Sheaff Brock Outlook 2019

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As 2018 comes to an end, some folks have asked for our opinion (best guess really) of 2019 and where investors should look for return. The most successful investors in history all say it is impossible to predict asset price moves in the short-term, but here is our stab at it.

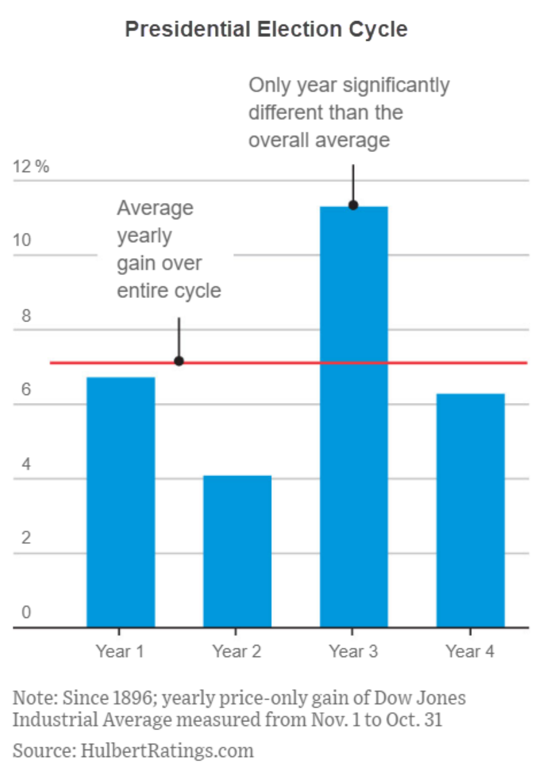
U.S. Stocks

According to S&P the average P/E ratio since 1988 based on operating earnings for the S&P 500 has been 17.4. Using this average P/E and applying it to the most recent estimate for 2019 would give a price target for the index of 3077. Our belief is that U.S. stocks should have a better-than-average 2019 with the S&P 500 rising to about 3100, a 17% gain.

2019 S&P 500 Price Target				
Using this P/E ratio	S&P 500 Operating Earnings Estimate for 2019*	Gives this S&P 500 Price Target	Vs. Today's S&P 500	Percentage Change
19	$176.86	3360	2632	28%
18	$176.86	3183	2632	21%
17	$176.86	3007	2632	14%
15	$176.86	2653	2632	1%

** Source: Yardeni Research 11/22/18*

This guesstimate would also follow the Presidential Election Cycle. The second year of a President's term (2018) has traditionally been the worst for the stock market. The third year, 2019 in this case, has been the strongest, as you can see in the below chart.



An event that could hurt equity prices is a recession. Two telltale signs that precede most recessions are falling consumer confidence and an inverted yield curve. Neither of those are present today. The Cleveland Federal

Reserve Bank publishes a recession probability every month, and the recession probability today is lower than it was two months ago. We feel a recession is probably not in the cards for 2019.
https://www.clevelandfed.org/our-research/indicators-and-data/yield-curve-and-gdp-growth.aspx

The rising prices may be accompanied by more volatility. Many strategists feel the Federal Reserve's tightening and balance sheet reduction causes volatility in both bonds and stocks. The VIX index is a measurement of expected volatility. Since 1998, the VIX has averaged 20.25. For much of the past few years until 2018, the VIX was very low, mostly between 10 and 15. We would expect volatility to be more normal, or higher than normal, as the Fed continues the process.

U.S. Bonds

With the Fed still pushing rates higher, high quality bonds may have a tough time earning positive returns. As measured by the Barclays Aggregate Bond Index (AGG), high quality bonds had the worst year in over a twenty-five years in 2018. If the Fed continues increasing rates, bonds may continue to struggle, at least through the first half of 2019.

There may be opportunity in preferred stocks. Below is an eleven-year total return comparison from Morningstar of AGG with the iShares U.S. Preferred Stock ETF (PFF). As you can see from the green highlights PFF has outperformed AGG most of the time.

History	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD
AGG (NAV)	5.88	5.14	6.30	7.58	4.04	-2.15	6.04	0.48	2.56	3.53	-2.41
PFF (NAV)	-23.24	39.27	13.96	-2.20	18.25	-0.59	13.45	4.62	1.26	8.33	-1.12

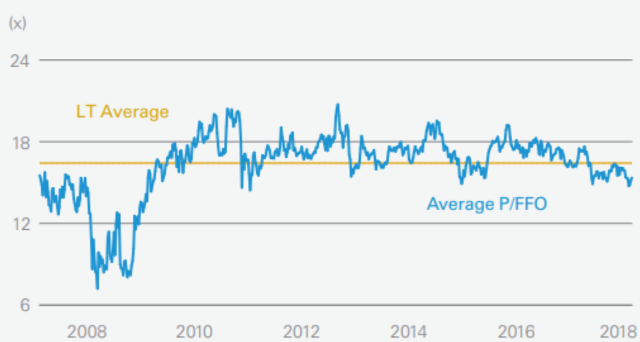
Source: Morningstar as of 11-23-18

The only years of severe underperformance were those surrounding global financial crisis events; the U.S. mortgage crisis in 2008 and the European crisis in 2011. Due to high regulation and the willingness of central banks to mitigate the effects of financial stress, we feel the likelihood of another large-scale crisis is low in the near-term. For these reasons our belief is a well-managed portfolio of preferreds stocks offer a good combination of mid-single-digit yield and reasonable stability of principal for the foreseeable future.

Real Estate Investment Trusts – REITs

It is our belief that REIT prices are low, and REITs can offer good potential returns. As you can see in the chart extracted from a Lazard US Real Estate Indicators Report the average price to funds-from-operations ratio (a REITs equivalent to P/E ratio) P/FFO is below average. In the past, dips like this have offered good buying opportunities. http://www.lazardnet.com/docs/sp0/4915/Lazard_USRealEstateIndicatorsReport_201403.pdf

Price-to-Funds from Operations (P/FFO)



As of 31 October 2018

The REIT market as represented is a basket of 53 large and investable REITs across all sectors, as identified and selected by SNL Financial. The basket also includes companies that over time have gone private or merged in order to avoid survivor bias in the historical data.

Source: SNL Financial.

REIT P/FFO valuations are now a full multiple turn below the long-term average of 16.5x P/FFO. With the third quarter 2018 earnings season just concluding, the results can be viewed as good for many of sectors (multifamily, office, industrials, retail), but with only a few pockets of weakening same-store growth heading into 2019 (health care). Overall, the vast majority of REITs have either met or beat analyst estimates, but few companies have issued 2019 expectations. The results continue to demonstrate that REIT earnings are very stable, and are growing in the mid-single digits annually. In addition, REIT earnings are more "local economy dependent" rather than "global economy dependent" given REITs' lower earnings volatility compared to other sectors. With dividend payout ratios still low, this earnings growth should translate into comparable dividend growth. Through September, 78 US real estate companies have announced dividend increases.[6]

Note: P/FFO is the standard REIT equivalent of the price-to-earnings (P/E) ratio.

The S&P 500 Index is a market capitalization-weighted index comprised of the 500 stocks with the largest market capitalizations trading in the United States. These are not managed portfolios and do not reflect the deduction of fees or expenses; returns include dividends. The Barclays US Aggregate Bond Index is a broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market in the United States, including Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and CMBS (agency and non-agency).

There is the chance that market conditions or portfolio performance may deteriorate in the future, and clients may experience real capital losses in their managed accounts. Portfolios are compared to the performance of various indices although the portfolio, which contains much fewer positions, may not reflect the securities making up these indices. None of the indices may be an appropriate comparison index as our managed accounts may own companies not represented in the benchmarks. SBIA provides this Newsletter for general informational and educational purposes, and where appropriate, to assist in explaining the portfolios and composites. It is not investment advice for any person. Information is obtained from sources SBIA believes are reliable, however, SBIA does not audit, verify, or guarantee the accuracy or completeness of any material contained therein. The statements and opinions reflect the judgment of the firm, and along with the information from third-party sources and calculations, are made on the date hereof and are subject to change without notice. SBIA does not assume liability for any loss that may result from reliance by any person upon any material in this Newsletter. Clients or prospective clients are directed to SBIA’s Form ADV Part 2A and to one or SBIA's representatives for individualized information prior to deciding to participate in any portfolio or making any investment decision. SBIA does not provide tax advice. Clients are strongly urged to consult their tax advisors regarding any potential investment. **Past performance does not guarantee future results, there is always a possibility of loss.**