Third Quarter 2018
Equity Market Commentary

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Covered in this Report:

- Stocks continue climb despite potential trade wars
- Inflation and higher costs create concern
- Higher rates not likely to cause recession in next 6-12 months

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<u>*Trumpian Trade Stance*</u>

Well, I won't back down
No, I won't back down
You can stand me up at the gates of hell
But I won't back down

No, I'll stand my ground, won't be turned around
And I'll keep this world from draggin' me down
Gonna stand my ground
And I won't back down

(I won't back down)
Hey baby, there ain't no easy way out
(And I won't back down)
Hey I will stand my ground
And I won't back down

Well, I know what's right, I got just one life
In a world that keeps on pushin' me around
But I'll stand my ground
And I won't back down

- *Apologies to Tom Petty and Jeff Lynne, I Won't Back Down*

In the third quarter of 2018, as investors focused on continued strong economic fundamentals including strong employment, robust manufacturing activity, record corporate earnings and the strongest consumer sentiment readings in 18 years, stocks surged. Last year's tax cuts flowed through to businesses and consumers alike and caused GDP growth of 4.2% for the second quarter, the highest reading since the third quarter of 2014. While most major market indices rose, the equity markets did have their share of volatility as negative head winds created uncertainty for future earnings prospects. The Federal Reserve raised short-term interest rates again creating concerns about the outlook for housing, hurricane Florence swamped South Carolina and surrounding states and auto sales stalled on a nationwide basis. The fog of potential trade wars caused weakness in emerging markets and commodities other than oil, but had

little impact on the broad market averages in the U.S. However, worldwide trade uncertainties caused certain economically sensitive issues and exporters to underperform. I am pleased to report we generated competitive returns as compared to our relevant benchmarks.

While most broad market indices rose for the quarter, there was great disparity between the performance of differing investment styles, with growth issues trouncing their value counterparts. Indeed, The Russell 1000 Growth Index soared 9.17% and the Russell 1000 Value Index rose only 5.70%. The Russell 2000 Index of small cap value stocks fared worse, gaining a meager 1.60%! Surprisingly, in a market driven by mega capitalization growth issues, the Dow Industrials nearly outperformed all the major indices and leapt a smart 9.0%, driven higher by tech behemoths Apple and Microsoft (+21.9% and 16.9%) and a large exposure to pharmaceutical shares Pfizer, Merck and Johnson & Johnson, rising by 21.5%, 16.9% and 13.9% respectively. Energy and Materials shares for the most part sat out the latest market advance even as domestic crude oil prices rose to over $70 per barrel. Chevron lost 3.3% for the period and DowDuPont slid 2.4%, while Intel had the ignominious distinction of worst Dow performer, sinking 4.9%.

There are many issues confronting the global energy markets including a U.S.-proposed ban on purchases of Iranian exported oil and production problems in countries like Venezuela. Furthermore, Saudi Arabia clearly envisions a fair price for its crude oil of $80 per barrel. President Trump has petitioned the Saudis to produce more oil and has considered unleashing some of our Strategic Petroleum Reserves, but thus far we have not seen indications that either of his hopes will be satisfied in the near term. As such, we believe the major international oil stocks and certain exploration and production companies offer compelling values and we have increased our exposure to the sector in recent months.

Consumer spending accounts for about two-thirds of the U. S. economy and with continued strong job growth and rising wages, it’s not surprising that the Conference Board’s measure of consumer confidence in August reached its highest level since September of 2000! The prospect of continued job growth for the next few quarters combined with accelerating wage gains suggest a strong backdrop for consumer issues. We have been investors in home improvement retailers for most of the bull market and have added to more traditional department store and sporting goods retailers in the past quarter. We now view the innovators and survivors of the washed-out retail sector as having attractive long-term fundamentals, offering solid earnings growth potential, above market dividend yields and sell at a significant discount to the broad market. Yes, Amazon continues to gain an increasing share of consumers’ wallets, but those retailers who invest in Internet-based selling initiatives and offer in-store pick up or returns of merchandise can gain share as well.

Even though the Federal Reserve continues to raise short-term interest rates, the rate for longer-term ten- and thirty-year issues have barely budged causing a flattening of the yield curve. While it sounds highly technical, the main

concern is if the Federal Reserve is raising rates too fast and will they choke off or slow the economic expansion. Thus far the Federal Reserve has proven to be adroit in its management of interest rates. However, Federal Reserve Governors have admitted the prospect of trade wars could make policy action more difficult and cause economic uncertainty. I was contemplating throwing in a ditty about "Tariffs and trade wars and tweets, Oh my!", but thankfully, we appear to have rebuilt NAFTA and included Canada at the 11th hour, so my readers and U.S. businesses have dodged those proverbial bullets. Whether we have a similar success with China will be determined in coming months, but if you believe that President Trump's bluster is worse than his bite, most industries will probably survive the threatened Chinese tariffs and trade situation as well. However, the prospect of tariffs has had a negative impact on the automotive industry as auto sales have slowed at home and abroad. We have minimal exposure to the automotive sector and will keep a cautious eye on those industrial companies who supply them as well.

Increases in short-term rates, limits on the deductibility of mortgage interest and state and local taxes have had a negative impact on the housing market. Indeed, the gains in home values have slowed for the past four months and sales of previously-owned homes fell in July for the fourth consecutive month. While August sales stabilized at year-earlier levels, it is clear that tax-law changes and housing affordability are beginning to impact sales levels. As such, we have begun to trim our exposure to the housing sector and reduced or eliminated positions in homebuilders and suppliers to the industry. We are also avoiding consumer issues, as the increases in the cost of wages, raw materials, power and transportation are hurting margins. While companies like Kimberly Clark and Proctor & Gamble have resorted to raising prices, thus far they have been unable to recapture all the cost pressures facing them. Inflation is real and it has become a part of the new economic reality. Therefore, we have limited our exposure to restaurants and consumer goods issues as they seem unable to maintain or improve margins in the current environment. Thankfully, most of our balanced and fixed income accounts hold Treasury Inflation Protected Securities (TIPS) whose values rise as inflation readings increase.

According to the Wall Street Journal, U. S. employers have added jobs for 95 straight months, the longest continuous job growth on record. Jobless claims are at their lowest levels in 49 years, the jobless rate is at a 17-year low, consumer sentiment readings stand at an 18-year high, the ISM services index is at an all-time high, GDP growth has accelerated and corporate profits are at record highs. According to Goldman Sachs, even though we are only ten months away from the longest economic expansion in history, the chances of a recession in the next three years are considered "below average." It's no wonder stock prices continue to advance. Furthermore, we are entering the seasonally strongest period of the stock market and since 1980, fourth quarter returns of an average 4.59% gain have trounced other quarters' returns and have been positive 82% of the time (Argus Research). Finally, according to the Stock Trader's Almanac, the fourth quarter of midterm election years starts the best nine-month period of stock market performance! Nevertheless, the tone of our letter is not as positive as previous quarterly letters as much of that good news is reflected

in the prices of certain sectors and this bull market has not followed most seasonal factors. With the market at record highs and the market multiple at nearly 17 times earnings, stocks in general seem fairly priced. Valuations matter and clearly excesses in certain sectors of the market are building.

While it seems like certain parts of the stock market are partying like it's 1999 (homage to Prince), we are still finding plenty of opportunities in long-ignored value stocks with considerable upside potential. In addition to the energy sector mentioned above, health care issues remain attractive on a long-term basis and certain companies servicing the needs of the financial industry offer secular growth opportunities. Finally, we continue to selectively invest in intriguing small and mid-capitalization companies that are not part of index baskets and should trade on their own merits. Yes, there is turmoil and uncertainty in the world and the equity markets. That's why you need a disciplined investor who has experienced how markets undergo transitions managing a portion of your assets.

It is an honor to manage a portion of your investment portfolio. As always, we welcome your comments and questions. The past year and a half under the banner of Granite Springs Asset Management has been a good one for Sunnymeath Asset and its clients. Now, in an effort to simplify and improve the structure of our combined business, we will be renaming the company Seelaus Asset Management, LLC. Rich Seelaus founded his broker dealer 34 years ago and due to the quality of his firm's reputation, it was natural for us to adopt the Seelaus name on the asset management side as well. The combination of Sunnymeath's and Granite Springs' products gives Seelaus Asset Management a complete platform of investment products and services to offer individuals and institutions. If you have any questions about those products and services, just ask and I will direct you to the appropriate individuals.

Sincerely,

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James P. O'Mealia joined the Seelaus Asset Management investment team as the Head of Equity Portfolio Management in April 2017 as part of the firm's acquisition of Sunnymeath Asset Management, Inc. James manages separately managed equity and balanced accounts for institutions, foundations, and high-net-worth individuals, as well as five private limited partnerships.

Seelaus Asset Management, LLC ("Seelaus AM") is a privately held U.S. Securities and Exchange Commission registered investment advisor that specializes in fixed income portfolio management and tactical asset allocation investment strategies for private clients, family offices, financial advisors, insurance companies, pension plans, and other institutional investors. Seelaus AM is qualified to do business in various state jurisdictions where required.

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Sunnymeath Asset Management, Inc., a U.S. Securities and Exchange Commission registered investment advisor, was acquired by Granite Springs Asset Management, LLC on April 1, 2017 to diversify the company's product offerings to include equity market strategies. On November 1, 2018 the company changed its legal name from Granite Springs Asset Management, LLC to Seelaus Asset Management, LLC. The nature of the rebranding was to leverage the established branding of its parent company R. Seelaus & Co., Inc.

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