A Registered Investment Adviser

3rd Quarter 2019 Commentary

Stark Financial Advisers, Inc.

July 1, 2019 **Volume 1 Issue 3**

Special points of interest:

- Be Greedy When Others are Fearful
- Steps for Achieving Financial Freedom
- We Remain Overweighted in Domestic Equities
- REITs a Good Choice for Income Investors
- Say Goodbye to 2% Savings Accounts
- Will Gold Breakout of its Trading Range?

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When Fear is Good?

According to a recent Bank of America survey 87% of fund managers with over $645 billion under management are bearish. The highest level of negativity since 2008. Concerns are that we are late in the economic cycle, trade tensions and the rising risk of recession As a result, funds are pouring money into bonds, defensive stocks and holding cash. If we heed Warren Buffet's advice to be greedy when others are fearful, now is not the time to be bearish. It's quite possible that investors are over-estimating market risk and potential downside. History has proved Buffet's advice to be sound. According to Leuthold Group, an independent research firm, when investors have been as defensive as they are today the Standard & Poor's 500 has gained over 18% in the next six months.   And if the market doesn't go up? Perhaps the current defensive positioning would provide a source of buying during market pullbacks, tempering declines.

Steps for Achieving Financial Freedom

The true measure of financial success isn't how much money you make—it's how much you keep. That's a function of how well you're able to save money, protect it, and invest it over the long term. Sadly, most people are bad at this. So, what steps could help bring greater success? First, *set goals*. It's a simple exercise but it serves to keep you on track and to motivate you. Know what you have and what you need. Think hard about wants versus needs so you can make conscious decisions about which discretionary expenses you want to keep. *Save systematically*. Put savings in the same expense category as your electric bill: mandatory and automatic. Invest in your retirement plan. Retirement plans are either tax-free or tax-deferred and may allow you to invest pretax money or take a deduction for after-tax investments. *Invest for growth*. This means stocks. Given the swings in U.S. stock markets lately, this may sound risky. But the upsides far outweigh the downsides. *Avoid bad debt*. Some debt such as a home mortgage enables wealth creation. Avoid credit-card debt. If you use a credit card pay it off each month. *Don't overpay for anything*. You can't avoid costs altogether but you can save a bundle over time by minimizing them. *Protect yourself by preparing for the worst*. Life is full of rough patches. Try to build an emergency fund equal to at least six months' expenses. Keep it simple. *Keep your emotions, political opinions, and hunches far away from your investment decisions*. Understand that when you most want to sell, it's probably time to buy, and vice versa. *Seek unbiased advice*. Make sure your advisor has your back. Following these few simple rules will greatly increase your chances of achieving financial freedom.

Asset Class Views

Our views on key asset classes over the next three months favor U.S. domestic equity and emerging market securities. Despite domestic stocks trading near highs, sentiment is bearish and there is plenty of cash to fuel a further rally. We favor stocks with a history of strong and sustainable earnings that are trading at attractive valuations. Technology is a favored sector. Emerging markets especially EM Asia are attractive. Economic reforms and policy stimulus support the sector. Trade tensions are an issue but, improved Chinese economic activity due to stimulus could help offset trade-related weakness. Any actual or perceived resolutions to current trade tensions could fuel a rally. We remain underweight developed European equities. Weak economic momentum and political risks are still challenges to earnings growth. We are neutral on Japan. Cheap valuations are supportive, along with shareholder-friendly corporate behavior, central bank stock buying and political stability. Earnings uncertainty is a key risk. We are cautious on U.S. Treasury valuations. We prefer shorter-dated and inflation-linked bonds. In the sector, we favor U.S. municipals. Demand is outstripping supply. In addition, tax overhaul has made municipals tax-exempt status more attractive in many states. In the commodities and currency class, a reversal of recent oversupply is likely to underpin oil prices. Any relaxation in trade tensions could boost industrial metal prices. We are neutral on the U.S. dollar. It has perceived “safe-haven” appeal but gains could be limited by a high valuation and a narrowing growth gap with the rest of the world.

REITs Offer Shelter and Income

Real estate investment trusts, REITs, are a good part of a diversification strategy. A REIT is a company that owns, and in most cases operates, income-producing real estate. REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centers, hotels and timberlands. Some REITs engage in financing real estate. They also offer several market benefits. First, the price movement of REITs are not completely correlated to the movement of the stock market in general. This feature does serve to reduce portfolio volatility. It’s noteworthy that during the recent volatility caused by trade tensions, REITs as a group were less volatile than the broader market. More defensive REITs in areas such as health care, self-storage facilities, and residential housing held up better than those focused on industrial or lodging properties. Second long-term returns are like other equity sectors. This year’s performance is even a bit better. Since 12/31/18 through mid-June the iShares Cohen & Steers REIT ETF has gained almost 20%. For the same period, the Standard and Poor’s 500 Index gained just under 16%. REITs, which typically own income-producing U.S. real estate, are required to pay out at least 90% of their taxable income to shareholders. That makes REITs a good choice for income investors. Current income varies significantly from company to company. However, a diversified group of REITs are well capable of paying income in excess of 2.5%. Of course, like all investments there are cautionary notes. First, each REIT is a different company. You need to understand how vulnerable a company is to changing economic conditions. The group is also sensitive to interest rates. As rates move down, borrowing costs for REITs decrease and vice versa. We have been over-weight the group for some time and continue to view the sector as attractive. Our opinion is based upon the expectation for interest rates to remain low in the foreseeable future, for the economy to remain strong, and for the group being able to maintain and even increase, current distributions.

Crude Oil Prices to Remain Subdued

Crude oil prices have been volatile this year with the primary trend being lower. Forecasts for global oil consumption have been cut. During June both the International Energy Agency and the Organization of the Petroleum Exporting Countries cut their expectations for demand. The IEA's revision follows a decline in projected global gross domestic product growth by the Organization for Economic Cooperation and Development for GDP to 3.2%. The IEA added that world trade growth has fallen back to its slowest pace since the financial crisis 10 years ago. OPECs downward revision was due to lower than expected demand in the first quarter by countries that are part of the OECD bloc, including the United States where gasoline demand slowed

against expectations. During October 2018 WTI crude traded for $76 per barrel. Concerns for slowing global growth and strong production were catalysts for prices sliding to $45 bbl. (Dec. 18). Trade tensions sparked a rally to $66 bbl. (April 2019), prior to prices sliding again to the low $50 bbl. range. Most recently a small rally was spurred by an unexpected escalation in Middle East tensions. The mid-June attacks followed previous attacks on pipelines in Saudi Arabia and ships in waters near Fujairah. The driving fundamentals are a slowing global economy and a plentiful supply of product. Unless there is a major escalation in world tensions in either the middle east or China, we expect to WTI to trade in a range between $50 to $65 bbl. this year. Good news for summer vacationers.

Investing for Yield is Tricky

Conventional wisdom has reversed. After years of near-zero returns on cash, the markets have been expecting interest rates to rise. After a brief rise, rates are falling again. Today, the consensus is for rates to continue to fall. Federal-funds futures markets are pricing in a half-point cut this year and another 40 basis points in 2020; a basis point is equal to one-hundredth of a percentage point. If the markets are right, rates could fall by three-quarters of a point over the next year, taking federal funds to a range of 1.5% to 1.75% from their current 2.25 to 2.5%. That would have wide-ranging consequences for stocks, bonds, and savings vehicles like money-market funds. The likelihood of rates going down is clouded in some uncertainty. The market is pricing in a recession scenario but, with current trade uncertainties, predicting the growth rate for the economy is not easy. "Uncertainty" is the key word and that suggests a bumpier road for both the stock and bond markets. With rates falling say goodbye to 2% savings yields. Rates for money -market funds, checking and savings accounts might edge back down to 1%. With inflation at about 1.5% it is tough to generate a real inflation-adjusted return. CDs may pay a little more, but the trade-off is lack of liquidity. Investing in longer-term fixed income is also tricky. Lower yields have caused prices to rise. That's been good for bond investors since last fall. However, if the Fed lowers short-term rates and the market sees the cuts as stimulative to the economy and inflation expectations, longer-term fixed income could easily fall in price. Given the uncertainty and duration of any moves in interest rates, it's best to play it safe. We favor inflation-linked notes and corporate bonds near a five-year maturity. Taxable investors should evaluate the attractiveness of tax-free municipals. In addition to the benefit of providing strong diversification from equities, municipal bonds present an attractive after-tax income opportunity. The group of investors who can benefit from the tax-exempt nature of munis is larger than most people think. Anyone whose tax bracket is 24% or higher could earn nearly a quarter of a percentage point more yield by owning munis on an after-tax basis. By keeping maturities relatively short and quality high, there is a lot of credit or interest rate risk. Another pocket of value is agency mortgage-backed securities. The securities are rated AAA implying no credit risk and currently yield more than AA corporate bonds. High-quality short-term funds are yielding 2.75% to 3% and would be defensive in an uncertain environment. What you want to avoid is buying bonds with long maturities and with lower quality balance sheets. The strategy will pay higher current income at the expense of high market risk and credit risk.

About Stark Financial Advisers

Stark Financial Advisers is a registered investment adviser affiliated with R.M. Stark & Co., Inc., an SEC registered broker dealer. SFA seeks to achieve positive returns over a long-term investment horizon by creating and maintaining the optimum portfolio for each investor. We view the optimum portfolio as one having the highest potential return consistent with the risk tolerance and investment horizon of the owner.

We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

Pursuant to Rule 204-3 of the Investment Advisers Act of 1940, we are required by the Securities and Exchange Commission to offer each client a copy of Form ADV Part II that describes our firm and methods of operation. To receive a copy, please call our Managed Account Services Department at (800) 410-0704.

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Gold Could be Ready to Rally

Gold prices rallied earlier this year peaking in February then shed all gains, bottoming in May and trading back to its yearly high in June. Year-to-date, gold has risen about 3% and has been a poor performer for the last five years having gained under 5%. Gold prices are once again bumping into gold's bear market wall of $1,375 per ounce. So, what is next? For gold to rise the euro needs to strengthen relative to the greenback, making purchases more attractive in dollars. Interest rates need to remain and trend lower and bullish speculators need to put upward pressure on prices. All three have shown signs that could boost gold later in 2019. Higher inflation would also help.

Gold has traded in a narrow range oscillating around $1,250 per ounce since 2013. Trading through the bear market wall will take strong tailwinds. A tailwind could develop if investors are seriously underestimating and underpricing risk in stocks and bonds. The summer months are a seasonally weak period for precious metals. If gold is to break the wall, energy may build up during the summer with a breakthrough in the fall. The wild card is monetary policy. If an unexpected change develops it could set off a rally. If a rally develops our 2019 target would be $1,550.

As always, the professional staff at Stark Financial Advisers thanks you for your confidence and business