NEWPERSPECTIVES

Commentary from New Century Advisors - February 2019

NCA Market Notes

- **Is NOW the Time to Buy Value?**
- **US Inflation – Core Remains Firm**
- **Australia – Is the RBA Going ZIRP?**

Is NOW the Time to Buy Value?

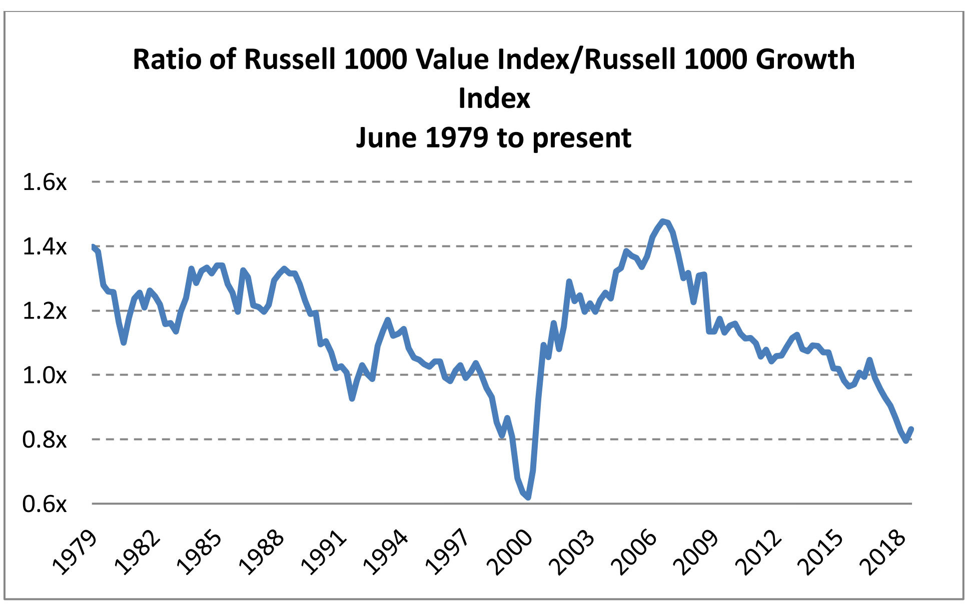
Value investing has been out of favor for so long, market pundits gleefully line up to pronounce it dead and buried.

It's easy to see why.

Since the beginning of 2009 through the end of 2018, the Russell 1000 Growth Index (RLG) produced a robust total return of ***360%***, while the Russell 1000 Value Index (RLV) delivered a paltry ***213%*** (S&P 500 returned 275% during the same period).

The high-growth "FANG" names and similar companies have captured the market's attention and wallet share during most of this business cycle.

Taking a step back, the chart below shows the historical ratio of RLV vs RLG. One will see we are currently experiencing a pattern similar to the late '90s, a period also when value investing was ignored in favor of companies with both high sales growth and the promise of future profits.

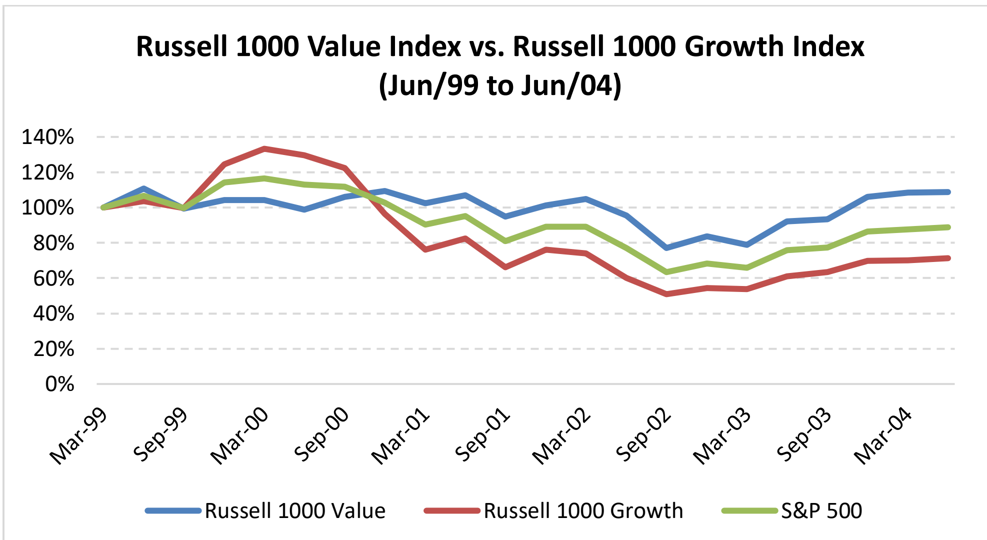


Source: Bloomberg, NCA

www.newcenturyadvisors.com
research@ncallc.com

Looking back, the S&P Technology sector returned nearly 220% from 1999 to 2000. The shouts of "this time it's different" rang out in financial firms as growth trounced value. No other sector compared in returns during that two-year period. The next best performing sector in the S&P 500 was the consumer-discretionary sector, which returned 77%.

But looking at the five years after the RLV/RLG ratio we are pointing out was first reached, value outperformed growth.



Source: Bloomberg, NCA

From a top-down sector perspective, being underweight technology would have been the right decision, as it returned about -25% during that period. The S&P 500 sectors that shined during this period were the ones that that were nearly ignored in late 90's: energy returned +192%, financials returned + 57% and industrials returned +47%. Classic defensive sectors, like healthcare, utilities and consumer staples produced returns that came close to the overall market.

One trait that is needed to wear the value investor label proudly is PATIENCE.

Perhaps we are moving into the period when the patience of the value manager will finally be rewarded.

Since 9/28/2018 through 1/31/2019, a period characterized by an increase in market volatility and global recession fears, RLV outperformed RLG by 3.5%.

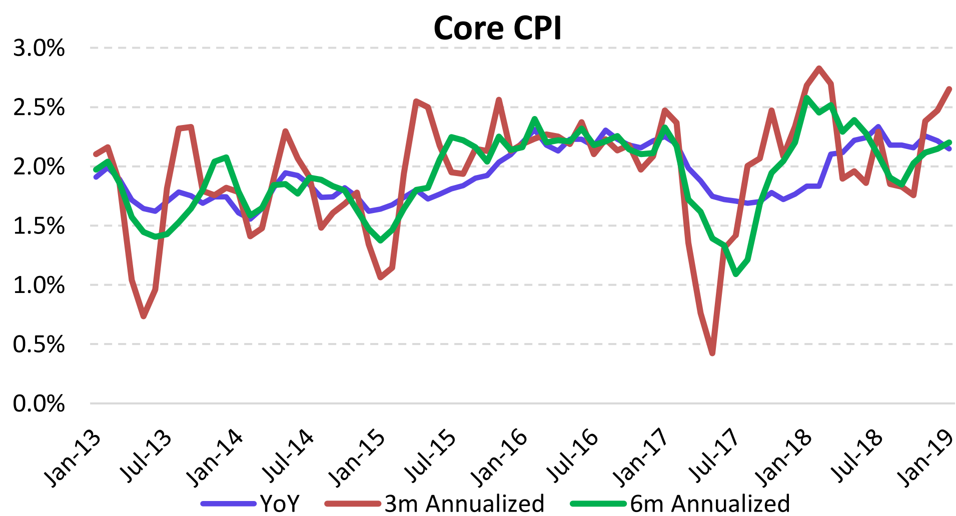
Albeit, both indices were negative during this period, RLG was down -8.3% while RLV was down -4.9%. (The S&P 500 was down -6.6% during the same period.)

There are no investing laws that state that value must outperform in absolute terms.

US Inflation – Core Remains Firm

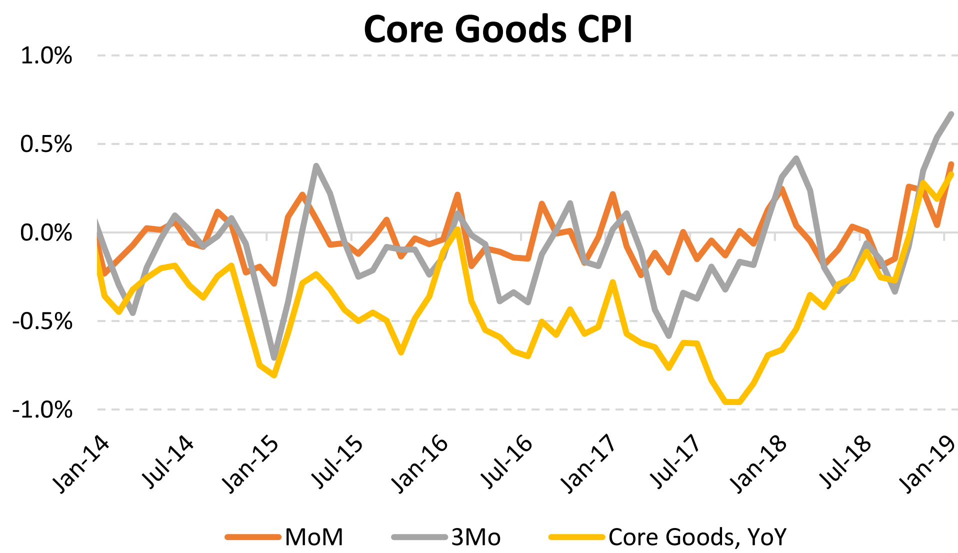
Headline CPI was flat MoM in January, pulled lower by a 3.1% drop in energy prices. That led the YoY print to decline to 1.6% from 1.9% in December, above the consensus estimate for a drop to 1.5%.

But while volatile energy prices weighed on headline inflation, Core CPI remained firm at 2.2% YoY, not far off the nearly 10 year high touched last summer. Recent trends show signs it could be headed higher, with Core CPI rising 2.65% on an annualized basis over the past three months (chart).



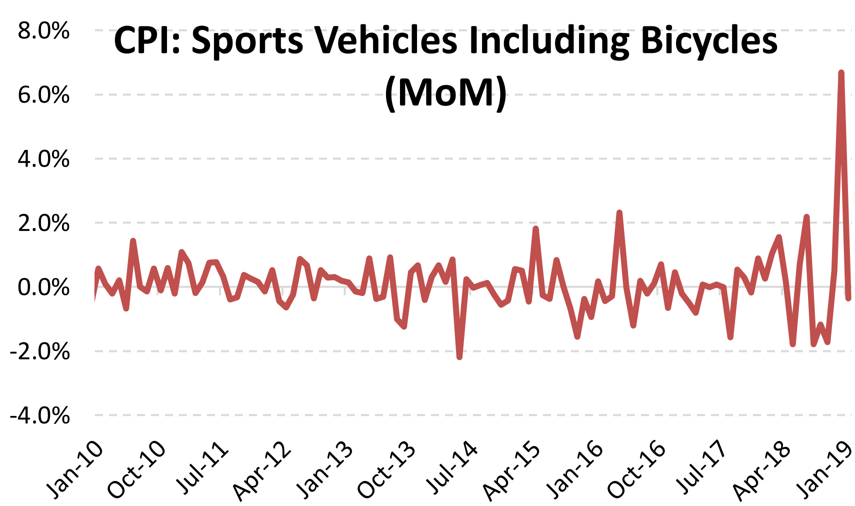
Source: Bureau of Labor Statistics, *NCA*

One of the drivers of the recent strength has been Core Goods inflation (19.5% of CPI), which broke meaningfully above zero on a YoY basis for the first time in six years back in November and has continued to trend higher since. January saw the biggest MoM gain in over 9 years.



Source: Bureau of Labor Statistics*, NCA*

Lest you were wondering, tariffs are not the culprit. They represent a one-time increase in prices, not an increase in the rate at which prices are increasing, which is what inflation measures. Seen below is the MoM change in Sports Vehicles Including Bicycles. While it is a small category (less than 0.3% of CPI), roughly 2/3 of the bikes sold in the U.S. are made in China, so these prices are heavily impacted by the tariffs. Note the big one-time jump in prices seen in December (+6.7% MoM), while January saw prices virtually unchanged (actually -0.36% MoM). While the December spike had a similar impact on the YoY data, that can be expected to drop out a year from now as the base effect passes through. Should the tariffs be reversed in the meantime, then a negative MoM spike can be expected, reversing the YoY impact all the sooner.



www.newcenturyadvisors.com
research@ncallc.com

Source: Bureau of Labor Statistics, *NCA*

(Avg. except noted)	2002-07	2013-18	
GDP Growth	3.5%	2.5%	↓
Output Gap	-0.2%	0.8%	↑
Unemployment (end-18)	4.0%	5.0%	↑
Underemployment (end-18)	5.7%	8.3%	↑
CPI Inflation	2.8%	2.0%	↓
Wage Growth	3.8%	2.2%	↓
Retail Sales	6.3%	3.7%	↓
RBA Policy Rate	5.5%	2.2%	↓

Source: Bloomberg, IMF, NCA

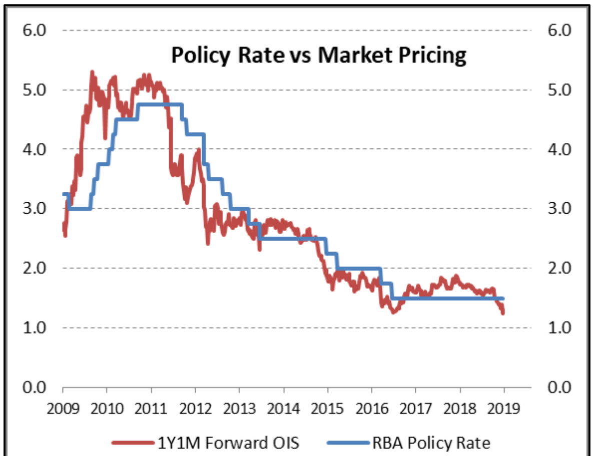
Australia: Is the RBA Going ZIRP[1]?

Post crisis monetary policy in the developed world is shaped by conventional and unconventional monetary policy tools. Central banks used rate cuts, securities purchases (QE), and forward guidance to ease financial conditions. A few of them (Fed & BOE) hit the zero lower bound (ZLB) and continued to stimulate through unconventional tools. Some (ECB, BOJ, and Riksbank) cut the rates into negative territory while *also* using unconventional tools.

The Reserve Bank of Australia (RBA) only had to use the policy rate to stimulate the economy as it had adequate economic and monetary buffers. Multiple tailwinds supported the Australian economy in early years such as still fast-growing China (60% of commodity exports), high commodity prices, strong housing market, relatively robust consumer spending, and business investment provided support.

However, tailwinds slowly reversed direction around 2010. The RBA was mostly reactionary and responded with rate cuts when it became necessary. The bank was not able to join the Fed when the US central bank started its hiking cycle in 2015.

The RBA has kept rates on hold since 2016 due to weak data (see table above) but leaned hawkish as it signaled the next move was going to be a hike. The rates market was also in line with the RBA's policy guidance and priced in hikes (see the chart on the right). However, last week two events changed the monetary policy calculus dramatically.



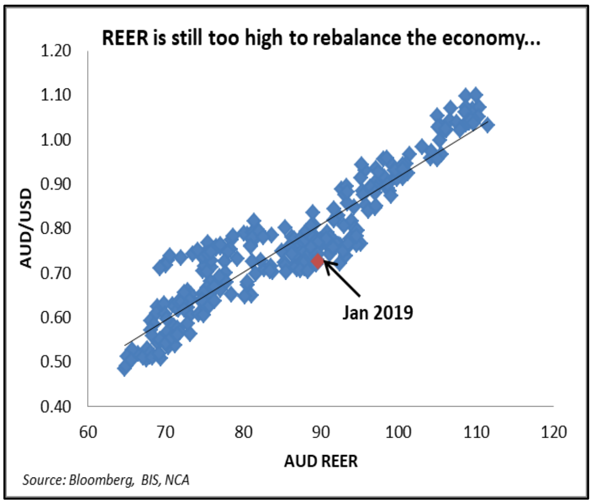
Source: Bloomberg, NCA

First, Governor Philip Lowe dropped a tightening bias in favor of a more neutral monetary policy stance. Then, two days after, the RBA downgraded its growth forecasts materially amid concerns about the strength of consumption and the prospect of spillovers from the weak housing market.

[1] Zero Interest Rate Policy

The rates market responded to this dovish tilt by pricing one full 25bp cut in the next 12 months from a full hike early November.

So, what's next for the Aussie economy and the RBA? Are the factors driving the economic trends expected to change in the medium term? If they don't, does the RBA have enough conventional ammunition to respond? Finally, is the RBA headed to the zero lower bound and what are the ramifications for the AUD?



We expect the weak data trends to persist in the medium term and Australian economy to underperform its pre-crisis performance. A new round of stimulus measures in China could help but that is unlikely to reverse the weak economic trends as the measures are likely to be small relative to past stimulus programs. Moreover, the Chinese economy's sensitivity to credit growth has been declining in recent years.

60% of China's iron ore imports and 30% of coal imports come from Australia. We think the recent rally in iron ore prices due to the supply drop after the Vale dam collapse in Brazil is temporary and expect it to reverse. China is dragging the Australian economy with it.

The weak housing market is another large downside risk. A fairly orderly slowdown in housing in the past few years could turn into a bigger correction and cause a large drop in household consumption (60% of the GDP). Recent data confirms that bleak view. Home loan approvals peaked late 2017 and loan growth rate declined to post-crisis lows. Consumer debt growth continued to slow and recorded its largest monthly decline since August 2012. Home prices recorded the largest monthly decline in November since the 2008 global financial crisis.

We expect at least two 25bp cuts from the RBA in 2019. The last time Australia experienced a recession was in the early 1990s when the policy rate was around mid-teens. Today the bank has significantly smaller room with the cash rate at 1.5%. The RBA wants to use the cuts slowly and wisely at the risk of being behind the curve. There is a non-trivial chance that the policy rate will hit the zero lower bound by the end of this easing cycle.

RBA's monetary policy dovishness also has huge ramifications for the AUD. Since monetary policy has a limited impact given the low policy rate, the adjustment must come from FX depreciation. The trade-weighted currency is off 20% from its 2011 highs. FX forwards are pricing almost no change in the currency up to the 10-yr maturity. AUD hit all time lows against the dollar in 2001, thanks to the weak construction sector. We expect the Aussie Dollar to decline towards AUD 0.50-0.60 region as the RBA cuts rates towards zero.

For more information on any of the data, trends, or trading strategies in this piece, or to discuss how New Century Advisors might help your fixed income allocation, please contact Leigh Talbot, CFA, Director of Client Relations at 240-395-0012 and ltalbot@ncallc.com

Important Disclosures:

PAST PERFORMANCE IS NOT AN INDICATOR OF FUTURE RESULTS.

Forward looking statements: Any projections, forecasts and estimates contained herein are forward looking statements and are based upon certain assumptions that New Century Advisors considers reasonable. Projections are necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the projections will not materialize or will vary significantly from actual results. Accordingly, the projections are only an estimate. Actual results may vary from the projections, and the variations may be material. Some important factors that could cause actual results to differ materially from those in any forward looking statements include changes in interest rates, market, financial or legal uncertainties, the timing of acquisitions of the underlying assets, the timing and frequency of defaults on the underlying assets, amongst others. Consequently, the inclusion of projections herein should not be regarded as a representation by the manager of the results that will actually be achieved. New Century Advisors, LLC has no obligation to update or otherwise revise any projections, including any revisions to reflect changes in economic conditions or other circumstances arising after the date hereof or to reflect the occurrence of unanticipated events, even if the underlying assumptions do not come to fruition. The securities listed in New Perspectives are not to be considered recommendations or an offer to buy or sell securities and are being used as illustrations only. Past performance is not an indicator of future results. There is no guarantee that the investment objective of the strategy will be achieved. Index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. One cannot invest directly in an index. CLIENTS MUST BE PREPARED TO BEAR THE RISK OF A TOTAL LOSS OF THEIR INVESTMENT. THE THEMES AND STRATEGIES HEREIN ARE NOT TO BE CONSTRUED AS RECOMMENDATIONS. THEY ARE FOR ILLUSTRATION PURPOSES ONLY AND SUBJECT TO CHANGE WITHOUT NOTICE.

Data provided by New Century Advisors, LLC, Bloomberg and BLS. NCA does not guarantee or warrant the accuracy, timeliness, or completeness of third party provided information and is not responsible for any errors or omissions. The discussion of any investments in this presentation is for illustrative purposes only and there is no assurance that the adviser will make any investments with the same or similar characteristics as any investments presented. The investments identified and described do not represent all of the investments purchased or sold for client accounts. The representative investments discussed were selected based on a number of factors including, investment process and subject matter applicability. The reader should not assume that an investment identified was or will be profitable.

The information contained in this email or document may not be reproduced or provided to others without the prior written permission of New Century Advisors, LLC. The information provided is neither an offering nor a solicitation of an offering for any securities. Nothing contained herein shall constitute any representation or warranty as to future performance.