Investor Quarterly

The Bull Takes Hold

Easing Central Banks + Trade Resolution + Profit Growth = Strong Asset Gains

The 2019 rally in asset prices, which consolidated during the third quarter, accelerated in 4Q19 on a potent combination of central bank easing, new trade agreements and surprisingly strong corporate profits. There was some sector rotation out of growth and into value. While still fully invested, we remain wary over a possible rise in rates and high leverage at this point in the cycle.

S&P500 Forecast & Other Key Indicators

We make the following adjustments to our forecasts: EPS (2020: $171 unch.), S&P500 (2020 year end = 3,365), GDP (2020: +1.8%), Gold ($1,500 to $1,600), Oil ($60 to $50), 10-yr US Bond Yield (unch=1.8%), Inflation (unch=1.5%), 5-yr expected CAGR (US Large Cap 1.9%, Developed 6.0%, Emerging 8.7%).

4Q19 in Review

After consolidating gains over the summer, asset prices climbed in 4Q19, with almost every asset registering gains. Benign inflation, accommodative central banks, decent corporate profits and possible trade talk resolutions led previously cautious fund managers and individual investors to jump back into markets.

Asset Class Performance (Total Return: 4Q19[i] and 2019)

We point out the following: S&P500 (+10.4% and +31.5%), Gold (+2.3% and +17.9%), Bonds (-0.1% and +8.4%), Commodities (+7.8% and 11.8%). After lackluster returns in 2018, it was a tremendous year for investors with every asset class, except agriculture and base metals, surging.

Rockingstone Performance

We recorded solid performance in 4Q19 (+6.8%). Our late 3Q19 buys in financials, energy and value helped results, offset slightly by BA and PEP. For 2019, our returns were mixed (+19.4%) as we underperformed in 1Q19 due to tax-loss harvesting in 4Q18 and two poorly performing small cap names (EVH and ETM).

About Us

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

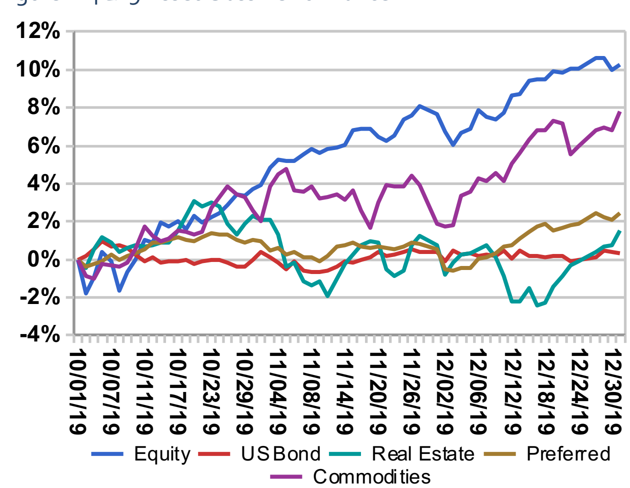
As an SEC-registered investment advisor, we provide multi-asset investment strategies to individuals, families and small institutions through separate accounts.

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:

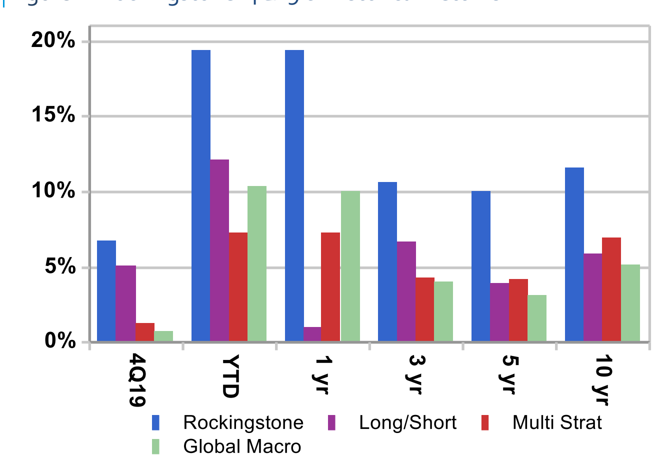
www.rockingstoneadvisors.com

Figure 1: 4Q19 Asset Class Performance[i]



Source: FactSet

Figure 2: Rockingstone: 4Q19 & Historical Returns[ii]



Source: Rockingstone Advisors, Morningstar, DJ Credit Suisse Indices

Please see our End Notes and Disclosures (pages 29-30 of this Investor Quarterly) for important information regarding performance measures. Form ADV available upon request.

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Portfolio Positioning

Rockingstone: Portfolio Positioning Strategies

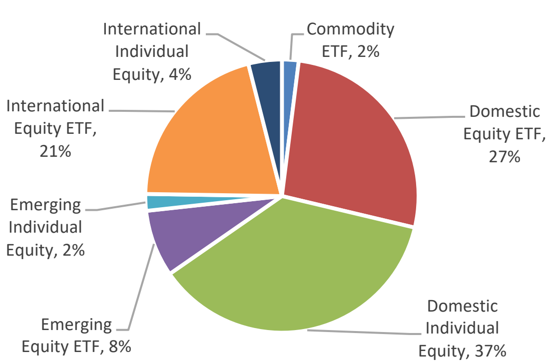
Based on investor feedback, we decided to update our quarterly newsletter with additional information on our portfolio positioning. We also added several new charts on real-time Recession Risk Indicators.

What makes our model unique is that we do not manage a fund, but rather "separate accounts" that are individually tailored and customized according to the needs of our clients. These accounts are custodied under our clients' names at Charles Schwab & Co., but we have discretion to trade and invest the accounts to meet the long-term objectives of our clients.

While no account is identical, there are generally four fundamental strategies that we manage: (i) *equity best ideas* – typically an all equity account invested globally and benchmarked against the S&P 500 or a global index; (ii) *capital appreciation* – typically a blended account comprised of long (and sometimes) short equity, debt and hybrids invested globally against a "retirement date" benchmark; (iii) *yield* — an account designed to produce annual income of 4-6% per year through dividends and bond coupons, and somewhat unique among income-oriented accounts, offering some protection against a rising interest rate environment; and (iv) *ESG* — designed to meet environmental, societal and governance objectives of our clients.

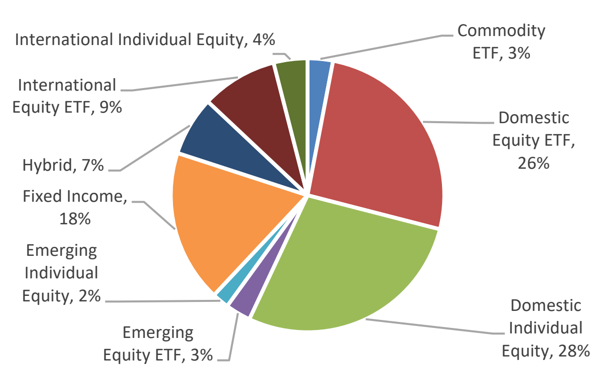
We use a combination of public securities (ETFs, stocks, bonds, hybrids and options) and private securities (real estate, venture, private equity, direct investing) to meet our clients' investment and return objectives. Notably, we record the value of private securities at cost until we exit the investment; hence, the presence of private securities will degrade performance in rising markets and enhance performance in declining markets.

Figure 3: Equity Best Ideas Positioning



Source: Rockingstone Advisors

Figure 4: Capital Appreciation Positioning

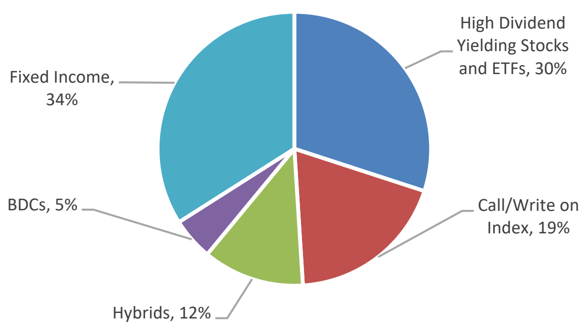


Source: Rockingstone Advisors

Figure 3 denotes a typical "Best Ideas" all equity portfolio. These portfolios are almost entirely invested in equities, although the composition between ETFs and individual securities may vary: some portfolios are 50/50 ETFs and individual names while others are almost entirely individual names. The portfolios are invested in US, international developed and emerging market stocks.

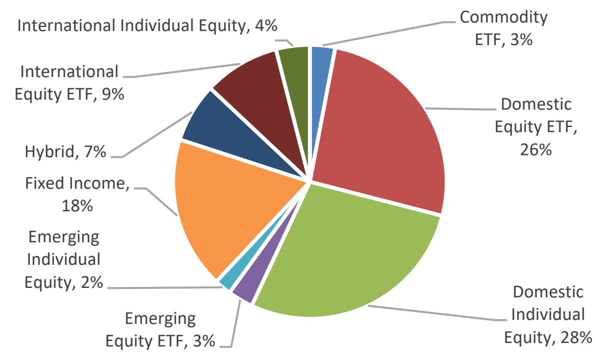
Figure 4 denotes our a typical "Capital Appreciation" portfolio, which is a combination of equity, fixed income and hybrids. The allocation across the three asset classes varies according to risk and relative valuation, but in general these portfolios have between 10% and 30% fixed income, between 5%-10% hybrids (REITs, MLPs, preferred stock and convertible bonds) and the remaining domestic and international equity in the form of individual securities or ETFs.

Figure 5: Yield-Oriented Portfolio Positioning



Source: Rockingstone Advisors

Figure 6: ESG Positioning



Source: Rockingstone Advisors

Figure 5 reflects our a typical "Yield-Oriented" portfolio, seeking to achieve annual income in the range of 4-6% while assuming modest interest, market and credit risk, which is challenging in a low rate environment. The portfolio is structured using a combination of high dividend yielding individual names and ETFs, fixed income, hybrids, and call/write ETFs that write calls on underlying positions, thereby adding income. We attempt to manage interest rate risk by including financials and commodities to offset high yielding securities that are rate sensitive, and credit risk is managed by including treasuries, even though current yield is anemic.

Figure 6 reflects an "ESG" portfolio, which can have any allocation of assets (i.e. fixed income vs. equities vs. hybrids), but is differentiated by the underlying holdings, which score highly on ESG criteria. To be sure, ranking and scrutinizing companies for ESG adherence is challenging. For example, one client may wish to avoid mining companies while another prefers no gaming or tobacco assets. We use a combination of ESG-oriented equity and fixed income-oriented ETFs as well as individual equities to make up an ESG portfolio. We tend to use third party research to aid in our analysis as to whether a company scores well across ESG metrics.

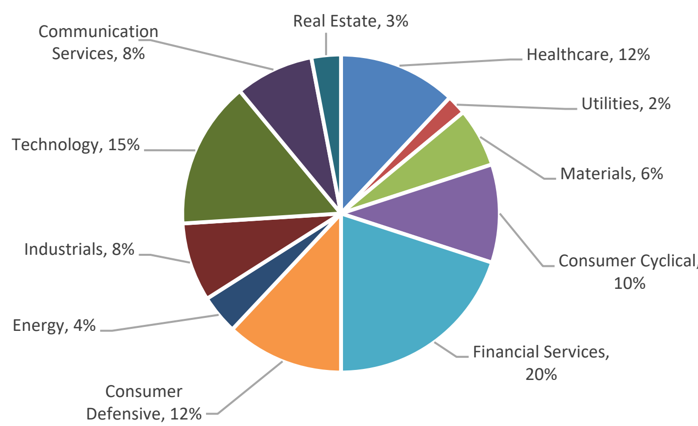
We go into more detail in the following pages but it is also worth emphasizing that investors shouldn't expect much change in these broader allocations from quarter to quarter

Equities

In terms of sector allocation, we keep a close eye on diversification. Investors can see in Figure 7 on the following page that while diversified, we underweight and overweight certain sectors based on our view of markets, macro-economic conditions, the business cycle, investor sentiment and valuation.

As a reminder, the pie chart on the following page is illustrative of Rockingstone's total investments, even though individual portfolio holdings will differ. For example, in yield-oriented accounts we feel it appropriate to "hedge" an over-weight in Consumer Defensives with Financials. The former sector tends to have above average dividend yields while the latter sector will likely rise if overall interest rates rise, as net interest margin is an important driver of financial institutions' earnings. Meanwhile in capital appreciation-oriented accounts we likely have greater holdings in Technology, Consumer Discretionary and Industrials as those sectors should benefit from a renewal in global growth.

Figure 7: Equity Allocation



Source: Rockingstone Advisors

Our top ten largest individual holdings (in order), as of early January, include: S&P Global (SPGI), Apple (AAPL), Estee Lauder (EL), McCormick (MKC), Intuitive Surgical (ISRG), Berkshire Hathaway (BRKB), Facebook (FB), Appian (APPN), Constellium (CSTM) and Google (GOOGL). As usual during the 4Q, we made select moves to be tax efficient on an account by account basis. But from a broader perspective, we completed the following adjustments:

1. Exchange Traded Funds: We purchased Vanguard's VFVA, an ETF that is focused on higher quality, value-oriented equities. Indeed, it is one of the few "factor" ETFs we have invested in over the last few years. Rather than simply purchase a broader-based value ETF, which would have essentially meant acquiring energy and financial companies, we wanted something that screened for more quality in case the global recovery doesn't pan out. This was the only major ETF change made in 4Q19.

2. Individual Equities: Leaving aside various changes we made for tax reasons, our stock adjustments were limited in 4Q19. In keeping with our desire to have more cyclical exposure but through higher quality names, we purchased shares in Linde (LIN). Linde combined with Praxair, bringing well regarded management, a reasonably stable end market combined with cost savings. Despite a challenging stock for much of 2019, we added to our Entercom (ETM) position. As a reminder, Entercom is the number two radio company in the US. Despite high leverage, we see a low valuation, insider buying and a stable end market as compelling. We had sold 10% of our Appian position in the third quarter at around $60 per share, but re-purchased those shares toward the end of the fourth quarter in the low $40s, replacing at a lower cost what we had sold at a higher price. Lastly, we sold our position in Charlotte's Web (CWBHF), a Colorado-based CBD company that performed poorly in 2019 on unfounded vaping fears as well as concerns about over supply. Unfortunately, our small position had lost value and we decided to use the losses to offset realized gains.

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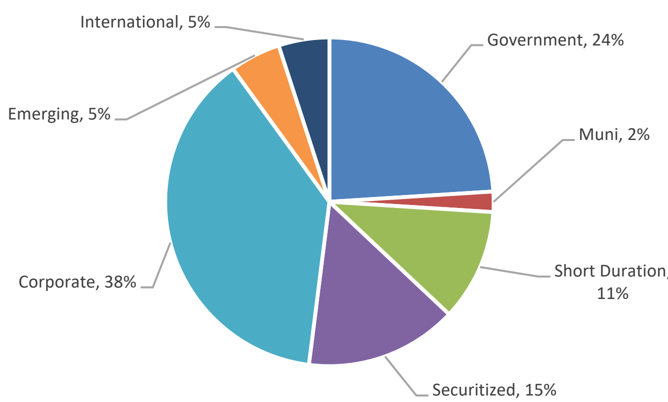
Fixed Income

Similar to our equity holdings, diversification remains important within our fixed income allocation. We own a very limited number of individual bonds and thus achieve our fixed income investments primarily through the use of lower cost and more liquid fixed income ETFs. Thus, the allocation detailed below is almost entirely made up of ETFs.

Figure 8: Fixed Income Allocation



Source: Rockingstone Advisors

Generally speaking, we see bonds as expensive. As we noted earlier, the Federal Reserve was expecting to raise interest rates three times in 2019 but actually lowered them several times last year! With interest rates on the US government 10-year bond declining from more than 3% to 1.7%, we see most fixed income investments as not especially compelling. Thus, 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).

There is well over $4 trillion in notional developed market bonds that currently have a negative yield! We see this as highly untenable long term. Thus, 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. We remain confident in the thesis long term and it has been an effective funding mechanism for higher-yielding US securities.

Commodities

We added Gold to most portfolio during the third quarter via the ETF (GLD). The ETF has appreciated a few percent, which has trailed most other assets. However, we invested in gold to hedge against possible inflation as well as the need for a "safe haven." The market became concerned over heightened recession risk in last summer 2019. This spurred us to be slightly more conservative. Yet as 3Q19 ended the market clearly dismissed the risk of a global recession. Nevertheless, we still feel having some exposure to GLD is worthwhile as an acceleration in global activity could spur inflation fears. 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.

Asset Class Performance Review

The Bull Takes Hold

After effectively treading water for the last 18 months (despite a large sell-off in 4Q18 and subsequent rebound rally in 1Q19), stocks started the fourth quarter roughly where they ended the first quarter of 2018. However, they finished the fourth quarter broadly higher, as global asset prices jumped between October and December. We believe the more optimistic tone reflected several factors including: (i) key central banks reiterating their position to remain accommodative into 2020, (ii) the US Federal Reserve shoring up the short term REPO market with over $70+ billion in liquidity, (iii) apparent resolution of the US – China trade dispute, (iv) agreement by US legislators to support USMCA, (v) corporate profits that were largely in line if not slightly better than expectations, and (vi) global macro-economic data that signaled stabilization after some worrisome reports during 3Q19.

Conventional wisdom is that the bull market continues to move forward in 2020, albeit at a more moderate pace. Most "experts" suggest the aforementioned factors will continue to be a positive influence on 2020 returns. We tend to agree but would also emphasize that the equity market is clearly discounting a fairly big improvement in corporate profits amid an anticipated turn in macroeconomic data that has yet to materialize, that central banks remain accommodative and debt levels do not become a problem. We have some concerns over these last few points, most notably the lack of public concern around massive debt balances in the US (despite a decade long expansion) and abroad.

While inflation is relatively benign, at some point the Federal Reserve may start raising interest rates again. We worry about the impact of rising rates, particularly after an expansion cycle that hasn't reduced annual budget deficits let alone global debt balances, on asset prices. To be sure, investors that have harped on leverage concerns have so far been at best early in expressing such fears, but with consensus seemingly bullish, we think it prudent to remind investors about issues that aren't top of mind.

Key Global Macroeconomic Data are Mixed but Show Signs of Stability

Each quarter we take a closer look at the three major economies (US, China and Europe). Focusing first on the US, we note most economic data series point to weak manufacturing, a reasonably strong service sector combined with a confident consumer. As evidenced in Figure 9 on the following page, it is clear the US Manufacturing ISM has declined below the all important 50 level (i.e. defining contraction vs. expansion). But as an offset and arguably more influential on the overall economy, the US Service ISM index remains in the mid 50s and relatively stable.

Meanwhile US consumer confidence has stabilized of late in the mid-120s, albeit down recently from a peak in the mid-130s. These figures are driven by a potent combination of low unemployment rates and strong household balance sheets, and evidenced by the recent robust holiday season reported by the nation's retailers. It is widely known that US unemployment rates are at record low levels and recent BLS figures indicated some wage growth. If employment remains high and wages increase, it is likely the US consumer will continue to spend, which in turn should drive corporate profits.

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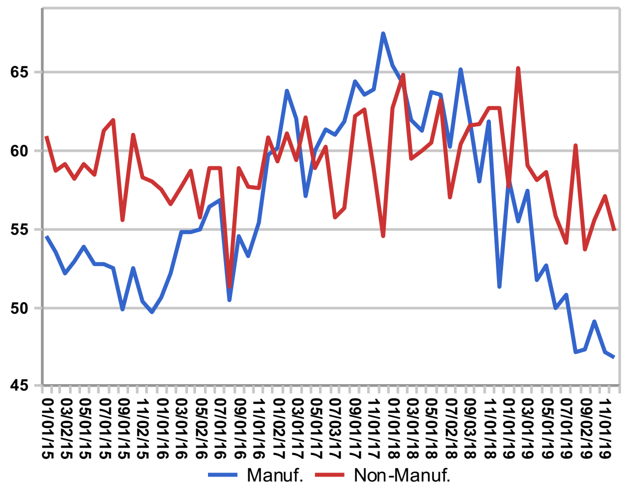
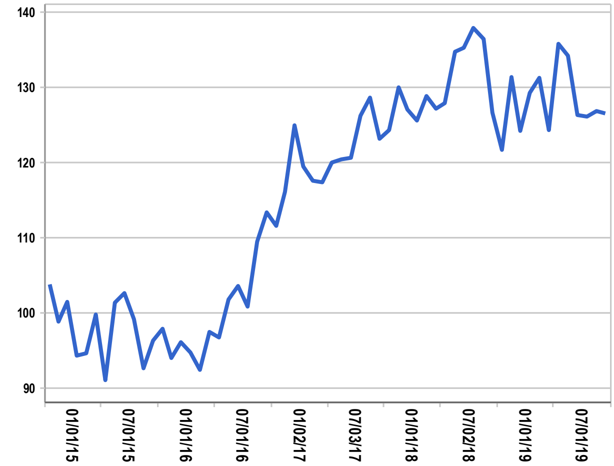
Figure 9: US ISM continues to moderate…



Source: FactSet

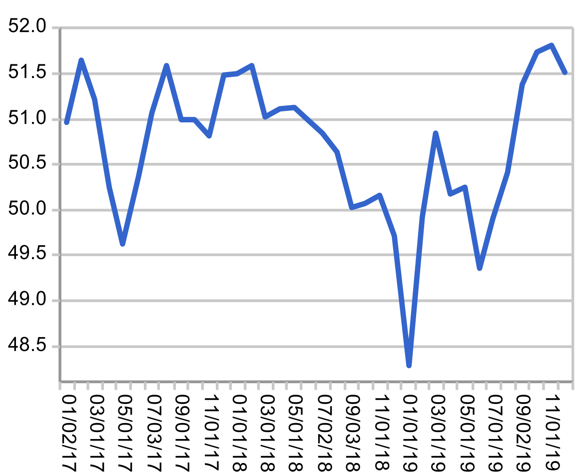
Figure 10: …while Consumer Confidence appears to have peaked



Source: University of Michigan

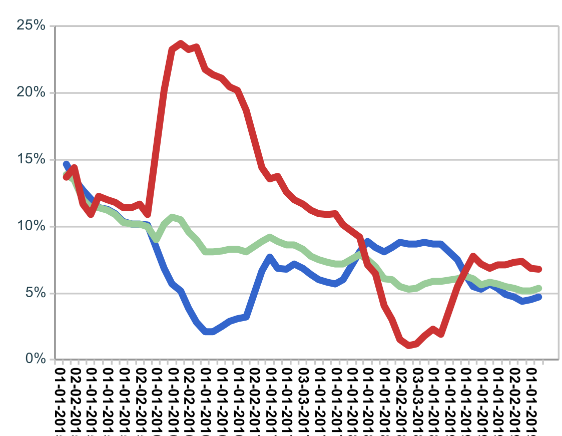
While the US statistics have displayed deterioration at worst and stabilization at best, China's Caixin PMI has clearly rebounded from the depths hit a year ago. As a reminder the Caixin PMI is a non-governmental survey of purchasing managers in China and thus arguably has more credibility vs. government statistics. China is still an economy that is dependent on manufacturing and thus investors take comfort when its manufacturing economy is above 50. Phase II negotiations between the US and PRC will be top of mind among investors. We will continue to track whether further trade gains will spur China's critical manufacturing capacity.

Figure 11: China Caixin PMI Rebounds



Source: FactSet

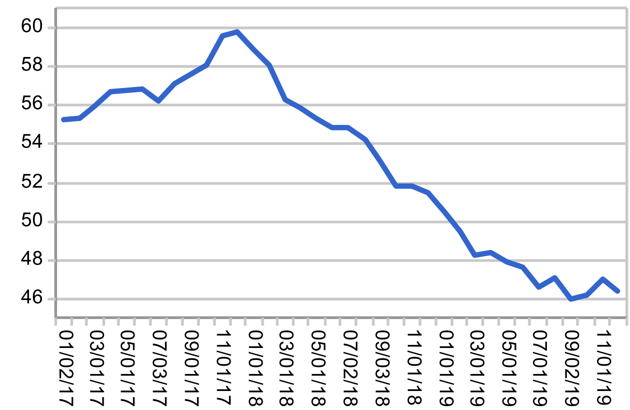
Figure 12: China Fixed Asset Investment, % Chg. YoY



Source: FactSet

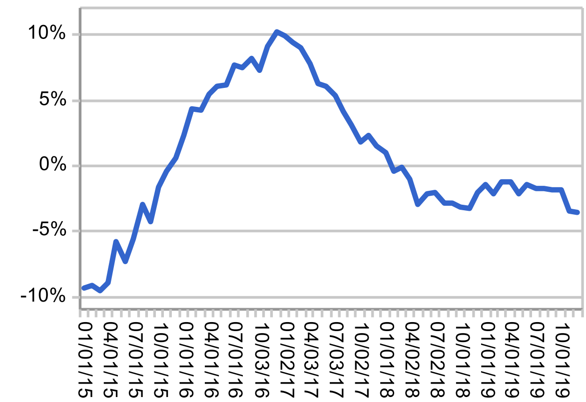
As has been the case since the global financial crisis in 2008, the EU remains the clear laggard in terms of economic performance. In recent newsletters we have highlighted the weak EU Manufacturing PMIs. Unfortunately, it remains a disappointing time series with the EU PMI well below 50 for over a year. The good news at least is that the EU PMI has stabilized and the region's industrial production, while still contracting, has at least stabilized of late.

Figure 13: EU Manufacturing PMI remains well below 50…



Source: FactSet

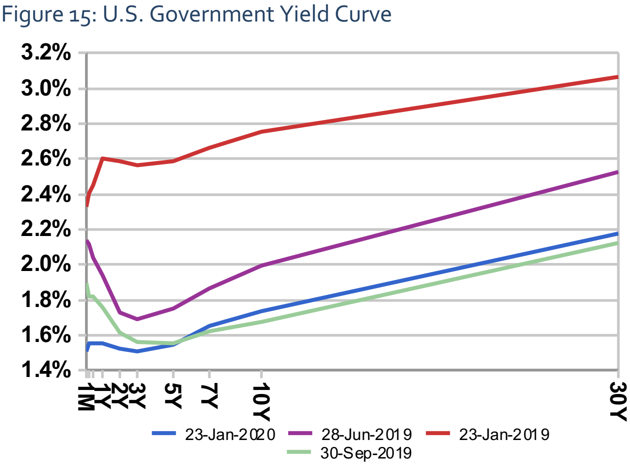
Figure 14: …while EU Industrial Production stays negative



Source: FactSet

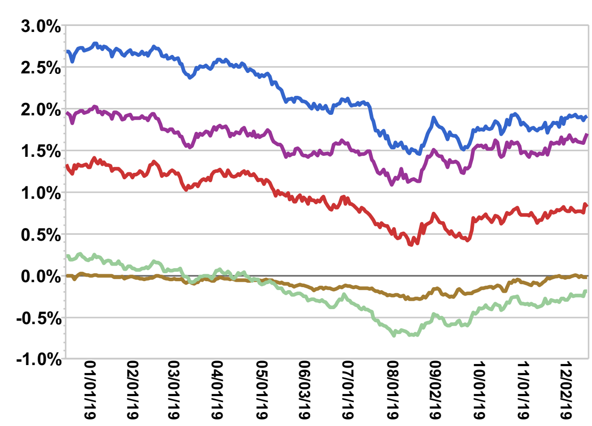
Over the last five months both US and global sovereign yields have moved up, although over the last month they have all declined. Regarding US interest rates, the shape of the curve is much less kinked than just 3 months ago. While rates remain below both six months and a year ago, they are up from Sept 2019 and importantly not inverted. It appears the Federal Reserve's decisions to (i) reduce interest rates throughout 2019, (ii) end the policy of reducing the balance sheet, and (iii) boosting liquidity into the short term REPO market, has resulted in a more "normalized" yield curve across maturities.

Figure 15: U.S. Government Yield Curve



Source: Factset

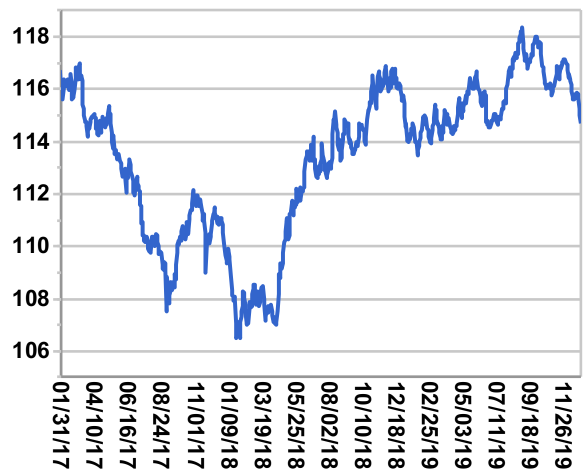
Figure 16: Global Sovereign Yields



Source: Factset

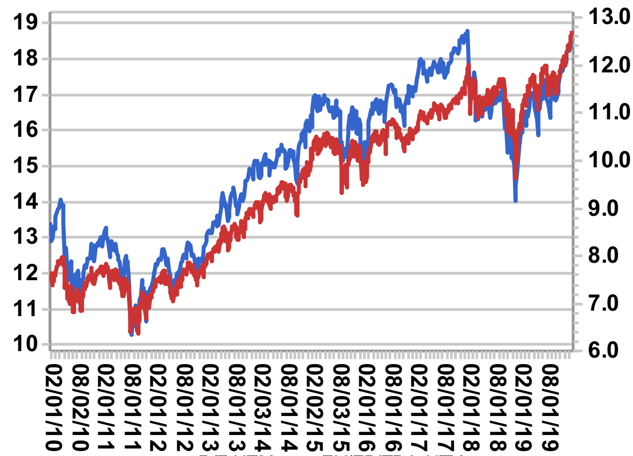
It is well known that over $4 trillion in global debt has negative yields. Looking back over decades, it is worth a reminder this is unchartered territory for economists and fixed income market observers! As investors can see from Figure 16, global sovereign rates hit a recent low this past summer. While interest rates have moved up since then, we remain perplexed as to such stark differences across countries and why any investor would voluntarily opt for bonds with negative yields.

Figure 17: Federal Reserve Nominal Broad $US Index



Source: FactSet, Federal Reserve

Figure 18: S&P500 NTM P/E (left) & EV/EBITDA (right)



Source: FactSet

In terms of the US dollar vs. other currencies for the past three years, there actually hasn't been a lot of change. For 2019, the US dollar appreciated slightly but saw some weakness over the 2H19. We note the slight appreciation in the US dollar combined with local slower growth resulted in non-US developed and emerging markets to under-perform the US (as measured by the S&P500). But that dynamic reversed itself in the 4Q19, at least for emerging market equities. Our sense is that the US dollar will modestly depreciate in 2020 and, as a result, we have slightly increased exposure to non-US equities vs. early 2019.

Finally, regarding valuation as measured by the S&P500, we focus investors on a forward P/E multiple that is close to record levels for the past decade. We also note the same can be said for EV/EBITDA although recognize there is some distortion vs. earlier periods due to the 2018 tax cut. To the extent the market is anticipating an acceleration in corporate profits, the picture of a high P/E may be slightly exaggerated. Nevertheless, we see valuation as an impediment to higher returns (please note our 5-Year Asset forecast later in this report for a detailed analysis).

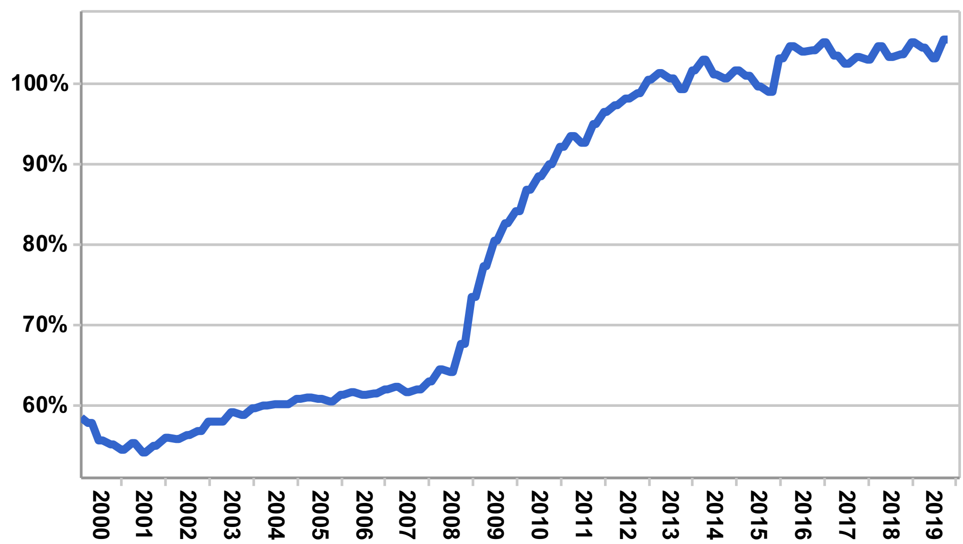
Why Focus on Debt? Nobody Else Seems to Be!

Debt usually isn't a problem until it is a big problem. The last sentence may seem like an oversimplification. Yet investors need only look back to the global financial crisis to get a sense as to how too much debt can quickly become overwhelming. For example, countries such as Greece, Italy and Spain had record levels of debt as a percentage of GDP in 2007. With the global recession in 2008-2009, all three countries suffered as a result of over leverage. Even with a combination of ECB actions and painful restructuring during the last decade, those countries' economies and populations have yet to fully recover.

Contrary to parts of the EU and numerous emerging market countries, the US economy has rebounded strongly from the global financial crisis. Yet we emphasize that ongoing US government budget deficits (currently projected at $1+ trillion), let alone total debt outstanding (close to $22 trillion), are receiving minimal attention from both investors and politicians. Budget deficits are at record levels and the US' long term debt continues to grow. What is worrisome to us is that at this point in the business cycle, both figures should actually be declining and certainly not rising!

What is also clear to us is that deficit concerns are far from top of mind among investors and politicians. There have been some market participants that call out the debt issue as well as corporate leverage (particularly among non-investment grade companies). Total US non-financial corporate debt now stands at over $15 trillion although the good news is that banks remain well capitalized. Yet our sense is that when interest rates rise and/or recession takes hold, asset valuations will be hurt as attention to deficits and debt take center stage.

Figure 19: US Public Debt (as % of GDP)



Source: FactSet

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Equity Performance

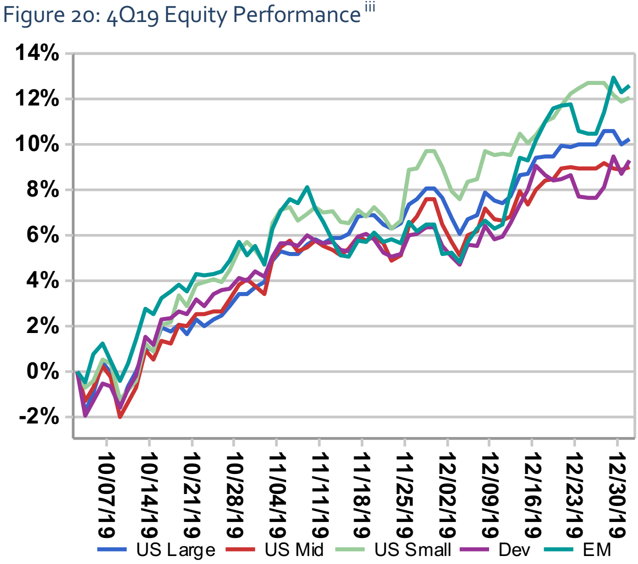
Making Up for Lackluster Returns Since January 2018

As we noted in last quarter's newsletter, the S&P500 was basically flat from late Jan 2018 until mid Sept 2019. This extended period of mediocre returns was due to a number of factors, including central bank tightening, trade wars as well as fears over weak corporate profit growth amid global economic softness. All such fears were essentially assuaged in 4Q19 with global investors suddenly taking a more optimistic view of 2020.

We believe Figure 20 below is particularly noteworthy given how highly correlated equity returns were in 4Q19! Indeed, one could argue the lifting of the macro-concerns mentioned above is what led to such a tight grouping in terms of percentage gains. At the same time, we note that investor expectations for mixed corporate profits were largely fulfilled during the last quarter and thus much of the price gain is a function of higher valuations (i.e. multiples). To the extent higher earnings multiples have increased (even as interest rates have moved upward), we start 2020 somewhat more cautious as both the bar for earnings and valuation has been lifted!

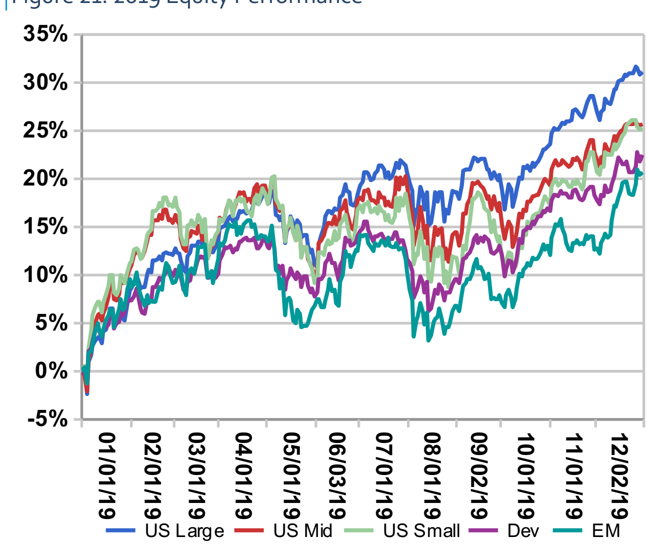
We highlight the following performance metrics regarding 4Q19 and 2019, respectively, results: US Large Cap (+10.3% and +31.2%), US Mid Cap (+9.1% and +25.5%), US Small Cap (+12.0% and +25.4%), Developed (+9.3% and +22.6%), Emerging (+12.6% and +20.7%).

Figure 20: 4Q19 Equity Performance [iii]



Source: FactSet

Figure 21: 2019 Equity Performance



Source: FactSet

Fixed Income Performance

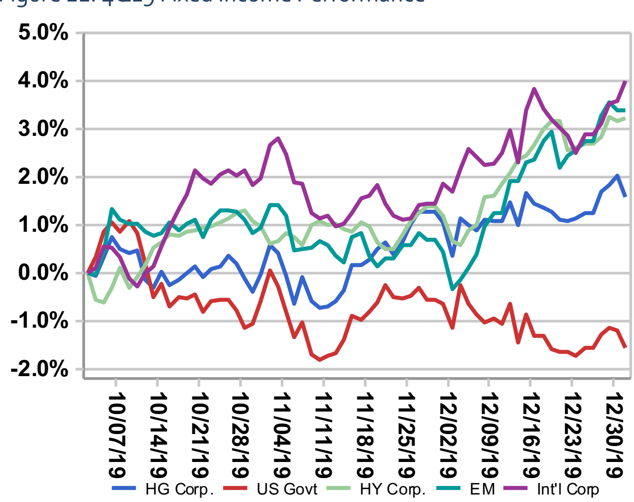
Returns Jump in 2019 due to Accommodative Central Banks

It was an incredible year in 2019 for fixed income returns. This is all the more stunning given the negative sentiment towards such assets going into the year. Based on Figure 23 below, it is clear that holding bonds was additive to investor gains, an outcome we certainly did not expect. Even the worst performing ETFs we track, including US government and international corporate bonds, were up over 7%. Meanwhile US high grade corporate bonds jumped close to 17%. Clearly the accommodative position taken by most central banks during 2019 helped performance as lower yields mathematically means higher prices.

Looking more closely at the 4Q19, there was greater disparity of returns compared to the full year. For example, international corporate bonds jumped close to 4% while US government bonds actually declined over 1% in value. We aren't too surprised at the latter given the Federal Reserve reiterated its near term desire to keep interest rates low while at the same time investor sentiment became more bullish on global growth prospects.

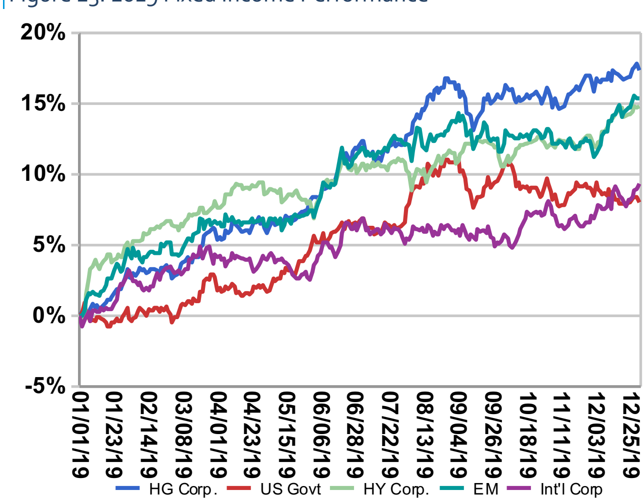
We note the following performance figures for 4Q19 and 2019, respectively: US High Grades (+1.6% and +17.4%), US Governments (-1.5% and +8.4%), US High Yield (+3.3% and +14.9%), International Corporates (+4.0% and +9.4%), Emerging Markets (+3.4% and +15.5%).

Figure 22: 4Q19 Fixed Income Performance[iv]



Source: FactSet

Figure 23: 2019 Fixed Income Performance



Source: FactSet

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Commodity Performance

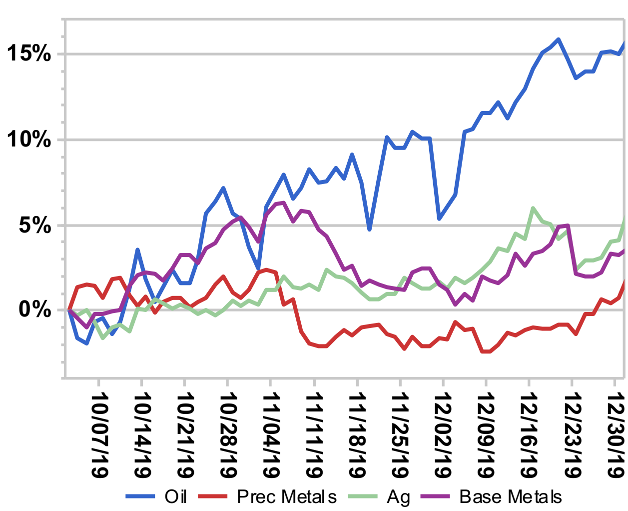
Oil Remains Volatile while other Commodities Meander

As we have noted in prior newsletters, we often look to commodities to confirm an outlook on global growth trends. If global GDP is accelerating, it is likely commodity prices, and especially industrial metals, will move higher. And of course the opposite is generally true. Thus, we view 4Q19 and 2019 commodity trends as sending mixed signals. For example, only oil moved materially higher in 4Q19 while other commodities we track (agriculture, precious metals, base metals) increased only slightly. We recognize that supply and demand dynamics for one commodity can be different from the rest and this could explain the jump in oil (i.e. Middle East tensions plus the prospect of improving global growth).

Yet 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.

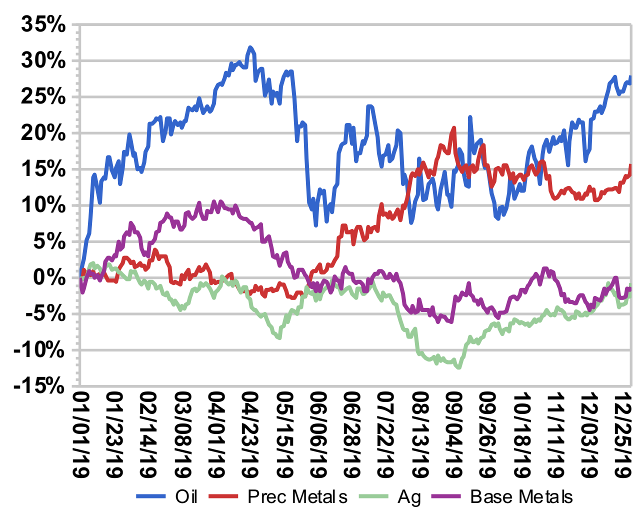
We point to the following returns during the 4Q19 and 2019, respectively: Oil (+15.0% and +28.0%), Precious Metals (+0.7% and -1.2%), Agriculture (+4.1% and -6.4%), Base Metals (+3.3% and -1.1%).

Figure 24: 4Q19 Commodity Performance[v]



Source: FactSet

Figure 25: 2019 Commodity Performance



Source: FactSet

ROCKINGSTONE ADVISORS LLC

Forecast: 2020

Rockingstone Advisors: Our Latest Forecasts

We have updated our forecasts to reflect the latest views on 2020. In general, we see modest US macro-economic growth, limited inflation, continued low interest rates, an average type year for corporate profit increases but modest rise for equities (based on the S&P500) given high valuation multiples.

Figure 26: Key Metric Forecast

	Year End December	
Metric	Band	Point
US Real GDP (2020)	1.7% - 2.3%	1.8%
S&P 500 2020 EPS (RSA/Street)	NA	$171 / $175
S&P 500 2020 Index	3250-3500	3365
10-Yr US Treasury Yield	1.7% - 1.9%	1.8%
Oil (WTI-2020 End)	$45 - $55	$50
Gold (2020 End)	$1,550 - $1,650	$1,600
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 have kept our GDP forecast for 2020 largely unchanged with expected growth of 1.8%. We note the Federal Reserve's expectations for GDP growth have been moderating. On the positive side, trade disputes seem likely to be less of a drag on economic growth and such resolution could result in business investing in capital. While corporate debt and US government debt is high, US consumer leverage is fairly modest, with higher wages and good employment helping confidence. On the negative side, however, many international markets remain challenged and thus exports growth is lackluster. Any rise in interest rates could trigger significantly higher debt funding costs, while long-term demographics and productivity measures remain a challenge.

2. S&P500 Index. With the S&P500 trading around 3300, or approximately 19x our 2020 EPS forecast of $171, there doesn't appear to be significant upside potential for 2019, and frankly for the next few years. Assuming 2019 S&P500 EPS end up being $158, this implies about 8% growth for the large cap dominated index. Granted interest rates are historically very low, supporting our expectations of slight multiple expansion during 2020, in order to arrive at our 3365 target. Yet we emphasize 8% corporate profit growth is very healthy for this stage of the business cycle, particularly given profit margins are at close to record levels. As detailed in our 5-year asset forecast (see next section), we see profit margin contraction as well as likely lower valuation multiples crimping returns. Hence our somewhat cautious view on how much the S&P500 can return in 2020 and beyond.

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Five Year Asset Value Forecast[vi]

Return Expectations Moderate for US Large Cap

As we have written in prior newsletters, 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 jump in equity prices over the last quarter vs. just slight improvement in macro-economic signals, our forecast now points to more moderate returns.

Figure 27: 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	1.9%	=	5.5%	-	1.8%	+	1.9%	-	3.7%
US Mid Cap Stock	S&P400	5.7%	=	5.4%	+	0.1%	+	1.8%	-	1.6%
US Small Cap Stock	S&P600	8.3%	=	5.6%	+	3.1%	+	2.0%	-	2.4%
Foreign DM Stock	MSCI-EAFE	6.0%	=	3.2%	-	0.2%	+	3.4%	-	0.5%
Foreign EM Stock	MSCI-EM	8.7%	=	6.2%	+	2.4%	+	2.9%	-	2.8%

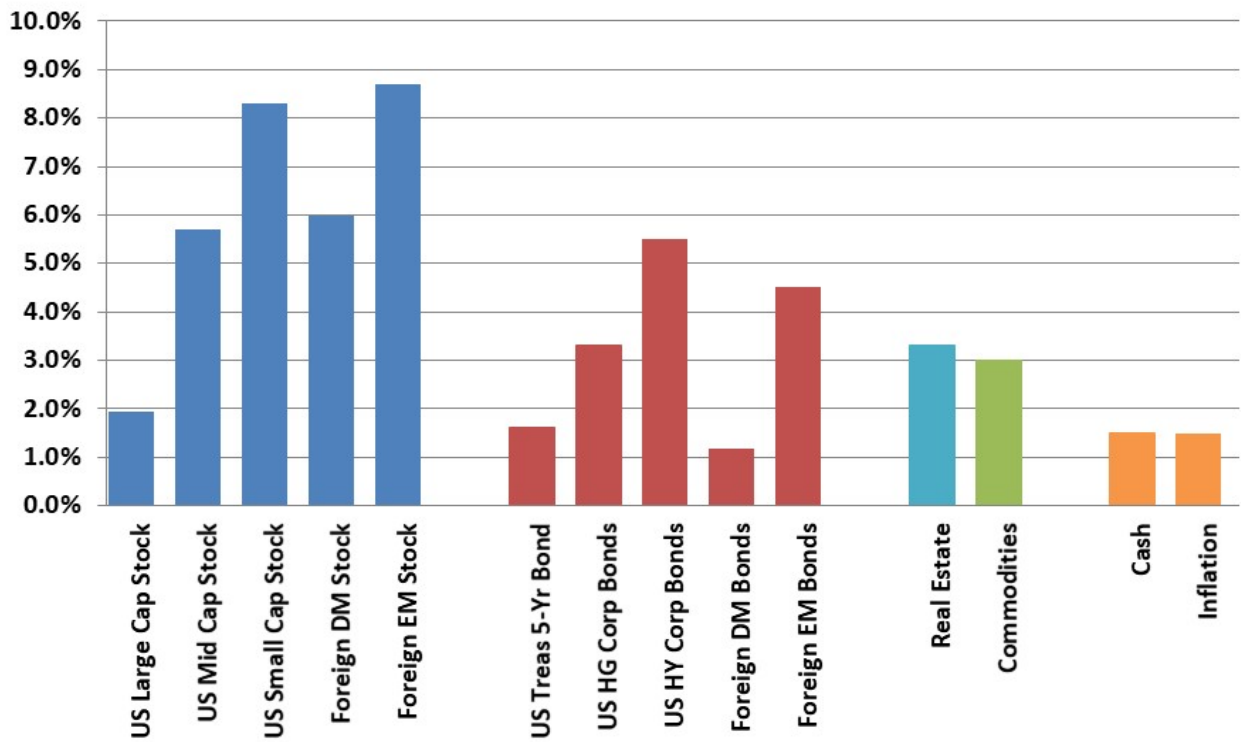
Source: Rockingstone Advisors

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 28: Five-Year Asset Class Total Return Forecast



Source: Rockingstone Advisors

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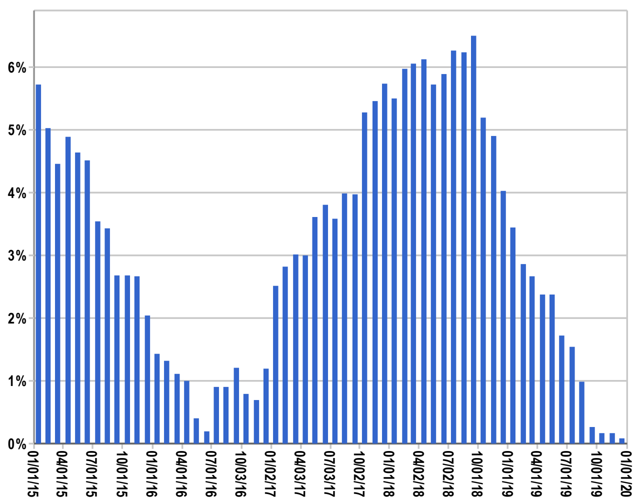
Chart Book

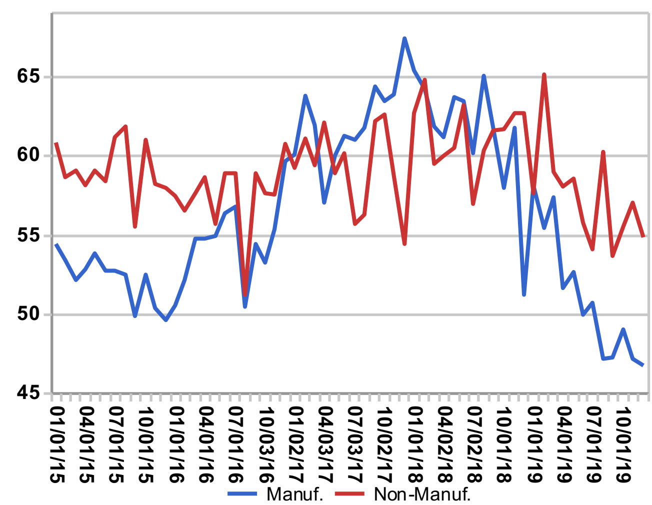
Leading Indicators

Figure 29: Index of Leading Economic Indicators



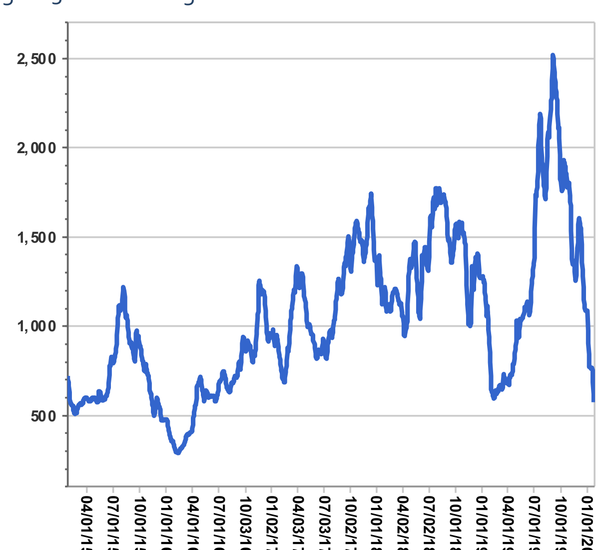
Source: FactSet

Figure 30: ISM New Orders



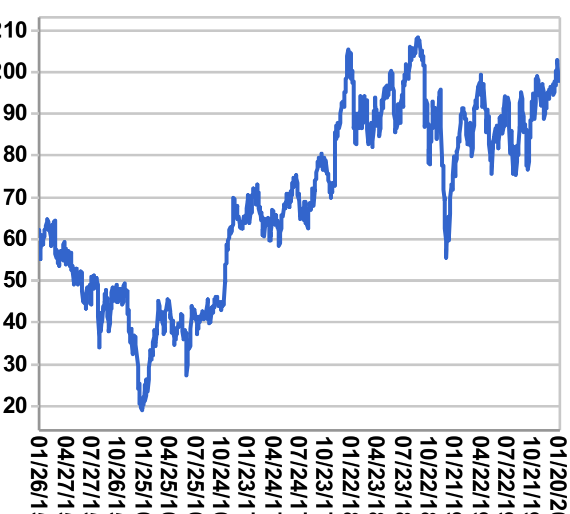
Source: St. Louis Federal Reserve, FRED Database

Figure 31: Baltic Freight Index



Source: FactSet

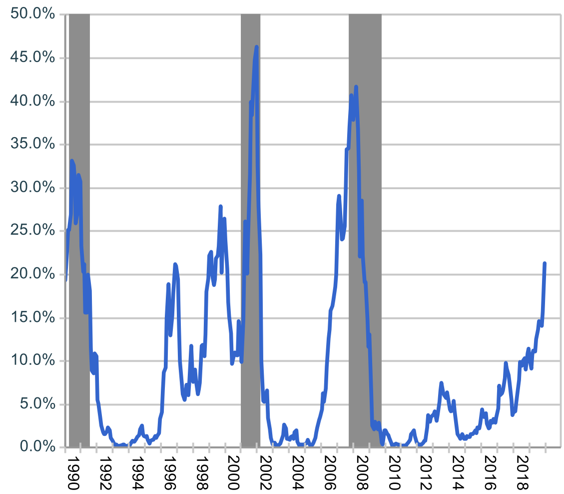
Figure 32: DJ Transports



Source: FactSet

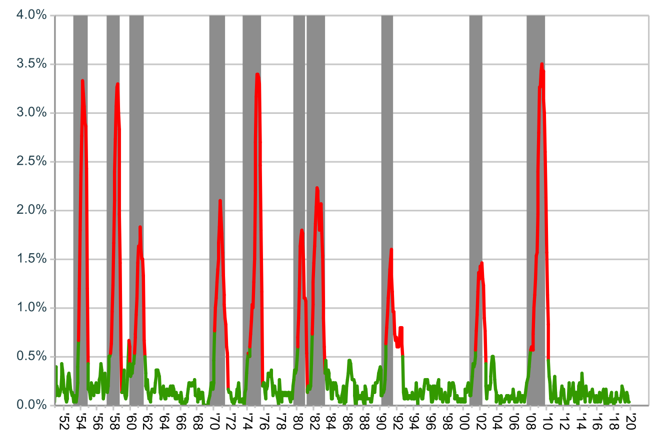
Real-time Recession Risk Indicators

Figure 33: Treasury Spread Recession Predictor



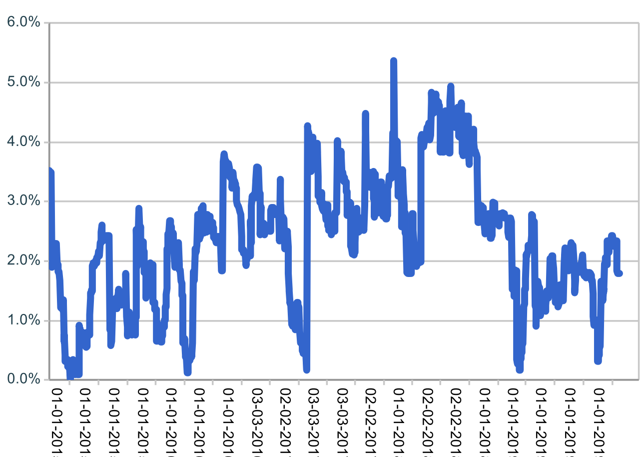
Source: FactSet, FRED Database

Figure 34: Sahm Real-time Recession Predictor



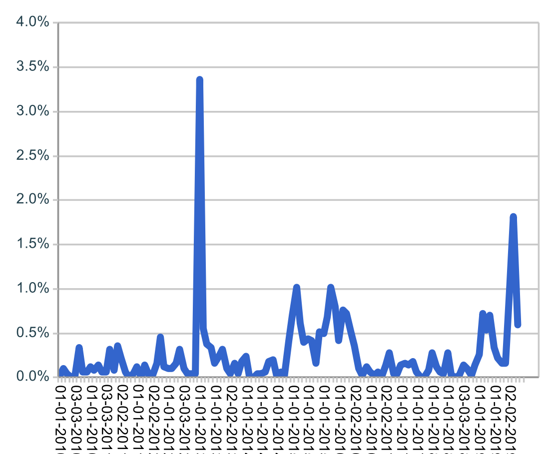
Source: St. Louis Federal Reserve, FRED Database

Figure 35: GDP Now (Atlanta Fed)



Source: FactSet; FRED Database

Figure 36: Smoothed US Recession Probabilities



Source: FactSet; FRED Database

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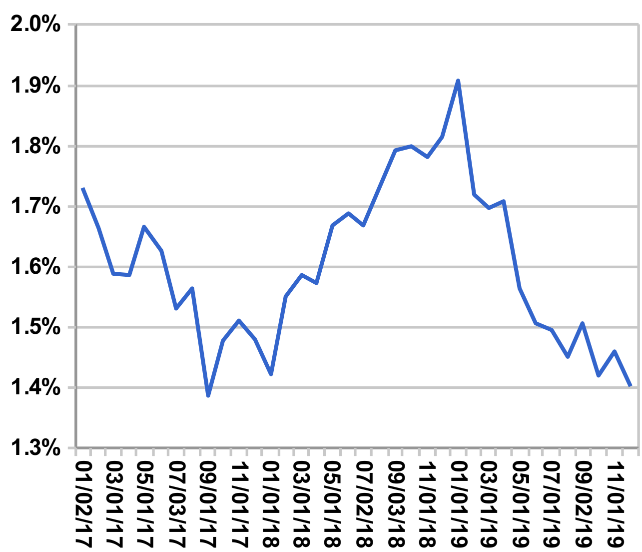
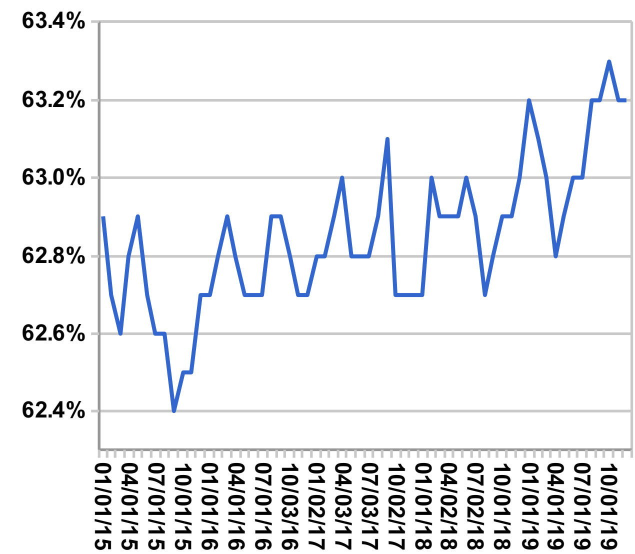
Labor Market Indicators

Figure 37: Payroll Growth (Establishment Survey, % Chg YoY)



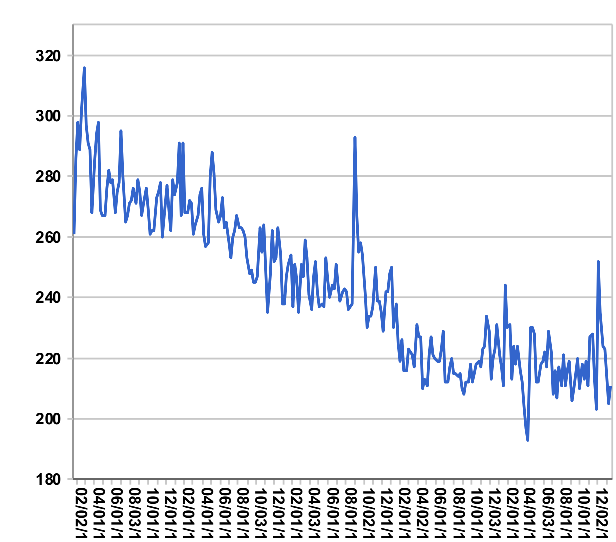
Source: FactSet

Figure 38: Labor Participation Rate (% of Workforce)



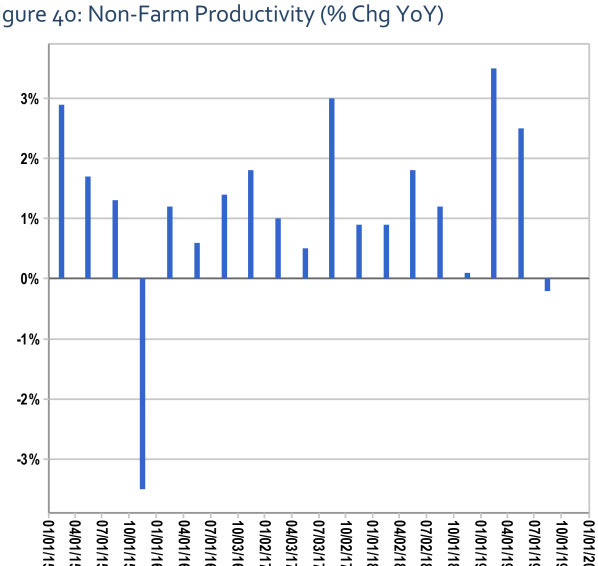
Source: FactSet

Figure 39: Initial Unemployment Claims



Source: FactSet

Figure 40: Non-Farm Productivity (% Chg YoY)



Source: FactSet

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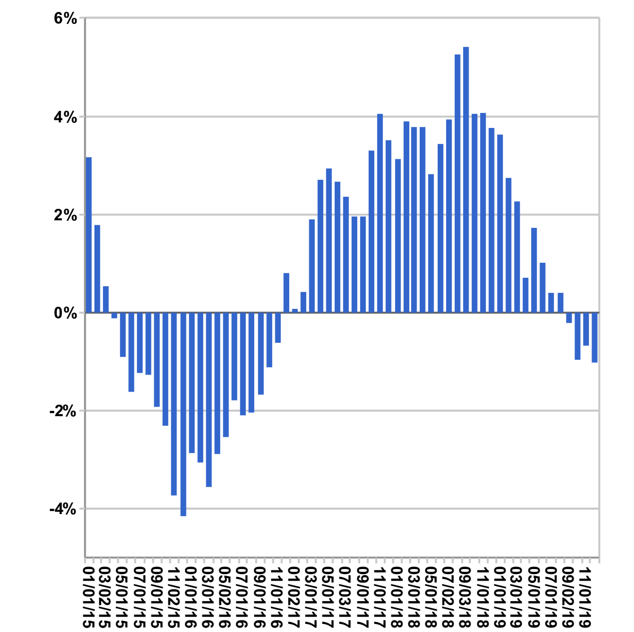
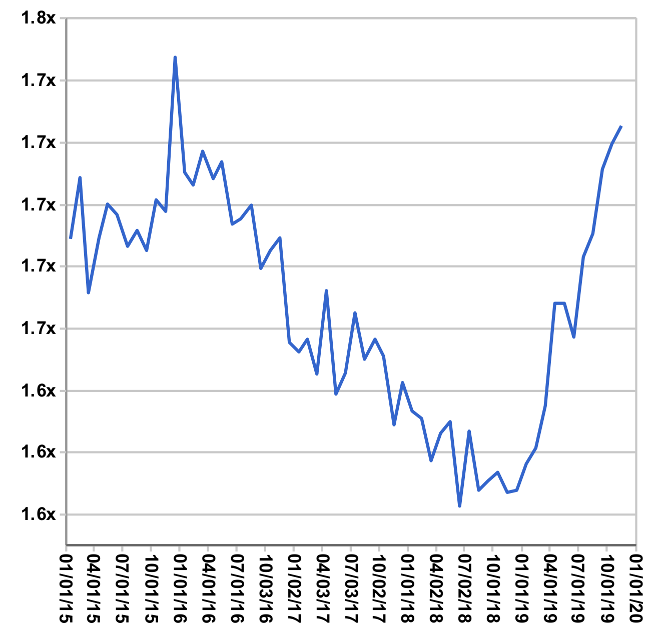
Production and Business Activity Indicators

Figure 41: Industrial Production (% Chg YoY)



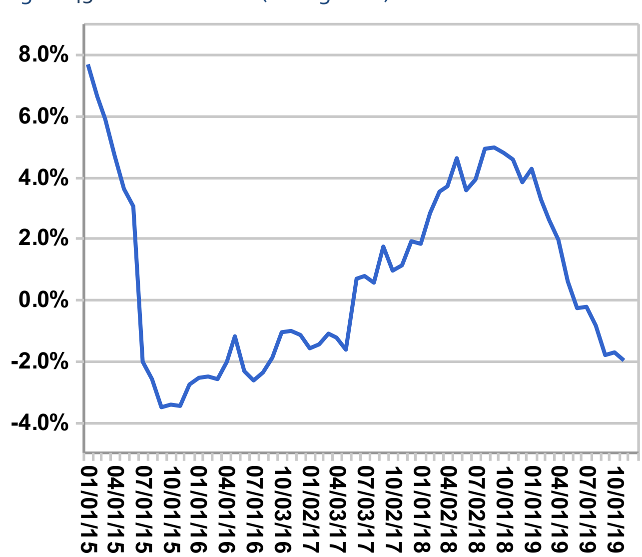
Source: FactSet

Figure 42: US Inventory to Shipment Ratio



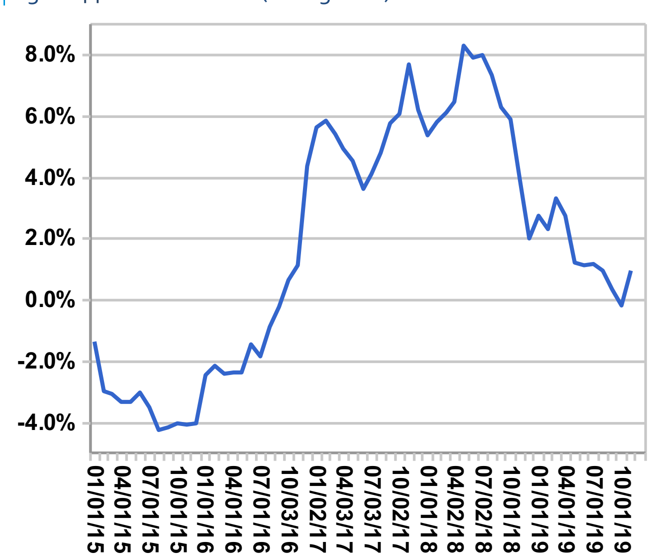
Source: FactSet

Figure 43: Unfilled Orders (% Chg. YoY)



Source: FactSet

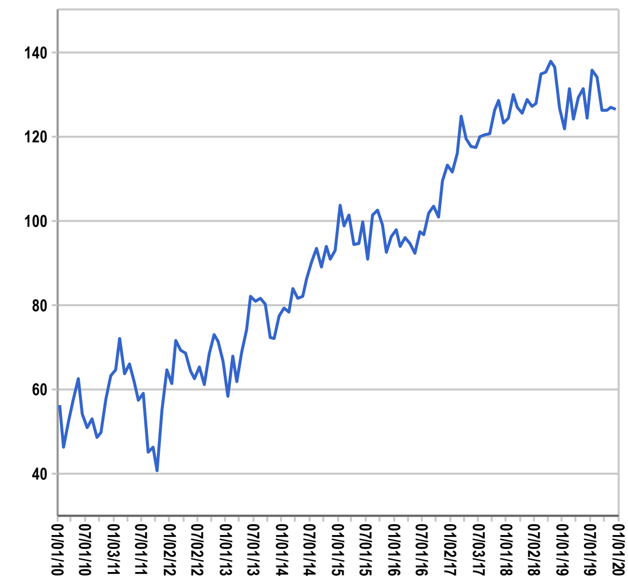
Figure 44: Business Sales (% Chg. YoY)



Source: FactSet

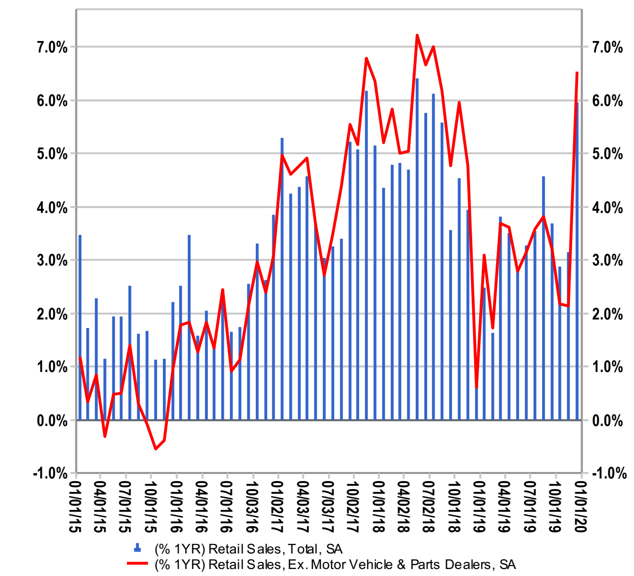
Consumer and Household Activity Indicators

Figure 45: University of Michigan Consumer Sentiment



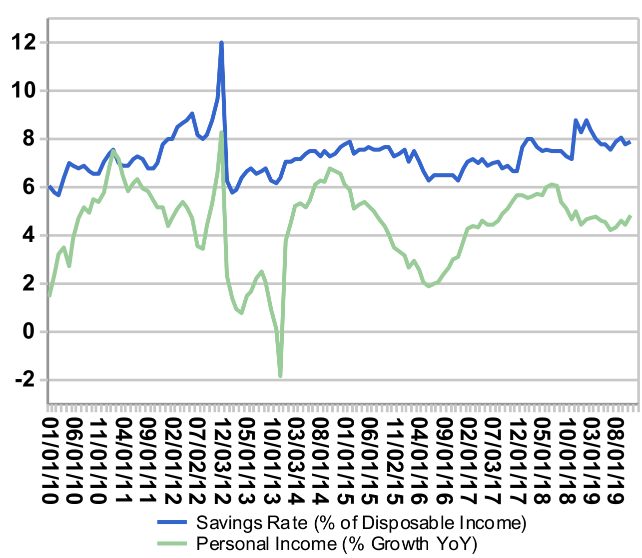
Source: FactSet

Figure 46: Retail Sales



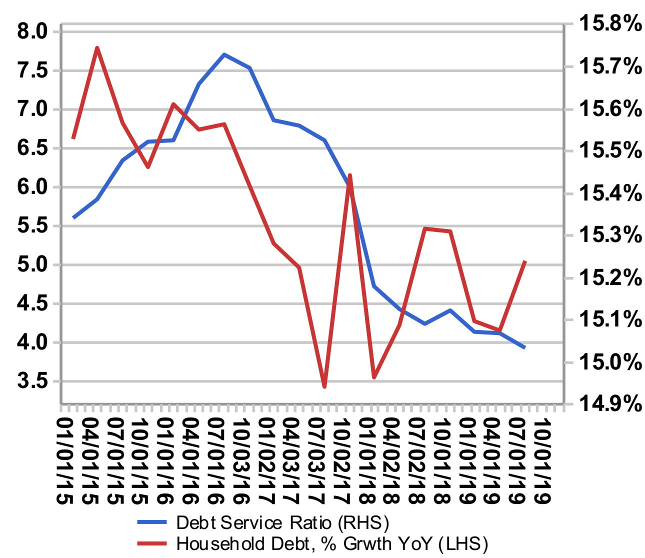
Source: FactSet

Figure 47: Personal Income and Savings Rate



Source: FactSet

Figure 48: Household Debt



Source: FactSet

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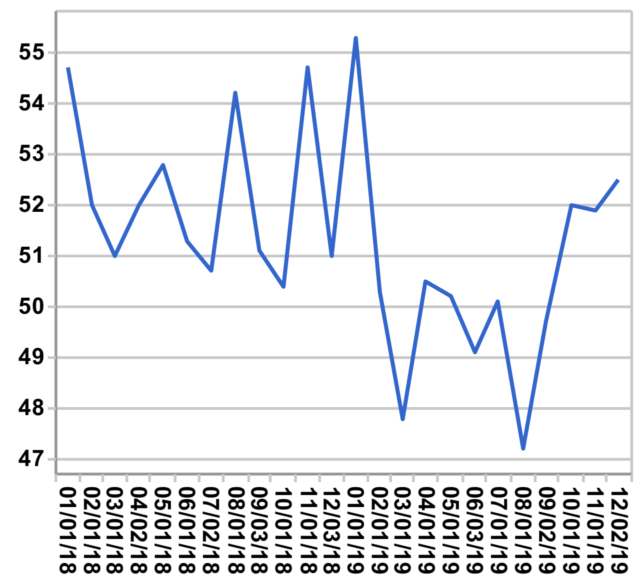
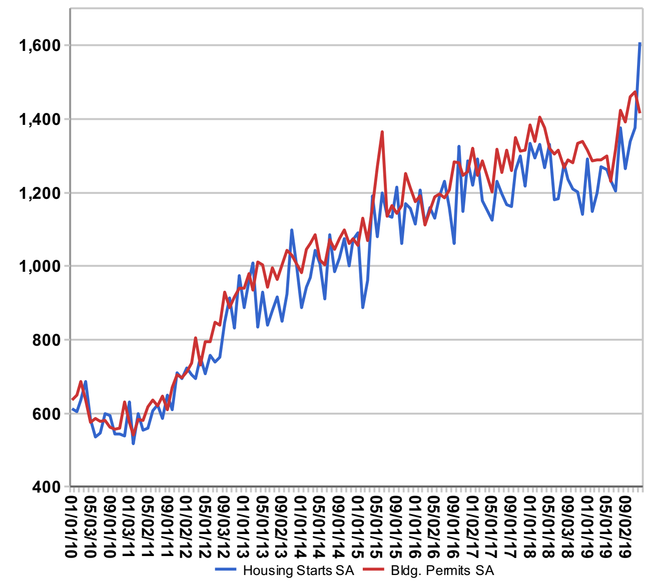
Housing and Construction Indicators

Figure 49: Architecture Billings Index



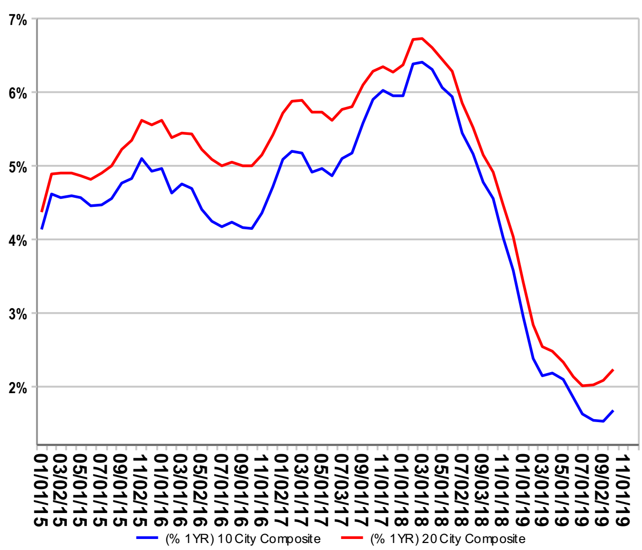
Source: FactSet

Figure 50: Housing Starts and Building Permits



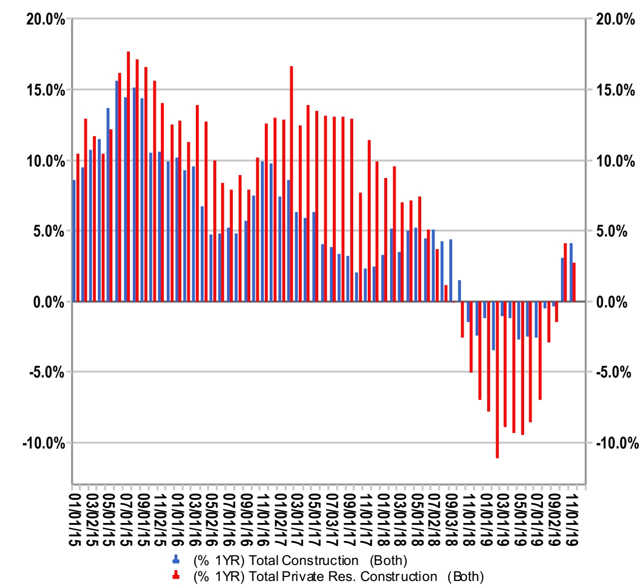
Source: FactSet

Figure 51: Case-Shiller 20-City & 10-City Index, % Chg YoY



Source: FactSet

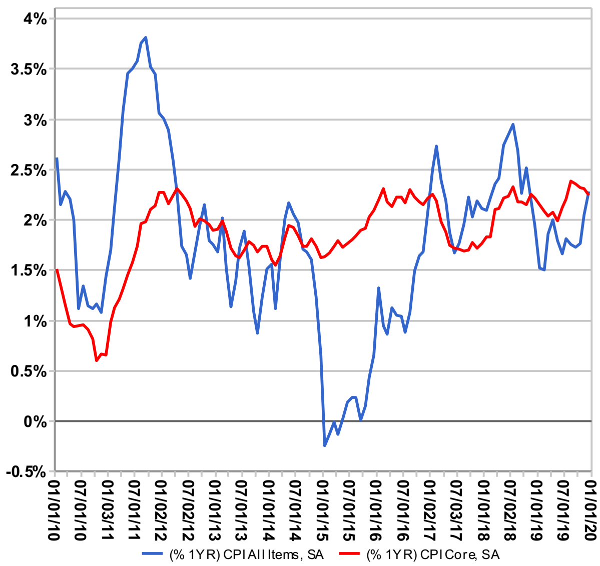
Figure 52: Private and Total Construction (% Chg YoY)



Source: FactSet

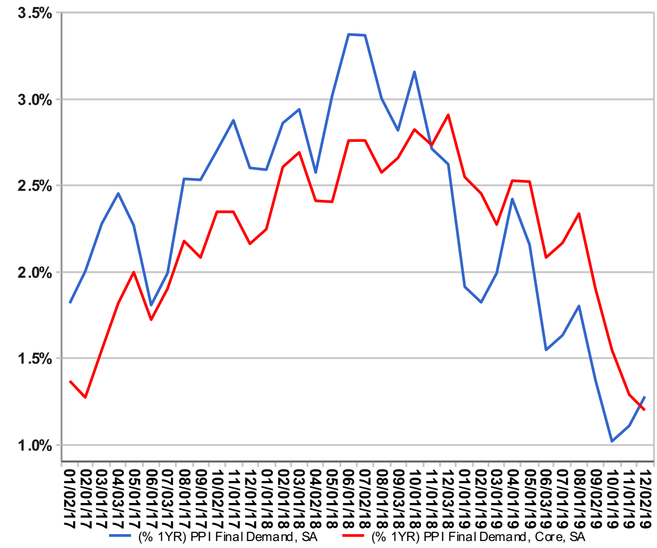
Price Indicators

Figure 53: Consumer Price Index



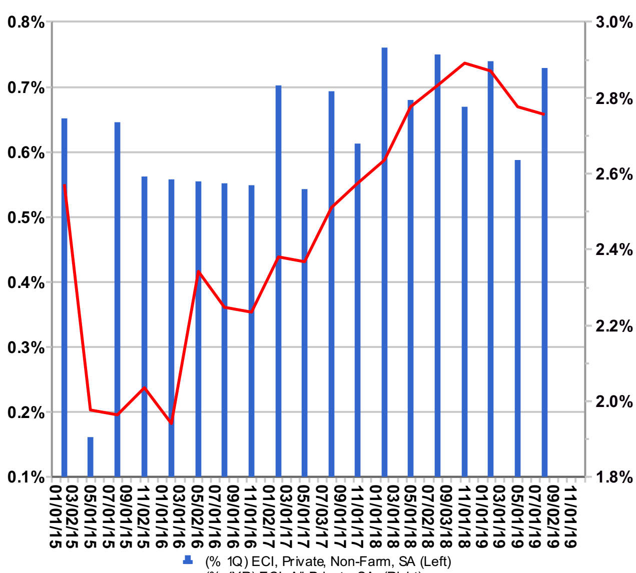
Source: FactSet

Figure 54: Producer Price Index



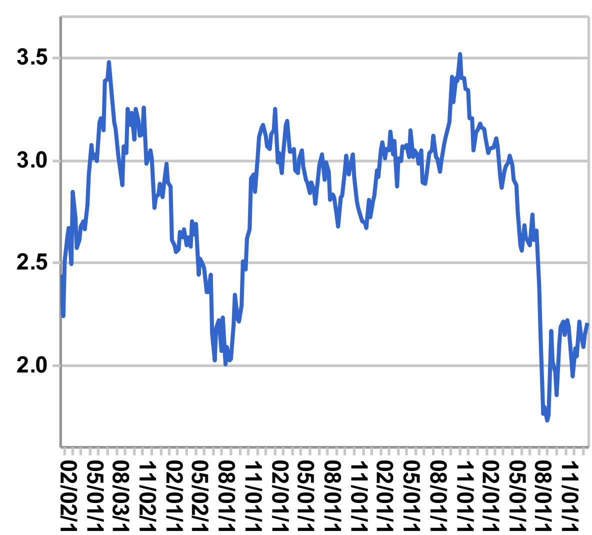
Source: FactSet

Figure 55: Employment Cost Index



Source: FactSet

Figure 56: 10-Year, 5-Year Forward Inflation Expectations



Source: FactSet

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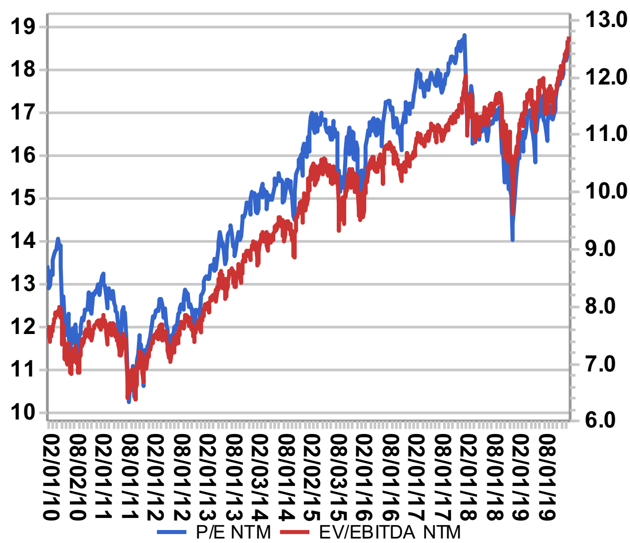
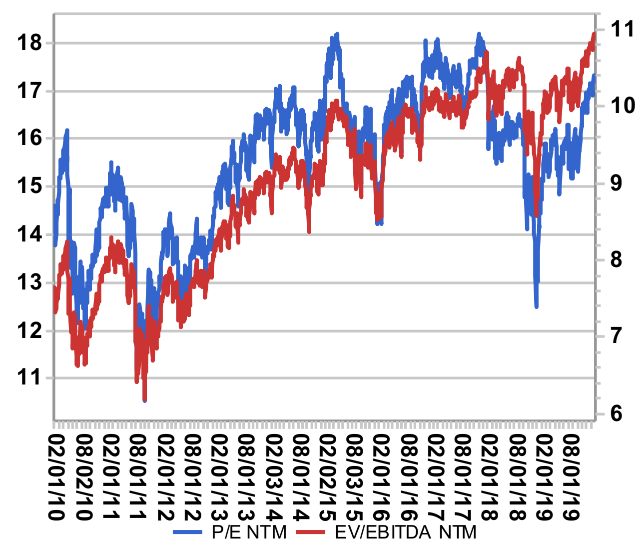
Valuation Indicators

Figure 57: S&P 500 P/E (LHS) & EV/EBITDA (RHS)



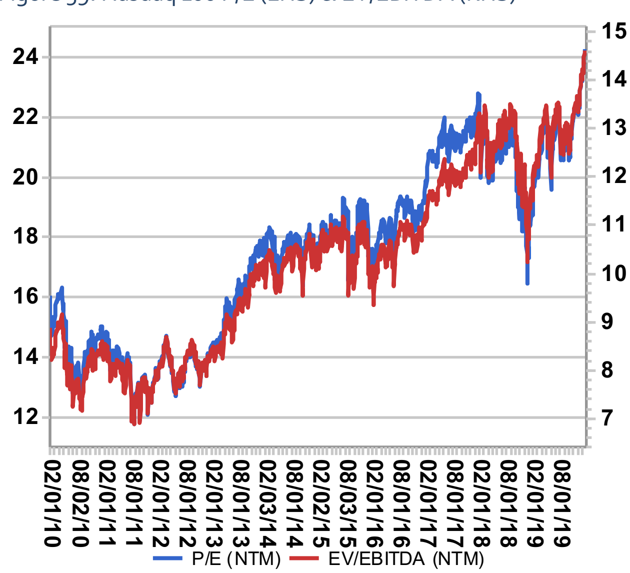
Source: FactSet

Figure 58: S&P Midcap 400 P/E (LHS) & EV/EBITDA (RHS)



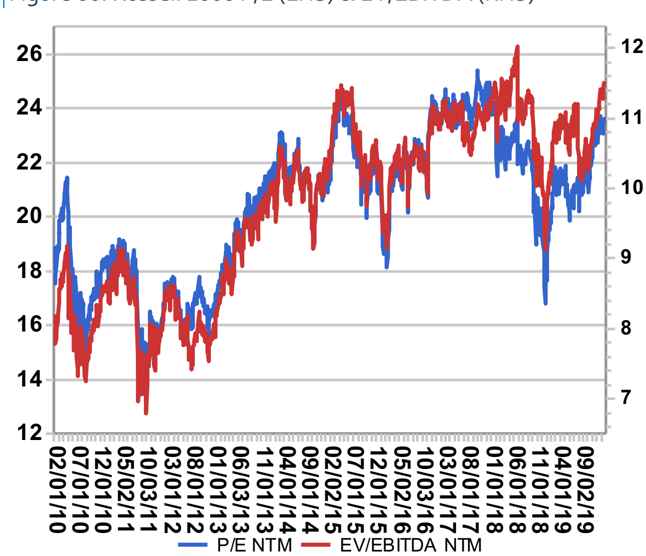
Source: FactSet

Figure 59: Nasdaq 100 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

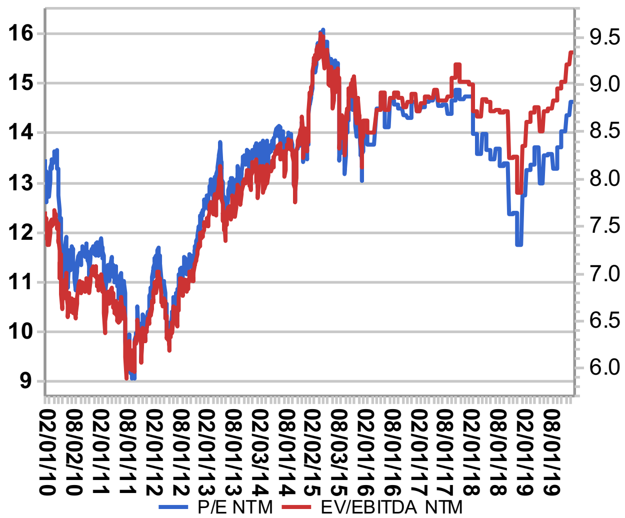
Figure 60: Russell 2000 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

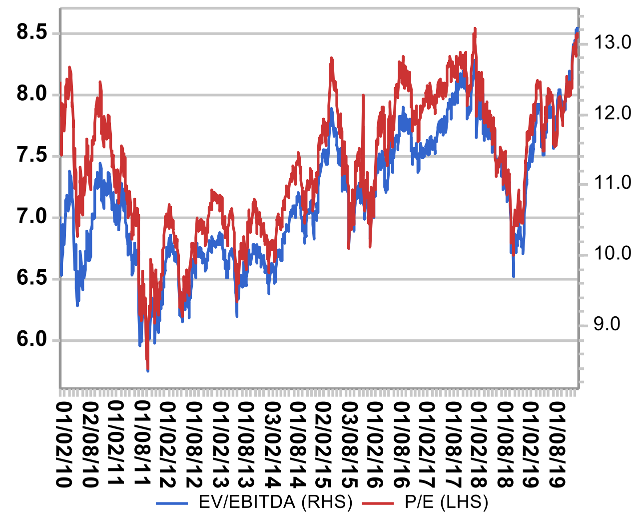
Valuation and Volatility Indicators

Figure 61: Intl Developed P/E (LHS) & EV/EBITDA (RHS)



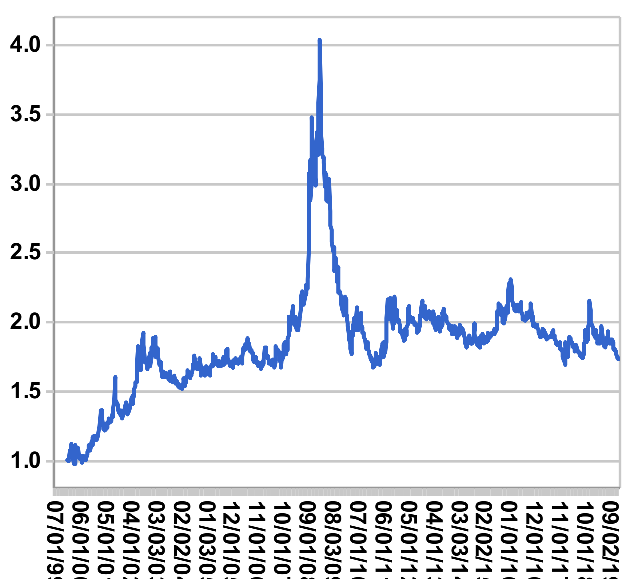
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 62: Emerging Markets P/E (LHS) & EV/EBITDA (RHS)



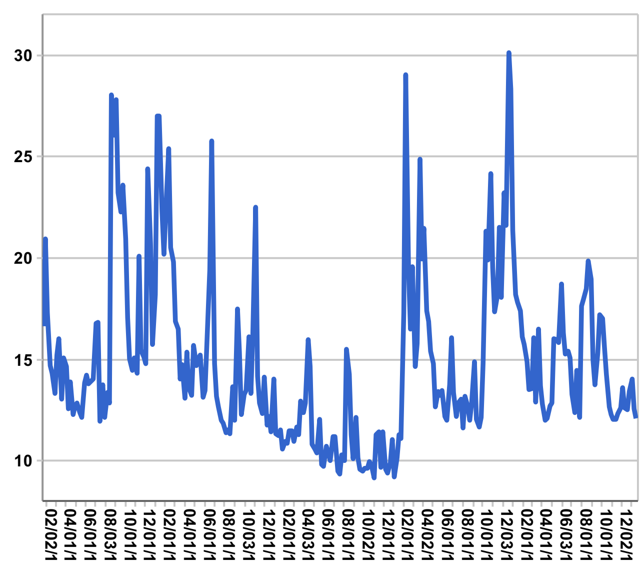
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 63: S&P 500 Dividend Yield



Source: FactSet

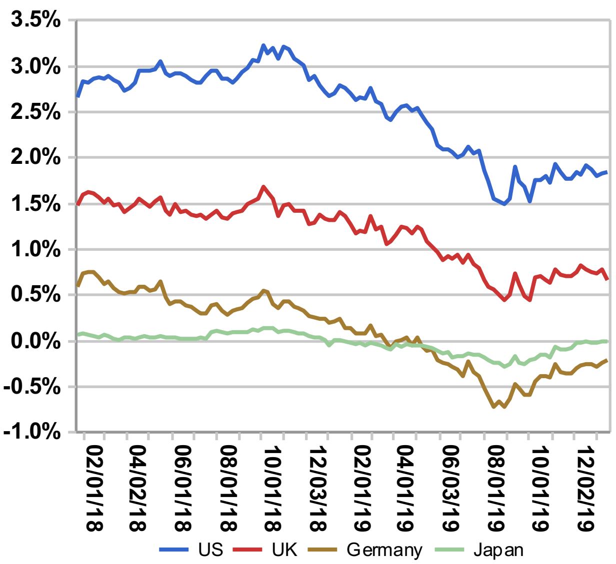
Figure 64: CBOE Volatility Index



Source: FactSet

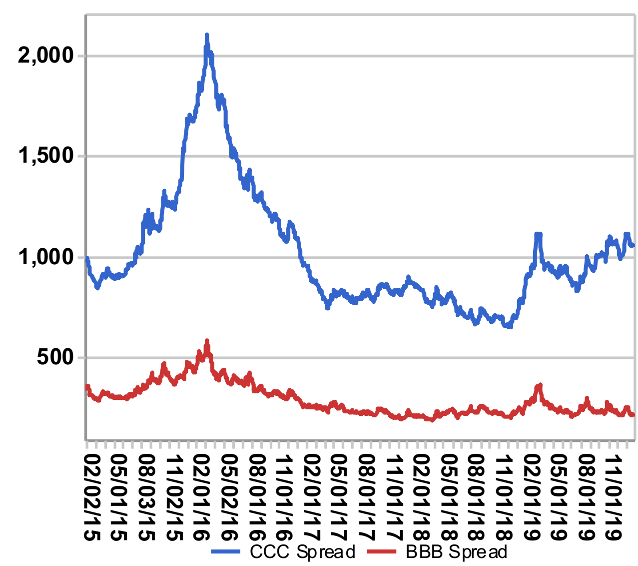
Bond Market Indicators

Figure 65: 10-Year Global Bond Yields



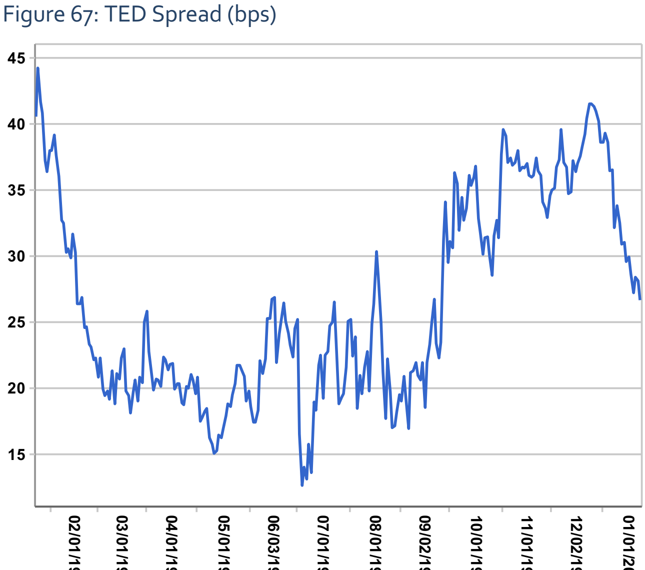
Source: FactSet

Figure 66: CCC and BBB Spreads (Option Adjusted)



Source: FactSet

Figure 67: TED Spread (bps)



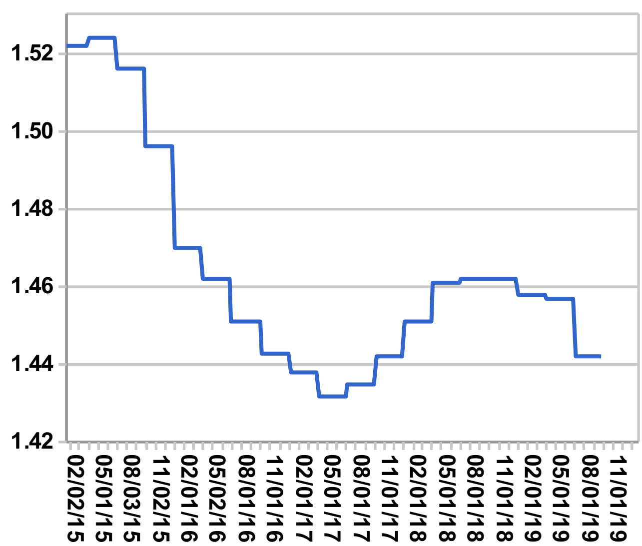
Source: FactSet

Figure 68: 10-Year Minus 2-Year Treasury

Source: FactSet

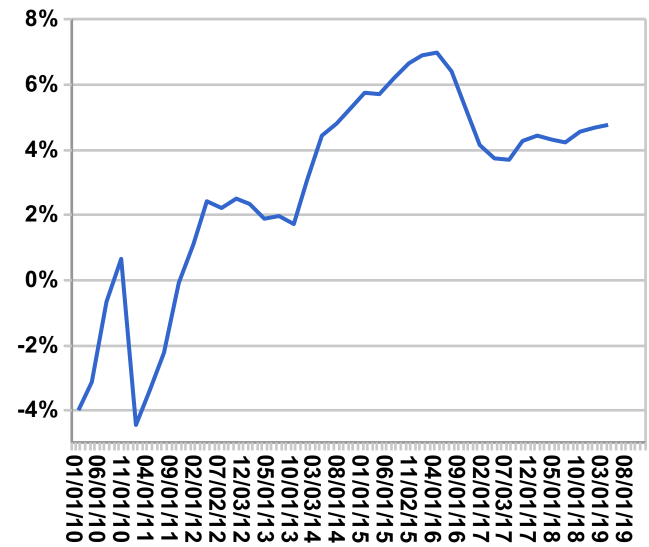
Liquidity and Other Indicators

Figure 69: Velocity of M2 Money Stock



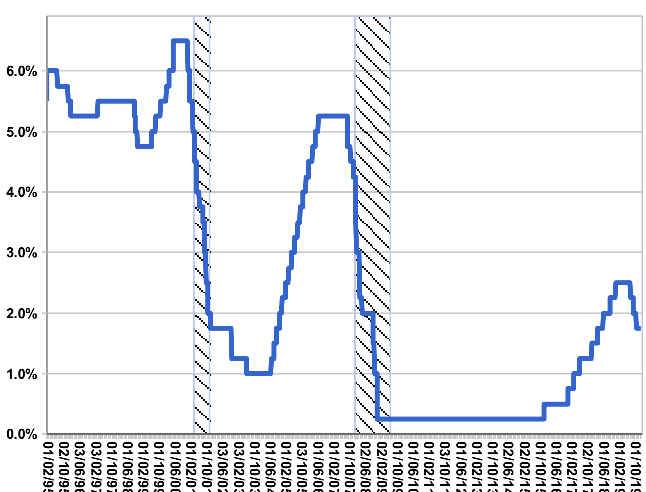
Source: FactSet

Figure 70: Loan Growth (Non-Financial, Private Sector)



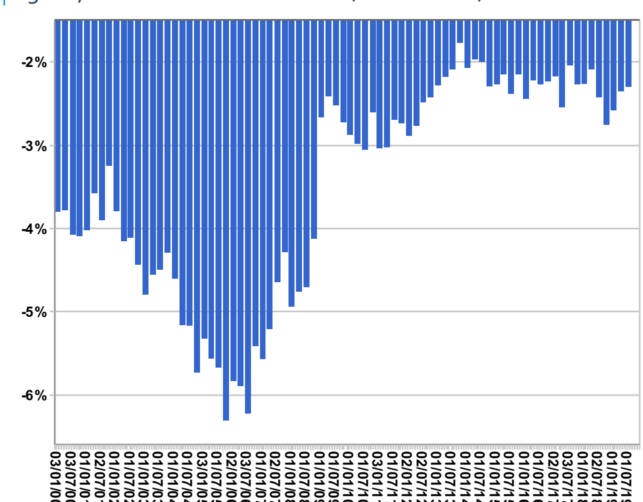
Source: FactSet

Figure 71: Fed Funds Target Rate



Source: St. Louis Federal Reserve, FRED Database

Figure 72: 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 or at cost. 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 December 31, 2019; most other prices and yields are as of January 25th, 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.

Our contact information:

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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.