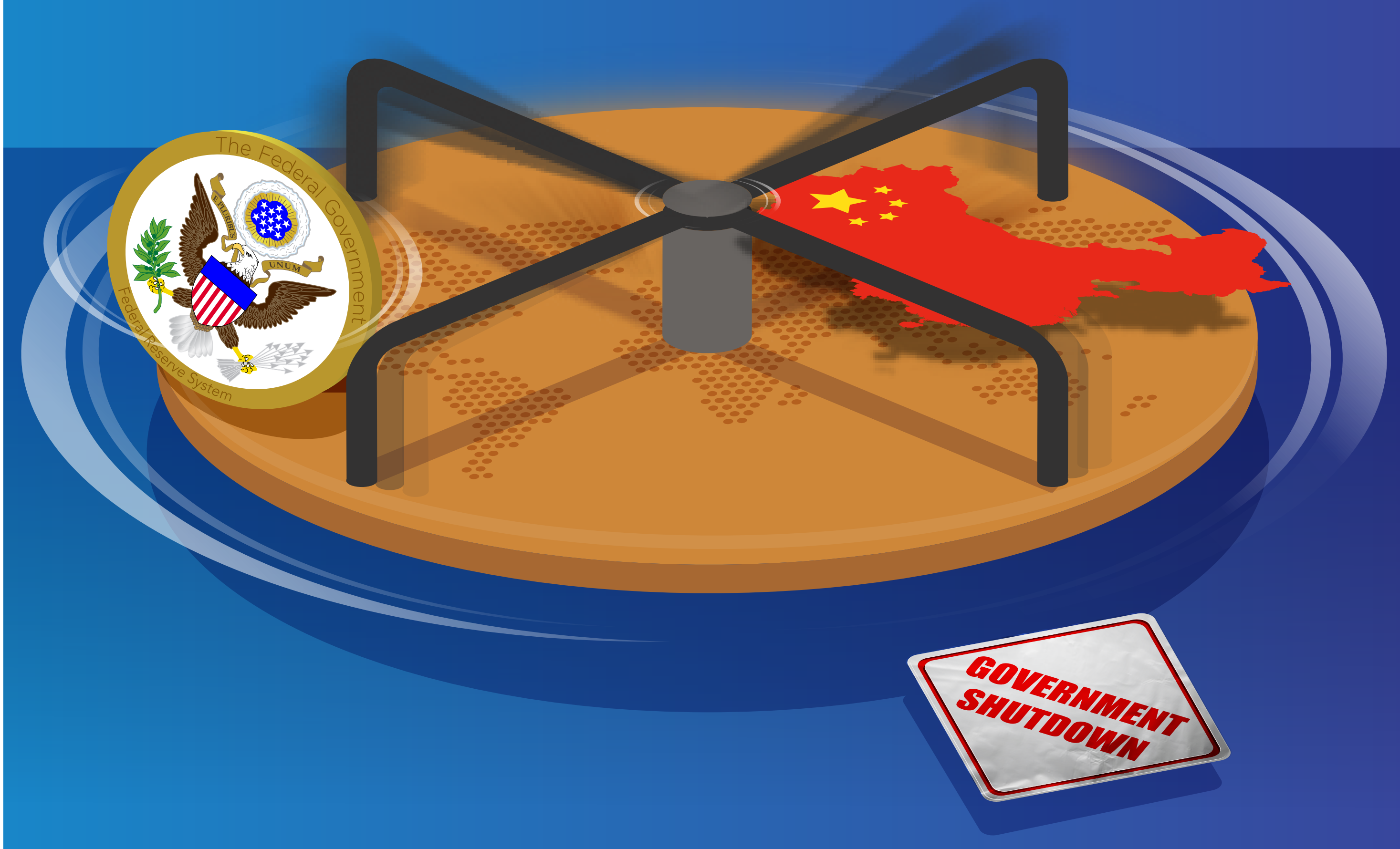
Q1

2019



QUARTERLY REVIEW

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Q1 MARKET NOTES

The first quarter opened with global stock markets rallying. U.S. equities posted the strongest January returns in 30 years, as the S&P 500 climbed 7.9%. This was a continuation of the upturn that began just after Christmas when U.S. Federal Reserve Chairman Powell indicated that the Fed was unlikely to raise rates much if at all in 2019, a reversal from previous stated policy.

The positive trend held through the quarter, with the S&P 500 up 13%, getting back most of the losses from the end of 2018, and posting the best returns since 2009. European and Asian markets were positive as well for the period, with MSCI Europe climbing 11%. Hong Kong's Hang Seng Index was a top performer as Chinese stocks continued to recover from a bruising 2018, up 12.58%.

In equities, growth topped value in the period, up 14.95% compared to 12.19%. Small cap, as represented by the Russell 2000, beat large cap climbing 14.58%. In fixed income, high-yield bonds led the way, recovering from a 4Q bloodbath to return 7.5%, followed by emerging market bonds, up 6.79%. Mortgages were up 2.17% and REITs just under 17%.

DATA MIXED IN THE PERIOD

As stocks rose, data in the U.S. remained mixed. 4Q GDP numbers came in at 2.2%, below the 3%+ target, but not bad given the impact of the government shutdown during the quarter and the uncertainty over US / China trade negotiations. For the year, GDP was up 2.9%, well ahead of the 10-year average of 2.3%. The January jobs report showed a huge 300,000 increase in employment, but that was quickly undercut in February when just 20,000 were created, below the predicted 180,000.

Long-dated Treasuries were up as rates declined. Meanwhile, after falling to start the year, the U.S. dollar rallied ending the quarter slightly higher against a basket of foreign currencies in spite of an effort by the Trump Administration to talk it down. This in turn dampened an expected improvement in emerging market (EM) returns.

Central banks around the world aggressively reversed course in the quarter in favor of more supportive interest rate policies, reducing the possibility that higher rates will trigger a recession. Globally, the World Bank now expects the $80 trillion + global economy to expand at a 2.9% rate in 2019, with emerging market growth for the year pegged at 4.2%. At home, the Atlanta Federal Reserve's GDPNow Tracker estimates first-quarter growth of 1.7%, up from just 0.2% in mid-March, but down from around 3% at the end of 2018.

HURRY UP AND WAIT

There was a lot of "hurry up and wait" in 1Q along with mixed messages from the data. Trade and Brexit made regular appearances in the headlines and drove news cycles, but struggled to reach a resolution. Talks with China proceeded in fits and starts, punctuated by not always helpful Presidential tweets. Both parties seemed to want to find agreement, while continuing to haggle over the details.

Some data was hopeful – consumer spending, for example, and housing starts, up 18.6% in January – some was not – German industrial production comes to mind. China continued to stimulate its economy through both fiscal and monetary policy and the impact of that started to work its way through the economy as evidenced by improved credit conditions, a recovery in housing prices, and, at month's end, a significant uptick in the Purchasing Manager's Index (PMI). Expectations for 2019 growth in China were marked down to the 6-6.5% range, still robust by global standards.

In 2018, S&P 500 earnings were up around 20%, but the market fell a little over 4%. In 1Q 2019, earnings growth slowed but the market climbed. Over longer periods of time, market results tend to track earnings, but expectations and valuations matter, too. Going into 2Q expectations for earnings are generally muted, and valuations appear reasonable, with the S&P 500 trading at around 17x.

At the same time, strong job growth continued to put money in the pockets of consumers, the major driver of economic growth, and global central banks have demonstrated their willingness to be supportive. Inflation remained under control – the most recent reading of the price deflator for personal consumption expenditures (PCE) came in at 1.8%, below the Fed's 2.0% target – supporting Chairman Powell's decision to stand pat on rates.

In this environment, we continue to look for opportunities and to reposition our portfolios accordingly. Most recently, we have been pulling back a little on foreign stocks and moving up in shifting some of our small cap allocations toward mid cap. We're maintaining some exposure to emerging markets, with an emphasis on China, where we see the stimulus now in place can have a positive impact in the second half of the year. In the U.S., we believe GDP growth is bound to slow as the impact of the tax stimulus fades, but we don't see a recession on the horizon.

WILL RETAIL INVESTORS RETURN?

The current bull market turned 10 years old on March 9, making it one of the longest on record. Over that period, the S&P 500 has more than quadrupled, the Dow is up almost 300% and the Nasdaq has climbed by nearly 500%. The 10-year bull market came within a fraction of ending last December, when the S&P declined by just under 20% before rallying. The Nasdaq did in fact enter bear market territory.

But age alone doesn't mean the bull will end and the newly more accommodative Federal Reserve policy provides some support for further growth. Retail investors may have a say in this as well. Based on an analysis of fund flow data, a substantial number of retail investors bailed on the market during the 4Q downturn. That money has been sitting on the sidelines, and those investors have missed a substantial rally. At some point, that cash may return, potentially providing the fuel for another leg up. In fact, we're already starting to see this. In mid-March, mutual funds and ETFs experienced $25 billion in positive flows, the largest weekly inflow in a year.

In our view, 1Q 2019 likely represents the bottoming out of both GDP and earnings growth. Looking ahead, we expect GDP to continue to expand at a modest pace, supporting earnings growth in the high single digits.

A WORD ON THE YIELD CURVE

The yield curve inverted during the quarter as the yield on three-month Treasury bills exceeded that on 10-year Treasury bonds. This has often – but not always – been predictive of the start of a recession anywhere from 12-24 months out. Historically the curve inverted as the Fed raised rates at the short end and longer-term rates fell. This time around the Fed is already on hold with speculation that a rate cut may be coming later this year, creating a different dynamic.

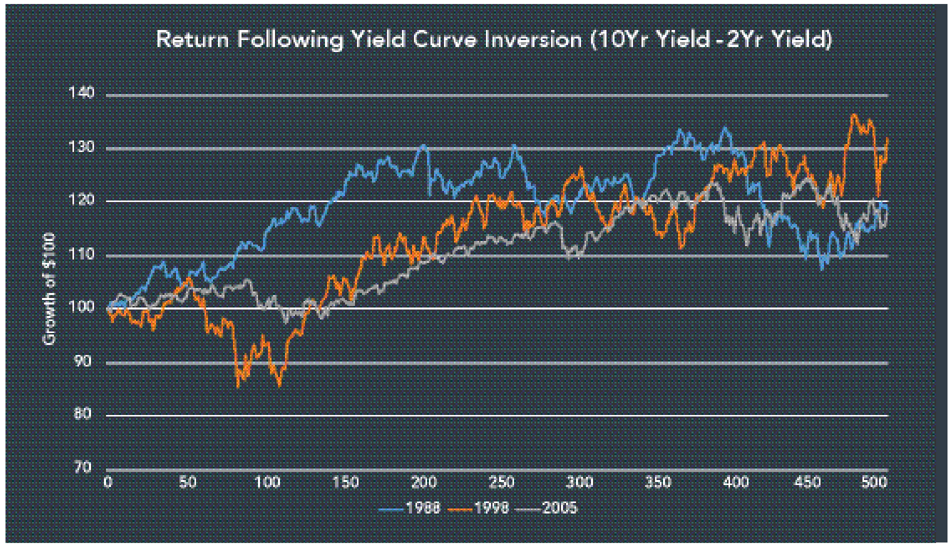

CHART 1 – Index Post Inversion Performance of S&P 500 over available time Periods

What's more, an inverted yield curve is not always bad for stocks. To cite one example: the S&P 500 was up 230% from 1994 to the end of the decade in the face of a yield curve inversion. So there are often other factors at work that can impact market performance.

WHAT THE TREASURY RALLY MEANS

Treasuries have risen sharply since late last year, with the yield on the 10-year falling from above 3.0% in November to around 2.4% at the close of 1Q. In our view there were several factors driving the rally in Treasuries during the period: the global slowdown, the breaching of some important technical levels, and, most significantly, hedging on the part of mortgage-backed securities investors.

How these factors are weighted is important; if growth is the major issue it signals trouble ahead for the global economy. But while the slowdown has played a part, we think the other factors are more important.

It's rare to see stocks and bonds rally together as they did in the first quarter, but given the stable economy and the Fed's dovish position on rates, it makes sense. That's one more reason we're not really subscribers to the "late cycle" theory as descriptive of the current state of the U.S. economy. While the expansion has undeniably been a lengthy one, we're not yet seeing the kind of economic signals that would indicate it's coming to an end.

Our Strategies

STAGE: GAIN

Seek capital gains through active asset allocation

active asset allocation

Features:

- Global diversification
- Tilts between international and domestic
- Designed to deliver a Beta range between 0.80 and 1.20 to global equity markets

Sunny Expectation: Opportunistic weightings among the S&P and global markets

Storm expectations: Will seek less volatile holdings for perceived long-term market dislocations, while shorter shocks may either be weathered with current positioning or may be repositioned to take advantage of the "normalization".

Stocks bounced back during the quarter, led by domestic large cap, with the S&P 500 rising more than 13%. Most global indices were up, too. International developed, emerging markets, and domestic small caps all saw double-digit returns (the Russell 2000 was up more than 14%; the S&P 600 climbed 11%+).

Our best performers were large-cap growth and small caps (due to having more Russell 2000 style exposure). The worst performers were internationals, led by Japan.

What drove the rally? It was jumpstarted in December by the Federal Reserve's decision to put rate hikes on hold. There was growing optimism that the slowdown seen in 4Q data was easing. Progress on the China trade talks helped. More to the point, it was just hard to find a reason to keep selling stocks following December's close brush with a bear market.

In the fixed income portfolios, we continued to overweight credit in the form of high-yield bonds and preferred stocks. Credit markets, like equities, bounced back from the 4Q rout, and liquidity returned to the markets. Long-dated bonds were generally the top performers for the period. For our part, we were modestly overweight in shorter-duration securities, which was a negative for performance.

active asset allocation

GLOBAL

The ability to target more opportunities in various segments of equity markets

FLEXIBLE

The ability to make portfolio adjustments in order to adapt to market changes

BALANCED

We screen opportunities through a balanced set of quantitative and qualitative perspectives

GLOBAL MARKET INDICATORS

Market indicators are a subset of technical indicators used to predict the direction of major financial indexes or groups of securities. We choose these popular Global Market Indicators to show trends and market breadth of Q1 2019 and 10-Year Annalized.

		Q1 2019	10 Year Annualized
GROWTH	CPI	**1.90%**	**1.60%**
	World GDP	**3.64%**	**3.37%**
	US GDP	**3.00%**	**1.77%**
	10 Yr Yield	**2.41%**	**2.48%**
	VIX	**13.71**	**17.99%**
RETURNS	S&P	**13.65%**	**15.92%**
	DJIA	**11.81%**	**15.97%**
	Russell 2000	**14.58%**	**15.36%**
	ACWI	**12.33%**	**12.58%**
	EAFE	**10.13%**	**9.47%**
	Emerging Markets	**9.95%**	**9.31%**
	Gold	**0.77%**	**3.47%**
	Oil	**32.44%**	**1.93%**

Inflation Data as of	3/31/19
Global GDP Data as of	6/29/18
US GDP Data as of	12/31/18
All Other Data as of	3/29/19

10 Yr Yield is yield as of most recent quarter end VIX Data is index level as of most recent quarter end 10 Year data points for CPI, World GDP, US GDP, 10 Yr Yield, and VIX are averages of last 10 years of data

Source: Bloomberg and World Bank

STAGE: PROTECT

Seek capital preservation during catastrophic markets

risk assist®

Objectives:

- Globally diversified
- Defaults to invested rather than de-risked
- De-risking begins to take effect as drawdown approaches 8%

Sunny Expectations:
Seeks the expectations of our Gain products with defined downside tolerance and potential for drag exists.

Storm Expectations:
Will react similarly to our Gain products for the first 8-10% of drawdown in global equity markets. Thereafter, de-risking actions are taken to help limit investor exposure to additional declines in global equity markets. These strategies use Horizon's volatility forecasting expertise to help guide de-risking speed and magnitude. Seeks to return to fully invested status as market conditions allow.

Following the huge drawdown in 4Q, Risk Assist models broadly entered 1Q with a defensive tilt, with moderate allocations to short-term Treasuries signaled by the Risk Assist algorithm. As global equity markets rallied and volatility fell, the PROTECT models systematically reinvested these conservative allocations back into global markets. (A reminder: because the Risk Assist algorithm is not a timing strategy, it does not make all-in or all-out decisions.)

Both the reduction in relative volatility from 4Q and the rebound in returns contributed to the speed of reinvesting activities within the Risk Assist models. Risk Assist reinvesting activities occurred throughout the quarter in increments, just like the de-risking activities from 4Q.

The PROTECT portfolios were allocated in a similar manner to the GAIN portfolios during 1Q. The best equity performers were large cap growth and small caps (due to having more Russell 2000 style exposure). The worst performers were internationals, led by Japan.

Risk Assist models containing fixed income exposure benefited from an overweight to credit (high yields and preferreds) in 1Q, while the shorter duration profile detracted from performance.

STAGE: SPEND

Seek longevity for retirement income

REAL SPEND®

Features:
- Globally diversified
- Embedded liquidity feature
- Embedded risk mitigation feature

Sunny Expectations: Regular distributions, adjusted annually for inflation.

Storm Expectations: More conservative allocation due to bucket strategy, but still has global equity exposure to manage longevity and inflation risks. Can experience drawdown, but dual risk management features of bucket implementation and Protect feature guard against catastrophic risk.

The SPEND portfolios were slightly more exposed to global equity markets than usual. This was due to an allocation of only 11 quarters worth of spend to the spending reserve for all RS models entering 1Q. This was a function of our rebalancing process following 4Q performance, and this tilt to equities helped the models in the strong global equity rebound.

Due to performance during 1Q, Real Spend portfolios were rebalanced back to their maximum spending reserve levels of 12 quarters worth of spending, following the end of the quarter. Real Spend's allocation toward domestic large-cap growth, smaller-cap stocks, and defensive large-cap stocks contributed the most to return for the quarter. Its exposure to international stocks contributed the least in the period.

We saw Risk Assist activity in the Real Spend portfolios during 4Q to protect against catastrophic loss in the SPEND portfolios, but 1Q saw most Real Spend models completely reinvested.

Within fixed income holdings, higher-yielding securities like preferred stocks and high yield bonds did the best while shorter-duration U.S. Treasuries in the spending reserve contributed the least for the quarter. Inflation expectations remained low during 1Q, with headline inflation trailing the core numbers due to falling energy prices. As energy prices have since recovered, we expect this to put upward pressure on headline inflation during 2Q.

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