



**Quarterly
Update**

Q4 2019



President's Post

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

"Keep cool; do not freeze." Printed on the top of the old metal lids of Hellman's mayonnaise.

A client of mine for over twenty years shared this anecdote about Hellman's mayonnaise with me in 1999 and I've never forgotten it. He picked it up from his boss at Exxon who would quote it to young managers who were rising up the corporate ladder, and now to me, it seems to perfectly capture my view on the market.

2019 was a really good year. What can an investor complain about -- Dow +25%, S&P 500 +30%, US bonds +9%, Global stocks +21% Global bonds +7%, Gold +19%. Everything appreciated in value. The economy grew, jobs were good, inflation was tame, and the Fed was supportive with three rate cuts during the year. And all of this looks to still be in play as 2020 opens. There is one thing in the back of my mind that bothers me though, which is getting harder to shake – the rise and the impact of the mega cap stocks.

It's not a coincidence that I chose a story from 20 years ago to start this letter. Why? Because the market's growth and the concentration of gains among the biggest stocks in the market reminds me a lot of January 2000. In 2000, the big names were Cisco, Intel, GE, and Qualcomm. The price/earnings multiple for the top 10 stocks in 2000 was 62.6! Analysts like Abby Joseph Cohen from Goldman were touting a new era for growth stocks and corporate leaders like Jack Welch were celebrated as investors greeted their companies as the new one-decision stocks (one-decision stock = buy and never sell. Popularized in the 70's with Xerox and Polaroid before their decline and then afterwards with IBM). Of course, we all know what happened next. The bubble burst in April 2000, ushering in a bear market that bottomed out in 2003 at -49%. Amazingly, even today 20 years later, stocks like Cisco and GE have not returned to their year 2000 high. Cisco is down -11% and GE is down -60% from their respective 2000 highs.

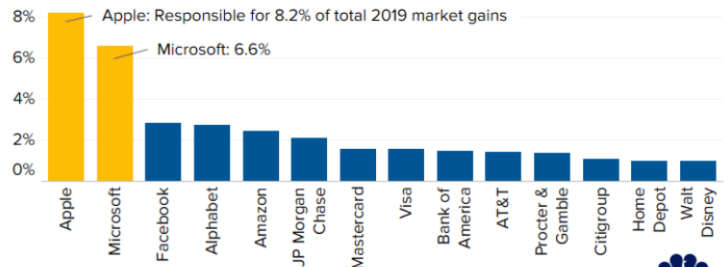
General Electric Co 1985-2020



Source: IBD

Top Contributors to the Market's 2019 Return

Apple and Microsoft accounted for 14.8% of 2019 S&P 500 gains



Source: S&P Dow Jones Indices. Data as of market close Friday, December 27, 2019.



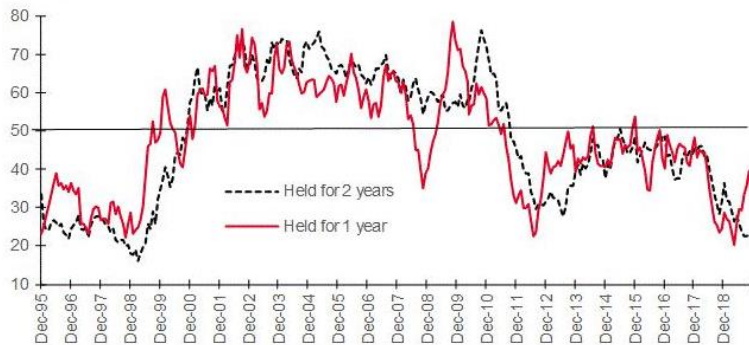
Today, the big names are Apple, Microsoft, Amazon, and Google (a combined market cap over \$4 trillion), and the current price/earnings multiple for these four is 42.5. In fact, 15% of the S&P 500's return this year is attributable to just two stocks, Apple and Microsoft. If their gains were stripped from the Dow Jones, the blue chip index would be nearly 1,100 points lower than its current level. As a money manager, this has made stock picking more challenging because just being big has historically not been an effective factor on which to base a buying decision. In fact, over time small caps tend to outperform. In 2019 though, small caps were beaten by 8 percent by the S&P 500. Other productive factors such as profit margin, earnings growth, and return on equity which have been historically good signals to buy a stock have similarly underwhelmed. Consider Apple - did you know the company earned \$11.91 a share in 2018 and has earned less in 2019 at \$11.89 a share? Yet during that time, the stock appreciated 85%. Its P/E multiple grew from 13 to its current 25 all while making 2 cents less a share. So long story short, this narrow market and more money being invested in passive ETFs and Index mutual funds is concerning.

Just because there are some crosswinds though doesn't mean too much in my mind. As the quote suggests, we will simply be cool and not freeze. After all, 2000-2002 was one of our brightest accomplishments as a firm – while the market sank -49% those three years, we were -5% in our tactical equity strategy. I believe we have the right two models to again do well navigating 2020 forward. First, regarding stock picking, we will continue to identify and invest in stocks that exhibit multifactor strength. Yes the last three years have been an amazing mega cap success but if the market has taught us anything over time it is that fads burn up and burn out. While the big cap S&P 500 dominated in 2019 just as it did in the run up to 1999, what happened after 1999?

Starting 12/31/1999	1 year later (2000)	3 years later (2002)	5 years later (2004)
S&P 500	-9%	-37%	-18%
S&P 500 Equal Weighted	+8%	-15%	+36%

The only difference between the two lines in the above table is that in the S&P 500 Equal Weighted each stock contributes 1/500 of the return. It's simply an average of 500 stocks together. The standard S&P 500 is cap-weighted which means the biggest stocks (AAPL, MSFT, etc.) can have as much as 5% influence because they're so big. Again, in our research, just because a stock is big is not a reason to expect longer term outperformance.

Percentage of Stocks That Have Outperformed the S&P



Source: SG Cross Asset Research

Second, I believe our cash scaling strategy will continue to pay dividends. We are near 1/3 in cash right now as valuation indicators are negative and the macro-economic signals have weakened. What is strong right now? Technicals. Or said another way, prices are up. So we respect the market's strength and are 2/3 equities exposed. As always, we will continue to measure the combination of these signals and report to you in our monthly Navigator how they are changing. In 2000-2002, there were times we held over 50% cash to hedge that market and I suspect there may be some times like that ahead in the next three years.

So to summarize, we come back to the advice I received long ago: keep cool, but don't freeze. Advice that is as good today as it was when a German immigrant, Richard Hellmann, began selling his wife's mayonnaise at his New York deli in 1905.

As always, thank you for your business, and best wishes for a happy, healthy and prosperous New Year.

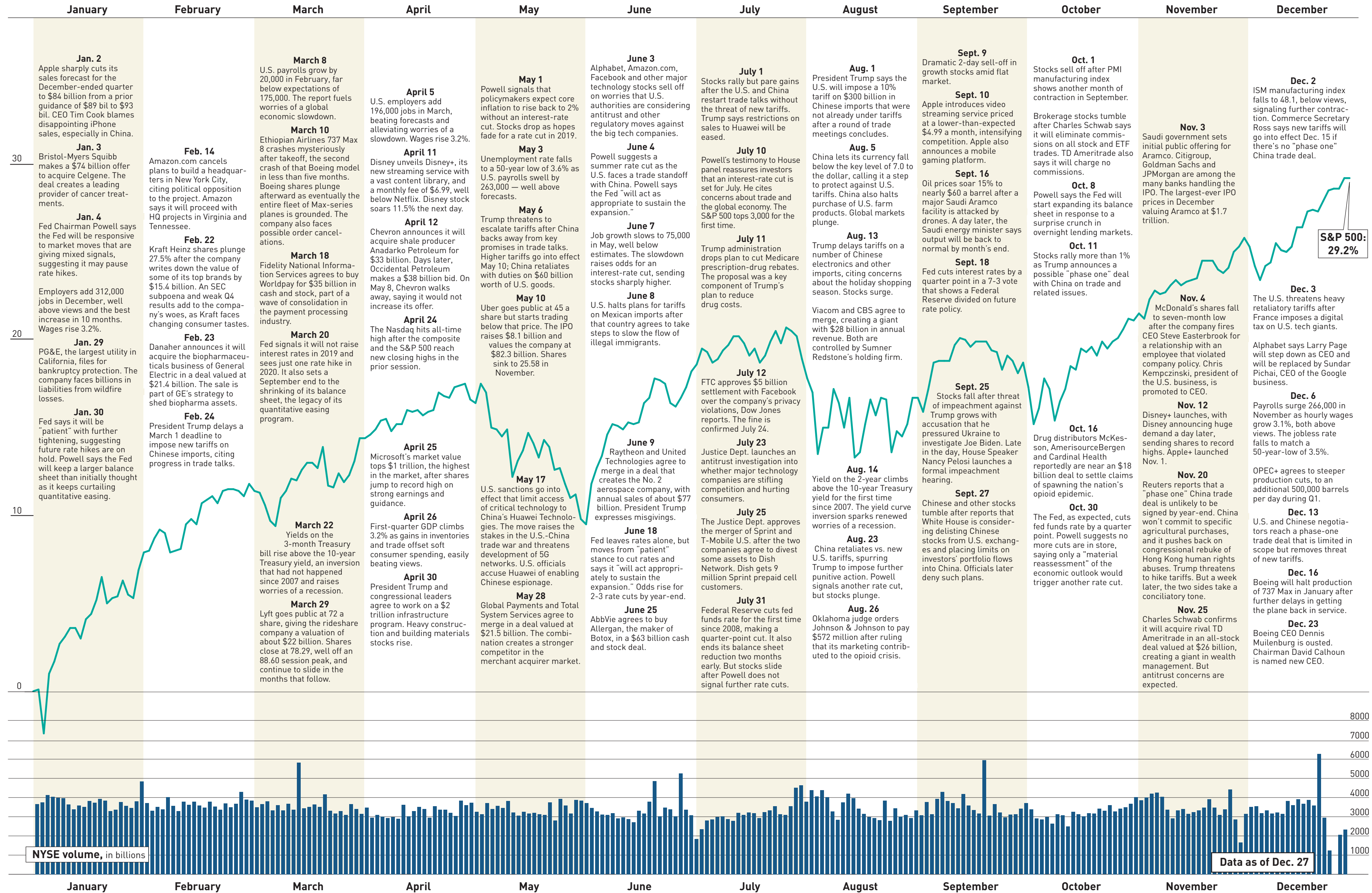
Sincerely,

Dan Kraninger
President & CEO



2019: One Of The Best Years Of The Decade

A strong economy, interest-rate cuts helped the stock market overcome tariffs and other bumps. The year started with the bottom of a sharp correction.



Data as of 12/31/19. Provided by Investor's Business Daily. Performance return is price return only. It does not include reinvestment of dividends.

NorthCoast Navigator

As of 12/31/19

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.



Consumers and Trade Conflict

Last month closed out a year that saw stocks and bonds rising in tandem. This is the first time since 1998 that both asset classes increased by such levels. This phenomenon was largely due to an accommodating monetary policy and an improving economic outlook combined with rising fear of trade conflicts and geopolitical tensions. The end of the year brought some optimism to the latter as the U.S. and China signaled a preliminary deal is close at hand and Brexit appears set for the end of January. U.S. stocks' rise this year has resulted in some dislocation from corporate earnings, which have had generally meager growth. As a result, valuations have deteriorated and equities currently appear overvalued. Earnings growth forecasts for 2020 have also been revised down.

U.S. economic data released in December showed that consumers are still driving the advance of the economy. The data also showed wage growth for lower-income workers – a sign of the tight labor market. Wage growth is typically a late-cycle indicator which may precede a recession.

Positive Outlook for the New Year

Generally, expectations for equities are positive but below the growth seen in 2019. The U.S. election will be top of mind for many investors, but election years have had little to no impact on long-term investing and there is no statistical evidence that equities perform worse in election years. Due to the divided U.S. electorate, the upcoming election may be turbulent and cause pockets of volatility next year. However, we expect impacts to be short-lived and sector-specific. U.S. manufacturing and corporate investment have the chance to strengthen if a trade deal is reached. This change would lessen the dependence on consumers to drive economic growth. We still see elevated levels of risk for domestic equities with valuations at such high levels. International equities currently look more attractive with recovering macroeconomic and more reasonable valuations.

Macroeconomic

- At 3.5%, November was the 21st consecutive month with a U.S. unemployment rate of 4% or lower, while adding 266,000 jobs over the month. Wages increased 5.3% in November over the same period last year. The wage growth rate topped the mortgage rate for the 1st time since 1972.

Sentiment

- Consumer sentiment, as measured by the UM Consumer Sentiment Survey, moved to its highest level since May, ending the year at 99.3. However, US Purchasing Manager Index (PMI) ticked down in November to 48.1.

Technical

- Trend-following technical indicators remained positive as the trend strengthened in December. The S&P 500 now sits 4%, 7% and 9% above its 50-, 100- and 200-day moving averages, respectively. The relative strength index, a measure of momentum, ticked up to its highest level since April.

Valuation

- U.S. equity valuations advanced to their highest levels in 2019 with the S&P 500 Index P/E finishing at 21.6 and Forward P/E at 19.8.

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.

		Strategy	Overview	Q4 2019	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	5.9%	17.8%
		U.S. Sector Select Hedged	U.S. Sector Rotation	7.3%	6.9%
		International Select Hedged	International Country Rotation	5.0%	2.9%
		Tax-Managed	Tax-Efficiency	5.1%	19.4%
		CAN SLIM®	All-Cap Growth	5.2%	17.3%
		CAN SLIM® International	All-Cap International Growth	6.7%	14.7%
Growth	Seek to generate growth returns greater than the respective market benchmark	Global Select	Global Country Rotation	8.6%	26.6%
		U.S. Sector Select	U.S. Sector Rotation	10.4%	29.1%
		International Select	International Country Rotation	9.0%	22.4%
		Emerging Market Select	Emerging Market Country Rotation	10.0%	21.7%
		Legends Value	All-Cap Value	9.1%	25.2%
		Vista	All-Cap Growth	5.5%	21.6%
Core	Designed to meet the broad goals of growth and income and serve as the 'core' of a portfolio	Diversified Core	Global Asset Allocation	4.8%	17.6%
		Diversified Growth	Global Asset Allocation	6.2%	21.0%
Income	Designed to generate yield and returns through traditional and non-traditional income sources	Core Fixed Income	Conservative Income Generation	0.7%	8.9%
		Tactical Income	Dynamic Income Generation	2.6%	12.0%
		Aggressive Income	Aggressive Income Generation	1.8%	9.7%
Alternative	Aim to generate returns that are independent of the equity and fixed income markets	Zero Beta	Liquid Alternative	0.0%	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.

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