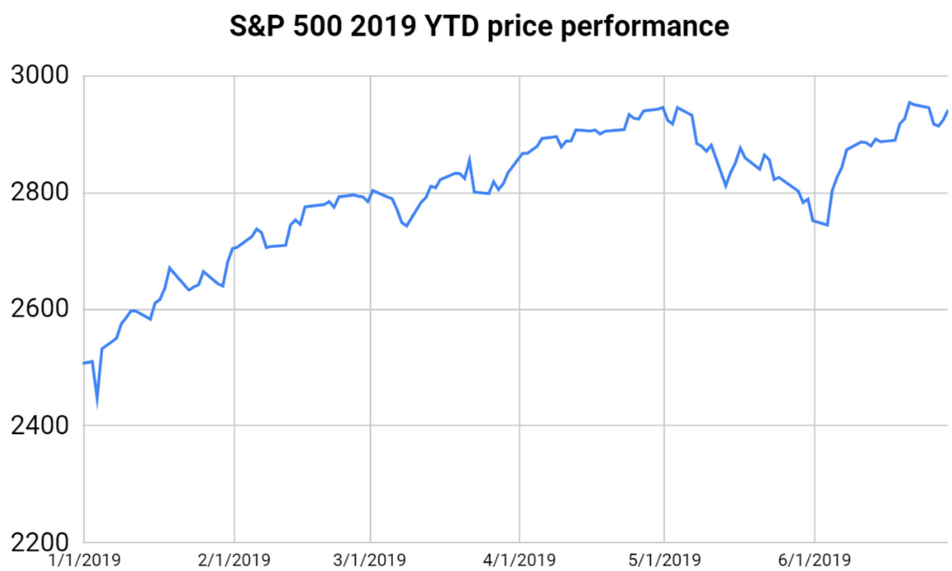
CFO CAPITAL MANAGEMENT
PLAN PROTECT PROSPER

Joseph Tatusko CFP®, CFA
CFO Capital Management
55 Greens Farms Road, Westport, CT 06880

July 20, 2019
jtatusko@cruicefinancial.com
203 221-0202

Second quarter 2019 markets review

U.S. stocks continued to drive higher during the second quarter of 2019 albeit at a slower pace compared to the first quarter. The S&P 500 (the 500 largest publicly traded companies) was up 4.8% for the quarter and 18.5% year-to-date through the end of June. The S&P 500 ended the quarter at 2942, a shade below its all-time high of 2954 set on June 20th. NASDAQ and growth-oriented stocks performed slightly better with the NASDAQ Composite up 20.7% through the end of June. As the following chart attests May was a shaky month for equities but quickly rebounded in June.



Source: GoogleFinance

Equities in the non-U.S. developed markets performed similarly well (next table) however emerging markets equities struggled during the second quarter dragged down by countries with a greater reliance on foreign trade most prominently China (down 3.9%) and Korea (0.9%) source: MSCI. Lower interest rates helped the bond market post strong gains through mid-year, especially riskier non-investment grade high yield bonds, which as a group were up over 10% through June. Commodity prices for the most part weakened during the second quarter led by price declines in crude oil, natural gas, and certain agricultural commodities.

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Total returns	2nd quarter 2019	Year to date through June	2018
S&P 500	4.8%	18.5%	(4.4%)
NASDAQ Composite	4.2%	20.7%	(2.8%)
Russell 2000 (small cap)	2.4%	17.0%	(11.0%)
MSCI EAFE Index (non-U.S. developed markets)	4.0%	14.0%	(13.4%)
MSCI Emerging Mkts Index	(0.4%)	9.2%	(14.3%)
Morgan Stanley US Real Estate Index	1.9%	18.3%	(4.2%)
Bloomberg Barclays Aggregate Bond Index	3.2%	6.1%	(0.1%)
ICE BofAML US High Yield Index (bonds)	2.7%	10.1%	(2.3%)
S&P GS Commodity Index	(1.7%)	13.3%	(13.9%)
Dow Jones Industrials	3.6%	15.4%	(3.5%)

Sources: Morningstar & Bloomberg

Positive U.S. equity performance (next table) was spread across most industries led by financial services (best performers included Visa, Mastercard, and Paypal, while most banks were little changed), consumer cyclicals (Amazon, Disney, Home Depot), and communications services (ATT, Comcast). Technology bested all sectors through the end of June led by Microsoft, Apple, and Facebook followed closely by the industrials, communications services, and consumer cyclicals sectors. The real estate sector (mainly REITs) also performed exceptionally well through mid-year being a beneficiary of the sharp drop in interest rates over the past two quarters.

Morningstar U.S. industry sector total returns	Second quarter 2019	Year to date through June	2018
S&P 500	4.8%	18.5%	(4.4%)
Basic Materials	6.6%	17.9%	(18.2%)
Consumer Cyclical	6.8%	21.3%	0.1%
Financial Services	9.3%	20.0%	(9.9%)
Real Estate	1.9%	18.3%	(4.2%)
Consumer Staples	0.2%	11.9%	(8.4%)
Healthcare	1.3%	9.2%	5.9%
Utilities	3.8%	14.5%	4.7%
Communications Svc	6.2%	22.9%	(6.7%)
Energy	(4.5%)	12.1%	(19.4%)
Industrials	5.1%	22.8%	(11.9%)
Technology	5.1%	24.7%	(1.3%)

Source: Morningstar

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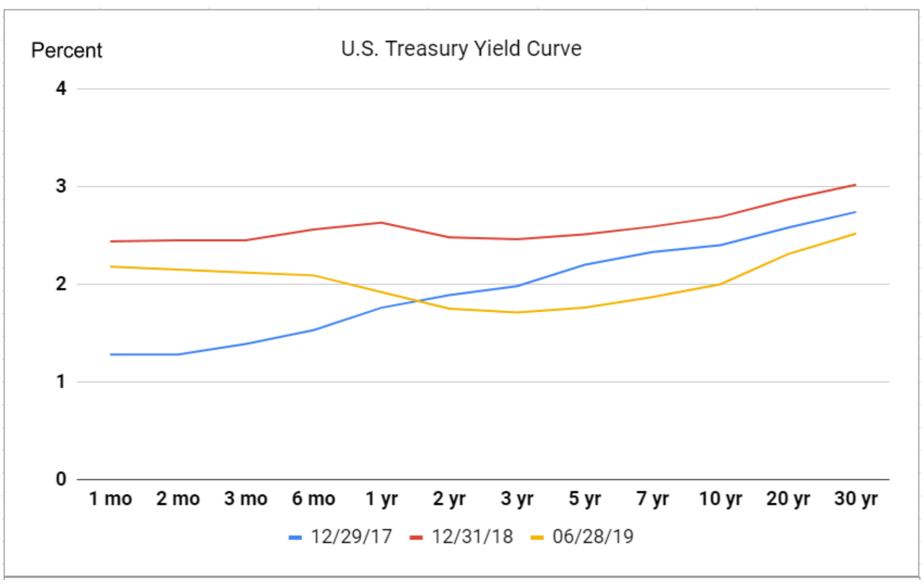
Rates and bonds

The Federal Reserve recently voted to lower the target federal funds rate by 0.25% to between 2.00% and 2.25% based on conflicting data hinting a slowing economy. We see few obvious signs supporting this call to action by the Fed other than adding a little juice to the economy prior to next year's very important election. Payrolls increased 224,000 in June well above expectations, obviously not a strong data point in support of the rate cut (update: 164,000 jobs added in July). It's also worth noting that interest rates hover near historic lows and leave the Fed with very little firepower should a serious slowdown materialize.

1-Month Net Change Non-farm Payrolls

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	-783	-742	-803	-694	-344	-465	-341	-184	-242	-198	12	-269
2010	3	-92	180	237	534	-136	-88	-5	-64	269	123	74
2011	20	213	232	321	95	235	61	122	236	204	132	204
2012	355	262	238	83	99	72	153	170	189	158	158	237
2013	195	279	136	192	224	181	105	242	189	225	267	67
2014	177	168	250	327	221	324	227	188	311	258	286	269
2015	213	248	77	300	319	170	293	122	133	339	235	280
2016	90	232	234	211	15	282	336	135	270	128	170	215
2017	252	141	127	213	128	229	204	187	18	260	220	174
2018	171	330	182	196	270	262	178	282	108	277	196	227
2019	312	56	153	216	72(P)	224(P)						
P : preliminary												

Source: Bureau of Labor Statistics



U.S. Treasury

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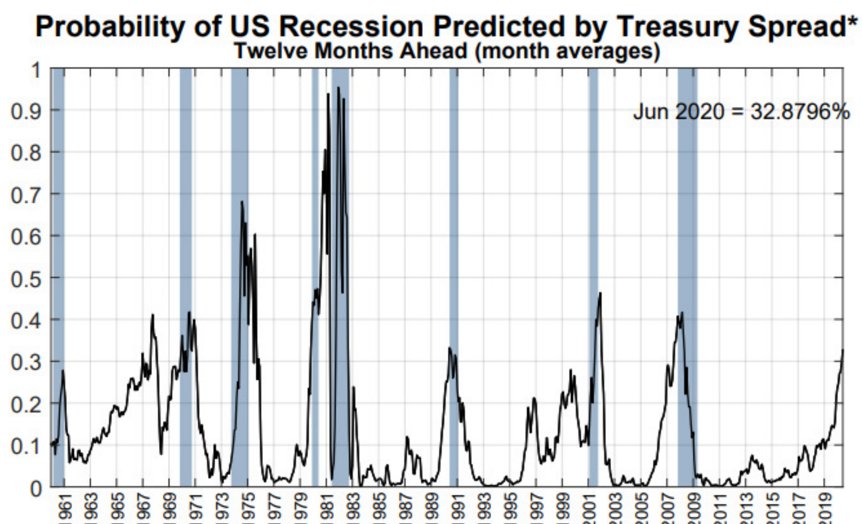
Mid-year 2019 outlook

Strong performance in the equity markets belies the impression that all is not right with Mr. Market. Some industry groups have not shared in the 2019 market rally and a case can be made that the market is priced for perfection. The average price to earnings ratio for the S&P 500 at the end of the first quarter was 22.4 compared to a 14.8 median P/E over the last plus 100 years (multpl.com). Earnings will have to grow around 20% over the next year and a half to restore the market P/E to its historic norm. So far so good with 83% of the companies having already reported for the second quarter either beat or met earnings estimates (65% reported). That said, 20% earnings growth over the next six quarters would seem a tad optimistic. Very slight revenue or earnings misses have led to more than a few stocks getting pummeled.

Some companies have started to set off warning bells. From a Morningstar research note on July 9: “BASF (a large fertilizer company) released a profit warning, stating 2019 EBIT is now expected to be up to 30% below the prior-year level, compared with previous guidance for an increase in the range of 1%-10%.” That’s a big difference. The automotive sector also has also not been immune to downward revisions and the consequences have been severe. Tenneco, a large global auto parts manufacturer, also revised estimates downward and combined with having trouble digesting a recent large acquisition has seen it’s stock fall 80% from its 52-week high. Tariffs both in China and the U.S. were cited as significant contributing factors.

Our first quarter commentary highlighted the hazards of an inverted yield curve and the next chart indicates a sudden increase in the probability of a U.S. recession. The odds for the slowdown rose to 33 percent in June based on the rate spread between the 10-year Treasury bond and the three-month T-bill. Granted false positives have occurred but these petered out at much lower levels.



New York Federal Reserve Bank

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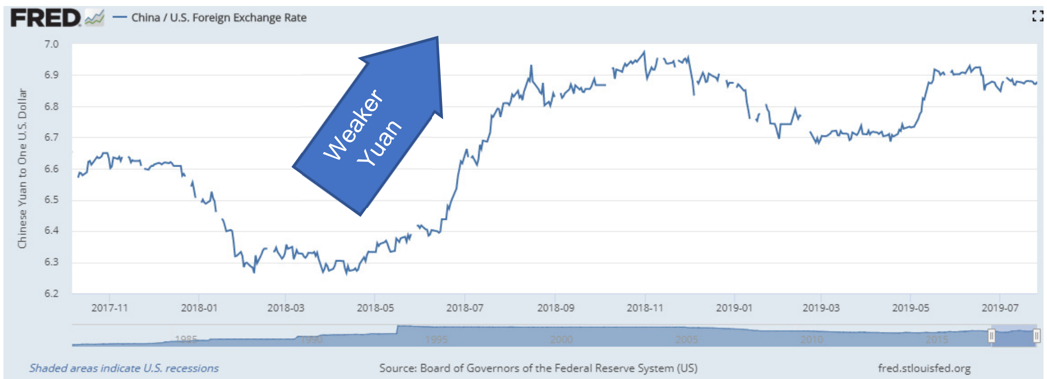
Implications for investors

Talk of a new round of tariffs is setting off tremors in the equity and commodity markets. Tariffs are nothing more than a tax paid by consumers and producers, and it is unclear any of the administration's objectives will come to fruition. It is increasingly apparent that a trade agreement with China may not ever come to being. China can erase some of the effect of tariffs simply by weakening their currency, which it has been underway since mid-2018 (next chart).



Investors committed to large equity weightings in their portfolios are best advised to take a long-term view in the face of some near-term disruption. No one can be certain that tariffs or other factors will trigger a recession or a market correction, but our view remains that either event will likely be a short-term phenomenon. Patience can sometimes be an uncomfortable virtue especially to investors holding sizable unrealized capital gains. We also want to avoid undesirable tax consequences attributable to selling positions and realizing those gains. Investors are best to assume at a minimum two-year horizon and wait out a correction that may or may not materialize.

The fixed income investor also faces significant challenges. The 10-year Treasury bond rate has fallen to a near crisis level 1.85% at the end of July, and interest rate spreads have tightened, therefore current yields on bonds may not be very appealing to income-oriented investors. BB and BB+ rated corporate bonds (one step down from investment grade) that yielded 5.5% at the beginning of the year have dropped into the 4.2% to 4.5% range. This state of interest rate repression is not at all favorable to investors in need of relatively stable income from bonds.

A portfolio comprised of high dividend stocks might provide an attractive alternative to earning greater income, but this comes with the risk of greater price volatility. We recently constructed a hypothetical high dividend stock portfolio able to generate a 5% average yield that also provides an opportunity for price appreciation in a rising market but may fall in value in a market downturn as well. The dividend stream somewhat offsets a portion of the price risk for holding these stocks.

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Another strategy we have favored this year even for the income investor is an all-of-the-above approach that combines high income securities with the inclusion of more growth-oriented equities that typically pay low or no dividends. Our focus in this area centers on companies with demonstrated ability to grow revenue or earnings at or greater than high single digits and hopefully purchased on temporary pullbacks. It's often feasible with this approach to generate adequate income to cover a large portion or all of one's annual distributions while seeking to build portfolio value with growth opportunities.

We look forward to working together and meeting to discuss your portfolio strategy and changing needs as well other concerns you might have over the second half of 2019. Please feel free to call us directly or email anytime you have questions.

Notes: Past performance is no guarantee of future results. All investing is subject to risk, including possible loss of principal.