FOUNTAINHEAD INSIGHTS

Q1 2019

Wednesday, April 3, 2019

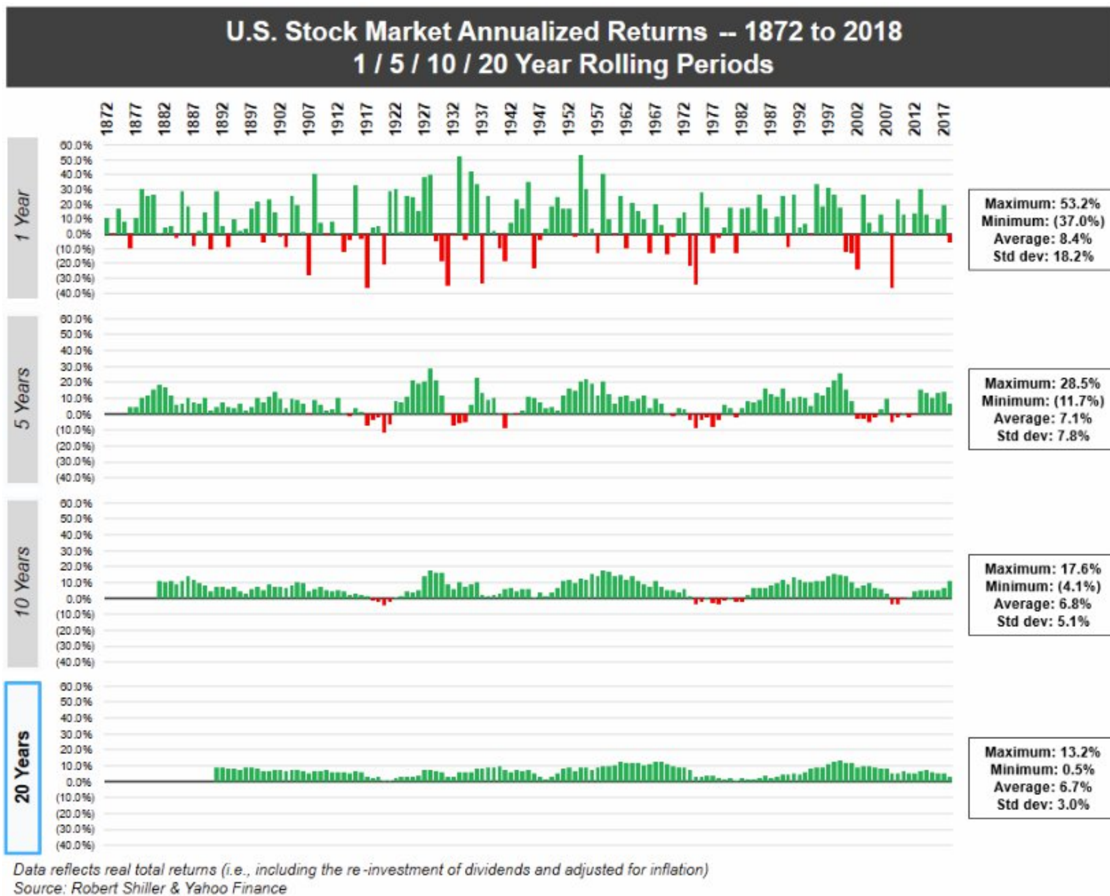
For the first time in history, infectious diseases kill fewer people than old age, famine kills fewer people than obesity, and violence kills fewer people than accidents[1]. Given current innovations, we will continue to see material benefits for humans in the decades to come. For example, autonomous vehicles can save 1 million lives a year from death due to car crash. We continue to make material inroads in disease control and prevention, lengthening and saving countless lives. As opposed to the Middle Ages, where large sums were raised for armies to take over land and sow destruction, the world is now raising large sums of money to innovate, creating value in the process. As long as the world continues to innovate, especially at the low global interest rates we are now experiencing, there will be long-term growth. Given the fast pace of innovation, there is no reason to believe that it will not continue.

Now it's true that our minds, which have an element of risk manager to them, go immediately to all that can go wrong. We cannot provide the certainty or promise that something will *not* go wrong but probability is in our favor. For instance, global warming has spawned vast industries surrounding green technology creating further opportunity and wealth while assisting in creating a cleaner environment - though there is still much work to do. A historical example overcome is the threat of human populations outstripping food resulting in mass starvation and ensuing war which was more than handled by innovations within agriculture. Thankfully, we cannot come up with a historical example threatening human kind that we did not overcome.

Much of the assets we manage are long-term in nature. They are your retirement savings. While we are constantly analyzing new investment strategies, managers and opportunities, our high-level exposures will not move too quickly. We believe it is short-sighted to attempt to time a short-term market move given the pile of evidence illustrating the negative returns associated, especially in view of a longer-term investment horizon. While we cannot provide forward-looking performance (how comforting would that be?), we can show how the markets have done historically over longer time periods as compared to shorter ones. While past performance is never a guarantee of future results, history is relevant here as there is no reason to believe that the world is not on a relatively similar general trajectory.

[1] This is a quote from one of the Yual Harrera books.

FOUNTAINHEAD INSIGHTS



As can be seen, the longer the time frame the less risk, at least historically, of losses on an inflation-adjusted basis[2]. Averaging into the market (i.e., investing continuously) for long-term investment objectives is especially good.

Now we also have accounts that have been set up for shorter-term events and we obviously care very much about short-term performance as well. The graphic above illustrates the need for a glide path towards retirement. Shorter periods have documented higher risk of providing negative returns in equity markets and it is the reason to adjust one's portfolio exposure conservatively as one approaches a period when an investment needs to be exited.

---

[2] Chart was created and brought to my attention by Visual Capitalist which provides compelling data- driven visuals that simply and clearly define concepts.

It is easy to lose sight of both goals and trajectory in today's fast-paced world, where there is more content more easily distributed than most of history combined. It is easy for this bombardment to cloud long-term views and thinking. However, it is our job to remain focused on your long-term objectives and therefore the world's long-term trajectory. Hopefully this helps in seeing our view.

Biases in favor of the US and shorter duration credit

Our general approach to investing on your behalf is to take a top-down approach in creating diversification of risks and returns in one's portfolio. Let's unpack that. A top-down approach means we start by viewing the high-level investing opportunities. Equities vs. Fixed Income exposure first. Then within equities, US, Developed Markets (e.g., Europe & Japan), and Emerging Markets (e.g., less- developed markets like China & India) and so forth. We continue on this path to actual strategy and manager selection. Diversification of risks and returns means we invest in multiple exposures on your behalf in order to increase the likelihood we'll have varied return streams as well as risk streams. Since we do not know with certainty (nor does anyone else to our knowledge) what investment will do best, we attempt to smooth out the experience. We do have biases though.

Compared to the investable equity universe, we have had and will continue to hold an over-exposure to the US markets. Hopefully this is not too much of a US love-fest, but we have the best checks and balances in government (regardless of your political leanings), best higher learning institutions, most developed, institutionalized markets, and a great environment for innovation. It is a reason we attract the best and brightest immigrants from around the world (note Google co-founder Sergey Brin as an example. He is a Russian immigrant who studied at Stanford). We are also well-positioned if the future is less rosy then we hope for. The US is geographically well-positioned, is amazingly well-resourced naturally, has one of the world's largest bread baskets (multiples larger than China's with a fraction of the people), and has by far the largest military presence in the world - our Navy is 7x larger than the world's navies combined! - we truly control global waterways.

We are also a bit shorter in duration in our fixed income holdings. One is typically paid a premium to take on more risk. Holding a bond that pays back principal in five years is inherently riskier than holding a bond from the same issuer who will pay back principal in two years. In today's environment, both are paying a similar coupon. So, we are slightly biased in favor of shorter duration as we believe it provides us more flexibility.

Concerns: A Scarier World Awash in Debt

- **Geopolitical climate**: Over the last century it seemed that the world had come to the conclusion that Communism and Fascism did not work; That the way forward was the American way: Liberalism and Capitalism. Country after country, though, seems to be re-examining that conclusion with strong men being elected too frequently (note South American and Eastern European countries). America itself is turning inward and away from the ideals of NATO post-World War II, where we basically agreed to keep peace in return for global commerce. We are concerned for the upheaval that may follow and its effects on world economies.

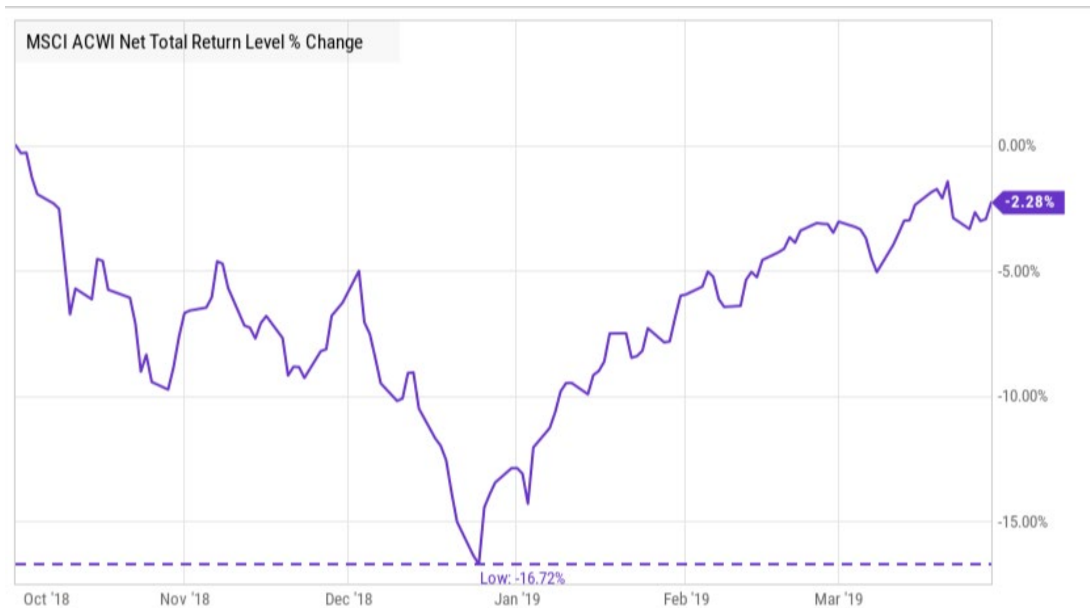
- **Artificial market support by governments**: While it is nice to have the government provide material support in downturns, does the extremely accommodative stance of the Fed over the last ten years materially hurt us at some point in the future?

- **Shorter-term volatility and risks**: How has and will trade wars affect growth? While interest rates are still relatively low, how much of an effect do they have on companies, and is that a warning sign on its own? Have companies squeezed out as much growth possible over the last few years, meaning the growth story going forward is compromised?

To be clear, there are and always will be concerns in the market and in the world. We explore them to obviously give ourselves the best chance to navigate them effectively. The world has historically not only effectively overcome concerns and seriously bad times in the past but, as the chart shows above, provided returns on an inflation-adjusted basis through those periods as well.

General Market Review: A Tale of Two Quarters

World markets rallied hard in the first quarter of 2019, rebounding from a difficult end for 2018. Both quarters ranked among the extremes in regards performance over the last decade. Why did this happen? We wish we could tell you which quarter was directionally correct, but we can tell you what we are watching.

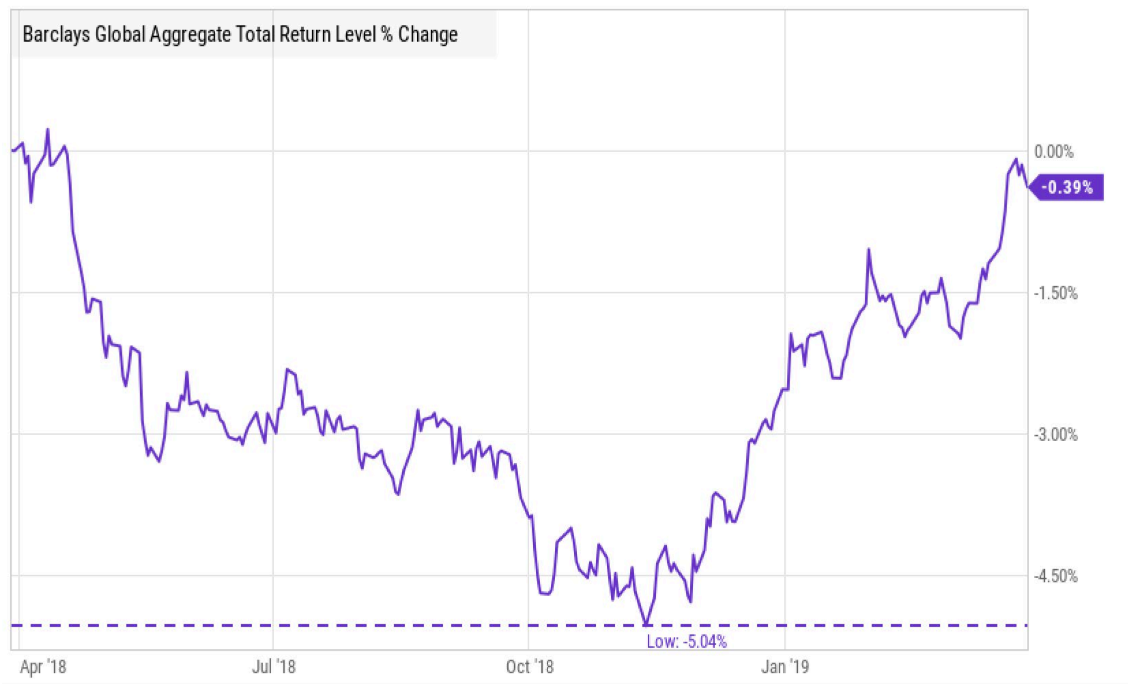


Fears of a slowdown in global growth exacerbated by US-China trade wars and a tightening of fed policy conspired to create a difficult market environment (stated lightly). In Q4 of 2018, market concerns became elevated as trade tensions heightened due

to a cross-border arrest and spying accusations[3]. Market concerns were exacerbated by a continued communicated policy of Fed tightening by Federal Reserve chief Jerome Powell[4].

The 2018 storyline partially reversed in 2019 with trade tensions relaxing and the Federal Reserve reversing their prior stance and strongly communicating that they would be accommodative as necessary to support the economy through any rough patches.

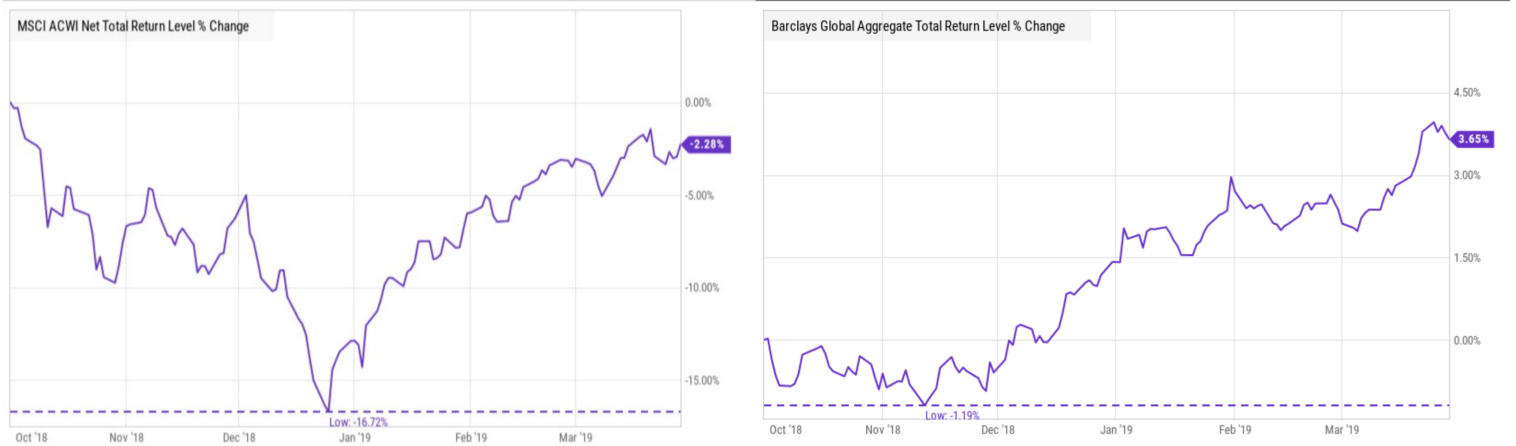
Below is a global fixed income index for the last year which illustrates the drop-in value (due to an increase in yields) through November 2018 prior to a rally that is still playing out. The initial drop in value was due to tightening by the US and expected tightening throughout the world. As the markets began to fall dramatically, bonds began rallying as the markets expected easing in monetary policy, which did eventually happen.



[3] Here (executive) and here (spy) are examples of articles from the time
[4] Tightening is where the Federal Reserve raises rates and/or sells securities into the marketplace, while easing is the opposite – they are essentially attempting to smooth out cycles by artificially adjusting monetary policy to allow more or less expensive capital.

FOUNTAINHEAD INSIGHTS

Which brings us to our final charts of the day.



The chart on the left reflects global equity performance over the last two quarters while the one on the right reflects global fixed income performance. As can be seen, global fixed income performance rallied into the equity market drop and then rallied with the equity market pop. This concerns some but part of the explanation is the relative monetary easing that took place in the beginning of Q1 2019. And part of the reason for easing is to compel borrowing and growth.

In closing, we continue to monitor markets closely and look for opportunity on your behalf.

The information contained in this report is informational and intended to provide background to clients of Fountainhead AM and Fountainhead Capital Management about our thinking concerning investing. Our opinions are only that, and we make no guarantee about future investment results or the impact of global and domestic events on investments. Nothing in this letter should be construed as investment advice; we provide advice on an individualized basis after understanding your own circumstances and needs. Indices shown are used to illustrate broad market movements related to the themes of this article and are not reflective of any actual portfolio advised by Fountainhead. Indices are unmanaged and it is not possible to invest directly in an index. Accordingly, index returns do not reflect the deduction of any trading costs or investment management fees.