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You may have noticed changes in the allocation of the underlying investments in your portfolio this past quarter. We think you will like the changes. Our objective with these changes to your allocation models is to reduce overall volatility and to improve long-term performance.

We have back-tested these models for their risk-adjusted returns for 1, 3, 5, and 10-year periods. While we have maintained well-diversified portfolios, the net overall primary effect of these changes will essentially increase the capitalization structure of the underlying equity positions (bigger companies) and reduce the foreign equities component. For more on our analytical process, and a detailed explanation of the discipline we are applying to the management of your assets, see the last section in this newsletter entitled "Efficient Frontier Theory."

What a difference a quarter can make. After the market disengaged from the economy in a strange and disappointing fourth quarter 2018 sell-off, we have roared back in the first quarter of 2019. Little has changed in the economy, confirming our view that the nearly 20% decline that bottomed on Christmas Eve was unmerited. Also unnecessary was Fed Chairman Jerome Powell's interest rate hike in December 2018 which contributed to the decline. The Fed is actually considering cutting the Fed Funds Rate now.

Economically speaking, not much else has actually changed since last year. The China trade dispute continues on. Economic conditions in the rest of the world continue to lag the U.S., which remains solid. Fortunately, the biggest change has been in the stock market as the S&P 500 rebounded 13.1% in the first quarter and the Dow gained 11.2%.

We expect to have a good year but it is likely that we have already experienced more than half of this year's gains. Adding confidence to our outlook is that the third year of the presidential election cycle is historically the best, averaging 16% annually since 1944.

We recently experienced an "inverted yield curve," defined as the Ten-year U.S. Treasury Bond having a lower yield than the Three-month Treasury Bill. The normal expectation is that the cost of capital is higher over the long-term and that a "normal yield curve" will reflect that (i.e., short-term interest rates are the lowest and continually rise as the term of a bond lengthens).

Many believe that an inverted yield curve portends a recession. It is also strange that in late December the market traded down 20%

intraday, which also often signals an impending recession. We believe market pundits are making too much of these warning signs. Barring some type of "black swan" event, we do not anticipate that a recession will occur until late 2020 at he earliest.

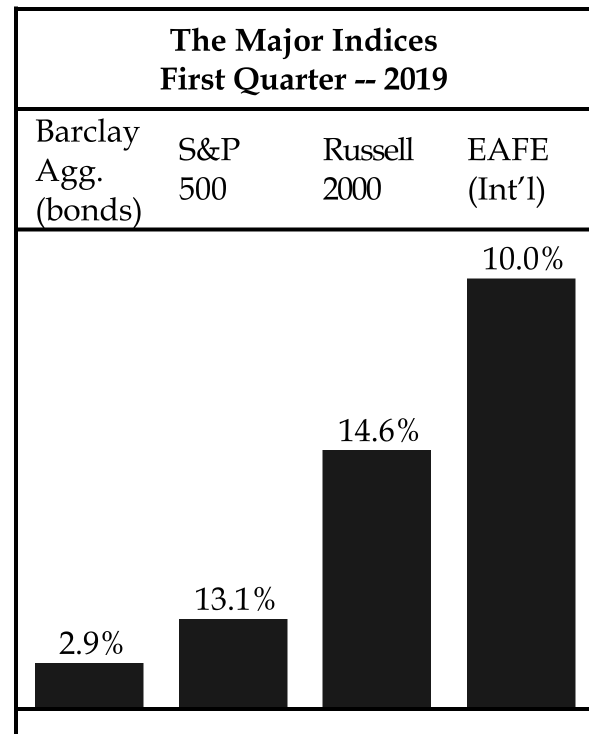
We believe that the reason for the inverted yield curve was overseas buying demand due to the relative attractiveness of U.S. Treasury Bond yields and more critically the strength of the U.S. dollar. Foreign investors seek to invest in our strong and stable currency and our good relative yields. As a result, that demand drives up bond prices, which in effect drives down yields. The weakness of foreign currencies (Euro, Yen, etc.) and the low interest rates in Europe and Japan (yields close to 0%) have turned foreign investors' attention toward dollar denominated U.S. Treasury Bonds.

We want to welcome Tonia Cornett. She has recently joined our staff and will likely be the first voice you hear when you call us and the first face you see when you walk in the front door of Woodard & Company.

We plan to roll out the new management agreement in compliance with evolving SEC requirements later this year.

Market Review and Forecast. What a terrific bounce back after 2018's fourth quarter dismal decline of 14%. The S&P 500 jumped 13.1% in the first quarter, ending about 3% below last year's September 20 all-time high. It was a broad-based stock rally as all the other major stock-market indices also posted double-digit gains.

The Dow gained 11.2%, the small-cap Russell 2000 chipped in with a nice 14.6% return, and even struggling international stocks were up 10%.



Overall, it was the best quarter for the S&P 500 since 2009 and the top-performing first quarter in 21 years – since 1998.

Given the strength of our economy with its near record low unemployment, it is fairly obvious now that the big sell-off last year was an over-reaction to the Fed's forecast that it would raise rates two more times this year and the worry that our trade dispute with China would morph into an all-out trade war.

Changing their tune in early January, Fed officials indicated that, given slower economic growth here and overseas, they would probably not raise rates at all this year. Encouraging comments from the White House regarding a possible trade deal with China also helped propel investor optimism. The S&P 500 rose 8% in January and nearly 5% more in February and March.

Energy stocks did well in the first quarter, rising 16% as crude oil prices increased 32%. One reason is that Saudi Arabia, Russia and other oil producing countries signed an

agreement last December to take 1.2 million barrels of crude oil out of daily production. That cut and no increased output here in the U.S. undoubtedly boosted prices.

It's clear that the top worry, cited most by the Fed and other market experts, is slowing economic growth worldwide. Japan's most recent forecast is for a lackluster 0.7% GDP increase this year. European Union GDP continues to weaken – it grew 2.4% in 2017, 1.9% last year and is projected to edge up only 1.5% this year.

Germany, the EU's largest economy, is predicted to grow its GDP only 1% in 2019. The EU's official report last February cited "a high level of uncertainty" and that "its projections were subject to downside risk." And, of course, no one knows how problematic Brexit will be as wrangling continues with no end in sight.

Here at home, our GDP increased 2.9% last year but slowed to 2.2% for 2018's fourth quarter while current estimates are averaging only 1.5% for the first quarter. However, U.S. GDP first-quarter numbers are almost always the worst for the year. Most economists forecast this year 's overall GDP increase will be between 2 and 2.5%.

The good news resulting from weaker economic growth and buying from foreign investors is that interest rates have plummeted as the 10-year bond yield has dropped from its high of 3.25% last fall to 2.41% when the quarter ended March 29. As a result, 30-year mortgage rates have declined from an average of 4.9% at their highs last year to 4.1% now.

Lower interest rates are good for the economy. Existing home sales were up 12% in February and mortgage lenders are reporting a big jump in refinancing inquiries. New car sales so far this year have been the lowest since 2014, the last time yearly sales were under 17 million. (Sales over 17 million from 2015-18 were the highest ever.) Current lower rates may make it possible to once again exceed that 17 million total this year.

Should investors fear higher rates? Given inflation under 2%, there is little chance the Fed will increase interest rates this year. Will the Fed lower rates? The answer is no, unless our economy weakens dramatically, which seems unlikely this year.

Manufacturing is holding its own as the ISM manufacturing index for March was 2% higher than expected at 55.3. (The dividing line is 50 – above that number, manufacturing is expanding; below that number, it is declining.) That good number and a better-than-expected manufacturing report from China helped push the Dow up 329 points April 1.

Since 1950, the very best month for the Dow has been April – it has averaged a solid 1.9% gain for 69 years. The last time the Dow recorded a negative return in April was 2005.

As always, there are concerns for investors. The biggest one is the on-going trade dispute with China. If we don't get some type of trade agreement as expected, the market will undoubtedly drop.

Corporate profits are forecast to be flat or down slightly when first quarter numbers are reported. As usual, they will most likely be better than expected, probably increasing by 5% or so year-over-year.

Even with weaker worldwide economic growth it seems likely that there will be no recessions later this year here and for our major trading partners overseas. Overall, we suspect growth numbers worldwide will be

better than now forecast for the second half of this year. Improving growth should push stock prices to all-time highs later this year.

Interest Rates. Investors bought fixed income investments the first quarter of 2019 across a wide variety of bond sectors. We see the buying activity in bonds reflected in the movement of the 10 Year Treasury. The 10 Year started the quarter yielding 2.68% and ended the quarter yielding 2.41%. This illustrates the inflows into fixed income, especially from foreign investors seeking both yield and dollar strength. Despite a slight and temporary inversion of the yield curve, the Federal Reserve's easy monetary policy stance has reassured investors that inflation is tame and recession is nowhere in sight. As with the stock market, the bond market is being heavily influenced by Federal Reserve policy, China trade talks and corporate earnings.

Efficient Frontier Theory. Back in 1990, a gentleman named Harry Markowitz shared the Nobel Prize for Economics for an analysis called Efficient Frontier Theory (EFT). Markowitz's work formed the foundational discipline for most investment portfolio management methodologies in use today by identifying optimal combinations of asset classes to define risk and reward parameters. Many years ago, when Markowitz was formulating his Nobel Prize theory, the companies in the S&P 500 generated only about 10% of their earnings from sales in foreign countries. Now that percentage is approximately 35% (some estimates put the number near 50%).

Reviewing performance at major investment firms in the U.S., it appears that most investment firms in the U.S. have not taken into account the increased exposure to foreign markets through U.S. corporations as a result of globalization. Consequently, these firms have over-weighted foreign stocks to their investors' detriment, in our opinion.

We believe investing in companies such as Proctor & Gamble, with 56% of their sales being derived from overseas sales of products such as Tide and Crest, offer better long-term returns than investing in their UK counter-part, Unilever, whose brands of toothpaste and detergent are little known (Smile, Surf). Therefore, we have reduced exposure to foreign stock funds to reflect the underlying exposure already inherent in the S&P companies.

The process that we implemented further delves down to style (growth vs. value) and sector weightings (technology, finance, energy, etc.). This should provide a more optimal mix of asset classes. Underlying capitalization is in closer correlation with appropriate benchmarks as well.

Our bond funds have historically done well. But even there, we have made some changes. We have increased the quality of the bond funds in our clients' portfolios and modestly lengthened duration. These funds should better act as a ballast to the stock side of the various models during times of market duress. The net effect should further dampen the overall volatility of each portfolio while maintaining solid long-term performance.

This re-engineering of Efficient Frontier Theory has been many years in the making for us at Woodard and Company. We have discussed these ideas at length with most of the major investment firms and at multiple conferences. We sincerely believe you will be very pleased with the new

allocations and that your long-term performance will improve while the volatility of your portfolio will be reduced.

One caveat: as we reallocated the taxable accounts, we have attempted to be conscious of the impact of taxable gains. However, in certain instances as we implemented the reallocation, some capital gains were necessarily realized. Thus, some taxes will be due on these capital gains next year. We believe this trade-off between paying some taxes to get better returns will be worth it.

If you have any other questions about your account or any concerns, please give us a call at 336-998-7000. We always enjoy talking with our clients.

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