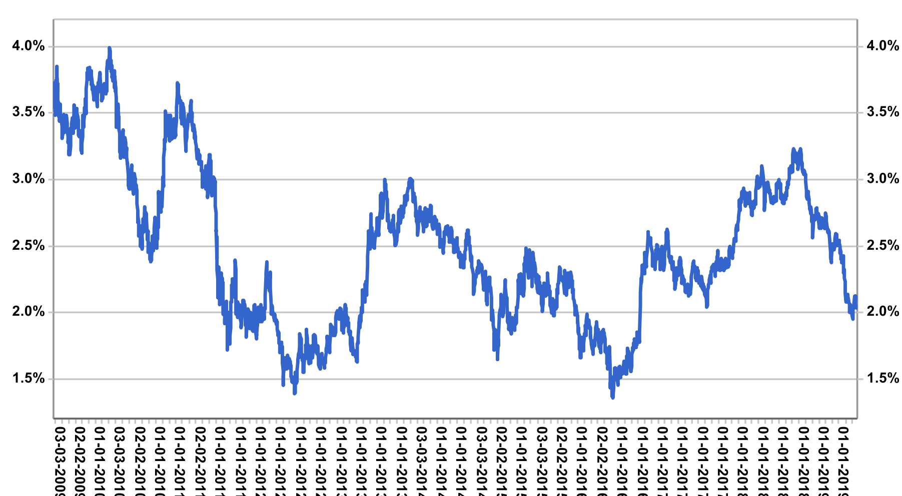


Source: Factset

Looking back a year ago, the yield curve was upward sloping, albeit at still historically low absolute rates. As the Fed continued to push short term interest rates up (note the Fed only controls the short end of the curve via its policy committee), a "kink" developed in late 2018. Today a buyer of US Treasuries is being compensated by the US government at a higher rate to hold a 1-month security vs. an investor purchasing a 3-, 5- or even 7-year bond! Indeed, the entire yield curve has shifted downward (i.e. interest rates dropped for every part of the yield curve vs. six months ago), including a plummeting in 10-year yields from close to 3% to now 2%. One good sign is that unlike late in 2018 and early 2019, the yield curve remains positively sloped (i.e. the 10-year minus the 2-year bond). Recall an inverted yield curve often signals recession is near and this was a major concern of investors just a quarter or two ago.

It is important to note, however, that intra-cycle moves in rates are more the norm than the exception. The 10-year bond rose from a low of 1.46% in the summer of 2012 to a high of 3.0% at the end of 2013. Rates then plummeted from 3.0% in January 2014 back down to 1.36% in the summer of 2016 before climbing again, peaking in November 2018 at 3.2% before starting on their subsequent downtrend.

Figure 11: US 10-year Treasury Bond

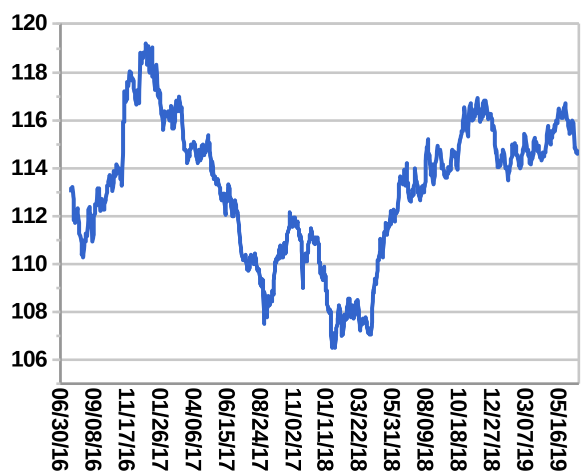


Source: Rockingstone Advisors, The Economist, Standard and Poor's, NYSE Arca, St. Louis Federal Reserve

From a global perspective, the move toward normalization appears to have failed. Interest rates in Japan and Germany have dropped below zero (see Figure 10). In other words, investors in those countries' bonds are paying the government to hold their money and the need for certainty is worth the cost. Clearly the ECB had hoped an EU recovery would be sufficiently strong that Germany's interest rates would not still be negative!

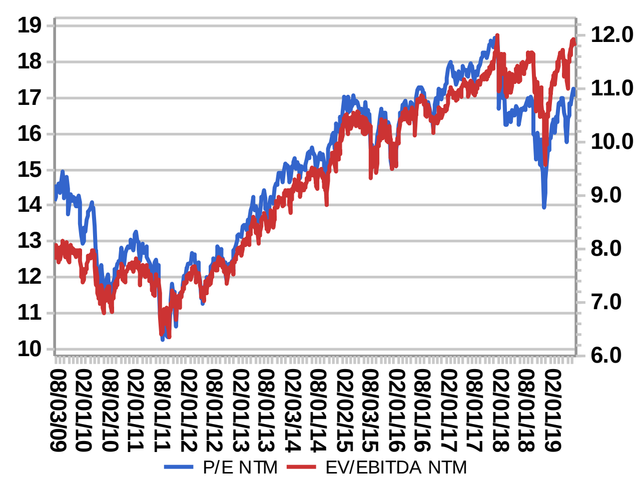
None other than Jamie Dimon, the CEO of J.P. Morgan, recently emphasized the bond market is in a bubble. We agree but acknowledge being surprised by the dramatic drop in rates during the 1H19. Most bonds out-performed equities in the 2Q19, and even more so on a risk-adjusted basis. We remain under-weight fixed income although continue to have some exposure in accounts that have balanced benchmarks.

Figure 12: Federal Reserve Nominal Broad $US Index



Source: FactSet, Federal Reserve

Figure 13: S&P500 NTM P/E (left) & EV/EBITDA (right)



Source: FactSet

With the Fed having raised interest rates for close to two years, combined with a relatively strong US economy, it isn't surprising to have seen the $US appreciate in value on a trade-weighted basis. More recently, however, with the fed funds market predicting one or more US rate cuts, the $US has started to weaken (see Figure 11). One additional reason non-US equities have under-performed US markets is the strength of the $US. We are keeping a close eye on non-US stock allocations as a continued drop in the $US could result in strong performance from this asset class.

Lastly and despite all the mixed signals from the global economy, we note valuation (as represented by the S&P500) has recovered from the 4Q18 lows and rebounded close to record levels vs. the last decade. Yet it is worth remembering that owning stocks is about the ongoing potential of business as opposed to a direct outlook on the economy.

Equity Performance

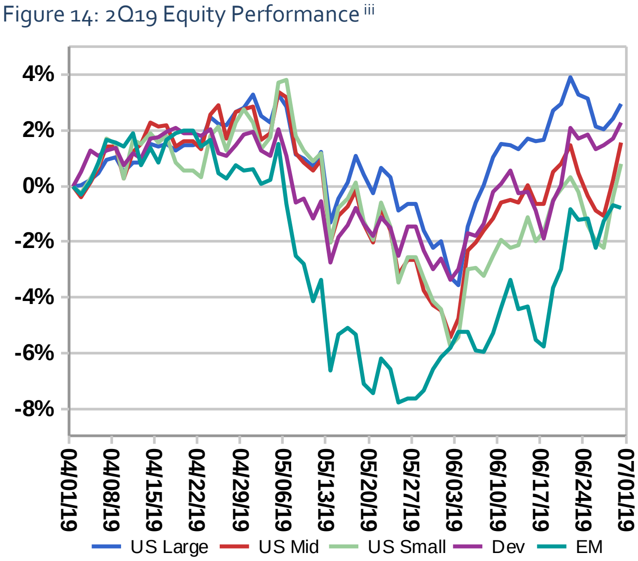
Mixed Months Ultimately Lead to Solid Quarter

As evidenced in Figure 14 below, 2Q19 displayed significant volatility. Initially stocks moved largely in sync during April with a positive reaction to initial earnings reports and the global environment (although we note EM trailed materially by month's end). As earnings season was coming to an end, macro factors superseded micro factors in May, including previously noted trade fears, preliminary signs of some global economic weakness and subsequent decline in interest rates. This sent every stock index we track into negative territory for the quarter. Yet by May's end, equities started to recover on expectations the Fed would lower interest rates combined with improving dialogue between China and the US over trade disputes. This continued through to June, with the S&P having a record month.

Both during and leading up to this period, the gap between large cap performance and small cap performance is definitely worth noting. Whereas at the end of the second quarter and into the first few weeks of July large cap stocks broke above the double top established in September 2018 and in April 2019, small caps (defined by the Russell 2K) still remain about 11% below the highs established at the end of September 2018, and also below their YTD high, which was established in May 2019. This is especially notable given the aforementioned strength in the $US, which typically provides a tailwind to small cap stocks relative to large cap stocks.

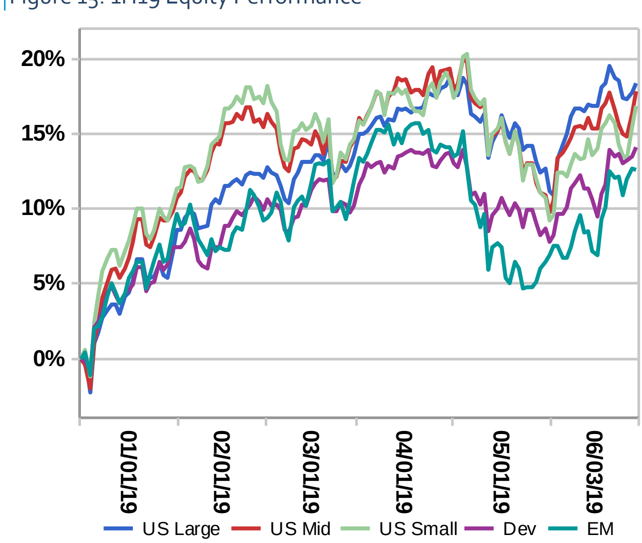
The other notable trend to highlight is the equity market's general lack of appreciation from January 2018 to the end of the second quarter. Despite headlines marking record closes, the reality is that since mid to late January 2018, the S&P 500 is up only about 5%, while the Russell 2K (small cap) *is down* about 3%. We highlight the following performance metrics regarding 2Q19 and 1H19 results: US Large Cap (+2.9% and +18.0%), US Mid Cap (+1.8% and +17.8%), US Small Cap (+0.8% and +16.9%), Developed (+1.8% and +14.1%), Emerging (-0.8% and +12.6%).

Figure 14: 2Q19 Equity Performance [iii]



Source: FactSet

Figure 15: 1H19 Equity Performance



Source: FactSet

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Fixed Income Performance

Fixed Income Enjoys Broad Rally

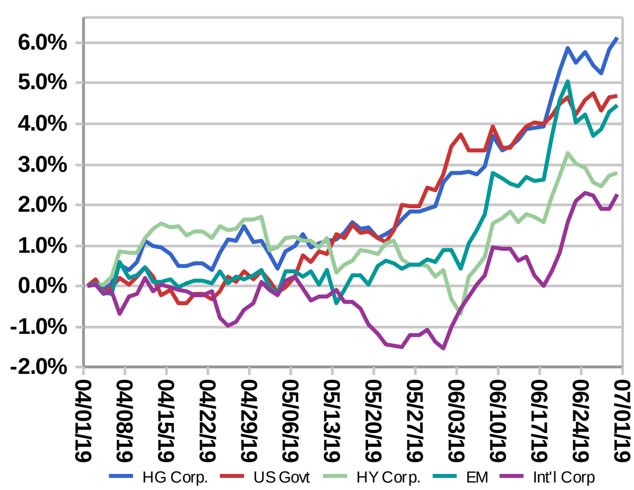
It is arguable that financial markets' biggest surprise in the quarter has been in fixed income. During 2Q19 and indeed for the 1H19, every major bond index we followed (see in the Figures below) had a positive return. Mathematically, bond prices move in the opposite direction from interest rates or yields. Consensus expectations, shared by the vast majority of experts, were that interest rates would increase, reflecting both a relatively strong US economy (GDP appears to be around 3.0%) and signals by the Fed to raise interest rates.

Yet the exact opposite occurred, as trade talks broke up without a deal, businesses postponed investments from everything to new plants and equipment to inventory. Economic data weakened, interest rates declined and both the Fed and ECB were essentially forced to capitulate (i.e. recognize the need for lower interest rates in the future).

We expect the Fed to cut rates by 25 bps at the FOMC meeting in July, with the possibility of one more rate cut in the fall, for a total of 50 basis points.

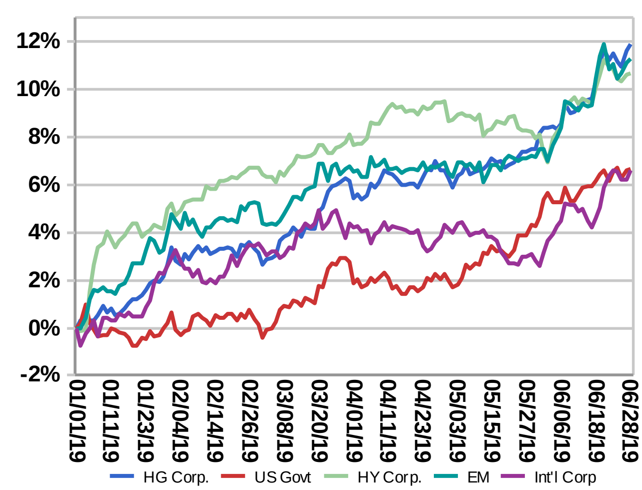
We note the following performance figures for 1Q19 and 1H19: US High Grades (+5,8% and +11.8%), US Governments (+4.4% and +6.6%), US High Yield (+2.3% and +10.6%), International Corporates (+2.1% and +6.6%), Emerging Markets (+4.0% and +11.1%).

Figure 16: 2Q19 Fixed Income Performance[iv]



Source: FactSet

Figure 17: 1H19 Fixed Income Performance



Source: FactSet

Commodity Performance

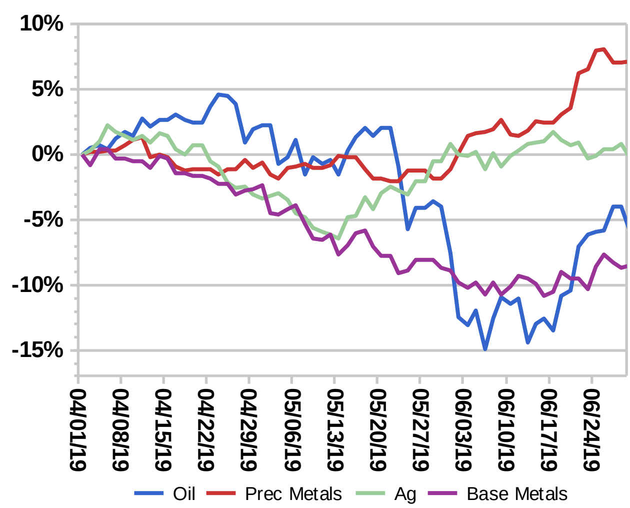
Generally Cautious Signals Abound

Precious metals (we use the ETF DBP) jumped in the latest quarter, although we emphasize this was due to the influence of gold (GLD was +9.6% in the quarter) as investors believe central banks are now working in concert to re-inflate global economies. Meanwhile most other commodities we track were flat or down significantly in 2Q19. One way to put volatile commodity prices in context is to use them as a proxy for global growth (i.e. demand ahead of supply for industrial and consumer products). In that light the weakness in commodity prices was disconcerting and only added to fears about macro-economic struggles across the globe.

We have also stated in past newsletters that it is difficult to draw conclusions from commodity prices at any given time. Most assets can be valued by discounting future cash flows. But an asset like gold or copper doesn't generate any intrinsic cash flow and thus deciding what is the correct value is a challenge, and primarily fueled by supply/demand dynamics. We track commodity trends via specific ETFs (which are the basis for the graphs below). Rockingstone uses ETFs to gain exposure to the asset class, in addition to owning the underlying equities or debt.

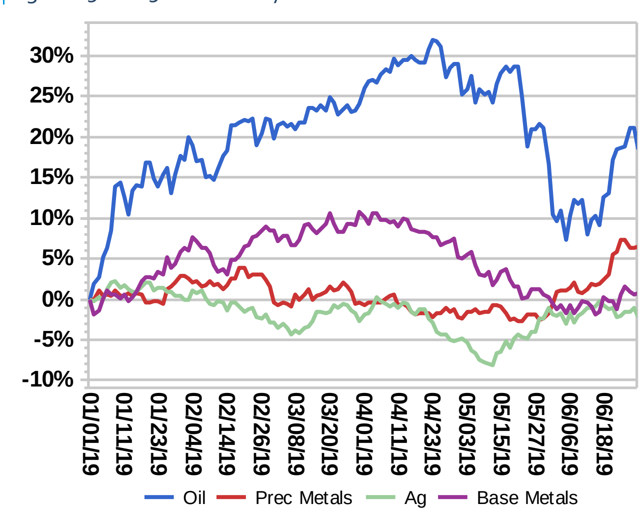
We note the following returns during the 2Q19 and 1H19, respectively: Oil (-6.0% and +18.5%), Precious Metals (+7.2% and +6.5%), Agriculture (-0.2% and -2.1%), Base Metals (-8.5% and +0.7%).

Figure 18: 2Q19 Commodity Performance[v]



Source: FactSet

Figure 19: 1H19 Commodity Performance



Source: FactSet

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Forecast: 2019 & 2020

Rockingstone Advisors' Latest Forecasts

We generally expect GDP growth in the US of between 1.4% to 1.9% given the current environment of uncertainty around trade and tariffs, as well as soft commodity prices and generally reduced industrial activity. Consumer spending has been the lone bright spot of economic activity, and as noted earlier, consumer confidence continues to be strong given low unemployment. But business investment and industrial production continue to be weak, hampered by decelerating global growth rates and increased uncertainty, which is leading to delays in investment spending.

We note that our 2019 EPS forecast for the S&P has been consistently below consensus, although post-4Q18 markets, the consensus has indeed come down. Based on 1Q19 results and early indications for 2Q19 EPS, we trim our S&P 500 forecast to $162 from $164, while the consensus forecast, which was originally $176 at the time we published our *4Q18 Investor Quarterly*, has now come down to $163. Our current estimate implies about 7% EPS growth in 2019, while the Street is closer to 8%. We note, however, that much of the gains in YoY EPS growth rates is coming from the 4Q19 forecast, as the consensus operating earnings forecast for the first three quarters of 2019 are relatively flat. Another important consideration is that companies continue to repurchase their shares, so flat net income translates to positive EPS growth. For instance, there are 4% fewer shares outstanding in 2Q19 than 2Q18, creating a nice tailwind for earnings per share.

Operating earnings expectations are up about 2.4% year over year ($39.59 vs. $38.65), while reported earnings expectations are up about 8.7% ($37.02 vs. $34.05). That said, given our previous point about the impact of share repurchases and their 4% tailwind, EPS growth of below 4% would imply YoY net income declines.

Margins are down year over year, however, from roughly 11.55% in 2Q18 to 11.41% in 2Q19. As of July 18th, 77 S&P 500 components had reported results, with 58 beating estimates and 5 meeting estimates; only 14 have missed. We trim our 2020 EPS estimate for the S&P 500 to $174 from $176.

Figure 20: Key Metric Forecast

	Year End December	
Metric	Band	Point
US Real GDP (2019)	1.4% - 1.8%	1.6%
S&P 500 2019 EPS (RSA/Street)	NA	$162 / $163
S&P 500 2020 EPS (RSA/Street)	NA	$174 / $183
S&P 500 2019 Index	3000-3200	3105
10-Yr US Treasury Yield	2.0% - 2.4%	2.2%
Oil (WTI-2019 End)	$50 - $65	$60
Gold (2019 End)	$1,450 - $1,600	$1,500
Inflation (NTM)	1.5% - 1.8%	1.5%

Source: Rockingstone Advisors, The Economist, Standard and Poor's, NYSE Arca, St. Louis Federal Reserve

A few observations and comments:

1. <u>GDP:</u> We trim our GDP forecast from 2.4% to 1.6%, based on slowing global growth due to trade tensions, declining commodity prices and political uncertainty. Factors that would lead to an upward revision of our GDP forecast

would include resolution of trade and tariff disputes, and re-accelerating growth in China. As Europe is tied more closely to the Chinese economy, improving economic data out of China would help to raise European growth rates and ultimately US growth rates. Factors that would lead to a downward revision of our GDP forecast would include further trade or tariff tensions, ongoing decline in energy and industrial metals prices, and reductions in consumer confidence.

2. S&P500 Index. As this newsletter goes to print, the S&P500 is trading at 2983, or approximately 18.4x our 2019 EPS forecast of $162. Based on our revised 2020 EPS forecast of $174, we estimate the Index should trade up to around 3100 by the end of this year (implying 4% appreciation over the next eight months, and total 2019 appreciation of around 24%). Despite lower EPS estimates for the S&P 500, we raise our price target as the decline in 10-year rates results in a lower discount rate for equities and subsequent higher P/E multiple.

3. 10-year Yield. As noted previously, we were surprised by the speed and extent of the decline in interest rates and rise in bond prices. Economic data have deteriorated, but in our view the deterioration was from the mid-two percent range to the mid-one percent range, which does not, in our view, justify the decline in rates witnessed to date, especially if trade issues are resolved. We see the 10-year at about 2.2% by year end.

4. Oil. The entire energy complex continues to see price pressure, although lower inventory levels and recent events in the Strait of Hormuz could stabilize prices. Price appears to be driven primarily by the demand side; for this reason, future price increases will most likely be dependent on the resolution of trade issues as well as the prospect for the $USD. Given our view for a slightly weaker dollar through the remainder of 2019, we expect oil prices to rise slightly by year end to roughly $60/bbl for WTI.

5. Gold. The combination of slower global economic activity, coupled with lower rates and weaker currencies has fueled gold's recent rise. Moreover, there is a case to be made that global debt levels have risen to the point at which future repayment will be difficult without devaluing the currency in which those debts are denominated. Hence, gold has caught a bid and the metal's recent price action makes us think prices are probably headed higher. Our price target is $1500/oz.

6. Inflation. Inflation expectations as measured by the 5-year, 5-year forward futures continues to point to muted inflation, currently at around 2%, up from 1.8% on June 17th. There is a growing sense among market participants and economists that the combination of aging populations in the developed world, the rise of offshore manufacturing centers like China, and the role of technology have all combined to lower inflation rates below the level at which central banks are most comfortable (2%). The current CPI is about 1.6% while the PCE deflator is running around 1.9%. We think the combination of decelerating economic activity will continue to pressure inflation to around 1.5%.

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Five Year Asset Value Forecast[vi]

Balanced Expectations from Current Levels given Rise in Asset Prices

Typical to our approach, we assume asset values mean-revert (with respect to margins and P/E multiples) over time. With the increase in equity prices over the last quarter vs. macro-economic signals of slower growth, our forecast now generally points to lower returns compared to both 4Q18 and 1Q19-end.

Figure 21: Five-Year Total Equity Return Calculations (Incremental Contribution)

Asset	**Index**	**LT Exp. Return**		**Sales**		**Profit Margin**		**Div.Yield**		**Valuation**
US Large Cap Stock	S&P500	3.4%	=	5.7%	-	2.5%	+	2.0%	-	1.7%
US Mid Cap Stock	S&P400	7.1%	=	5.7%	-	0.2%	+	1.8%	-	0.1%
US Small Cap Stock	S&P600	7.6%	=	5.7%	+	0.9%	+	1.9%	-	0.9%
Foreign DM Stock	MSCI-EAFE	5.0%	=	3.4%	-	1.2%	+	3.4%	-	0.6%
Foreign EM Stock	MSCI-EM	8.9%	=	5.8%	+	1.4%	+	3.1%	-	1.4%

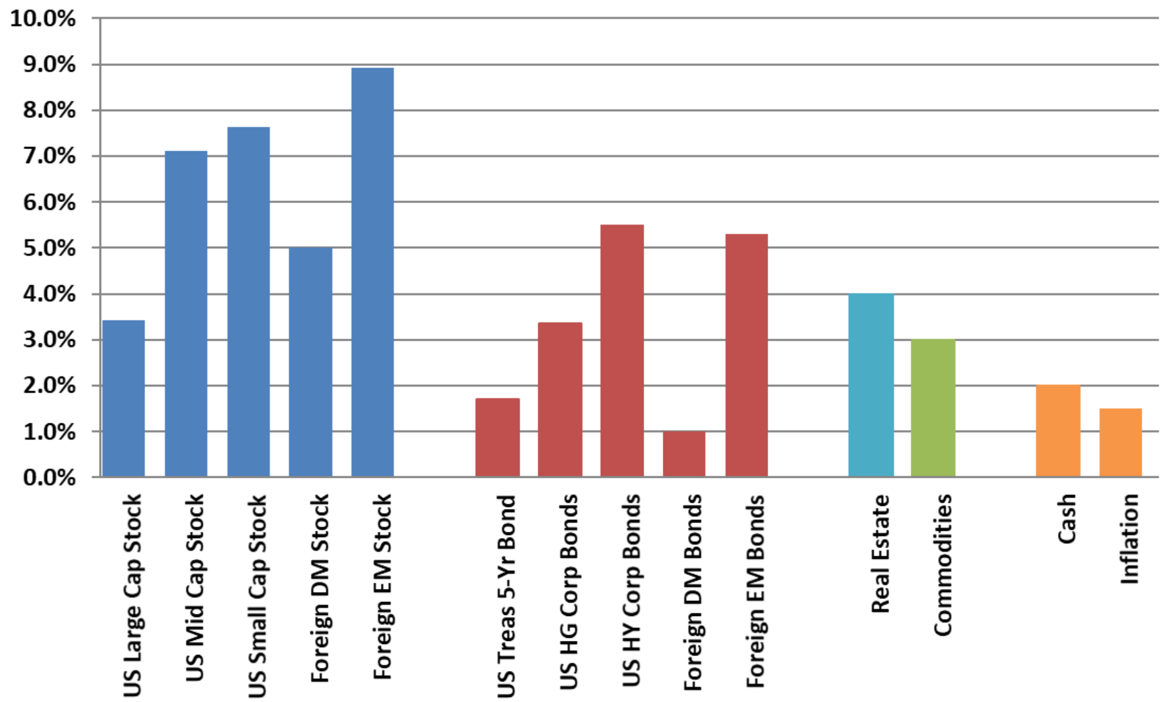
Source: Rockingstone Advisors

For equities, we examine key variables such as (1) historical sales growth, (2) corporate profit margins, (3) dividend yields, and (4) valuation to determine potential long-term returns. Using valuation as an example, P/Es should theoretically decline (if currently above the historical mean) or expand (if currently below the historical mean) over the long term.

Based on our outlook for total returns, we expect the "give" of sales growth, valuation and dividends to be partly offset by the "take" of mean-reverting margins. We expect sales growth to be relatively close to long term average performance although the economy suggests lowered expectations are likely prudent. As has been the case for a while, profit margins are high vs. history but we don't see significant pressure (due to ongoing productivity and cost reduction measures) in the next few years as well as benign inflation.

In fixed income (see the next page for various assumptions), we expect the "give" of coupons will be exceeded by the "take" of mean-reverting inflation and real rates, both of which are below their historical mean. Of course, short-term returns may not necessarily match our longer-term return predictions; markets are significantly more random over the short-run than the long-run.

Figure 22: Five-Year Asset Class Total Return Forecast



Source: Rockingstone Advisors

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Portfolio Positioning

Equities

Although our performance was roughly in line with the S&P500 during 2Q19, we nevertheless feel a bit disappointed. From an individual stock perspective, we had a few investments such as Evolent Health (EVH) and Red Rock Resorts (RRR) that struggled for a variety of reasons. As we have noted previously, smaller cap names under-performed in the quarter, particularly those with leverage. On the other hand, we had a number of stocks that added to performance, including Constellium (CSTM), Disney (DIS), Facebook (FB), Fleetcor (FLT), Lockheed Martin (LMT) and Microsoft (MSFT).

Our top ten largest individual holdings (in order), as of early July, include: S&P Global, McCormick, Estee Lauder, Amazon, Facebook, Intuitive Surgical, PayPal, Pepsi, Apple, and Calavo Growers. We didn't make any material changes in our ETF allocation with the exception of reducing our exposure to emerging (VWO) and developed markets (VEA) about midway through the quarter.

We decided to make a number of changes in early July to our holdings and it would be remiss to not highlight them despite occurring after the 2Q19-end.

1. Exchange Traded Funds: In terms of ETFs, we exited XLE and replaced it with RYE. Both are energy ETFs but the latter is equal weighted and thus less likely to be dragged down by the large integrated stocks that dominate the former. In either case we are generally slightly under-weight the energy sector. We added PHO, a somewhat unique ETF that focuses on growth companies involved in water processing, filtration and delivery of what is a limited resource. Rockingstone also exited GSIE, GSLC and GSEU as we determined these modestly higher cost ETFs were not out-performing other investment options with similar regional exposures and financial targets. We sold a couple of individual regional bank holdings but used those proceeds to boost our existing position in KRE (the regional bank ETF). Lastly, we exited a number of value-focused ETFs such as VTV and RSP, due to under-performance and our concern that value-oriented investing would not likely out-perform near term (especially given value-focused ETFs are heavily skewed to large capitalization energy and pharmaceutical companies).

2. Individual Equities: We decided to exit a few individual investments including Royal Caribbean (RCL), Johnson & Johnson (JNJ), Webster Bank (WBS), Continental Resources (CLR) and Northstar Realty Europe (NRE). Regarding RCL, we recognize the stock appears inexpensive and still view the long term as compelling. Yet we are concerned over intermediate term capacity increases and mixed signals on recent pricing trends. In terms of JNJ, we have owned the defensive-name for a while but mounting litigation headwinds have turned us more cautious. For WBS our original thesis was that a rapidly growing health savings account business would be spun off and create value. Unfortunately, that has yet to occur and we aren't sure when or if it will occur. Regarding CLR we decided to exit our position and reinvest in the equal weighted RYE energy ETF (see above). Lastly, we sold NRE as the company announced it was being acquired for a nice premium and our view is that another bidder is unlikely to emerge.

Fixed Income

As noted previously in this newsletter, our under-weight position in fixed income led to us missing out on an asset class that performed well in 2Q19. Fixed income had a solid 2Q19 and this followed decent performance in 1Q19. The decline in yields caught most investors by surprise. We are reluctant to increase our fixed income holdings as the asset class appears to be expensive (i.e. the yield received does not adequately compensate for the risk incurred).

But within balanced portfolios where benchmarks include fixed income, we still have select, modest positions in high grade corporates (ticker LQD), high yield ETFs (such as HYD), hybrids like PFF, and through actively managed ETFs such as DoubleLine (TOTL). The bulk of our fixed income exposure is in relatively short-term bonds and ETFs (JPST).

Our short position in International bonds (for those accounts that allow short positions) via the BNDX ETF remains an investment across most portfolios. As we have mentioned a number of times, this is a long-term oriented position to exploit what we view as yields that are simply too low in Europe. Unfortunately, this position has proven to be incorrect and we are closely monitoring the price action in BNDX.

Commodities

Our exposure to commodity ETFs continues to be modest. Select portfolios continue to hold small positions in precious metals, namely gold and silver. As a reminder we use ETFs for such exposure including GLDI, an ETF where gold is being used as an inflation hedge that also includes yield via covered call writing.

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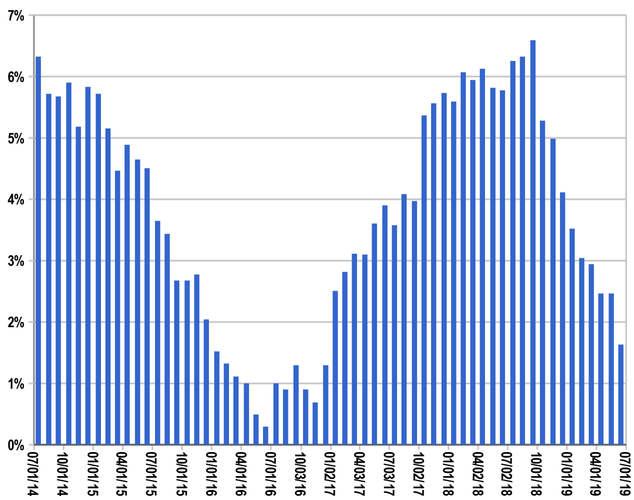
Chart Book

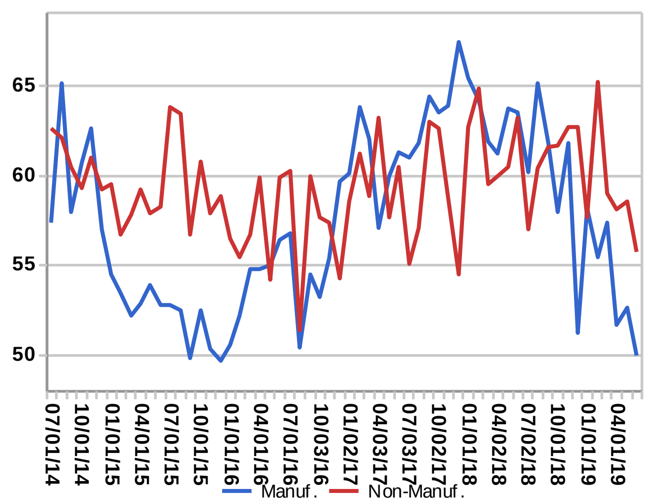
Leading Indicators

Figure 23: Index of Leading Economic Indicators



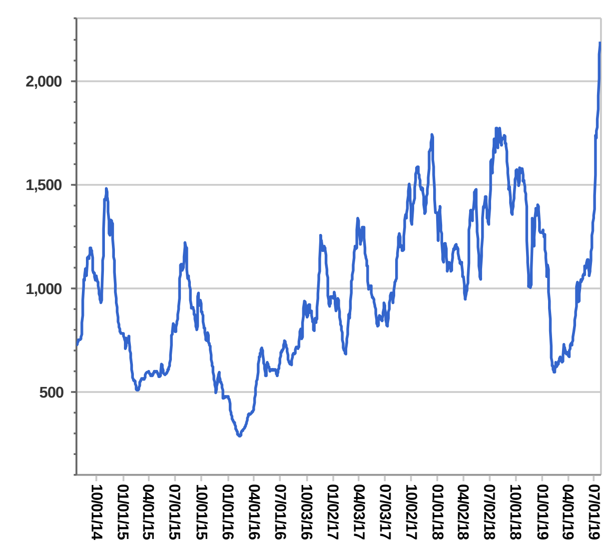
Source: FactSet

Figure 24: ISM New Orders



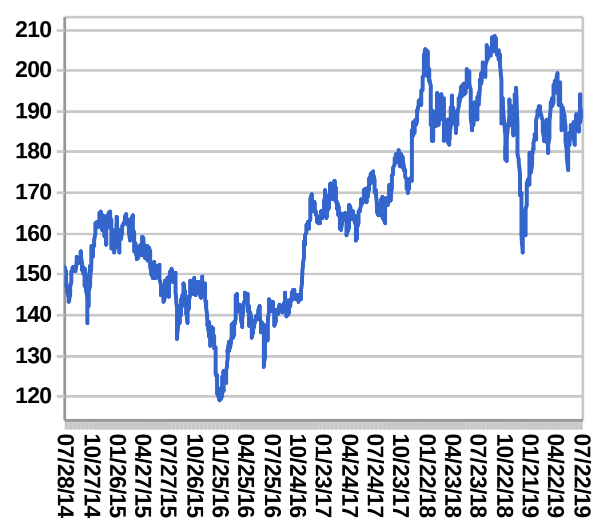
Source: St. Louis Federal Reserve, FRED Database

Figure 25: Baltic Freight Index



Source: FactSet

Figure 26: DJ Transports



Source: FactSet

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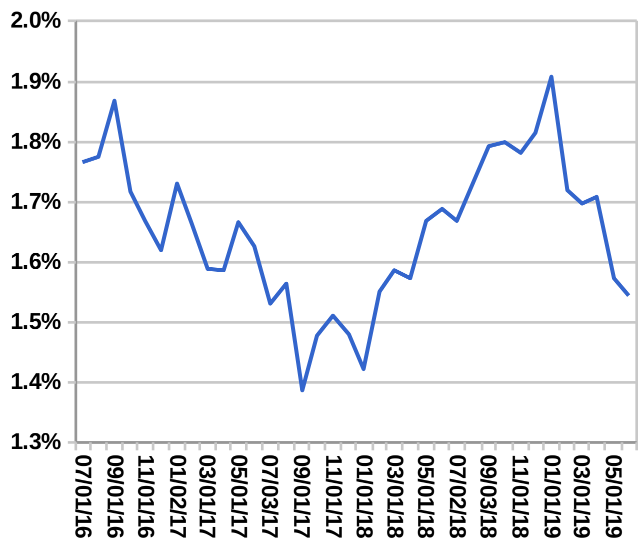
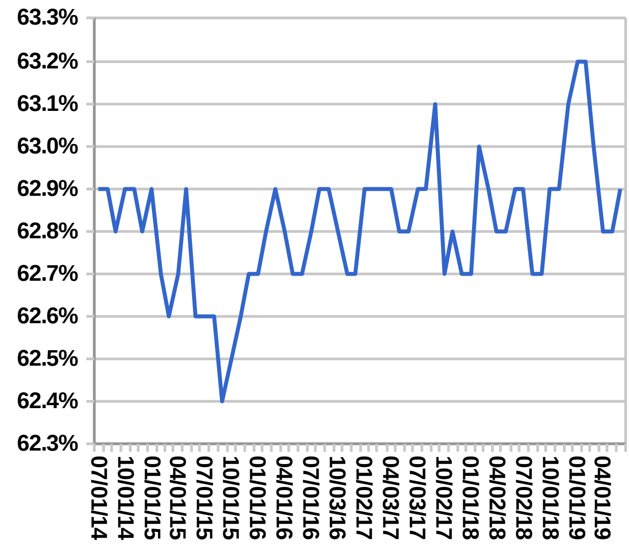
Labor Market Indicators

Figure 27: Payroll Growth (Establishment Survey, % Chg YoY)



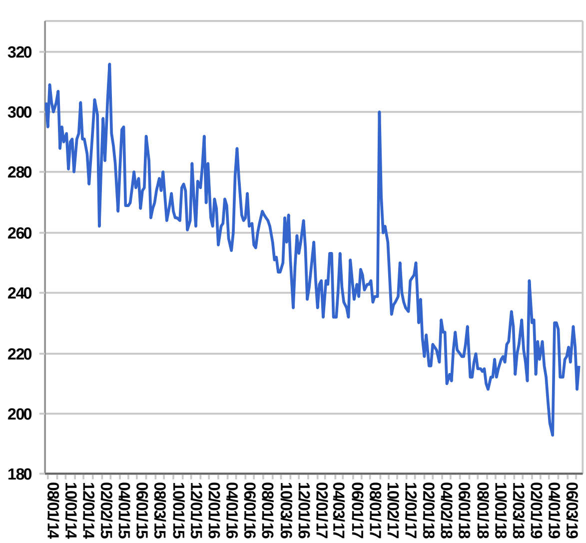
Source: FactSet

Figure 28: Labor Participation Rate (% of Workforce)



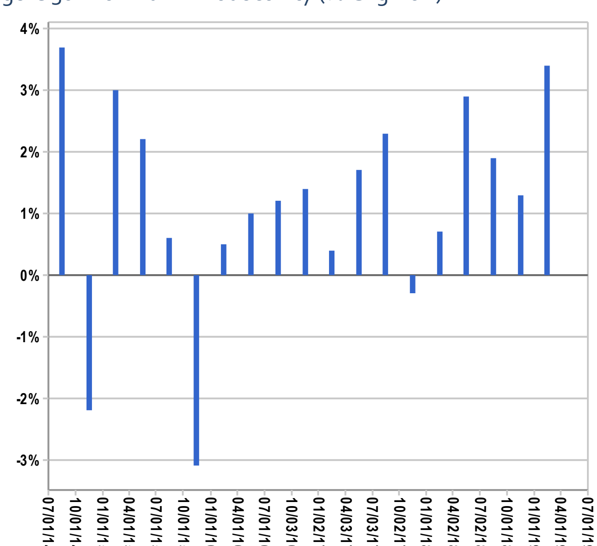
Source: FactSet

Figure 29: Initial Unemployment Claims



Source: FactSet

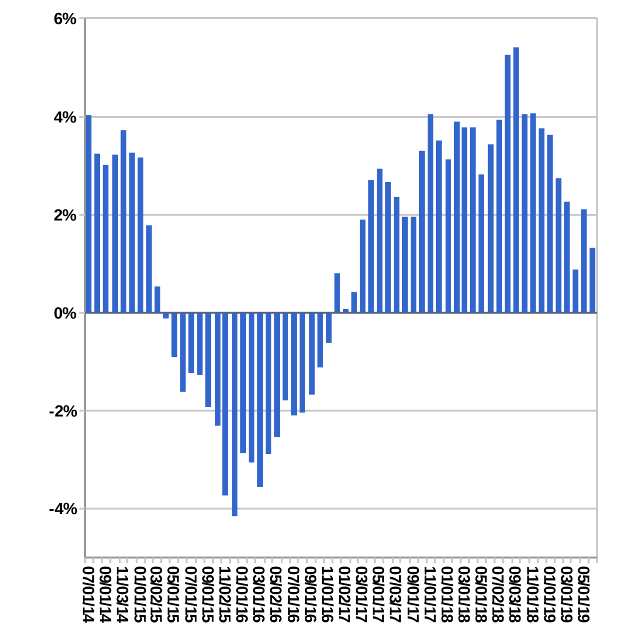
Figure 30: Non-Farm Productivity (% Chg YoY)



Source: FactSet

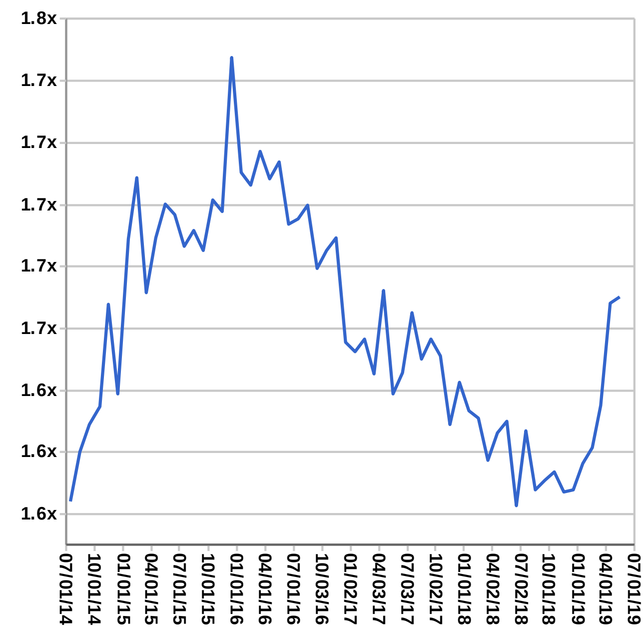
Production and Business Activity Indicators

Figure 31: Industrial Production (% Chg YoY)



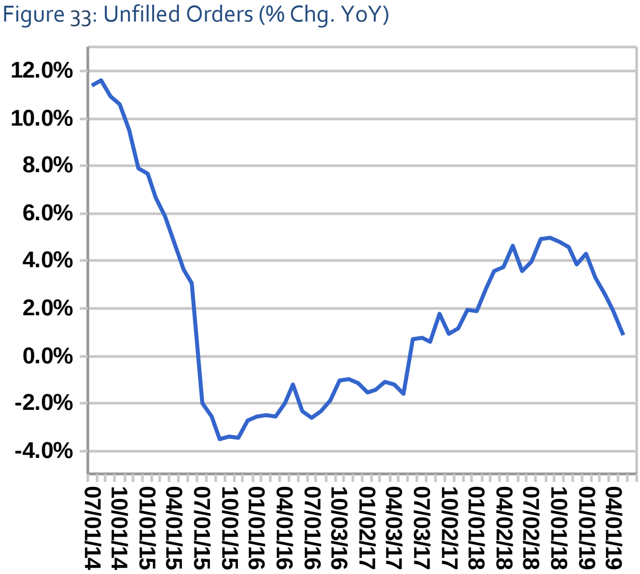
Source: FactSet

Figure 32: US Inventory to Shipment Ratio



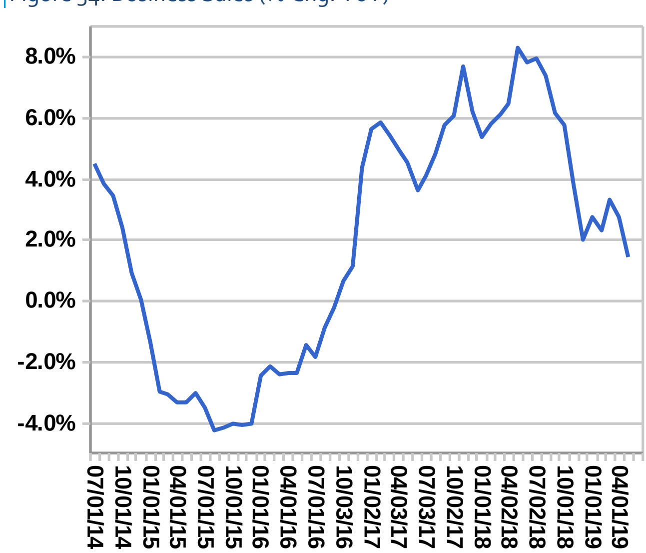
Source: FactSet

Figure 33: Unfilled Orders (% Chg. YoY)



Source: FactSet

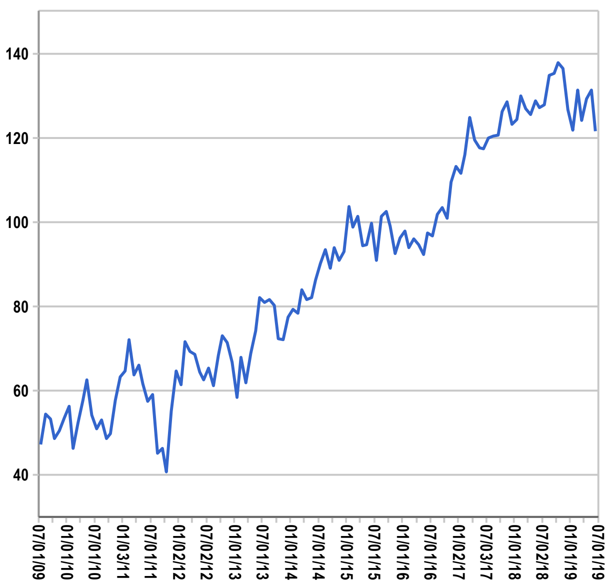
Figure 34: Business Sales (% Chg. YoY)



Source: FactSet

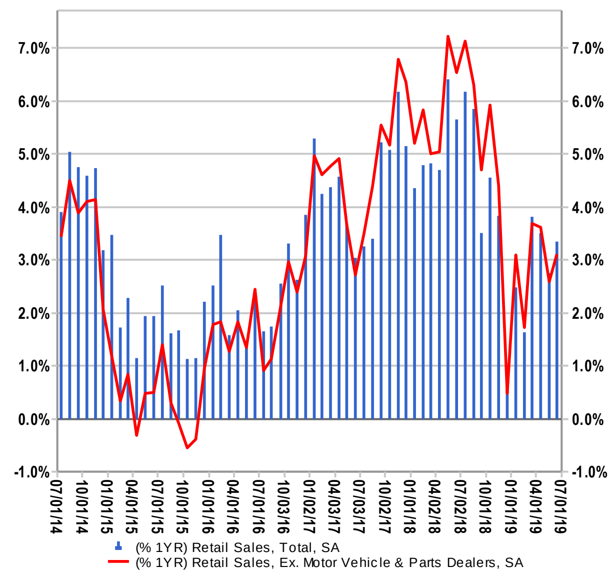
Consumer and Household Activity Indicators

Figure 35: University of Michigan Consumer Sentiment



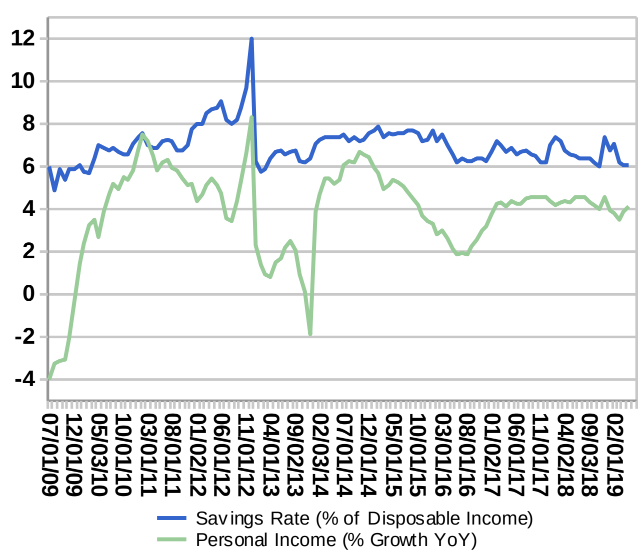
Source: FactSet

Figure 36: Retail Sales



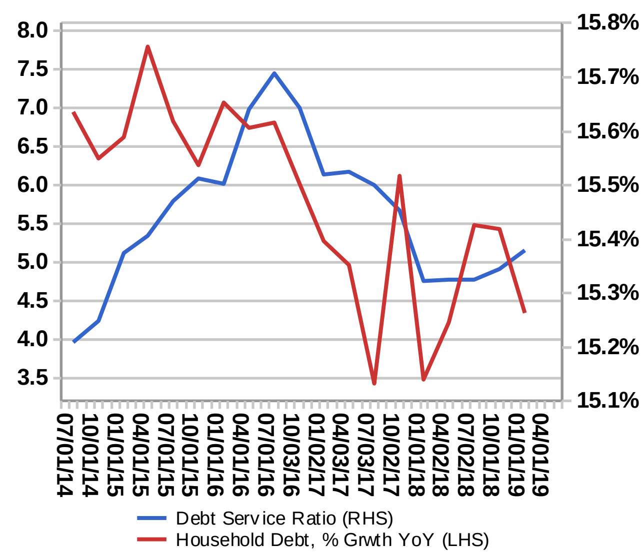
Source: FactSet

Figure 37: Personal Income and Savings Rate



Source: FactSet

Figure 38: Household Debt



Source: FactSet

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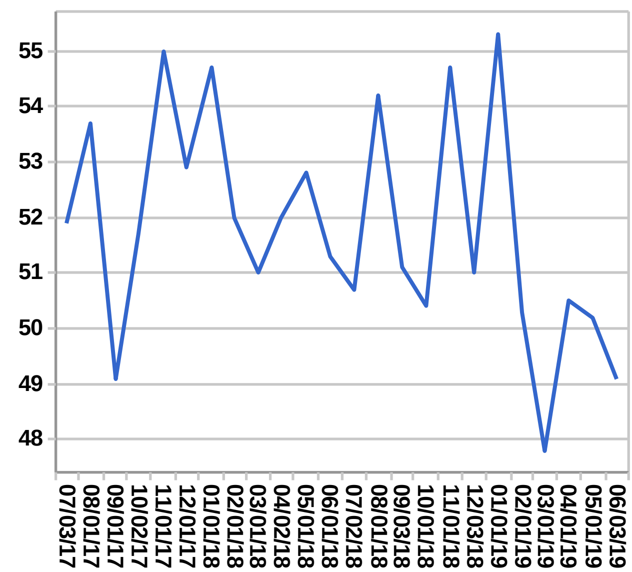
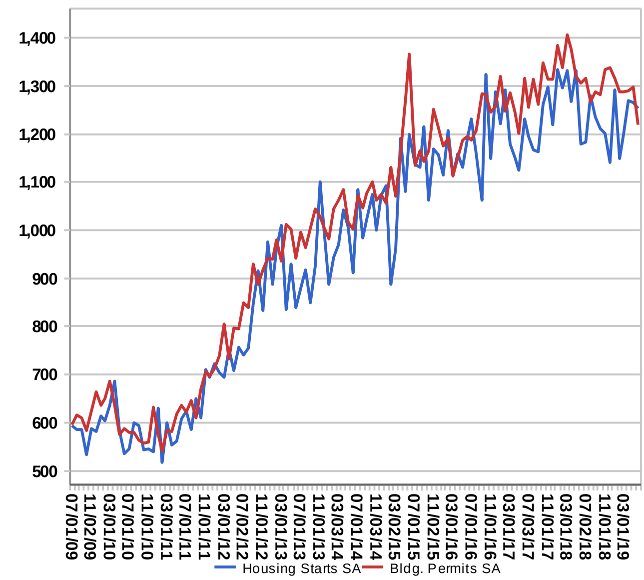
Housing and Construction Indicators

Figure 39: Architecture Billings Index



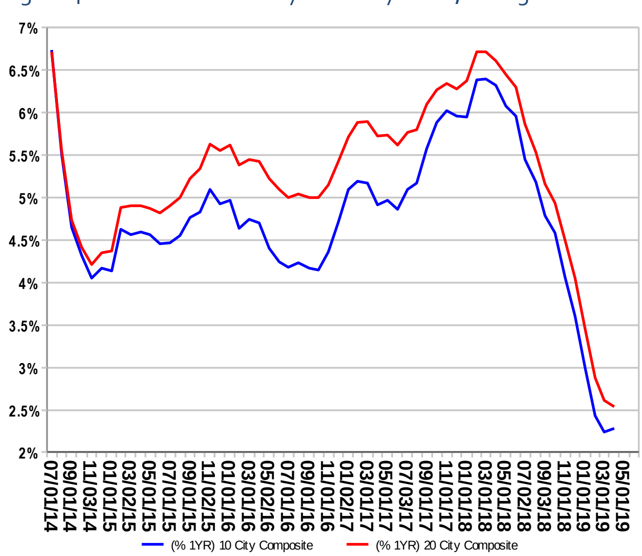
Source: FactSet

Figure 40: Housing Starts and Building Permits



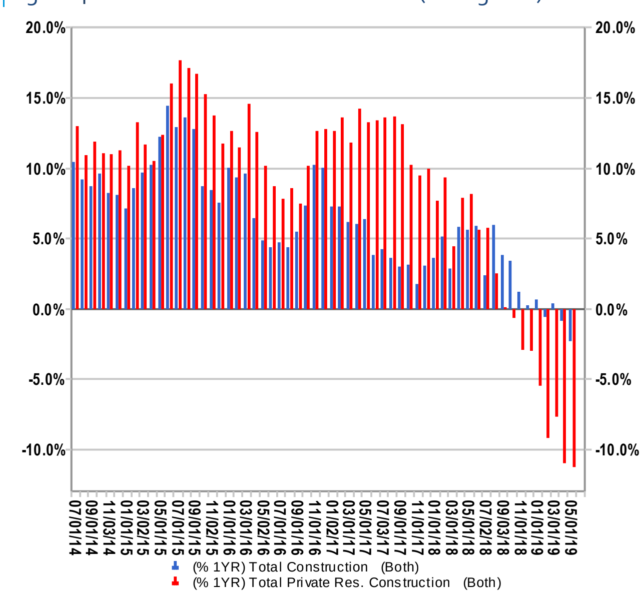
Source: FactSet

Figure 41: Case-Shiller 20-City & 10-City Index, % Chg YoY



Source: FactSet

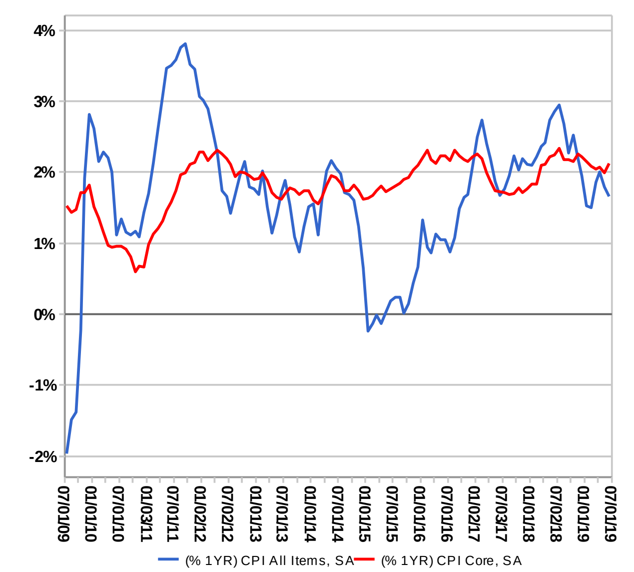
Figure 42: Private and Total Construction (% Chg YoY)



Source: FactSet

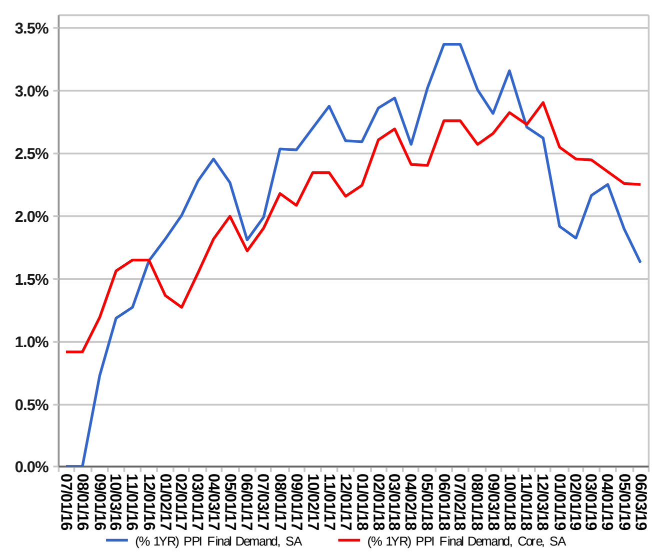
Price Indicators

Figure 43: Consumer Price Index



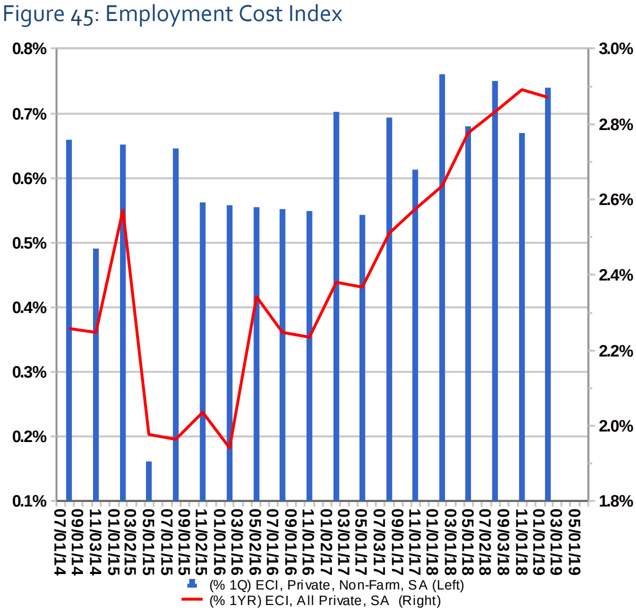
Source: FactSet

Figure 44: Producer Price Index



Source: FactSet

Figure 45: Employment Cost Index



Source: FactSet

Figure 46: 10-Year, 5-Year Forward Inflation Expectations

Source: FactSet

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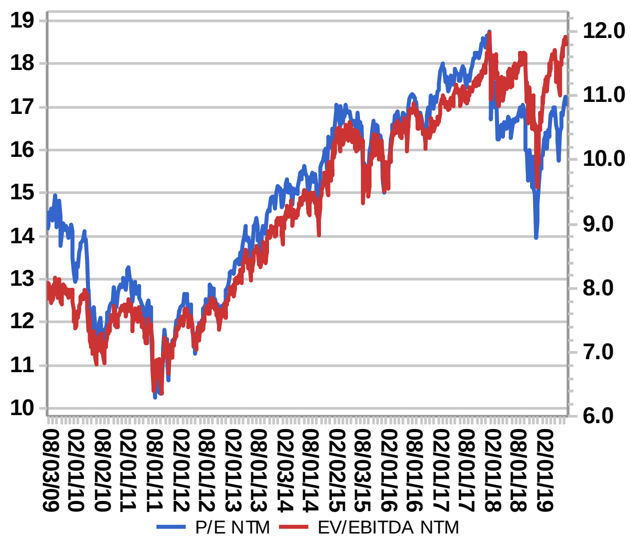
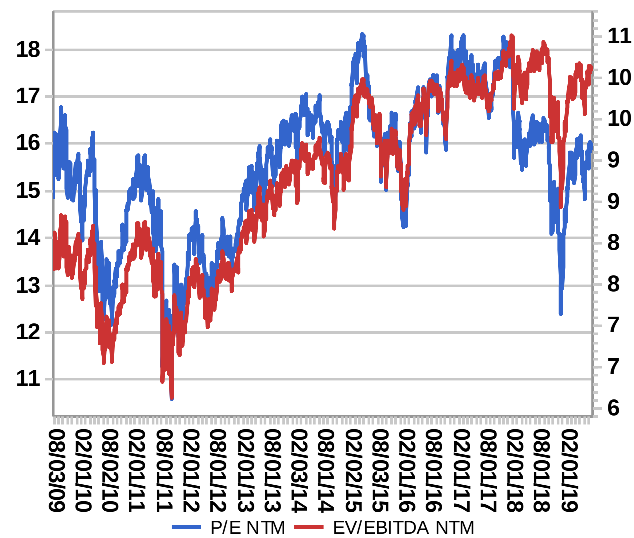
Valuation Indicators

Figure 47: S&P 500 P/E (LHS) & EV/EBITDA (RHS)



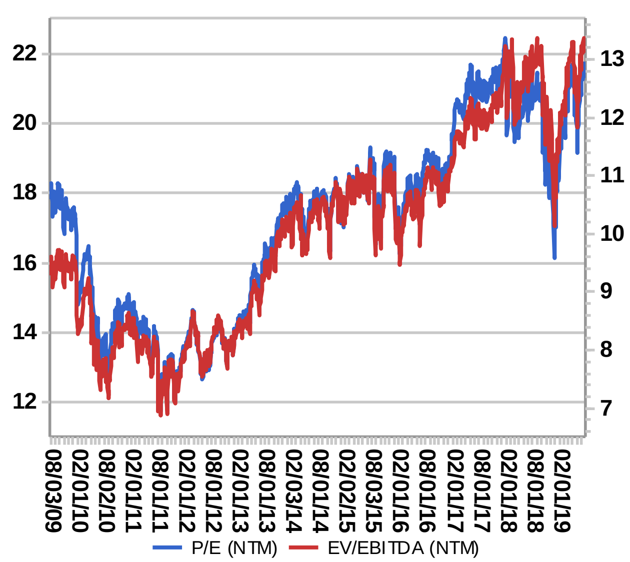
Source: FactSet

Figure 48: S&P Midcap 400 P/E (LHS) & EV/EBITDA (RHS)



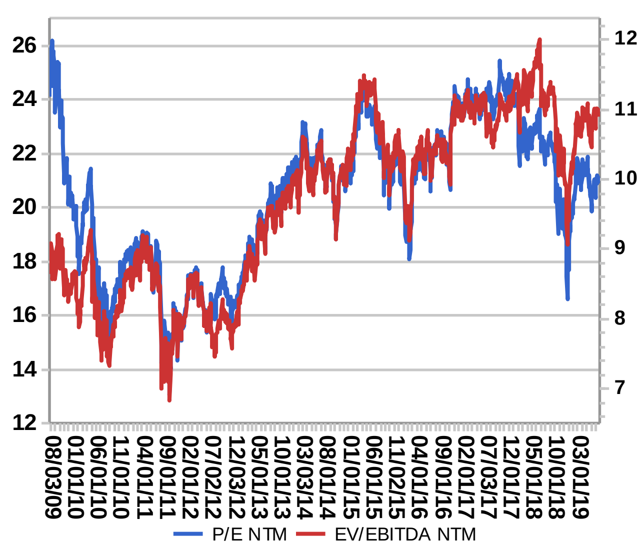
Source: FactSet

Figure 49: Nasdaq 100 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

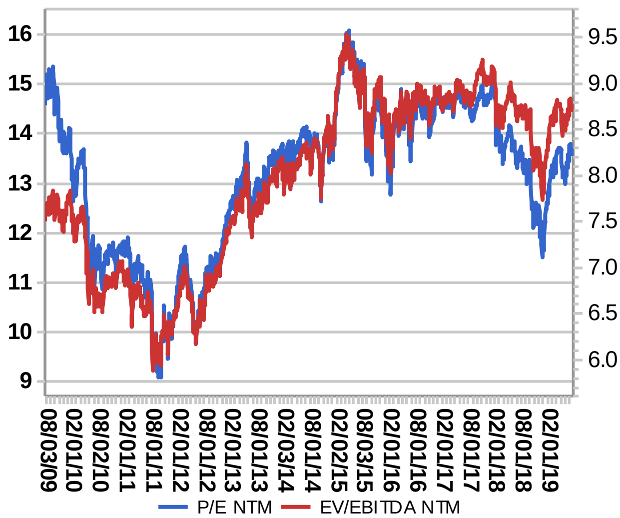
Figure 50: Russell 2000 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

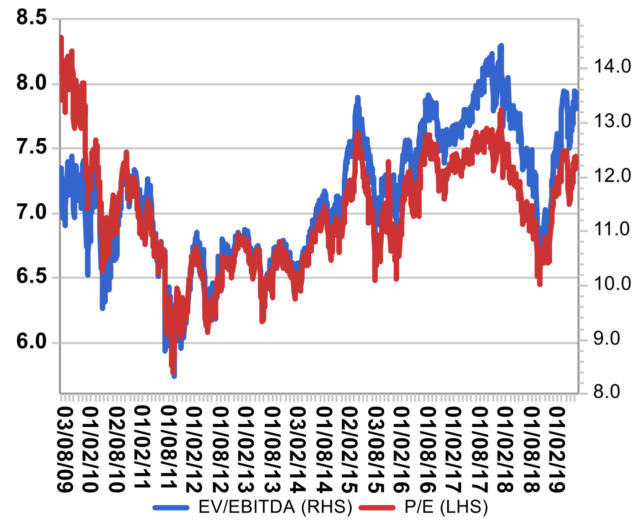
Valuation and Volatility Indicators

Figure 51: Intl Developed P/E (LHS) & EV/EBITDA (RHS)



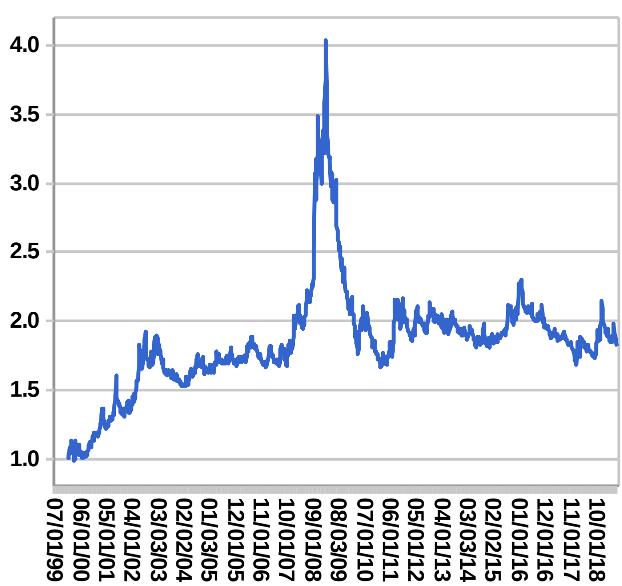
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 52: Emerging Markets P/E (LHS) & EV/EBITDA (RHS)



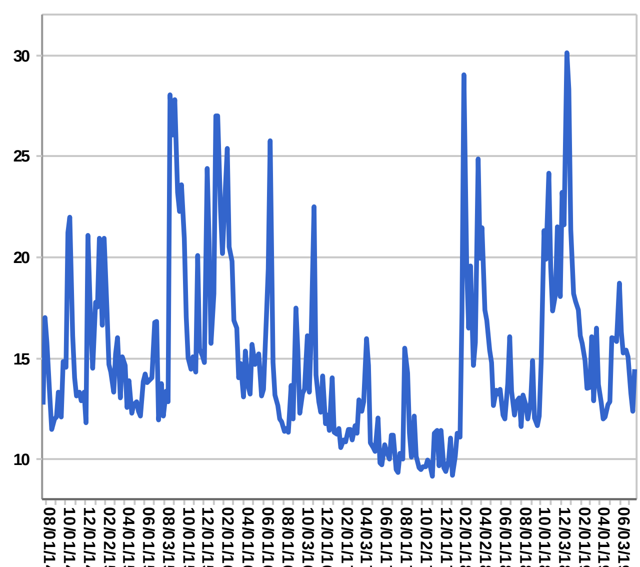
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 53: S&P 500 Dividend Yield



Source: FactSet

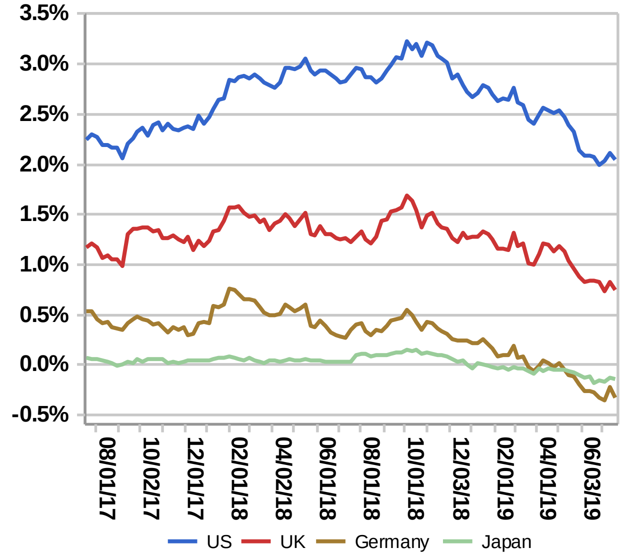
Figure 54: CBOE Volatility Index



Source: FactSet

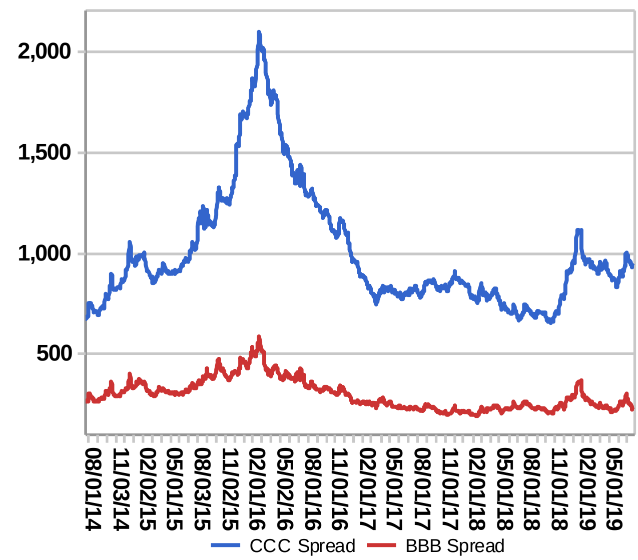
Bond Market Indicators

Figure 55: 10-Year Global Bond Yields



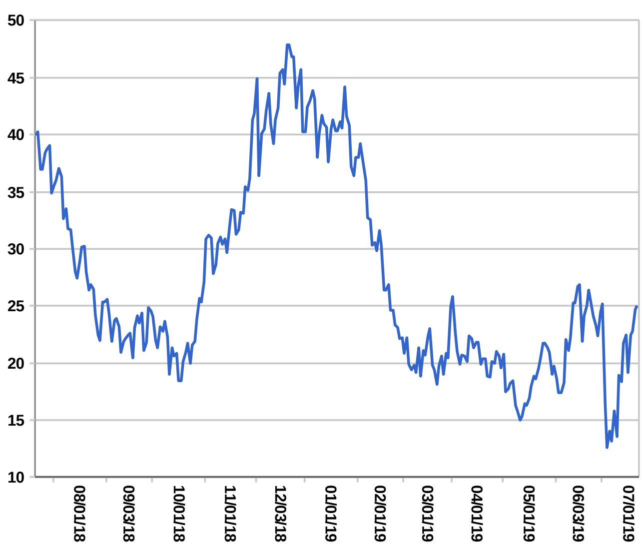
Source: FactSet

Figure 56: CCC and BBB Spreads (Option Adjusted)



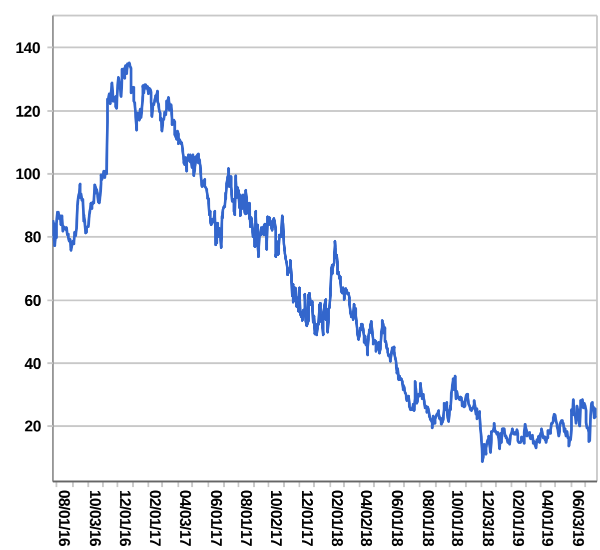
Source: FactSet

Figure 57: TED Spread (bps)



Source: FactSet

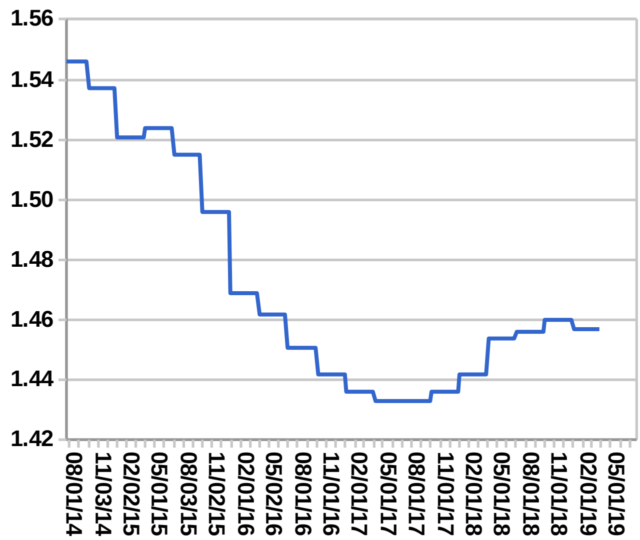
Figure 58: 10-Year Minus 2-Year Treasury



Source: FactSet

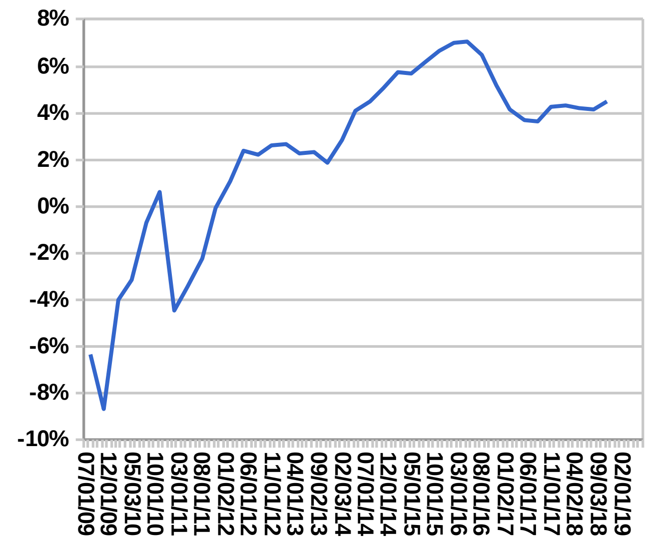
Liquidity and Other Indicators

Figure 59: Velocity of M2 Money Stock



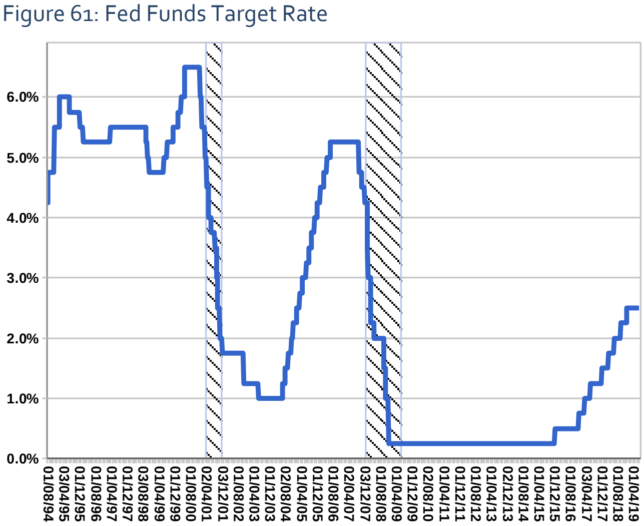
Source: FactSet

Figure 60: Loan Growth (Non-Financial, Private Sector)



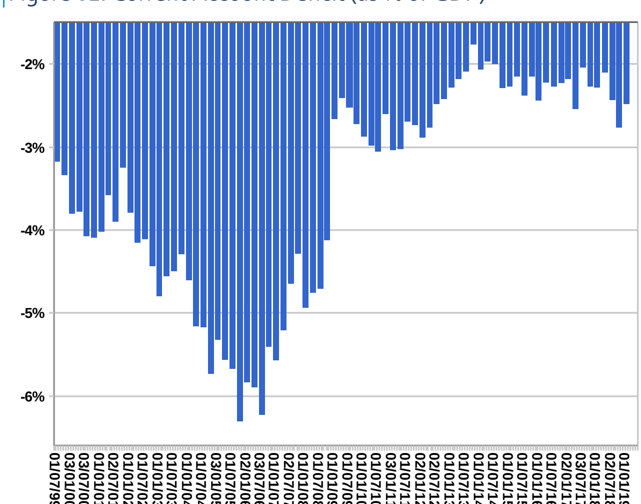
Source: FactSet

Figure 61: Fed Funds Target Rate



Source: St. Louis Federal Reserve, FRED Database

Figure 62: Current Account Deficit (as % of GDP)



Source: St. Louis Federal Reserve, FRED Database

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Appendix

Important Regulatory Disclosures and End Notes

Form ADV available upon request.

This quarterly is only for informational purposes and not a solicitation to buy or sell securities or as a source of specific investment, legal or tax recommendations.

Rockingstone Advisors is solely responsible for the content of this Quarterly. The information and statistical data contained herein have been obtained from sources we believe are reliable but cannot guarantee.

Rockingstone Advisors performance charts depict the mean aggregate return of all accounts invested with a similar objective and risk tolerance during the entire return period; individual account performance may materially differ according to strategy and portfolio composition. Returns are calculated using time-weighted method (TWM) and are weighted by portfolio assets. Returns can be influenced not only by the actual performance of the underlying portfolios, but by the mix (composition) of portfolios in any given year and the number of portfolios within the sample set. Public equity returns are calculated by Morningstar based on information received from our custodian(s). Other investment returns, including private equity and real estate investments are calculated based on valuation data from parties other than Rockingstone Advisors. Fixed income returns generated by private notes are recognized when the cash coupon is paid, rather than on an accrued interest basis (except for PiK securities). Annualized return is based on portfolios invested as of June 1, 2009. The sample set of portfolios within each annual cohort has increased over time and the mix changes every year. Our investment returns may reflect investment opportunities that are unavailable to all of our clients, for reasons including: (i) certain funds in which we have invested are now closed to new investors, (ii) certain clients may not meet "accredited investor" standards, (iii) certain investments are available only to officers or directors of a business, and /or (iv) we may believe that historical returns most likely will not be generated by a specific security or strategy and thus are no longer allocating new capital to a specific security or strategy. Past performance is neither indicative of-- nor a predictor of-- future performance. Mean reversion is a powerful force, meaning periods of outperformance are typically followed by periods of underperformance. All figures are net of fees and expenses. Rockingstone's performance must be assessed in light of not just how we performed relative to the benchmarks, but how much risk we assumed in generating portfolio returns.

Quarterly Data prices are as of June 30, 2019; most other prices and yields are as of July 23, 2019.

We are happy to provide the raw data and source links for any of the charts or tables in this Quarterly. We are also happy to provide individual account performance data by annual cohort or by IRR (instead of TWM) so you can better understand the range of portfolio returns. We thank you for your interest and always appreciate any feedback.

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[i] Asset class performance charts depict Equity (SPY ETF), Bonds (BND ETF), Commodities (DBC ETF), Preferred (PFF ETF) and Real Estate (VNQ ETF) price change plus dividends and interest during the selected period.

[ii] Rockingstone Advisors performance charts depict the mean aggregate return of all accounts invested with a similar objective and risk tolerance during the entire return period; individual account performance may materially differ according to strategy and portfolio composition. Returns are calculated using time-weighted method (TWM) and are weighted by portfolio assets. Returns can be influenced not only by the actual performance of the underlying portfolios, but by the mix of portfolios in any given year. Public equity returns are calculated by Morningstar based on information received from our custodian(s). Other investment returns, including private equity and real estate investments are calculated based on valuation data from parties other than Rockingstone Advisors. Fixed income returns generated by private notes are recognized when the cash coupon is paid, rather than on an accrued interest basis. Annualized return since inception is based on portfolios invested as of June 1, 2009. The sample set of portfolios within each annual cohort has increased over time. Our investment returns may reflect investment opportunities that are unavailable to all of our clients, for reasons including: (i) certain funds in which we have invested are now closed to new investors, (ii) certain clients may not meet "accredited investor" standards, (iii) certain investments are available only to officers or directors of a business, and /or (iv) we may believe that historical returns most likely will not be generated by a specific security or strategy and thus are no longer allocating new capital to a specific security or strategy. Past performance is not indicative or a predictor of future performance. Mean reversion is a powerful force, meaning periods of outperformance are typically followed by periods of underperformance. All figures are net of fees and expenses. Rockingstone's performance must be assessed in light of not just how we performed relative to the benchmarks, but how much risk we assumed in generating portfolio returns.

[iii] Equity performance charts depict U.S. large-cap (SPY ETF), U.S. mid-cap (VO ETF), U.S. small-cap (IWM ETF), International Developed (VEA ETF), and Emerging Markets (VWO ETF) price change plus dividends and interest during the selected period. We note that Vanguard highlighted a trading glitch in the shares of VO during March 31, 2015 that led to prices materially higher than underlying NAV. Hence you should assume VO's valuation and total return was inflated as of the end of the first quarter.

[iv] Fixed income performance charts depict Intermediate Government (IEF ETF), High Yield Corporates (JNK ETF), High Grade Corporates (LQD ETF), International Corporates (PICB), and Emerging Markets bonds (EMB ETF) price change plus interest income earned over the selected period.

[v] Commodity performance charts depict Precious Metals (DBP ETF), Base Metals (DBB ETF), Oil (DBO ETF), and Agriculture (DBA ETF) price change.

[vi] Our Five-Year Forecast is updated quarterly and reflects our best judgment on future performance based on current valuations relative to historical valuations, as well as our outlook for earnings and macroeconomic conditions. We caution that predicting outcomes is inherently risky and subject to change.