Investor Quarterly

Jogging in Place

ROCKINGSTONE ADVISORS LLC

Eroding Fundamentals, DC Hijinks, Solid Earnings Lead to Range-bound Market

While asset prices rebounded in 1H19, markets were decidedly more wary over ongoing trade and political disputes along with weaker global economic fundamentals in 3Q19. We find markets hard to navigate, given all the above combined with above-average valuation metrics. Indeed, US equity indices are largely unchanged since Jan 2018!

S&P500 Forecast & Other Key Indicators

We make the following adjustments to our forecasts: EPS (2019: $162 to $160, 2020: $174 to $171), S&P500 (3,105 to 3,075), GDP (unch = 1.6%), Gold (unch = $1,500), Oil (unch = $60), 10-yr US Bond Yield (2.2% to 1.8%), Inflation (unch= 1.5%), 5-yr expected CAGR (US Large Cap 3.7%, Developed 4.4%, Emerging 9.7%).

3Q19 in Review

Investors, except in defensive-oriented markets like fixed income, were largely disappointed in 3Q19. Global equities were caught between hopes around trade dispute resolutions vs. fears of weakening fundamental data. Versus a year ago, we emphasize most macro data has disappointed while valuation is unchanged.

Asset Class Performance (Total Return: 3Q19[i] and 9M19)

We note the following: S&P500 (+0.9% and +20.6%), Gold (+6.3% and +14.5%), Bonds (+2.3% and +8.2%), Commodities (-4.3% and +3.8%). The defensive tone of markets was notable in 3Q19 with gold and bonds significantly out-performing equities (especially non-US).

Rockingstone Performance

Our performance was flat in 3Q19 (0.1%) as struggles in small caps (ETM, RRR) offset good returns in defensives (EL, PEP) and other select names (APPN, CSTM, SPGI). We added to our AAPL, BRKB, GLD, KRE, VNQI stakes vs. selling MINI and RCL. Initiated positions in PHO and RYE. NRE was acquired. We now have a 10-year track record!

About Us

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

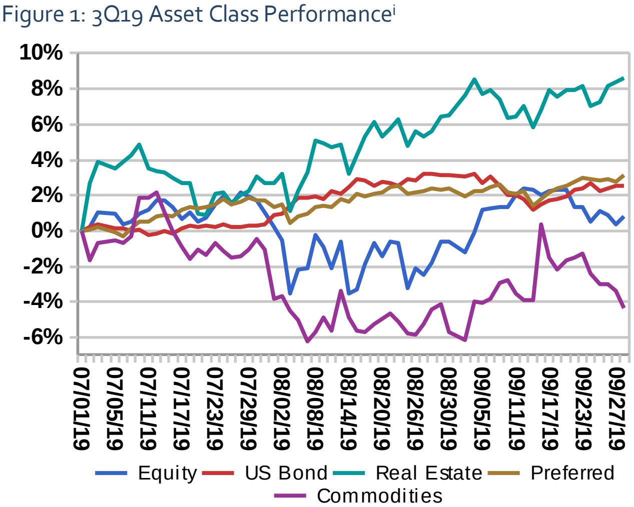
As an SEC-registered investment advisor, we provide multi-asset investment strategies to individuals, families and small institutions through separate accounts.

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:

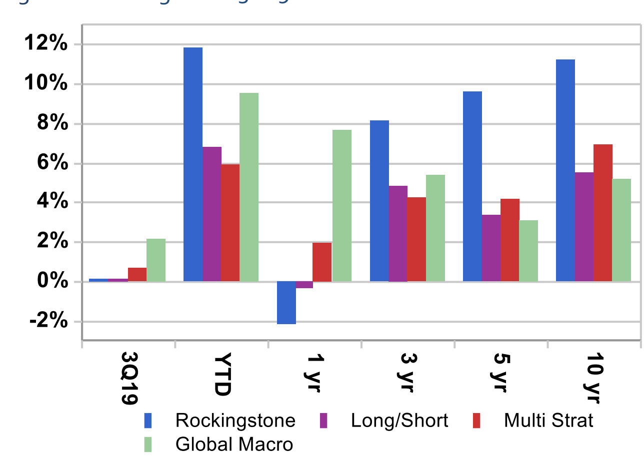
www.rockingstoneadvisors.com

Figure 1: 3Q19 Asset Class Performance[i]



Source: FactSet

Figure 2: Rockingstone: 3Q19 & Historical Returns[ii]



Source: Rockingstone Advisors, Morningstar, DJ Credit Suisse Indices

Please see our End Notes and Disclosures (pages 28-29 of this Investor Quarterly) for important information regarding performance measures. Form ADV available up

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Asset Class Performance Review

Overview: Jogging in Place

Most major US equity indices haven't moved much in nearly two years! This is likely a surprise to most investors given strong YTD performance across asset classes. But the stark reality is that after a run up in 2017, arguably a function of corporate earnings growth plus the fuel from tax reform, wealth creation in the form of equity gains hasn't occurred. Looking beyond the US, we also note that most other global markets have struggled even to hold onto their 2017 gains.

We believe the lackluster equity markets reflect a few related and intertwined factors. First, we have witnessed a cyclical slowdown that began in manufacturing-related industries that was fueled in part by (i) normal inventory de-stocking following a dramatic build in 2018 and in part by (ii) the lack of resolution of on-going trade disputes. Second, economic uncertainty coupled with political dysfunction in Washington DC and across Europe (notably Brexit) appears to have led businesses to postpone some capital investment decisions, adding to growth pressures. Third, slowing growth and disinflationary pressures out of China led to declines in inflation expectations, most notably in Europe, whose exports are more closely tied to China than the US, driving global yields lower and flattening the yield curve. These three negative factors have been partially offset by ongoing strength in the US consumer, where confidence and spending, fueled by plentiful jobs and solid wages, continues to be robust.

While the aforementioned economic trends have persisted for the last 12-18 months, there has been a notable and material shift in the mindset of the world's central banks. While initially the Fed was continuing to signal a tightening bias, when GDP growth decelerated from the mid 2% percent range to the mid 1% range and inflation expectations fell, the Fed pivoted, signaling future rate cuts, and perhaps more importantly, a cessation of their quantitative tightening (in this case, letting bonds mature from their balance sheet). The ECB also became more dovish, slashing its deposit rate to -0.5% and buying €20 billion in bonds in the open market each month, leading to negative yields across a quarter of all corporate bonds.

This shift in central bank posture was obviously well received by markets and has helped to buttress stocks from reacting too negatively to declining macro and micro fundamentals.

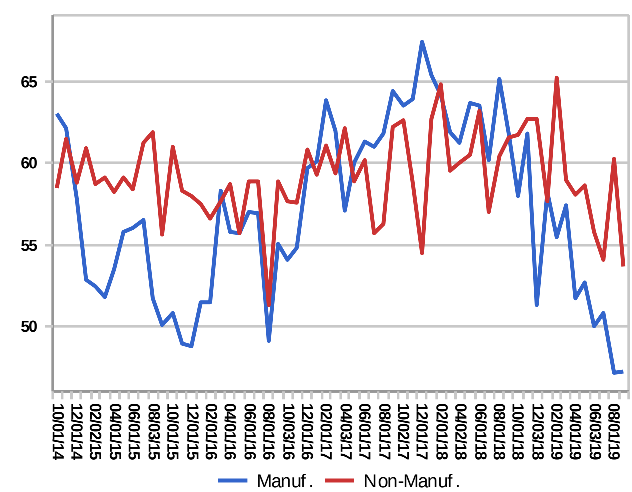
Hence this is the stalemate that investors are trying to navigate and the presence of which is evidenced in a range-bound equity market: on one hand deteriorating macroeconomic indicators are real and potentially problematic, but on the other hand the US consumer is reasonably solid and the prospect for easier money and a trade deal could very easily lead to a return in business confidence and renewed capital investment. This in turn would drive a cyclical and manufacturing recovery.

We believe this explains the Jekyll and Hyde nature of the financial markets: when trade accords seem close at hand, investors plow back into equities in the hope that a cyclical recovery will fuel higher earnings. Furthermore, growth / momentum-oriented equities tend to lead, with especially notable out-performance vs. value stocks. Bonds, especially Treasuries, trade off, with yields rising. High yield bonds trade higher with spreads tightening. Conversely, when trade disputes seem even further from resolution, investors flee equities for the safety of defensive investments like fixed income (Treasuries, high grade corporates), real estate and gold. We admit that trying to navigate the bi-polar nature of financial markets has been challenging, as moves have been "risk-on" or "risk-off" with very little focus on the underlying fundamentals of individual businesses or relative valuation across asset classes.

The Macroeconomic Environment Deteriorates across the Big 3…

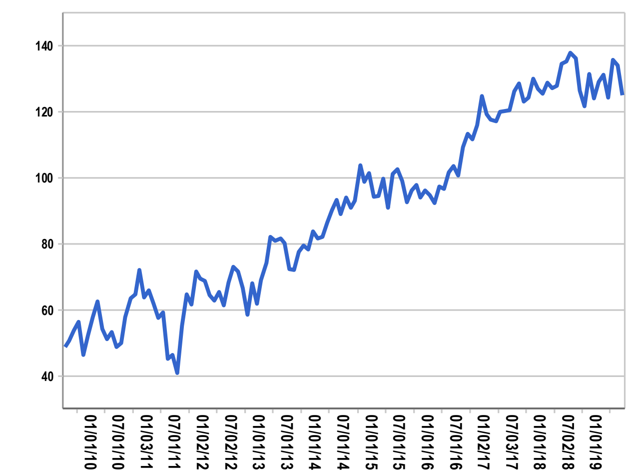
If we examine the three major economies (US, China and Europe) more closely, the data generally point to slower economic growth. Focusing on the US first, we emphasize that many data series, including the Index of Leading Economic Indicators, ISM New Orders (see Figure 3 below), and Industrial Production, exhibited weak signals during the 3Q19. Our business contacts also support the idea that global growth started to ebb after peaking in the summer of 2018. The good news is that most economic data suggests the slowdown hasn't accelerated. The Atlanta Fed's GDPNow shows the economy running at a pace of about 1.8%. As we noted above and show in Figure 4, another supporting factor is that US consumer confidence remains elevated, albeit below peak levels.

Figure 3: US ISM rolling over for the past year…



Source: FactSet

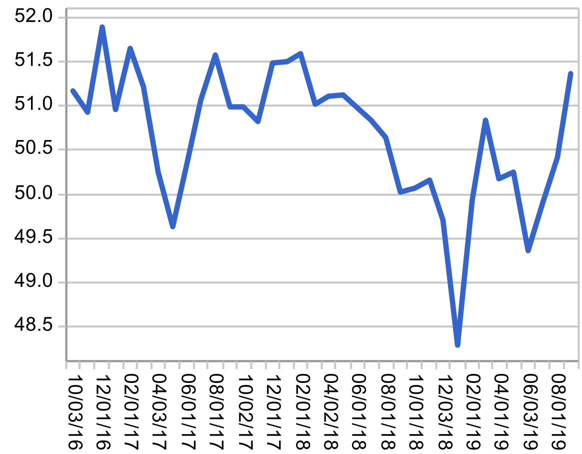
Figure 4: …and Consumer Confidence appears to have peaked



Source: University of Michigan

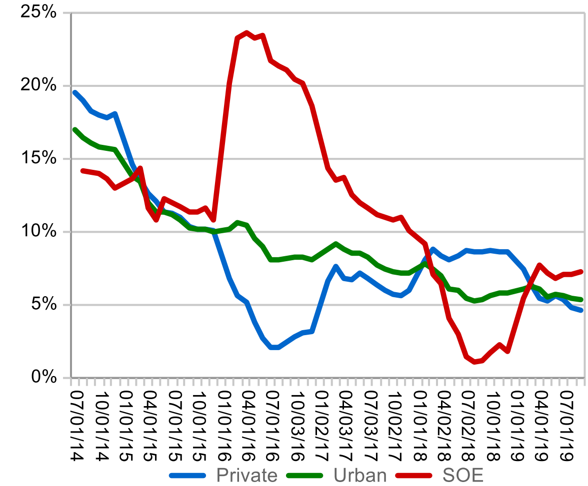
For much of the last decade since the global financial crisis, investors have looked to China as the world's growth engine. Every time it appears the global economy was slowing, China used its considerable capital surplus– and willingness to take on massive amounts of debt– to fund projects that boosted economic growth. Whether it was domestic stimulus or the more aggressive "Belt & Road" initiative, orchestrated spending moves have attempted to limit the trade war's impact on China's growth rate. While the world's second largest economy's GDP has slowed from 9% a decade ago, recent official figures of 6% indicate growth, although most private participants believe growth has slowed to the low single digits.

Figure 5: China Caixin PMI



Source: FactSet.

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



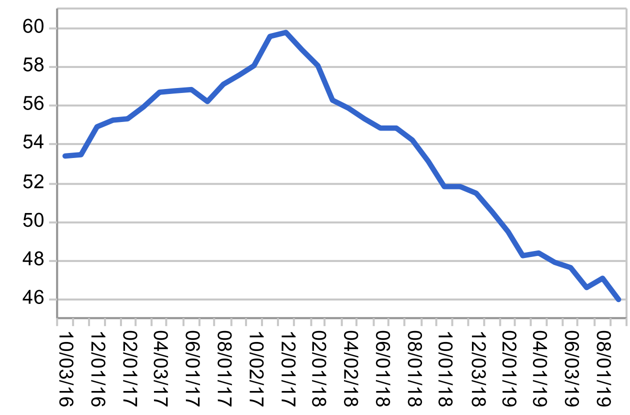
Source: FactSet.

But despite likely positive GDP growth, many problems exist for China. These challenges, in our view, include: (1) likely overstated GDP growth and understated debt problems, (2) long term demographic issues tied to the one-child policy, (3) risks around the transition from an export-led to a consumer-dependent economy, (4) less competitive labor rates vs. other developing countries, and (5) political risks, including Hong Kong.

Ultimately, we believe it is both in the US' and China's self-interest to find a resolution on trade, although admittedly the discussions around intellectual property are challenging. If or when a trade deal is completed, we could see a relief rally in Chinese stocks (our holdings are generally concentrated in the MCHI ETF as well as BABA). And it does appear that China's PMI has recovered of late which bodes well for continued growth in that market. Yet we recognize the above listed problems are worth monitoring and could limit the country's gains long term.

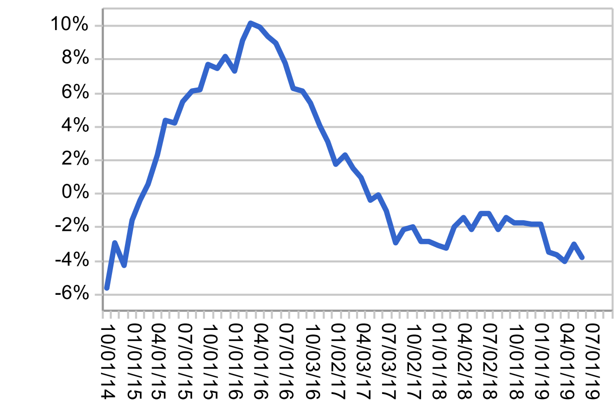
Moving to the EU, investors need not look beyond the negative interest rates for Germany to get a sense as to how the EU's economy is faring. As evidenced in Figure 7 on the next page, investors can see the continued decline in the region's manufacturing PMI. For an economy that is dependent on manufactured exports, especially to China, it is a worrisome development. Although the ECB had expected to be raising interest rates in late 2019 and into 2020, it is clear that more stimulus is necessary. Germany continues to be a critical economic linchpin for the EU and the large export driven economy has stagnated of late. Clearly with negative interest rates, the region's banks are also under significant pressure. Unfortunately, the EU has struggled with these dynamics since the global financial crisis. It is difficult to see how these headwinds abate near term along with the long-term challenges related to demographics and to its broken political structure in which a single currency ties together countries with disparate fiscal policies and divergently competitive economies.

Figure 7: European Union Manufacturing PMI



Source: FactSet.

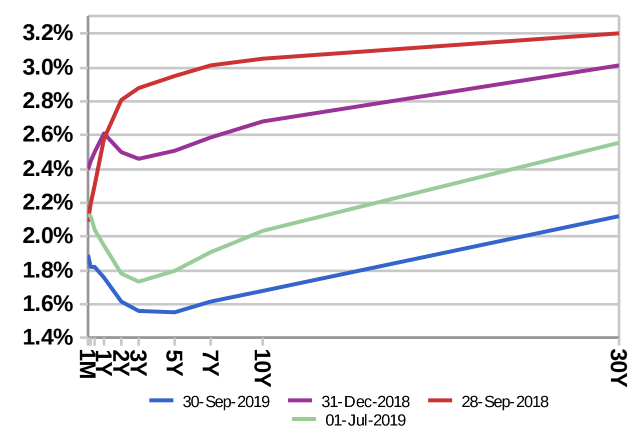
Figure 8: EU Industrial Production, % Chg. YoY



Source: FactSet.

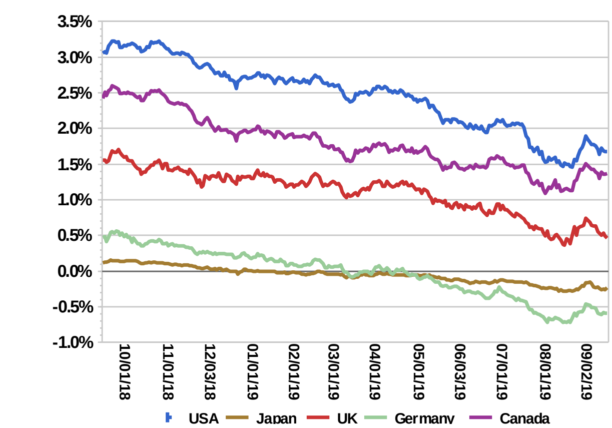
Global interest rates (see Figure 10) have steadily declined over the last year, although we admit to being surprised by the degree. Specifically, Germany and Japan sovereign yields are now firmly in negative territory. What are the factors behind negative interest rates for two of the globe's largest economies? We see a combination of investor recession fears, signs of deflation (particularly in Japan) and ECB / BOJ short term monetary policy as the main reasons.

Figure 9: U.S. Government Yield Curve



Source: Factset

Figure 10: Global Sovereign Yields

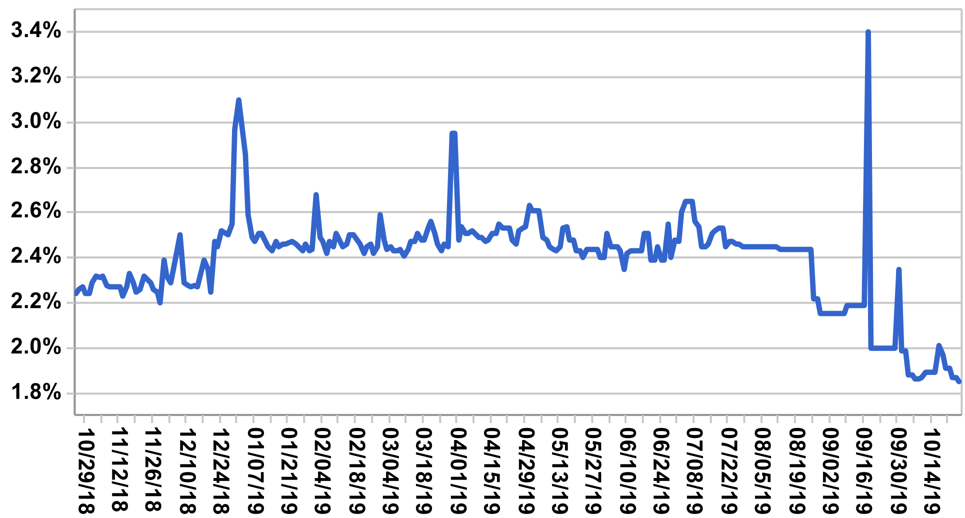


Source: Factset

Looking more closely at US government yields, it is worthwhile to note that rates have dropped vs. prior periods across the entire curve. In addition, a "kink" in the curve remains, i.e. very short-term rates remain above most of the curve, including out to the 10-year bond. Fortunately, to the extent one measures the curve's slope by subtracting the 2-year from the 10-year, a US recession appears less likely. As a reminder an inverted yield curve (the 10-year minus the 2-year results in negative basis points) almost always portends a coming recession, although the timing can be anywhere from six months to three years.

Chairman Powell has been in a difficult position since shortly after his taking over the role. The strained political environment has led to overt pressure on the Federal Reserve to lower interest rates. At the same time, fiscal stimulus is at record levels with seemingly no interest by either party to confront increasingly worrisome deficits, especially at this time of the cycle when the US ought to be running surpluses let alone deficits! Of course, the impact of tariff disputes and the uncertainty this engenders is also an issue the FOMC must consider. Entering 2019 the FOMC was expected to raise interest rates three times. At this point in the year, the Federal Reserve has lowered rates two times and a third decrease is expected in the coming month.

Figure 11: US REPO Rates

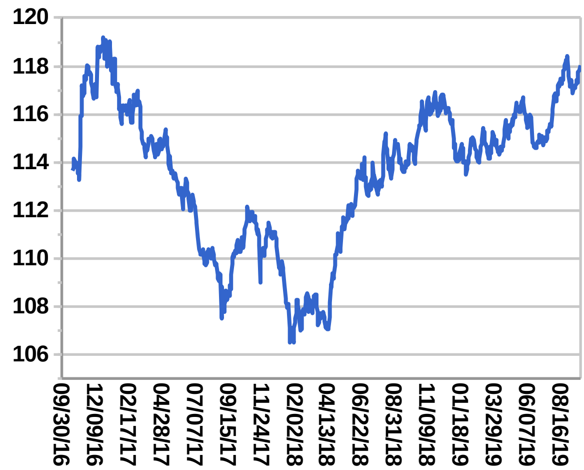


Source: FactSet

In the above graph we note the recent anomaly in the US repo market. While somewhat esoteric for most investors, the repo (short for repurchase agreement) market is an overnight collateralized interest-bearing funding tool largely used by banks and the Federal Reserve. On average each night lenders and borrowers exchange about $3 trillion of repos. The liquidity and rates associated with the repo market often has a direct impact on trillions of additional dollars lent and borrowed on other longer duration securities. That is why the anomaly in mid-September 2019 was important.

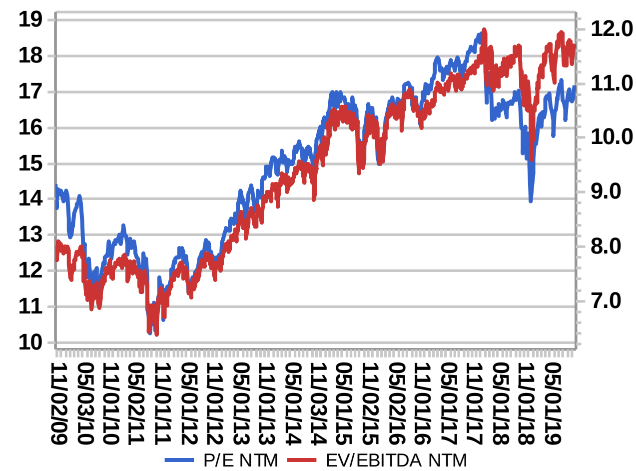
The Federal Reserve has targeted a 2% rate for the repo market of late, but the rate spiked to around 10% (intra-day) on Sept 17th. In reaction, the FOMC agreed dramatically to increase liquidity to the tune of $80+ billion in recent weeks, all the while Chairman Powell insisting this is not a new quantitative easing. Experts have suggested the timing of US government debt maturing and tax payments due led to a lack of dollar liquidity. While the repo market volatility has settled down so far in October, we nevertheless believe it important to focus on any hint of liquidity problems. Many market observers believe that significant declines in equity values are often signaled early by liquidity challenges, widening credit spreads and other discount rate issues.

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 major markets such as the EU, Japan and Latin America struggling, it isn't a surprise that relatively strong US GDP growth is helping support the $US. The Federal Reserve has lowered rates during 2019 but global sovereign yields have declined at a faster pace. The stronger $US combined with local slower growth has led non-US developed and emerging markets to under-perform the US (as measured by the S&P500).

Lastly, on valuation as measured by the S&P500, we note that forward P/E multiples have rebounded from the 4Q18 but are largely unchanged since the US tax cut went into effect in 2018. Without the distortion from the tax cut, we point out that forward EV/EBITDA multiples have not changed since mid to late 2017. In other words, approximately two years of corporate earnings have had no noticeable benefit to what investors are willing to pay for those profits.

Equity Performance

US Large Caps Outperform but Otherwise Mediocrity Rules

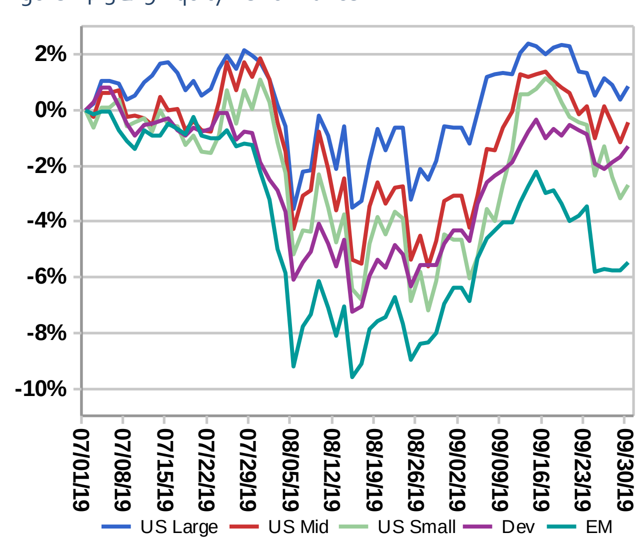
In the 3Q19, US large caps generated modest gains but other equity indices we measure all declined in value. We see the broad-based weakness in global equities as a function of poor macro-economic signals and uncertainty, despite a more accommodative Fed. Given such concerns, it would appear that investors are taking a somewhat barbell approach by owning US large cap equities and fixed income while avoiding most everything else!

As noted earlier, the reality is that most major indices (DJIA, S&P500, Russell 2000) were flat from early 2018 through the end of 3Q19. During this 21-month time period, investments characterized as "momentum" and "large cap" have out-performed "value" and "small cap." Indeed, some market watchers have summarized the current situation as one where the majority of investors have run to one side of the boat, which of course leads to concerns about capsizing.

At Rockingstone, we have tried to be more balanced which, in part, has led to some under-performance in 2019. We note that in early September the S&P500 experienced one of its most dramatic rotations, with "growth" investments weakening while "value" surged ahead. With hindsight it still isn't clear if this was just a short-term reversion to the valuation mean or if investors believe value is simply too cheap to ignore.

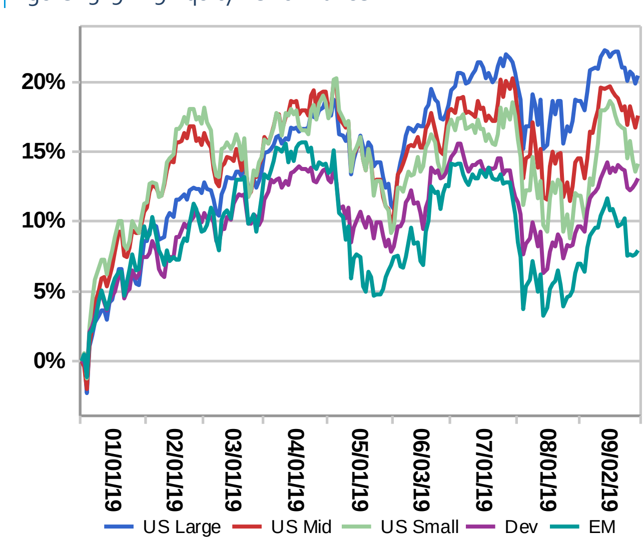
We highlight the following performance metrics regarding 3Q19 and 9M19 results: US Large Cap (+0.9% and +20.5%), US Mid Cap (-0.4% and +17.6%), US Small Cap (-2.7% and +14.1%), Developed (-1.3% and +13.2%), Emerging (-5.5% and +7.8%).

Figure 14: 3Q19 Equity Performance [iii]



Source: FactSet

Figure 15: 9M19 Equity Performance



Source: FactSet

Fixed Income Performance

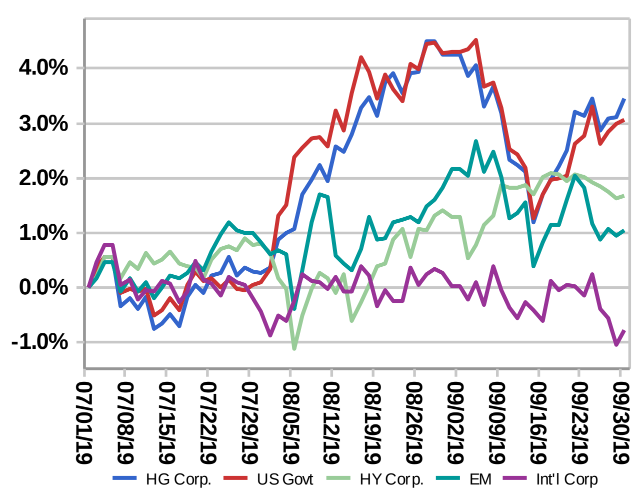
Fixed Income…Strange Days

With the exception of non-US corporate bonds, fixed income generally out-performed equities in 3Q19 and thus continued the strong 1H19 performance, especially on a risk-adjusted basis. Typically, interest rates (i.e. the cost of money) move upward with macro-economic growth and inflation. But with most economic series pointing to slower global growth of late, yields declined across most of the world. At the same time, nervousness led to such "blind-buying" of fixed income investments to the point where market participants wondered if even US yields would turn negative!

In mid-September in a more obscure part of the fixed income market, the Repo market (see Page 7), it is fair to say the Fed was surprised as overnight liquidity became a significant problem. In short, the Fed's move to reduce its balance sheet (which was expanded in 2009 during the GFC) the last few years perhaps resulted in insufficient liquidity such that repo yields jumped to a disconcerting 9% intra-day (vs. the Fed target of 2.0-2.25%). Although Chairman Powell had announced the suspension of the balance sheet reduction program earlier in the year, the Fed acted quickly in September to boost liquidity in the amount of $50+ billion. This action appears to have calmed the markets for the moment but requires watching as many equity market downdrafts often start due to a lack of liquidity.

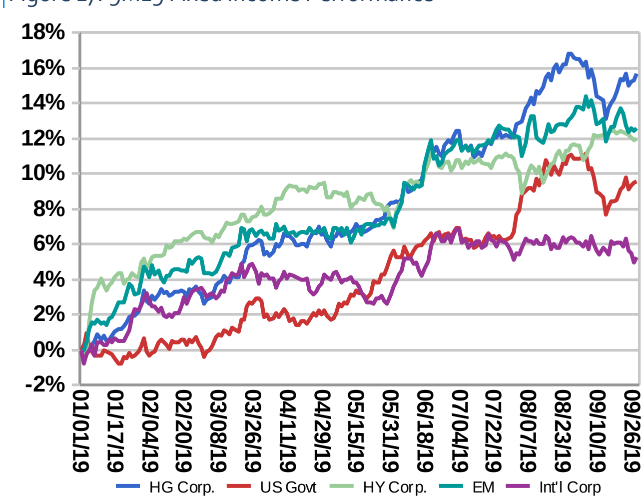
We note the following performance figures for 3Q19 and 9M19: US High Grades (+3.5% and +15.7%), US Governments (+3.0% and +9.6%), US High Yield (+1.7% and +12.2%), International Corporates (-0.8% and +5.3%), Emerging Markets (+1.1% and +12.6%).

Figure 16: 3Q19 Fixed Income Performance[iv]



Source: FactSet

Figure 17: 9M19 Fixed Income Performance



Source: FactSet

Commodity Performance

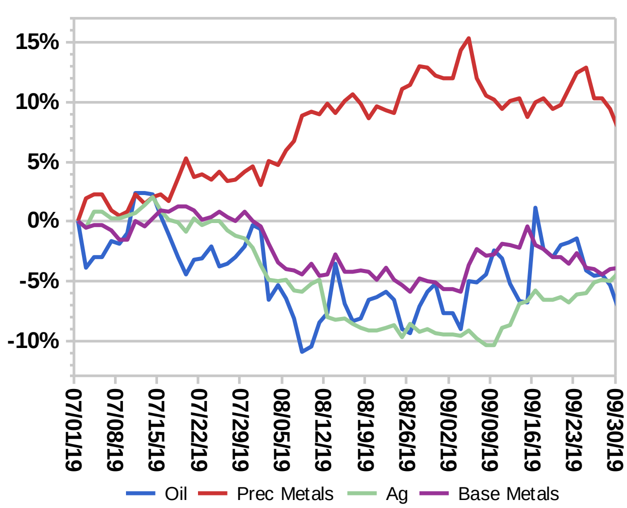
Most Commodities Point to Slower Growth

Although individual commodities often have specific supply and demand influences, it is fair to say the overall commodity complex, and especially base metals and the energy complex, can be viewed as a leading or coincident reflection on global growth. To the extent other macroeconomic data series pointed to lower growth prospects in 3Q19, so too did commodities. We note that oil, agriculture and base metals all weakened over the summer. On the other hand, precious metals surged, especially gold. We see the jump in precious metals as another reflection of investor defensiveness and concerns, as investors flock to gold when fears of potential debasement of fiat currency take hold.

But as we emphasized in past newsletters, it is difficult to draw conclusions from commodity prices at any given time. Most assets can be valued by discounting future cash flows. Yet assets like gold or copper don't generate any intrinsic cash flow and thus calculating what is the correct, intrinsic value is a challenge. 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.

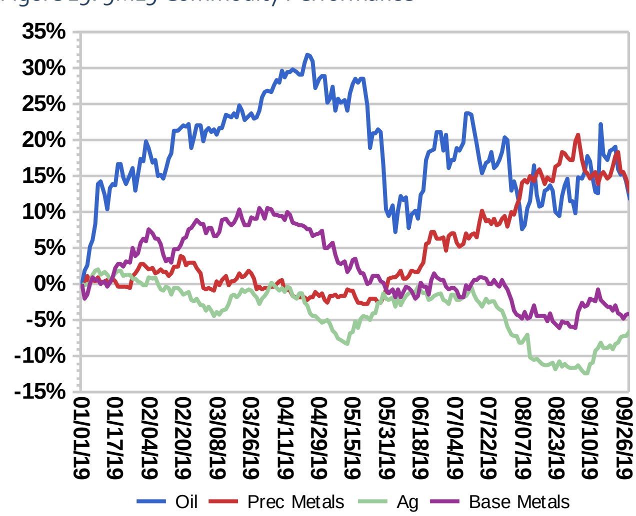
We point to the following returns during the 3Q19 and 9M19, respectively: Oil (-7.6% and +12.6%), Precious Metals (+7.5% and +12.7%), Agriculture (-5.0% and -6.4%), Base Metals (-3.8% and -4.0%).

Figure 18: 3Q19 Commodity Performance[v]



Source: FactSet

Figure 19: 9M19 Commodity Performance



Source: FactSet

ROCKINGSTONE ADVISORS LLC

Forecast: 2019 & 2020

Rockingstone Advisors: Our 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. US Consumer spending has been the lone bright spot of economic activity, and as noted earlier, US consumer confidence continues to be solid (albeit a bit weaker of late) given low unemployment. But as noted previously, 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 1H19 results and early indications for 3Q19 EPS, we trim our S&P 500 forecast to $162 from $160, while the consensus forecast, which was originally $176 at the time we published our *4Q18 Investor Quarterly*, has now come down to $160. Our current estimate implies about 5.5% EPS growth in 2019, in line with the Street. 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 (up just 1.6%). Another important consideration is that companies continue to repurchase their shares, so flat net income translates to positive EPS growth. For instance, roughly 80% of companies within the S&P 500 have 4% fewer shares outstanding in 3Q19 than 3Q18, creating a nice tailwind for earnings per share.

Operating earnings expectations for 3Q19 are down about 2.6% year over year ($40.31 vs. $41.38), while reported earnings expectations are flat ($36.57 vs. $36.36). That said, given our previous point about the impact of share repurchases and their tailwind, EPS growth of below say 3.2% would roughly imply YoY net income declines.

Margins for the third quarter are forecast to be down year over year from 12.13% in 3Q18 to 11.49% in 3Q19. Notably, this is the fourth consecutive quarter of YoY margin declines that began in 4Q18 (10.10% vs. 10.27%) and continued through 1H19, in which 1Q19 margins declined (11.21% vs. 11.40%) and 2Q19 margins declined (11.55 vs. 11.41%).

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	$160 / $160
S&P 500 2020 EPS (RSA/Street)	NA	$171 / $178
S&P 500 2019 Index	3000-3200	3075
10-Yr US Treasury Yield	1.7% - 1.9%	1.8%
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. GDP: We maintain our GDP forecast at 1.6%. Last quarter we reduced our 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 3028, or approximately 18.9x our 2019 EPS forecast of $160 and 17.7x our revised 2020 EPS forecast of $171. Based on our revised 2020 EPS forecast of $171, we estimate the Index should trade up to around 3075 by the end of this year (implying 1.5% appreciation over the next few months, and total 2019 appreciation of around 26%).

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 and central banks continue easing. While rates have recently backed-up, we see the 10-year at about 1.8% by year end.

4. Oil. The entire energy complex continues to see price pressure, although lower inventory levels and recent events in the Middle East 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, unchanged from last quarter.

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 unchanged at $1500/oz.

6. Inflation. Inflation expectations as measured by the 5-year, 5-year forward futures points 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%.

ROCKINGSTONE ADVISORS LLC

Five Year Asset Value Forecast[vi]

Balanced Expectations from Current Levels given Rise in Asset Prices

One of our main assumptions regarding capital markets is that 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	3.7%	=	5.6%	-	2.2%	+	2.1%	-	1.8%
US Mid Cap Stock	S&P400	6.9%	=	5.6%	-	0.0%	+	1.9%	-	0.5%
US Small Cap Stock	S&P600	7.7%	=	5.7%	+	2.0%	+	2.0%	-	2.0%
Foreign DM Stock	MSCI-EAFE	4.4%	=	2.9%	-	0.7%	+	3.4%	-	1.2%
Foreign EM Stock	MSCI-EM	9.7%	=	5.8%	+	1.9%	+	3.2%	-	1.1%

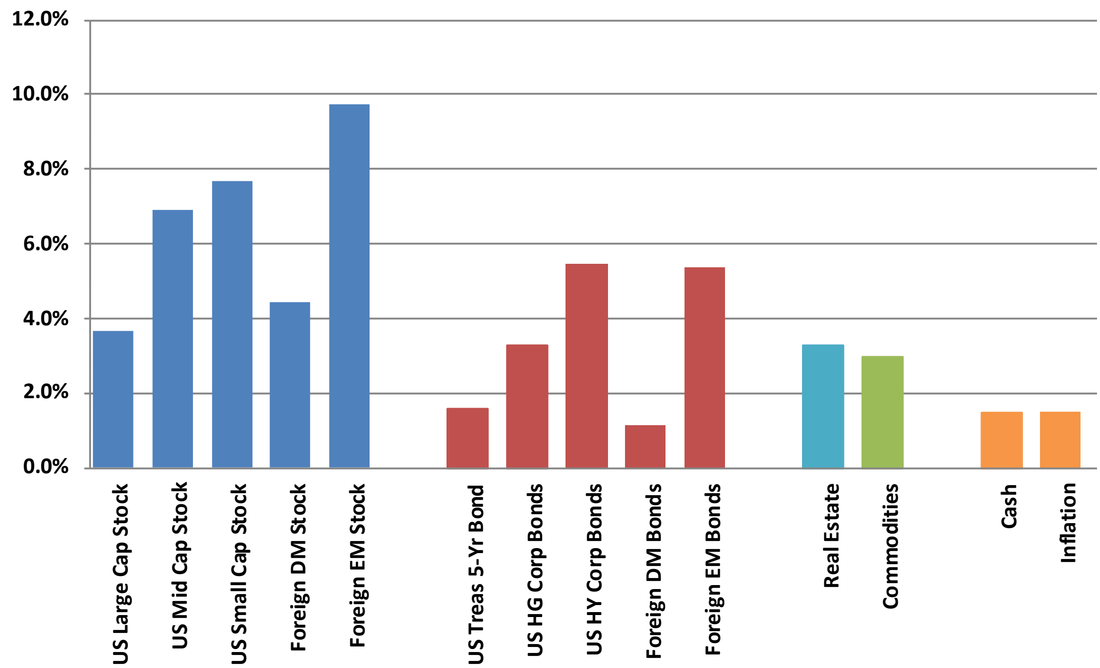
Source: Rockingstone Advisors

We analyze equities using four 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. 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

We remain disappointed and frustrated that some of our individual stock picks have under-performed recently. Taking a step back, the market has been very challenging for most small-cap and/or companies with high leverage. For example, the Russell 2000 is down 9% over the last year (end Sept 2019) while the S&P500 was up 1% over the same time period. Given the consensus' move away from small caps, we shouldn't be too surprised that Entercom (ETM) and Red Rock Resorts (RRR) fell sharply.

At the same time healthcare policy concerns hurt our position in Anthem (ANTM) while global growth concerns limited Royal Caribbean (RCL). But we enjoyed good performance from a number of stocks including: Alphabet (GOOGL), Apple (AAPL), Appian (APPN), Constellium (CSTM), CostCo (COST), Estee Lauder (EL), JP Morgan (JPM), PepsiCo (PEP).

Our top ten largest individual holdings (in order), as of early October, include: S&P Global (SPGI), McCormick (MKC), Estee Lauder (EL), Apple (AAPL), Boeing (BA), Constellium (CSTM), Berkshire Hathaway (BRKB), Intuitive Surgical (ISRG), Appian (APPN), PepsiCo (PEP). We made a number of changes to both our holdings in ETFs as well as individual stocks during 3Q19 including:

1. <u>Exchange Traded Funds</u>: With global growth a concern, we decided to get more defensive and acquired shares in the main gold ETF (GLD). We also believed the valuation of regional banks was too low and thus purchased shares in the main regional bank ETF (KRE). One of our stock holdings, Northstar Realty Europe (NRE) was acquired and we replaced it with the broad-based international real estate ETF (VNQI). Meanwhile we decided to reduce our exposure in small cap ETFs and thus eliminated VB with the understanding our small cap individual stock holdings was sufficient.

2. <u>Individual Equities</u>: Early in the quarter we sold our holdings in Royal Caribbean (RCL) based on global growth concerns and the potential impact of increased industry capacity in 2020. After 2Q19 earnings results were released in the summer, we added to existing positions in Entercom (ETM) and Red Rock Resorts (RRR). In terms of new positions and with an eye towards a potential rebound in value-oriented stocks, we acquired shares in Berkshire Hathaway (BRKB). While some accounts had ownership in Apple (AAPL), we decided to make this a more broadly held stock seeing valuation too low for the tech industry leader.

Fixed Income

We noted earlier in this newsletter that fixed income has been in a bull market, yet this perplexes us. Investors around the globe and notably in Germany and Japan are essentially, via negative rates, paying their governments to hold on to their funds in the form of bonds. Even in the US, where GDP has been relatively strong vs. other countries, fears of negative rates emerged in 3Q19. Generally speaking, we see bonds as expensive.

Our slight under-weight position in fixed income for separate accounts with a "balanced" benchmark unfortunately detracted from performance. As noted in our last newsletter, 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).

We have maintained our short position in international bonds (for those accounts that allow short positions) via the BNDX ETF. The ETF is hedged for currency so it essentially questions whether non-US interest rates can remain so low. Granted, with fears over slower global growth, non-US yields have plummeted and our BNDX short has under-performed. But we remain confident in the thesis long term and it has been an effective funding mechanism for higher-yielding US securities.

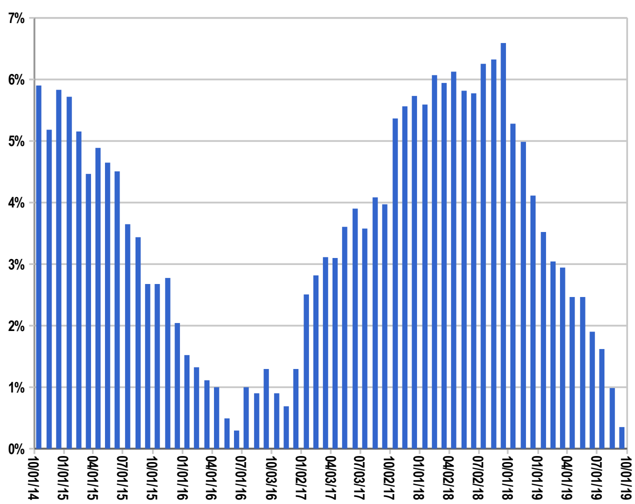
Commodities

As noted previously, we added gold to most portfolios via the ETF (GLD). We had been under-weight commodities seeing minimal inflation on the horizon. Indeed this has been the right approach with most commodities significantly under-performing. Yet gold prices tend to react to a combination of inflation concerns as well as a safe haven. It was the latter reason that spurred us to add GLD to our holdings. As a reminder we also use GLDI, an ETF where gold is being used as an inflation hedge that also includes yield via covered call writing.

Chart Book

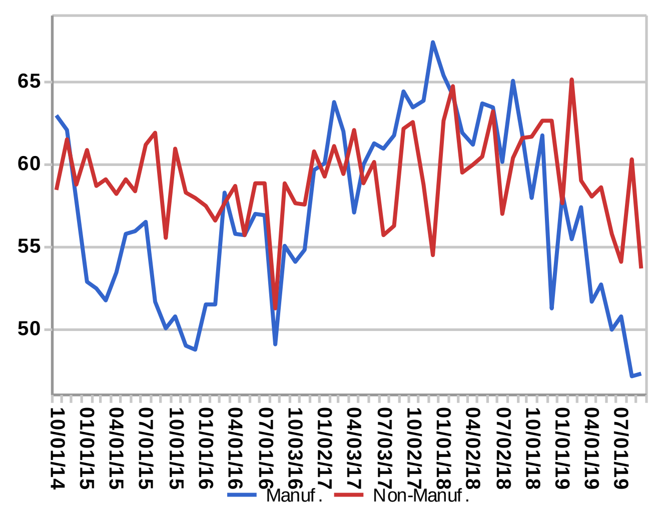
Leading Indicators

Figure 23: Index of Leading Economic Indicators



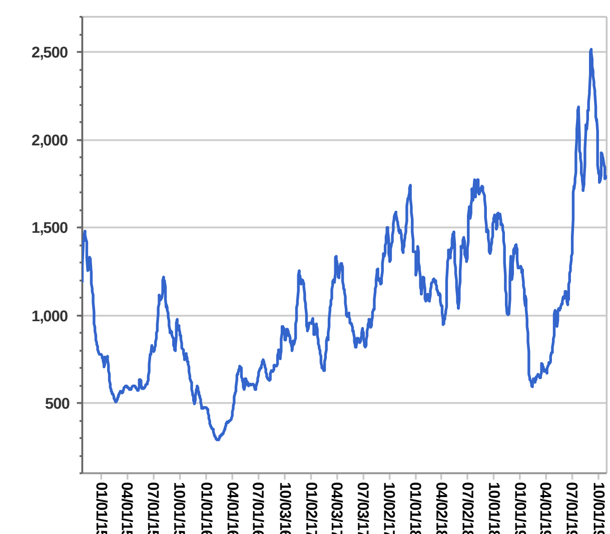
Source: FactSet

Figure 24: ISM New Orders



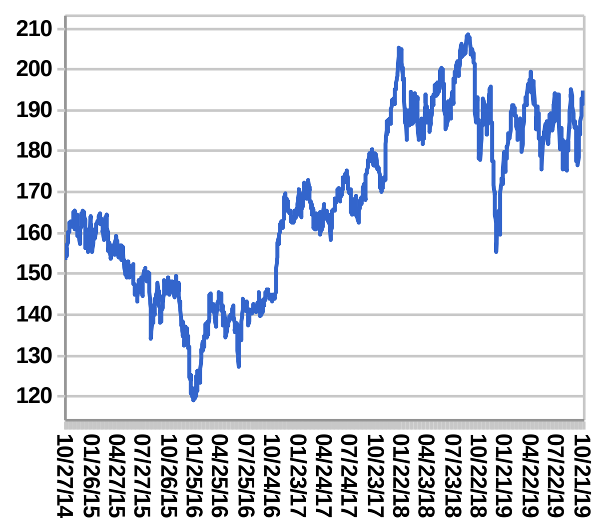
Source: St. Louis Federal Reserve, FRED Database

Figure 25: Baltic Freight Index



Source: FactSet

Figure 26: DJ Transports



Source: FactSet

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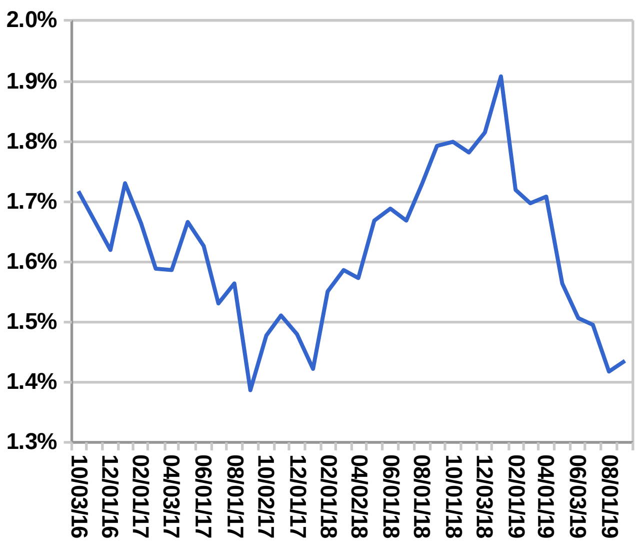
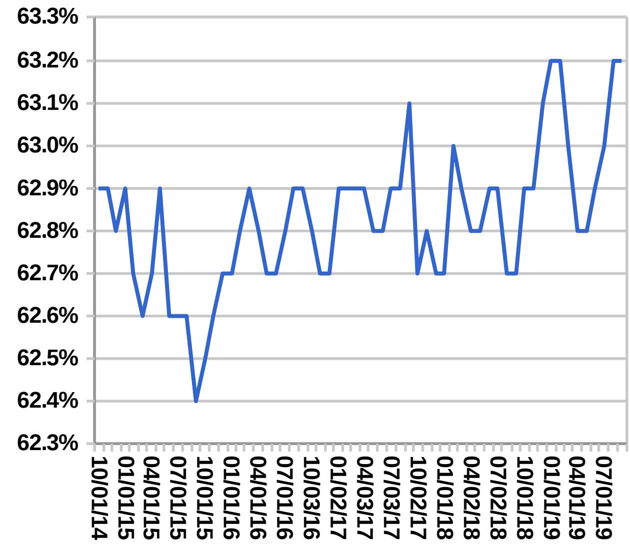
Labor Market Indicators

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



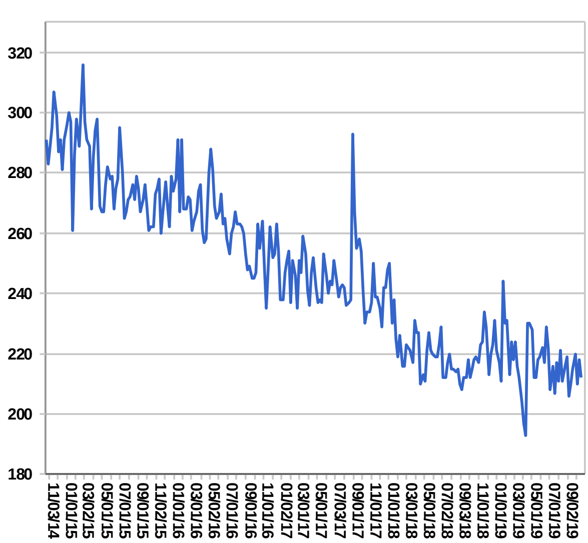
Source: FactSet

Figure 28: Labor Participation Rate (% of Workforce)



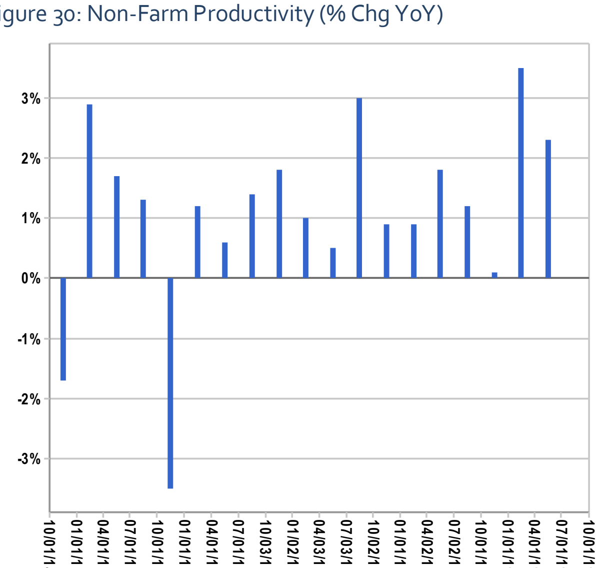
Source: FactSet

Figure 29: Initial Unemployment Claims



Source: FactSet

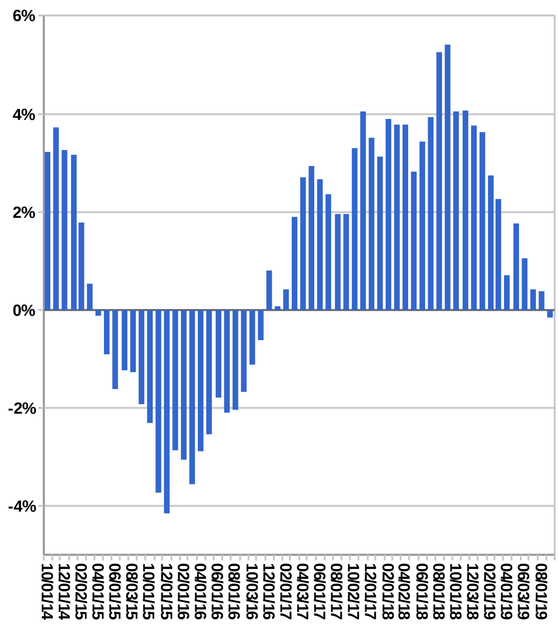
Figure 30: Non-Farm Productivity (% Chg YoY)



Source: FactSet

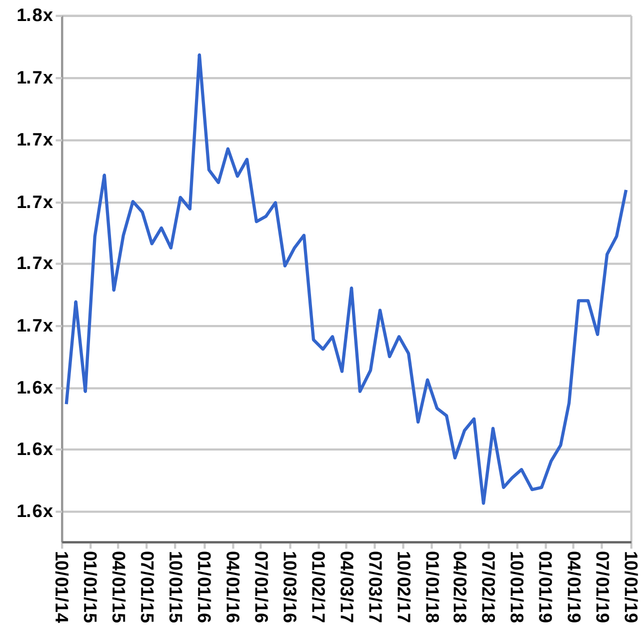
Production and Business Activity Indicators

Figure 31: Industrial Production (% Chg YoY)



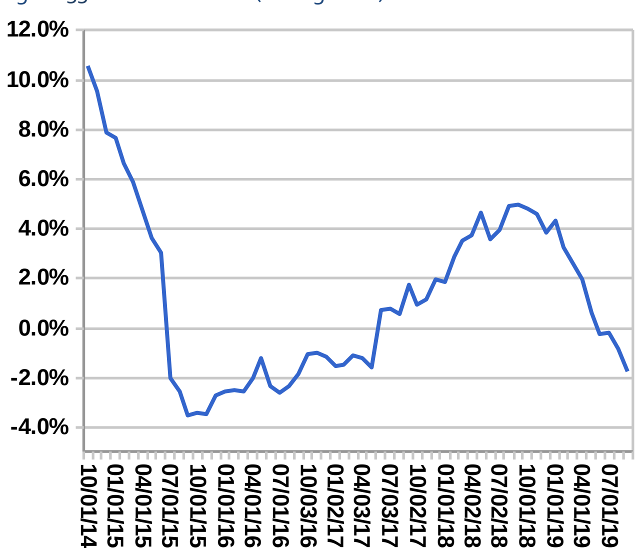
Source: FactSet

Figure 32: US Inventory to Shipment Ratio



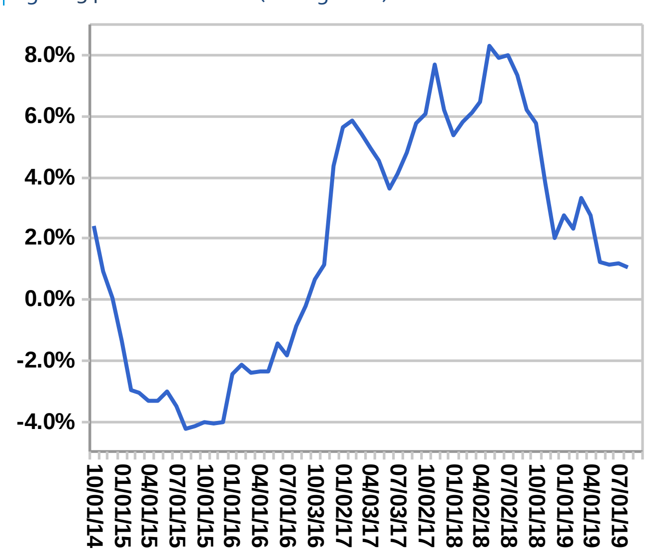
Source: FactSet

Figure 33: Unfilled Orders (% Chg. YoY)



Source: FactSet

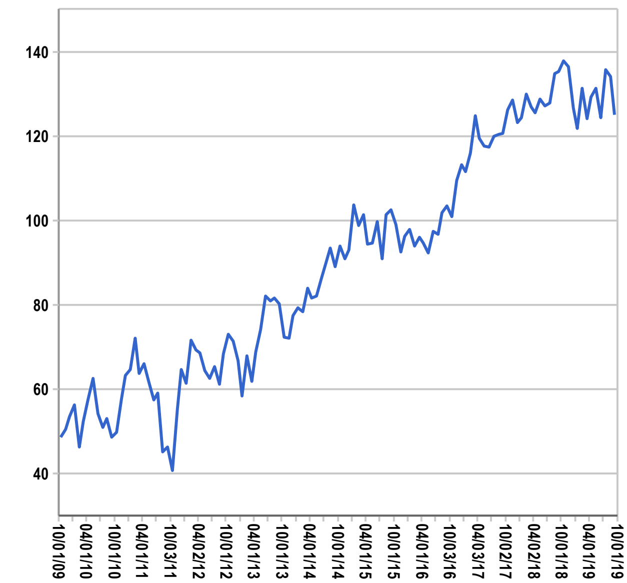
Figure 34: Business Sales (% Chg. YoY)



Source: FactSet

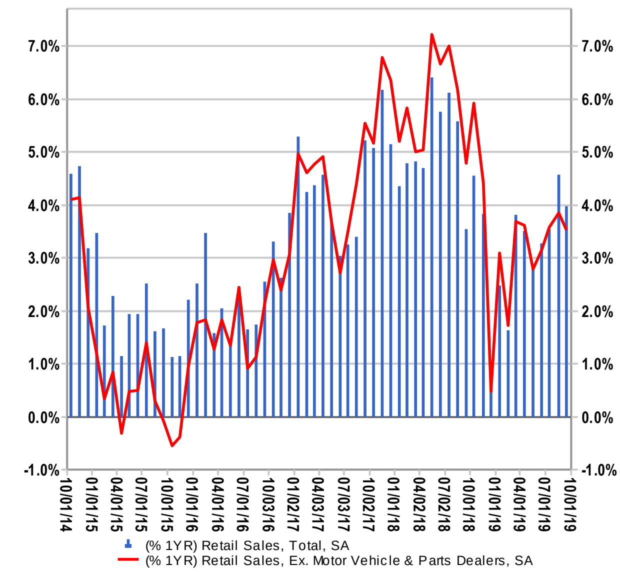
Consumer and Household Activity Indicators

Figure 35: University of Michigan Consumer Sentiment



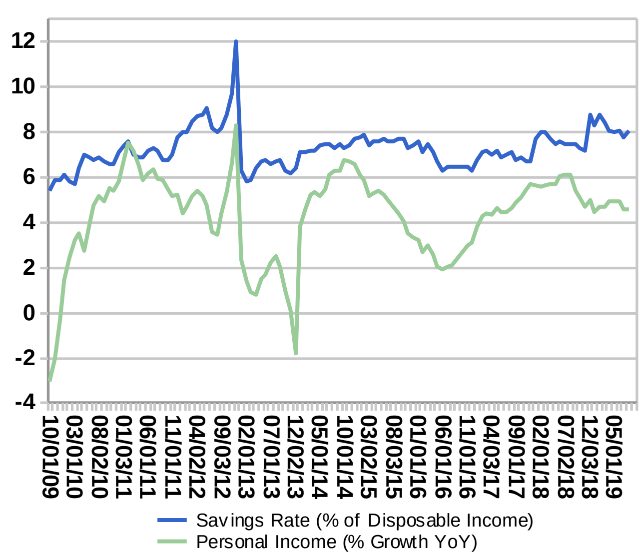
Source: FactSet

Figure 36: Retail Sales



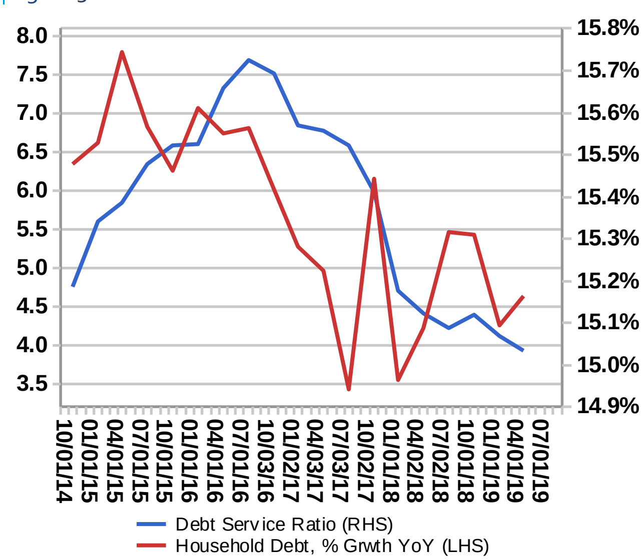
Source: FactSet

Figure 37: Personal Income and Savings Rate



Source: FactSet

Figure 38: Household Debt



Source: FactSet

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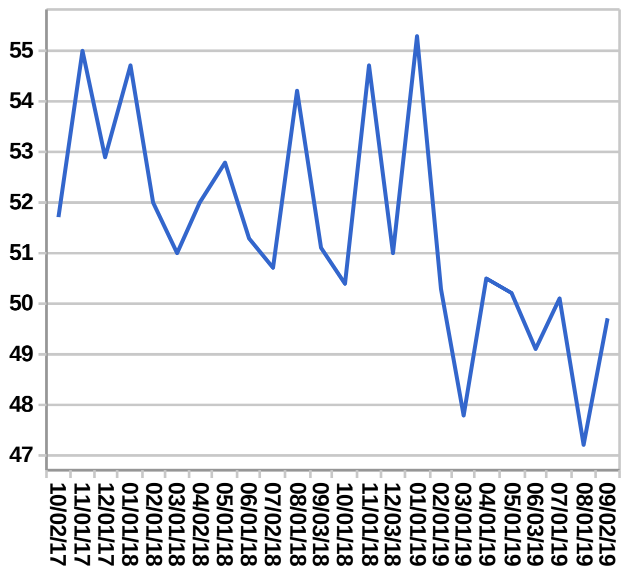
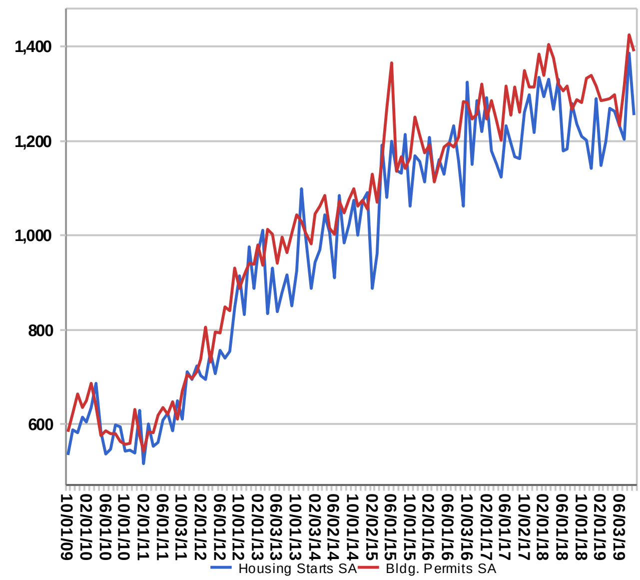
Housing and Construction Indicators

Figure 39: Architecture Billings Index



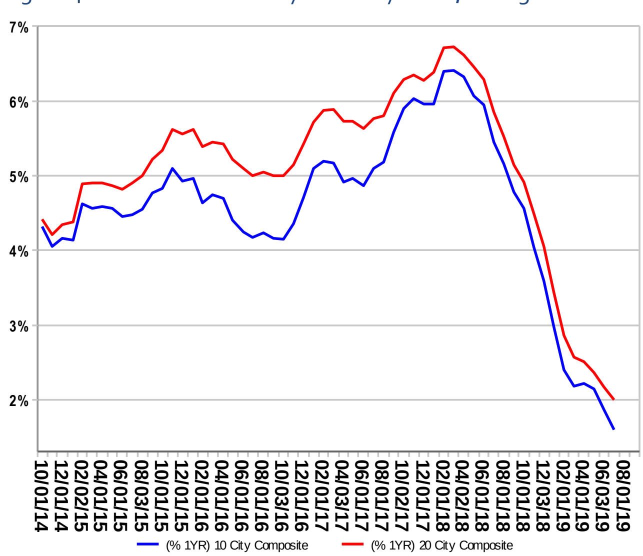
Source: FactSet

Figure 40: Housing Starts and Building Permits



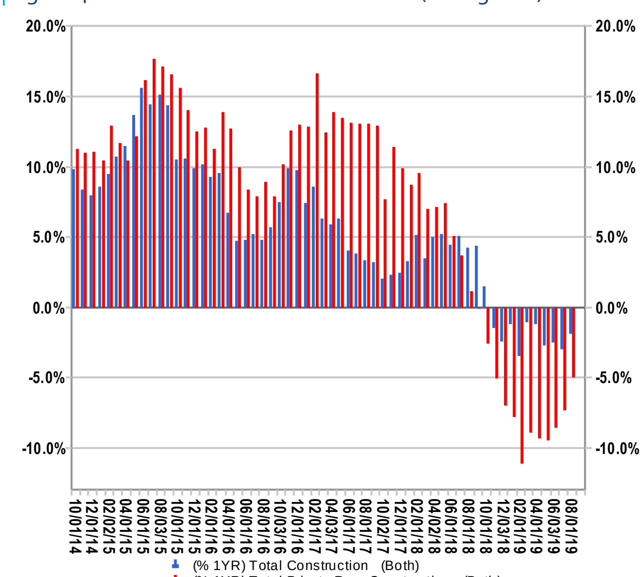
Source: FactSet

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



Source: FactSet

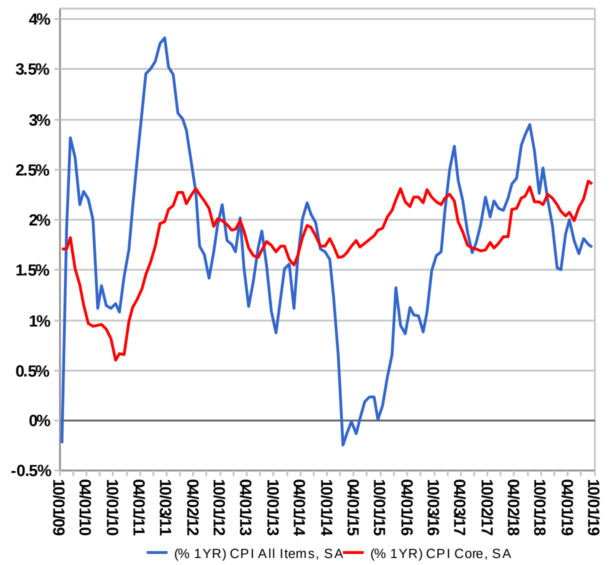
Figure 42: Private and Total Construction (% Chg YoY)



Source: FactSet

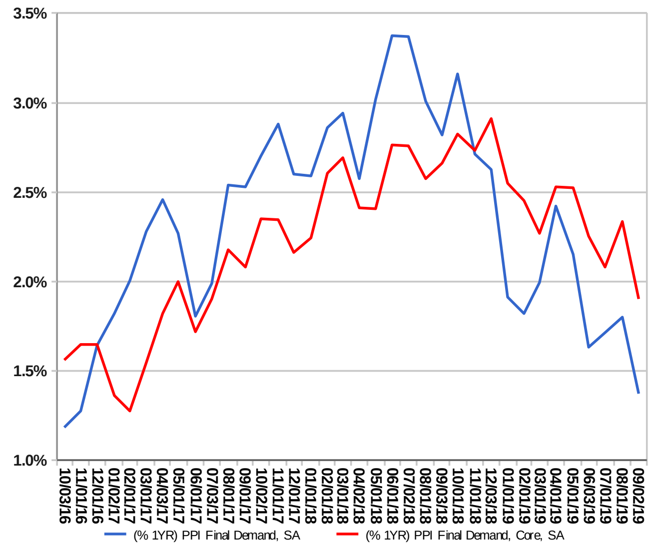
Price Indicators

Figure 43: Consumer Price Index



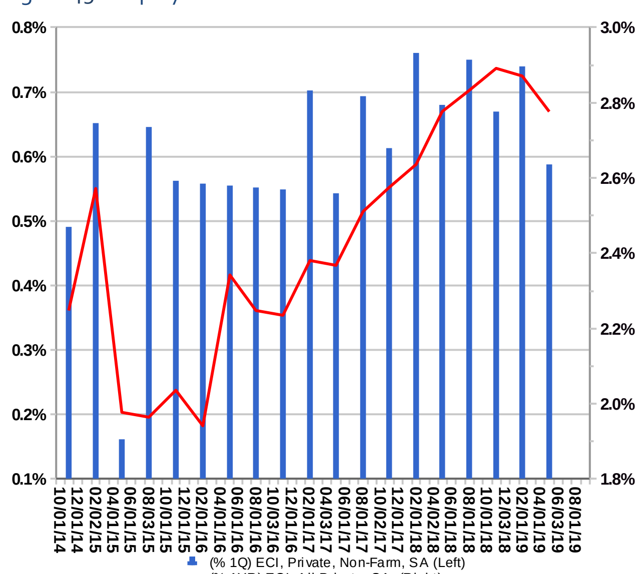
Source: FactSet

Figure 44: Producer Price Index



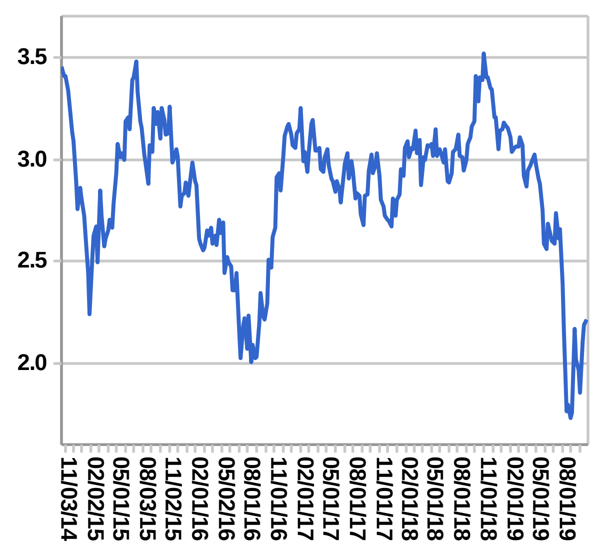
Source: FactSet

Figure 45: Employment Cost Index



Source: FactSet

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



Source: FactSet

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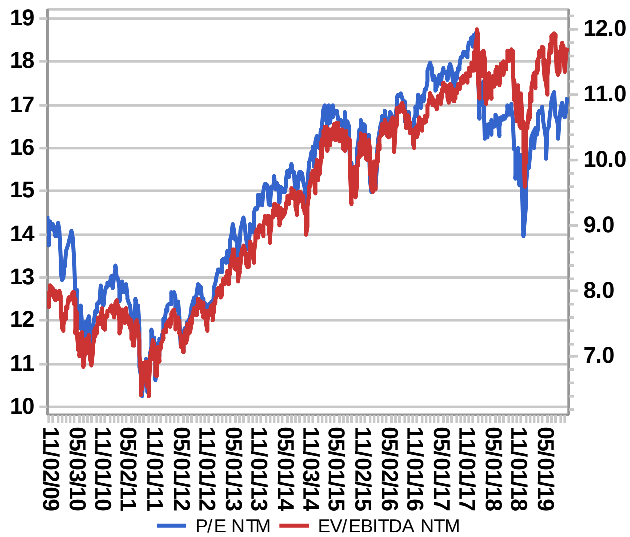
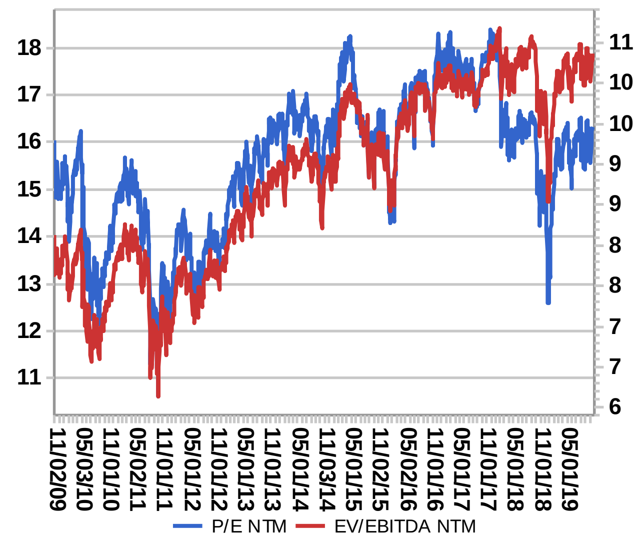
Valuation Indicators

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



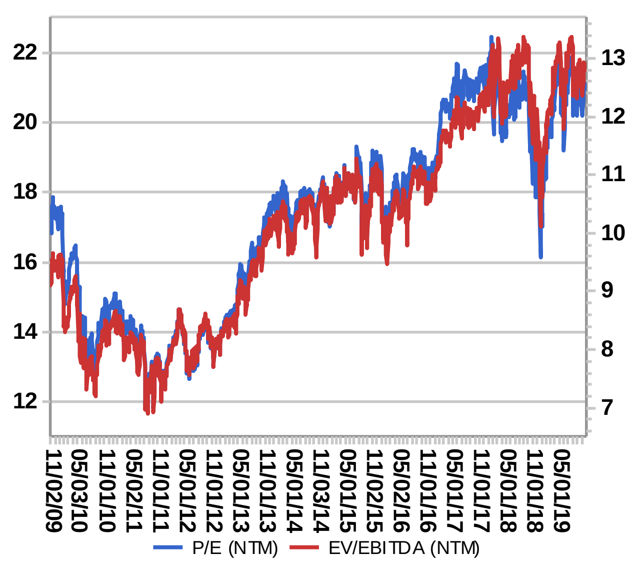
Source: FactSet

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



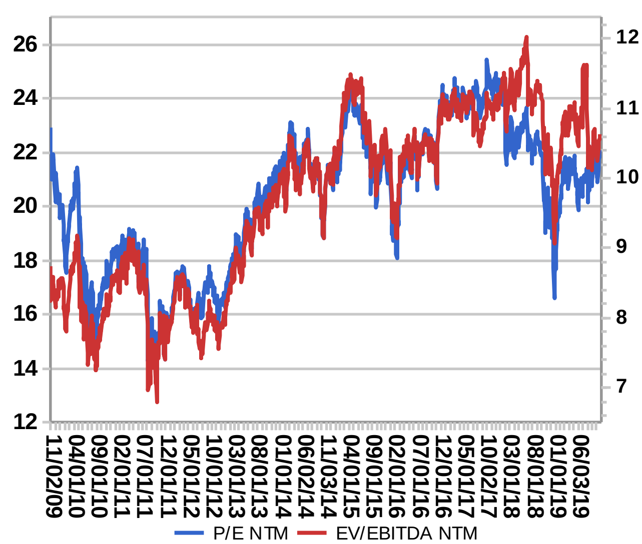
Source: FactSet

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



Source: St. Louis Federal Reserve, FRED Database

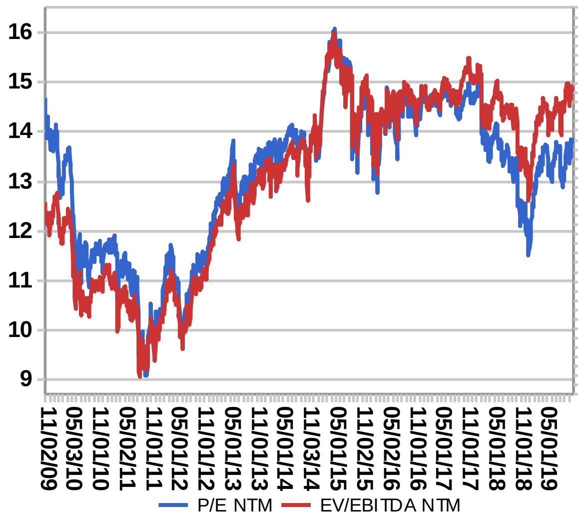
Figure 50: Russell 2000 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

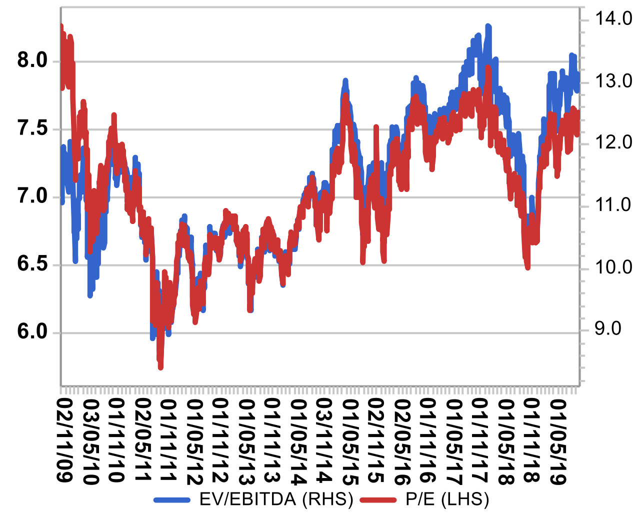
Valuation and Volatility Indicators

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



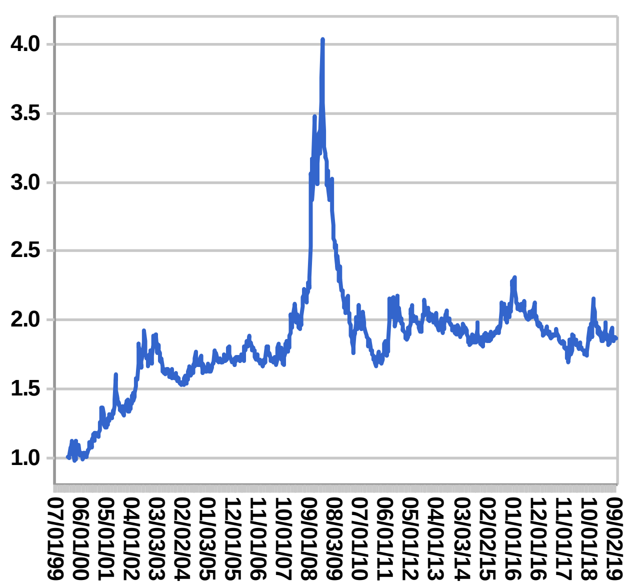
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

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



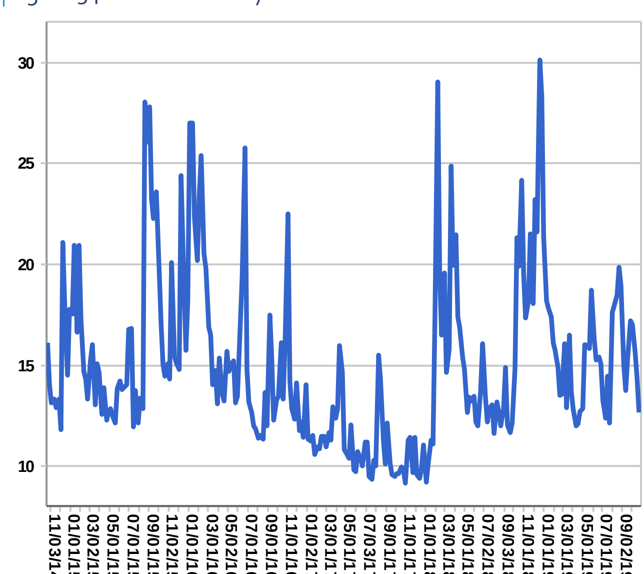
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 53: S&P 500 Dividend Yield



Source: FactSet

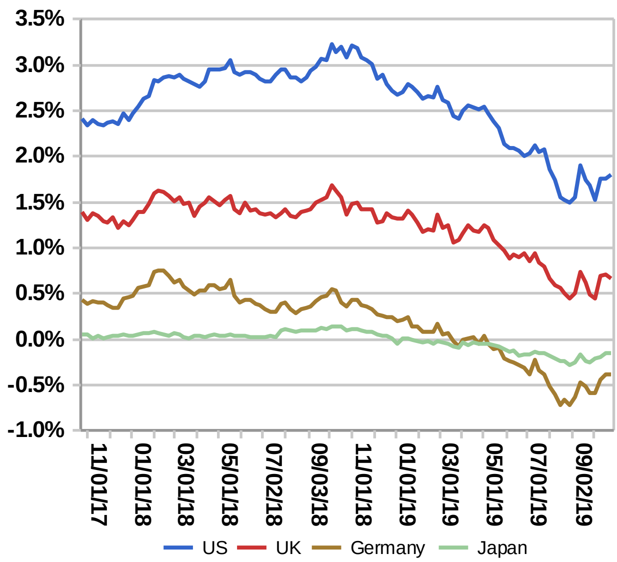
Figure 54: CBOE Volatility Index



Source: FactSet

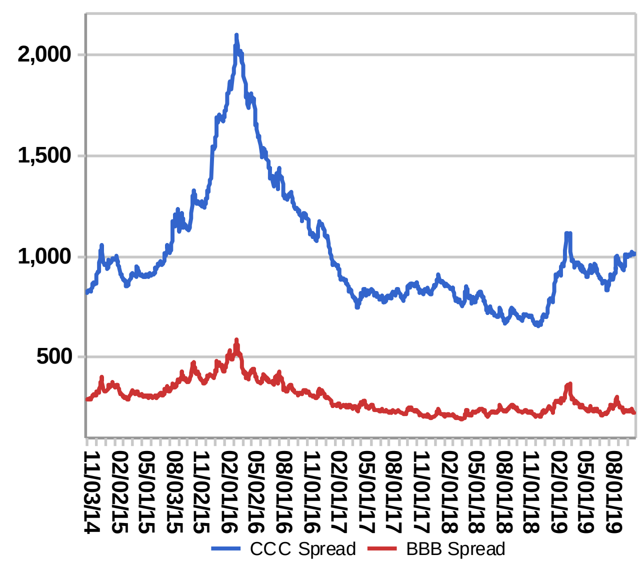
Bond Market Indicators

Figure 55: 10-Year Global Bond Yields



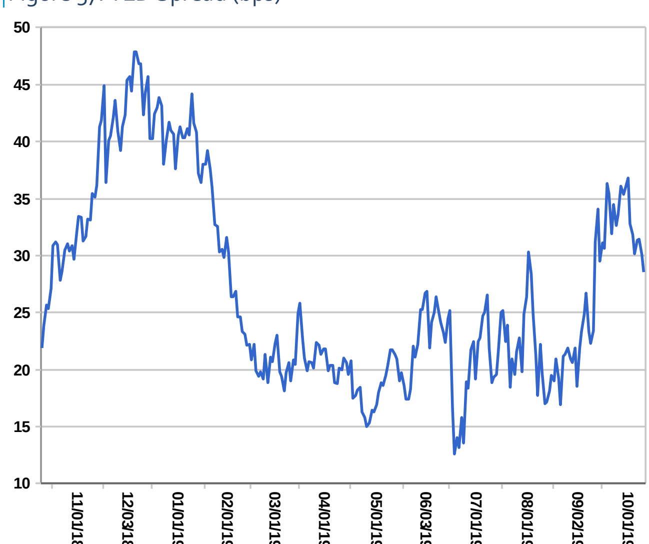
Source: FactSet

Figure 56: CCC and BBB Spreads (Option Adjusted)



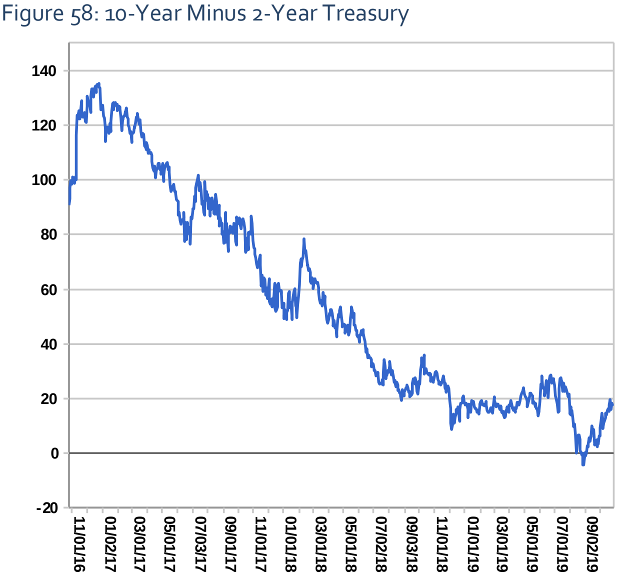
Source: FactSet

Figure 57: TED Spread (bps)



Source: FactSet

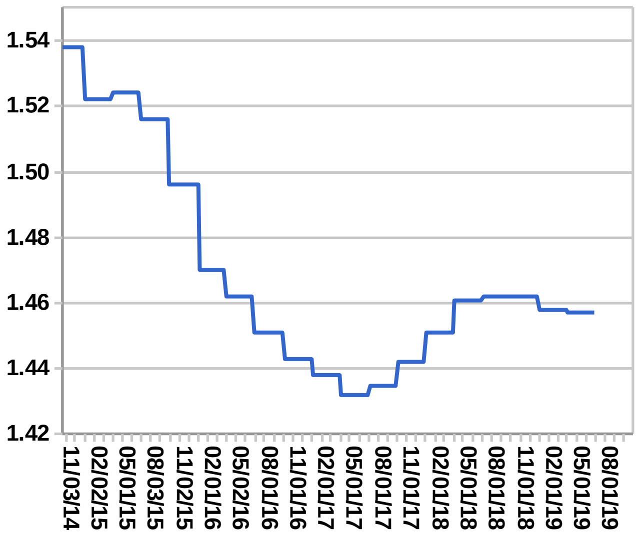
Figure 58: 10-Year Minus 2-Year Treasury



Source: FactSet

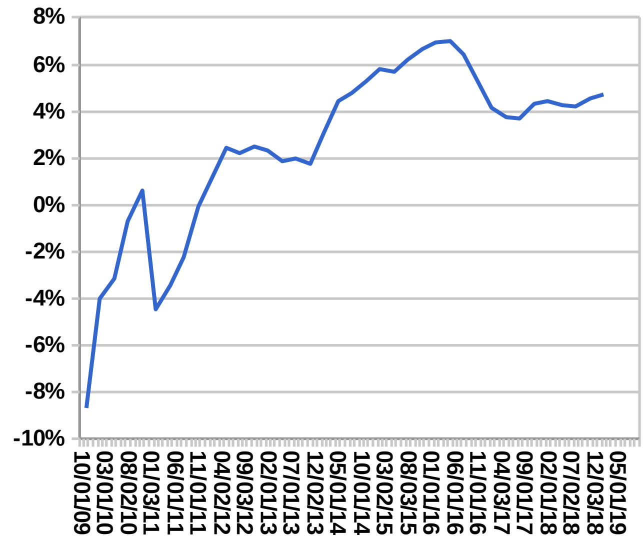
Liquidity and Other Indicators

Figure 59: Velocity of M2 Money Stock



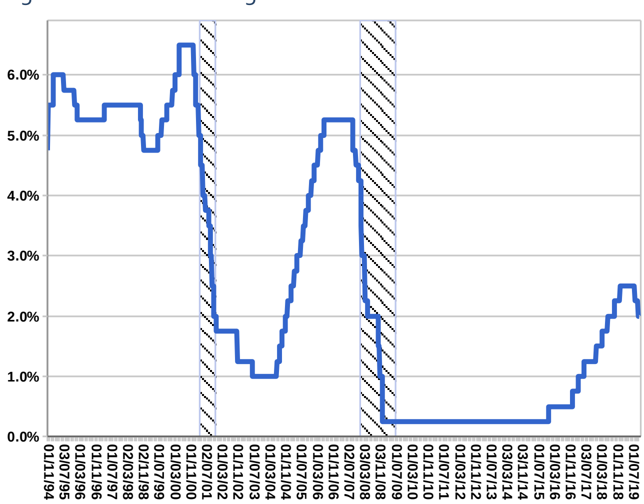
Source: FactSet

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



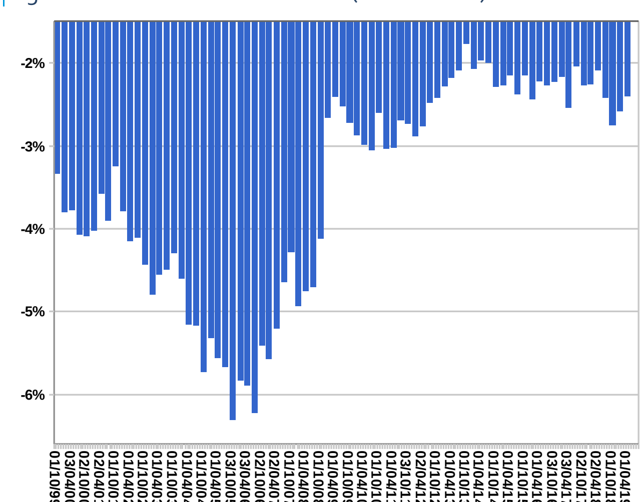
Source: FactSet

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

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 September 30, 2019; most other prices and yields are as of October 25, 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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eric@rockingstoneadvisors.com

[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.