

Market Commentary

**The U.S. policy-making environment is about to shift in Washington, D.C.** Democrats are slated to take control of the House in January, while Republicans will maintain control of the Senate. In this outlook, we share our views on the upcoming policy-making environment and discuss how trade and Federal Reserve tightening may impact markets. **Gridlock:** An overused word by the pundits, but accurate to describe what likely unfolds in 2019. But there are ample policy catalysts in a gridlock which should drive markets over the coming years.

Q1 Outlook

We expect House Democrats to use their subpoena power as a check against the Trump administration (e.g. examining the deployment of the National Guard to the southern border, payments from the Trump campaign, Trump organization business dealing with Russia, the firing of FBI Director James Comey). The result could be mountains of information requests and hearings that clog the legislative calendar, which would **stall Congress through 2020**.

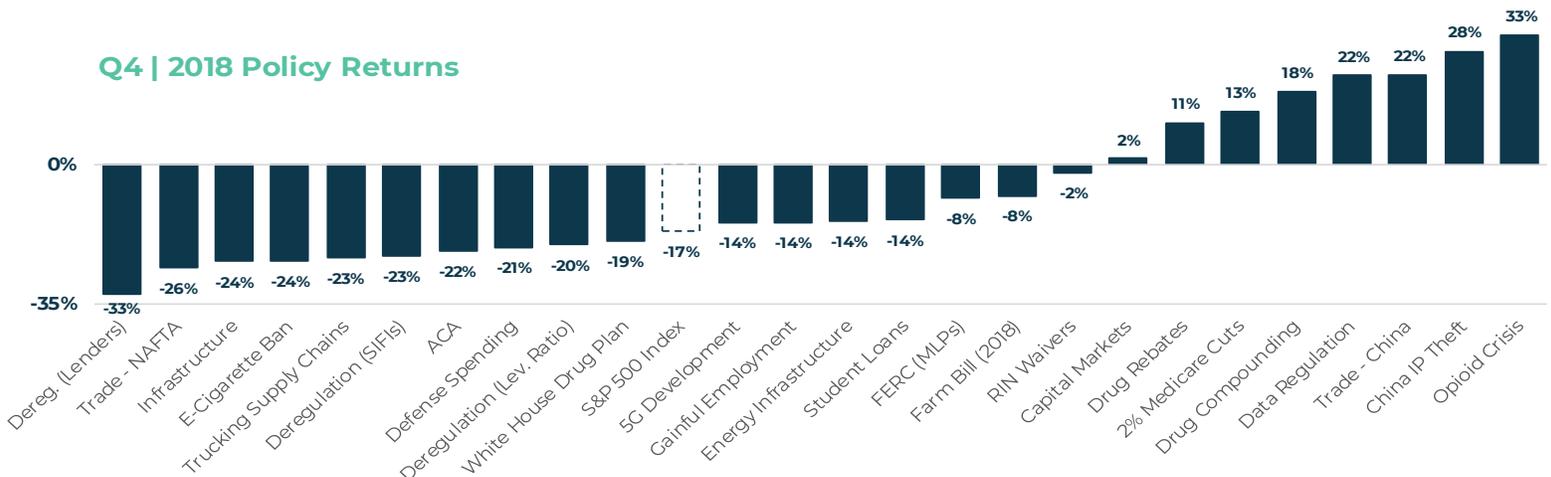
**Where should investors look for policy-making in this environment?** As we highlighted in our Q4 2018 outlook, government agencies play a significant role in setting policy. Due to the upcoming split Congress and potential for subpoena gridlock, we continue to believe investors should look outside of Congress to identify new policies over the next two years. Below are two policies not solely dependent on congressional action:

**(1) 5G Deployment:** A geopolitical battleground, with the U.S. and China racing to develop their respective 5G networks. The winner will likely set the technical standards for 5G, impacting the software and products used in such varied items as Internet of Things products and autonomous

vehicles. The Federal Communications Commission (FCC) is supporting the 5G rollout by freeing up spectrum and deregulating small cell deployment. In our view, the U.S. is in the early stages of a multi-year 5G buildout. The buildout will require significant investment in fiber infrastructure and communication equipment (e.g. small cells), which represents an additional revenue opportunity for the communications industry.

**(2) Infrastructure:** Indecision by Congress and the Federal government is pushing state governments and local voters to take matters into their own hands. For example, Los Angeles county voters overwhelmingly passed Measure M in 2016, which imposed a new \$0.005 sales tax and indefinitely extended an existing \$0.005 sales tax originally set to expire in 2019. Measure M provides LA county's transit authority \$120 billion over the next 40 years to expand public transportation. Seattle voters also passed an infrastructure package, called Sound Transit 3, in 2016 to expand the light rail system, and airports are being updated, with Newark Liberty International approving a \$2.7 billion redevelopment plan and NY LaGuardia currently undergoing an \$8 billion renovation.

Q4 | 2018 Policy Returns



This chart tracks the performance of policies by measuring the performance of separate baskets of stocks. The adviser selects stocks for each basket based on what it believes will be impacted by each policy. See the disclosure section at the bottom of page 2 for a complete list of the stocks included in each policy and the calculation methodology.

**How are states and localities financing these projects?**

According to a recent Congressional Budget Office (CBO) report, states and localities are utilizing federally supported mechanisms, such as tax-exempt bonds and direct federal credit programs, to finance infrastructure. Between 2007 and 2016, states and localities invested ~\$64 billion per year in infrastructure, including \$43 billion in tax exempt bonds annually. If you can look past Congress, there's infrastructure activity occurring. **The dollar amounts are small relative to President Trump's \$1.5 trillion infrastructure plan, but the revenues are material to project managers and raw material providers.**

**Trade**

In our view, trade will continue to impact markets during Q1 2019 as traders and investors react to daily headlines and create volatility. Jeff Miller, author of a *Dash of Insight*, recently wrote an article discussing the noise surrounding current U.S.-China trade negotiations. (You can read it [here](#).) Like Jeff, **we are encouraged by recent developments, but remain realistic of what can be accomplished during the 90-day truce period.** If there are signs of a deal coming together, stocks with significant China revenue exposure could experience relative outperformance. We recommend investors not get caught up in the recent headline volatility.

In addition to China negotiations, **we expect the recently negotiated NAFTA agreement, European tariff negotiations, and Brexit negotiations to continue to impact markets as we enter in 2019.** Any sign of disagreement between the U.S.-Mexico-Canada delegations or within Congress could destabilize the interconnected North American supply chain and economy and impact

companies with significant Canada and Mexico revenue. Brexit also continues to be a hurdle in Europe, with internal Great Britain deliberations increasing the risk of a "No Deal" with the European Union and creating continent wide chaos for supply chains and citizens.

**Federal Reserve Tightening**

In addition to trade, the Federal Reserve continues to have a significant impact on markets as it contemplates raising interest rates. While it's important to monitor the projected number of interest rate hikes in 2019, we believe investors should take a longer-term view. **In our view, the Federal Reserve is signaling a contractionary monetary policy to combat recent expansionary fiscal policy by the Trump administration and Congress** (e.g. 2017 tax reform paired with increased government spending and deficits).

What does this mean for investors in the bigger picture? There is a structural change occurring in the markets. In our view, **investors should heed the Federal Reserve signal and review their current risk levels.**

**Our View on Positioning**

**Investors should consider long-term thematic alpha exposure while reducing equity market (beta) exposure.** We will look to continue lowering the beta of investment strategies on further market rallies. That said, we would likely maintain some below market exposure as long-term growth fundamentals in the US still look very strong, but we feel we must respect the technical weakness.

Stay tuned for the Policy Tracker in late-January for some fresh single stock policy ideas.

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The 4Q 2018 Policy Returns (on page 1) are calculated by averaging the performance of a group of stocks that AWA considers to be impacted by each respective policy for the dates of 9/30/2018 to 12/27/2018. The following includes the tickers used for each policy and whether the security was long (L) or short (S) — Defense Spending: LMT (L), RTN (L), NOC (L), BA (L), HII (L), BWXT (L), AVAV (L), FLIR (L), AJRD (L), KTOS (L), OSIS (L), UTX (L), TDG (L), COL (L), HXL (L), HON (L), TXT (L), MOG.A (L), BAH (L), LDOS (L), CACI (L), ICFI (L), SAIC (L); RIN Waivers: ANDV (L), CVRR (L), HFC (L), PSX (L), VLO (L), ANDE (S), GPRE (S), REX (S), PEIX (S); Energy Infrastructure: LNG (L), PWR (L); FERC (MLPs): SEP (L), EEP (L), TCP (L), WMB (L); Student Loans: GHC (L), CHGG (L), NNI (L), NAVI (L), SLM (L); Gainful Employment: CECO (L), ATGE (L), LAUR (L), LOPE (L), STRA (L); ACA: HCA (L), UHS (L), LPNT (L), EHC (L), MOH (L), CNC (L), WCG (L), HUM (L), CERN (L), TDOC (L), ASGN (L), MDRX (L), OMCL (L), VCRA (L), EVH (L), TRHC (L), MASI (L); Opioid Crisis: MCK (S), CAH (S), ABC (S), MNK (S), INSY (S), JNJ (S), MYL (S), ENDP (S), TEVA (S); E-Cigarette Ban: MO (L), PM (L), BTI (L); 2% Medicare Cuts: LHCG (S), AMED (S), CHE (S), SEM (S), MDT (S), ISRG (S), SYK (S), TFX (S); Drug Compounding: ANTM (S); White House Drug Plan: AGN (L), MMK (L), VRTX (L), TEVA (L), MYL (L), PFE (L), LLY (L), GILD (L); Drug Rebates: ESRX (S), CVS (S), UNH (S); Farm Bill (2018): WMT (L), TGT (L), KR (L), DLTR (L), DG (L); Trade - NAFTA: KSU (L), UNP (L), BWA (L), STZ (L), TAP (L), COST (L), PWR (L), FLR (L), MGA (L), ASLN (L), AXL (L), APTV (L); Trade - China: EXPD (S), MATX (S), AAWW (S), CAT (S), DE (S), DLPH (S), BWA (S), SWKS (S), QCOM (S), AVGO (S), MU (S), WYNN (S), LVS (S); 5G Development: ERIC (L), NOK (L), QCOM (L), SWKS (L), QRVO (L), CSCO (L), ZAYO (L), AMT (L), GLW (L), CCI (L), UNIT (L), IDCC (L), T (L), VZ (L), S (L), TMUS (L); Data Regulation: FB (S), TWTR (S), AMZN (S), GOOGL (S), ACXM (S), CLGX (S), EFX (S), TRU (S); China IP Theft: INTC (S), QCOM (S), NVDA (S), MU (S), IBM (S), AMD (S), TXN (S); Infrastructure: FLR (L), KBR (L), GVA (L), ACM (L), PRIM (L), MLM (L), VMC (L), EXP (L), SUM (L), USCR (L); Trucking Supply Chains: DSKE (L), KNX (L), WERN (L), ARCB (L), SNDR (L), SAIA (L), ODFL (L), LSTR (L), HUBG (L), XPO (L), EXPD (L), ECHO (L), RRTS (L), NSC (L), UNP (L), JBHT (L), KSU (L), TRTN (L), TRN (L), ARII (L), GATX (L), WAB (L), GBX (L); Deregulation (Lenders): ENVA (L), CURO (L), FCFS (L), GDOT (L), OMF (L); Deregulation (Lev. Ratio): BAC (L), C (L), GS (L), JPM (L), MS (L), WFC (L), STT (L), BK (L), NTRS (L); Deregulation (SIFIs): ASB (L), PACW (L), ZION (L), KEY (L), AXP (L), STI (L), BBT (L); Capital Markets: CBOE (S), ICE (S), NDAQ (S), CME (S)