FSA INVESTMENT GROUP

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What a Difference a Year Makes!

After seeing dismal returns from just about every asset class in 2018, we saw a stark contrast in 2019. Global equities and bonds posted the highest returns since 2009 and 2002, respectively. Cash, which was one of the only asset classes to post positive returns in 2018, was the worst performing asset class this past calendar year.

Economic Indicators: Close to Neutral, but Still Growing

Going into 2019, a potential recession was on the minds of many investors as equities fell hard in December 2018, high yield bond spreads rose, and the yield curve became inverted. However, investors that rebalanced their portfolios and remained invested were rewarded. We did see a slowdown in economic activity and an uptick in political risk, central banks shifted from tightening to easing bias, making risk assets like equities attractive.

Before we discuss our thoughts for 2020, it's always important to look at our key calls and see what worked and what didn't.

- Overall, our framework continues to call for a higher allocation to return-seeking assets over safe assets. As noted above, our overweight to equities was very beneficial. If we look over the last three years, it is apparent that maintaining a risk-on stance benefited investors willing to remain steadfast in volatile periods.

- *Investment Services*
- *Reporting Services*
- *Consulting Services*

ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor. As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results.
FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

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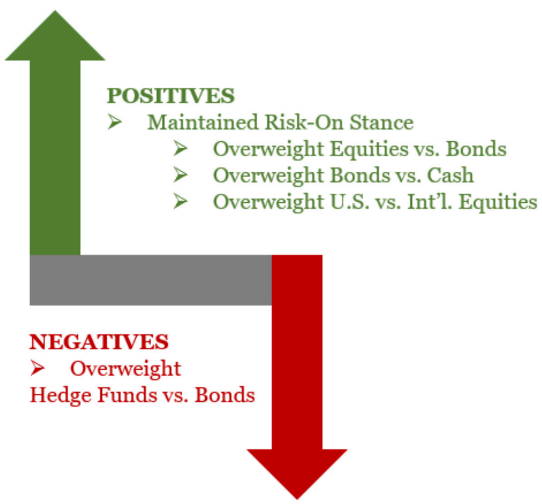
• The U.S. market continues its dominance over foreign markets, helped by a strong showing from technology and consumer services sectors. We maintained our U.S. overweight throughout 2019.

• Our position to overweight hedge funds over core bonds was not beneficial for our clients. Core bond yields declined almost 100 basis points in 2019.

• With these same bonds now yielding only 2.3%, we continue to favor a diversified basket of hedge fund strategies over bonds.

Figure 1



A New Decade, a New Focus?

Our focus is now on 2020 and how portfolios should be positioned. The global economy has been slowing since 2018 on the back of a stronger U.S. dollar, trade war uncertainties, and a slowdown in emerging markets. Yet, there are signs that some of these issues are abating and growth is turning higher in both manufacturing and services. The shift from tightening to easing global monetary policy has coincided with a move higher in the J.P. Morgan Global PMI Composite. With the U.S. and China signing Phase I of a trade deal and BREXIT moving forward, the dwindling uncertainty of these two events could result in an increase in business investment.

There remains the threat of geopolitical shocks, which could translate into an economic slowdown. The number of known potential geopolitical risks are numerous and include the following:

• Phase II of trade talks between the U.S. and China

• China / Hong Kong relations

• U.S. and Iran conflict

• Coronavirus

• 2020 U.S. elections

Although these geopolitical risks have caused short-term volatility in the markets, equity investors have largely been rewarded for overlooking these disturbances.

The most common question on the minds of investors is who will win the 2020 election and what does that mean for the market? It is still too early to tell. The reality is that although most of the Democratic challengers are promising significant changes to tax policy, immigration, and infrastructure, post-election outcomes are rarely as extreme as the promises given on the campaign trail. We will continue to monitor these developments, but in our view, we have a long way to go before this begins impacting capital markets.

As we look at the impact of the election cycle for U.S. equities, we see that historically the S&P 500 Index has typically been better than average in the year leading up to the election and the year of the election. This was certainly the case last year. While we do not drive portfolio positioning based on these facts alone, we are mindful of them when considering the probability of market returns throughout the year.

As we review fundamentals, market indicators, and sentiment through Highland's Diffusion Index framework, we maintain our view that favors return-seeking over safety assets.

• Economic fundamentals have weakened as the slowdown globally has filtered into the U.S. This has been especially felt in the manufacturing sector. While our base case view is to see a turnaround globally benefiting all regions, there's no question that manufacturing has struggled.

• From a consumer perspective, employment continues to remain strong and wages have been increasing, thus buoying the U.S. economy.

• Central banks remain accommodative, and while we are not anticipating additional rate cuts, we don't believe we will see any rate hikes in 2020 and most likely in 2021 as well.

• While bond yields remain low and negative interest rates continue to dominate Europe and Japan, credit spreads have remained relatively contained, although the number of issuers rated B- or lower are at the highest levels since the Global Financial Crisis.

• Equity market momentum has increased on the back of a strong fourth quarter, and we may be in the midst of a rebound in emerging markets, the cheapest of all the regions. However, we are wary that most of the returns last year were driven by investors paying higher multiples for earnings, which showed virtually no growth last year.

If economic growth rebounds, corporate profits rise, then we would expect equities to perform better than cash or bonds. However, geopolitical unrest could be the catalyst that derails the economy and the bull market. The economy is still on fragile ground, and there are hotbeds of instability that threaten trade routes, commodity prices, and consumer sentiment.

With Phase 1 of U.S. - China trade wrapped up, it is on to Phase 2 and the biggest hot button issue, intellectual property. If the negotiations take on the tone of the first phase, then we should see increased volatility in the markets rather than a full stop in the bull market. If growth rebounds globally, then we would expect investors to benefit from owning equities versus safe assets. Although we continue to be overweight U.S. equities, we could see this changing this year. Valuations are much cheaper in non-U.S. markets, and if we do get some clarity with trade and manufacturing moves out of the doldrums, then these markets could very well outperform U.S.

Positioning in 2020

We believe assets tied to growth will outperform safety assets. A strong labor market, a resilient consumer, easing monetary policy, and strong momentum confirm our positioning. While 2018 was best characterized as a market when nothing worked and 2019 was a market where everything worked, we believe 2020 will be one that is more discerning, especially with stocks versus bonds.

Maintaining Risk-On Stance

Reasons for Maintaining	Risks We are Watching	Portfolio Positioning
Strong Labor Markets	Economy Turning Soft Again	⊕ Overweight Equities
Resilient Consumer	Geopolitical Unrest	⊕ Overweight US Equities
Easing Monetary Policy	US Elections	⊕ Overweight Alternatives
Strong Momentum	Phase 2 Trade Talks	⊖ Underweight Fixed Income
		⊖ Underweight Intl Equities

Source: Highland Associates; as of 12/31/19

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