MORSE ASSET MANAGEMENT, INC.

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<u>2019 Q1 Investment Outlook-</u> April 18, 2019

During the first quarter of 2019, the stock market rebounded dramatically with the best first quarter performance since 2009. Calmer heads prevailed over the emotional sell off we saw in December and the market reacted well to a dovish shift in the Federal Reserve. US economic growth remains on trend and corporate data is positive. There are few signs we have reached a cyclical market peak or will contend with a protracted correction. The weight of the evidence remains positive and suggests further upside in the year ahead.

In our last letter we commented that "…on the monetary side, the Federal Reserve's 'normalization' of its balance sheet and interest rates certainly has the potential to constrain the economy. However, it has been clearly stated that the current path is data dependent and the Fed is open to pause or reverse if necessary." We underestimated the markets perception of these events and the narratives momentum.

Following the fourth quarter market decline, the Federal Reserve took steps to shore up investor confidence by announcing their balance sheet tightening will end in September and they will hold the current level of interest rates. Chair Jerome Powell made sure to strongly reassert an openness to additional easing if conditions warrant. This was not a major change in intentions, which was written in prior statements, but the clarity and emphasis did the trick.

According to Factset's *Earnings Insight* on April 12th, the S&P 500 blended year over year earnings growth rate for the first quarter of 2019 is -4.3%, the first year-over-year quarterly decline since 2016. Consensus estimates also expect there will be a -0.4% earnings decline in the second quarter. Earnings growth should accelerate in the back half of the year and be back to double digits in 2020. See attached chart 1.

On the surface, the quarterly decline in earnings and earnings expectations is worrisome, similar to 2016, but beneath there is a much different picture. In both 2016 and the end of 2018, earnings expectations were lowered, too far and too quickly, and we saw several quarters of negative earnings growth. This coincided with an emotional market correction. But there are two significant difference between these two periods; the US economy and long-term business trends are in substantially better shape.

Recall that in 2016, GDP was in a downtrend, testing lows close to 1% stoking fears of a recession. As indicated in chart 2, GDP is now in a clear uptrend and for the last year has been in the 2-3% range. Second, the current year-over-year decline in earnings is primarily due to very difficult comparisons to the positive earnings anomaly caused by the prior year corporate tax cuts. Stepping back, the primary earnings trend is still strong and the current level is consistent with historical average return of +7-10% for the S&P 500. This provides a significantly more positive backdrop and means that near term we are not at risk of a recession.

The China trade negotiations continue to make progress and a resolution will provide an additional and significant boost to the US economy and markets. The US is taking advantage of our leverage by drawing out the negotiations, but the administration will need closure prior to next year's presidential election. The upside of a deal is not currently priced into estimates so offers significant risk to the upside.

We are disciplined; focused on the facts, fundamentals and long-term trends most relevant to your investments. Our outlook remains bullish.

Morse Asset Management Investment Team

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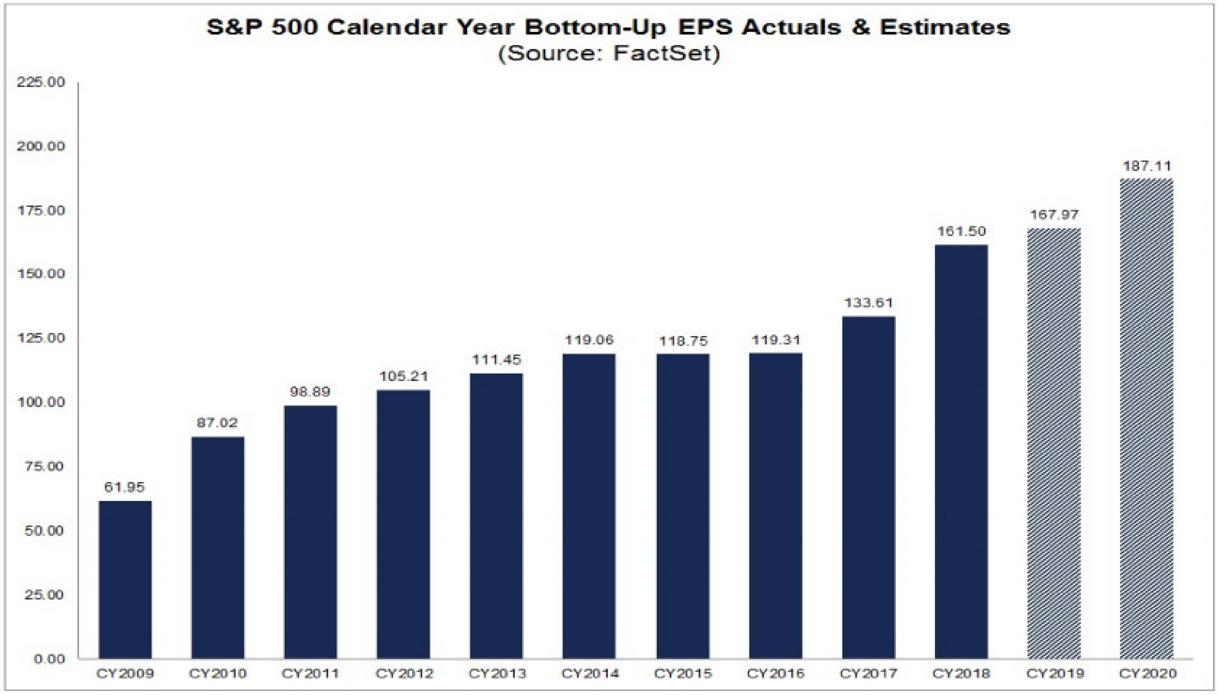
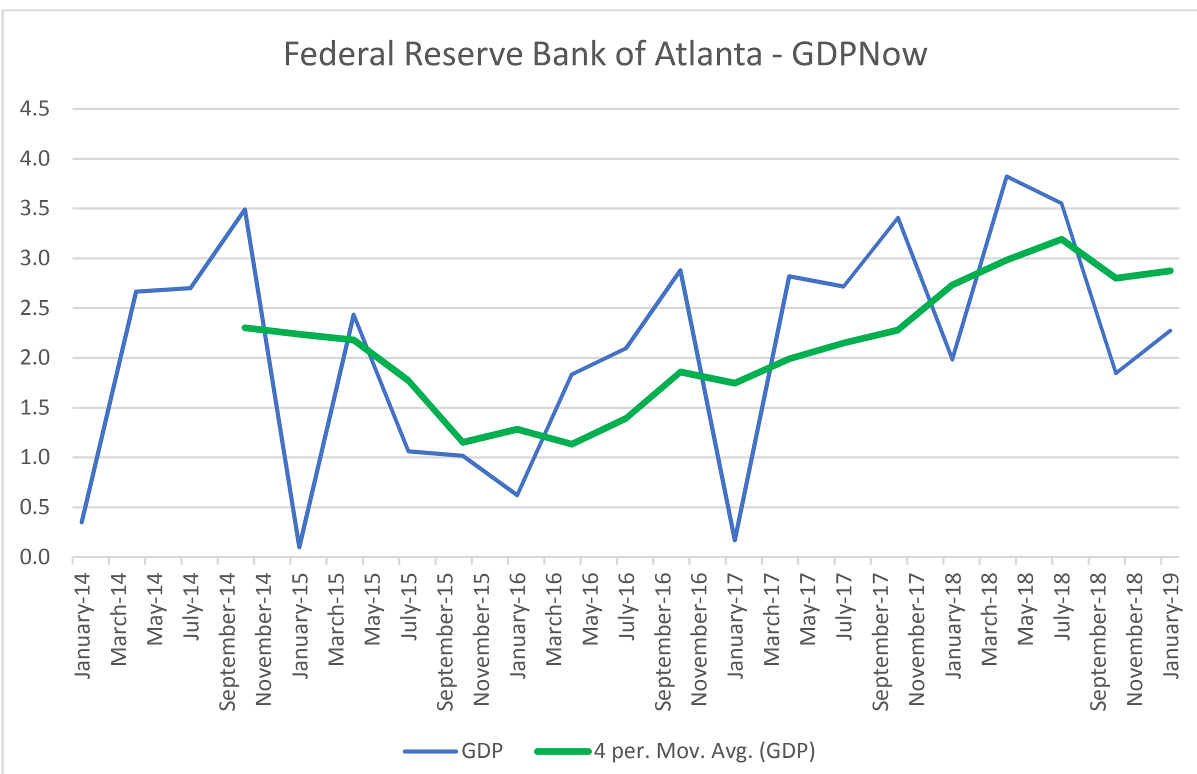
1. S&P 500 Recent Earnings and Consensus Estimates



Factset. *Earnings Insight*. April 12, 2019

2. United States Gross Domestic Product Trend



Federal Reserve Economic Data. *Federal Reserve Bank of Atlanta GDPNow release.* April 8, 2019