REDHAWK WEALTH ADVISORS

WEEKLY UPDATE

PERSPECTIVE for BETTER FINANCIAL OUTCOMES

Market Commentary

Historically, the last holiday-shortened week of the year has been muted and uneventful, but that was far from how markets traded last week. Extreme volatility continued, with stocks finishing higher and breaking a three-week losing streak. Monday marked the worst Christmas Eve for the Dow in its history and the S&P 500 flirted with a bear market (down 20% from its peak). Losses then reversed to gains the following business day, as oversold conditions and positive reports about consumer spending for the holiday shopping season led to stocks posting their best percentage gain since March of 2009. The recent price swings are likely exaggerated by low volumes and liquidity during the holiday season. A lot of uncertainties remain, including the Federal Reserve rate policy, the global growth slowdown, and trade tensions, but economic and corporate fundamentals are still solid.

For the year, a historically strong January was offset by a weak December, leaving the U.S. stock market in the red, which is the first annual decline in a decade. The U.S. economy and corporate profits were clear bright spots, but the emergence of tariff wars, tighter Fed policy, plunging oil prices, and weaker global growth created more risks than experienced in many years. As we head into 2019, we are closer to the end of this expansion than the beginning (2009), and we expect market swings to persist.

Let’s look at the highlights from 2018:

1. The Dow crossed 26,000 for the first time as U.S. equities rallied to start the year. Stocks gained 7.5% in the first three weeks of the year, logging one of the best starts on record. Another midyear rally led stocks to new highs, with U.S. equities posting a year-to-date gain of 11.2% by late September.

2. After several years of below-average market fluctuations, volatility came roaring back including two corrections in the calendar year for the first time in more than a decade. Stocks dropped 10% in February as investors worried about rising interest rates, and then fell into correction again toward year-end amid worries over Fed rate hikes, trade disputes, and a global slowdown.

3. After big swings into both positive and negative territory, the U.S. stock market will finish 2018 in the red, ending the streak of annual gains at nine consecutive years, matching the streak in the 1990s. The year-end pullback was steep, but it's worth putting performance in perspective. Since this expansion began in 2009, the S&P 500 has returned more than 350%, one of the strongest bull-market gains in history. Even with the recent drop, stocks have still posted gains of 15% over the past two years, 29% over the past three, and 50% over the past five.

4. The final tally for the fourth quarter is not yet official, but it appears 2018 will be the strongest year of U.S. GDP growth since the financial crisis, likely coming in around 3%, compared with an average of slightly better than 2% during this expansion. Unemployment reached the lowest level in half a century as the U.S. economy added 2.3 million jobs this year. This sets a solid foundation heading into 2019.

5. Interest rates were a key story in 2018 and will likely remain so in the year ahead. The Fed hiked short-term rates four times this year, the most in a year since 2006. The path for longer-term rates wasn't as smooth, with the 10-year yield reaching 3.24% (the highest since 2011) early in the year before dropping back below 2.75% by year-end. There are a few key takeaways from the interest rate story. First, Fed rate hikes are the result of a healthy economy. Interest rates gradually move higher in the latter stage of an economic cycle, yet the 10-year rates are still historically low.

6. Market declines are always painful, but they are also normal. Since March 2009, there have been six corrections, averaging a 14.5% decline. In fact, this recent drop is not uncharted territory for this expansion, as stocks fell 19.4% in 2011 amid the eurozone debt crisis and U.S. economic fears. The market rose 33% over the 12 months following that pullback. Stocks fell 19.8% from September to Christmas Eve, near the edge of bear-market territory. Stocks are up more than 5% since then, and while there is no guarantee that the pullback is exhausted, corrections can create attractive opportunities. Over the past decade, stocks rose an average of 29.2% over the next 12 months following a 10% correction. Moreover, the stock market experienced steep declines in 1998, 1987 and 1966 (falling an average of 25%), but these did not mark the end of the broader positive cycle for stocks, and recessions did not follow. In fact, stocks rose by an average of 21% in 1999, 1988 and 1967.

7. Bitcoin dominated the headlines for much of 2017, but 2018 was the year when the bubble burst. Extreme optimism and questions about the impact of government policies both contributed to the digital currency's fall from 18,600 to 3,600, down 80% from its peak. Cannabis stocks also captured attention this year as Canada became the first major industrialized country to legalize recreational marijuana. While large, established companies have formed partnerships with some of the major cannabis players, these stocks remain highly volatile.

8. Oil had a year of price volatility, with crude oil finishing 25% lower. While prices climbed steadily during the first half of the year, oil peaked in October and then fell 40% from the high. Oil price declines started with supply concerns but were compounded as worries over a global slowdown impacted the demand outlook. The oil slump eventually led OPEC and its partners to reach a deal to cut oil production to balance supply and demand.

9. The FAANG stocks (Facebook, Apple, Amazon, Netflix and Google) rose steadily throughout the year, up 35% at their peak, leading U.S. markets into new highs in September. While this rather narrow leadership from the tech heavyweights helped on the way up, they were leaders to the downside when tech began to sell off in October. Increased regulatory scrutiny, higher rates, and more cautious sentiment all contributed to the tech weakness. However, even after the recent sell-off, the technology sector was still one of the best performing sectors for 2018 along with health care and utilities.

10. The flattening yield curve (a measure of longer-term rates minus short-term rates) captured the spotlight this year as Fed rate hikes pushed short-term rates up while fears of slowing economic growth weighed on longer-term rates. A flatter yield curve generally means that we're in the latter stages of this cycle, but historically it's when short-term rates exceed long-term rates (not currently the case) that recessions tend to follow.

11. Corporate earnings rose by about 20% in 2018, the strongest growth in eight years, as faster economic growth and tax reform helped lift bottom lines. Historically, bear markets tend to emerge when corporate earnings start to decline compared with the prior year. In fact, in the past 20 years, there have only been two years in which corporate profits rose and the stock market declined (2000, 2002). Rising earnings are most often accompanied by a rising stock market.

12. Tax reform was passed in late-2017, setting the stage for the early 2018 rally. As the year-over-year boost of tax cuts fades, the U.S. GDP growth will begin to moderate slightly. At the same time, tariff and trade tensions between the U.S. and China will remain a source of contention for the market.

The balance of positives and negatives continues to evolve as we progress in the market cycle. The fundamentals of economic and earnings growth remain intact, which supports the broader course but won't prevent periodic fluctuations or pullbacks. The silver lining to the decline is that market valuations are at their most attractive level in five years. The rise in corporate profits led to a sizable decline in the price-to-earnings ratio (P/E) for stocks. Since 1991, in years when the P/E ratio fell by 10% or more, the average return in the stock market the following year was 11%.

Victoria Capital's Strategy Update

The end is near…oh, we mean of the year! In a perversion of the idiom, "out like a lamb, in like a lion," 2018 is going out like a lion with stock market volatility setting records for both downside and upside moves. Experiencing a 1,000+ point move in the Dow Jones Industrial Average was only rewarding to the extent the move was up, not down. The way the fourth quarter and December were going, technicians were expecting Armageddon! After a 600-point decline there was a 1,000-point rally. Finally, the market swung over 800 points to the upside during the following day. Feeling dizzy? As one confused market observer vented: “What’s happening?”

Over thirty years ago, on Black Monday (October 19, 1987) the S&P 500 lost 20% of its value. The decline was attributable to a combination of portfolio insurance and program trading. While the Brady Commission recommended several safeguards to shield stocks and markets from these tools that undermined stock prices, modern technology seems to have brought them back in the form of high frequency trading and trading by algorithms. Stock markets are no longer liquid enough to absorb huge buy and sell stock orders that are generated by computers within seconds. The resultant volatility undermines investor confidence and can become a self-fulfilling prophecy as lower and lower stock prices trigger more selling and forced margin calls with fallout that undermines the stock market.

Back to 1987: On “Black Tuesday,” specialists on the New York Stock Exchange began closing stock trading down in the face of enormous sell orders. Psychology eliminated buyers a week before. The reason we can say that is we were there trying to sell a few thousand shares of blue-chip stocks. There is one thing to sell a stock lower and another thing not to be able to sell a stock at all. In the nick of time, the Federal Reserve stood up and told those specialists to use the “Fed’s checkbook” and buy stocks until the market turned. And they did, and the market turned and never looked back.

With the mood of the market extremely bearish and a bear market in stocks accelerating, something must have happened on December 26th. Santa came late, and the Dow Jones rallied more than 1,000 points, a record gain. Wait, didn’t President Trump tweet to buy stocks before the rally? Hmm. With all that bearishness who could possibly step in and rally the market by that much? And then another swing to the upside of 800 points during December 27th.

Santa could be visiting us in the form of portfolio rebalancing. Asset allocation is the preferred strategy for managing a portfolio structured for retirement and that portfolio usually consists of a mix of bonds and stocks with a targeted mix between the two. When that mix gets upset by market volatility, the “managers” push some buttons to buy and sell securities to get back to the target balance. As the fourth quarter was a disaster for stocks relative to bonds, one could expect a surge in demand for stocks in early January.

No changes were made to either the Growth Equity or Target Return models. Happy New Year!

Redhawk's Strategy Update

While many traders took the holiday week off, there was no shortage of action. Stocks made huge swings as the major U.S. indexes climbed around 3% for the week, easing some of the pain from the previous week's losses of 7% to 8%. Monday's sell-off left the S&P 500 near a bear market, or a decline of at least 20.00% from a recent high. At the closing bell, the index was down 19.78% from its record level of September 20. Wednesday's market rally subsequently gave the S&P 500 breathing room to avoid bear market territory.

The surge in market volatility has been accompanied by a pullback in earnings growth expectations. At the start of December, analysts expected fourth-quarter profits at companies in the S&P 500 would rise 14% compared with the previous year. As of December 27, the projected gain had slipped to 12%, and expectations for 2019 profits were also scaled back.

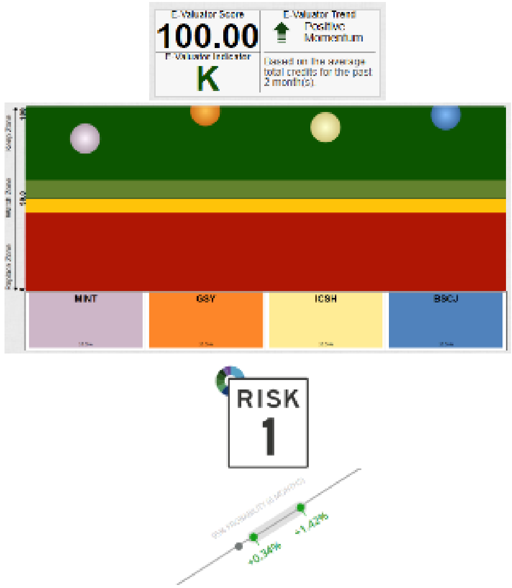
The partial U.S. government shutdown continued to rattle markets throughout the latest week, as the White House and both houses of Congress appeared to make little progress toward a resolution of disagreements over border security spending. The dispute was expected to be the first order of business when a new Congress is sworn in on January 3, with Democrats taking over leadership in the House.

Redhawk Model Signals

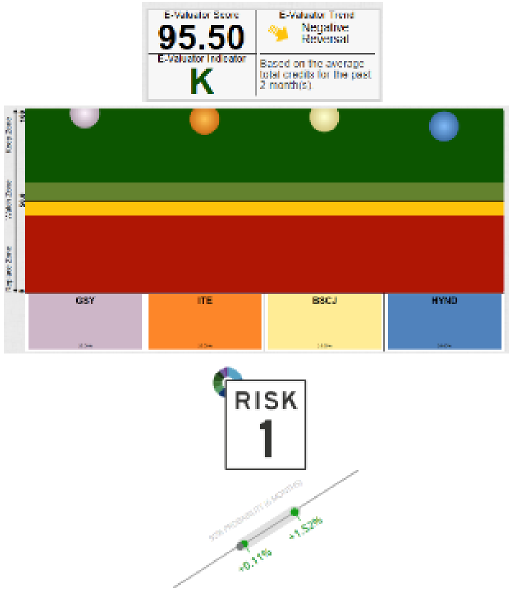
S&P Portfolios: No changes.

S&P Portfolio Bubble Reports as of 11/30/2018

RSPC



RSPM



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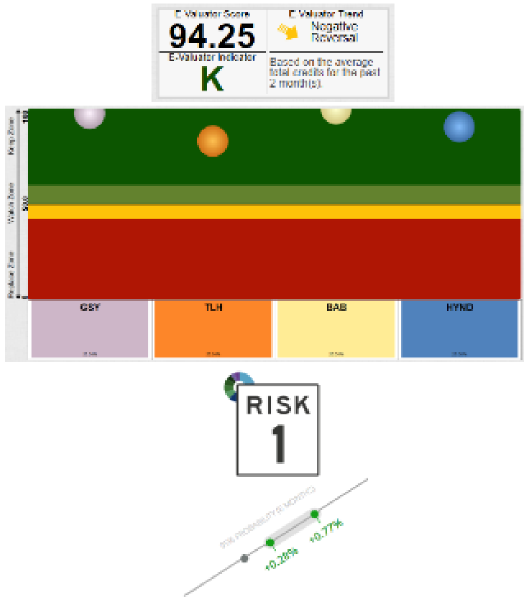
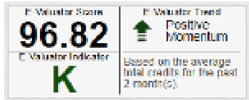
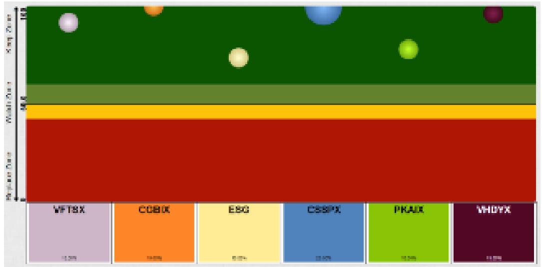


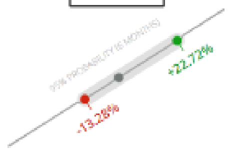
Environmental, Social, and Governance Portfolio: No changes.

Portfolio Bubble Reports as of 11/30/2018

RESG







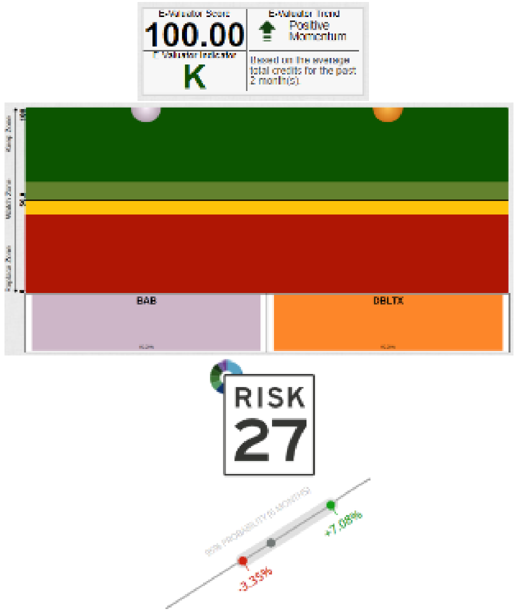
Growth Stock Portfolio: No changes.

High Dividend Stock Portfolio: No changes.

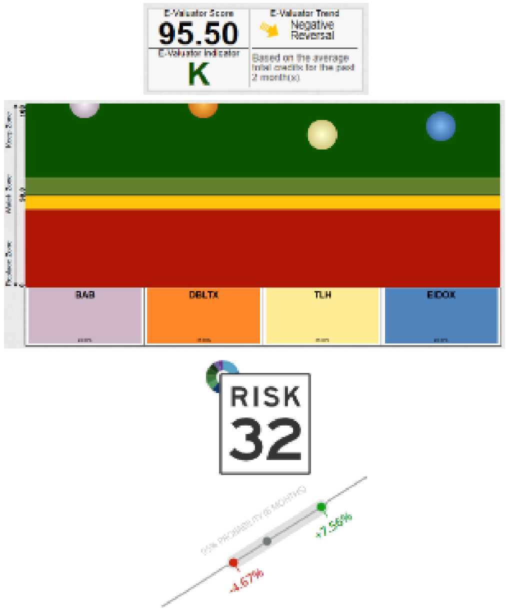
High Income Portfolios: No changes.

High Income Portfolio Bubble Reports as of 11/30/2018

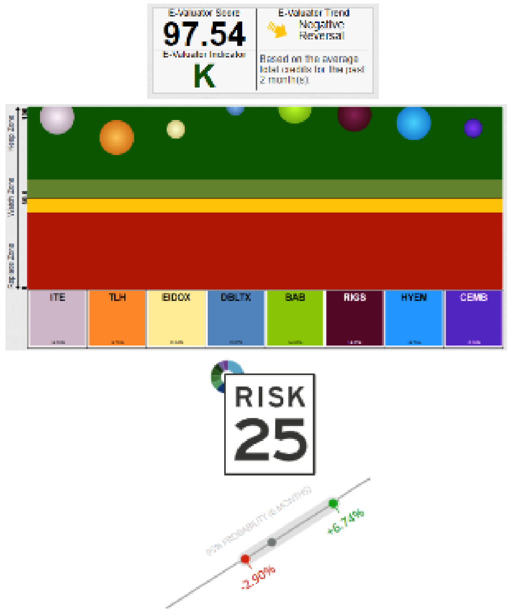
RBI



RHY



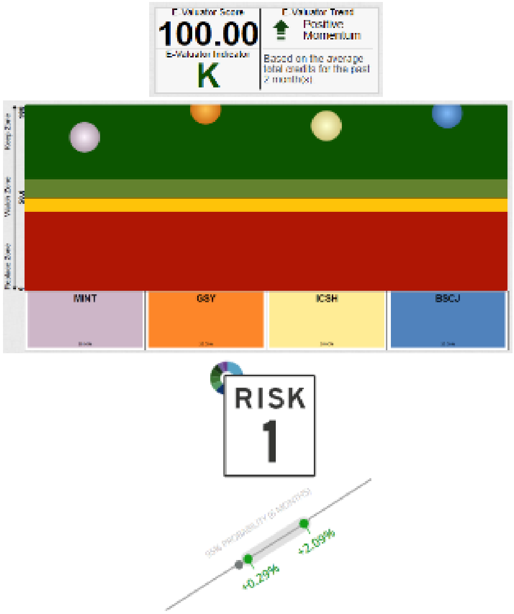
RTHI



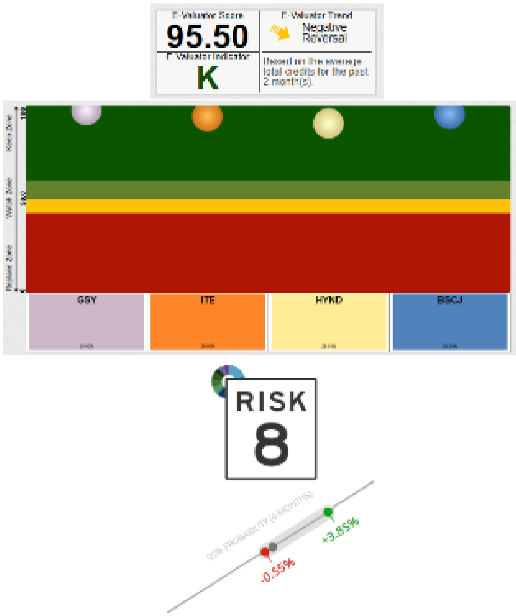
Liquid Income Portfolios: No changes.

Liquid Income Portfolio Bubble Reports as of 11/30/2018

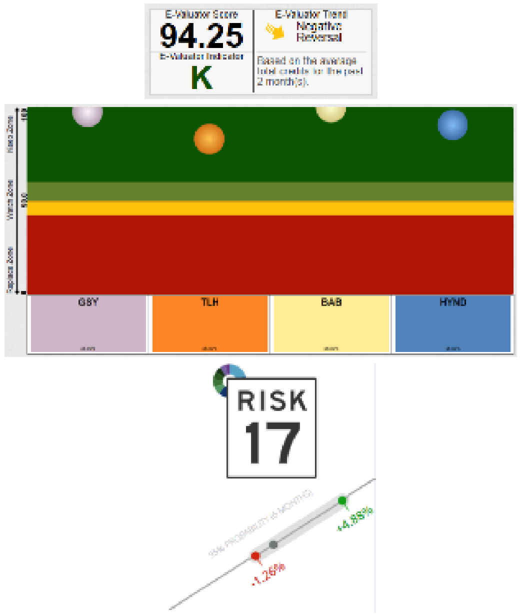
LINCC



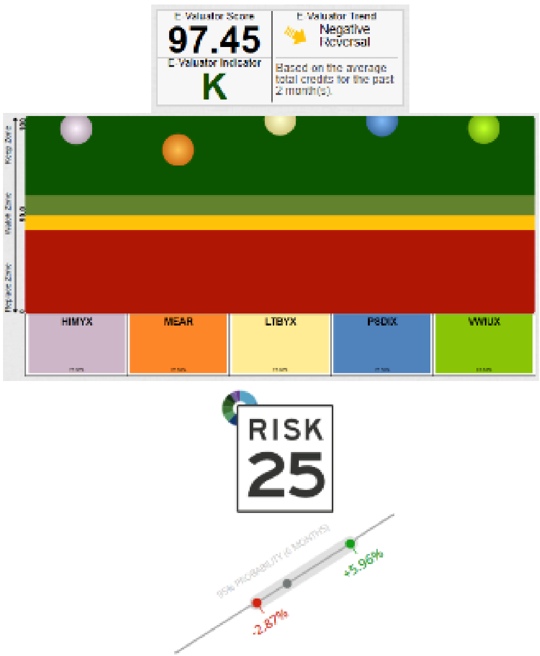
LINCM



LINCA



LINCB



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Economic Data for this Week

Monday:

1. No major reports scheduled.

Tuesday:

1. New Year's holiday observed, financial markets closed.

Wednesday:

1. No major reports scheduled.

Thursday:

1. Construction spending, U.S. Census Bureau.
2. Vehicle sales, U.S. Department of Commerce.

Friday:

1. Jobs and unemployment, U.S. Bureau of Labor Statistics.

The algorithms have been in the "Risk Off" position since 12/19/2018. The stochastic models are reviewing non-correlated asset classes (treasuries, precious metals, utilities, and consumer staples) to determine which, if any, should be invested with the cash that is on the sideline. We will continue to gather relevant data points on the market while in this risk off period.

Portfolio Managers

The Target Return (TR) portfolios consist of a blend of exchange-traded funds (ETFs) to provide a range of risk and return characteristics that should meet the needs of investors saving for retirement. Each of these portfolios is designed to achieve a long-term target rate of return. By utilizing low cost ETFs and by keeping portfolio turnover low, the ability to produce targeted rates of return is dramatically increased. For investors seeking current income, the TR Income Portfolio (TRIP) has been structured to focus on producing both high current income and growing dividend income. The goal of the Victoria Capital Growth (VCG) portfolio is to provide long-term growth through a diversified portfolio of individual equities. A theme-based investment strategy concentrates investments in common stocks of companies that are expected to grow faster than the overall economy. Owning individual stocks gives greater flexibility to make changes on a stock by stock basis for each client. By applying a bottom-up defensive tactical trading discipline, substantial portfolio reserves can be generated.