AN Unobstructed View
WINTER 2019
QUARTERLY INVESTMENT INSIGHT FROM HIGHTOWER LAS VEGAS

The JANUARY Indicator

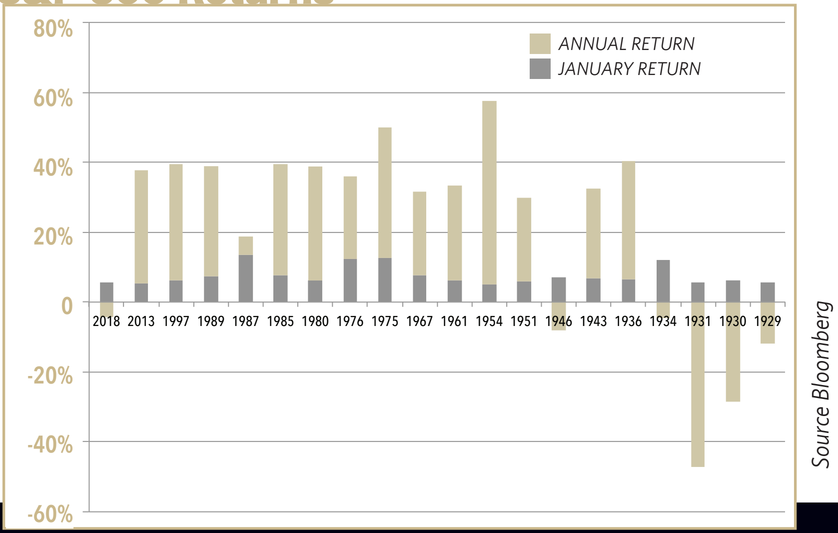
After what can only be described as a horrible December, markets roared back to life in January. The S&P 500 posted a total return of just over 8% for the month. Typically, when January is strong the rest of the year follows suit. Let's take a closer look at the numbers.

Since 1929, there have been 20 instances when returns in the month of January were north of 5% (what we will consider strong for data analysis purposes). In those years, the average yearly return for the S&P 500 was 15.5%. Not every year turned out to be positive, but 70% of the time the S&P 500 was higher when January returns were strong. In fact, when a positive year followed a strong January, the average return for the year was a whopping 29.6%.

In those instances where the market struggled after a strong January, the returns weren't exactly friendly. The average return in those bad years was negative 17.4%. Now, it is worth noting that four of the six instances where a strong January was followed by a bad market occurred during the Great Depression. The other two instances occurred in 1946 and, interestingly, 2018.

Only time will tell if the January indicator will play out positively for investors, but history is certainly on their side.

S&P 500 Returns



HIGHTOWER
LAS VEGAS

The Bar Has Been Raised

The corporate tax cuts were a boon to earnings growth in 2018. After corporate tax rates were lowered from a top rate of 35% to one flat rate of 21%, earnings soared. According to Bloomberg, S&P 500 earnings jumped over 20% in fiscal 2018. The surge in earnings allowed companies to make additional investments in their businesses as well as employ shareholder friendly initiatives such as increased dividends or stock buybacks.

While the surge in corporate earnings was a windfall to companies and their shareholders in absolute terms, there is a devil in the details. Wall Street expects growth and now companies will be faced with much higher hurdles heading into 2019. From a simply mathematical perspective, if a company's revenue in 2017 was $10 billion dollars and expenses were $5 billion dollars, the company's before tax income was $5 billion. Let's assume their effective tax rate was 34%, which would result in 2017 earnings of $3.3 billion.

All else being equal, a reduction in the corporate tax rate to 21% would have increased the company's 2018 earnings to $3.95 billion, an increase of just under 20%. However, the difficulty comes in 2019, when the new baseline for earnings growth is the elevated earnings figure of $3.95 billion. Without an additional tax cut, the onus for earnings growth now falls squarely on the shoulders of sales growth and profit margin growth.

Sales growth has picked up in recent years, but is nowhere close to running at a 20% level. Even in a robust year of economic activity like 2018, we struggled to see double digit sales growth. According to Bloomberg, sales per share are expected to grow at just 5.5% over the next twelve months. As a result, sales growth alone is unlikely to drive substantial earnings growth, which leaves profit margin growth as an important factor to consider.

Profit margins ebb and flow from a variety of actions, but some inputs to cost are driven by bigger picture macroeconomic factors. For instance, oil prices tend to influence the cost of manufacturing and transporting products, so the year-over-year reduction in oil prices could certainly help boost margins and corporate earnings. Wage trends also impact profit margins and here the story is not as friendly to businesses. As the unemployment rate has declined, available labor has diminished, making it difficult for businesses to find workers. This dynamic has shifted the bargaining power of wages in favor of workers rather than employers. Rising wages put downward pressure on profit margins and will most likely be a drag on corporate earnings.

A lot can change throughout the year, but as it stands now, corporations will see a challenging earnings growth environment as high hurdles make comparables difficult and rising wages put pressure on profit margins. The good news is that in absolute terms, company earnings are still robust and provide ample cash flow for companies to continue to employ stock buyback plans, which tend to support share prices.

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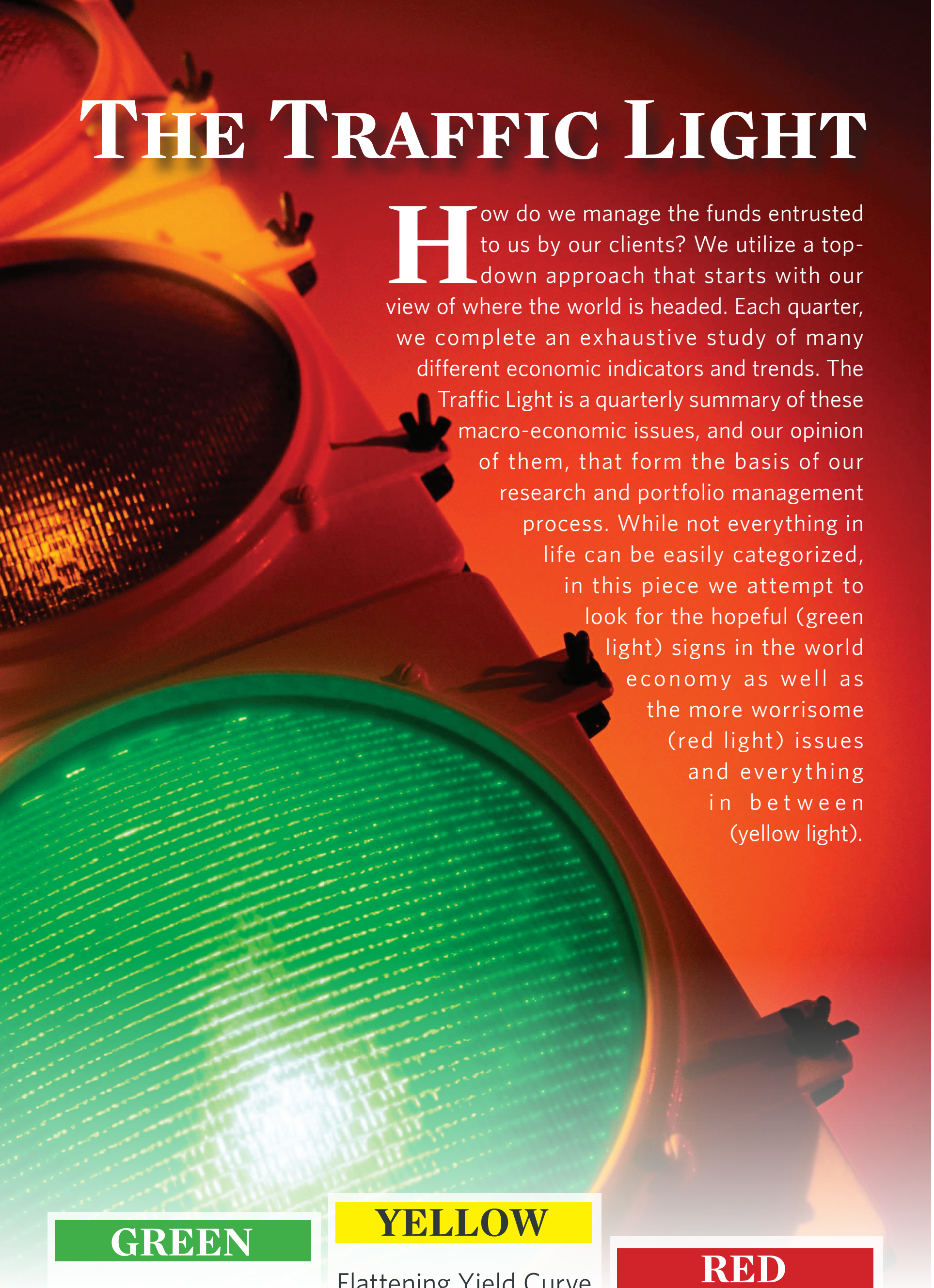
The Traffic Light



How do we manage the funds entrusted to us by our clients? We utilize a top-down approach that starts with our view of where the world is headed. Each quarter, we complete an exhaustive study of many different economic indicators and trends. The Traffic Light is a quarterly summary of these macro-economic issues, and our opinion of them, that form the basis of our research and portfolio management process. While not everything in life can be easily categorized, in this piece we attempt to look for the hopeful (green light) signs in the world economy as well as the more worrisome (red light) issues and everything in between (yellow light).

GREEN	YELLOW	RED
Strong Labor Market	Flattening Yield Curve	Geopolitical Tensions
Elevated Confidence	Slowing Earnings Growth	Political Dysfunction
Low Energy Prices	Tightening Bank Lending Standards	Tariffs & Trade Restrictions
Wage Growth		

Despite significant volatility in financial markets over the past few months, economic conditions remain strong. Job growth surprised to the upside in January and confidence levels remain elevated. Worker wages gradually rose over the course of 2018, which puts more money in the pockets of those most likely to spend it. Higher wages and lower prices at the gas pump have created a nice tailwind for consumer spending.

While there is certainly plenty to cheer about economically, a few concerning signs have bubbled to the surface. First, corporate earnings growth is set to slow as the year-over-year impact of the tax cuts fade. Additionally, banks have begun to tighten lending standards, which will likely constrain credit growth. Typically, slower credit growth leads to slower economic growth, which can also negatively impact earnings. We will be keeping a close eye on these indicators as the year progresses.

As always, there are a few "red light" factors that we continue to watch. The government shutdown highlighted the severe political dysfunction that we face today. While the market was able to shrug off the shutdown during January, a renewed and lengthy government shutdown would negatively impact economic activity and reduce consumer confidence. On the global front, Chinese/U.S. trade relations continue to be a wildcard that market participants cannot ignore.

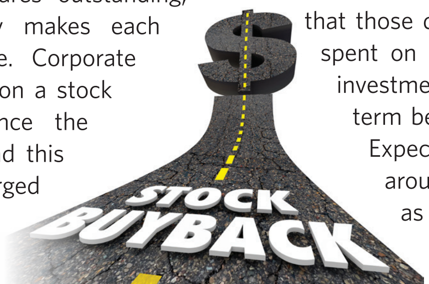
Although we remain optimistic that the economy will continue to progress, we have to be prepared for a slowdown in growth and another bout of market volatility. Our defensive positioning worked well in the fourth quarter and we believe it is prudent to maintain exposure to more defensive assets like precious metals, necessity stocks, and short-term fixed income as the market works through elevated levels of volatility.

WHAT ARE THEY TALKING ABOUT?

STOCK BUYBACKS

Stock buybacks are exactly what they sound like; a company buying back its stock in the public market. Stock buybacks have become a popular way to "return cash" to shareholders. Unlike a dividend, where actual cash is sent to investors, a stock buyback reduces the number of shares outstanding, which theoretically makes each share more valuable. Corporate America has been on a stock buyback spree since the Great Recession and this trend was supercharged with the introduction of the new tax law. Goldman Sachs estimated that over $1 trillion dollars of stock buybacks were authorized in 2018 even though the full amount has not yet been spent.

Stock buybacks certainly provide support for stock prices as they create a continuous flow of demand for shares. However, not everyone is in favor of the tactic. A valid argument can be made that those dollars would be better spent on productivity enhancing investments rather than short-term benefits to shareholders. Expect the political debate around buybacks to heat up as the year progresses.



In the Media

Mike
Featured on Channel 3 News

Check out our HighTower Las Vegas Blogs:

ruminATions:
https://www.hightoweradvisors.com/team/lasvegas/blogs

Thinking & Thriving:
https://www.hightoweradvisors.com/team/lasvegas/blogs

The Stat Pack:
http://www.thestatpack.com

What's New?

It will be a year of adventure at HighTower Las Vegas. Shelby has signed up for two epic runs; the Whiskey Basin trail run (55 miles) and the Yeti Endurance 100 mile run. Her commitment and tenacity in these endurance activities is remarkable.

Adam, trying not to be outdone, will head to Africa in October to climb Mt. Kilimanjaro, following in the footsteps of Mike who summited Kili twenty years ago on March 5, 1999. The 19,341 foot mountain is one of the seven summits and the tallest freestanding mountain on the planet.