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CMG Opportunistic All Asset Strategy
2019 Q1 Quarterly Update

After a historic drawdown in the fourth quarter, the strategy added modest equity risk exposure during the first quarter. The CMG Opportunistic All Asset Strategy is designed to identify intermediate-term trends in multiple asset classes and while it was able to avoid most of the drawdown at the end of last year, the strategy has been slower to add risk exposure back on after a V-bottom market reversal that started in December. Despite the market rally this year, markets are essentially back to where they were last year after a roller coaster ride of volatility. This dynamic speaks to the benefits of diversification amongst traditional long only strategies and tactical investment strategies. While both investment strategies may end up at roughly the same point, they have gotten there in vastly different ways. How they got there, in a volatile manner or a smoother less risky way, makes a difference to investors and speaks to the necessity of both types of investments in a well-diversified portfolio. Furthermore, the last two quarters also illustrate the tradeoff between risk management and capturing all of the market upside. Investors cannot have both in one investment but can asset allocate in a way that allows them to reap some benefits from each approach. Tactical strategies that have the ability to risk manage and avoid large market declines are typically not going to capture all of the upside on a market rebound, especially when that market bottom is rapid. Traditional long-only buy and hold strategies keep investors invested for that market rebound but often at the cost of investors' turmoil that tests the extremes of their emotional spectrum, oscillating from fear and panic to greed and anxiety of missing out.

In January, the strategy rotated out of several ultrashort duration bond positions into emerging market equities, specifically Latin America, municipal bonds and long government bonds. Moving into February, the strategy rotated into several equity positions, including a China specific fund and the aerospace and defense sector. Fixed income allocations moved out of ultrashort bond positions into emerging market bonds, international developed bonds and short-term corporate bonds, reflecting an increased appetite for duration risk. The strategy reduced risk exposure in March as the equity market rally that started the year flattened out, facing resistance from last year's market highs. The strategy was primarily invested in fixed income positons while still holding its position in Chinese equities. After a difficult year for the Chinese market, Chinese policymakers have stimulated the economy in response to slower growth and the trade war. Equities have perked up from oversold levels and the Chinese market has showed strong momentum to start the year. Within the strategy's fixed income positions, the portfolio was comprised of ultrashort bond positions, international developed bonds and short-term corporate bonds. At the end of the quarter, the strategy added additional risk exposure favoring longer duration fixed income holdings and technology, U.S. preferred stocks and consumer services equity positions.

The strategy held the following allocations (individual portfolio allocations may vary) to equities, fixed income, commodities and cash/cash equivalents at the end of January, February and March:

	Equities	Fixed Income	Commodities	Cash*
January	9.69%	18.07%	0.00%	72.24%
February	20.09%	30.06%	0.00%	49.85%
March	10.87%	20.03%	0.00%	69.10%

***Please note that cash holdings include cash equivalents like ultra short duration bond positions.**

If there is one word that I could choose to describe the past six months of market activity, it is "absurd". The panicked decline and irresolute recovery was absurd, illogical and wildly unreasonable. There is really no other way to describe it although adolescent comes close. The sell-off last year was purportedly triggered by concerns that the Fed had hiked rates too far thereby creating headwinds for growth. After the Fed offered guidance in December suggesting no rate

CAPITAL MANAGEMENT GROUP
1000 Continental Drive (800) 891-9092
Suite 570 (610) 989-9090
King of Prussia, PA 19406 (610) 989-9092 FAX
www.cmgwealth.com

hikes were on the table for 2019, investors were exuberant and have since pushed equity markets back to all-time highs. Now, after a solid first quarter, the debate is not about when or whether the Fed should increase rates at all, but rather about whether they should cut rates. While there is at least a plausible case to be made for slowing the pace of rate hikes or the withdrawal of other accommodative policies, the argument for cutting interest rates is nothing less than absurd.

The Dueling Mandates of the Dual Mandate

What is known today as the Fed's "dual mandate" has an interesting history. Its origins reside in the Employment Act of 1946, a policy passed by Congress that was meant to address the challenge of finding jobs for American soldiers returning from war and inspiring confidence in the economy. The specter of the Great Depression still loomed large for the country and the original act declared that "All Americans able to work and seeking work have the **right** (this word was ultimately removed from the final bill) to useful, remunerative, regular and full-time employment…". Clearly, jobs were the priority and inflation was only a modest concern against the deflationary period of the Depression. At the time, some economists felt the legislation ignored price stability and its impact on standards of living. The two decades following the act saw stable employment and inflation in a healthy range of 1 to 5 percent (stable by the standards of those times). Stagflation in the 70s led policymakers, and indeed the executive branch, to a renewed focus on inflation. Starting with President Ford's WIN (Whip Inflation Now) speech in 1974, Congress set about refining the Fed's mandate to include stable prices, culminating in Resolution 133 in 1975. The key and now familiar statement from the resolution instructed the Fed to: "maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates". In 1977, Congress formally amended the Federal Reserve Act to include this mandate and it was signed into law by President Carter in 1978 as the Full Employment and Balanced Growth Act, more commonly known today as the Humphrey-Hawkins Act. Some of the more radical proposals left on the cutting room floor included explicit employment targets and government action to reach those targets and a greater role for the executive branch in monetary policy in the form of the President's recommendations on monetary policy submitted for the Fed's consideration.

By the late 70s the monetary policy pendulum had completely swung to the side of price stability as Fed Chairman Paul Volcker sought to fight inflation at all costs. The cost was higher unemployment and Volcker was pressured to do more on jobs. Despite pressure from Congress and the President, Volcker saw inflation as the more important battle, and more significantly, a battle that he could win. Volcker would be proven right as unemployment levels fell alongside stable inflation in the late 80s and 90s. Scrutiny of the dual mandate was scarce during this period although calls for an explicit inflation target were discussed amongst members of the FOMC. Fed Board Vice Chairman Alan Blinder, poured cold water on these proposals, arguing instead that that dual mandate provided the flexibility for the Fed to do its job more effectively than other proposals, suggesting there was little evidence supporting a fundamental change.

Fast forward through two major domestic crises and the pendulum once again swung back to the side of employment. In the wake of the worst financial crisis since the Depression, jobs were the focus and the political loadstar. Never mind that loose monetary policy fed the credit bubble that would bring the economy down. Over the past decade, not only did we get low interest rates, the Fed used several unorthodox policies, most notably QE, to stimulate the economy and drive unemployment to the current low level. What is notable about the current cries for help from the Fed is that neither employment nor inflation are a problem. So why the anxiety about the economy and the wishful thinking about a rate cut?

The answer may lie in a paper Alan Blinder published in 1982, titled "Issues in the Coordination of Monetary Policy". Blinder examined issues concerning the coordination between fiscal and monetary policies and stressed that his findings are not meant to be answers to the questions at hand but was meant to stimulate discussion. It is an interesting read (please contact me if you would like a copy of the paper) with several insightful sections that include a game theory

approach to determine what coordination would look like, ranging from perfect coordination to complete lack of coordination. Utilizing the Nash equilibrium, Blinder suggests why "uncoordinated behavior will result in tight money and loose fiscal policy" despite the fact that both the Fed and the fiscal authority would prefer "easy money plus tight fiscal policy". Clearly, the optimal situation of easy money and tight fiscal policy cannot exist. There is no political will (and no support from voters) to raise taxes or cut spending on Social Security or healthcare. Policies from the current administration are mixed and, as a result, the response from the Fed is mixed. Corporate tax cuts meant to stimulate the economy have been offset by negative trade policies that create uncertainty and potential inflation if the situation does not de-escalate. The Fed has had to react to these policies, at times increasing interest rates in response to expansionary policy (tax cuts, lower tax revenues and higher deficits and a desire for a cushion before the next crisis) and more recently pausing rate hikes as the benefits of tax cuts wane and the trade war escalates (something akin to tighter fiscal policy without the explicit tax hike). How these interactions play out over the next several years will determine what path the Fed takes, raising rates to historical norms or keeping rates subdued for longer.

While it is always dangerous to make predictions, I would venture to say that the pressure on the Fed will overwhelm good policy making and make it that much more difficult for the Fed to keep policy stable. This is likely to lead to higher debt levels, lower interest rates for longer periods followed by bouts of volatility and ultimately debt crises in the long-term (that's how these episodes always end). It is like two parents, one permissive and one who disciplines: at some point even the disciplined parent throws in the towel and lets the kids have what they want. The fiscal authorities (in my example, both Congress and executive branch with the markets as cheerleader) want expansion at all cost to achieve growth rates that are not realistic. How the Fed faces down these challenges will, in no small part, be determined by the personalities (and physical stature) of the board and the chairman. In this light it is a relief that the kibosh has been put on the rumored nominations of Herman Cane and Stephen Moore, two of the worst nominations ever and noted sycophants to Trump. No matter whether a president is a Republican or a Democrat, an independent central bank is a worthy aim and investors, market commentators and policymakers would do well to look at other solutions to generating growth: education, infrastructure and investment, increasing productivity, healthcare and tackling growing monopolies or the opioid crisis to name a few. That said, what's the big problem with the economy we have: 3% growth, sub 4% unemployment and sub 2% inflation. You can't always get what you want, but if you try, sometimes you might find, you get what you need.

Kindest regards,

PJ Grzywacz
President

CAPITAL MANAGEMENT GROUP
1000 Continental Drive (800) 891-9092
Suite 570 (610) 989-9090
King of Prussia, PA 19406 (610) 989-9092 FAX
www.cmgwealth.com

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