Toroso Market Commentary January 2019

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Introduction

Putting things into perspective

We are now officially in the midst of the longest growth rally in recent history. The historical first quarter erased almost all losses across most broad asset classes. In reality not much has changed. In our previous commentary we focused on the global QE drawdown and stretched profit margins for US equities. From a recession watch, we highlighted the effects of a yield curve inversion as well as credits spreads usefulness as a signal for upcoming volatility. All of that will be reviewed again in the following commentary but first let's take a step back and put things into perspective.

What makes an economy grow?

Technological improvements, increased productivity, access to credit, and demographics. Its been quite some time since you've heard many focus on demographics. Over the last few decades much of the growth the developed world has been built on the backs of debt accumulation. There's sound economic theory to that, but as always when applied at scale, it's the micro details that make the difference.

Much of the developed world has an aging problem. The combined EU fertility rate is approximately 1.59 babies per woman. Japan is at 1.4. China potentially engineered this issue for itself with it's one child policy. Growth on debt accumulation is sustainable on a growing workforce. But the developed world's work force is shrinking (as a total percentage).

What's worse, recessionary periods tend to exacerbate this issue as less families feel financially stable to begin a family. You are seeing Its effect on pension plans across the country. Social Security Administration has stated our economy needs a 2.8 ratio of workers paying into the system for every retiree collecting benefits, a ratio we are about to cross below.

Why all this talk about fertility rates and social security? Because this all ties back to Quantitative Easing. Quantitative Easing gave those with the strongest balance sheet access to below market rate capital. At the country level, corporate level, and individual persons level. This isn't to say QE is ever going away, looking at Japan as example leads us to believe this will be in play for the foreseeable future.

Who's this Ray Dalio guy?

He's the founder of quite arguably the most successful hedge fund in history. Ray Dalio reportedly took home $2,000,000,000 in 2018, and then proceeded to tell the world that the system is flat out broken, and the possibility of an actual class war is actually in the realm of possibilities. Think about that. The man that pretty much won capitalism, ranting the system is broken.

Why does this matter?
This matters because of what QE is. And frankly what currencies represent. Currency is paper backed by the faith of its government. Quantitative Easing is basically the second derivative of that. Different, but just as dependent on the trust of the system. And fewer and fewer people believe in its ability to spur actual economic growth. It's quite possibly fueled the desire of those seeking alternative forms of currency (crypto-curries) as people chose to believe in the faith of the network over the elected.

The point – the Fed put
The Federal Reserve put is the golden child of US markets. It's the get out of jail free, buy the dip backbone of the market. Where we stand today, there is little room for interest rate increases, and less and less confident in QE's effects. We're also seeing politics creep into the Federal Reserve more so than we feel comfortable with. What if the Fed Put doesn't work? Ultimately, it's more likely some new solution will eventually be pushed as the next great thing, and as long as enough believe it, it can work for a significant period of time as evidenced by this last decade of quantitative easing.

We just experienced the longest bull market in recent history, it's time to put things into perspective and assess your risk.

The psychological effect of experiencing 10 years of near Market Bliss

2009 "just don't lose me money"
2019 "beat the S&P 500 ever year, and maybe the NASDAQ 100 and DJIA while you're at it"

The worst "broad" asset class in US equities returned 12.66%, and the highest standard deviation was 18.5% (with the exclusion of energy). Pretty much any way you slice it, US equities were king over the last decade. Regardless of sector, market cap, style box, factor focus (a universe of 19 that have 10 years of data); US equities outperformed ALL broad fixed income and international equity (with the exception of XLE – energy).

Dark Green: broad US equity ETFs

• Market cap, sector, dividend, equal weight

Light Green: Intl equity ETFS

• Broad markets, regions, and large intl countries such as China, Japan, UK etc.

Blue: Fixed Income

• Short term treasury, long term treasury, corporates, high yield

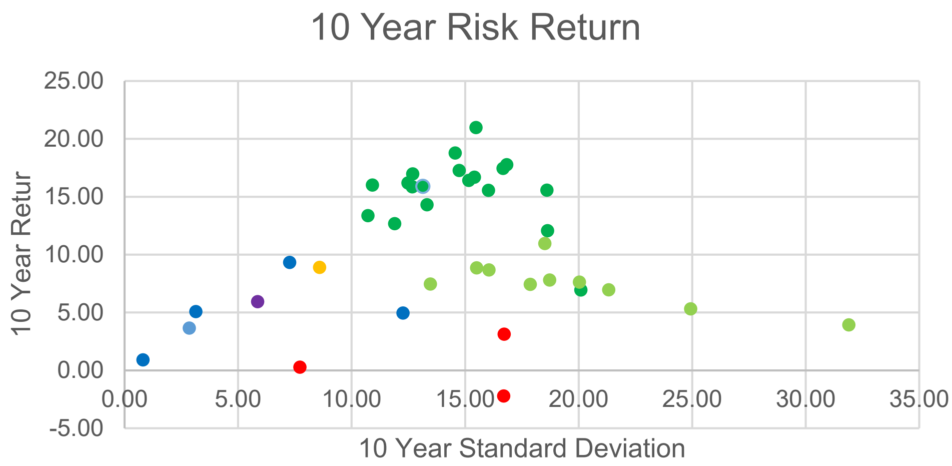
Red: alt ETFs

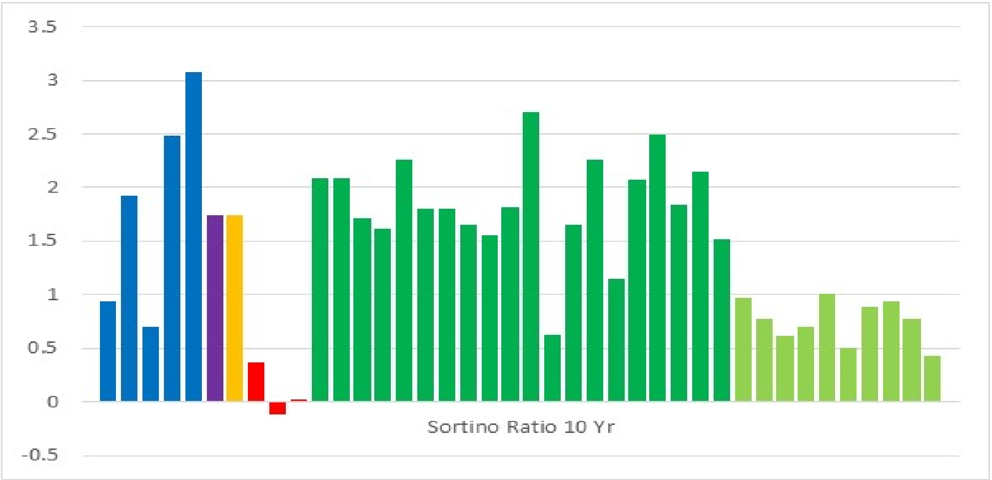
• Commodities, Gold, Strong Dollar

Purple: All weather

Yellow: 60 ACWI 40 AGG

The 3 notable spikes in blue, soaring past parts of the US equity market come from fixed income. The sortino ratios (in blue) from highest to lowest are, the iShares intermediate term corporate bond (ICIB), iShares High Yield (HYG), and iShares AGG (AGG). Be wary of your US focused 60/40 portfolio, its quite possibly never had a better run than this (relative).





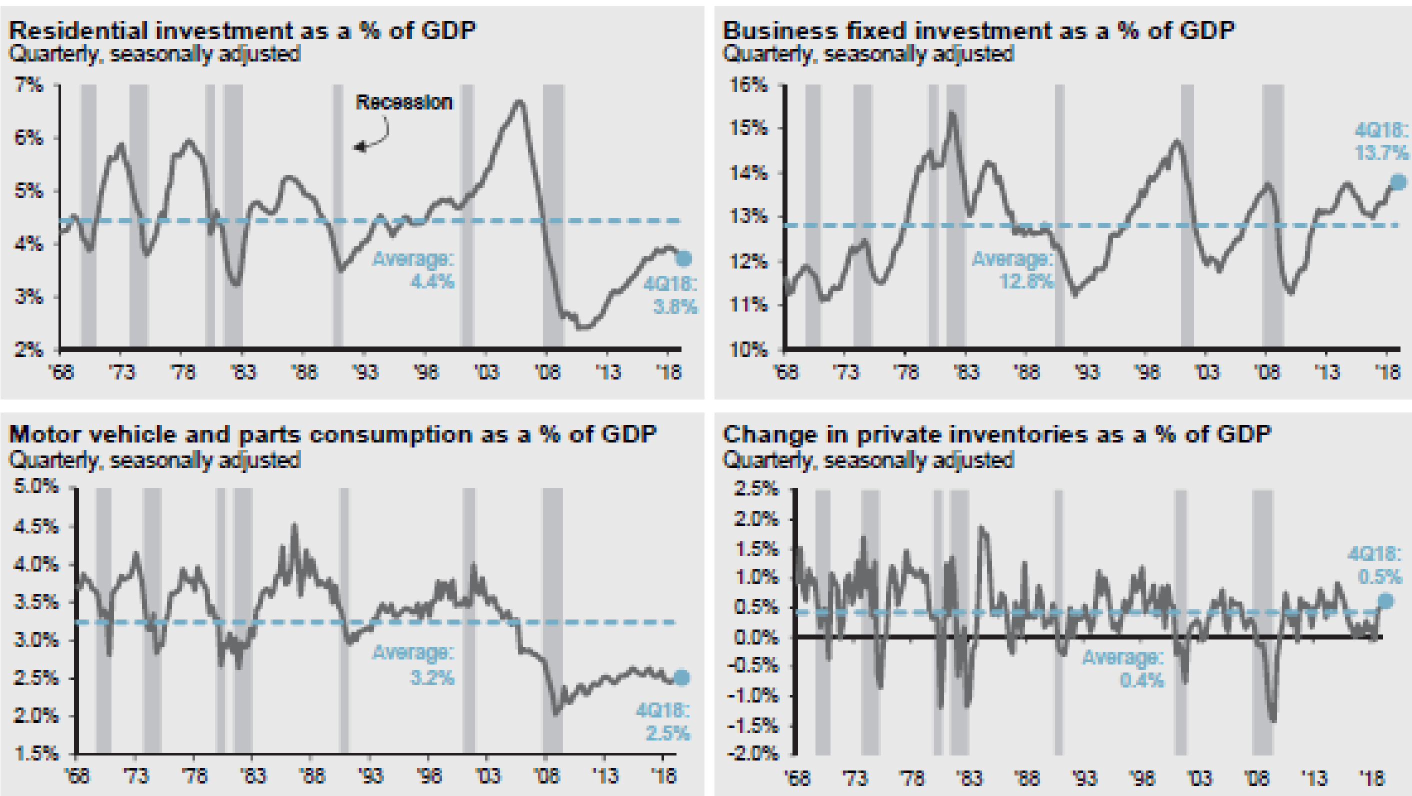
(Source: Morningstar, Toroso)

We are not market timers

We are not sounding the alarms for cash. There is always a bull case to be made (see below). Market disruptions can take years to play out. With elections 18 months away, the forces that be will do anything to keep the status quo.

So we don't appear totally biased… The Bull Case

- Fundamentals still within historical norms
- Full employment
- Core inflation appears subdued
- While some indicators are softening, the levels from which they began softening don't appear to be overheated, compared to historical context (cyclical sectors)
  - Residential invest as %/GDP
  - Business fixed invest as a %/GDP
  - MV consumption as %/GDP
  - Change in private inventories as a %/GDP

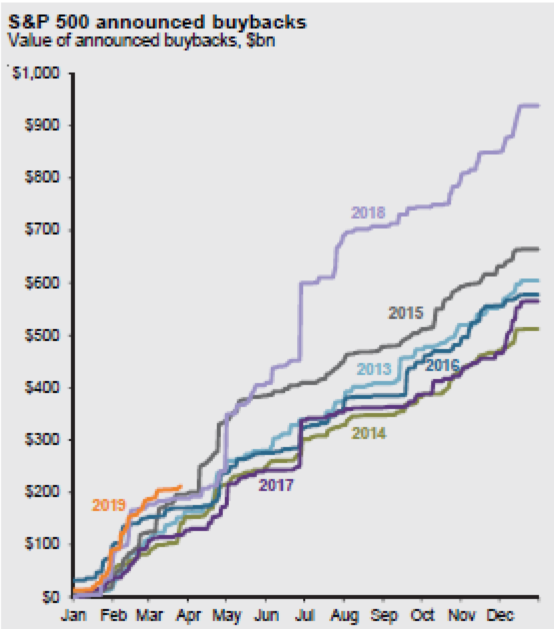


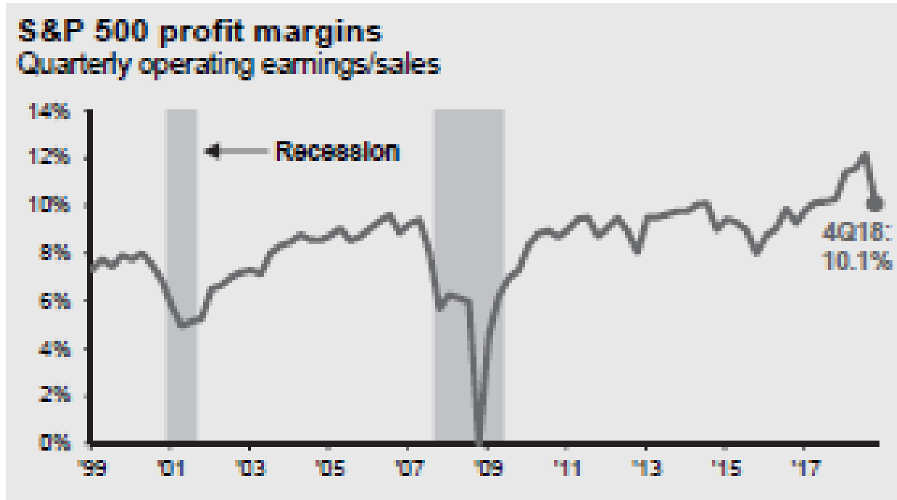
Source: BEA, FactSet, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2019.

(Source: Morningstar, Toroso)

US EQUITIES

At the end of the day, markets are still a game of supply and demand. Companies don't necessarily have set values, only record of where it has last traded. The day to day movements are dictated by that day's supply and demand willing to participate in markets.





(Source: JP Morgan)

It seems like every year buybacks hit new records. As you can see from the chart above, 2018 was a banner year for buybacks, but at some point, companies who've leveraged their balance sheets through the bond market to create a steady flow of demand for their owns stock will have to deal with all of that debt.

Over the last few commentaries, we've mentioned a fear of far expanded profit margins in the US. You may have seen charts in the last 12 months highlighting the US's relative cheapness compared to historical levels with looking at traditional metrics such as Price to Earnings ratios (P/E). What is not shown in these bullish charts are the record profit margins and tax cuts needed to get there. The chart above shows 20-year profit margins on the S&P 500. With minimal wage growth and nothing resembling inflation for a decade, companies have increased margins to impressively high levels – levels that are unlikely to be beat in the near future.

The iShares total market ETF (ITOT) &iShares Core S&P 500 ETF (IVV) returned 14.02% & 13.65% for the 1st quarter in 2019. The iShares S&P Mid Cap (IJH) and iShares S&P Small cap (IJR) returned 13.37% and 10.6% respectively. Growth Continued to outperform value in the large and mid-cap space, underperforming in small caps.

2014-Q2	2014-Q3	2014-Q4	2015-Q1	2015-Q2	2015-Q3	2015-Q4	2016-Q1	2016-Q2	2016-Q3	2016-Q4	2017-Q1	2017-Q2	2017-Q3	2017-Q4	2018-Q1	2018-Q2	2018-Q3	2018-Q4	2019-Q1
5.8% Dividend	2.9% Momentum	8.3% Dividend	3.6% Momentum	2.1% Momentum	-1.3% Low Vol	7.7% Momentum	9.5% Dividend	5.7% Low Vol	6.6% Value	8.0% Value	9.4% Momentum	7.9% Momentum	7.9% Momentum	8.6% Value	2.8% Momentum	4.1% Momentum	8.8% Momentum	-7.6% Low Vol	16.0% Quality
5.4% Equal Weight	2.6% Quality	8.0% Low Vol	2.6% Quality	0.2% Value	-2.4% Dividend	7.2% Quality	5.6% Low Vol	5.3% Dividend	4.4% Total Market	4.1% Total Market	6.0% Low Vol	3.1% Low Vol	5.8% Value	8.0% Momentum	0.3% Quality	3.9% Total Market	8.8% Quality	-9.8% Dividend	14.8% Equal Weight
5.2% Momentum	1.7% Low Vol	6.0% Equal Weight	2.4% Low Vol	0.1% Total Market	-3.8% Quality	6.6% Total Market	2.9% Equal Weight	4.8% Momentum	4.4% Equal Weight	4.0% Dividend	5.9% Quality	3.0% Total Market	4.6% Total Market	7.9% Quality	-0.6% Total Market	3.6% Dividend	7.8% Low Vol	-13.9% Equal Weight	14.0% Total Market
5.0% Total Market	0.4% Total Market	5.2% Total Market	1.7% Equal Weight	-0.3% Quality	-4.2% Momentum	6.3% Low Vol	2.1% Quality	2.6% Total Market	2.7% Quality	3.7% Equal Weight	5.8% Total Market	2.7% Quality	4.2% Quality	6.4% Total Market	-1.1% Equal Weight	2.9% Low Vol	7.1% Total Market	-14.3% Total Market	12.7% Low Vol
5.0% Value	0.4% Value	5.0% Momentum	1.4% Total Market	-1.2% Equal Weight	-6.7% Total Market	4.9% Equal Weight	0.9% Total Market	2.6% Equal Weight	1.6% Momentum	2.9% Quality	5.3% Equal Weight	2.4% Equal Weight	3.5% Equal Weight	6.2% Equal Weight	-1.1% Low Vol	2.8% Equal Weight	7.0% Value	-14.7% Quality	12.6% Momentum
3.9% Low Vol	-0.8% Equal Weight	4.9% Quality	0.2% Value	-1.8% Low Vol	-7.6% Equal Weight	4.4% Value	0.0% Momentum	1.2% Quality	1.3% Dividend	0.1% Low Vol	4.8% Value	2.0% Dividend	3.4% Low Vol	6.1% Dividend	-1.4% Value	1.3% Value	5.4% Equal Weight	-15.6% Momentum	11.0% Value
3.7% Quality	-3.3% Dividend	4.5% Value	-1.1% Dividend	-2.7% Dividend	-8.0% Value	4.3% Dividend	-0.4% Value	1.0% Value	-1.2% Low Vol	-1.6% Momentum	3.8% Dividend	1.3% Value	2.4% Dividend	5.3% Low Vol	-2.6% Dividend	1.3% Quality	3.0% Dividend	-16.9% Value	11.0% Dividend

(Source: Morningstar, Toroso)

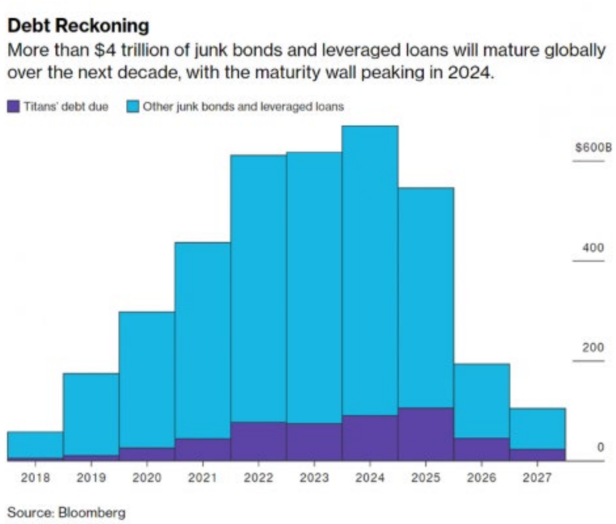
After ending its two-year dominance, momentum continued to disappoint, underperforming in a strong first quarter, returning 12.6% in the first quarter, measured by the iShares MSCI USA Quality Factor ETF (QUAL). A vehicle we like in this space, the Reverse Cap Weighted US Lage Cap ETF (RVRS) returned 16.08% in Q1, turning the weighting of the top 500 stocks upside-down. We continue to believe unique vehicles such as this will be needed to drive portfolio returns beyond traditional portfolio construction metrics.

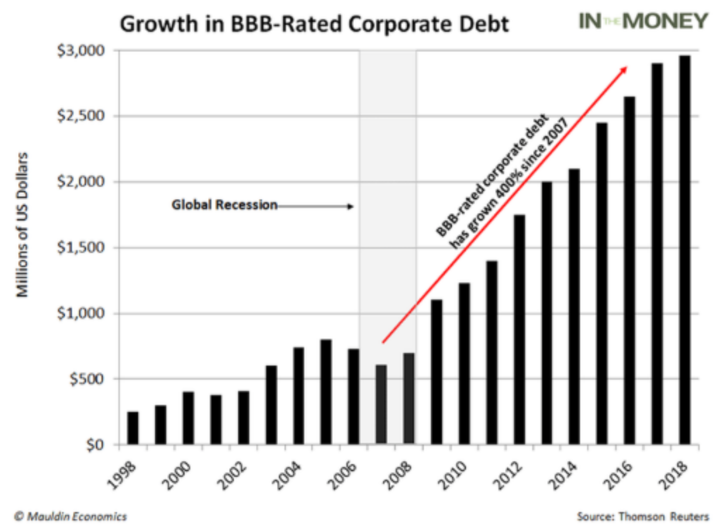
INTERNATIONAL EQUITIES

The iShares MSCI EAFE ETF (EFA) returned 9.96% for the first quarter. It's more of the same here. Political uncertainty, fears of zombie banks. The real value we see is in truly unconstrained strategies across these regions, as market cap weighted indexes have the same issues at the end of bull market here as they do in the US. 3 strategies we would like to highlight here are; the Davis Select Worldwide ETF (DWLD), Ark Innovation ETF (ARKK), and the Robo Global Robotics and Automation ETF (ROBO), returning 18.04%, 25.66%, and 18.18% respectively in Q1.

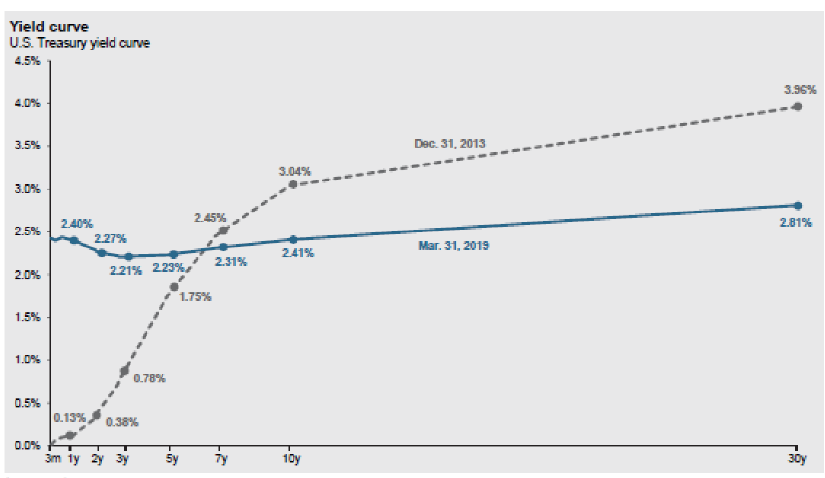
EMERGING MARKET EQUITIES

The iShares MSCI EM ETF (EEM) returned 9.7% for the first quarter. What's most interesting here is, EEM is slowly becoming less volatile than IVV (iShares S&P 500). This won't be the case in all markets, and certainly not when our president is tweeting about tariffs with this region on a frequent basis, but there's value here. Fundamentals are cheap. Volatility (relative to US equities), is dropping. If growth were to be dependent on traditional metrics such as demographics (excluding some areas), this is the region to focus on. Much of this world has spend the last 10 years transitioning, or attempting to transition, from traditional export economies to ones more dependent on their own consumption. Similarly to other equity markets, we see the need for high active share vehicles to drive returns. We'd like to highlight EMQQ Emerging Markets Internet of Things ETF (EMQQ), returning 22.24% in Q1. You can think of these as the "FAANG" of emerging markets.





The iShares Core US Aggregate Bond ETF (AGG) returned 2.94% for the 1st quarter. Longer term treasuries measured by the iShares 20+ Year Treasury Bond ETF (TLT) returned 4.67%. High yield measured by the iShares iBOXX $ High Yield Corp Bd ETF (HYG) was up 7.38%. A great year for a 60/40 portfolio, but still a bleak outlook. There is $4 trillion in junk bond & leveraged loans maturing over the next decade. And Growth in BBB rated corporate debt (buyback fuel?) is this cycle's leverage acceptance of choice. It's interesting how much the curve has really changed in just a few years.



Similar to equity markets, we believe traditional indexes constructed by debt issuance are set up for failure. Over the last decade the duration of AGG continues to grow, with it, its risks, but its choice as an industry benchmarked is left unquestioned. Cash like investments are offering such attractive yields, that bar belling them with unique risks such as the Saba Closed-End Fund ETF (CEFS) makes a ton of sense. CEFS returned 15.14% in Q1.

TOROSO® ASSET MANAGEMENT

ALTERNATIVES

Commodities measured by Invesco DB Commodity Tracking ETF (DBC) returned 10.16% for the 1st quarter. Gold measured by SPDR Gold Shares (GLD) returned 0.98%. The Bloomberg Galaxy Crypto Index (BGCI) was up 8% after losing -81% in 2018. The AGFiQ US Market Neutral Anti-Beta ETF (BTAL) lost -2.14% in Q1, after returning 14.7% for 2018.

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	10 Yr	10 Yr Std Dev
71.8% Emerging Markets	27.3% Gold	33.6% Long Term Treasury	17.3% Emerging Markets	32.3% S&P 500	27.4% Long Term Treasury	1.3% S&P 500	11.9% S&P 500	36.4% Emerging Markets	1.5% Short Term Treasury	13.7% S&P 500	15.9% S&P 500	18.7% Emerging Markets
31.4% International	15.9% Emerging Markets	11.2% Gold	17.2% International	22.6% International	13.6% S&P 500	0.5% Aggregate Bonds	10.5% Emerging Markets	24.9% International	-0.1% Aggregate Bonds	10.0% International	8.9% Global Balanced	16.7% Gold
27.1% Gold	15.0% S&P 500	7.6% Aggregate Bonds	15.9% S&P 500	12.6% Global Balanced	6.0% Aggregate Bonds	0.4% Short Term Treasury	8.7% Gold	21.8% S&P 500	-1.5% Gold	9.7% Emerging Markets	8.8% International	15.5% International
26.4% S&P 500	13.8% All Weather	4.9% All Weather	11.6% Global Balanced	0.5% All Weather	4.7% Global Balanced	-0.9% International	6.0% Global Balanced	16.0% Global Balanced	-1.9% All Weather	8.7% Global Balanced	7.8% Emerging Markets	12.7% S&P 500
20.6% Global Balanced	10.2% Global Balanced	2.0% S&P 500	6.6% All Weather	0.2% Short Term Treasury	3.8% All Weather	-1.1% Global Balanced	5.6% All Weather	11.4% Gold	-2.1% Long Term Treasury	4.7% Long Term Treasury	5.9% All Weather	12.3% Long Term Treasury
14.1% All Weather	9.3% Long Term Treasury	1.4% Short Term Treasury	5.3% Gold	-2.2% Aggregate Bonds	0.5% Short Term Treasury	-1.7% Long Term Treasury	2.6% Aggregate Bonds	9.0% All Weather	-4.4% S&P 500	4.5% All Weather	4.9% Long Term Treasury	8.6% Global Balanced
5.1% Aggregate Bonds	7.5% International	-1.6% Global Balanced	4.0% Aggregate Bonds	-3.1% Emerging Markets	-0.6% Gold	-2.7% All Weather	1.4% Long Term Treasury	8.9% Long Term Treasury	-5.4% Global Balanced	2.9% Aggregate Bonds	3.6% Aggregate Bonds	5.9% All Weather
0.5% Short Term Treasury	6.3% Aggregate Bonds	-12.2% International	3.3% Long Term Treasury	-13.9% Long Term Treasury	-2.8% Emerging Markets	-11.8% Gold	1.0% International	3.5% Aggregate Bonds	-13.8% International	1.0% Gold	3.1% Gold	2.9% Aggregate Bonds
-21.5% Long Term Treasury	2.2% Short Term Treasury	-18.9% Emerging Markets	0.3% Short Term Treasury	-28.1% Gold	-5.0% International	-15.4% Emerging Markets	0.8% Short Term Treasury	0.3% Short Term Treasury	-15.0% Emerging Markets	0.9% Short Term Treasury	0.9% Short Term Treasury	0.8% Short Term Treasury

Data as of March 31, 2019. Source: Toroso Investments, Morningstar

All Weather Plus	25% IVV; 25% AGG; 25% SHY; & 25%GLD	Tracks a Fully Diversified Strategy of Equal Weighted Stocks, Short and Long Term Bonds, & Gold
S&P 500	iShares Core S&P 500 EF (IVV)	Tracks International Large an Mid-Cap Stocks (Excludes US and Canada)
Emerging Markets	iShares MSCI Emerging Markets ETF (EEM)	Tracks Large and Mid-Cap Stocks from Emerging International Markets
Aggregate Bonds	iShares Core US Aggregate Bond ETF (AGG)	Tracks Total US Investment-grade Bond Market
Short Term Treasury	iShares 1-3 Year Treasury Bond ETF (SHY)	Tracks US Treasury Bonds with maturities between 1 and 3 years
Long Term Treasury	iShares 20+ Year Treasury Bond ETF (TLT)	Tracks US Treasury Bonds with remaining maturities greater than 20 years
Global Balanced	60% ACWI & 40% AGG	Tracks a Global Balanced Strategy for All World Stocks and US Investment Grade Bonds
International	iShares MSCI EAFE ETF (EFA)	Tracks International Large an Mid-Cap Stocks (Excludes US and Canada)
Gold	SPDR® Gold Shares (GLD)	Tracks the Price of Gold

TOROSO ASSET MANAGEMENT

CONCLUSION

A deep dive into your investments is crucial now more than ever. Looking at a fund's past performance is no where near the level of due diligence necessary. Your 10 year charts will show you nothing but flowers, or tulips if you will. If you aren't doing a deep dive on the holdings, prior holdings, and overall analysis on how the methodology of the product will perform over different markets. Please find more from us at Toroso at www.etfthinktank.com