NorthCoast Asset Management

Quarterly Client Update

2019 Q3

September 30,2019

President's Post

Insight & market commentary from NorthCoast President & CEO, Dan Kraninger

"People only see what they are prepared to see." Ralph Waldo Emerson

Count the number of F's in the following sentence…

FINISHED FILES ARE THE RESULT OF YEARS OF SCIENTIFIC STUDY COMBINED WITH THE EXPERIENCE OF YEARS.

How many did you count? Try again and count the number of F's carefully. In two decades, I've never referenced this fun brain trick in a newsletter but I often use it in public presentations. The common answer is 3, then 4 and then 6 (look to the bottom for the correct answer). I first saw this in 1994 and it changed my life. I was working at Merrill Lynch and struggling to understand why there were so many mutual funds that were consistently underperforming their benchmarks. Everyone worked hard and was really smart, so what was the source of the underperformance? It was then when I attended a workshop where the facilitator introduced me to this exercise. He explained that many people see only 3 F's because our brains read the word "of" and process it as a "V". So when counting, we skip over. We see it but don't register it.

This led me to rethink my approach. I began devoting much of my time and energy into the world of behavioral finance which was just beginning to find its roots in 1994. Traditional finance at the time held that (1) both the markets and investors are rational and that (2) investors have perfect self-control. Behavioral finance introduced the concept that we are human – irrational, biased, angry, loving, hopeful, excited, and scared beings. Our decisions are more influenced by our emotions than we care to admit. I left Merrill in 1996 because I believed this is why so many managers underperformed and why benchmarks were winning. Managers were human and making bad investment decisions based on their feelings and benchmarks, of course, did the same thing every day without judgement or emotion.

I'm bringing this up because not much has changed in 25 years and I'm starting to wonder if things are getting worse. With simple-to-use technology and almost non-existent trading costs, it's never been so easy for people to make quick, knee-jerk decisions that can have significant ripple effects on their financial future. I'm starting to believe one bias in particular has worsened in part because of social media.

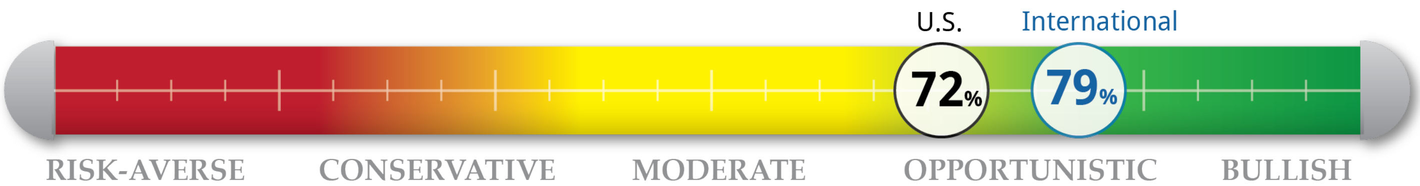
Confirmation bias (pictured above) is defined as the tendency to interpret new evidence as confirmation of one's existing beliefs or theories. My belief is that apps like Twitter and mobile notifications from subscribed websites are hurting people's ability to see the other side of the coin because everything they hear, read, and see are confirmations of their own belief system. Every day, the market provides reasons to be bullish and reasons to be bearish and that's what we are watching unfold in real-time . . . it's a business of matching buyers and sellers in an auction market. However, successful investors are able to make the best, informed, and well-rounded decisions based on their own objectives.
Impeachment, an inverted yield curve, and missile tests are just some of today's bearish headlines whereas, technology improvements, low interest rates, and good job and economic activity are some of the bullish justifications. Try to be measured on both sides. We use our Navigator (next page) to manage market conditions in an unemotional manner. We take into account 40 indicators that are historically predictive and reflect common sense. So what are we seeing right now? We feel the market will be generally neutral ahead… perhaps +3-4% over the next 6 months. Why? Technical and fear gauges are supportive of growth, economy is not great but good (and that's ok), investor optimism is still healthy and valuations are better. More explanation on the following page.

So in a nutshell, we are walking the line -- constantly mining for the F's, testing and measuring data daily in order to make decisions designed to avoid bias. I encourage you to do the same, and we can help too. Our advisors have access to the same data that we use to manage the portfolios --- over 250,000 lines of source code. Put that to work for you – so whether you are thinking about a new investment, changing an existing investment or trying to align a portfolio with your outlook, give us a call. Besides having another set of eyes, I think you'll find that decades of investment experience and terabytes of data at your disposal will help you see some F's that you may have missed at first glance.

NorthCoast Navigator

As of 9/30/19

The NorthCoast Navigator is a market "barometer" displaying NorthCoast's current equity outlook. This aggregate metric is determined by multiple data points across four broad dimensions including Technical, Sentiment, Macroeconomic, and Valuation indicators. The daily result determines equity exposure in our tactical strategies.



What happened in the 3rd quarter?

U.S. Equities had a relatively calm July with generally positive quarterly earnings reports and a down tick in concerning headline news. Then volatility returned in August. After two positive and generally calm summer months, a series of headline-worthy events caused a few abrupt downturns that, despite recouping some losses towards the end of the month, dragged the S&P 500 down -1.7% for the month.

After the volatility in August, U.S. equity markets rebounded to push the S&P 500 index positive for the 3rd quarter. The index now sits just over 1% below its record high set in July. Investors appeared to rotate away from the more expensive momentum equities towards undervalued stocks. The tech-heavy Nasdaq finished the month with its first quarterly decline in 2019.

Despite the general market rise during September, some cautious domestic economic data was released. Consumer spending grew at a modest 0.1% during August, below the average 0.5% a month during the first 7 months of the year. Slowed consumer spending still raises concerns that the economic slowing abroad coupled with continued trade conflict may be affecting the U.S. The Federal Reserve will also announce their rate decision at the end of October. By then, some new economic data will have been released and their decision will likely be clearer. For now, expectations are that the central bank will cut rates.

Moving into the 4th quarter

Not only will October bring fresh Federal Reserve speculation and finally a decision, but also the continuation of U.S. and China trade talks. Excluding political controversy and headlines, September saw little in the way of drastically market moving headlines relative to August. However, it is possible that next month is set to reignite some volatility driving events. Third quarter earnings and economic data due to be released during the month will provide a clearer picture of U.S. equity and economic health as well as insight into the Fed's decision. Our indicators are showing only minor changes from last month in the U.S. and some improvement abroad. We are 72% invested in our domestic tactical strategy and 79% in the international tactical strategy.

Macroeconomic

- Macroeconomic indicators are still positive with consumer spending slowed slightly, but homeowners saw a mild uptick in housing prices.
- Data released last month showed that U.S. household net worth growth was still modestly positive in the 2nd quarter, though below 1st quarter's growth rate.

Sentiment

- The University of Michigan consumer sentiment survey rose almost 4% month-over-month to 93.2. The modest change does little to move the overall indicator, which has stayed relatively in line with last month.

Technical

- The S&P 500 reverted back above the 50-day moving average and sits further above its 100- and 200-day moving averages.
- Market volatility, measured by the VIX, came down to July's levels around 16.

Valuation

- With the S&P 500 closing in on its all-time high set back in July, valuations indicators are still negative and equity prices still elevated.
- Earnings reports will shed more light on U.S. companies' earnings. P/E ratios sit at approximately 19.6.

Strategy Performance

NorthCoast offers a suite of active investment strategies designed to meet the individual goals and objectives of the investor. Our dedicated advisory team will work with you to construct a portfolio catered to your needs.

Category	Description	Strategy	Overview	2019 Q3	2019 YTD
Risk-Adjusted (Tactical) Growth	Designed to first analyze market risk then determine the desired asset allocation and security selection	Tactical Growth	Global Asset Allocation	-0.9%	11.2%
		U.S. Sector Select Hedged	U.S. Sector Rotation	-0.5%	-0.4%
		International Select Hedged	International Country Rotation	-5.0%	-2.0%
		Tax-Managed	Tax-Efficiency	0.4%	13.7%
		CAN SLIM®	All-Cap Growth	-0.5%	11.5%
		CAN SLIM® International	All-Cap International Growth	-1.8%	7.5%
Growth	Seek to generate growth returns greater than the respective market benchmark	Global Select	Global Country Rotation	-1.2%	16.6%
		U.S. Sector Select	U.S. Sector Rotation	0.1%	17.0%
		International Select	International Country Rotation	-3.3%	12.3%
		Emerging Market Select	Emerging Market Country Rotation	-4.8%	10.6%
		Legends Value	All-Cap Value	-0.3%	14.8%
		Vista	All-Cap Growth	0.2%	15.2%
Core	Designed to meet the broad goals of growth and income and serve as the 'core' of a portfolio	Diversified Core	Global Asset Allocation	0.2%	12.2%
		Diversified Growth	Global Asset Allocation	0.0%	13.9%
Income	Designed to generate yield and returns through traditional and non-traditional income sources	Core Fixed Income	Conservative Income Generation	1.6%	8.1%
		Tactical Income	Dynamic Income Generation	1.4%	9.1%
		Aggressive Income	Aggressive Income Generation	1.4%	7.7%
Alternative	Aim to generate returns that are independent of the equity and fixed income markets	Zero Beta	Liquid Alternative	1.0%	1.2%
		Concentrated Stock	Concentrated Stock	N/A	N/A

PAST PERFORMANCE DOES NOT GUARANTEE OR INDICATE FUTURE RESULTS. INVESTING ENTAILS RISKS, INCLUDING POSSIBLE LOSS OF SOME OR ALL OF THE INVESTOR'S PRINCIPAL.