MRP CAPTIAL INVESTMENTS, LLC

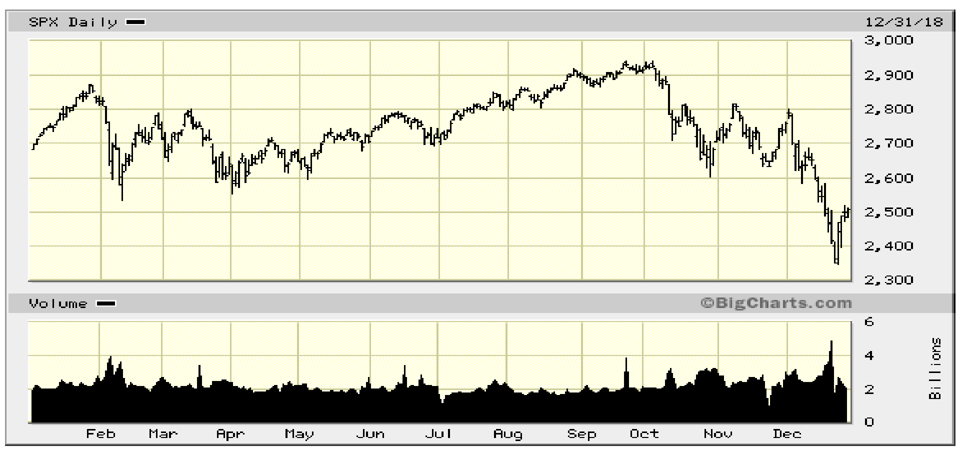
4th Quarter 2018 Client Newsletter

Capital Market Update

Inside this report:

The S&P 500 ended the 3rd quarter in good shape and usually the 4th quarter is pretty decent with a "Santa Claus" rally to end the year. However, this year Santa left us all a lump of coal! In fact, in December alone the price change on the S&P 500 was –9.18% and for the 4th quarter it was down 13.97%.

All in all, this terrible quarter ended up pulling the entire market down for the year. The price change on the S&P 500 for the year ended up being –6.24%



S&P 500 2018 Chart Supplied by BigCharts.com

Oddly enough, this collapse in equity prices coincided with surging earnings. And much like at the end of the 1st quarter, when the markets were weak but earnings were good, we have a market the is very attractively priced. In fact, the S&P 500 currently trades at 16.04 times 2019 earnings estimates. This is the cheapest the market has been in almost 7 years. Longer term this should set the table for solid gains going forward, but in the meantime we have to deal with all current troubles worrying the market; trade wars, interest rates, and political uncertainly, to name a few.

It is our goal to be able to use this last quarter's weakness as an opportunity to improve our chances of long-term success by accumulating attractive assets at cheaper prices.

Market Volatility

In the last newsletter, we had an article entitled “Mid-term Election and Beyond.” In that article, we discussed what might happen after the election and into 2019. Some key points that we suggested needed to be watched were how high interest rates could go and how strong inflation would get. With the economy demonstrating 20%+ earnings growth, jobs growth being robust, and wage growth finally beginning to make some real gains, things looked great. And, evidently, Fed Chair Jay Powell thought the same thing. In fact, he made some historic and market moving comments to Judy Woodruff on October 3rd; the day before the bone-crushing sell off began.

When asked about our current economy, he said:

The U.S. is experiencing a “remarkably positive set of economic circumstances, and we’re trying hard to sustain the expansion and keep unemployment low and keep inflation on target.”

He added:

“there is a strong relationship between very low levels of unemployment and tight levels of resource utilization, inflation.

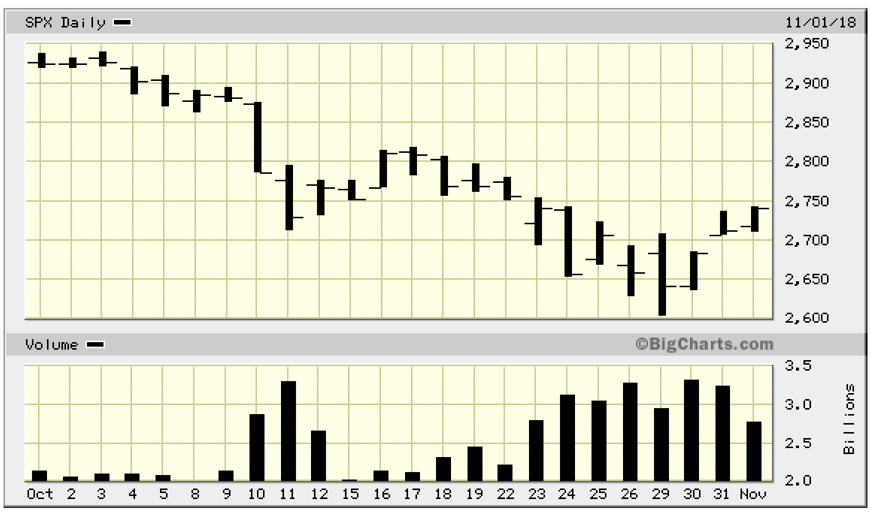
...central banks around the world really stepped up and got inflation under control...that has tended to reduce the sensitivity of inflation to changes in employment.

That’s where we are now. But we got here by having a credible commitment to keeping inflation on target...we have to keep that commitment.”

And, frankly, all that was fine and good. Where he stepped into a mess was with the following comments:

"Interest rates are still accommodative, but we're gradually moving to a place where they'll be neutral...**but we are a long way from neutral at this point**."

These comments implied that the Fed would be raising rates quite a bit further before they were done. And, of course, the threat of substantially higher interest rates spooked the markets. In fact, the S&P 500 hit 2,939.86 on the day of his comments. And subsequently fell to 2,603.54 on 10/29/2018; a decline of 11.44%.



S&P 500 from 10/1/2018 to 11/1/2018 provided by BigCharts.com

Given the timing of his speech and immediate, and violent, decline in the markets, there can be no mistake that Fed Chair Powell's comments were the catalyst to kick off this cascade of selling.

Of course, there was a plethora of other issues that were on the minds of market participants. But with the cover of accommodative interest rates, these issues weren't full blown worries. However, when you take away the clarity associated with monetary policy, these worries turn into a panic.

And after Powell scared the markets, the possibility of a full-on trade war with China got priced into the market. The political issues within the United States, namely the Congress versus the President, made people price in impeachment proceedings. And, of course, after an over 20% gain in earnings in 2018, the market priced in a slow-down in earnings growth.



And just when you thought things couldn't get any worse, they did!! Once again, our Fed Chair made a verbal blunder. On Wednesday December 19th he was making comments on the FOMC's latest interest rate decision, when he was asked about the Fed "normalizing" its $4 trillion balance sheet. Specifically, he was asked two questions within the span of 15 minutes about their current "autopilot" program.

(For some background, the last Fed Chairperson, Janet Yellen, set up a program that automatically rolled off, or allowed to mature, $50 billion of bonds from their balance sheet every month. This process is the "autopilot" program).

Those questions asked, essentially, if he would ever consider changing that policy. He said "no" in both instances. This implied that no matter what the financial conditions of the global economy are like, he is going to keep rolling those bonds off and keep "quantitively tightening" monetary conditions. As he answered the first question, the Dow was up about 150 points. After he answered the second one, the market was down over 400 points. Once again, this is clear evidence that the market sold off because of Fed Chair Powell's comments.

For the second time in two tries, our eloquent Fed Chairman stuck his foot in his mouth and scared the pants off the market. Now, do I honestly think he would keep that "autopilot" program in place regardless of economic conditions; no! But that is exactly what he said he would do. And the market had to price that in...and price it in, they did.

On the following Friday, NY Fed President Williams was interviewed by CNBC and beautifully articulated what the Fed would, should, and could do regarding the balance sheet normalization process. He stated the Fed would look at all the data, listen to business and market participants, and make adjustments to any and all of their programs as necessary.

The market loved his comments and as he was speaking, the Dow was up about 370 points. BUT almost immediately following this wonderful interview, President Trump threatened a government shutdown over the details of a spending bill. The market didn't like this and sold off all of those 370 points and finished down big AGAIN!

In the subsequent days, Congress and the President couldn't reach a deal on the spending bill in question and the government was, indeed, shut down. And in the midst of all this, our President was rumored to have wanted to fire the Fed Chair.

With all this uncertainty, economic fears were created out of thin air and a panic-like aura enveloped the markets. So much so, that Treasury Secretary Mnuchin was forced to call the CEO's of the 6 largest banks to ensure liquidity was normal and the banks were functioning well. Which, they were. But, nevertheless, all of this uncertainty and fear truly began to shake people and the markets. Even though there was NO EVIDENCE OF AN ECONOMIC SLOWDOWN AT ALL!!!

To be frank, this sell off, which drove the S&P 500 down to 2,346 (20% from its peak) on Christmas Eve, was simply a matter of fear running wild in the market place. Fear based on careless comments by our leaders and irrational knee-jerk reactions to the circumstances created by those comments.

Long story short, the market volatility is warranted on some level. It does seem likely that earnings growth for our corporations in 2019 will be slower than in 2018. But current expectations are still for earnings to grow around 5%. But as far as the other "stuff", it was plain and simply panic being created by poor leadership and communication from our most important officials.



Until we see more stable leadership, we need to expect more volatility. Which, to be frank, can create some great buying opportunities. In fact, our current place and time leads me to recall a famous quote: *"Be fearful, when people are greedy. Be greedy, when people are fearful"*- Warren Buffett

Ugh; Another One!

As we just lived through the worst December stock market since 1931, I am sure we are all bruised, battered, frustrated, and, perhaps, angry. There are a plethora of reasons for the market sell off, as we discussed in the last article, but very few of them are economic related. The economy is doing very well and that's the frustrating part but also the market's saving grace. Nevertheless, this isn't the first market sell off for many of us. In fact, I got to thinking. How many times have I been through this? Well, here is that list and a little story about each of the significant market sell offs that I've been through.

1998—Russian Rubble Crisis

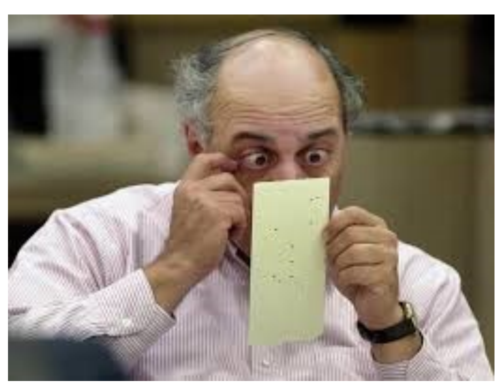
This one happened when I was a newbie at Merrill Lynch. Seemingly out of nowhere, beginning in the late summer, the market fell 19.3%. The Russian default in August kicked off a cascade of events that led to Long-Term Capital Management bringing the financial system to the brink of collapse. What was especially neat for me was that the Merrill Lynch CEO was in Atlanta during this time and a host of other big wigs came in and out of our office as they met to save the world. It was really cool to see the larger than life Dave Komansky's leadership in action. After the issue was fixed, the market went on to rally over 60% until finally peaking in late 1999.

1999—The Forgotten Pullback

In late summer of 1999 through early fall the S&P 500 fell 12.1%. And, frankly, no one seems to remember this one because there wasn't any major catastrophe that kicked it off and because after this correction the market roared upwards another 26.5% before peaking in early 2000.

2000-2002—Tech bubble bursts

As much as people forgot the 1999 pullback, everyone remembers the 2000-2002 Bear Market. Tech stocks were over-valued and when they began to collapse, everything started to give way. It certainly didn't help that the election of 2000 was botched with the "hanging chads" in Florida. And then we all had to endure the terrorist attacks of September 11th, 2001. Nevertheless, from its 2000 peak through its 2002 trough the S&P fell 40%.



2008—The Financial Crisis

After the market bottomed out in late 2002, it ran up over 80% until late 2007. What happened then, no one will ever forget. The ensuing Global Financial Crisis that forever changed the way our global economy functions knocked the S&P 500 down 37% in 2008. The crisis saw many major and powerful banks go out of business or get gobbled up by stronger banks at fire sale prices. This was the worst recession since The Great Depression and without coordinated global efforts, this calamity may have brought our entire way of life to and end.

2010—Greek Debt Crisis

The Financial Crisis did get "resolved" and the S&P rallied 78% from its lows until 2010. It was then that the market began to focus on the aftermath of The Great Recession and the fact that it left many countries around the world in bad shape in terms of debt relative to GDP growth. Perhaps Greece was in the worst shape. Fears grew that they couldn't service their debt, they might default, and/or leave the EU. These worries caused the S&P 500 to fall 16%.

2011—Euro debt crisis

The market did bounce after a "solution" was found for the Greek crisis in 2010, but it soon became evident that many other countries in Europe had severe financial issues. This caused the S&P to fall nearly 20% peak to trough in 2011 and the fallout actually hit the United States when its debt was downgraded.

2015—China slowdown

After the Euro debt crisis issue, the market did rally by about 86%. However, in late 2015 the market sold off on fears of a China slowdown. After a brief rebound, in early 2016 it sold off again. The peak to trough drawdown was –14.2%.

2018—January Correction

Earlier this year, the market sold off after a tremendous run. From the lows of the China driven sell off and including the post-2016 election rally, the market gained nearly 50%. It was in late January of 2018 when it looked like the market realized it had come a little too far, too fast. It had a plain and simple price correction that took the market down about 10% in just a 12 days. It may have been a simple price correction from slightly overvalued levels, but the speed of the sell off rattled quite a few investors. Nevertheless, the market did appreciate after that by about 15% right before our current pullback.

2018—Our Current Sell Off

We've been talking about our current sell off for the bulk of the newsletter, so I won't rehash it. But from peak to trough, this 4th quarter sell off has taken the S&P 500 down 20%.

As you can see, these sell offs happen frequently. Additionally, they usually contain hints of something very sinister and damaging to the global economy, which makes them very scary. We just talked about Long Term Capital Management bringing the economy to the brink of collapse, a European debt crisis that threatened the survival of the European Union, the Tech Bubble Bursting, 9/11 attacks, The Global Financial Crisis, and the Chinese economy collapsing. **But through all of that, the S&P 500 is up about 200% on a total return basis over the time frame we discussed.**

In the end, I am in the fortunate/unfortunate situation of having done this drill many times over. Fortunate because I have experience handling it and I hope this gives me the wisdom to take a prudent and proper path while navigating this market for clients. Unfortunate because managing money through sell offs is, just plain and simply, miserable. With this in mind, we all need to focus on our own individual sets of needs and goals and keep our wits about us while remaining patient.

I do truly believe when the dust settles a lot of these fears ruling the market today will turn out to be unfounded and never actually materialize. Per my analysis, it does look like there is significant upside to the markets when things settle down. But until then, we need to do the best we can with the cards we have been dealt.

Non-Financial Events occurring this quarter

Atlanta United won the MLS Cup

Former President George HW Bush passed away on November 30th.

December saw France erupt into its worst level of civil unrest since the 1960s, as Macron's policies came under fire.

Canada legalized Marijuana on October 16th.

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MRP CAPITAL INVESTMENTS, LLC

8440 Holcomb Bridge Road, Suite 520

Alpharetta, GA 30022

404-274-7851

www.mrpci.com