Investor Quarterly

Stocks Climb a Wall of Worry

ROCKINGSTONE ADVISORS LLC

Global Markets Rebound as Recession Fears Ebb

The fourth quarter's technically-driven collapse reversed itself in 1Q19 as global equity markets rose along with bonds and commodities. Concerns that a hawkish Fed and a China trade-fueled recession would lead to earnings declines were offset by generally positive commentary in 4Q18 earnings calls, bullish news on trade negotiations and improving macro data out of China.

S&P500 Forecast & Other Key Indicators

The S&P surpassed our 2800 forecast during the quarter. Our 2019 EPS forecast remains unchanged at $164; we introduce a 2020 estimate of $176 and raise our S&P price target to 3000. We also tweaked higher our estimates for the following: GDP (+2.4% vs. +2.2%), Gold ($1,300/oz vs. $1,250/oz) and Oil ($70 vs. $60). We leave unchanged our 10-yr US Bond Yield (2.8%) and Inflation (1.9%) forecasts.

1Q19 in Review

Asset prices rebounded strongly in the quarter, with stocks, bonds and commodities all posting gains. While global growth has slowed, there are no near-term indications of recessionary pressures; meanwhile, a more accommodative central bank and resolution of trade fears spurred a broad-based global rally.

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

We highlight the following: S&P500 (+13.5%), Gold (+0.6%), Bonds (+3.0%), Commodities (+9.7%). Global equity markets rose as well, with developed markets (+10.6%) and emerging markets (+11.7%).

Rockingstone Performance

Our portfolios rebounded with the recovery in global asset prices. That said, we were 2-3 percentage points below our expectations due to some tax efficient sales at 2018 year end (which kept us out of the January rebound due to the wash-sale rule) and experienced poor performance in a few individual stocks (EVH, CSTM and ETM) that have since partially recovered. We added DIS, PEP and BA in 1Q19.

About Us

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

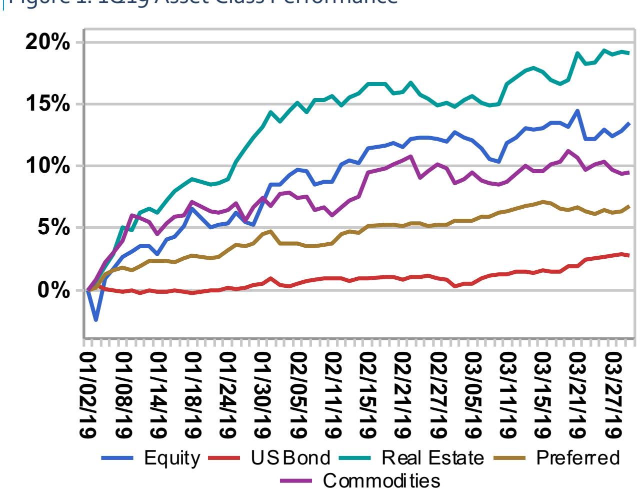
As an SEC-registered investment advisor, we provide multi-asset investment strategies to individuals, families and small institutions through separate accounts.

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:

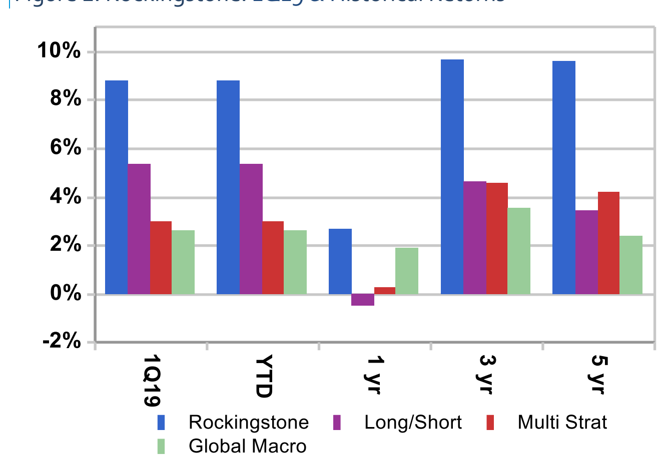
www.rockingstoneadvisors.com

Figure 1: 1Q19 Asset Class Performance[i]



Source: FactSet

Figure 2: Rockingstone: 1Q19 & 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 upon request.

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Asset Class Performance Review

Stocks Climb a Wall of Worry

As noted in our last quarter commentary, we viewed the US and global equity market correction that occurred in the fourth quarter as mainly technical in nature. Sure, global growth was showing some signs of slowing as the trade talks between the US and China dragged on, uncertainty around Brexit rose and the Fed seemed more hawkish perhaps than the macroeconomic data might support. But our view at the time—which remains unchanged today—is that 2019 should witness slower, but positive GDP growth vs. 2018. We also expected lower (but positive) corporate earnings growth due to slower top-line growth and slightly higher input costs.

This outlook was reflected in our below consensus EPS estimate for the S&P 500 of $164 for 2019. We set our year-end price target for the S&P 500 at 2800, or a little more than 17x earnings, about two turns above average due to the lower interest rate environment. Since US equity markets bottomed Christmas Eve, the combination of better-than-expected GDP data, positive earnings commentary, improved likelihood of a Sino-US trade deal and re-accelerating growth out of China have all helped to underpin a sharp rally in global asset prices during the quarter. The S&P rose 13.5%, topped only by real estate (REITs), which jumped about 17%. Preferred securities posted a solid gain of 7.8% and even bonds rose.

Notably, the catalyst to the 4Q18 sell off was a fear that interest rates (the 10-year US bond broke above 3.2% in early Oct) were perhaps rising too quickly and would soon start to draw investment dollars from equities into bonds. Frequently when stocks start to decline, they trip "technical" levels which fuels more selling. Such sell-offs tend to create their own narrative, as commentators try to explain what is happening, painting the declines with the most pessimistic brush. At some point, which generally seems to coincide with the volatility index (VIX) surpassing 30, prices become too cheap to ignore, stocks bottom and start to recover. This occurred with brutal efficiency on the 26th of December and continued through the 1Q19 and into the first few weeks of April.

Stock market corrections are never pleasant as stocks decline at a far faster rate than they appreciate. Moreover, one rarely knows where shares will ultimately bottom. On average, there is about a 5% decline in share prices three times per year; a 10% decline approximately once per year; a 15% decline about once every 3.5 years, and a 20% decline once every 6.3 years. However, stocks typically recover fairly quickly afterwards. Unlike corrections, bear markets are defined as a 20%-plus decline in the index; the average bear market decline is 33% and they typically last only 14 months vs. 71 months for the typical bull market. Bear markets usually coincide with economic recessions.

While timing the market is very difficult, Rockingstone's approach is to attempt to mitigate the impact of a bear market on client portfolios. Hence, if we remain constructive on the general macroeconomic outlook, we are willing to suffer through what we believe are temporary declines in asset values during bull-market corrections. The Chart Book at the end of this newsletter outlines several of the economic indicators that we follow. When many of these indicators begin to flash caution, we would look to reduce cyclical exposure, raise some cash, add some hedges and position client portfolios more defensively. Because we aim to be tax efficient, we would rarely contemplate full scale liquidation of portfolios and a move to cash. We also own several names that should perform well through an economic slowdown, which is part of the benefit of owning a diversified portfolio.

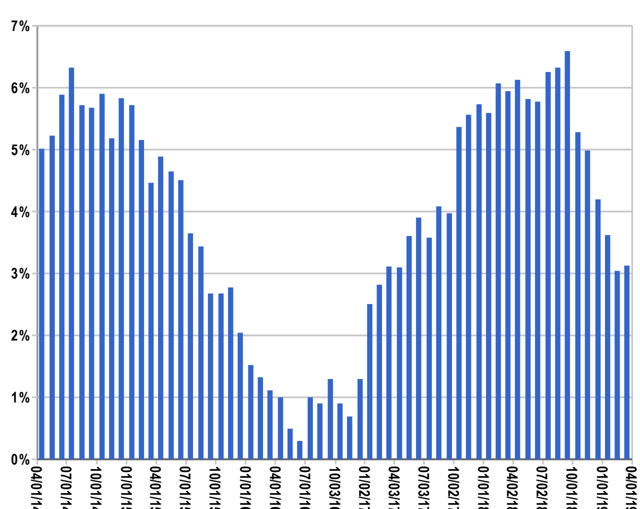
Part of this diversification is also owning US Treasuries, and while we've been reasonably cautious on the US Treasury market as rates have risen since the summer of 2016 from 1.4% to 3.2% in October 2018, the recent decline in bond yields down to 2.5% caught us by surprise. US Treasuries do tend to be inversely correlated with equity prices (meaning that when stocks fall, US Treasury prices rise), so we would look to increase our holdings of Treasury and other US sponsored debt (agencies) should we turn more cautious on the economic outlook.

At this juncture, following a substantial run in asset prices to our forecasted levels, we believe risk and reward are equally balanced. On the downside, there are a couple factors that worry us.

First, as global economic growth has slowed and input costs (mainly labor rates, but also shipping / freight costs) have risen, corporate earnings growth is slowing, which leaves less cushion for unforeseen shocks that inevitably arise. While this pressure is not yet widespread, as GDP should run in the mid-2% range (despite the 1Q19 "estimated" figure coming in at 3.2%) and wage inflation remains surprisingly muted despite low levels of unemployment, earnings estimates for the first half of 2019 for the S&P 500 are roughly flat with the year ago period. Unlike in the first quarter 2019 when disappointing fourth quarter 2018 earnings were met with rising stock prices, at current levels that is a lot less likely.

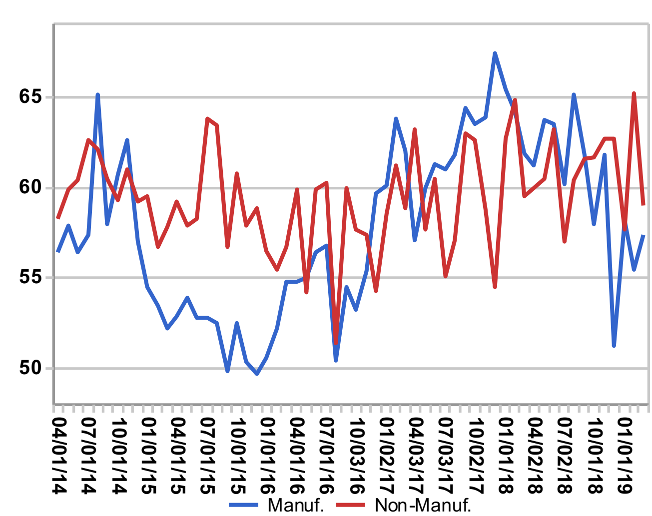
Second, we could see becoming more cautious based on the fact that several of our favorite economic indicators are starting to show some stress. These include: (1) the yield curve has flattened (though is still positive), (2) industrial production has slowed, (3) the index of leading economic indicators is decelerating, (4) bond spreads are widening, (5) ISM new orders are softer, (6) the Baltic Freight Index has been declining, (7) construction activity is slowing and (8) inflation expectations are falling.

Figure 3: Index of Leading Economic Indicators, A 2016 Redux?



Source: FactSet

Figure 4: ISM New Orders

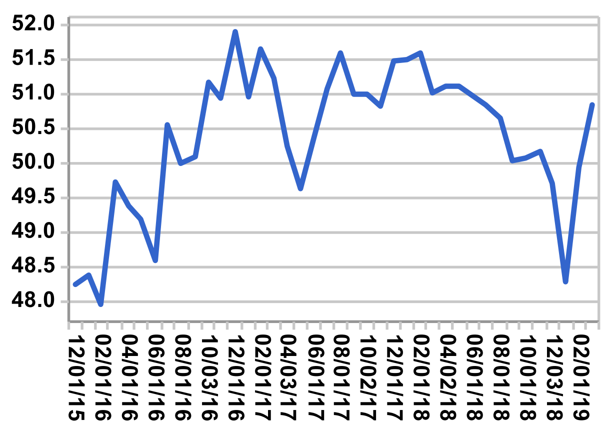


Source: St. Louis Federal Reserve, FRED Database

Admittedly, a very similar pattern occurred around 2010 and also from 2015-2016 whereby the economy decelerated rapidly, only to pick-up steam again at the very point where it looked like it was heading into recession. We highlight this point now, as there is some evidence that a similar dynamic may be occurring. This is why we believe—despite the aforementioned cautionary issues sited above— risk and reward are evenly balanced.

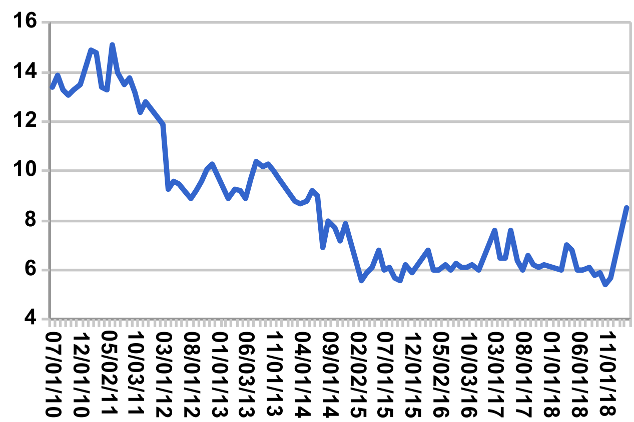
On the positive side, amid Washington DC theatrics, trade disputes, Fed tightening fears, Brexit uncertainty as well as European and China slowdowns, it is not surprising that some investment decisions may have been deferred in the back half of 2018 that are cumulatively impacting economic activity today. In our view, what really matters though, is if there is a Sino-US trade agreement and the Fed continues to be on hold throughout the year. Should that occur, a case can be made that earnings will trough in the 1H19 and potentially re-accelerate with a strengthening economy into the back half of 2019, setting up for growth into 2020, a renewed leg higher in equity markets and lower yields in treasury markets. As if on cue, the recent data (see figures below) out of China show a marked improvement in business sentiment and industrial production levels. Because Europe's economy is far more sensitive to demand from China than is the US, the more favorable outlook in China bodes well for improving but lagged demand trends in Europe.

Figure 5: China Caixin PMI



Source: FactSet.

Figure 6: China Industrial Production, YoY % Growth



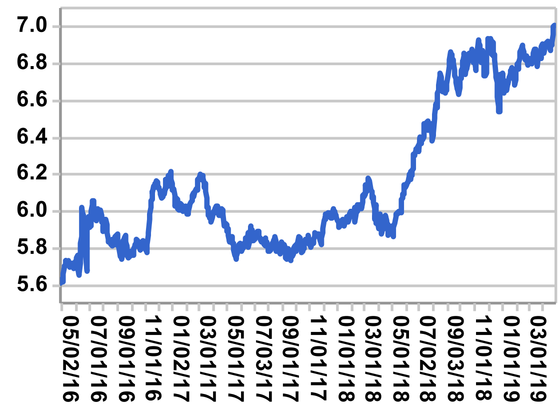
Source: FactSet.

Improving trends in Europe would be a welcome relief: unlike the S&P, which peaked in September of 2018, global developed and emerging markets peaked in January of 2018 and spent the entire year recording lower lows, only to post an anemic recovery in 2019 that has lagged US markets year to date.

Hence, if China's economy were really to improve, we would expect to revisit the synchronized global growth story that fueled a powerful rally in risk assets back in 2017. In that case, foreign and emerging markets could outpace the US market for the remainder of 2019 and into 2020. This is due to two reasons. First, as cited earlier, foreign and emerging markets have more exposure to China that does the US market. Second, both foreign and especially emerging markets have underperformed the US market for what seems like forever. While valuation levels are not materially cheaper in those markets compared to the US given depressed/trough earnings, if a recovery takes hold and earnings re-accelerate, then current multiples for foreign and emerging companies are woefully understated and we could witness a sustained rally in prices and a re-rating higher of current multiples.

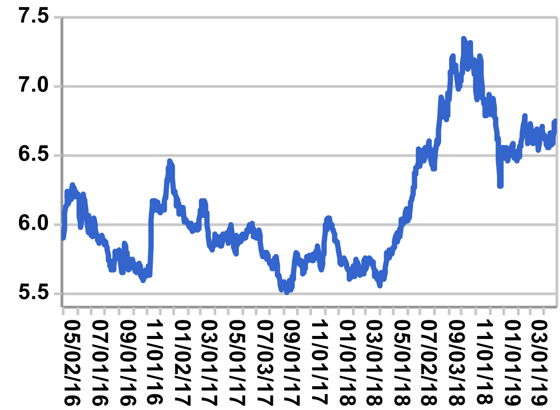
The figures on the following page show the ratio of the S&P 500 to both foreign developed markets (VEA – Figure 7) and the ratio of the S&P 500 to emerging markets (VWO – Figure 8).

Figure 7: S&P 500 vs. Developed World, 5 Years



Source: FactSet.

Figure 8: S&P 500 vs. Emerging Markets; 5 Years



Source: FactSet.

As we progress through the second quarter, our overall outlook remains unchanged from Rockingstone's last quarter newsletter. We generally expect S&P earnings growth in 2019 to be in the low, mid-single digits and GDP to be roughly 2.4%; nothing exciting but still limited likelihood of a recession. We think earnings and GDP build throughout the year, such that the second half is generally better than the first half of 2019.

This forecast considers that several of the issues concerning investors continue to persist in 2019, but don't necessarily deteriorate. Those issues include: (i) slowing global growth and slightly higher input costs, (ii) central banks that are neutral, (iii) the resolution of bilateral trade disputes, (iv) high debt levels around the world, and (v) political paralysis in numerous countries and/or regions. We would emphasize the following:

1. Slowing Global Growth. To be sure China, the second largest economy, has slowed from the pace it established over the last few years: Published growth rates of 7-8% a few years ago have decelerated to 6% or less. Clearly investors are concerned that slower growth, coupled with significant leverage across China's economy and an ongoing trade disputes with the US, could result in larger than expected deceleration in GDP growth. But such growth is still well above the EU, Japan and even a stronger US economy, and most recently shows signs of reaccelerating due to potential resolution of the trade dispute with the US as well as public policy changes that were designed to stimulate the economy. Recent PMI, industrial production and loan growth data seem to support the reacceleration thesis. With an emphasis on the long term, we believe China will continue to grow, emerging markets such as Latin America should rebound and developed markets including the US are attractively priced.

2. Central Banks. As is well known since the global financial crisis in 2008, central banks around the globe have been incredibly accommodative. Starting in 2016 and continuing throughout 2018, the US Federal Reserve became more restrictive. Looking at employment figures and capacity utilization, we believe this is a rational and prudent approach, including reducing the Fed's balance sheet. That said, the Fed has recently announced a willingness to "wait and see" how some of the current headwinds (government shutdown, trade, international weakness) affect the US economy before continuing to raise short-term rates. It's unclear if the Fed will be on hold for the entire year, but we suspect no rate increases for at least the next quarter or two. The ECB had indicated it will stop its own quantitative easing and look to raise interest rates in 2019, though recent

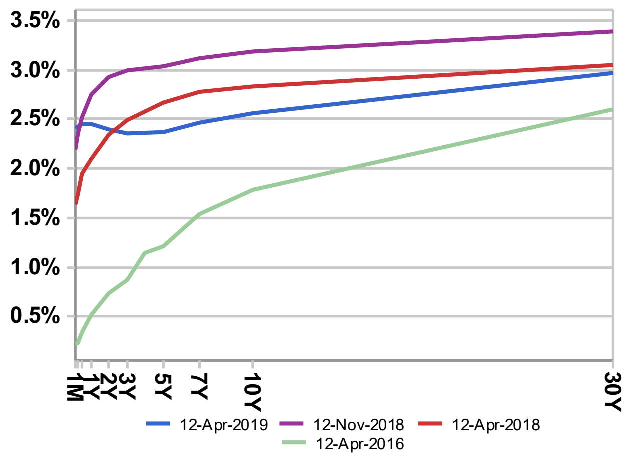
statements are a lot more dovish. Together, developed world central banks seem much more accommodative in 2019 than they were in 2018.

3. Trade Disputes. While investors were bullish on US tax reform, the market is clearly concerned by the arbitrary use of tariffs and by the potential for slower growth due to trade disputes. From an economic theory standpoint, free trade allows for increased efficiency and comparative advantages to play out in the marketplace. The use of tariffs reduces such efficiency and essentially imposes a tax, i.e. higher steel tariffs will result in a pass through of higher costs in the form of pricing. Ultimately, we believe leaders (EU vs. UK, US vs. China, US vs. EU) will see the value of not allowing disputes to last too long and faith will be restored in the post WWII global trading system (along with mechanisms such as the WTO to resolve disputes).

4. Debt Levels. Based on an analysis published in the WSJ (Jan 2, 2019), global debt is now approaching $250 trillion. The same analysis suggests that debt as a percentage of global GDP is approaching 320%. A lot of the growth in outstanding debt has come from Asia, as well as emerging markets that borrowed heavily in US dollar-denominated debt. While less transparent, China's private and quasi-private sectors have loaded up on debt over the last decade. Of all the concerns noted in this section, we are most worried over debt levels. Even the US, which currently is running a $1 trillion Federal budget deficit (in addition to the $20+ trillion in outstanding government debt), doesn't seem to have the political will or broad-based public concern to address the issue. To be sure increasing debt can be a signal of a strong economy as lenders extend credit to borrowers that see opportunity. Yet we know that numerous equity bear markets have been caused by a decline in liquidity and widening credit spreads. Once a debt crisis occurs, it is generally too late to deal with it.

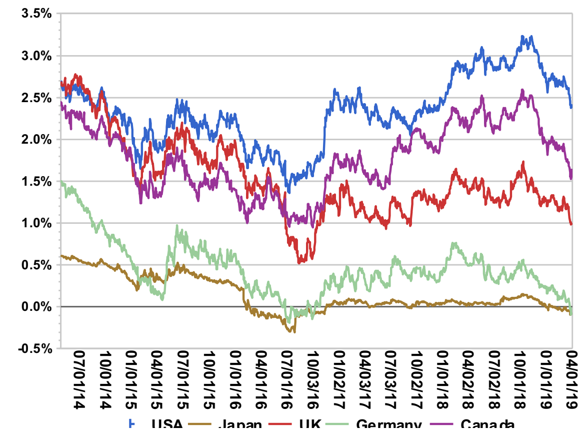
5. Political Paralysis. While investors seem to be fretting over political acrimony and paralysis in DC, history suggests that a split US government is often positive for market returns. This is a function of less change occurring, which is typically viewed by investors as reducing the chance for negative surprises. To the extent some bipartisan legislation can be passed (infrastructure) and select trade issues resolved, we would view this as a positive. While the US corporate tax cut was supposed to spur a jump in capital spending, so far Boards have largely approved higher share repurchases and dividends. Our sense is that CEOs and CFOs have been reluctant to invest long term capital given so many global trade relationships are under review.

Figure 9: U.S. Yield Curve



Source: Factset

Figure 10: Global Sovereign Yields

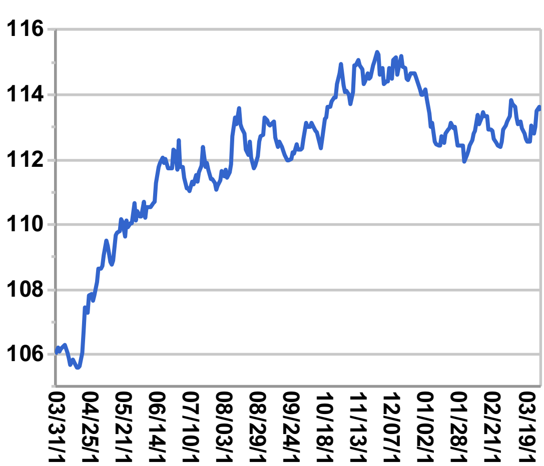


Source: Factset

Meanwhile, parts of the yield curve have been sending mixed signals, helping to contribute to the poor performance in equities witnessed last quarter and the impact on investor psychology related to the sell-off toward the end of 2018. We note that while yields (see Figure 9) along most of the curve are above a year ago, the shape of the curve is flatter and yields have dropped noticeably since October 2018. The curve is also "kinked," whereby 1-year yields are above 2- and 3-year yields. While flatter than a year ago, the differential between the yields of 10s-2s and 10s-1s (mentioned previously) is still positive, and frankly we have seen some steepening of the curve since year end. We believe this trend should continue in 2019, albeit modestly, due to (i) low single- to mid-digit GDP growth in the US, (ii) government borrowing to fund the US Federal deficit and (iii) unwinding of the Fed's balance sheet.

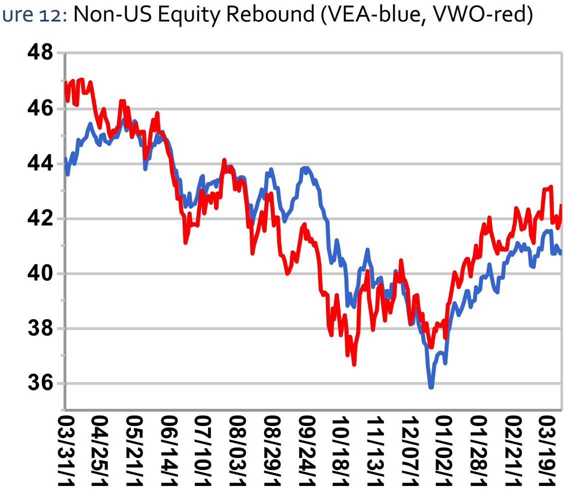
Although fixed income performed relatively well in 4Q18, we remain under-weight given our view on yields (which are inversely related to price). As has been the case for a while, we are also bearish on non-US developed market bonds. In Figure 10 we emphasize the surprisingly low relative yields in countries such as the UK vs. the US.

Figure 11: Federal Reserve Nominal Broad $US Index



Source: FactSet, Federal Reserve

Figure 12: Non-US Equity Rebound (VEA-blue, VWO-red)



Source: FactSet

As the Federal Reserve has raised short term rates over the last two years, the $US has strengthened (see Figure 11). Combined with relatively strong US GDP growth and weaker EM GDP results, this has pressured non-US equities (see Figure 12). We believe the $US is likely to pause at best and possibly depreciate in coming quarters. This should help non-US equity performance which is one reason we still have exposure to these markets, coupled with ongoing attractive valuations, despite slower growth.

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Equity Performance

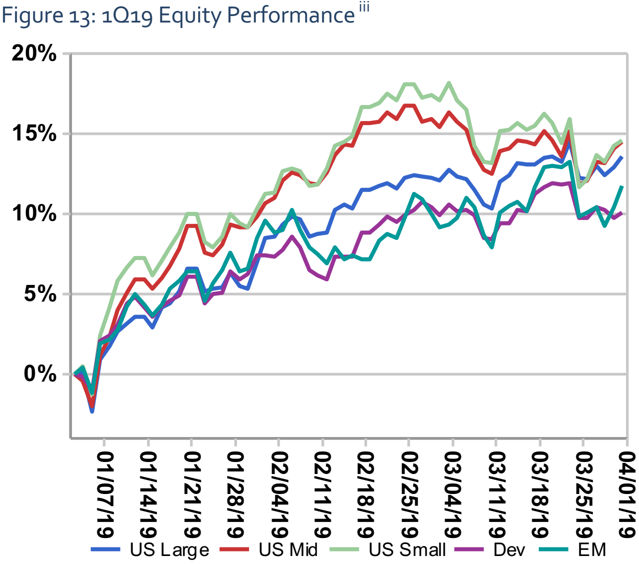
As Good in the First Quarter as the Fourth Quarter was Bad

As evidenced by Figure 13 and Figure 14 below, investors witnessed a solid rebound in global equity prices, with all categories and styles showing a sharp recovery to the oversold conditions experienced during the fourth quarter of 2018.

It's tough to point to a single catalyst that started the move higher on December 26th, though we would highlight a few factors, including: (i) the VIX breaking above 30 on Christmas Eve, which typically is a level that marks a bottom in prices and (ii) the cessation of year-end tax loss selling, which frequently occurs in December. The equity rally was sustained on a combination of favorable reports during 4Q18 earnings season (which runs roughly from mid-January to the end of February), dovish commentary from the Federal Reserve and lastly, favorable comments surrounding the on-going US-China trade negotiations. Just as negative price action fuels further selling, the inverse is true as well: positive price action results in technical repair and recovery, which then drives more buying. Such dynamics were alive and well during the last six months.

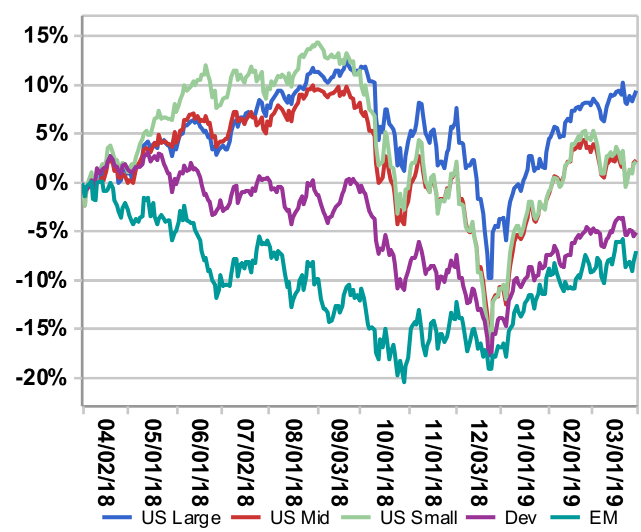
We note the following performance metrics regarding 1Q19 ending March 31, 2019: US Large Cap (+13.5%), US Mid Cap (+14.4%), US Small Cap (+14.4%), Developed (+10.6%), Emerging (+11.8%). Notably, Foreign Developed and Emerging Markets actually preceded the US declines, as international markets peaked way back in January of 2018 and eroded throughout last year. This led to a massive performance gap differential by September 2018 vs. US equities. More recently US equity markets outperformed International markets in 1Q19 mainly due to stronger earnings growth recorded during the quarter, as well as a slightly stronger dollar that generally rose against its trade-weighted basket. But the dollar peaked on March 11th and has started to weaken against most major currencies. Despite rising nearly 15% this year, small company performance has been disappointing as small cap stocks declined more than 20% in the fourth quarter sell-off.

Figure 13: 1Q19 Equity Performance [iii]



Source: FactSet

Figure 14: LTM Equity Performance



Source: FactSet

Fixed Income Performance

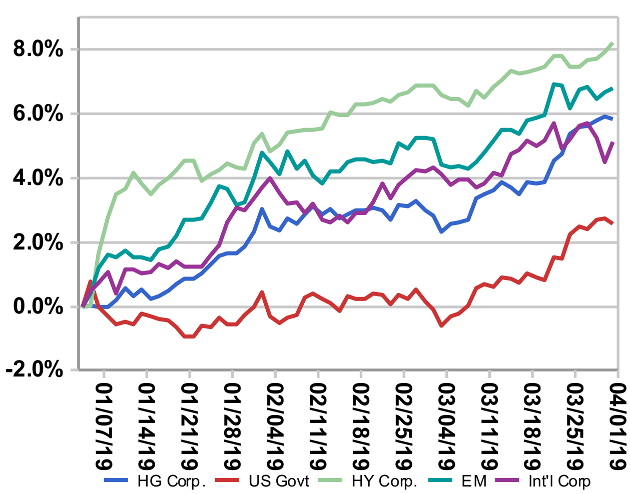
Despite A Recovery in Equity Prices, Fixed Income Still Rallies

Bonds (notably treasuries) were generally a haven during the fourth quarter sell-off in the equity markets. Of course, like equities, fixed income spans the risk spectrum from super safe short-term treasuries on one hand, to high grade corporates then speculative high yield and mezzanine financing on the other. Despite the recovery in equity markets, bonds recorded a solid quarter, with spread products (high yield bonds, corporates, emerging markets) outperforming safer treasuries and agency bonds, though we note even treasuries recorded gains during 1Q19.

The Federal Reserve's recent decision to put rate hikes on hold until the path of global growth is clearer has fueled the rally in treasuries. Meanwhile the positive GDP figures and favorable company commentary has fueled the sharper rally in the more speculative side of fixed income, including high yield and emerging markets debt. Overseas, European growth rates continue to decelerate, aiding European and developed market bonds. In emerging markets, potential reaccelerating demand in China has helped lift those bonds as well.

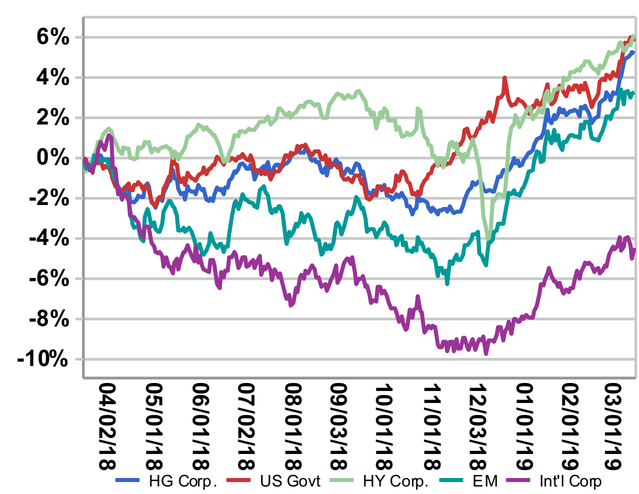
We note the following performance figures for 1Q19: US High Grade (6.2%), US Governments (+2.8%), US High Yield (8.1%), International Corporates (3.0%), Emerging Markets (5.7%).

Figure 15: 1Q19 Fixed Income Performance[iv]



Source: FactSet

Figure 16: LTM Fixed Income Performance



Source: FactSet

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Commodity Performance

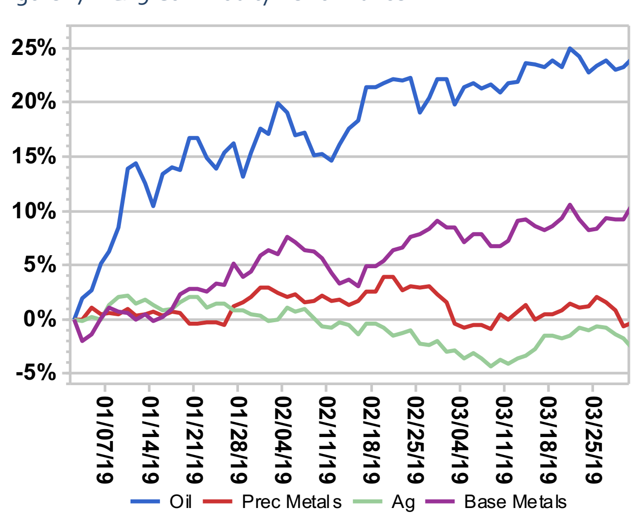
Oil's Wild Ride Continues

Putting oil's wild ride aside for the moment, the other commodities we track paint a reasonable picture of global growth dynamics. As noted previously, the global macro-economy has been lackluster vs. early 2018 expectations, with the US the exception. Reflecting a still weak EU, challenges in select emerging markets and fears about China, non-oil commodities were flattish to up slightly in the 1Q19, and mostly down over the last year. We also note that a strong $US tends to limit commodity price gains, as most commodities are priced in US dollars.

Meanwhile, oil (as represented by the ETF DBO) jumped 23% in the 1Q19. But that followed a dramatic 38% decline in the 4Q18! Recall that was after a 35% jump during the first nine months of 2018. Between political dynamics in the Middle East (Saudia Arabia vs. Iran, Libya Balkanization), Russia energy exports, US fracking / technology gains and EM news (Venezuela's collapse vs. Guyana's potential), we expect oil to remain volatile. Nevertheless, we have kept some exposure to oil and to energy stocks. Our top two holdings are EOG and ConocoPhillips. Interestingly, as this newsletter is to be published, M&A has taken center stage among US energy equities.

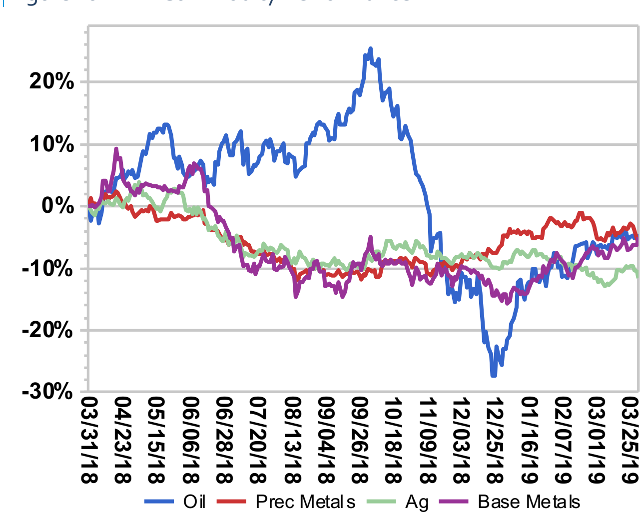
As noted in past newsletters, it is tough to draw conclusions from commodity prices at any given time. Most assets can be valued by discounting future cash flows. But an asset like gold or copper doesn't generate any intrinsic cash flow and thus deciding what is the correct value is a challenge. We track commodity trends via specific ETFs (which are the basis for the graphs below). Rockingstone uses ETFs to gain exposure to the asset class, in addition to owning the underlying equities or debt. We note the following returns during the 1Q19, respectively: Oil (+23.0%), Precious Metals (-1.0%), Agriculture (-2.5%), Base Metals (+10.0%).

Figure 17: 1Q19 Commodity Performance[v]



Source: FactSet

Figure 18: LTM Commodity Performance



Source: FactSet

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Forecast: 2019

Rockingstone Advisors' Latest Forecasts

Our forecast for 2019 is little changed from the views we expressed at the beginning of the year in our *4Q18 Investor Quarterly*, with only some minor upward revisions. We generally expect low-to-mid 2% GDP growth in the US and slightly higher interest rates. Our growth rate assumptions for GDP are predicated on a solid service economy aided by an improving manufacturing economy. Re-stocking of inventories and solid consumer demand should support growth as well. Our assumption for slightly higher US interest rates is based on the expectations of ongoing GDP growth, coupled with higher input costs due to a combination of a tightening labor markets (putting pressure on wage rates) and slightly higher prices for commodities as China rebounds and Europe stabilizes.

At the margin we are raising our 2019 GDP growth forecast from a range of 2.0-2.4% to a range of 2.2%-2.6%, with a midpoint of 2.4% based in part on the first quarter GDP "advance" estimate of 3.2%. While this figure was inflated by higher than normal inventory adjustments, without the government shut-down it would have been slightly higher.

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 4Q18 results and early indications for 1Q19 EPS, our S&P 500 forecast of $164 remains unchanged, while the consensus forecast, which was originally $176 at the time we published our forecast, has now come down to $165. Our current estimate implies about 6% EPS growth in 2019.

Despite commentary that earnings for 1Q19 is expected to decline from 1Q18, we cannot find evidence to support that view: operating earnings expectations are up about 1.9% YoY ($37.23 vs. $36.54), while reported earnings expectations are flat ($33.05 vs. $33.02). Margins are down YoY, however, from roughly 11.4% in 1Q18 to 11.04% in 1Q19. As of April 26th, 228 S&P 500 components had reported March 31 results, with 171 beating estimates and 17 meeting estimates; only 40 have missed. Based on our GDP forecast and other current trends, we introduce a 2020 estimate of the S&P 500 of $176, up about 7.3% from 2019. This figure is below the current Street view of $186.26 for 2020.

Figure 19: Key Metric Forecast

	Year End December	
Metric	Band	Point
US Real GDP (2019)	2.2% - 2.6%	2.4%
S&P 500 2019 EPS (RSA/Street)	NA	$164 / $165
S&P 500 2020 EPS (RSA/Street)	NA	$176 / $184
S&P 500 2019 Index	2900-3100	3000
10-Yr US Treasury Yield	2.6% - 3.0%	2.8%
Oil (WTI-2019 End)	$60 - $80	$70
Gold (2019 End)	$1,250 - $1,350	$1,300
Inflation (NTM)	1.8% - 2.0%	1.9%

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

A few observations and comments:

1. <u>S&P500 Index</u>. As this newsletter goes to print, the S&P500 is trading at 2939, or approximately 18x our 2019 EPS forecast of $164. Based on our new 2020 EPS

forecast of $176, we estimate the Index should trade up to around 3000 by the end of this year (implying 3% appreciation over the next eight months, and total 2019 appreciation of around 20%). With EPS up 6%, slightly below the long-term average, we believe the market's multiple can remain roughly flat. Our assumption for no contraction in the multiple is driven by two factors: (1) expectations for limited rate increases from current levels, and (2) higher confidence in the earnings outlook for 2019, which is currently constrained by fears of a global slowdown.

2. <u>10-Year Treasury Yield</u>. After declining substantially in 2019, 10-year Treasury yields have stabilized and are starting to back-up. We leave our current forecast of 2.8% for the US 10-year unchanged. Over the last month, the 10-year's yield has risen from 2.41% to 2.52%. We expect yields to rise another 30 bps for several of the reasons cited earlier, but specifically re-accelerating global growth rates due to a recovery in China that fuels demand improvement in Europe, plus some higher cost pressures and inflation due to tighter labor markets and higher materials and shipping costs. Offsetting these pressures remain low government bond yields across Europe, which help to anchor US yields.

3. <u>Oil and Gold</u>. As global growth recovers and inflation pressures mount, we continue to be marginally constructive on oil and gold prices. That said, there are several secular trends that may limit oil's price appreciation over the long-term, but for now we think that the trend is higher. Hence, we raise our year-end WTI forecast from $60 to $70 per barrel. We raise slightly our gold forecast from a range of $1,200-$1,300 to a range of $1,250-$1,350 and a midpoint price target of $1300 by year end.

4. <u>Inflation</u>. We maintain our current range of 1.8%-2.0% for inflation, with a mid-point of 1.9%. The forecast is above current trends, but we remain comfortable that the forces cited above should continue to put upward—albeit mild—pressure on inflation.

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Five Year Asset Value Forecast[vi]

Balanced Expectations from Current Levels given Rise in Asset Prices

Return expectations are materially lower from the prior quarter due primarily to the rise in asset prices this quarter. Typical to our approach, we assume asset values mean-revert (with respect to margins and P/E multiples) over time.

Figure 20: 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	5.5%	=	6.5%	-	1.6%	+	2.0%	-	1.5%
US Mid Cap Stock	S&P400	6.8%	=	5.8%	-	0.4%	+	1.7%	-	0.2%
US Small Cap Stock	S&P600	6.1%	=	5.7%	+	0.1%	+	1.9%	-	1.7%
Foreign DM Stock	MSCI-EAFE	4.5%	=	3.6%	-	1.6%	+	3.4%	-	0.9%
Foreign EM Stock	MSCI-EM	7.6%	=	5.8%	+	0.5%	+	3.0%	-	1.6%

Source: Rockingstone Advisors

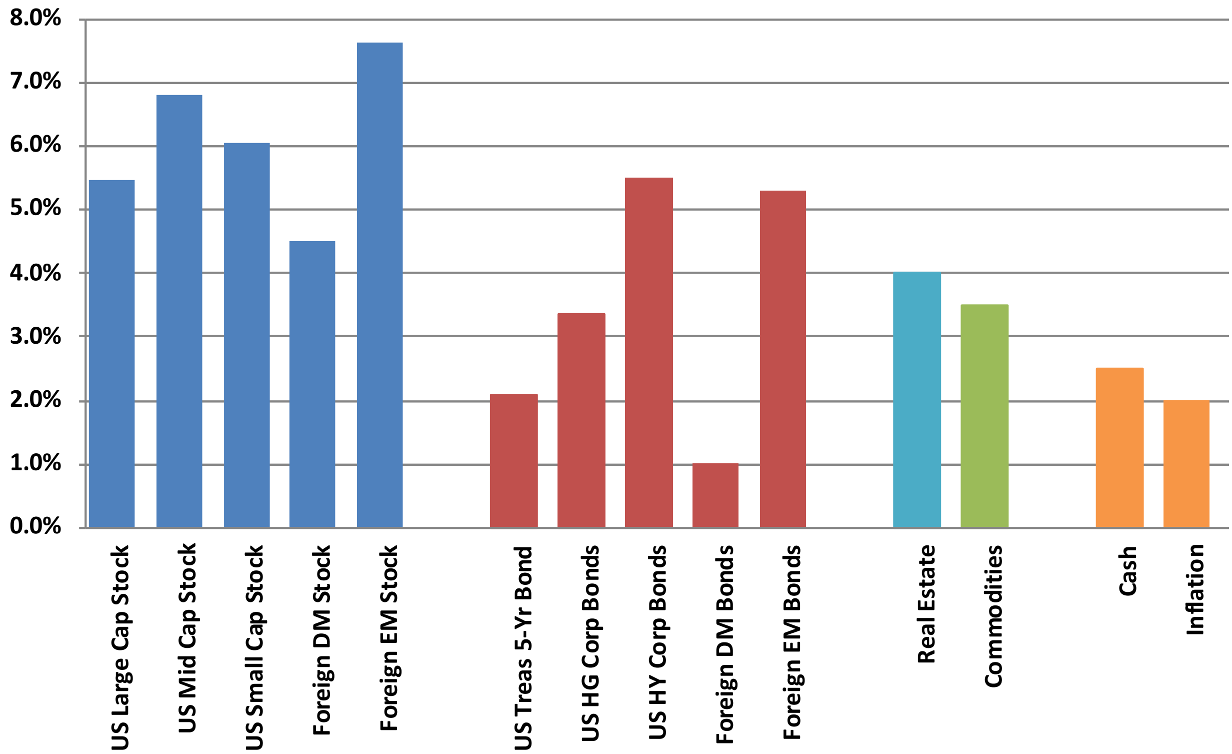
For equities, we examine key variables such as (1) historical sales growth, (2) corporate profit margins, (3) dividend yields, and (4) valuation to determine potential long-term returns. Using valuation as an example, P/Es should theoretically decline (if currently above the historical mean) or expand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

In contrast to the past few years, and due mainly to the 4Q18 market correction coupled with strong earnings growth, we noted in our 4Q18 Investor Quarterly that valuation was actually a broad-based positive contributor to our forecasted returns. Given the strong rebound in asset prices, that is no longer the case, as all the major indices are now trading above historical metrics. The one offset, as noted earlier, is that margins have declined YoY, but it is not a material component of our forecast. Dividend yield is also a key input and can be assumed relatively stable long term. Currently, dividend yields are now above their historical averages for most indices.

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. As has been the case for a while, profit margins are high vs. history but we don’t see significant pressure (due to ongoing productivity and cost reduction measures) in the next few years.

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 21: Five-Year Asset Class Total Return Forecast



Source: Rockingstone Advisors

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Portfolio Positioning

Equities

We were arguably a bit more active in the 1Q19 than is normally the case. Although the S&P closed in on our 2,800 target, we nevertheless saw value in select stocks and put some of the extra cash (from 4Q18 tax loss selling) to work as the quarter progressed, starting new positions. Yet we also existed some positions based on concerns over earnings risk and high valuations. This is on top of some shorter-term hedging (which we view as the equivalent to insurance…necessary but not what one wants to actually use!) and option trading activity (to try and take advantage of discrete, near term opportunities).

We implemented a few changes to our sector / geographic allocation including reducing exposure to small cap stocks, software and biotech. Our top ten largest individual holdings include: S&P Global, McCormick, Estee Lauder, Amazon, Intuitive Surgical, Apple, Pepsi, Calavo Growers, Alphabet (i.e. Google), PayPal. We reduced and/or eliminated some positions during the quarter (Appian, Chubb, Delta, DowDupont, Evolent Health, Fleetcor, General Dynamics). But we also added positions including Pepsi, Anthem, Boeing and Disney (with the last three occurring in early April).

Fixed Income

We have remained under-weight fixed income across almost all portfolios for an extended period. While fixed income had a decent 1Q19 as the Fed moved to neutral, equities out-performed significantly. Though the Fed moved to neutral and there isn't much fear over inflation, we are content with an under-weight position in long-term bonds. Long term we don't see fixed income investors being sufficiently compensated by low yields vs. the risk of widening US deficits and a still unusually large Fed balance sheet.

Yet 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). But the bulk of our fixed income exposure is in relatively short-term bonds and ETFs (JPST). Our short position in International bonds (for those accounts that allow short positions) via the BNDX ETF remains an investment across most portfolios. As we have mentioned a number of times, this is a long-term oriented position to exploit what we view as yields that are simply too low in Europe.

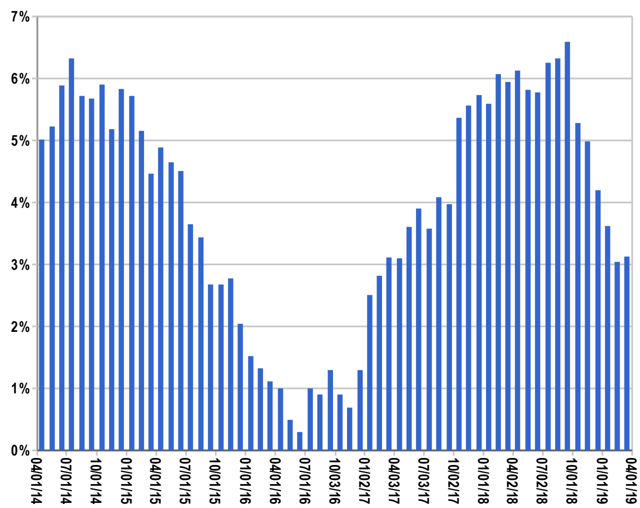
Commodities

Rockingstone's exposure to commodity ETFs remains very modest. Holdings include small positions in precious metals (gold and silver). As has been the case for some time, these positions are through ETFs, with gold being an inflation hedge and (for select portfolios) yield producing via covered call writing.

Chart Book

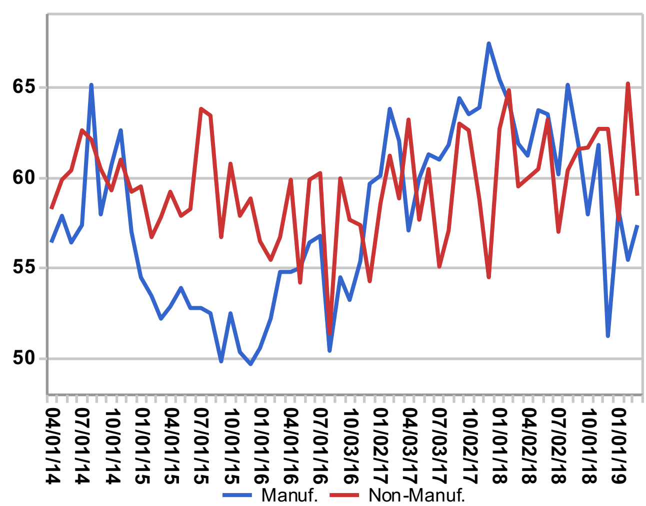
Leading Indicators

Figure 22: Index of Leading Economic Indicators



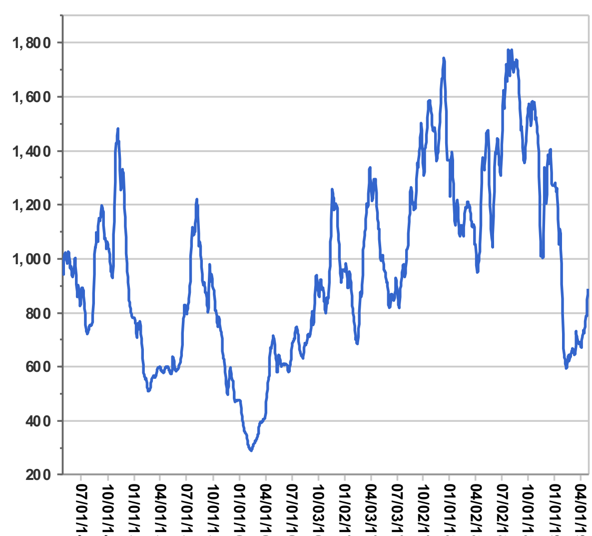
Source: FactSet

Figure 23: ISM New Orders



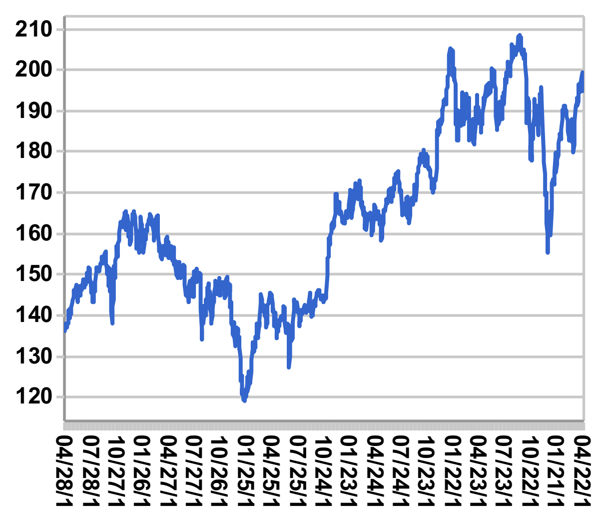
Source: St. Louis Federal Reserve, FRED Database

Figure 24: Baltic Freight Index



Source: FactSet

Figure 25: DJ Transports



Source: FactSet

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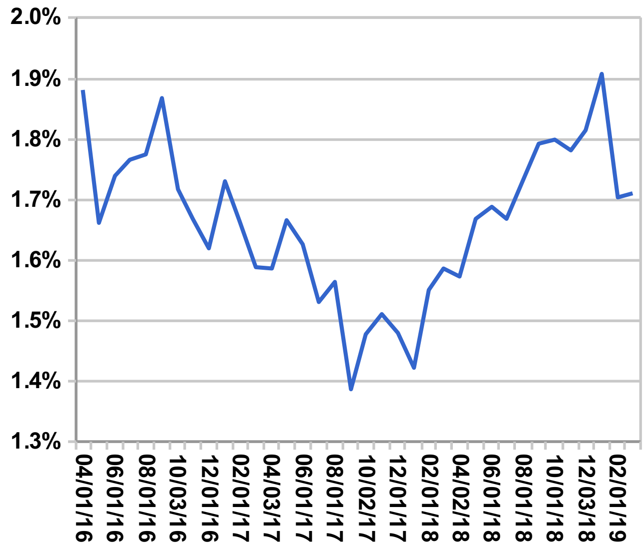
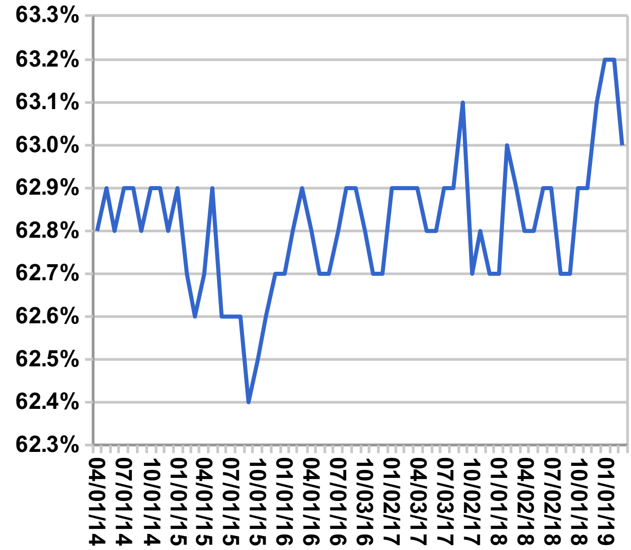
Labor Market Indicators

Figure 26: Payroll Growth (Establishment Survey, % Chg YoY)



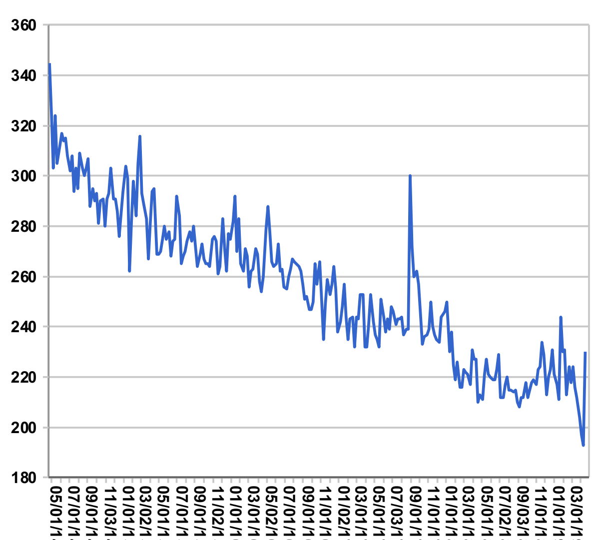
Source: FactSet

Figure 27: Labor Participation Rate (% of Workforce)



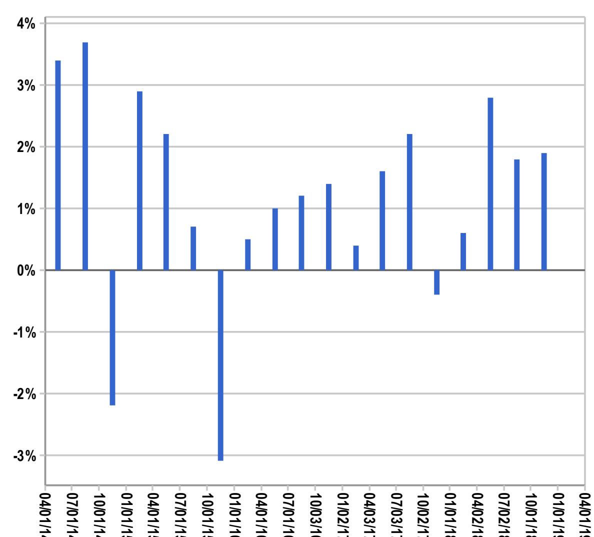
Source: FactSet

Figure 28: Initial Unemployment Claims



Source: FactSet

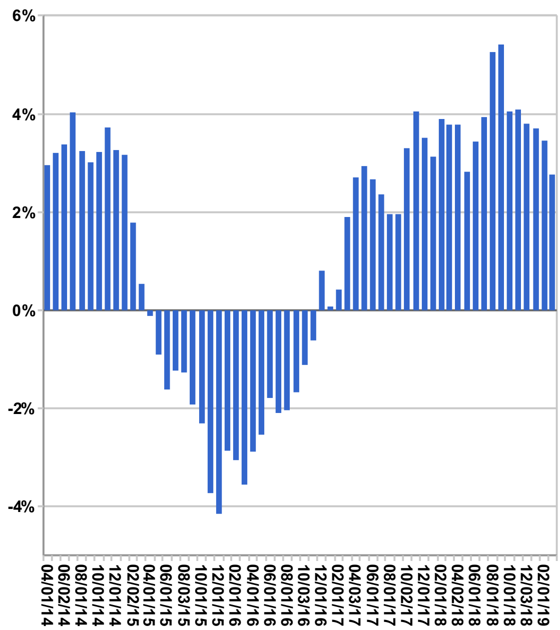
Figure 29: Non-Farm Productivity (% Chg YoY)



Source: FactSet

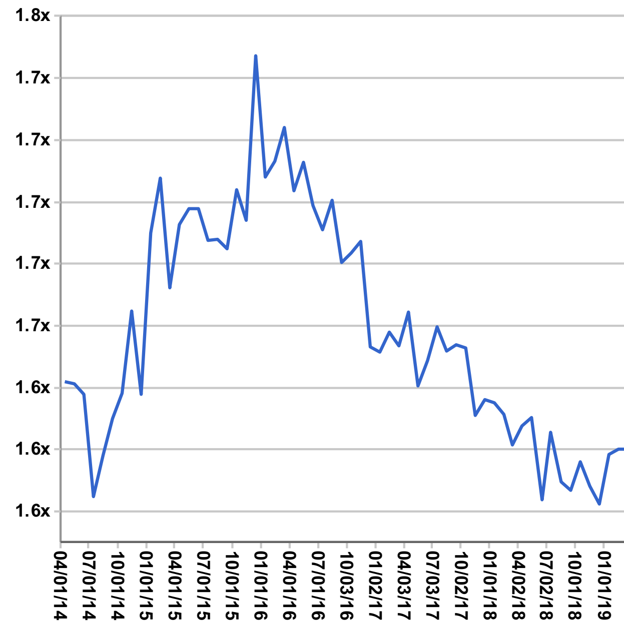
Production and Business Activity Indicators

Figure 30: Industrial Production (% Chg YoY)



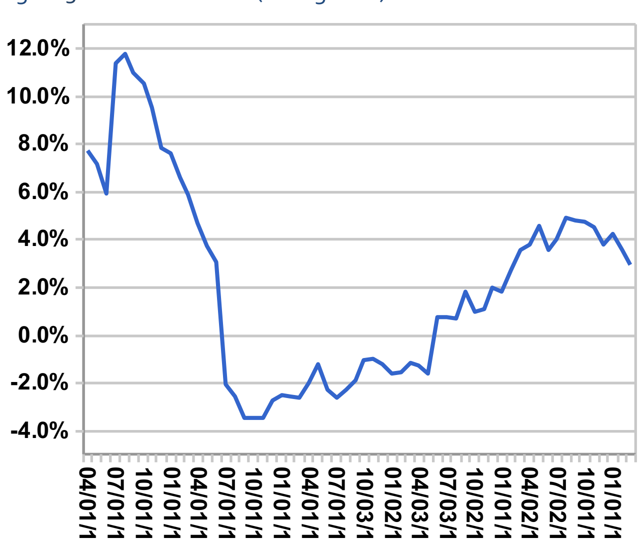
Source: FactSet

Figure 31: US Inventory to Shipment Ratio



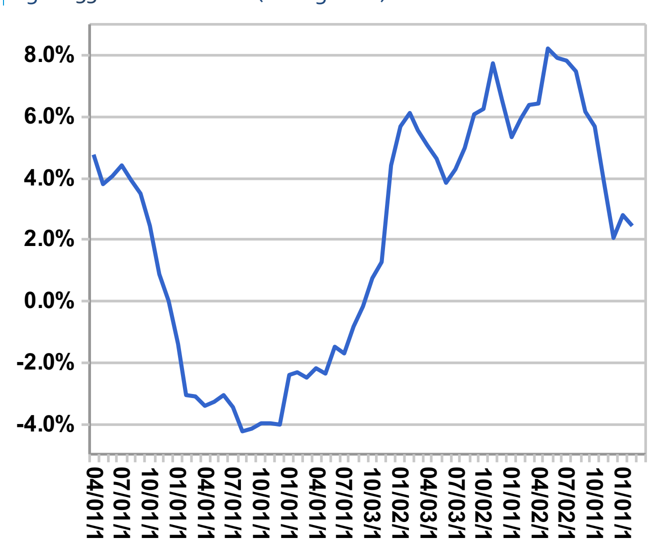
Source: FactSet

Figure 32: Unfilled Orders (% Chg. YoY)



Source: FactSet

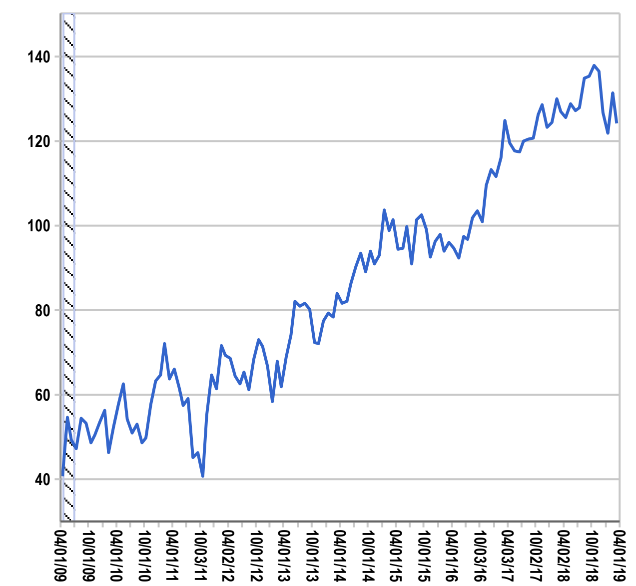
Figure 33: Business Sales (% Chg. YoY)



Source: FactSet

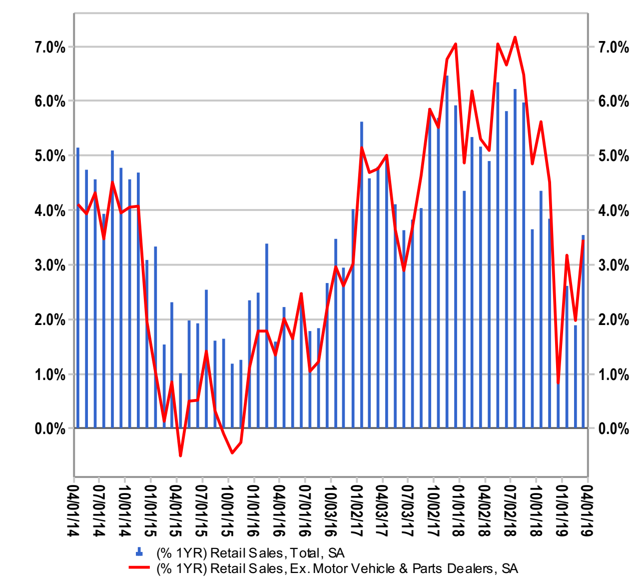
Consumer and Household Activity Indicators

Figure 34: University of Michigan Consumer Sentiment



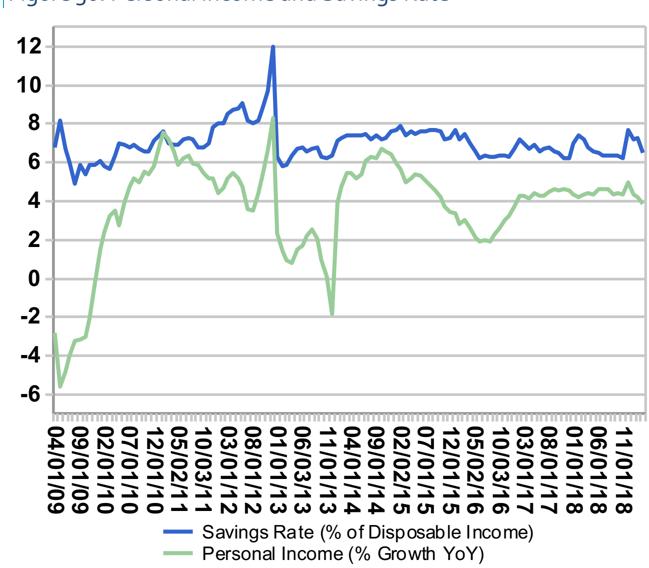
Source: FactSet

Figure 35: Retail Sales



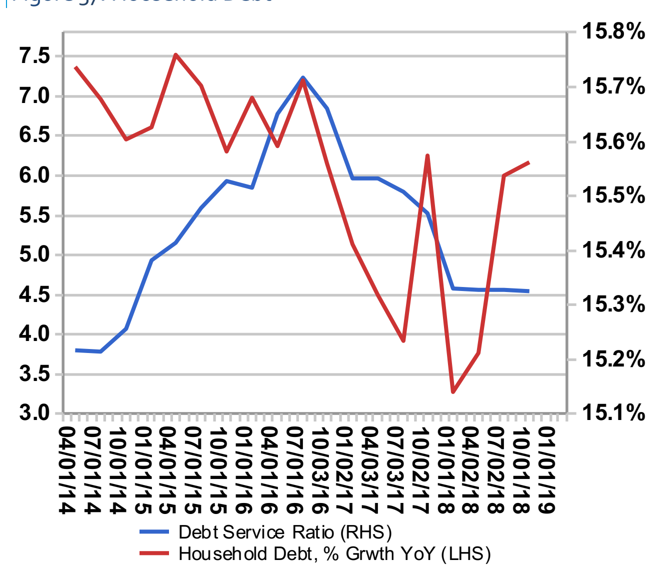
Source: FactSet

Figure 36: Personal Income and Savings Rate



Source: FactSet

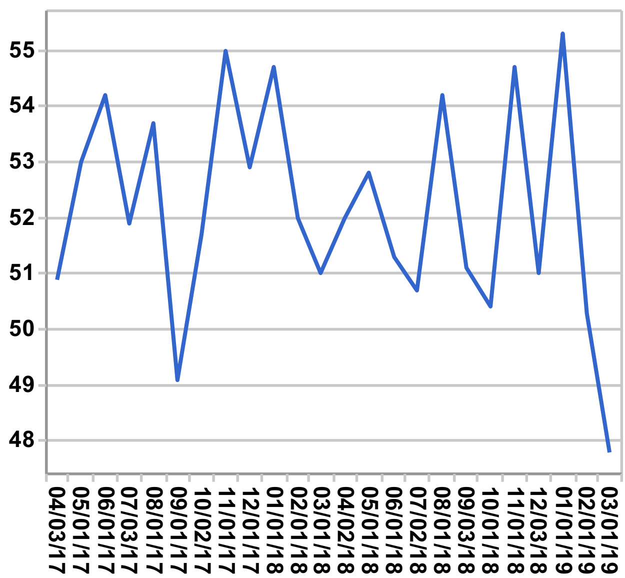
Figure 37: Household Debt



Source: FactSet

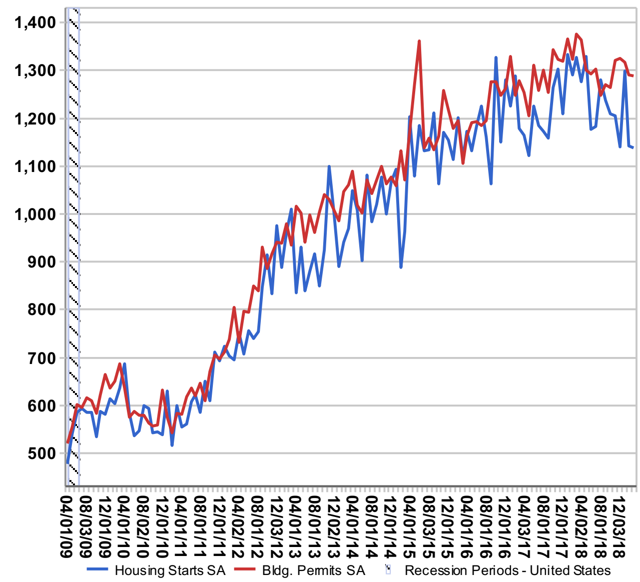
Housing and Construction Indicators

Figure 38: Architecture Billings Index



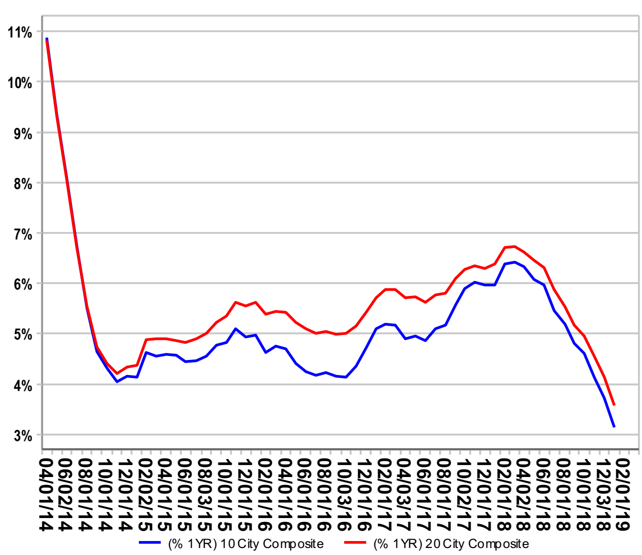
Source: FactSet

Figure 39: Housing Starts and Building Permits



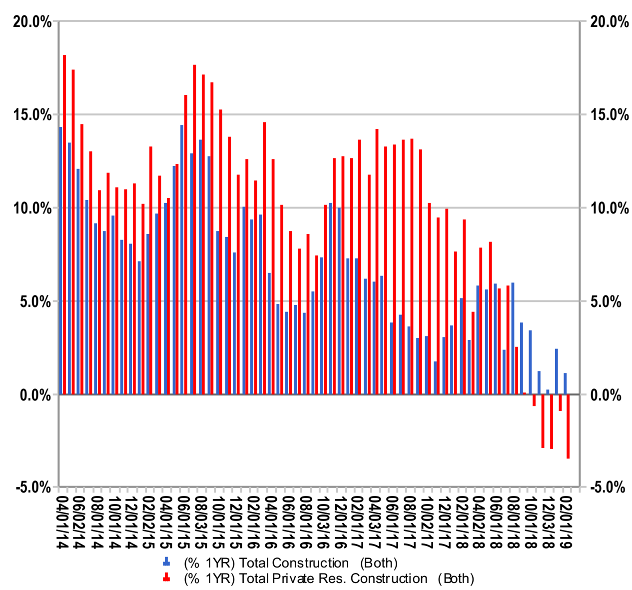
Source: FactSet

Figure 40: Case-Shiller 20-City & 10-City Index, % Chg YoY



Source: FactSet

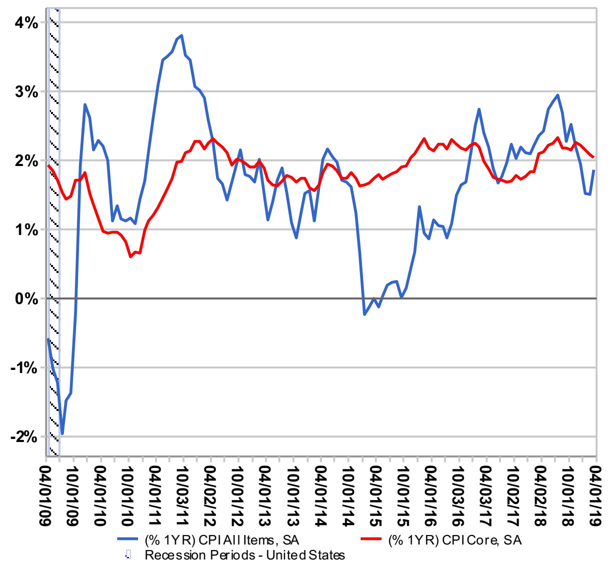
Figure 41: Private and Total Construction (% Chg YoY)



Source: FactSet

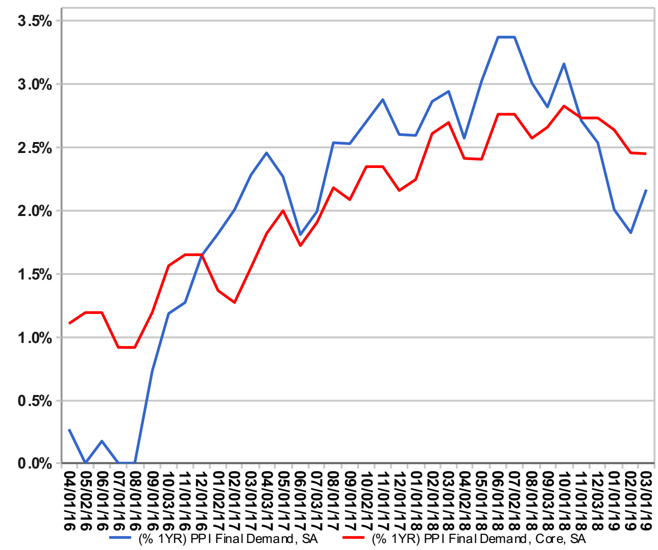
Price Indicators

Figure 42: Consumer Price Index



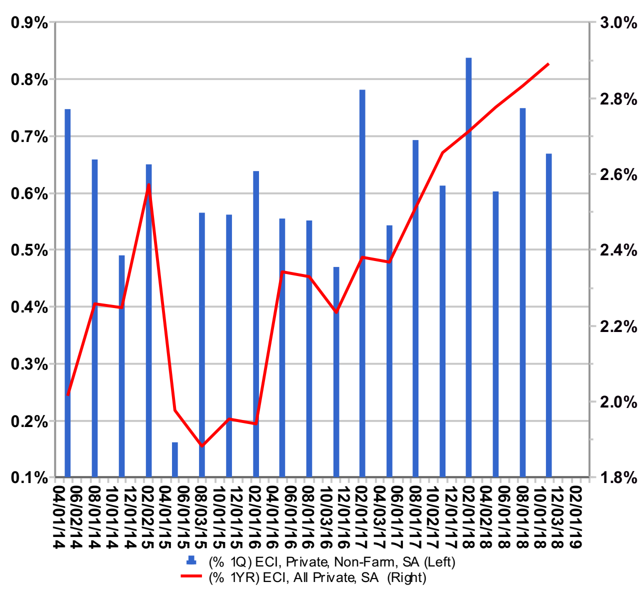
Source: FactSet

Figure 43: Producer Price Index



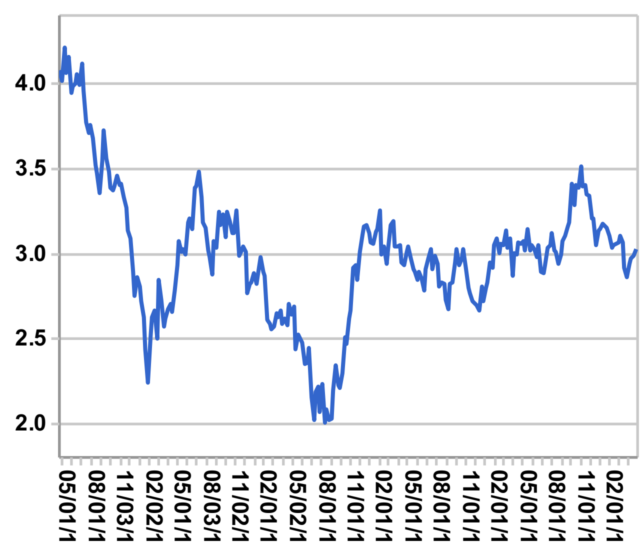
Source: FactSet

Figure 44: Employment Cost Index



Source: FactSet

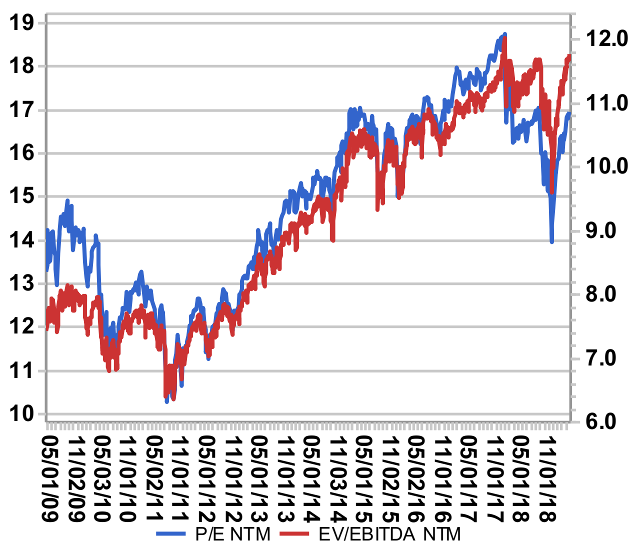
Figure 45: 10-Year, 5-Year Forward Inflation Expectations



Source: FactSet

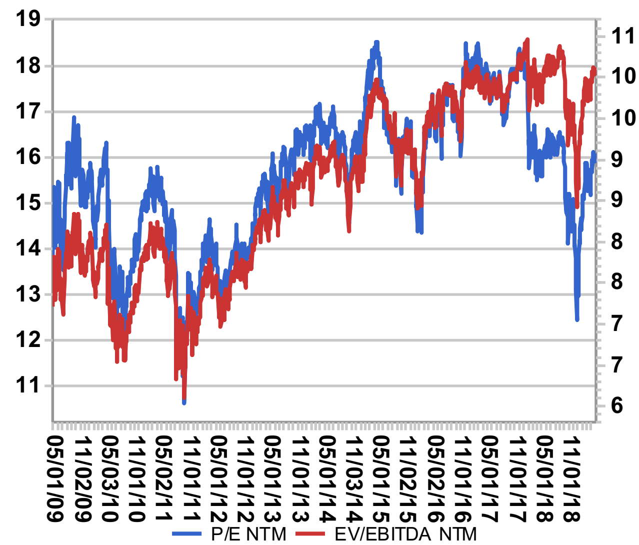
Valuation Indicators

Figure 46: S&P 500 P/E (LHS) & EV/EBITDA (RHS)



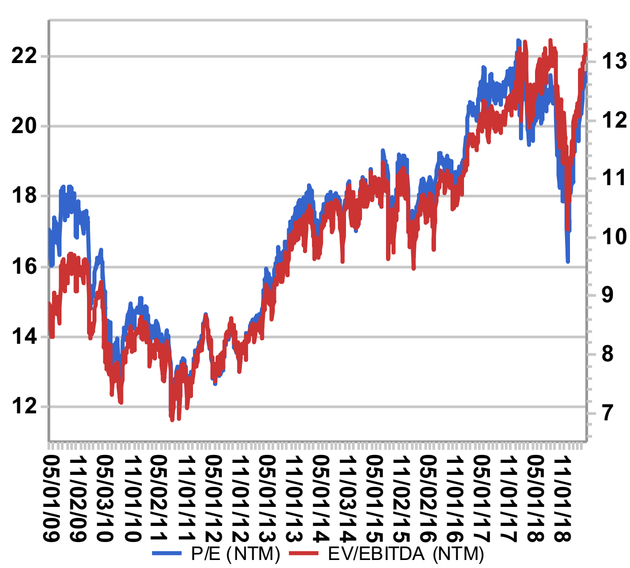
Source: FactSet

Figure 47: S&P Midcap 400 P/E (LHS) & EV/EBITDA (RHS)



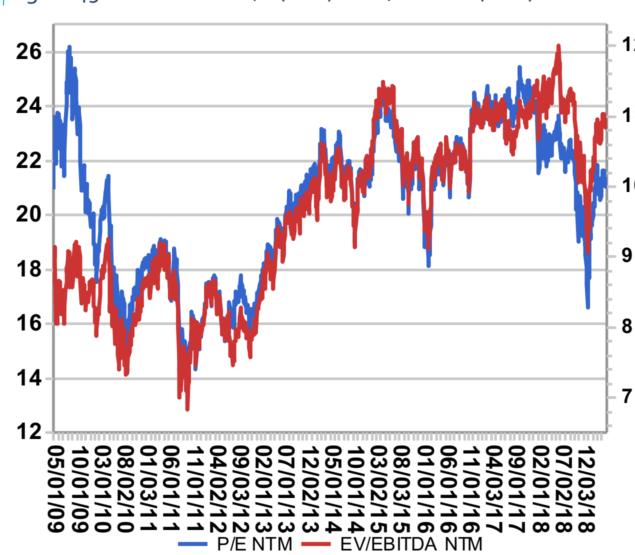
Source: FactSet

Figure 48: Nasdaq 100 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

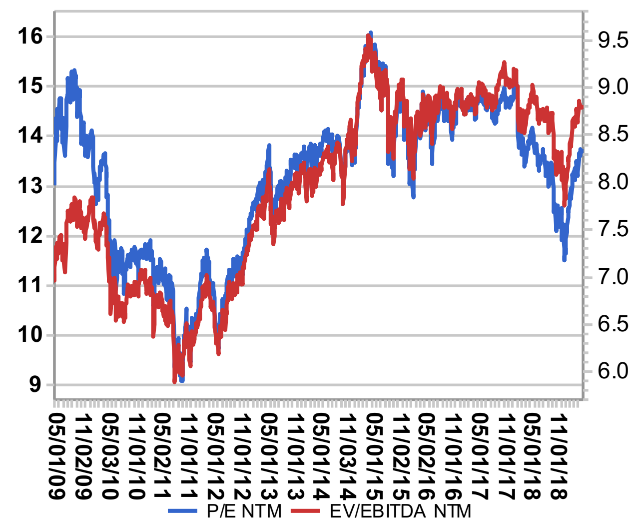
Figure 49: Russell 2000 P/E (LHS) & EV/EBITDA (RHS)



Source: St. Louis Federal Reserve, FRED Database

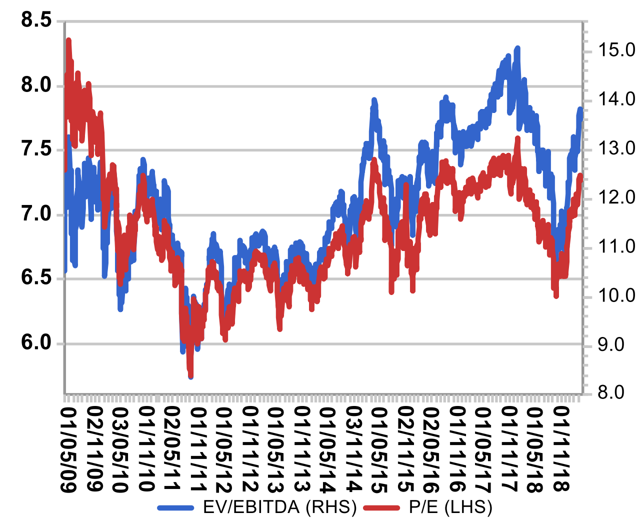
Valuation and Volatility Indicators

Figure 50: Intl Developed P/E (LHS) & EV/EBITDA (RHS)



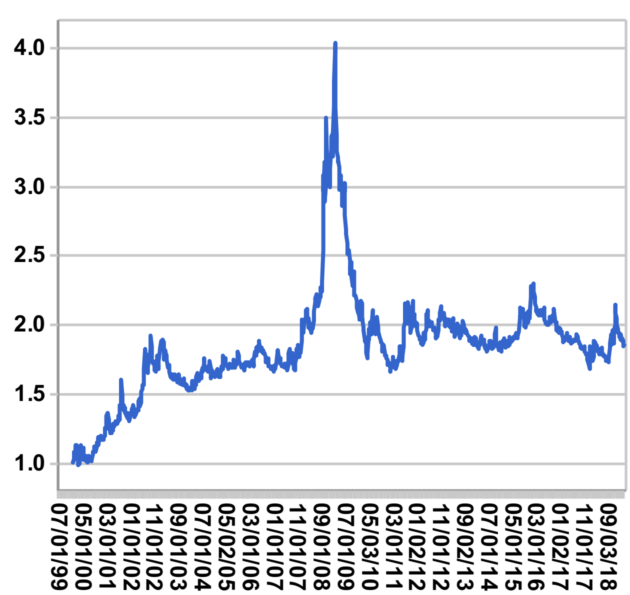
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 51: Emerging Markets P/E (LHS) & EV/EBITDA (RHS)



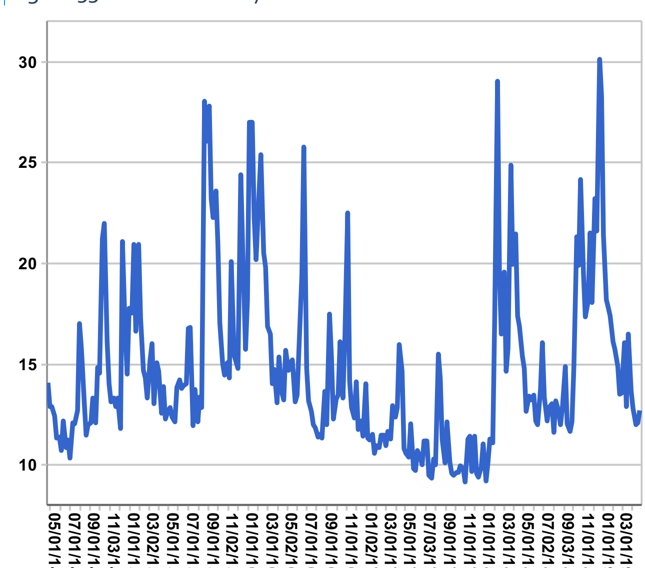
Source: Robert Shiller, Yale University, Rockingstone Advisors, Standard & Poor's

Figure 52: S&P 500 Dividend Yield



Source: FactSet

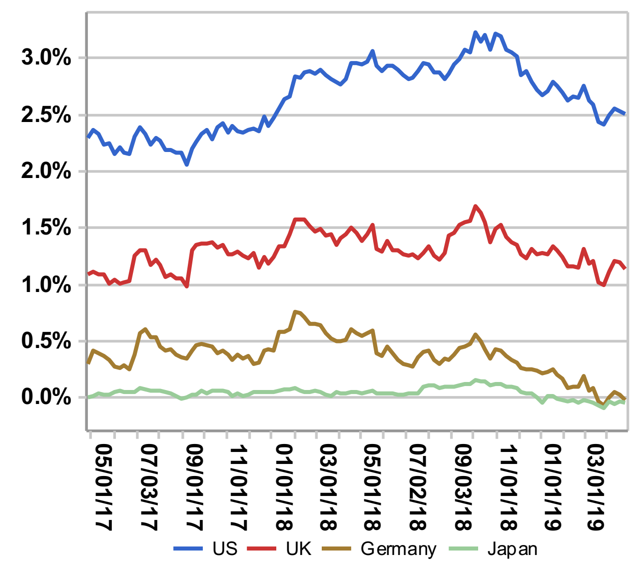
Figure 53: CBOE Volatility Index



Source: FactSet

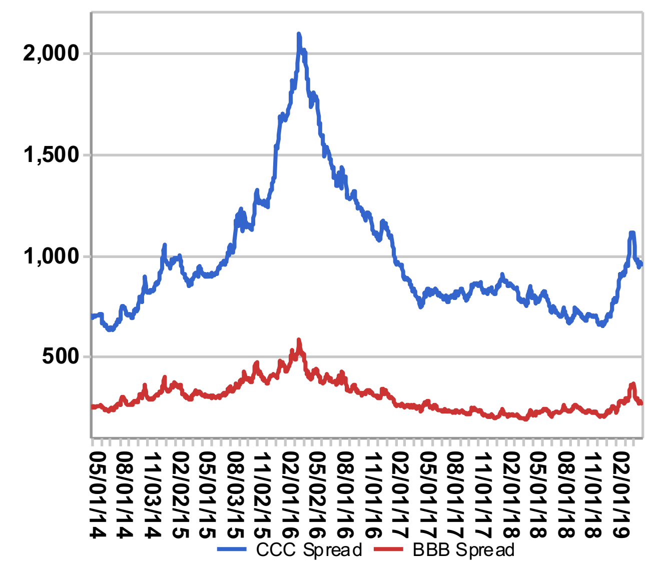
Bond Market Indicators

Figure 54: 10-Year Global Bond Yields



Source: FactSet

Figure 55: CCC and BBB Spreads (Option Adjusted)

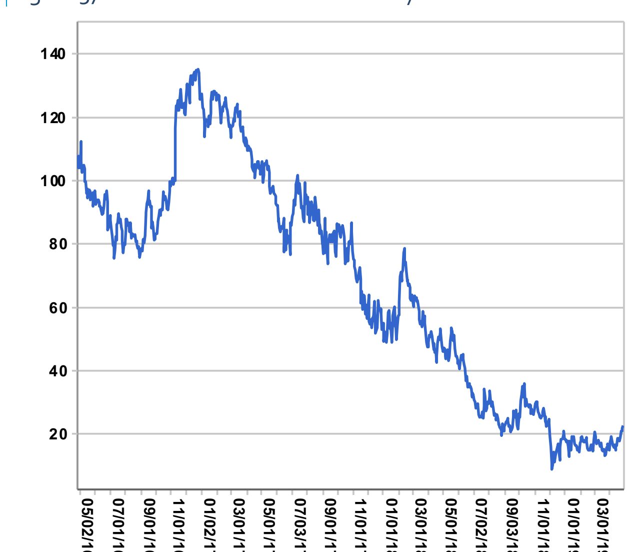


Source: FactSet

Figure 56: TED Spread (bps)

Source: FactSet

Figure 57: 10-Year Minus 2-Year Treasury



Source: FactSet

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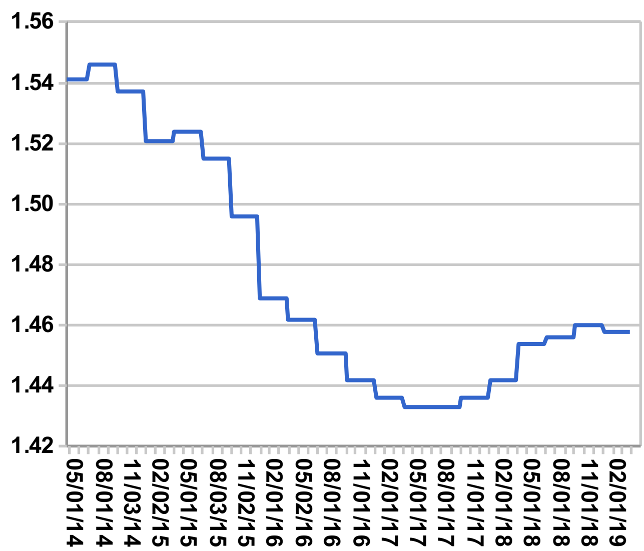
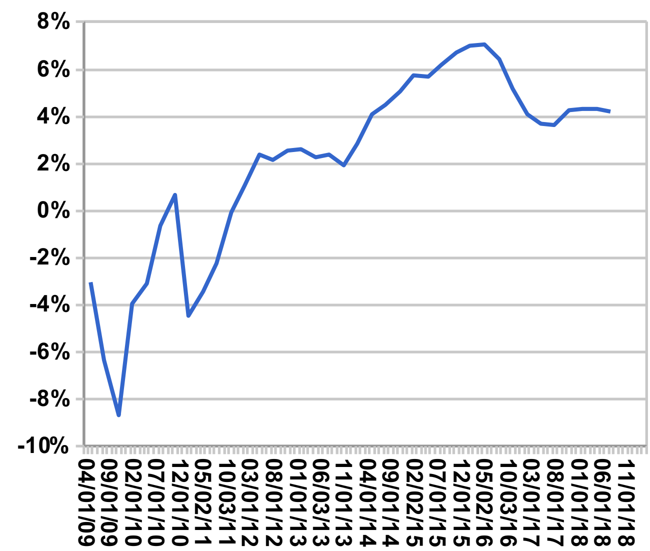
Liquidity and Other Indicators

Figure 58: Velocity of M2 Money Stock



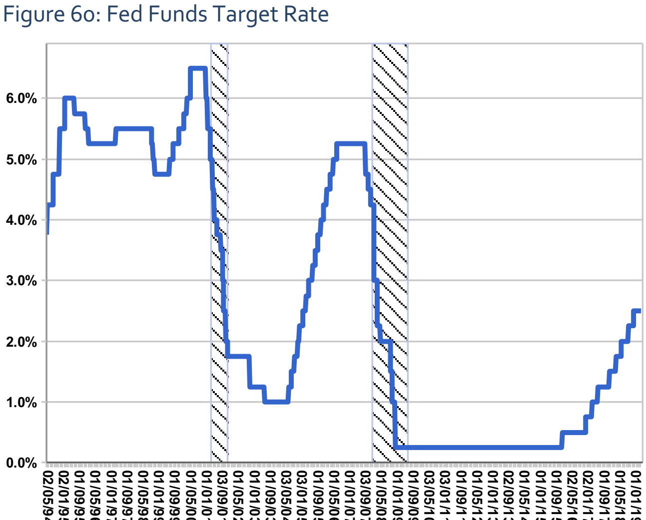
Source: FactSet

Figure 59: Loan Growth (Non-Financial, Private Sector)



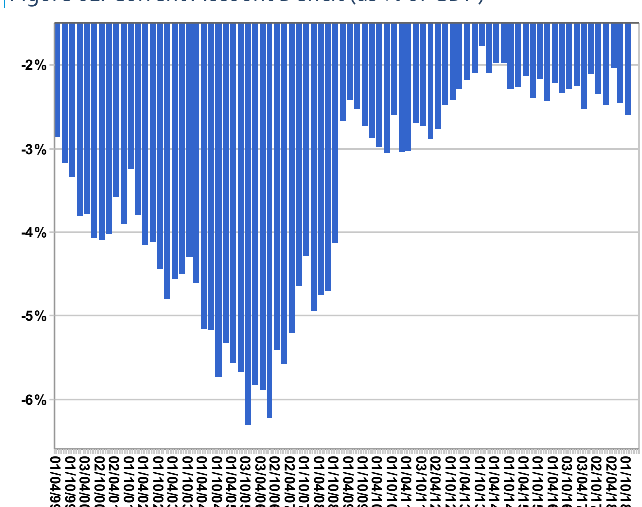
Source: FactSet

Figure 60: Fed Funds Target Rate



Source: St. Louis Federal Reserve, FRED Database

Figure 61: 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 March 31, 2019; most other prices and yields are as of April 26, 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:

Brandt Sakakeeny & Eric Katzman, CFA
Rockingstone Advisors LLC
200 Park Ave., Suite 1700
New York, NY 10166
212-430-2240

brandt@rockingstoneadvisors.com
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.