J2 CAPITAL MANAGEMENT MARKET UPDATE

J2 Capital Management 4th Quarter 2018 Update

TILT!

Selected Benchmarks	4th Qtr	2018
S&P 500 TR	-13.52%	-4.38%
Russell Midcap Growth	-15.99%	-4.75%
MSCI All Country World Index	-12.65%	-8.93%
60% MSCI ACWI/40% Agg Bond	-7.04%	-5.22%
*Diversified Emerging Markets	-7.47%	-16.07%
*****Barclays Aggregate Bond	1.64%	0.01%
*Tactical Allocation	-9.25%	-7.70%

*S&P and MSCI data provided by S&P and MSCI. Russell Mid Cap Index data provided by FTSE Russell Inc. *data provided by Morningstar.com.*

Back in the day, I loved playing pinball at the local arcade. If you were good, you would be able to tweak the path of the ball and coax it to where it needed to go. Pinball players referred to this as “nudging.” While this skill could make you a pinball wizard, too much would break the game and the “Tilt” light would come on.

World governments, including our own U.S. Federal Reserve, have been nudging the economy and markets to where they want it to go for nine years. The problem with this “nudging” is that they run the risk of “tilting” the market and potentially breaking it.

4th Quarter Market Review

Hey, have you heard that the stock market performance was awful in the 4th quarter? Unless you were living on a remote island without access to the outside world, of course you know that. We at J2 Capital were not surprised and were well prepared. All but one of our strategies on net basis, bested their benchmarks for the year-to-date 2018 period. All strategies outperformed in the 4th quarter, helped by our large cash positioning.

I won't bore you with data on just how awful it was, as you are quite aware that almost the entire global investment universe was negative for 2018. Diversification, they say!

What I would rather do is look forward and help you with how to manage through this type of market—which projects to be just as difficult in 2019.

While others were telling you in September and early October to buy the dip, J2 Capital saw it much differently. We wrote the following in our 3rd quarter update:

> *In my estimation, it's highly likely that the combination of the Trump tax cuts along with deregulation and corporate buybacks stimulated (juiced) earnings and thus the economy in the short term. Just how exactly is the U.S. getting along so well, while every other global economy is turning down? A true miracle, I must say. It is for these reasons that I theorize that the economy will slow down a little. Again, it's about trajectory here, and good versus great. It's slower, and that's all that needs to happen for risk to be brought in.*
>
> *On that note, should I be correct, then we should <u>see interest rates back down a little</u>, or at least stop rising sharply. <u>We would also come to see a more dovish fed</u> that starts walking <u>back the number of rate increases it sees happening</u>. I'll be watching earnings and the economic data to either confirm or disprove this thesis.*

Let's check the scoreboard:

- **Economy slowing? Check**
- **Earnings slowing Check**
- **Interest rates down? Check**
- **Fed turns dovish? Check**
- **Rate increases walked backed? Check**

J2 started to get more conservative in the summer, which cost us some upside as the markets were rallying on fumes to all-time highs. We didn't change our approach, and now with 2018 closed, we feel that we achieved our single most important mandate to you and your clients: managing risk!

What's at work in the markets here?

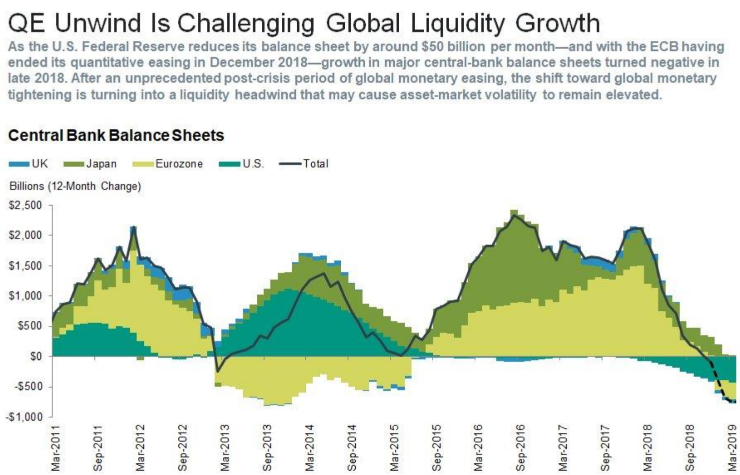
World markets, and specifically the U.S. markets, are increasingly beholden to monetary policy: specifically, easy money and the liquidity that comes from it. Isn't it something that no market anywhere in the world can seem to make headway without some sort of stimulus? According to our Federal Reserve, U.S. growth is quite good. But then why can't the economy sustain interest rate normalization? Isn't that quite the conundrum?

Over time, the financialization of the markets have turned our equity markets into the economy. After all, trillions of dollars have been poured into the global economies, and yet inflation is still somewhat subdued. I think what the central bankers have come to realize is that market losses can lead to drops in consumer sentiment, and ultimately economic contractions. While our esteemed, and certainly brilliant, Federal Reserve chairman, Jerome Powell, tells us the Fed is data dependent, it appears the only data the Fed depend on is the S&P 500. I believe the Fed is increasingly putting themselves in a box here, with the risk of a policy error increasing. I can no longer figure out if bad news is good or bad or vice versa.

The major issue is liquidity, the lifeblood of the market, which is now in decline. I have been writing about the effects of quantitative easing (QE) and other monetary policy for years, as well as my beliefs about how quantitative easing affects the markets. These thoughts can all be found in past missives on our [J2 Capital Management blog](). Globally, QE is over (for now). The U.S. is now running off its balance sheet, engaging in the opposite of easing, i.e., tightening. [Europe has also ended its QE program](). These programs allowed speculators to chase risk and yield. Now that this is in reverse, is it any wonder that volatility has exploded along with market loss?

The U.S. Federal Reserve may have made the liquidity issue worse in the 4th quarter by raising rates right into a global slowdown. Markets reacted to this liquidity crunch as they should, by selling off. The Fed, with its new sheriff in town, had a tough and rather refreshing message for Wall Street in October. They put Wall Street on notice that Wall Street was independent and that markets would have to adjust to normalization. No more medicine to save you, the Fed told us. Fast-forward 90 days, and Powell is now engaged in an apology tour after the S&P 500 dropped almost 20% from its peak. Interest rate increases are now likely on hold, and it's possible the balance sheet runoff could slow or even pause. So much for tough love.

Source: Bloomberg

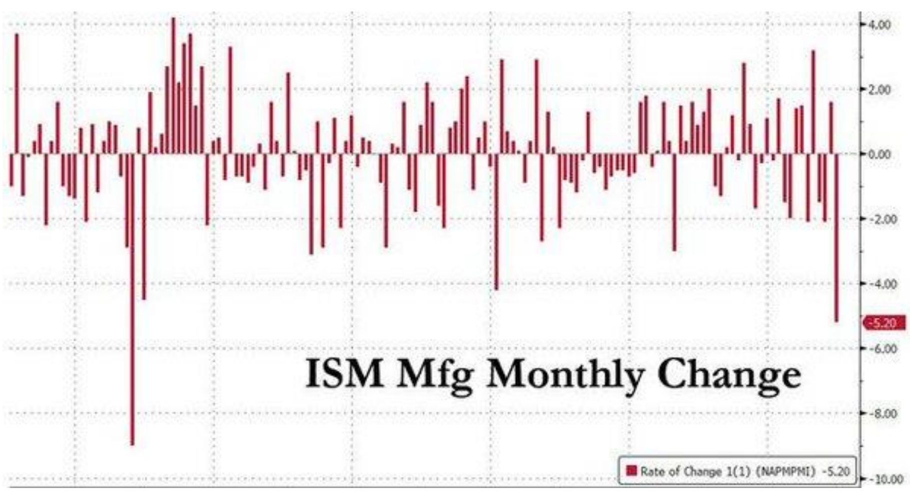


Source: Deutsche Bank

What the Fed missed, in all its brilliance, was that a global slowdown was underway in the 4th quarter. Europe is now almost in official recession territory. Germany, which is one-third of the European economy, just saw its industrial production drop year-on-year to near-recession levels.

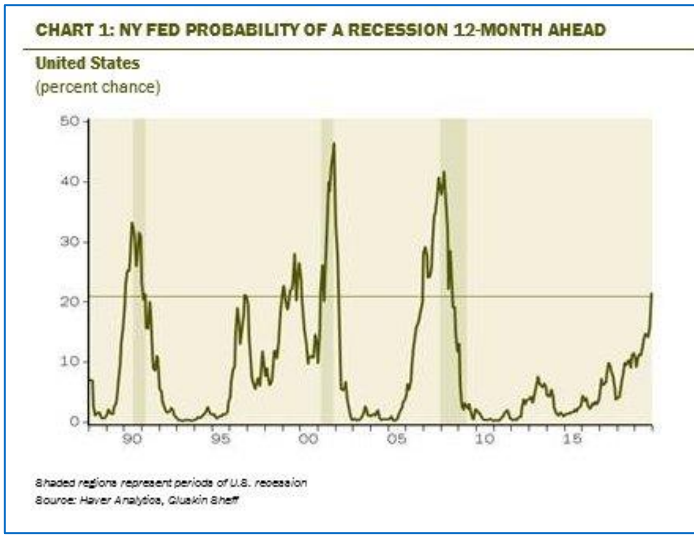
Source: Dailyshot.com

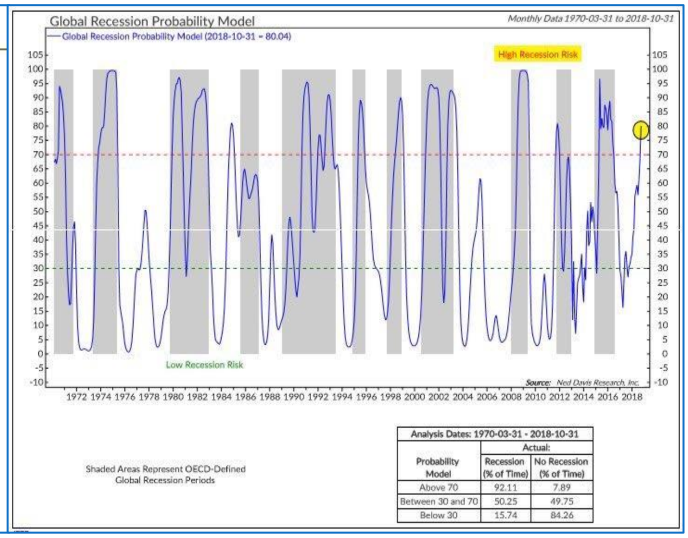
The picture is also turning sour in the U.S., as ISM manufacturing is cratering here. Certainly, the trade tensions between the U.S. and China are being seen here, but it doesn't explain everything.



Source: https://www.instituteforsupplymanagement.org/ismreport/mfgrob.cfm?SSO=1

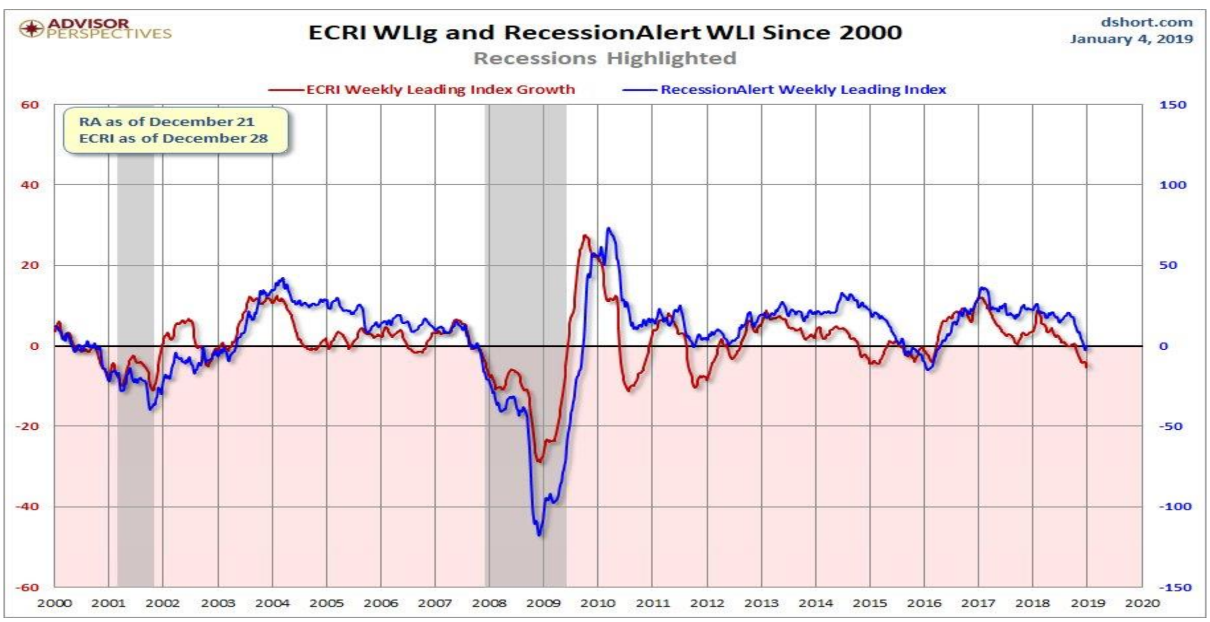
Recession probabilities have also increased substantially.





(Left chart): Gluskin Shef Research (Right) Chart from [Ned Davis Research] currently shows a 92.11% chance we are already in recession.

Data from the [Economic Research Institute] shows their proprietary Leading Weekly Indicators also pointing to an increased chance of a recession.



Source: [Advisor Perspectives]

Economic Summary

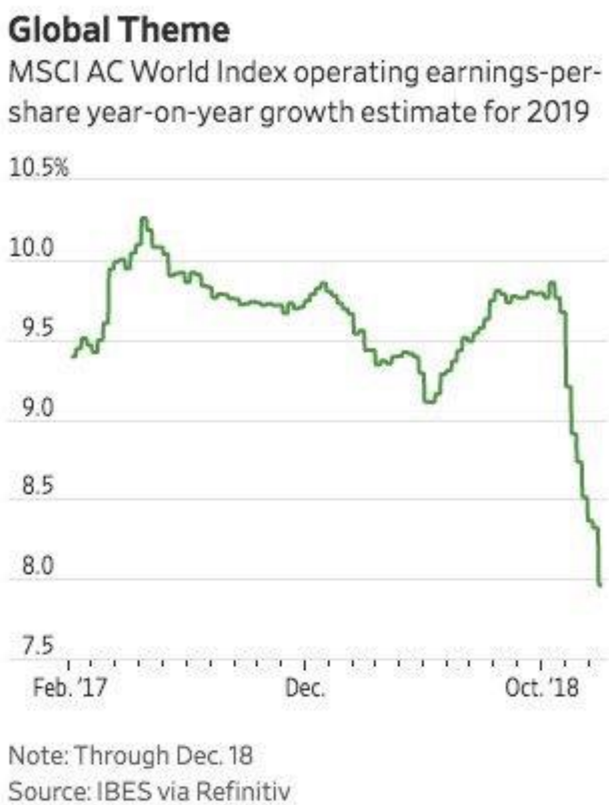
The hard data is pointing to a major global slowdown while the global stock markets at the end of the 4th quarter were pricing for a recession. It's possible that the markets may be ahead of the data here and have become too negative too fast. This while the U.S. Federal Reserve is back to a dovish stance and

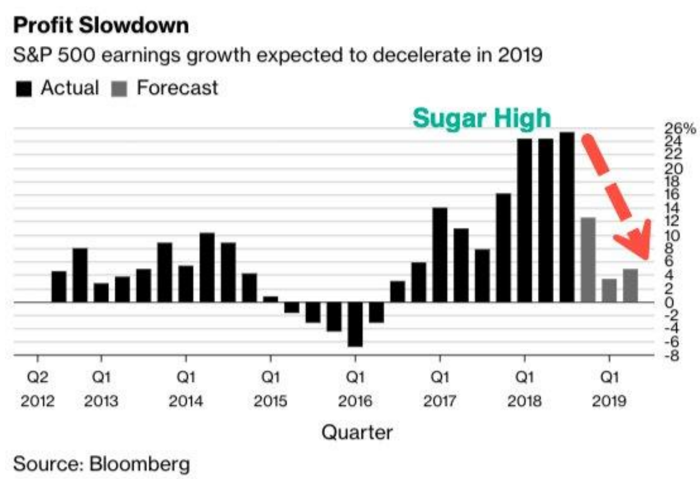
China is again having to stimulate its economy. Is this the same old market that will rally on easy money, or will the slowdown end the buy-the-dip mentality that has created the strong market momentum of the past few years?

Earnings

J2 Capital was positive on earnings in August 2016 when the majority were still negative. These thoughts can be found in my 2016 4th quarter update. Earnings would go on to increase way above most analyst estimates. We rode that miscalculation in our RS Leaders model and loaded up on growth names.

As I wrote last quarter, the earnings peak likely happened in the 2nd quarter of 2018. Again, the majority opinion was that better earnings were to come. Below is a chart of the MSCI ACWI year-on-year growth estimates along with the U.S. growth estimates. Some will argue that earnings will still be good, and as I have said before, so what? The trajectory is down. Stocks may make little headway, or at best the wonderful gains of 2016–2018 will now be subdued. The worst-case scenario is a consumer that pulls in discretionary spending.



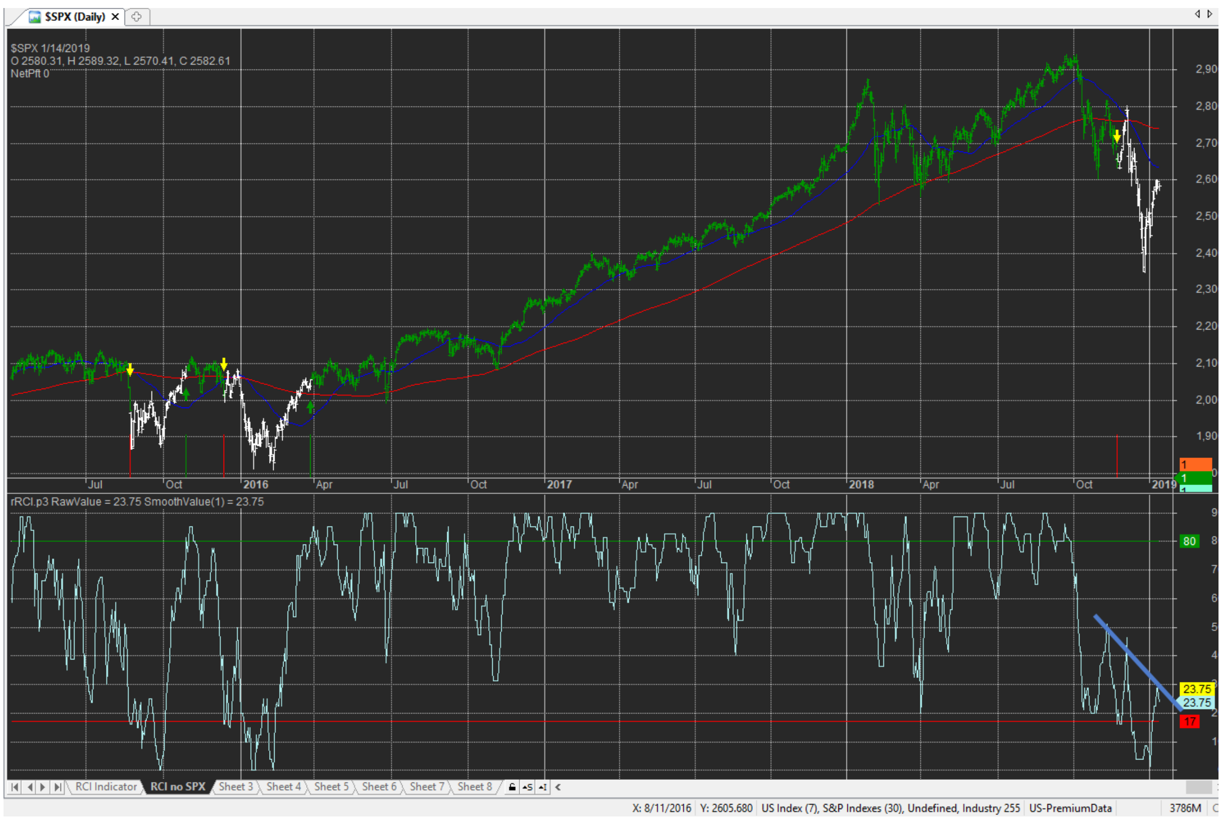


Technical Picture

In October, we wrote the following: ***"We do not view the recent drop as providing a good entry point yet. This very well could be a buyable low, but I am not viewing it as a durable low that is of low risk."***

Our technical indicators helped guide us when many were looking for just a short, shallow correction. Currently, our technical indicators haven't improved much and are a long way away from signaling a healthy bull market. As they say, you can be late to a bull market, but it's best to be early to a bear market.

Our RCI Indicator, which is our longer-term trend indicator, has done a good job historically of catching all corrections and bear markets, and continues to signal an unhealthy market. It's best to look at this as a windsock. At present, the wind is still in our face and caution (i.e., risk management) should be the name of the game. We do have shorter-term indicators that attempt to catch market bottoms, and in fairness, those are close to potentially signaling a bottom. But until they do, this current January rally needs to be viewed as a bear market rally. While we have strong opinions on the macro economy and corporate earnings, we will let our technical indicators help guide us as we move forward. We have done an excellent job managing the volatility for your clients thus far and see nothing that changes our approach at the moment. We will let others try to be heroes in their attempt to hit home runs.



J2 Capital's proprietary indicator showing supply demand.

Selected J2 Capital Management Strategies Review

- RS Leaders, with its mid-cap growth portfolio, outperformed its benchmark in 2018. We outperformed our benchmark both in the up move from January to October as well as in the 4th quarter selloff.
- Our RCI Tactical ETF Strategies gained ground against the benchmarks as we limited downside more than our benchmark in the 4th quarter.

J2 Risk Managed RS Leaders

We achieved our quarterly results by increasing our cash position in September and October. By mid-October, we were close to 30% cash. On average, we were capturing 60% of the downside daily moves, as we were holding a higher beta portfolio than the benchmark. It was key for us to raise cash, as the losses would have been closer to -20% if we hadn't.

Current positioning

We have reduced our weightings in technology, consumer discretionary, and industrials—the winners of this bull market cycle. We now have significant under-weights in all sectors compared to the benchmark.

Sector	RS Leaders Currently	Russell Midcap Growth Benchmark	Plus/minus benchmark
Technology	14.1%	31.3%	**-17.3%**
Industrials	12.4%	15.7%	**-3.3%**
Consumer Discretionary	11.7%	16.6%	**-4.9%**
Health Care	5.4%	14.6%	**-9.3%**
Financials	4.4%	6.6%	**-2.2%**
Basic Materials	1.6%	3.7%	**-2.1%**
Consumer Staples	0.0%	3.3%	**-3.3%**
Real Estate	0.0%	2.2%	**-2.2%**
Energy	3.6%	1.6%	**2.0%**
Telecommunications	0.0%	4.1%	**-4.1%**
Utilities	0.0%	0.0%	**0.0%**
Cash and/or Derivatives	**47.1%**	**0.2%**	**46.9%**

We have been using this selloff to trade out of riskier names and trade up for quality. We believe we now have a core of market leadership names. On most names, we own a half position and are willing to move to a full position either lower or when our indicator signals less risk. We also are maintaining a wish list of about 15 names we would love to own at lower prices. In short, we have plenty of firepower to buy.

RS Leaders selected top holdings

Description	Symbol	Sector	Industry	Weight
USD Cash	**CASH**	**Cash**	**Cash**	**38.5%**
Dollar Tree	DLTR	Consumer Discr.	Retail	3.5%
Graco Ind.	GGG	Industrials	Manufacturing	2.6%
Progressive Insurance	PGR	Financial	Insurance	2.5%
Nexstar Broadcasting	NXST	Telecom	Broadcasting	2.4%
Zebra Technologies	ZBRA	Industrials	Bus. Svcs	2.1%
Palo Alto Networks	PANW	Technology	CyberSec	2%
Fleetcor	FLT	Financial	Financial Tech	2%
Cummins	CMI	Industrials	Capital Goods	1.8%
Total System Svcs	TSS	Financial	Financial Tech	1.8%
Carrizo Oil and Gas	CRZO	Energy	Oil Svcs	1.7%
Old Dominion Freight Line	ODFL	Industrials	Transports	1.7%
Electronic Arts	EA	Technology	Software	1.6%
			Total:	**74%**

J2 RCI Tactical Strategies (Aggressive, Growth, Moderate)

Our Tactical RCI Tactical strategies all beat their benchmarks for the 4th quarter and year-to-date period. Our cash position and timing into long-term treasuries (TLT) contributed to the outperformance.

During the summer, consensus opinion was that the 30-year bond bull market was over. We believed that this was not the case. With 10-year yields approaching 3.2%, we took a position in TLT—a contrarian call that turned out to be correct. The high in yields was reached in late October, and since that time yields have backed down substantially. We continue to feel, as we have for years, that yields have a ceiling and that the path remains for low interest rates for some time. Should the market continue to experience turbulence, we feel that long-term treasuries will continue to offer a low-risk hedge to falling equity prices.

Also, during the quarter, we sold our position in a bank loan ETF. We did this prior to the recognition of potential issues in the leveraged loan market. The technicals of leveraged loans and corporate bonds were telling us that something wasn't right.

Current positioning

	Equity	Alt/Currency	Bonds	Cash	TOTAL
RCI Tactical Aggressive	52%	15%	15%	**18%**	100%
RCI Tactical Growth	50%	0%	20%	**30%**	100%
RCI Tactical Moderate	37%	0%	25%	**38%**	100%

We are currently positioned defensively, holding more than usual cash. As noted in my technical outlook section, we believe the current environment has higher risk than reward. We are awaiting a new strong buy signal as our cue to add more risk. The trend remains down for now.

—John Benedict
CIO and Portfolio Manager for J2 Strategies

For Investment Advisor Use Only. Not for Public Disclosure.

Disclosures

Orion Advisor Services provides index returns. Blended indexes are rebalanced daily and are quoted as gross or total return. The US dollar is the currency used to express performance. J2 Strategy returns are presented as asset-weighted, time-weighted net of third-party management fees and include the reinvestment of all income after all trading fees and all expenses charged by the underlying funds and investment vehicles. Net-of-performance was calculated using an annual maximum third-party model-based fee of 0.50%. Model fees are deducted quarterly at a rate of 0.125%. Please see disclosure presentations for full disclosures.

Investment advisory services offered through J2 Capital Management, an SEC-registered investment advisor.

J2 Capital Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with those standards. J2 Capital Management has been independently verified for the period July 1, 2008, through December 31, 2018 The verification report is available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS. Verification does not ensure the accuracy of any specific composite presentation.

Fees: Strategy returns presented in this quarterly/year-end review are composited gross and net of our maximum model-based 0.50% bps fee. For full disclosure of fees, please see disclosure presentations. The US dollar is the currency used to express performance.

J2 Capital Management RIA clients should review their investment advisory contracts for full fee disclosures, which may be different from the fees outlined here and in our disclosures.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST. The Dow Jones Industrial Average, S&P Indexes, MSCI Indexes, Barclays U.S. Aggregate Benchmark, Barclays Municipal Bond Benchmark, Russell Indexes, and New York Stock Exchange Composite (NYSE) are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. For further information, please visit the index issuer's website.

J2 Capital Management's investment strategies are appropriate for investors with a long-term time horizon only. Contact J2 Capital Management for a discussion of the risks when evaluating model portfolio results or if you have other questions concerning the calculation of our investment returns. Investing involves certain risks. Please discuss with a qualified tax or investment/financial professional before investing. Models and strategies are for informational purposes only. J2 Capital Management is not responsible for individuals implementing models discussed on this site. For information on how to invest in one of our models, please call us at 248-641-4444. Each model or strategy has a different risk profile. Some clients may own one or several of our strategies.

J2 Capital Management is an SEC-registered investment advisor. We offer investment advisory and supervisory services to clients (principally individuals, professionals, corporations, university professors, and qualified retirement plans) by the investment objectives stated by the client. In providing these services, J2 Capital Management uses its discretion in the purchase and sale of investment securities on behalf of the client ~~by the~~ stated objectives. J2 Capital Management may invest the client's assets in a range of securities, including exchange-listed and over-the-counter equities, mutual fund shares, corporate and government debt securities, commercial paper, and certificates of deposit; and it may employ trading strategies including long- and short-term trading, short sales, margin transactions, and option writing. The client will pay transaction fees on ETFs and stocks in addition to J2 Capital Management's annual management fee. The average transaction cost for an ETF or stock through our custodian, TD

John Benedict

Portfolio Manager for J2 Strategies
johnb@j2cmonline.com
1-888-888-0430

www.j2cmonline.com

Ameritrade, is roughly between $6.99 and $9.99 per trade unless we hold over 30 days, which in most but not all cases we do, or unless held in an asset-based pricing account. Please see our ADV, Part II, for more information.

Information presented is for educational purposes only. Nothing on this website should be meant as investment, legal, or tax advice, or any advice of any manner. Please review our Investment Disclosures when reviewing any of J2 Capital Management's investment strategies listed on the Strategies Offered page or when visiting any of our other properties (Twitter, Facebook, LinkedIn).

The RCI Indicator is a proprietary index built and maintained by John Benedict. It is a hypothetical, back-tested strategy. Money cannot be directly invested in the RCI Indicator. The Indicator is used as a tool only to gauge supply and demand in the S&P 500 Index and give guidance on whether to increase or decrease risk-based assets such as equities. Past performance is not indicative of potential future results.

WARRANTIES AND DISCLAIMERS

There are no warranties implied.

J2 Capital Management is a registered investment advisor (RIA) located in Troy, Michigan. J2 Capital Management may transact business only in those states in which it is registered or qualifies for an exemption or exclusion from registration requirements. J2 Capital Management's website is limited to the dissemination of general information about its advisory services, as well as access to additional investment-related information, publications, and links. Accordingly, the publication of J2 Capital Management's website on the Internet should not be construed by any consumer or prospective client as J2 Capital Management's solicitation to effect or attempt to effect transactions in securities, or as the rendering of personalized investment advice for compensation, over the Internet. Any subsequent direct communication by J2 Capital Management with a prospective client shall be conducted by a representative that is either registered or that qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information about the registration status of J2 Capital Management, please contact the state securities regulators for those states in which J2 Capital Management maintains a registration filing. A copy of J2 Capital Management's current written disclosure statement discussing J2 Capital Management's business operations, services, and fees is available at the SEC's investment adviser public information website (www.adviserinfo.sec.gov) or from J2 Capital Management upon written request. J2 Capital Management does not make any representations or warranties as to the accuracy, timeliness, suitability, completeness, or relevance of any information prepared by any unaffiliated third party, whether linked to J2 Capital Management's website or incorporated herein, and takes no responsibility therefor All such information is provided solely for convenience purposes, and all users thereof should be guided accordingly.

The information contained herein has been compiled from sources deemed reliable, and it is accurate to the best of our knowledge and belief. However, J2 Capital Management cannot guarantee its accuracy, completeness, or validity, and cannot be held liable for any errors or omissions. Changes are periodically made to this website and may be made at any time.

All information contained herein should be independently verified and confirmed. J2 Capital Management does not accept any liability for any loss or damage whatsoever caused by reliance upon such information.

Readers are advised that the material contained herein should be used solely for informational purposes.