LEVEL FOUR®
Advisory Services

Q3 2019 QUARTERLY NEWSLETTER

THE SONG REMAINS THE SAME

Chart 1. Index Performance Q2 2019

INDEX PERFORMANCE

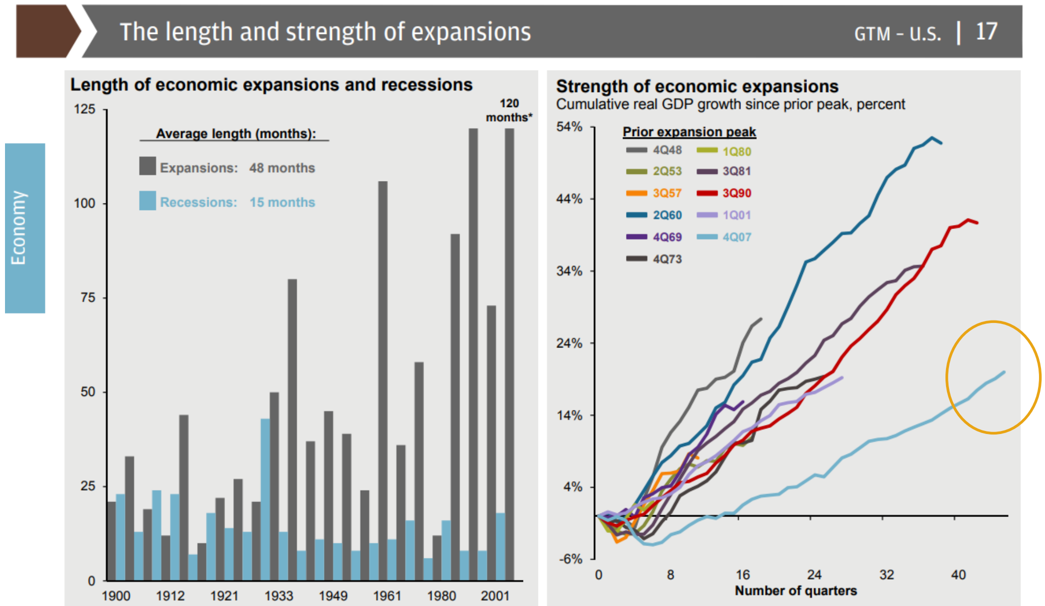
	Quarter Return
S&P 500 (SPX)	4.30%
Dow Jones Indus. Avg (INDU)	3.21%
Russell 1000 Value	3.84%
Russell 1000 Growth	4.64%
MSCI EAFE (Non-U.S.) (MXEA)	3.93%
MSCI ACWI (Non-U.S.)	2.98%
U.S. Corp High Yield	2.50%
Alerian MLP	0.05%

Source: 2019 Bloomberg Finance L.P.

The song remains the same. Throughout the recovery that began in 2009, we have seen many of the same themes repeated. As we look back on previous quarterly letters and our research, we thought it important to revisit a mantra that we have discussed in the past; specifically, what is signal and what is just noise as it relates to market themes and headlines. Investing always involves separating signal from noise, and it could be the most important thing we as investors must do. The main recurring themes related to market volatility and the economic cycle are: China/trade, Federal Reserve (Fed) policy uncertainty, yield curve, Iran (or North Korea), politics/Tweet flow, and length of the current expansion. Currently, our focus is on addressing the question, where are we in the current economic cycle? We are currently in the longest economic expansion in US history, 10 years. However, we do not hold the world record, for that belongs to Australia's current expansion at 27 years. In our opinion, we are not sold on the idea that the length of the current U.S. expansion is where our efforts should be focused, but rather on the *strength* of the expansion.

Chart 2 reflects the length of the current and past U.S. Expansions, but one will notice right away that GDP growth in connection with the current expansion is by far the most anemic as compared to other periods of expansion. Stock performance is also the second worst of the last five expansions (Chart 3), and on the employment front, on page 3, Chart 4, *calculatedrisk.com* shows the extreme level of jobs lost in the "Great Recession" and the unprecedented amount of time it took to return to normal. Clearly, the current expansion has not been as prolific on as many fronts as previous expansionary periods, and compared to global historic expansions the length is less of an issue. So, what about the signal?

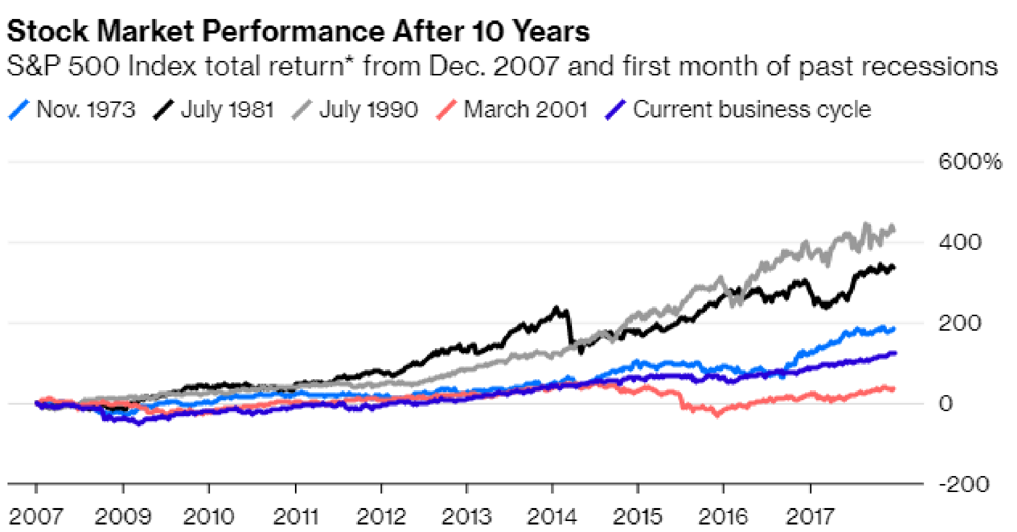
Chart 2



Source: 2019 J.P. Morgan

Chart 5 on the following page shows the current expansion in terms of the level of U.S. GDP, and the PMI (NAPM Purchasing Managers Index). The PMI has also been talked about quite a bit lately. A PMI below the level of 50 is historically associated with an economy in contraction, while a number above 50 is typically associated with an expanding economy. Hence, PMI is a closely watched number. Keep in mind it is a survey and it shows sentiment, but it has recently fallen significantly from 10-year highs and is now at 51.7; still in expansion territory but nonetheless worrisome. Of note, we have experienced three similar slowdowns in PMI during this recovery. The last two were a

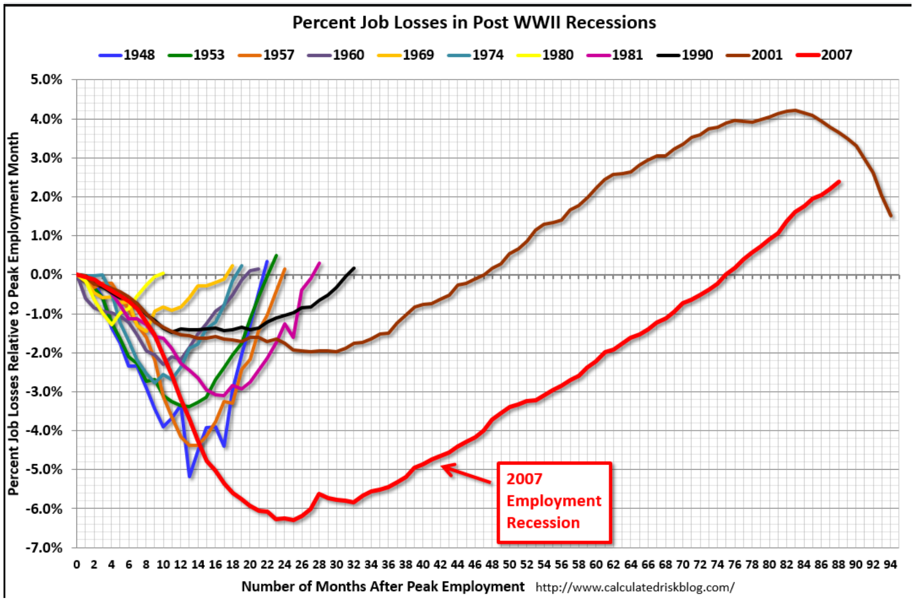
Chart 3



Source: 2019 Bloomberg Finance L.P.

soft landing and the expansion resumed. The key takeaway is that there can be a cycle within a cycle, and when the short-term cycle is tested on the downside, and those tests fail, we usually go into recession. From a high level, considering factors such as S&P earnings, PMI, and interest rates, we are at a somewhat precarious point and in our opinion could be pushed into recession by a shock of some sort. We are currently most concerned by the possibility of a Fed misstep, major trade war escalation, or global strife (Persian Gulf). In our opinion, the biggest factor is the Fed, and whether they can engineer another soft landing.

Chart 4



Source: 2019 Calculatedriskblog.com

Chart 5

Source: 2019 Bloomberg Financial, L.P.

Let's get back to our initial question relating to the length and strength of the current expansion. From the Investment Committee's perspective, we want to play offense *and* defense when it comes to portfolio management. We are a bottom-up manager on the equity side (offense), but also believe from a defensive perspective we need to have a plan regarding the economic cycle and what that means to the portfolios we manage. When we think about the economic cycle, we are trying to determine how we should be positioned from a top down perspective; should we be over or underweight defensive, balanced, or growth sectors. The table on the following page (Table 1) was created to communicate our interpretation of a key theme from a report published by Fidelity Investments. It shows which S&P sectors tend to outperform and underperform during different stages of a typical economic cycle. The green shaded cells show patterns of outperformance, the red cells show patterns of underperformance, with gray indicating no clear pattern. The pluses and minuses show the consistency or "hit rate" of the signal; we have added the YTD performance ranking of each sector and circled a few areas that are interesting. For example, in the late cycle column, Information Technology should be *underperforming* the overall market according to historical trends, and this has been a very consistent signal (2 pluses). Yet YTD, it is the number one performing sector. So, while the current consensus is that we are in the late part of the economic cycle, the data shows the "market" is currently telling us the consensus might be wrong.

YTD the sector performance trend is clearly telling us we are early to mid-cycle, and not late cycle. This is decidedly shorter term, but does show the current trend. Do we believe we are in early cycle on a secular or long-term basis? No, but we do think the shorter business cycle trend has possibly *reset* and is poised to continue upward. Chart 6 from Fidelity investments gives us good perspective on the different economic cycles.

To support our positive outlook, we are continuing to see green shoots return, and an increasingly positive back drop. The Fed is back to easing; though the U.S./China trade situation remains uncertain, and the data out of China is turning positive. Additionally, from Cornerstone Macro, PMI/CAPEX represented in Chart 7 looks like it is about to turn positive.

Table 1

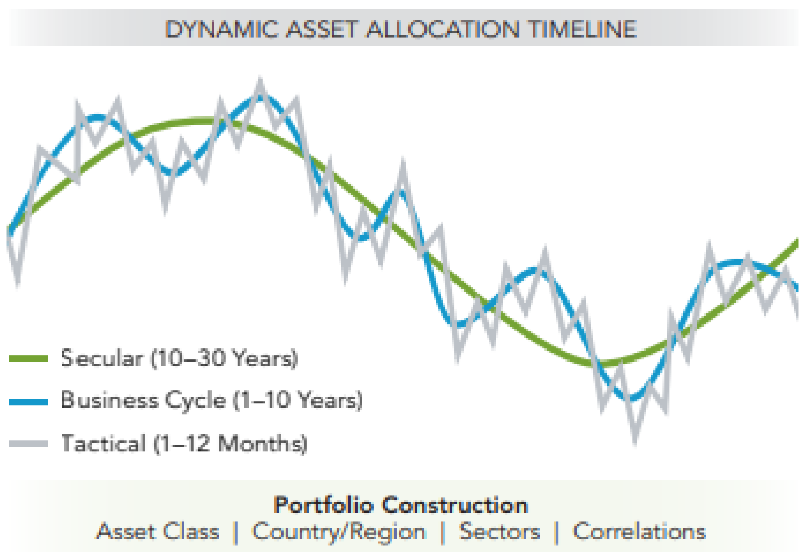
	Early Cycle Rebounds	Mid Cycle Peaks	Late Cycle Moderates	Recession Cycle Contracts
Financials	5 +	5	5	5
Real Estate	7 ++	7	7	7 --
Consumer Discretionary	3 ++	3 -	3 --	3
Information Technology	1 +	1 +	1 --	1 --
Industrials	2 ++	2	2	2 --
Materials	9 +	9 --	9 ++	9
Consumer Staples	6	6	6 ++	6 ++
Health Care	10 --	10	10 ++	10 ++
Energy	11 --	11	11 ++	11
Communication Services	4	4 +	4	4 -
Utilities	8 --	8 -	8 +	8 ++

Pattern of Outperformance
No Clear Pattern
Pattern of Underperformace
+/- Consistency of Signal

Source: 2019 Investment Committee/Fidelity

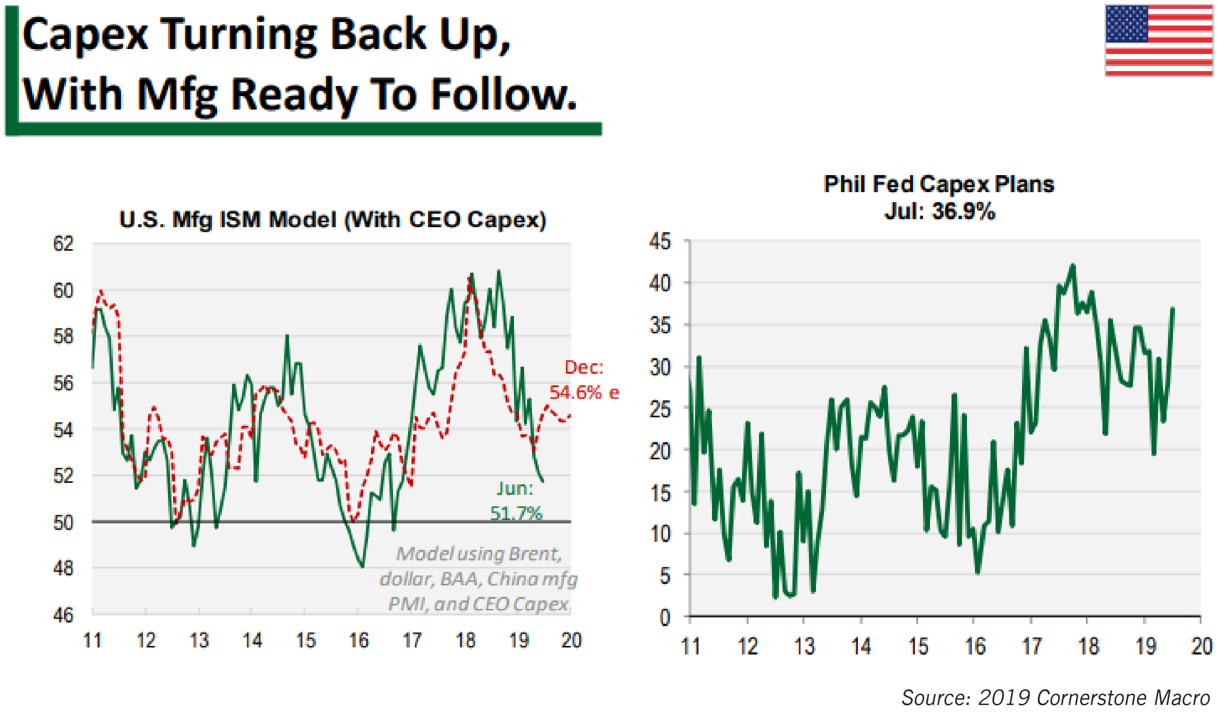
Chart 6

Asset performance is driven by a confluence of various short-, intermediate-, and long-term factors.



Source: 2019 Fidelity Investments

Chart 7



So, if we can avoid the potholes mentioned earlier in this report, mainly if the Fed can continue to successfully manage for a soft landing, we should remain in a long-term expansion in our opinion, and it is back to the same old song and dance.

INTERNATIONAL REVIEW

As we look back on the 2Q, International market performance shows the tale of two different stories, broken down by region. While under or overperformance can be attributed to a country's economic health, the overarching theme we saw throughout the quarter was Europe's outperformance against Asian Pacific counterparts and in-line with U.S. returns. Europe outpaced Asian markets by a sizable margin due to three primary reasons weighing on the APAC region:

- Trade War Concerns
- Weakening of some economic data
- Expectations for further policy easing in Europe

Additionally, throughout the quarter we saw a deteriorating diplomatic relationship between the U.S. and Iran, causing further uncertainty for global investors and developed markets to be "more in favor" over that of emerging.

European Markets

- Euro Stox: +6.16
- Stoxx Europe 600: + 3.44%
- Cac 40: 6.19%
- DAX: 7.57%

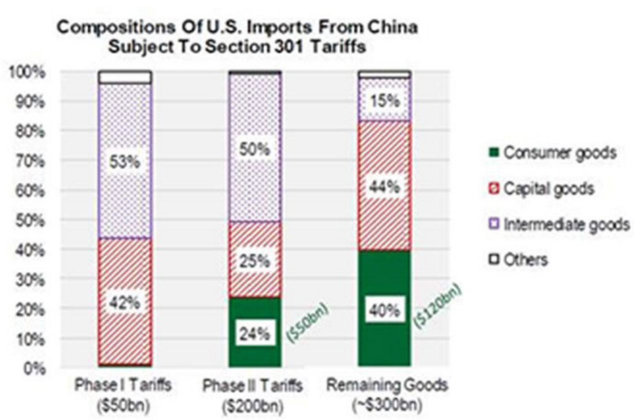
Asian Pacific Markets

- Nikkei: +.46%
- SHCOMP: - 2.41%
- KOSPI: -.45%
- TWSE: Taiwan: 1.85%

Running the risk of sounding like a broken record, and in-line with our comments on the U.S. markets, part of the International story also remains the same, as Trade war tensions once again surfaced and was a large part of the APAC region under-performance. Throughout the quarter we saw discussions between the world's two largest economies deteriorate, outright stop, escalate with threats of additional tariffs, come to a temporary truce, re-engage with one another, and most recently, regress once again.

As we await the full effect of increasing tariffs on the original $250B worth of goods, expectations call for inflation to pick up by .25% y/y according to Cornerstone Macro, which we recently saw in July's U.S. economic data as CPI numbers came in slightly "hotter" than anticipated. Additionally, Cornerstone Macro believes if the last tranche of proposed tariffs were to be put into place, it would have a significant impact on inflation, as well as growth. Consumer goods made up about 1% of "Phase 1" tariffs & 24% of "Phase 2 tariffs" however, "Phase 3" tariffs would comprise 40% of consumer goods (Chart 8).

Chart 8 Cornerstone Macro as of 5/20/19



Consumer Goods Subject To Section 301 Tariffs

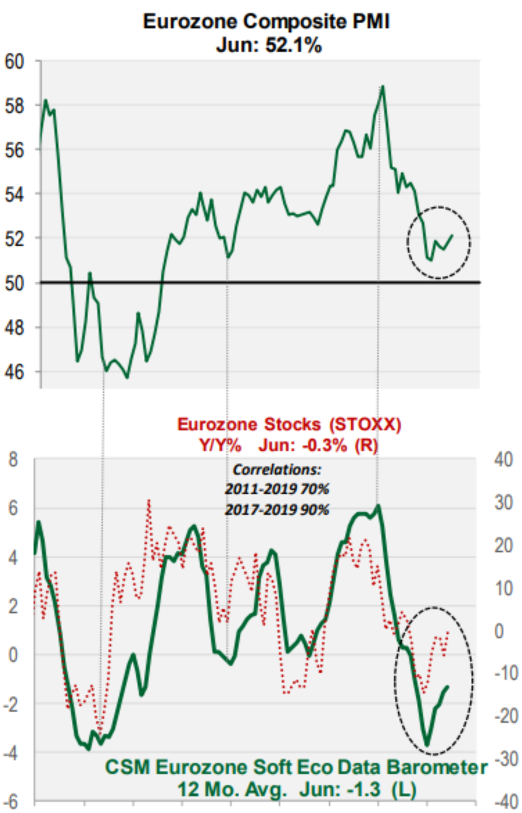
	Phase 2 (implemented, $200bn)	Phase 3 (potential, ~$300bn)
Foods	fish & seafood, fruits, vegetables, dried beans, juices, flour	tea, nuts, oils, spices, sweets, pasta, distilled spirits
Transportation	auto parts, tires	large capacity motorcycles & parts
Appliances	refrigerators, air conditioners, space heaters, vacuum cleaners	dishwashing machines, cooking stoves, washing machines, microwaves
Electronics	photo equipment, video cameras, amplifiers, smart cards	cell phones, laptops, flat screen tvs, set top boxes, routers, printers, copiers, fax machines, lithium batteries, hard drives
Household Eqp & Furnishings	furniture, mattresses, mirrors, lighting fixtures, vacuum cleaners, flatware, home decorations	dishes, glassware, bedding, bed/bath/table/window linens, rugs, ceiling fans, scales, lawn mowers, clocks
Apparel & Accessories	handbags, luggage, gloves, scarfs, hats	apparel, footwear, eyeglasses, watches, sunglasses, imitation jewelry
Recreational Goods	bicycles, trailers, boats, photographic eqp and supplies	skis, water skis, golf clubs, tennis rackets, fishing eqp, tents, camping goods, musical instruments
Misc.	soap, shampoo, makeup, paper, paint, glue, insecticides, tools, Christmas lights, yarn, household cleaning products	toys, games, crafts, pencils/pens, strollers, diapers, books, wall hangings, cards/pictures, hearing aids, Christmas ornaments, sawing machines

Source: 2019 Cornerstone Macro

As previously mentioned, Chinese economic data has deteriorated slightly in some numbers, yet has picked up in others. While China is a large factor in global growth, it appears sentiment may be too negative with some green chutes emerging. As the economy drives global PMI's, any resolution on the trade front could result in an up-tick for other economies. Despite GDP figures falling y/y, albeit remaining a very healthy 6.2%, the Caixin PMI slipped to 50.6. Although this is a level right above contraction territory, we have seen data start to improve with firmer Industrial production, housing prices, retail sales and fixed asset investments. As trade war tensions dissipate and solutions to outstanding disagreements are found, we expect the country's global economic growth to once again accelerate, likely to lift other economies around the world.

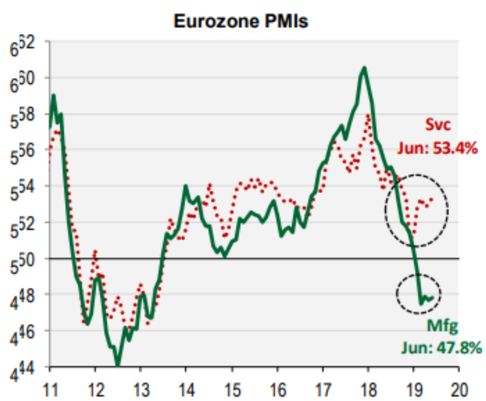
Chart 9 Cornerstone Macro Weekly Update as of 6/21/19

	PMI	Jun	Pct. Pt. Change From Recent Low In	
Eurozone	Composite	52.1%	1.2	Jan 2019
	Mfg	47.8%	0.3	Mar 2019
	Svc	53.4%	2.2	Jan 2019
Germany	Composite	52.6%	1.2	Mar 2019
	Mfg	45.4%	1.2	Mar 2019
	Svc	55.6%	3.8	Dec 2018
France	Composite	52.9%	4.7	Jan 2019
	Mfg	52.0%	2.3	Mar 2019
	Svc	53.1%	5.3	Jan 2019



Source: 2019 Cornerstone Macro

Looking at Eurozone economic data we have also seen an improvement in some economies such as France & Spain, while others faltered slightly (Germany). With the release of June PMI's, data suggests the Eurozone economy continues to move in the right direction. Despite the slightly negative effect the US/China trade war had on German exports, which accounts for almost 40% of German GDP, we believe a weaker Euro, narrowing bond spreads, an accommodative ECB, and a potential trade war solution should help spur the nation's economy, which in turn should help drive additional gains within the region. France's economy, another large driver behind Eurozone growth helped lift the region over the course of the quarter due to its service sector, which accounts for 85% of its GDP, making it less susceptible to the U.S./China trade conflict.



Expectations for Eurozone growth have improved, despite the ECB turning more dovish over the course of the quarter, in large part due to lackluster inflation data. Expectations call for GDP to improve slightly from 2nd quarter lows of .9% y/y to 1.3% y/y in early 2020, meaning that inflation numbers should remain subdued and yields to remain capped. Additionally, geopolitical tensions between the US and Iran continue to spook investors as diplomatic relations have deteriorated after multiple escalating conflicts in the Persian Gulf. However, most investor concerns appear overdone as a physical conflict is increasingly less likely. Over the course of the 2Q and into the 3rd quarter, Iran has largely been responsible for attacking and taking control of various freighters within the Straits of Hormuz, a global oil choke-point for 40% of the world's sea-born oil. With the Trump administration applying maximum pressure by imposing tougher sanctions on the country's oil exports, aimed at further hurting the nation's economy, we have recently seen Iranian envoy Mohammad Javad Zarif reportedly offer limits on their ballistic missile program, helping the narrative improve.

We continue to monitor global economic developments and believe that with dissipating geopolitical tensions, synchronized monetary policy and a solution to the U.S./China trade war, international markets could offer a promising backdrop for investors.

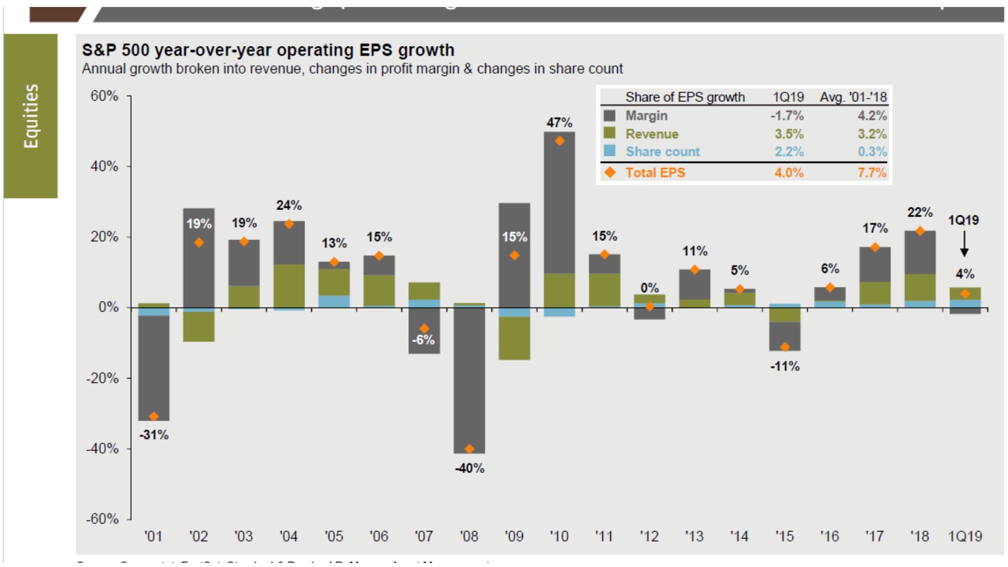
ASSET ALLOCATION VIEW

THE SAME DANCE UNTIL THE MUSIC CHANGES

During the second quarter we saw the markets continue in "risk on" mode as U.S. firms' forward EPS continued to increase. In Chart 10, we see that share count, or the contribution to earnings per share from stock buybacks have become a meaningful component of EPS since 2016, comprising 2.2% of a total 4% of year over year operating EPS growth in the first quarter of 2019.

As this quarter progresses, we will be looking to see how Q2 earnings progress and if the US markets can hold the new highs that have recently been reached. Seasonally, we are also moving into the period that is most likely for healthy market pullbacks to occur. So, the cautiously optimistic dance remains the same until the music changes.

Chart 10



Source: 2019 J.P. Morgan

Current global market conditions factor into, and have the following implications for asset allocation:

<u>**General Allocation**</u> – As equity markets remain in choppy risk-on posture, we continue to recommend a slightly defensive position as we monitor how markets respond to the recent period of economic pause, the resolution of global trade issues, and the Fed's upcoming policy moves. We believe that the Fed's overall policy bias (easing vs. tightening) is uncertain, but will likely include a 25-bps "insurance" interest rate cut during their

July meeting. However, it remains to be seen if such a cut will reduce long term rates, simply steepen the yield curve, or do some of both as we have observed in recent weeks. In the face of a continuing flat U.S. yield curve and fully valued equity markets, we expect continued volatility in all asset classes to be a likely scenario.

Equity Allocation - We continue to monitor financial conditions and market returns to determine our optimal asset allocation. Relative to benchmarks, we are neutral equities relative to fixed income, moderately overweight U.S. equities, and are neutral small/mid-cap equities. We also continue to maintain a factor overweight regarding low volatility as low volatility investments have generated an excess return relative to the S&P 500 in the second quarter and year to date with less volatility. We favor low volatility strategies based on a portfolio construction basis as opposed to those that achieve low volatility using only individual low volatility investments. We continue to monitor developed international markets, especially developed Europe, and find valuations continue to be favorable, however earnings and returns have benefited U.S. equities in the first half of 2019. We maintain a neutral weighting on emerging markets.

Fixed Income Allocation – We continue to recommend a modest underweight in duration and a cautious exposure to credit spreads. In light of the current flatness of the yield curve and potential volatility in interest rates, we do not like the risk/reward prospects of holding longer maturities. In practice, this means exposure to areas such as short-term and high-quality floating-rate securities are preferable. We continue to monitor company health and interest rate movements closely and will adjust positioning in accordance with the evolving economic and interest rate environment.

THANK YOU!

Investment Committee

IMPORTANT INFORMATION

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. The economic forecasts set forth above may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All performance referenced is historical and is no guarantee of future results. No strategy including asset allocation assures success or protects against loss. All indices are unmanaged and may not be invested into directly.

Stock investing involves risk including loss of principal. Value investments can perform differently from the markets as a whole. They can remain undervalued by the market for long periods of time.

International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

The Standard & Poor's 500 index is a market capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The MSCI World ex USA Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries--excluding the United States. With over 1,000 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. The CBOE Volatility Index® (VIX®) is meant to be forward looking, showing the market's expectation of 30-day volatility in either direction, and is considered by many to be a barometer of investor sentiment and market volatility, commonly referred to as "Investor Fear Gauge".

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq. Price-weighted means stocks with higher share prices are given a greater weight in the index. The DJIA is a stock market index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The value of the Dow is not a weighted arithmetic mean and does not represent its component companies' market capitalization, but rather the sum of the price of one share of stock for each component company.

The Russell 1000 Index is a market capitalization weighted stock market index that tracks the highest-ranking 1,000 stocks in the Russell 3000 Index, which represent about 90% of the total market capitalization of that index. The Russell 1000 is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks. The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.

The Bloomberg Barclays U.S Corporate High-Yield Bond Index is an unmanaged market value weighted index composed of fixed-rate, publicly issued, non-investment grade debt.

The Alerian MLP Index is the leading gauge of energy Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents represent approximately 85% of total float-adjusted market capitalization, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

IMPORTANT INFORMATION

CHARTS

[1] 2019 Bloomberg Finance L.P

[2] 2019 J.P. Morgan

[3] 2019 Bloomberg Finance L.P.

[4] 2019 Calculatedriskblog.com

[5] 2019 Bloomberg Finance L.P.

[6] 2019 Fidelity Investments

[7] 2019 Cornerstone Macro

[8] 2019 Cornerstone Macro

[9] 2019 Cornerstone Macro

[10] 2019 J.P. Morgan

TABLE

[1] 2019 Investment Committee/Fidelity

Investment advice offered through Level Four Advisory Services, LLC, an SEC-registered investment adviser.