TACTICAL INVESTMENT NOTE - Key Planks Over the Next Year
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To develop the tactical investment notes, I analyzed the Strategic Investment Notes and developed themes that are anticipated to be particularly important in 2019. The weekly investment notes will highlight specific investments that we are analyzing within our tactical framework.

In general, 2019 is anticipated to be a market of two halves. We are optimistic for the first half for the following reasons: 1. The Fed and ECB speak will become more dovish. 2. China will stimulate as much as they can. 3. The US Congress, the British Parliament and the China/US trade missions will find a way to work. 4. Securities are at historical fair valuations and investors are under invested. Therefore any upturn will be pushed from money on the sidelines being deployed. The second half we are less optimistic. The question of 'too little, too late' will be foremost. If the US and ECB quantitative tightening was too fast or too simultaneous, we will not see the effects until second half. If China's stimulus is not enough or takes too long to come into effect, it will be felt in second half. If the working result of the US Congress, UK Parliament and the China/US trade missions were too little too late (which we believe they will be), it will be felt in second half. Finally, with a rally, securities will not be a fair value and earnings estimates will be reduced second half as the real effects of problems now, will start to be reflected and the euphoric margins of 2018 will be diminishing. In other words, 2019 will be a case of 'buying on the rumor' (the relative progress of the first half), 'sell on the fact' (the reality that the progress was not enough).

In examining our Strategic Plan, there are themes with commonalities that can be addressed in a tactical allocation. A slowing global labor force, ageing populations, inflation-supply/demand, the end of QE, government finances coming under pressure- all point to higher interest rates, if not in absolute terms, at least in real terms. This is a threat to current equity valuations. In examining the large brokerage and investment houses' year end letters- not one said that inflation would be a problem. Perhaps their complacency is due to the fall in oil prices (that have now recovered), or the creeping wage increases that do not seem to be threatening, or the belief that increased money supply will be taken up by government debt and not be leveraged in the broader public or that increased government spending will not lead to increased demand due to its crowding out the private sector.

As stated in the Strategic Investment notes of last week, we believe that real interest rates will trend higher over the next 10 years. Whether the market can cope with this gradual increase we believe, largely depends upon inflation. We are, in contrast to the large houses, in the camp of higher inflation for the following reasons: 1. Unemployment is at record low levels, with many economists claiming the US is at full employment. As stated in the Strategic notes, the working population of the main economies of the world have peaked and are declining (substantially in the case of China). This is and will continue to lead to wage increases. These increases have been dampened until now by lower prices of goods due to globalization and greater retail competition through the internet. We believe both of these trends have peaked. 2. The Populist Movements in many governments have led to trade protection. The largest case being the trade wars/talks between the US and China. China has been the great price deflator of the world. The increased competition that they brought through their membership in WTO has served to keep prices low. Trade wars, duties, etc. will only lead to higher prices for the consumer. 3. Commodity prices have been kept in check since the GFC (Global Financial Crisis). Currently stockpiles of key commodities to produce batteries, silicon chips, and other industrial products are low due to prices not encouraging new exploration, environmental hurdles to new exploration and uncertainty about future demand. Political tensions that might affect commodity prices also have been manageable. We believe, as stated in the Strategic notes, that political tensions due to the continued strength of Populism, will increase.

We also believe that demand for key commodities will increase as countries such as India, Indonesia, Brazil, etc. continue the long-term trend of increasing the discretionary spending of their populations.

Therefore, tactically, we will keep the duration of our bond portfolio short and buy TIPS at opportune trading moments. We will also continue to look for opportunities in select commodities such as rare metals, cobalt, helium and others.

China will be another dominant force this year. Just last week the S&P 500 went vertical on the rumor that Secretary Mnuchin was sympathetic to reducing Chinese tariffs although the Treasury later denied it. This however, could be a harbinger of what could happen if a trade truce is called in March. Chinese economists are claiming that even with a trade war, the GDP growth at the low end would be 6% and without it could be as high as 9.5%. The international finance community doesn't put much faith in these numbers, however we must not forget that China is a managed economy- not a free enterprise economy. China seems to be practicing the new monetary theory which simplified, states that large government deficits/debt are not a problem if the debt is in the country's own currency because the central bank can just print money to repay the debt. This theory states that government should only worry about inflation and unemployment and use tax rates to adjust demand. While this theory is sound, in reality, once governments lower taxes it is very difficult to raise them- especially since modern government's first goal seems to be re-election. China does not have that problem. Therefore we put more credence into their claims. Interestingly, China is lowering tax rates and reserve rates in order to stimulate the economy. Transitioning from an export led economy to a consumption led economy has never been estimated to be easy. No economy historically has made such a large transition without a hick-up. However, no large, managed economy has ever tried therefore the words, 'it might be different this time', may ring true.

This is why we are more bullish equities, especially in the first half of the year as we believe for all concerned, China/US trade wars will not continue and China will be able to stimulate its economy. Therefore we are analyzing China A shares, Vietnam shares (as a beneficiary of China strength or weakness), select exporters to China who are trading at historically low multiples such as VW, and companies who might be targets of continued Chinese buying- perhaps US banks if China opens its financial market.

Our largest call for 2019 is that active management will outperform substantially. This is the result of QE ending and the money that flowed freely into the equity markets slowing. Money will be more discerning with greater focus on profitability and earnings growth versus wholesale momentum movements. As we stated in our Strategic notes, there will be more divergence to performance across asset classes and within markets, with greater focus on individual or idiosyncratic drivers. We believe mergers and acquisitions will be a large force in outperformance with multi-national companies combating populist political policies by diversifying their asset base. We also believe that cash flow will once again become important as borrowing becomes more expensive. Finally, companies that can still afford their buyback programs will continue to outperform although these programs will wane throughout the year.

The market appears to still be positively biased. Much bad news was discounted in December. It is surprising to us how resilient the market is with the US government being shut down, China reporting weaker than expected numbers, the UK being paralyzed with Brexit (even though we uncovered our GBP exposure last week as a delay of Brexit seems highly likely and will strengthen the pound in the short-term), France being maneuvered by a

Populist Movement and violent political uprising increasing across the globe. Perhaps the market is anticipating good news but we think it is the remnants of QE (the belief QT is on hold) and unwittingly optimistic bias of most investors causing them to have a greater fear of missing a bull market than preparing for a bear market.

Currently we are approximately 15% Equity, 42% money market and sovereign bonds (mainly T-bills), 5% gold and 36% cash. We are looking for opportunity to selectively add individual securities to the fund such as VW, China A shares, Vietnam shares, Brazilian shares, US defense sector stocks and continuing to add to our cyber security stocks. We will also be looking for opportunities to add exposure to helium. Other stocks that we are analyzing now are Sky Network Television Ltd, H&R Block, Standard Chartered, WPP, Pearson and Centrica.

We will have target prices in place and anticipate that our equity exposure will be lower in the second half of the year. As always, our weekly investment notes will inform you of current thinking, analysis taking place and position initiation and closing.