Argent
Wealth Management, LLC

Investment Outlook
Summer 2019

Second Quarter 2019 Review; Third Quarter 2019 Outlook

Still Rangebound

Equity markets surged in June as trade tensions eased and the Fed positioned to lower interest rates. While first half 2019 returns are impressive - and a few select U.S. indices such as the Dow set new all time highs - most other equity markets around the globe remain well below their peak levels of nearly 18 months ago. As such, we still believe markets are more consistent with rangebound conditions, not the resumption of a bull market.

While we believe the bull market will return at some point, a more cautious outlook remains appropriate for now. "Secular" bull markets can last up to 20 years. These very long-term bull markets normally end with extreme overvaluation and investor euphoria. We are not at that point either.

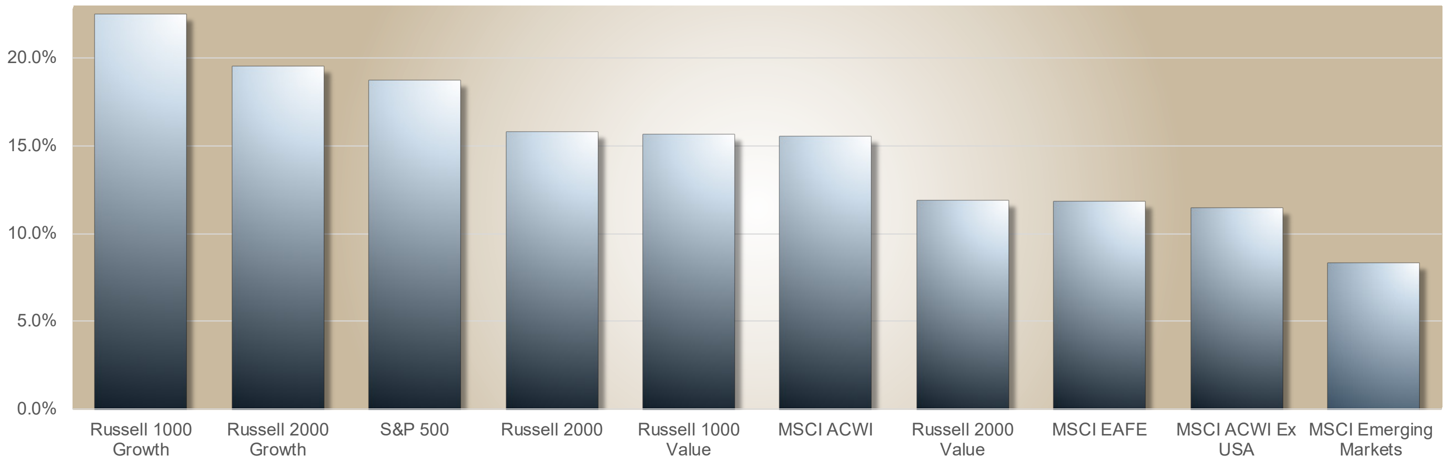
We continue to expect significant volatility. That has certainly been the correct view, as markets swooned late last year and again in May.

> ***"As we discussed in our last Outlook, rangebound markets suggest a more cautious and tactical approach."***

These sharp corrections are never evenly distributed, as some sectors always suffer disproportionally. We did exploit this latest period of weakness by adding positions in the mid-stream energy sector (more about that later).

There are several important reasons for continued caution. First, the latest market surge pushed valuations to the very upper end of ranges. Many of our most predictive forward indicators of the economy are softening. Profit growth has been slowing. At now 17 times forward earnings in U.S. markets, there is not much additional room to the upside without a meaningful pickup in the economy and resumption in profit growth.

Equity Performance Year-to-Date



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Secondly, we believe the euphoric reaction to both trade talks and anticipated Fed action are too much, too soon. The recent truce with China (not imposing additional tariffs) was less than meets the eye. None of the tough issues have been addressed. China has not made any serious concessions on matters of intellectual property rights or in changing their laws. Until that happens, this is just a lot of negotiating rhetoric. We expect negotiations to continue for some time.

The market now expects a virtually 100% probability of a lowering of short-term interest rates at the upcoming meeting this month, and another 75 basis points over the next 12 months. Such an aggressive lowering of rates would only happen if the economy were heading into recession or equity markets dropped sharply. A more likely outcome, in our view, is a muddling economy centering around a 2% growth rate and two cuts of 25 basis points this year.

Target Rate Probabilities for July 31, 2019 Fed Meeting

	Basis Points					
Meeting Date	**75-100**	**100-125**	**125-150**	**150-175**	**175-200**	**200-225**
07/31/2019	-	-	-	-	4.0%	96.0%
09/18/2019	-	-	-	2.7%	66.1%	31.2%
10/30/2019	-	-	0.9%	24.6%	54.1%	20.4%
12/11/2019	-	0.4%	10.1%	36.0%	41.0%	12.5%
01/29/2020	0.1%	3.0%	17.2%	37.4%	33.3%	9.1%
03/18/2020	0.7%	5.7%	21.0%	36.6%	28.7%	7.4%

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The bottom line is that it is challenging to get both a meaningful trade deal and a highly accommodative Fed at the same time. If a substantive trade deal is struck, then the Fed does not need to drop interest rates as much as the market anticipates. Conversely, escalating trade tensions and/or a large market correction (more than 10%) would likely result in a sharp lowering of interest rates.

Either way we expect ample market volatility in the coming quarters.

Mid-Stream Energy

We exploited recent volatility by adding positions within the mid-stream energy sector. These companies offer an attractive combination of solid fundamentals, favorable valuation and high distributions. Additional positives for the sector are some of the lowest expectations and most negative investor sentiment. In other words, the expectation bar is set really low.

A key reason for such low expectations is that the sector has treated investors very badly over the past decade. Most of these companies were structured as master limited partnerships (MLPs) until recently. Many were very highly leveraged utilizing massive amounts of debt to finance continued acquisition of mostly pipeline assets. That created an illusion of perpetual growth of distributions. It worked well until the swoon of oil prices in 2015. As access to debt markets closed, many companies went bankrupt, were merged or changed structure.

That has changed dramatically as companies have reduced leverage and changed their structure to treat investors better. Importantly, mid-steam energy companies are generally in the business of earning a "toll" to transport energy products through pipelines. They are dependent on volume, not the price of crude oil, for profits. The volume of oil, natural gas and other energy products continues to increase sharply due to the revolution of shale technology. Additionally, capital spending in future years looks more disciplined than we have observed in the past.

This sector is also one of the very best places to get attractive yields, in our view. As Treasury yields have plunged and credit spreads have tightened, we expect many yield-starved investors to find the sector compelling.

The Fed Finally Throws in the Towel on Inflationary Expectations

A critical reason for the Fed's recent pivot to lowering interest rates is anchored within the realization of structurally low inflation. As recently as a few months ago, the Fed was still referring to below-target inflation readings as "transitional." As such, they continued to guide markets that inflation would rise to the Fed's target of 2%. Not any more.

United States Oil & Gas Pipelines - IND

	Dec.'04	Dec.'05	Dec.'06	Dec.'07	Dec.'08	Dec.'09	Dec.'10	Dec.'11	Dec.'12	Dec.'13	Dec.'14	Dec.'15	Dec.'16	Dec.'17	Dec.'18
Net Debt/EBITDA	5.24	4.14	4.35	4.38	3.88	4.31	4.27	4.29	5.44	5.17	5.19	6.46	6.22	6.23	5.05
Net Debt/(EBITDA-Capex)	10.90	12.99	32.17	-75.48	-20.90	48.66	16.74	19.94	33.81	-1,197.16	-73.86	-16.48	-52.46	59.20	17.76
Total Debt/EBITDA	5.90	5.45	4.75	4.75	4.29	4.60	4.50	4.49	5.65	5.38	5.39	6.64	6.39	6.41	5.26
Total Debt/EBIT	8.88	8.81	7.01	7.32	6.32	7.13	7.03	6.82	8.12	7.88	7.75	10.62	10.15	10.04	7.62
EBIT/Interest Expense (Int. Coverage)	1.60	1.74	2.43	2.26	2.80	2.47	2.30	2.61	2.53	2.55	2.76	2.08	2.09	2.14	2.65
EBITDA/Interest Expense	2.41	2.81	3.58	3.48	4.12	3.82	3.60	3.96	3.64	3.74	3.97	3.33	3.32	3.35	3.84
CFO/Interest Expense	1.71	1.66	3.20	3.12	3.87	3.04	2.94	3.55	3.13	3.55	3.52	3.50	3.21	3.53	3.79
LT Debt/EBITDA	5.51	5.17	4.40	4.56	4.08	4.47	4.25	4.16	5.25	5.12	5.11	6.34	5.94	6.09	4.99
Net Debt/FFO	710.86	487.45	536.80	586.80	429.87	507.57	525.72	497.15	624.99	592.26	631.68	665.80	701.30	696.58	576.50
LT Debt/FFO	746.22	609.25	542.47	611.48	452.15	527.51	523.21	481.95	603.84	586.51	621.77	653.96	669.98	680.17	569.23
FCF/Total Debt	2.78	-1.85	-0.32	-4.50	-7.22	-3.71	0.83	1.80	-0.38	-2.82	-5.28	-7.15	-4.47	0.19	2.82
CFO/Total Debt	11.57	10.65	17.97	17.77	20.37	16.10	17.40	19.24	14.47	15.78	14.51	13.82	13.02	14.13	16.39

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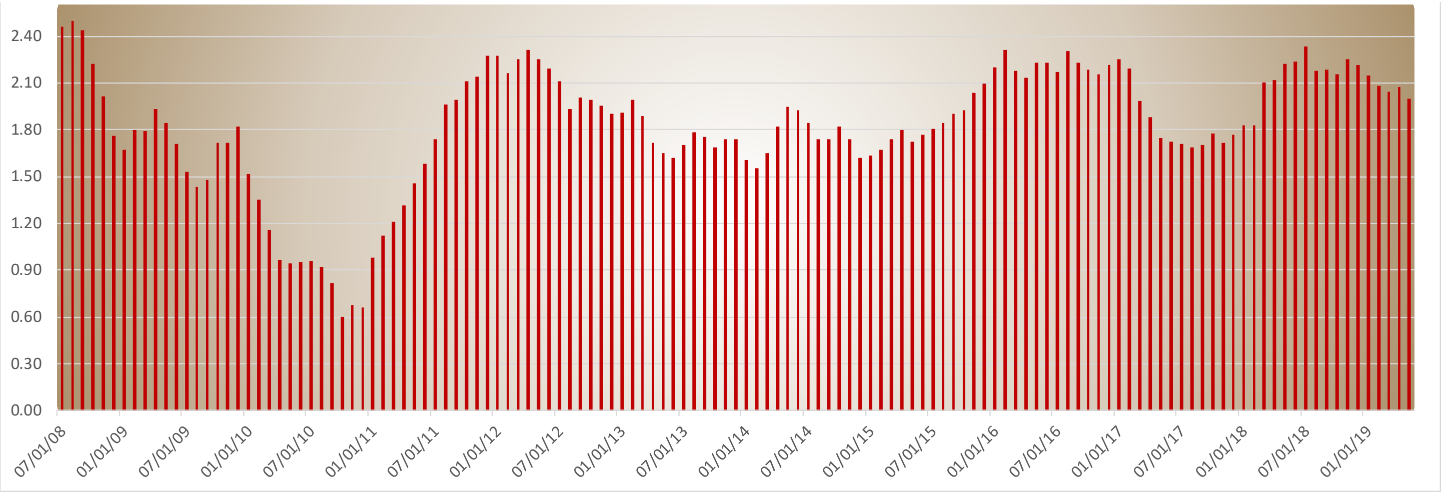
We have noted in many past reports that we believe the Fed's methodology is both dated and flawed. Inflation has met the Fed's 2% target for only one of the last seven years. Even then, if was a very short-lived period before plunging again well below targets.

A root cause for these consistent errors in their forecast is continued belief in the so-called "Phillips Curve." That is an economic model that suggests a tradeoff between inflation and the unemployment rate: As the unemployment rate falls, inflation supposedly rises.

The Phillips Curve model worked well in the 1970s and 1980s but has been a poor predictor of inflation for many years now. Globalization and technology, among other factors, have structurally changed the economy. While the unemployment rate has fallen to record lows in the United States, wage inflation has hardly budged. Further complicating matters, super-low inflation rates in many other parts of the world (even deflation) are being effectively imported into U.S. markets.

This is a big deal, as it suggests a much lower path for the Fed Funds rate. Yield will continue to be very hard to find. Assets that offer respectable yield at a reasonable level of risk should be bid higher in price. It is also supportive for "risk assets" such as stocks, private equity and real estate. All of these assets are, to a greater or lesser degree, driven by the cost of capital and by the competition of bond yields (the "risk-free" rate of return).

USA - CPI Core Total (YoY%)



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The Fed’s Challenge to Avoid Market Bubbles and Let “Markets be Markets”

As discussed previously, we do expect the Fed to lower interest rates but less than the market now expects. Inflation will remain structurally low, and the Fed finally accepts that reality. However, the Fed has a tricky job of balancing inflationary goals with another key goal: not creating market bubbles. The bursting of market bubbles such as real estate, credit and tech stocks has triggered past recessions. The Fed cannot afford that in a low-inflation world.

Additionally, Chairman Powell has distinctly different views from predecessors Bernanke and Yellen. Both prior chairs were appropriately blamed for the notion of a “Fed Put,” as they came to the rescue of markets at the slightest signs of volatility. From the beginning of his term, Chairman Powell has articulated that normal market volatility is healthy and appropriate. We agree. That actually lowers the risk of a major bear market by controlling speculation through more frequent 5% to 15% corrections.

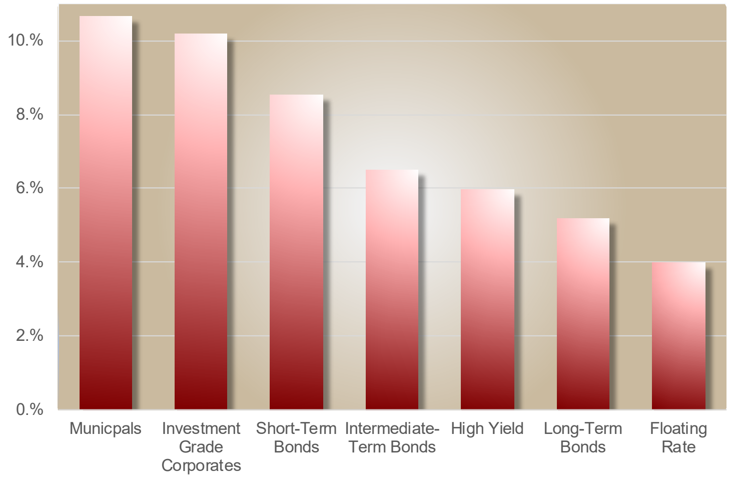
Current Portfolio Positioning

Until proven otherwise, we believe markets are in a range. As such, we are cautiously positioned, expecting reasonably frequent moderate market corrections. While these corrections may feel uncomfortable, they also produce opportunity to add value for prudent and disciplined investors.

Within equities, we reduced our underweight this past quarter as we added in mid-stream energy. We remain focused on generally high-quality assets (as measured by earnings predictability, dividend yield and valuation). We remain skeptical of most aggressive areas of the growth universe, as they remain highly valued and more volatile. We would expect to add to positions over the next several quarters.

Within fixed income, we are positioned with lower-duration assets (shorter maturities) and favoring investment-grade bonds and other higher-quality “spread” assets, such as senior secured loans. At this time, there is limited incremental reward to extend maturities or lower credit quality. As with equities, we expect enough volatility to be able to periodically add both duration (on periods whereby the economy appears stronger and interest rates rise) and also some credit risk (if there is a correction in risk assets).

Fixed Income Performance Year-to-Date



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We are marginally more optimistic within private equity and private real estate. The key reasons here are the expectation of a lower range of interest rates and a muddling, not recessionary, economy. Selective private assets can continue to produce above-market returns. However, as these assets are illiquid, complicated and long-term, careful selection and investor prudence is necessary. These categories are not appropriate for clients with shorter time horizons or limited capacity for illiquidity.

Finally, generally rangebound conditions coupled with significant volatility makes portfolio rebalancing even more critical. Studies repeatedly show that rebalancing materially adds return and decreases risk. Even more important, periodic rebalancing keeps portfolios aligned with strategic targets and with an investor’s tolerance for risk and liquidity. As rebalancing, by its very definition, results in selling the assets that have done the very best recently and adding to the sectors that have done the worst, it is the most effective technique we know for controlling investor emotion and staying disciplined.

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