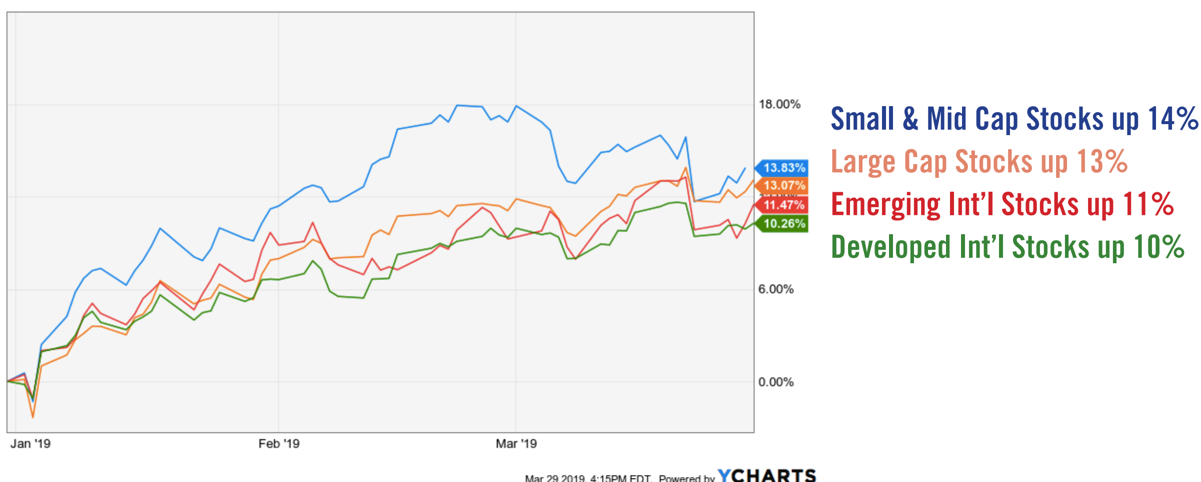
Quarterly Investment Report
March 31, 2019

ASCEND Investment Management, Inc.

Dear Investor:

Stocks have put up a solid 12% gain so far in 2019, albeit not without their signature stamp of volatility. The tension between bulls and bears is intense. Bulls snort that the U.S. economy is stable. They cite earnings growth which increased 13% in the 4th quarter of 2018 and many analysts anticipate further, though slower, growth for all of 2019. Gross Domestic Product (GDP) clocked in at a respectable 2.2% for the 4th quarter. Housing starts, an important driver and indicator for economic health, have been strong in 2019 thanks to mortgage rates coming off their 2018 highs. Interest rates and inflation are still historically low. Assets aren't yet reaching the exuberant price levels one sees just before a major sell-off, and household and corporate debt levels are at manageable levels.

1st Quarter Stock Price Returns



Bears growl that corporate earnings will likely drop down into single digits in 2019 and point out that the Federal Reserve's GDP estimates for the U.S. in 2019 have been lowered from 2.3% to 2.1%, a probable slippery slope. February's employment numbers were dreadful. The huge miss was chalked up to the government shutdown and the fading fiscal stimulus from the 2017 tax bill. March's employment numbers will be under close scrutiny.

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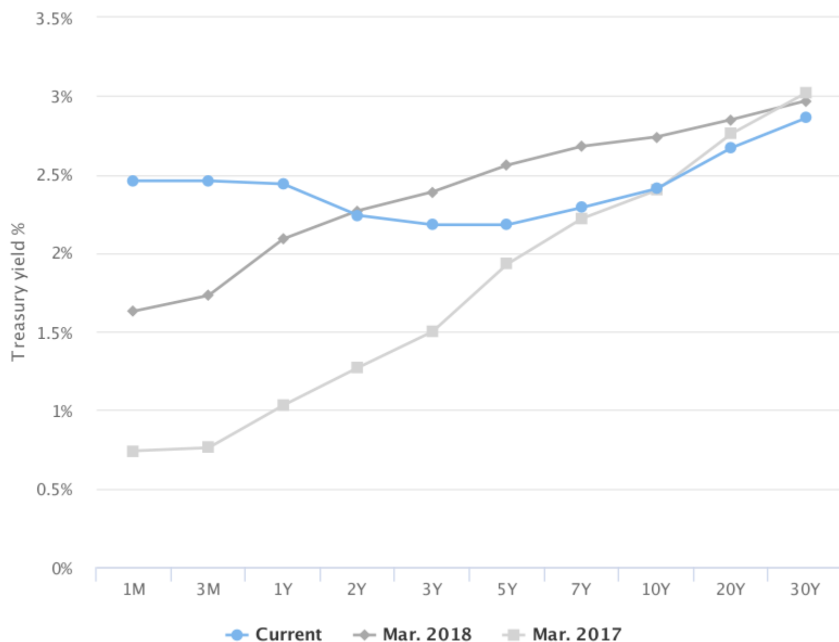
Globally, we have seen GDP growth decline from 3.8% in mid-2017 to 2.6% at the end of 2018. Europe is a mess. Germany's economy recently fell into recession and German interest rates have turned negative. In fact, much of Europe had seen negative bond yields for a long period until the brief bout of economic strength over the last couple of years. England's unresolved Brexit fiasco is jeopardizing its GDP growth and recession appears likely as companies scramble to move manufacturing to more stable countries. China's economy is slowing down precipitously and debt bubbles are surfacing.

The Federal Reserve's surprising release of doves on the first day of spring announcing a pause in interest rate hikes for all of 2019 helped solidify the bear point of view. The Fed's message was a slightly downbeat assessment of the global economy. In its post-meeting statement they said that the U.S. labor market remains strong but economic activity has slowed down from the fourth quarter. The famous dot-plot of rate forecasts was cut modestly, but not a single Fed forecaster among the dot-plot contributors expects any rate cuts through the end of 2021. We think we'll see another rate hike by 2021 since all 12 contributors expect one-to-five rate hikes by 2021.

Bond investors reacted to the Fed's pause in rate increases by turning to the safety of treasury bonds, and, now understanding that the economy is slowing down, they felt at ease going out a little longer on the curve to grab the higher yield. That shift in demand towards longer bonds inverted the curve whereby the ten year treasury bond is now yielding slightly less than the three month treasury note. We are quite sure you have heard the deafening cry lately that this inversion is a precursor to a recession lurking just around the corner.



Note the graph on the left showing the yield curves at this time over the last two years - a normal positive slope. Investors expect higher yields for longer maturities.

The current yield curve, shown in blue, has inverted between three months and ten years.

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While it is true that inverted yield curves typically portend a recession, the timing of recessions after an inversion is never immediate. In fact, looking at a sample of the last four inversions, in 1978, 1989, 1998, and 2006, it's evident that it took about 18-24 months on average before stocks fell apart. And, more specifically, after the most recent yield curve inversion in February 2006, the S&P 500 increased 11% during the following twelve months before getting pummeled at the end of 2007 through 2008. So, what does all of this mean? The Fed is telegraphing a global slowdown. This slowdown appears to be largely due to a decline in manufacturing across the globe thanks to tariff wars, trade outcome uncertainties, Brexit, and the dissipation of 2018's corporate tax cut stimulus. We think it's evident that an economic recession and stock market decline could emerge by mid 2021. But for now, we see the global economy downshifting as opposed to stalling, and the patience that the Fed is showing with regards to interest rate increases will serve to boost stocks over the next year or so and delay an economic downturn. However, leading economic indicators do seem to confirm that peak growth is behind us, not in front of us.

Relative valuation is critical for projecting investment returns in the future. The most well known and useful valuation measure is the price to earnings (PE) ratio. As portfolio managers, we talk about stocks returning 10% per year on average over the long term. But, we really should be more specific. A 10% return on average per year is true, but when you look closely and break down past years into rolling ten year periods, it's clear that average annualized returns depend on what the stock market PE level is at the beginning of each ten year period. There are many 10 year periods where the average annual return is much lower or much higher than 10%. Unsurprisingly, the lower the PE level is at the start of a ten year period, the higher the returns are for that ten year period and vice-versa. Stock market returns are all about earnings and the level at which prices are transacted in the market place for those earnings.

We are entering a period where earnings are slowing down and PE ratios have been higher than their historical average for the last ten years. We expect the next ten years of stock returns to be well under the historical 10%. Individual stock valuation and actively managed portfolios are essential for minimizing investment declines when stocks turn south. Passive investors may be in for a negative surprise.

At Ascend we have established clear long-term asset allocations for our clients that are carefully reallocated as necessary within prescribed targets. We are prepared for stock volatility and an eventual temporary correction or even a bear market. Our sharp research software tools and constant valuation reviews have protected client portfolios well in past downturns and we expect nothing less going forward.

Sincerely,

Ellen P. Le, CFA
President

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CHARITY AND YOUR TAXES

DONOR-ADVISED FUNDS

The 2017 tax bill, with its doubling of the standard tax deductions, has brought greater attention to donor-advised funds. The standard deduction increased to $24,000 for a couple or $12,000 for an individual. Estimates are that 30% of taxpayers previously itemized deductions. We've seen reports indicating that will be closer to 5%-10% of taxpayers itemizing their deductions now.

A donor-advised fund is a charitable vehicle that allows the donor to contribute cash or securities to a public charity fund that can be invested for growth and the donor can maintain control over which IRS qualified public charities receive their donations. It is helpful for donors who don't itemize every year, but can bunch their charitable gifts and itemize in alternate years or every several years.

It's an elegant vehicle for several reasons:

- Donors can contribute several years worth of donations in one year and get the benefit of a tax deduction greater than the standard deduction.
- Donors do not need to set up a costly charitable foundation.
- Donors can donate long-term appreciated stock and eliminate paying capital gains tax on those low-cost assets.
- Donor contributions can be invested for growth, thus allowing for potentially larger charitable donation amounts down the road.
- Donors can control which charities they wish to donate to and when they are given.

Fidelity, Schwab, and Vanguard have large donor-advised fund businesses with reasonable minimum donation requirements and extremely low annual administration costs.

Please feel free to call us if you wish to learn more about how to be charitable while helping your pocketbook at the same time.