STONE
ASSET MANAGEMENT LIMITED
Sleep well.

MARCH
MARKET COMMENTARY & FORECAST

MARKET MARCH MADNESS

The markets have experienced a “snakes and ladders” type ride over the past six months. The S&P 500 went from record highs in the fall of 2018 to the cusp of a bear market by Christmas Eve and back within striking distance of its peak in the new year. The MSCI World Index jumped another 1.05% in March bringing it up 11.89% for the first quarter. This was once again led by a stellar 1.79% gain in the S&P 500 in March, and 13.07% for the quarter. The Dow Jones was held back with a 0.05% gain in March due to the fall in Boeing shares but was still up 11.15% for the quarter. The S&P has had its best first quarter since 1998! The TSX added to its yearly winning streak with a gain of 0.64% in March and 12.42% for the quarter. The lower interest rate environment had a positive impact on the interest-sensitive sectors such as utilities (+4.26%) and real estate (+3.44%) while having the opposite effect on financials (-1.41%), consumer discretionary (-1.43%) and energy (-0.90%). Once again, Asian markets were on fire with China’s Shanghai Composite up another 5.09% in March taking its YTD gain to 23.93%. These Chinese market gains resulted even in the face of continual US-China trade negotiations and downward GDP growth revisions. The yield on the benchmark US 10-year Treasury note plummeted to 2.41%, down 27 bp for the year and down from a high of 3.23% in the fall of 2018.

Federal Reserve Chair Jerome Powell has recently made a policy pivot on his auto-pilot tightening stance of 2018 to an extended pause in the new year. North America has experienced a freeze on further interest rate increases and this has spread globally. This milder version of the FOMC has brought back the TINA theme, “There Is No Alternative”, across all markets as plummeting interest rates are less competition for equities. In recent months, signs of weakening growth in China, the US and Europe have helped drag treasury yields lower. The Fed has concerns across several baskets such as slower global economic growth, lower inflation expectations, tighter financial conditions and policy uncertainty. The most important item is slower global economic growth as the weak PMI in Europe, cooling in China and slippage in the US’s domestic demand have all contributed to the wave of disappointing global economic data. Some economists are now thinking the next rate move can be a cut rather than an increase. Bank of Canada’s Stephen Poloz is facing an even bleaker picture for the Canadian economy. Fading competitiveness due to an over-dependence on natural resources, a growing trade spat with China and an overleveraged consumer are forcing Poloz to join other central bankers on the sidelines.

MARKET PERFORMANCE

Market	Return (%)*
Canada (S&P/TSX)	1.0
US (S&P)	3.3
MSCI (World)	2.4
Best (India)	11.8
Worst (Argentina)	(11.1)

*In Canadian dollar terms as at March 31, 2019

Investors' cautiousness has driven them to seek the safety of US government bonds, especially with earnings estimates bleeding lower for 2019 and exogenous event risks such as Brexit-linked disruptions and trade risks.

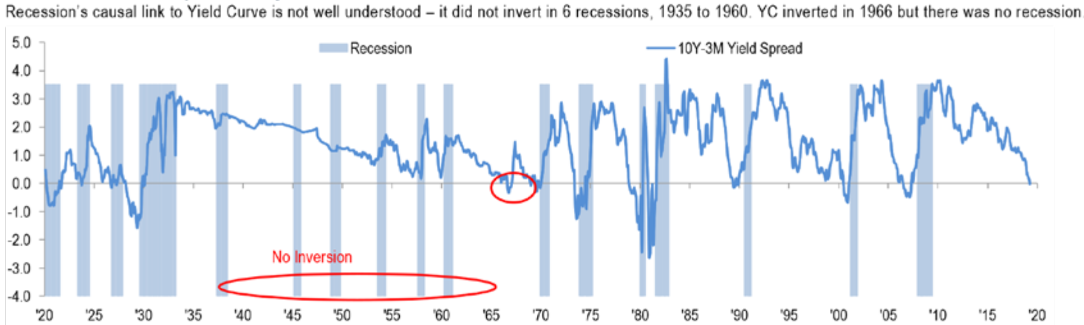
The yield curve had inverted by the end of March, for the first time since 2006, as short-term rates were higher than long-term rates. This is usually a precursor to an economic downturn as evidenced by the S&P 500 dropping 2% on the day the yield curve inverted on March 22. The 10-year Treasury had fallen below the three-month T-bill yield for five consecutive trading days in late March, spurring concerns about the pace of economic growth and the risk of a future contraction. We have subsequently seen the inverted yield curve reverse itself on promising manufacturing and economic numbers. Investors will be watching the upcoming economic data closely with a laser focus after dismal numbers thus far and the above recessionary warning signals from US Treasury yields. After the longest US government shutdown on record and a late 2018 equities collapse, investors are hoping for a clearer view.

The recession link to yield inversion is not always a given. In fact, the yield curve did not invert in six recessions from 1935-1960 (see figure #1). In addition, there are many unusual characteristics of the current economic cycle and the global macro backdrop that warrant careful review. This decades-long cycle has had stubbornly low inflation compared to other late-cycle macro environments.

Figure #1

US Yield Curve: Term Spread of 10-year Bond Yield and 3-Month T-Bill Rate Has Inverted Prior to 7 of the Last 8 Recessions

Recession's causal link to Yield Curve is not well understood – it did not invert in 6 recessions, 1935 to 1960. YC inverted in 1966 but there was no recession.



Recession bars based on The NBER's Business Cycle Dating Committee's chronology of the U.S. business cycle. Average monthly yield except the last data point (3/26/2019).
Source: J.P. Morgan US Equity Strategy and Quantitative Research, Bloomberg

Warren Buffet recently said, "the lower bond yields go; the more attractive stocks are as a long-term investment". This likely explains the resilience and strength of equities we have witnessed year to date. But what level of equity valuation makes sense? Another theme also kicks in, FOMO, the "fear of missing out" is driving investors to buy equities as they march higher. Lower interest rates and renewed deflationary pressures should provide room for multiples to re-rate higher. History shows that there is a negative correlation between interest rates and equity multiples and stock market performance. Figure #2 shows this staggering inverse correlation. A 100 bp decline in rates has resulted in the S&P 500 gaining about 10% within a year, and multiples rating higher accordingly. Looking at 2020 forecast EPS numbers for the S&P 500 of $181, the market is pricing in under 16x PE. This is not necessarily a high level given the low interest rates as an alternative.

Figure #2

S&P 500 Returns vs. 1yr Change in 10yr Bond Yield
Since 1950

			Performance		Δ in PE		
	1yr Δ in 10yr Bond Yield	Count	Last 12Mos	Next 12Mos	Last 12Mos	Next 12Mos	
Lower	-500 to -400bps	4	24%	22%	3.5x	3.8x	Higher
Rates	-400 to -300bps	11	31%	14%	4.2x	1.7x	Multiples
	-300 to -200bps	18	24%	19%	2.9x	2.4x	
	-200 to -100bps	78	8%	8%	0.3x	0.3x	
	-100 to 0bps	256	6%	10%	0.3x	0.5x	
	Rates ↑ (all periods)	**367**	**9%**	**10%**	**0.6x**	**0.6x**	
	Rates ↓ (all periods)	**463**	**9%**	**8%**	**(0.2x)**	**(0.2x)**	
	0 to 100bps	363	10%	8%	(0.1x)	(0.0x)	
	100 to 200bps	76	8%	7%	(0.3x)	(1.1x)	
	200 to 300bps	15	8%	14%	(2.1x)	0.2x	
Higher	300 to 400bps	8	6%	3%	(0.1x)	(0.0x)	Lower
Rates	400 to 500bps	1	8%	(15%)	1.0x	(1.5x)	Multiples

Source: Federal Reserve, J.P. Morgan US Equity Strategy and Quantitative Research

Our cash level has stayed the same and our portfolios have been structured as more defensive compared to the index. We believe the best way to invest in markets such as these is to have a total return mandate. Investors should be rewarded by buying companies with a strong growth profile and growing dividend stream.

We use our proprietary investment process daily and in volatile market conditions such as these, we seek to ensure that we can manage downside risk and adjust the portfolio accordingly while seeking to achieve our long-term investment goals.

We remain invested and are committed to companies that provide revenue growth, improving free cash flow and higher earnings per share. We are active portfolio managers with a disciplined investment process including the implementation of various risk management tools to benefit our investors.

Kindest Regards,

Richard Stone,
Chief Investment Officer
Stone Asset Management Limited

FUND PERFORMANCE - Series F/FF

	1 mo	3 mo	6 mo	YTD	1 yr	3 yr	5 yr	10 yr	Since Inception	Inception Date
Stone Dividend Growth Class, Series F	1.5	9.6	(0.3)	9.6	8.3	8.4	5.5	10.0	9.5	08/01/2003
80% S&P/TSX Composite, 20% S&P 500 C$	*1.5*	*13.0*	*1.8*	*13.0*	*9.2*	*10.4*	*7.4*	*11.0*	*8.4*	
Stone EuroPlus Fund, Series F	2.9	9.0	3.6	9.0	1.1	4.0	3.8	8.3	3.9	05/02/2008
Comparable European Equity Index $C	*2.2*	*8.7*	*(0.1)*	*8.7*	*(0.2)*	*7.6*	*5.0*	*9.6*	*3.8*	
Stone Global Balanced Fund, Series FF	2.9	8.5	2.0	8.5	4.9	6.1	5.8	9.2	8.4	01/05/2009
15% S&P/TSX Composite, 15% S&P 500 C$, 30% Comparable Global Equity Index C$ and 40% FTSE TMX Canada Universe Bond	*2.5*	*8.4*	*3.1*	*8.4*	*7.9*	*8.2*	*7.1*	*9.1*	*8.7*	
Stone Growth Fund, Series F	2.7	8.3	(2.7)	8.3	10.3	9.2	8.1	10.4	6.6	08/01/2003
50% S&P/TSX Composite and 50% S&P 500 $C	*2.3*	*12.4*	*1.7*	*12.4*	*10.8*	*11.8*	*8.3*	*11.4*	*8.0*	
Stone Global Growth Fund, Series F	3.9	13.8	(0.4)	13.8	8.8	13.4	13.1	15.4	9.0	08/01/2003
Comparable Global Equity Index $C	*2.9*	*10.4*	*0.6*	*10.4*	*7.9*	*11.8*	*10.9*	*13.0*	*7.4*	
Stone Select Growth Class, Series F	(1.5)	5.4	(9.8)	5.4	(11.9)	(3.9)	n/a	n/a	(14.3)	09/01/2014
50% S&P/TSX Capped Energy, 50% S&P/TSX Capped Materials	*0.2*	*10.4*	*(5.4)*	*10.4*	*8.1*	*4.5*	*n/a*	*n/a*	*(5.7)*	
Stone GaleForce Dividend Growth Pool	0.9	8.0	0.2	8.0	7.4	7.5	5.3	n/a	6.3	05/17/2012
Stone American Dividend Growth Fund Series F	0.3	4.7	(6.2)	4.7	(1.6)	4.5	n/a	n/a	6.4	07/17/2014
Stone Monthly Pay Fund	2.4	9.2	(7.1)	9.2	(4.5)	(0.1)	(3.0)	6.2	1.7	02/07/2006
Stone Global Strategy Fund Series F	1.4	5.0	(3.0)	5.0	3.6	4.5	4.6	10.9	4.2	09/22/2006
Stone Covered Call Canadian Banks Plus Fund Series F	(0.6)	9.2	(3.9)	9.2	(2.2)	7.1	n/a	n/a	4.2	07/17/2014
Stone Small Companies Fund Series F	0.4	9.1	(1.8)	9.1	2.0	2.4	(1.1)	2.6	(3.1)	02/07/2006

The returns set out above are historical annualized compounded returns net of all fund fees and expenses. The returns assume a re-investment of all distributions. Historic returns are provided for general information purposes only and may not be indicative of future returns or fund performance. Performance data of other Series of the Funds may differ from those shown above due to differences in fees. Please visit our website at www.stoneco.com for performance data of all Series.

As at March 31 2019

CANADIAN FACTS – Quick-Release Buckle, the fast way into the saddle

Most of the technologies of the horse and buggy were swept aside with the arrival and embrace of the automobile. The quick-release buckle remains. In fact, it grows more popular with time. Arthur Davy of New Glasgow, Nova Scotia created the device in 1911 as a way to attach the ends of two reins quickly and securely – and to detach them equally quickly and smoothly. Instead of the conventional buckle, Davy's version featured one part equipped with a pair of spring activated dogs (a dog is a mechanical device for gripping) adapted to extend into and engage slots in the second part. Click! That sound is heard now more than ever, as people fasten tight clothes, car seats, briefcases, backpacks – anything that requires a quick, secure click shut.

*Adapted from Ingenious - How Canadian Innovators Made the World Smarter, Smaller, Kinder, Safer, Healthier, Wealthier, and Happier, by David Johnston & Tom Jenkins

Sleep well

Knowing you'll have the financial resources to live well.

STONE ASSET MANAGEMENT LIMITED

Sleep well.

40 University Ave, Suite 901
Toronto, Ontario M5J 1T1

Toll free. 800 336 9528
Fax. 416 364 8456

www.stoneco.com info@stoneco.com