EUBEL BRADY & SUTTMAN
ASSET MANAGEMENT

MARKET REPORT
FIRST QUARTER 2019

Key Takeaways

- Most asset classes were off to the races during the first quarter as they partially recovered from a difficult end to 2018.

- The economic expansion continued in the face of a myriad of obstacles.

- We do not believe cryptocurrencies such as Bitcoin have a place in your portfolio due to an inability to value them and the unregulated nature of the cryptocurrency space.

- Cryptocurrencies and their underlying technology (Blockchain) hold promise as tools to improve various transactions and processes…but it is early in this technology's development.

Total Return as of March 31, 2019						
			Annualized			
	QTD	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**
S&P 500	13.7%	13.7%	9.5%	13.5%	10.9%	15.9%
NASDAQ	16.8%	16.8%	10.7%	18.1%	14.4%	19.0%
Russell 3000						
Index	14.0%	14.0%	8.8%	13.5%	10.4%	16.0%
Value	11.9%	11.9%	5.3%	10.5%	7.6%	14.5%
Growth	16.2%	16.2%	12.1%	16.4%	13.1%	17.4%
Russell Mid Cap						
Index	16.5%	16.5%	6.5%	11.8%	8.8%	16.9%
Value	14.4%	14.4%	2.9%	9.5%	7.2%	16.4%
Growth	19.6%	19.6%	11.5%	15.1%	10.9%	17.6%
Russell 2000 (Small Cap)						
Index	14.6%	14.6%	2.1%	12.9%	7.1%	15.4%
Value	11.9%	11.9%	0.2%	10.9%	5.6%	14.1%
Growth	17.1%	17.1%	3.9%	14.9%	8.4%	16.5%

Overview

During the quarter, markets rebounded from a difficult fourth quarter of 2018 as a feared global economic downturn did not occur and U.S.-China trade relations seemingly moved in a better direction. Additionally, the U.S. Federal Reserve suggested it may not increase interest rates or decrease the amount of bonds on its balance sheet as significantly as some market participants previously expected. Market participants appeared to view these actions, as well as the accommodative actions of other global central banks, as a good thing for economies and markets.

At the same time, there are several indicators suggesting all may not be well in economies, markets, and asset valuations. Examples include:

- While the U.S. economy continues to grow, the pace of growth slowed. International growth was also more challenging as China's economy continued to slow and Europe experienced little growth.

- Certain foreign bonds still have negative yields, which is atypical.

- Yield curves of various types of bonds have incurred additional **flattening** (when yields of long-term bonds and short-term bonds are *similar*) or even **inverted** (when yields of long-term bonds are actually *less* than

- yields of short-term bonds). Long-term bonds typically yield more than short-term bonds, thus compensating an investor for risk associated with the longer holding period. However, when yield curves flatten or invert, the dynamic changes which can often make it more difficult for banks and other financial intermediaries to make money using their typical business model of taking short-term liabilities (like CDs, bank deposits and short-term bonds) and providing longer-term loans to their clients. Flat and inverted yield curves may also be a harbinger of more difficult times ahead, as they oftentimes occur before economic recessions.

- Great Britain's difficulty in creating an orderly transition out of the European Union.

- The large U.S. national debt and increasing deficits; we believe these issues will be more difficult to address as time goes on.

We were able to capitalize on a bit of market mayhem around year end, before markets moved higher during this quarter. With valuations less attractive and providing less margin-of-safety to protect against obstacles such as those mentioned above, we remain defensively positioned (in our view).

U.S. Equities

The S&P 500 returned 13.7% (including dividends) during the quarter. This was the best performing first quarter since 1998, the best performing quarter since 2009, and all sectors generated positive returns for the first time since 2014. Technology and industrials, two of the weakest performing sectors in the last quarter of 2018, snapped back and generated some of the strongest returns this quarter. Healthcare and financials trailed the most of all sectors, but still produced quarterly returns of 6.6% and 8.6%, respectively.

Statistically expensive stocks outperformed statistically cheap stocks, and small cap stocks edged out large cap stocks.

Fixed Income & Commodities

Corporate bonds' total returns, as measured by the BofAML 1-to-10 Year Index, increased 3.8% during the quarter. U.S. Treasuries and Agencies, as measured by a similar index, increased 1.5% for the quarter. The 10-Year Treasury bond's yield of 2.4% finished lower than the previous year end's yield of 2.7%.

Commodities, as measured by the Bloomberg Commodity Index, increased 6.3% during the quarter, reversing a portion of its 11.2% decline last year. West Texas Intermediate oil recovered a portion of its fourth quarter losses by rising 32% to $60.14 a barrel. This was its largest quarterly gain since 2009. A significant economic downturn did not manifest as some market participants feared late last year. Major oil suppliers also seem to be playing well together and keeping global oil supplies in check.

Lean hog futures raced up 33.4% during the quarter as a lethal pig disease known as African swine fever wiped out as much as 17% of China's pig herd. This may drive demand for U.S. lean hogs even in the face of 62% import tariffs that China imposed on American pork imports. Many U.S. pig farmers have recently struggled to make a profit…these higher prices should help.

Coffee and wheat suffered during the quarter. An excess supply of global coffee, driven by Brazil's near record coffee crop, has driven prices down to levels not seen in more than a decade and that are below the cost of production in most countries. Good growing conditions helped keep wheat supplies high, to the detriment of wheat prices.

Some Takeaways on Cryptocurrencies such as Bitcoin and its Underlying Technology Blockchain
We have been reading about and trying to get our heads around cryptocurrencies such as Bitcoin and their underlying technology Blockchain. We do not claim to be expert in these areas and are still evaluating them, but here is what we have learned so far:

- **Cryptocurrencies may provide value to some market participants**. For example, some people like the idea of them as an alternative to other types of currencies that can be more controlled and regulated by governments and their central banks. Others may like them because of some of their abilities to increase anonymity (it is probably no surprise to you that criminals have taken a liking to cryptocurrencies for the purpose of money laundering). And, while the volatility of cryptocurrencies tends to be much greater than that of most countries' currencies, we can see how they may provide value to citizens in countries experiencing hyperinflation. For example, think about Venezuela and how the potential for a cryptocurrency to maintain its value beats the sure loss of value from holding a country's currency with your purchasing power eroding by several percent *each day* due to hyperinflation.

- **However, it is very difficult to value cryptocurrencies**. Let's take the cryptocurrency the public is most familiar with: Bitcoin. Bitcoin is a digital coin that can theoretically be used to buy and sell things. We have difficulty valuing Bitcoin because we value assets primarily based on the estimated cash earnings that those financial assets generate over time. Bonds generate cash streams of coupon payments and principal repayments over time that we can value today. Stocks are ownership stakes in companies that generate cash earnings that we can estimate the value of today. The problem with Bitcoin is that it does not generate any cash over any time period (you could say it is not a productive asset in that respect), so we cannot value it based on cash. Additionally, we have not heard of alternative valuation methods for valuing cryptocurrencies that make sense to us. As Bitcoin prices raced up into the stratosphere and came crashing down, we have been believers that its price movements were primarily driven by unbridled speculation.

- **We believe there is a significant amount of mischief occurring in this new space.** For example, we recently learned of a study concluding that almost 95% of Bitcoin trading over a short period on 81 unregulated exchanges was not real! At least one other research effort has shown high levels of fraudulent trading as well. It's the Wild West!

The inability to value cryptocurrencies, coupled with the fraudulent aspects of this nascent area of the market, led us to conclude that this is not an area we currently want to invest on your behalf. That being said, we believe the technology underlying cryptocurrencies (Blockchain technology) has the potential to be useful for certain types of transactions; however, it is very early in its development and adoption. Various companies and industries are excitedly evaluating and experimenting with various flavors of Blockchain, but real world examples of successfully deploying this type of technology at scale are not abundant.