Wealth through ingenuity.

CMG Tactical Fixed Income Strategy
2019 Q3 Quarterly Update

The CMG Tactical Fixed Income Strategy began the quarter invested in municipal and international bonds. The strategy held municipal bonds for the entire month of July. The other half of the portfolio rotated between international developed and emerging market bonds over the course of the month. The Fed's rate cut in July started a rally in bonds that picked up steam in August as the expectation of another Fed rate cut for September set in. As a result, riskier credits and higher duration bonds gained new momentum as the risk of interest rates became a distant memory. For the month of August, the strategy was again invested in municipal bonds for the entire month with the balance of the portfolio rotating amongst international, emerging markets and corporate bonds. In September, the strategy was invested in high yield bonds for a large portion of the month. Additionally, the other half of the portfolio was allocated to emerging market, convertible and international developed bonds. After a strong August across fixed income sub-asset classes, September proved to be the opposite: fixed income assets sold off across the board consolidating the gains that came on the heels of the Fed's rate cuts. High yields performed best amongst the funds the strategy assesses, followed closely by ultrashort bonds. The remainder of the fixed income universe was negative on the month offering few opportunities for upside capture.

Market Commentary

As expected the Fed cut rates twice during the quarter, easing the Fed Funds Rate from 2.25% to 1.75%. Although the moves were well telegraphed, the surprise was that the decisions were not unanimous: 8-2 in July and 7-3 in September. The September vote in particular was interesting as Jim Bullard was in favor of a 50 bps cut while Esther George and Eric Rosengren voted for no change. While a difference of opinion is healthy for debate, it does show how the crosscurrents of underlying economic data have flummoxed the Fed. Nobody ever said this job was easy.

Since the talk of a rate cut began last year, a number of economic indicators have turned negative. The real question is how bad will they get and are we close to a bottom or not. Specifically, sentiment, confidence and manufacturing indicators are all pointing down and paint a decidedly more negative picture than other economic fundamentals we look at. All three of these peaked in the last two years: sentiment peaked in late 2017 / early 2018 while confidence peaked in the second half of 2018 and has accelerated its decline. The ISM manufacturing indicators which are negative across the board (indicating contraction), peaked in late 2017 and represent the worst levels in a decade. Below is a table of the sub-components of the ISM's October 2019 manufacturing report. It is decidedly negative and at odds with the overall economy.

MANUFACTURING AT A GLANCE

Index	Sep Index	Aug Index	% Point Change	Direction	Rate of Change	Trend* (months)
PMI®	47.8	49.1	-1.3	Contracting	Faster	2
New Orders	47.3	47.2	+0.1	Contracting	Slower	2
Production	47.3	49.5	-2.2	Contracting	Faster	2
Employment	46.3	47.4	-1.1	Contracting	Faster	2
Supplier Deliveries	51.1	51.4	-0.3	Slowing	Slower	43
Inventories	46.9	49.9	-3.0	Contracting	Faster	4
Customers' Inventories	45.5	44.9	+0.6	Too Low	Slower	36
Prices	49.7	46.0	+3.7	Decreasing	Slower	4
Backlog of Orders	45.1	46.3	-1.2	Contracting	Faster	5
New Export Orders	41.0	43.3	-2.3	Contracting	Faster	3
Imports	48.1	46.0	+2.1	Contracting	Slower	3
OVERALL ECONOMY				**Growing**	**Slower**	**125**
Manufacturing Sector				**Contracting**	**Faster**	**2**

*Number of months moving in current direction. Manufacturing ISM® Report On Business® data is seasonally adjusted for the New Orders, Production, Employment and Supplier Deliveries Indexes.

CMG 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

When the index drops below 50, it signals contraction in the manufacturing sector. But what happens after and what impact does it have it on markets? The chart below summarizes how many times a recession has occurred after the ISM index falls below 50.

Exhibit 2: Equity market rises after ISM falls below 50 outside of recessions

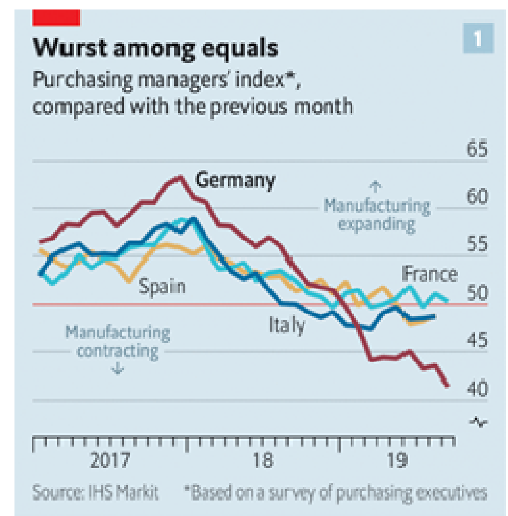
as of September 5, 2019

Episodes when ISM Mfg. index first falls below 50 since 1975

First month ISM below 50	Months before recession	Months from 50 to trough	ISM at trough	S&P 500 total return in subsequent 3-mo	6-mo	12-mo	24-mo
31-Aug-79	6	9	29.4	(2)	4	16	21
31-Jan-81	7	16	35.5	5	3	(2)	26
28-Feb-85		3	47.1	6	6	30	68
31-May-89	15	20	39.2	11	10	16	30
31-May-95		8	45.5	6	15	28	66
30-Jun-98		6	46.8	(10)	9	23	32
31-Aug-00	8	14	40.8	(13)	(18)	(24)	(38)
31-Oct-02		6	46.1	(3)	4	21	32
29-Feb-08	0	10	34.5	6	(3)	(43)	(13)
30-Jun-12		5	48.9	6	6	21	50
31-Oct-15		3	48.0	(6)	0	5	29
Median							
Recession (n=5)	**7**	**14**	**35.5**	**5 %**	**3 %**	**(2)%**	**21 %**
No recession (n=6)		**6**	**47.0**	**1**	**6**	**22**	**41**

Source: ISM, FactSet, and Goldman Sachs Global Investment Research

It is a mixed picture but a couple of things stand out. First, the median trough for the index during recessions (35.5) is decidedly lower than when there is no recession (47.0). We currently stand at 47.8. The next several months will be critical to watch: if the index stays at or above 47, history suggests a recession will be avoided. If we break below 47, it could mean momentum takes us much lower. If that were to occur, expect sentiment and confidence to react negatively as well. What is more encouraging is that equity market returns are generally good in the 3, 6, 12 and 24 mo. subsequent periods after the ISM index breaks below 50. When recession is avoided, the returns are very good. In these cases, the ISM index acts as a countertrend indicator. What is particularly surprising is that even when the ISM index foretells a recession, median returns are generally positive. Although manufacturing accounts for a much smaller share of the U.S. economy than in the past, the ISM index has historically had an outsized role in shaping economic outlooks. In addition to the U.S., readings across the globe suggest we are facing a global slowdown that is affecting all of the major economic zones, not just the leading actors in the trade war (see chart of PMI indicators for European countries).



The Economist

It is all well and good that the Fed is attempting to get out in front of a downturn but how much more will lowering interest rates help? A lack of cheap money is not the issue. The committee, as is tradition, typically sends elusive, coded messages to the market, particularly in times of uncertainty. The last couple of months has been no exception especially as the demands from Trump on the Fed in public have intensified. In the latest press release, persistent low inflation along with poor manufacturing and service data are some of the data points supporting the cut. The mention of the trade war is more ethereal, like a ghost of recessions past, not to be discussed except in vague Fed speak: "In light of global developments…" or "…readings on

financial and international development". That certainly doesn't sound like they're talking about a heavyweight trade war between the two largest economies in the world or a hard Brexit. More like a negotiated G7 communique, so watered down that it says nothing at all.

Of course it is obvious that the trade war is the key catalyst for the global slowdown. Markets have been trading off of "hope" for a trade deal for months now, shaking off the reality of the situation we find ourselves in. The most recent round of negotiations illustrates this point: all of the conversations between the administration and the Chinese are focused on freezing additional tariffs and other small tradeoffs – essentially an armistice…a détente, not a resolution. There has been no discussion, and we believe there will likely be no discussion, of rolling back the tariffs that have already been put in place. In our opinion, the trading relationship between the U.S. and China, and to an extent, globalization, have entered a new paradigm, one that will survive the Trump presidency no matter who succeeds him. Whether this shift in anti-trade sentiment kick starts a de-globalization movement is yet to be seen. Global businesses and CEO's continually cite trade uncertainty as the highest risk to growth and while the business community as a whole has been willing to wait and see on a deal, at some point everyone has to get on with business. On the ground, this will take the form of reconsidering supply chains, making them more local, regional and less global. The impact of such changes will inevitably be higher costs and slower growth in the short-to-intermediate term. No amount of rate cuts can remedy this situation. They can only numb the effects for a period of time, like a painkiller that doesn't actually treat the source of the pain but buys time for additional treatment. Finally, there is virtually no chance of fiscal policy (tax cut, infrastructure or stimulus) helping the Fed. Three years on from the publication of Mohamed El-Erian's last book, the Fed remains the "Only Game in Town". Without some action, beyond monetary policy, a recession (albeit a mild one) could become a self-fulfilling prophecy in 2020 or 2021. While we are not calling for a recession (it's more likely that there is just enough global liquidity that we will skirt by and build up more pressure for a larger event several years down the line), the probability continues to rise if constructive action is not taken.

Kindest regards,

PJ Grzywacz
President

Important Disclosures

CMG Capital Management Group, Inc. is an SEC registered investment adviser located in the Commonwealth of Pennsylvania. **Investing involves risk. Past performance is no guarantee or indication of future results.** Different types of investments involve varying degrees of risk. Therefore, it should not be assumed that future performance of any specific investment or investment strategy (including the investments and/or investment strategies recommended and/or undertaken by CMG (or any of its related entities) will be profitable, equal any historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. No portion of the content should be construed as an offer or solicitation for the purchase or sale of any security. References to specific securities, investment programs or funds are for illustrative purposes only and are not intended to be, and should not be interpreted as recommendations to purchase or sell such securities.

Certain portions of the content may contain a discussion of, and/or provide access to, opinions and/or recommendations of CMG (and those of other investment and non-investment professionals) as of a specific prior date. Due to various factors, including changing market conditions, such discussion may no longer be reflective of current recommendations or opinions. Moreover, you should not assume that any discussion or information contained herein serves as the receipt of, or as a substitute for, personalized investment advice from CMG or the professional advisors of your choosing. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisors of his/her choosing. CMG is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice.

In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise CMG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investment strategies devised or undertaken by CMG) will be profitable for a client's or prospective client's portfolio. All performance results have been compiled solely by CMG and have not been independently verified. Information pertaining to CMG's advisory operations, services, and fees is set forth in CMG's current disclosure statement, a copy of which is available from CMG upon request (or on CMGs website, www.cmgwealth.com/disclosures/advs).

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE PERFORMANCE.

CMG 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