



CANDOR ASSET ADVISORS

Third Quarter 2019 Investment Environment

This document highlights:

- The Economic Environment
- Federal Reserve and European Central Bank Activity
- Recessions, Stock Market Corrections, Bear Markets and Recoveries

For more information on our strategies' performance, portfolio positioning and areas of opportunity please review the strategies' quarterly commentary or contact Candor Asset Advisors.

The Economic Environment

Economic data suggests moderate economic activity, low inflation and low interest rates in developed economies and mixed economic growth, moderate inflation and normal interest rates in emerging economies.

World Economic Statistics																
	GDP YoY Growth				Inflation YoY Growth				Short Term Interest Rate				% of World			
	Current	Previous	Change	Freq.	Current	Previous	Change	Freq.	Current	Previous	Change	Freq.	GDP	Population		
US	2.0%	2.3%	-0.3%	Q	1.8%	1.7%	0.1%	M	1.75%	2.00%	-0.25%	D	24.2%	4.2%		
Euro Area	1.2%	1.2%	0.0%	Q	0.7%	0.8%	-0.1%	M	0.00%	0.00%	0.00%	D	22.2%	4.4%		
Japan	1.3%	0.9%	0.4%	Q	0.2%	0.2%	0.0%	M	-0.10%	-0.10%	0.00%	D	6.0%	1.7%		
Canada	1.6%	1.3%	0.3%	Q	1.9%	1.9%	0.0%	M	1.75%	1.75%	0.00%	D	2.0%	0.5%		
South Korea	2.0%	2.0%	0.0%	Q	0.0%	-0.4%	0.4%	M	1.25%	1.50%	-0.25%	D	2.0%	0.7%		
China	6.0%	6.2%	-0.2%	Q	3.8%	3.0%	0.8%	M	4.15%	4.15%	0.00%	D	15.9%	18.2%		
India	5.0%	5.8%	-0.8%	S	4.6%	4.0%	0.6%	M	5.15%	5.40%	-0.25%	D	3.2%	17.2%		
Brazil	1.0%	0.5%	0.5%	S	2.5%	2.9%	-0.4%	M	5.00%	5.50%	-0.50%	D	2.3%	2.7%		
Russia	1.7%	0.0%	1.7%	Q	3.8%	4.0%	-0.2%	M	6.50%	6.50%	0.00%	D	1.9%	1.9%		
	Manufacturing PMI				Service PMI				Unemployment Rate				Retail Sales YoY Growth			
	Current	Previous	Change	Freq.	Current	Previous	Change	Freq.	Current	Previous	Change	Freq.	Current	Previous	Change	Freq.
US	52.2	51.3	0.9	M	51.6	50.6	1.0	M	3.6%	3.5%	0.1%	M	3.1%	4.1%	-1.0%	M
Euro Area	46.6	45.9	0.7	M	51.5	52.2	(0.7)	M	7.5%	7.5%	0.0%	M	3.1%	2.7%	0.4%	M
Japan	48.6	48.4	0.2	M	50.4	49.7	0.7	M	2.4%	2.2%	0.2%	M	9.1%	1.8%	7.3%	M
Canada	51.2	51.0	0.2	M	NA	NA			5.5%	5.5%	0.0%	M	1.0%	1.3%	-0.3%	M
South Korea	48.4	48.0	0.4	M	NA	NA			3.5%	3.4%	0.1%	M	3.3%	4.1%	-0.8%	M
China	51.7	51.4	0.3	M	51.1	51.3	(0.2)	M	3.6%	3.6%	0.0%	Q	7.2%	7.8%	-0.6%	M
India	50.6	51.4	(0.8)	M	49.2	48.7	0.5	M	8.5%	7.2%	1.3%	M	NA	NA		
Brazil	52.2	53.4	(1.2)	M	51.2	51.8	(0.6)	M	11.8%	11.8%	0.0%	M	2.1%	1.4%	0.7%	M
Russia	47.2	46.3	0.9	M	55.8	53.6	2.2	M	4.6%	4.5%	0.1%	M	1.6%	0.7%	0.9%	M
Freq. = Reporting Frequency, M = Monthly, Q = Quarterly, S = Semi Annual, Y = Yearly																
NA = Not Available																
Source: Trading Economics 11/24/19, Wikipedia 1/17/19																



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Our analysis suggests:

- The US, Europe, and China are the most important markets to watch as they account for 64% of world GDP. India and China are important emerging markets to watch as they represent 35% of the world's population.
- GDP growth is subdued and largely unchanged globally. The US continues to outpace international developed markets although the growth gap may be shrinking. China and India remain relative growth areas.
- Inflation has been modest in developed countries and normal in emerging markets.
- Interest rates remain accommodative in developed economies. Interest rates have declined in 4 of 9 areas surveyed as central banks have attempted to stimulate economic activity.
- Manufacturing purchasing manager activity has modestly improved in 7 of 9 areas surveyed. The Euro Area, Japan, South Korea and Russia's manufacturing surveys suggest contracting activity.
- Service purchasing manager surveys suggest expansion and relative strength versus manufacturing.
- Unemployment is relatively flat globally. The unemployment rate remains low in the US, Japan, South Korea and China. Unemployment remains a trouble spot in the Euro Area, India and Brazil.
- Retail sales were solid in 5 of 9 areas surveyed and were relatively weak in Canada, Brazil and Russia.

International Monetary Fund (IMF) economic growth data as of October 2019 is below. Global economic forecasts have declined.

		GDP Growth Rate			
Region		2017	2018	2019	2020
United States		2.2%	2.9%	2.4%	2.1%
Developed International Markets					
	Euro Area	2.4%	1.9%	1.2%	1.4%
	Japan	1.9%	0.8%	0.9%	0.5%
Emerging Markets		4.8%	4.5%	3.9%	4.6%
World		3.8%	3.6%	3.0%	3.4%
		Revisions since April 2019			
		2017	2018	2019	2020
United States		0.0%	0.0%	0.1%	0.2%
Developed International Markets					
	Euro Area	0.0%	0.1%	-0.1%	-0.1%
	Japan	0.0%	0.0%	-0.1%	0.0%
Emerging Markets		0.0%	0.0%	-0.5%	-0.2%
World		0.0%	0.0%	-0.3%	-0.2%

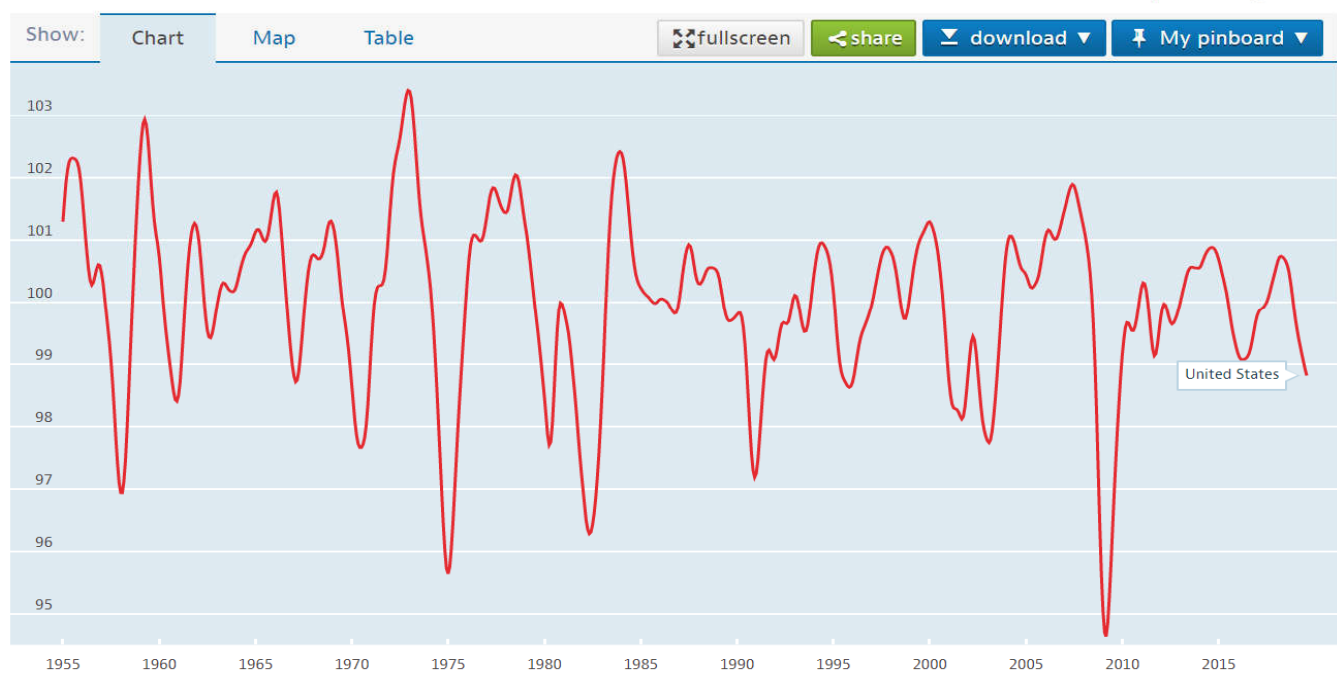


Consensus economic forecasts call for moderate global economic growth and subdued inflation looking out through the rest of 2019 and 2020. Tepid European economic growth, weak business investment sentiment, mixed manufacturing activity, and political and trade tensions (UK Brexit, China/US trade negotiations) have been cited as concerns. A healthy service sector, stable consumer, relatively strong US economy, accommodative monetary policy and moderate inflation have been cited as bright spots.

US leading indicators suggest slowing but still positive economic growth over the next few quarters. A leading indicator of 98 has generally been associated with a US recession. The US reading is 98.8 today.

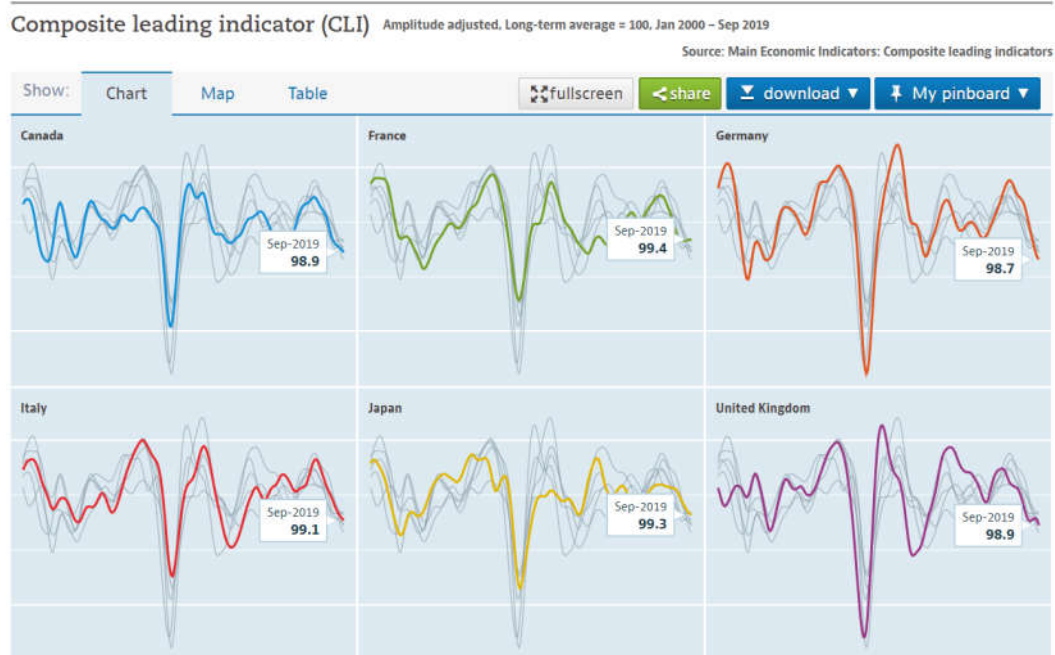
Composite leading indicator (CLI) Amplitude adjusted, Long-term average = 100, Jan 1955 – Aug 2019

Source: Main Economic Indicators: Composite leading indicators

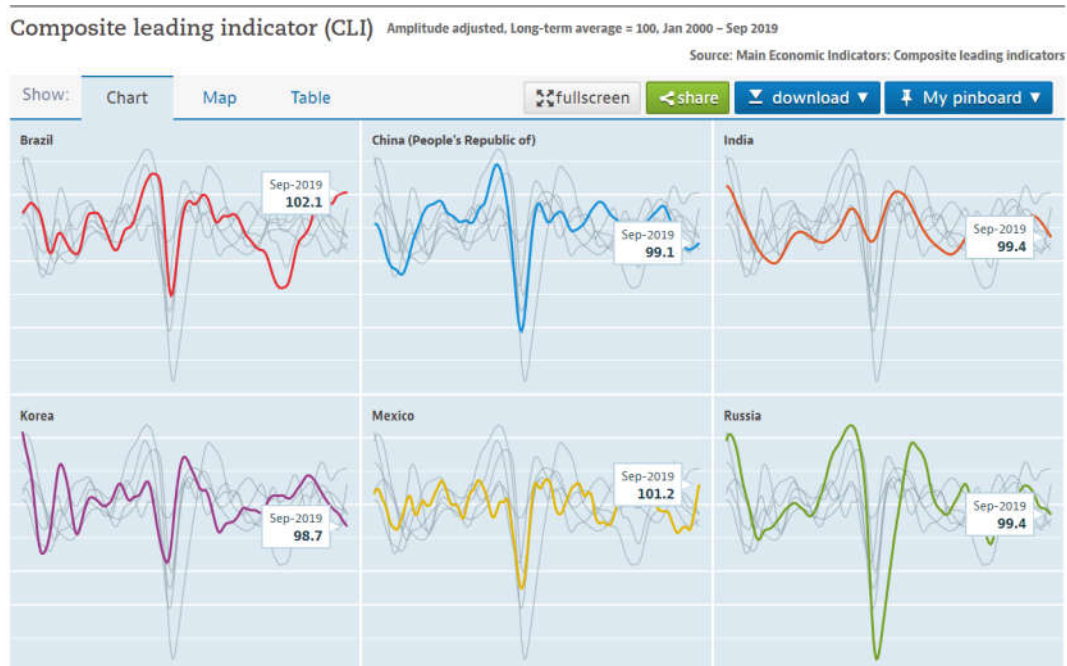




Other G7 OECD leading indicator data suggests moderating but still positive economic growth.



Leading indicator trends in less developed economies have been less uniform and have been generally stronger than developed economies.

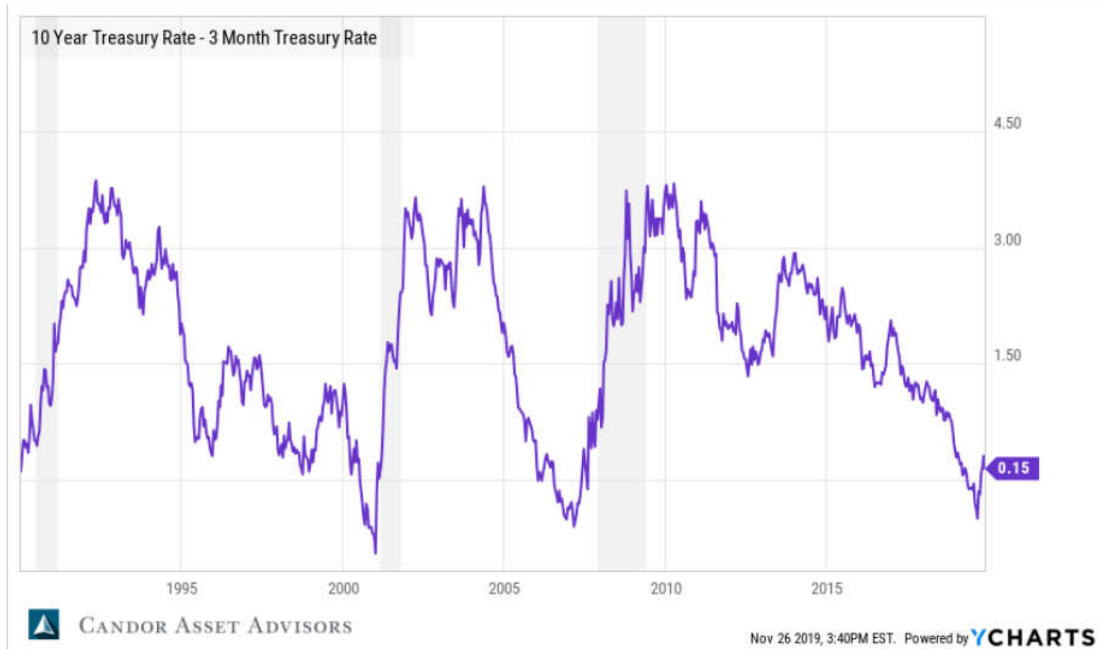


Source: <https://data.oecd.org/leadind/composite-leading-indicator-cli.htm#indicator-chart>



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History suggests monitoring the yield curve (the difference between long-term yields and short-term yields) can help investors spot a recession. An inverted yield curve usually precedes a recession by 6 to 19 months. The US yield curve inverted earlier this year.



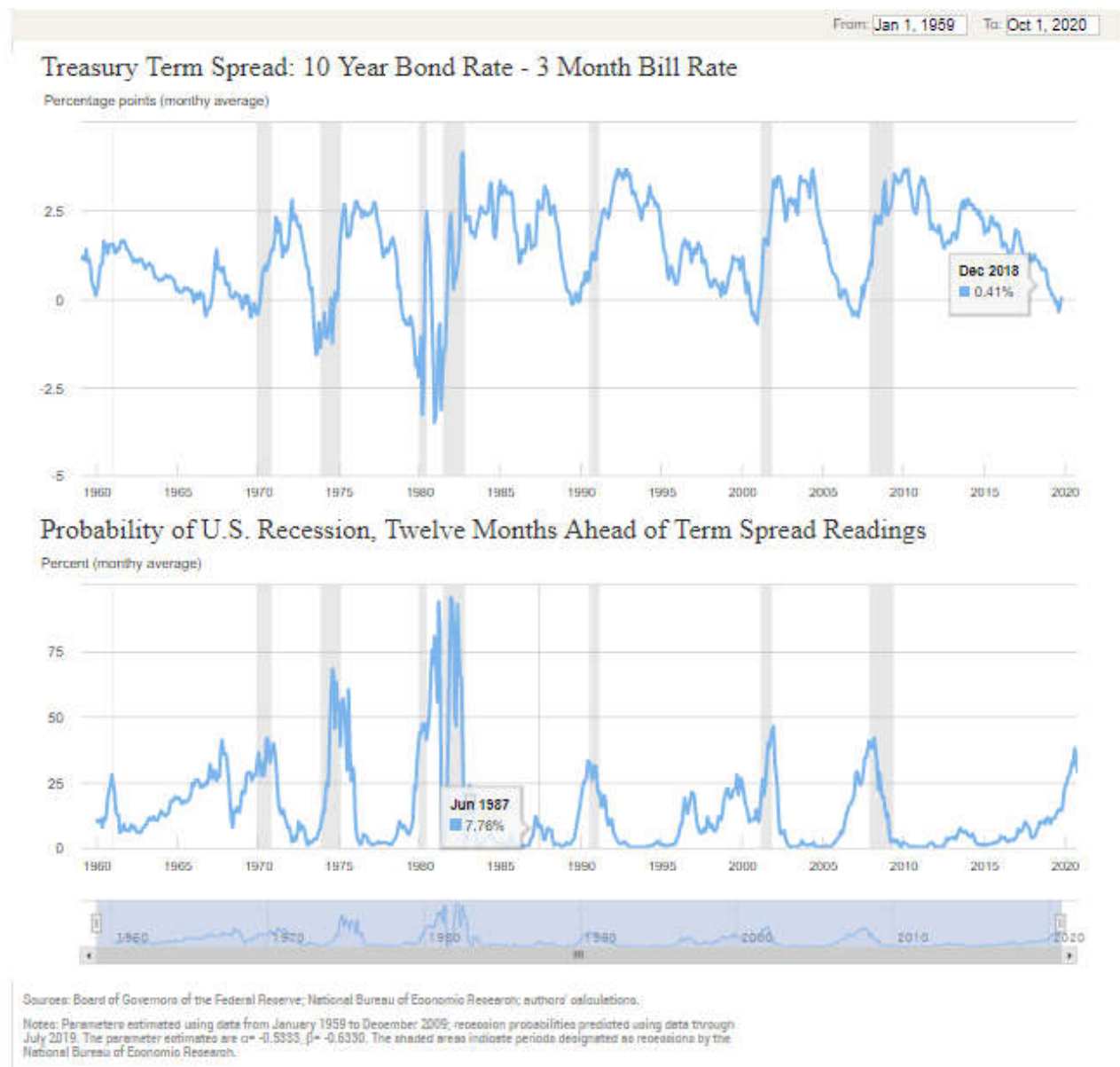
The yield curve reverted to an upward sloping shape in the last few months as investors priced in a lower probability of a near-term recession.





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The Federal Reserve Bank of New York has a model that tracks the yield curve and the probability of a recession over the next twelve months. The model measures the difference in the US treasury 10-year bond rate and the US treasury three-month bill rate. In August this reading suggested a 38% probability of a recession by August 2020. The recession probability registered 29% in the latest October reading.

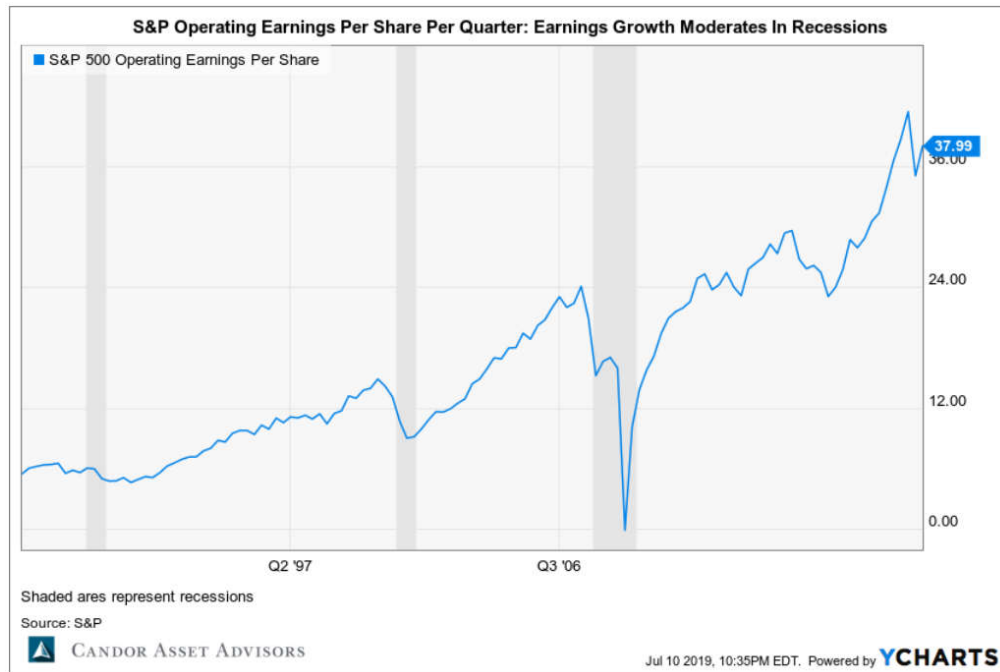


These graphs underscore how close we are to a recession. Central bank actions and commentary (discussed later) underscore the downside risk to the economy.



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If a recession occurs, history suggests earnings growth will turn negative for a short while. The US provides supporting evidence.



According to S&P, 2019 S&P 500 operating earnings estimates have fallen by 7.5% since the beginning of 2019. Also, 2020 operating earnings estimates have fallen by 5.1% over the same period.

S&P 500 earnings grew 3.5% in 4Q 18, 4% in 1Q 19 and 3.9% in 2Q 19. Consensus estimates suggest earnings decline 3.9% in 3Q 19 and grow by 15.7% growth in 4Q 19, 7.2% in 1Q 20, 9% in 2Q 20 and 11.4% in 2020. Investors should pay close attention to whether earnings growth continues to sag or improve.

International and emerging market earnings growth comparisons to the US are expected to improve.

International Relative Growth Comparisons Should Ease				
	2017A	2018A	2019E	2020E
United States	11.9%	24.3%	1.0%	9.6%
International Developed Markets	21.5%	3.7%	-1.5%	8.5%
International Emerging Markets	24.0%	6.2%	0.4%	14.6%
US- Intl. Developed Markets	-9.6%	20.6%	2.5%	1.1%
US - Intl. Emerging Markets	-12.1%	18.1%	0.6%	-5.0%
Source: Yardeni Research MSCI Earnings and Revenue 2018-2020E, 11/18/19				



Federal Reserve and European Central Bank Background

The US Federal Reserve tightened the money supply from 2014 through 2018 by a combination of raising short-term rates and reducing the size of its balance sheet. These actions served as a dampener to economic activity.

The Federal Reserve previously used its balance sheet to stimulate the economy. The Fed's balance sheet assets grew from \$870 billion in August 2007 to \$4.5 trillion by January 2015 as the Fed bought government debt to increase the money supply, stimulate lower rates and encourage borrowing. This action was alternatively called quantitative easing.

From early 2015 through December 2018, the Federal Open Market Committee (FOMC) allowed the debt it owned to mature, and it did not fully reinvest the proceeds (AKA quantitative tightening). The Federal Reserve's balance sheet assets contracted to \$4.1 trillion as of December 2018. The US Federal Reserve raised the targeted fed funds rate from 0-0.25% in November 2016 to 2.25-2.5% in December 2018 to contain inflation pressures associated with economic expansion.

Since late in 2018 the Federal Reserve has become more cautious about the economy.

The Fed Chairman's comments have changed from:

- October 2018 – The fed funds rate should return to higher and more normal levels (e.g., Federal Funds Rate of 3-4%)
- March 2019 – Fed fund decisions will be based on data dependency
- June and July 2019 – The Federal Reserve is committed to the economic expansion and it will act as appropriate (hint: lower rates) to continue the expansion
- August through November 2019 – The Federal Reserve has cut the targeted fed funds rate by 0.25% three times to 1.5-1.75% to stimulate economic growth

FOMC median forecasts now call for the fed funds rate to register 1.9% by the end of 2020. This figure represents a -0.7% revision from the first quarter of 2019.

Consistent with adopting less restrictive monetary policy, the Federal Reserve has become less committed to reducing its balance sheet. The timeline is as follows:

- As recently as early December 2018, the Fed was committed to a \$50 billion reduction in the balance sheet per month going forward.
- In late December 2018, the Federal Reserve indicated it would be data dependent in subsequent balance sheet moves.
- In March 2019, the Fed announced that it planned to slow down balance sheet reductions by May 2019 and end this practice by September 2019.
- In Fall 2019, the Fed announced that it would maintain or grow the balance sheet to stimulate economic growth. The Fed's balance sheet has grown from \$3.8 trillion in late August 2019 to \$4.0 trillion as of early November 2019.



Looking outside the US, the European Central Bank (ECB) has mostly engaged in monetary stimulus in the form of lower rates and quantitative easing since the financial crisis. A brief history of activity from 2007 through 2018 is below.

- The ECB's balance sheet assets grew from ~\$1.1 trillion dollars in 2007 to ~\$3 trillion by 2013 as the ECB bought government debt due to weak economic growth and the sovereign debt crisis. The ECB lowered the marginal lending rate 5% to 0.75% over this period.
- Between early 2013 and early 2015 the ECB allowed its balance sheet assets to shrink from ~\$3 trillion to ~\$2 trillion as sovereign debt fears diminished. To encourage lending the ECB lowered the marginal lending rate from 0.75% to 0.40%.
- Weak economic activity between 2015 and 2019 caused the ECB to resume government debt purchases. The ECB balance sheet assets grew from \$2.0 trillion in early 2015 to \$4.7 trillion by early 2019. The ECB lowered the marginal lending rate from 0.30% to 0.25%.

Witnessing weaker economic growth and benign inflation in the second half of 2018, the ECB expressed a commitment toward maintaining the size of its balance sheet for an extended time period and maintaining low rates. Throughout 2019 the ECB has reinvested maturing asset proceeds and its balance sheet has been relatively flat.

Like the US Federal Reserve, the ECB has discussed raising rates later and later.

- October 2018 – January 2019
 - The ECB said it did not intend to raise rates through at least the summer of 2019
- March 2019 – April 2019
 - The ECB said it did not intend to raise rates until 2020
- June & July 2019
 - The ECB said it does not expect to raise rates until at least the first half of 2020
- September & October 2019
 - The ECB maintains a 0.25% marginal lending rate but says it “expects the key ECB interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2% within its projection horizon”



Recessions, Stock Market Corrections, Bear Markets, and Recoveries

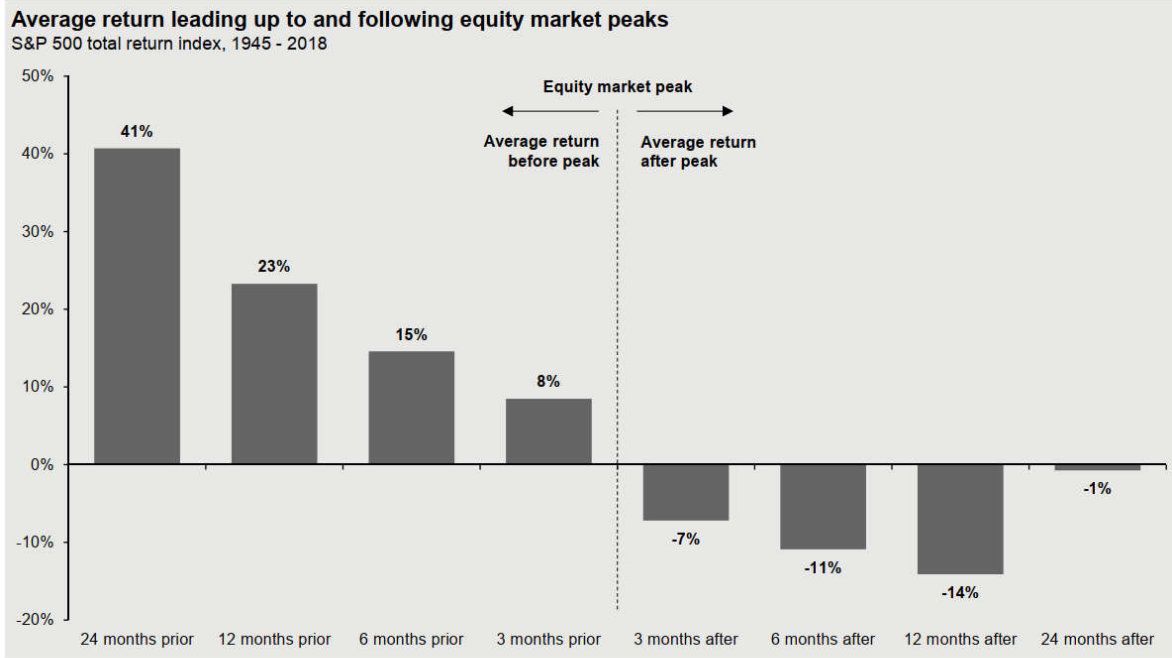
- A recession according to NBER, which is the official arbiter in characterizing business cycles, defines an economic recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." In practice this means a recession can represent a slowdown in economic growth over a few quarters rather than an actual decline in economic statistics.
- Stock market corrections are defined as a 10-20% drop in stock prices. Corrections usually occur every one to three years.
- Bear markets are defined as a drop of 20% or more in stock prices. Bear markets usually occur around recessions (see below). In late 2018 the S&P dropped 19.8%. This decline fell just short of being called a bear market and represented a correction.

Year	S&P Annual Return	Recession			
		Year Before	Same Year	Year After	Year Before, During, After
1930	-25.1%	Yes	Yes	Yes	Yes
1931	-43.8%	Yes	Yes	Yes	Yes
1937	-35.3%	No	Yes	Yes	Yes
1940	-10.7%	No	No	No	No
1941	-12.8%	No	No	No	No
1957	-10.5%	No	Yes	Yes	Yes
1966	-10.0%	No	No	No	No
1973	-14.3%	No	Yes	Yes	Yes
1974	-25.9%	Yes	Yes	Yes	Yes
2001	-11.8%	No	Yes	No	Yes
2002	-22.0%	Yes	No	No	Yes
2008	-36.6%	Yes	Yes	Yes	Yes
Yes		5	8	7	9
No		7	4	5	3
Probability		42%	67%	58%	75%
Source: NBER, Morningstar					

- Since 1929, the average bear market decline is 35% with the maximum bear market decline being 61% in 1931-32.
- Most bear markets last less than 18 months with the average bear market lasting 10 months.
- The last bear market was in 2009, and this bull market is the longest ever.
- Since 1945 equity returns two years after a market peak have been roughly flat (see next page).
- Stock bear markets have usually been followed by larger and longer rallies (see next page).

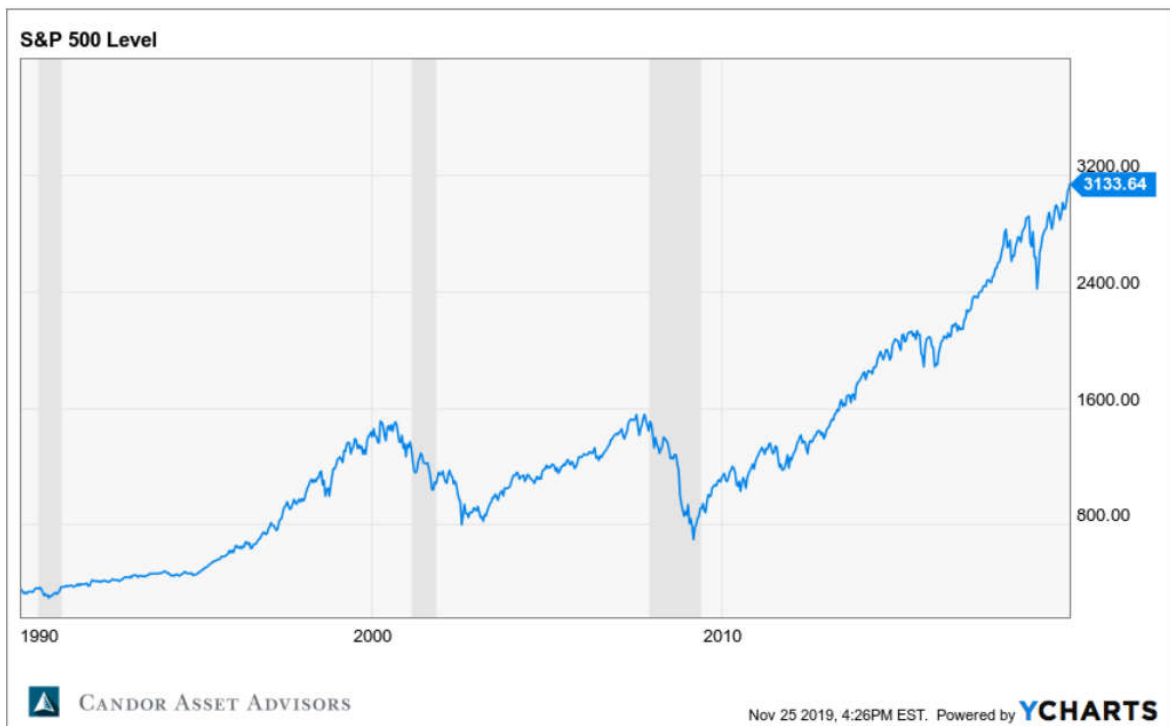


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Source: FactSet, Robert Shiller, Standard & Poor's, J.P. Morgan Asset Management.
Chart is based on return data from 11 bear markets since 1945. A bear market is defined as a decline of 20% or more in the S&P 500 benchmark. Monthly total return data from 1945 to 1970 is from the S&P Shiller Composite index. From 1970 to present, return data is from Standard & Poor's. *Guide to the Markets - U.S.* Data is as of March 31, 2019.

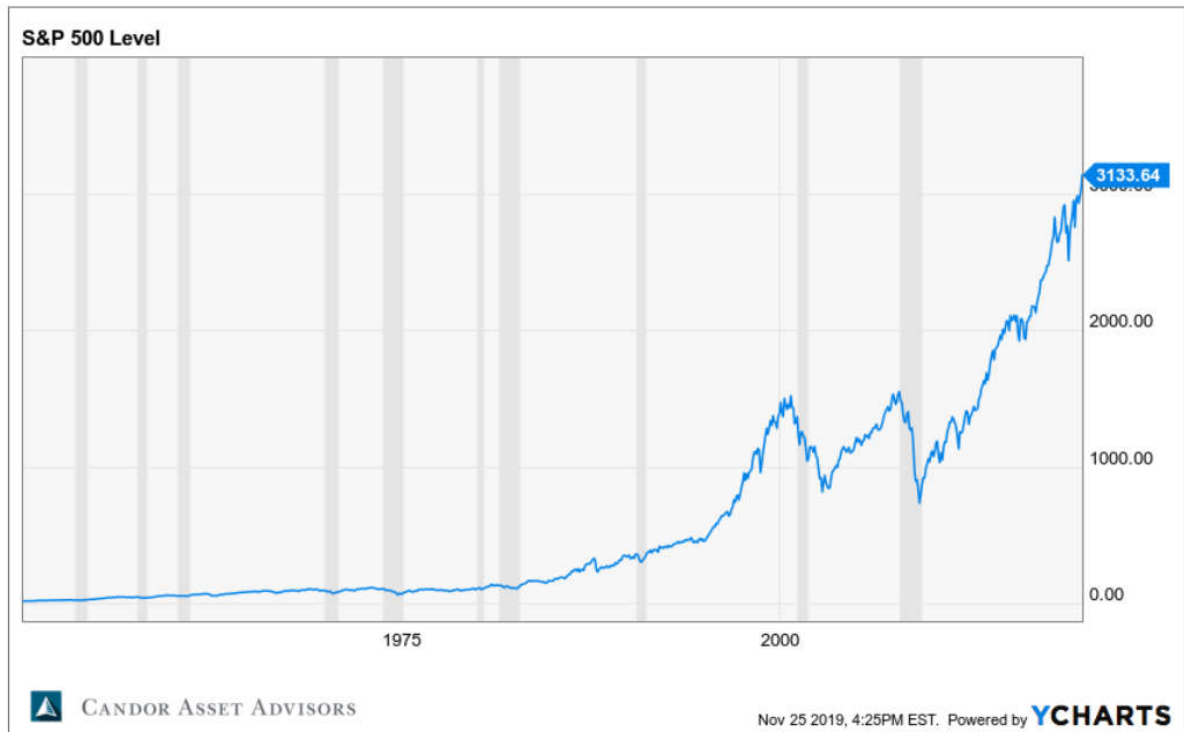
Corrections have been painful in the short run.





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Trying to time the market hasn't paid off for most investors over the long run.



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