Outlook Fourth Quarter 2018

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Currencies Commodities Bonds Stocks

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3rd Quarter 2018 Performance led by Big Growth Stocks while Bonds were Flat

The biggest company and core holding in most client accounts, **Apple,** got even bigger during the third quarter. Apple rose 22% and Amazon rose 15%. The SP500 returned 7.7% while the Barclay's Aggregate bond index was unchanged (interest income offset decreased in value as interest rates rose). Large cap growth stocks continue to outperform mid and small stocks in 2018 so far. Client equity portfolios generally performed in line with the SP500, while bond portfolios were a bit better than the Barclay's Aggregate Bond Index due to large exposure to floating rate securities that benefited from rising interest rates.

Apple

Underlining factors supporting the appreciation of stocks include strong earnings growth, stock buy backs which reduce the number of shares outstanding, and the relative stability in long-term interest rates. Innovative companies continue to be the front-runners. As trade tariffs began to take effect, they negatively affected several core holdings including **Deere**, **SolarEdge** and **Skyworks Solutions.** However, these three holdings have significant appreciation potential over time.

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U.S. Dollar Sets the Tone for the Markets

While not as interesting to the financial media as Elon Musk's most recent tweet, the trend of the US Dollar relative to foreign currencies has set the tone for the major financial markets (commodities, bonds and stocks). Domestic interest rates, economic growth, and the budget deficit are factors that impact the trend of the US Dollar. However, the implications of the US Dollars' trend are more impactful. As the Dollar rises, the cost to sell products or services to foreign markets rise.

After falling for most of 2017, the dollar has crept higher in 2018. Corporations are beginning to comment that the higher dollar is beginning to impact export sales as the rising dollar makes goods more expensive to foreign customers.

U.S. Dollar

Commodities: Oil is Up; Everything Else is Down or Flat in 3rd Quarter

Recent tariff policies have been more impactful than traditional supply and demand matrix for commodities. The big change in the commodities markets began to take shape in May when tariffs against Chinese imports went from discussions to reality. Since then, many economically sensitive commodities have trended lower. Copper, a benchmark for worldwide economic activity, has dropped about 23% since the spring. Also, soybeans have lost 19% year-to-date. Soybean exports are at risk due to Chinese tariffs on US farm products. China has begun sourcing soybean from Brazil.

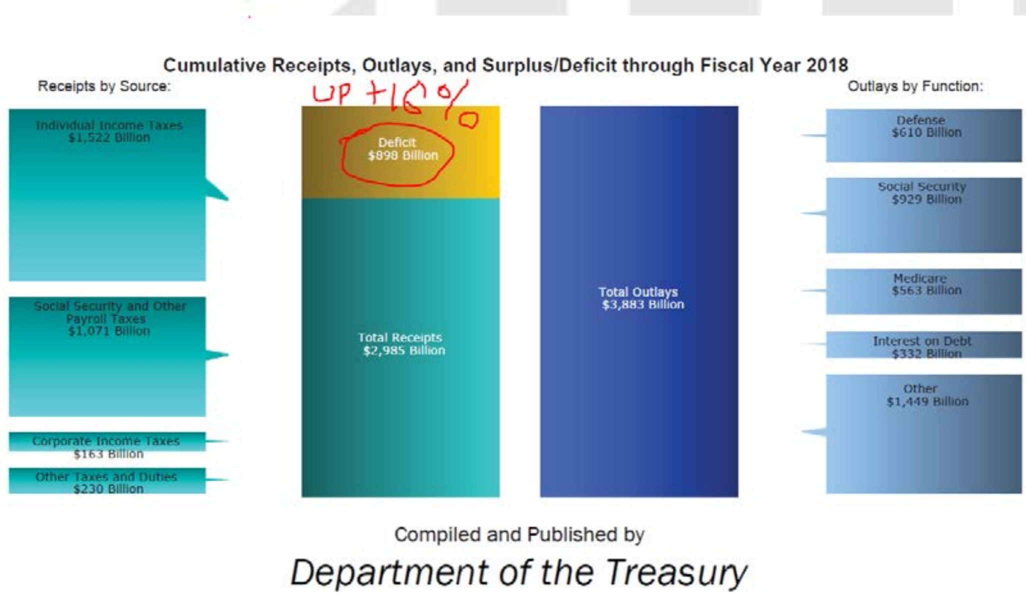
The strongest commodity has been oil, up 22% (West Texas Crude) in 2018. The oil markets are on the verge of a "supply shock" as Iranian sanctions take full effect on November 4th. Iran exported nearly 4 million barrels a day. Expect to see oil trend higher as the world looks to replace Iranian lot production which will be difficult as many producers are near full capacity and Venezuela is in the process of self-destruction. Surprisingly, energy stocks have not kept pace with the appreciation of oil suggesting that traders don't expect the rise in oil prices to hold long term.

Brent Crude Oil

Down the road (5 to 10 years) oil will be at risk to changes in fuel. Initially, electronic vehicles will hurt the demand for oil but will help natural gas demand as utilities could see demand rise. Also, fuel cells using hydrogen may have a role especially for commercial vehicles and small power plants.

U.S Treasury Debt: It's not a Problem Until it is One

One of the factors driving the economy this year has been massive government spending up 6% for the first 11 months (through August) of the fiscal year. Tax revenues rose 1% over the same time but may begin to fall as the full benefit of the tax cuts is experienced when business owners file their tax returns next year.



For the first 11 months of the fiscal year, the deficit rose by about 1/3 or $898 billion and is likely to exceed a trillion dollars next year. Notable changes in fiscal 2018 include an increase of 7.5% in Social Security benefits, 7.2% increase in defense spending and 5.6% increase in health and human services (Medicare, Medicaid etc.). A significant decline was in education with direct student loans falling by two-thirds.

Summing up the Federal Budget analysis, for every dollar of spending, $.23 had to be borrowed from investors through the sale of Treasury bonds. Funding the deficit is not a problem, *until it is a problem*. The problem could spark from investors who may require higher interest rates to compensate for increasing risks. Italy is experiencing this exact scenario now. Also, China holds over $1 trillion of U.S. Treasury debt. A material increases in Treasury bond yields from 3%, to possibly 3.5-4% poses a significant risk for all financial assets, especially the high valuation growth stocks that have led the markets for years.

Fixed Income: Yields Creep Higher

During the 3rd quarter, the benchmark 10-year Treasury bond yield rose by ¼ % to about 3.1%. Short-term interest rates have risen much faster than longer term rates that have inched higher. In late September, the Federal Reserve raised the Fed Funds rate by another ¼ %. With short-term Fed Funds now at 2 ¼%, the procrastinators are speculating on how high the Federal Reserve will raise short term rates: 3% is a reasonable expectation as it is a nice round number.

Treasury Bond Yield Just Above 3%

One of the most important factors in keeping the long-term interest rates stable has been the dramatically lower yields of other countries. Germany's 10-year bonds yield 0.47 %. One of the reasons why government bond yields in other nations are dramatically lower than U.S. Treasuries, is because the U.S. has a huge budget deficit compared to a budget surplus in Germany.

From a strategic perspective, the bond market is used to ensure client cash needs are somewhat predictable. One of the key strategies of AHIA has been to match annual cash needs of the portfolio to bond maturities over the business cycle (3 to 7 years). Based on this tenant of our investment strategy, many client bond portfolios have laddered bond maturities aligned to their anticipated cash needs.

The core of our fixed income strategy continues to focus on laddered, high-quality bonds. We look for higher returns in the equity market using long-term funds. To enhance fixed income returns, we use various high yielding issues. In the past, closed-end bond funds provided attractive returns, but we are waiting for the Federal Reserve to conclude their interest rate increases. Recently, we have been investing client funds in floating rate funds. These funds invest in securities that have yields that are tied to short-term interest rates so that higher interest rates increase investor yields.

Equities-Sticking with the "Cool" Stocks for Now

Looking at the equity market, the big recent news is the restructuring of technology and telecommunications components. The telecommunications sector has been renamed "communications" and will pick up many new companies including Disney, Comcast, Netflix, Facebook and Alphabet. Because of these sector changes, technology is reduced from 26% to 20% of the SP500. Most likely, the changes will not impact the overall SP500 performance, but the character of the individual sectors will change.

Diving deeper into our equity selection process, we select quality companies that are expected to grow their sales and profits (more the better, but slow and steady is ok too), stable profit margins and good corporate citizens. At present, six of our largest holdings exhibit incredible innovation and are leaders in their industries. The largest core holding, **Amazon**, grew sales 39% in the June quarter as Cloud hosting and retail sales continue to take more of consumers spending. **Microsoft** recurring revenue is expanding, as customers convert to Cloud versions of their "Office Suite" of programs (Outlook, Work, Excel, and PowerPoint). **Visa** is riding the secular growth of digitizing financial transactions securely. The beauty of **Visa** is that as volumes rise, incremental costs only rise marginally, creating earnings growth significantly faster than sales growth.

Transitioning to healthcare, the largest holding is **Intuitive Surgical**, the leader of robotic surgery. Their DaVinci systems assist surgeons who perform prostate, hysterectomy & hernia procedures. Looking to the future, **Intuitive Surgical** is developing a lung cancer detection procedure. Other healthcare holdings include **Johnson & Johnson** and a recent addition, **Illumina,** a provider of genomic tools.

Financial sector holdings outperformed largely due to the 19% increase in long-time holding **Assured Guaranty**, **(AGO),** which is a classic value stock that may benefit from rising interest rates.

In the consumer discretionary sector, **Ulta Beauty** increased 21% in the third quarter**. Ulta** had a roller coaster earnings report in late August. The sales and earnings growth were in line with estimates, but margins declined, a death wish for investors sending the stock sharply lower. Initially during the conference call with investors, CEO, Mary Dillon mentioned a new agreement to sell Kylie Jenner's line of cosmetics. Jenner's' celebrity status spiked up the stock by 10%. In addition, during the quarter, a position was added in Garmin, a GPS product supplier.

Shifting to the stock holdings that performed below par, energy stocks were surprisingly a weak performing group. The rise of oil has outpaced the oil sector stocks by a wide margin. **Helmerich & Payne** rose by 7% but **Pioneer Natural Resources** declined by a similar amount cancelling out any sector profit. Energy stocks may be a strong performer as investors gain confidence in the price of oil.

The decline in energy stocks may be due in part to investors' lack of confidence in emerging electronic vehicles. **Tesla** is the current leader; however, energy competition is coming from numerous competitors. **Tesla** is an interesting ESG stock. With their energy saving battery, technology paired with solar gets a grade of "D" in E-Environmental. Conversely, governance analysis based on Elon Musk's recent antics makes a grade of "F". This is why **Tesla** is a very small holding in only a few client portfolios.

The driving force behind the appreciation in stocks this year has been innovation, which often leads to strong earnings growth. The sector with the most of these attributes is technology. Artificial Intelligence, Cloud computing, driverless cars, 5G, Bitcoin and cybersecurity are just a few of the secular trends driving technology stocks. Further, investors are also willing to take excessive risk as evidenced in the marijuana and Bitcoin stocks. In the short-term, the speculative fever stimulates, but this might be a sign that the current bull market may be approaching its final rally. Another factor that is not well known to the public is that due to acquisitions and stock buybacks, there are fewer publicly traded companies on the stock market.

Historically, the 4th quarter is the strongest. Our expectation is for moderate gains, but as always, we remain prepared for a more significant rise or fall of 5%. The outlook for equities is supported by the growing economy, increasing corporate earnings, and investor interest in stocks. Potential risks include moderate earnings growth in 2019 and a sharp increase in long-term interest rates. Higher interest rates make bonds marginally more attractive to investors who may sell stocks in favor of bonds.

Stocks have moderate appreciation potential. Bloomberg's models of the "fair value" of the SP500 are at 3,090, or about 5% upside potential. Earnings growth will be the driving force as there is not an expected increase in the price to multiple earnings. Currently, the price-to-earnings ratio is at 18.

5G (Fifth Generation Cellular Technology) is beginning to be introduced to **Verizon** customers in Houston, Indianapolis, Los Angeles & Sacramento. 5G offers significant benefits to consumers with all kinds of new technologies as reflected in the below chart from **Skyworks Solutions**. **Skyworks** stands to significantly benefit as their wireless semiconductor chips will be the building block to all sorts of new wireless technologies. Today, **Skyworks** is believed to get about a 1/3 of their business from **Apple**. The only "small" problem for **Skyworks** is that most of their sales are in China which puts them in the crosshairs of tariffs.

The solar stocks have been materially hurt by tariffs and the pro-fossil fuel policies of the Trump Administration. **SolarEdge** may need to relocate manufacturing from China to another country to avoid tariffs on US sales. Fortunately, our research saw negative developments emerging as we sold a significant portion of the **SolarEdge** position. Long term, **SolarEdge** offers excellent return potential and could be an acquisition target by a larger technology or electronics company.

Important Year-End Notices

Clients who are subject to required minimum distributions (RMD's) from IRA accounts must do so before 12/31/2018 per IRS regulations. To ensure that our clients meet this deadline, we will be processing any outstanding RMD's on 12/15/2018.

Clients may consider using their qualified charitable distribution (QCD) for a portion or all of their RMD. A QCD to a charity excludes the amount gifted from taxable income.

Self-employed individuals can boost their retirement savings and defer taxes by setting up a small business retirement account. If you open a qualified retirement account by December 31, 2018, you have until the day you file your taxes next year (2019), including any extensions, to make this year's contributions. The Solo 401(k) is an ideal plan for self-employed individuals and allows contributions up to $55,000 or $61,000 if age 50 or over.

If you are a participant in an employer-sponsored retirement plan, such as a 401(k), 403(b) or 457 Plan, try to max out your contributions limits for 2018. Contribution limits are $18,500 and if you are age 50 or older, you get an additional $6,000 or a total of $24,000.

Considering a financial gift to your favorite charity? Fidelity offers a "Giving Account", which is a donor-advised fund to make it easier for you to plan your giving and be more strategic. This account can be established online in minutes or via paper form. Once the Giving Account is established, you can transfer in cash and/or securities from one of your existing Fidelity accounts or other account. This provides you with an immediate tax-deductible donation, which will grow tax-free until you decide which charity to support. You can set up multiple charities as well. Any IRS qualified public charity can receive funds from the Giving Account. Please call us if you would like more information.

Fully fund 529 college savings plans before year-end. Single individuals can contribute up to $15,000, and married individuals can each contribute $15,000 or a total of $30,000 to as many individuals as you like. The funds within the 529 plan grow tax free and some states offer state tax deductions for the contributions.

In Memoriam- Dr. Robert D. Lovett

It is with a heavy heart that we announce the passing of Dr. Robert Lovett on August 21, 2018. Dr. Lovett was an investment advisor representative and solicitor for the Firm from 2012 to 2018. He was extremely knowledgeable having over 40 years of experience in the financial sector. In addition to his advisory services, Dr. Lovett spent over 25 years instructing financial professionals at several universities and colleges. He is a past Regional Director for Florida State University, Certificate in Financial Planning Program, past Director of The Institute of Financial Studies at Nova Southeastern University, and past director of the CERTIFIED FINANCIAL PLANNER ™ Certification Education Programs at Florida Gulf Coast University and Barry University. He formerly taught accounting classes at Hodges University. Dr. Lovett earned a Doctorate in Business Administration, Accounting, at Nova Southeastern University, and a Master of Science, Taxation at Seton Hall University. He completed his undergraduate studies at Northeastern University, Boston, MA. He was a member of the Academy of Financial Services, the Academy of Finance, and Sigma Beta Delta International Honor Society for Business, Management and Administration. The staff and partners of the Firm are grateful to have had the opportunity to know and work with Dr. Lovett. His wisdom and sense of humor will be missed.

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