ONECAPITAL
MANAGEMENT, LLC

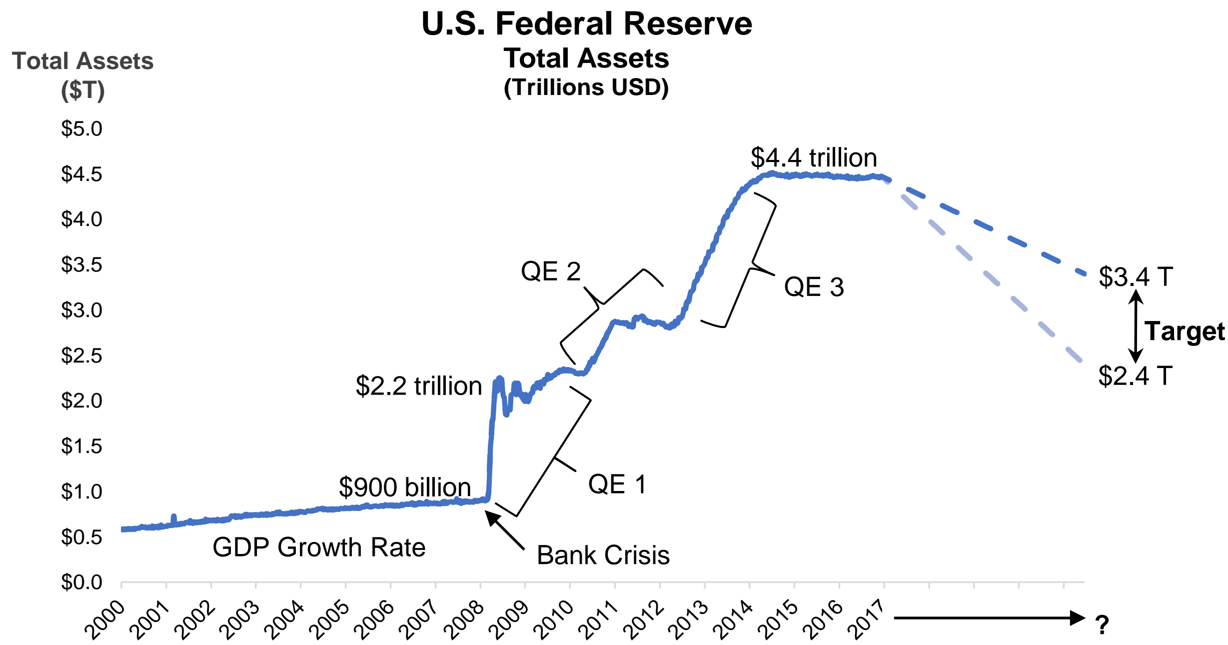
Playbook

Summer 2017

Our *Playbook* is designed to share our quarterly views in a visual presentation with comments providing context to what we believe are the pertinent issues of the most recent quarter and what we see moving forward.

Back to Normal

- *U.S. Federal Reserve assets jumped from $900 billion to $2.2 trillion in the 2008 banking crisis as it bought bonds and other securities to recapitalize financial institutions*
- *Quantitative Easing (QE)* subsequently doubled the Fed balance sheet again to $4.4 trillion as it purchased Treasury bonds, mortgage-backed and asset-backed securities in an effort to provide liquidity and stimulus to the economy, banks and financial markets. This inflated stock, bond and real estate prices by increasing Price-to-Earnings multiples, decreasing yields and lowering mortgage rates*
- *The Fed recently announced plans to shrink the balance sheet ("Normalization") by reinvesting only some of the principal it receives from maturing bonds. This could increase yields and/or dampen stock prices by limiting multiple expansion*



** Quantitative Easing is a monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply with the objective of stimulating economic growth.*

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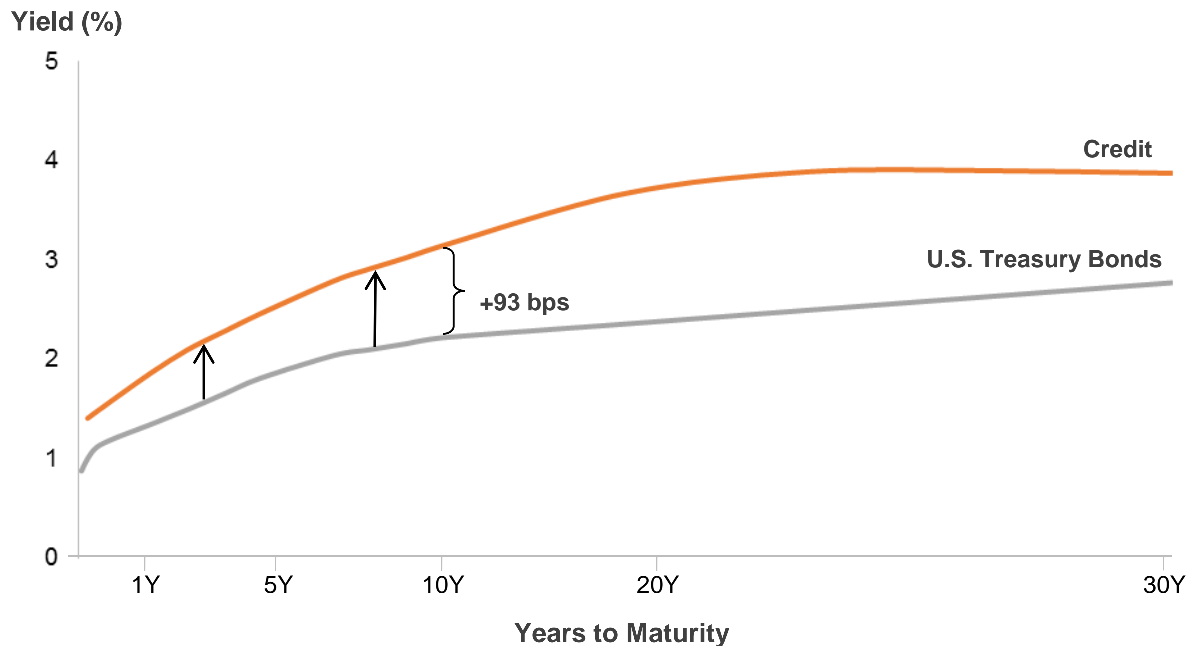
Go Short and Take Credit

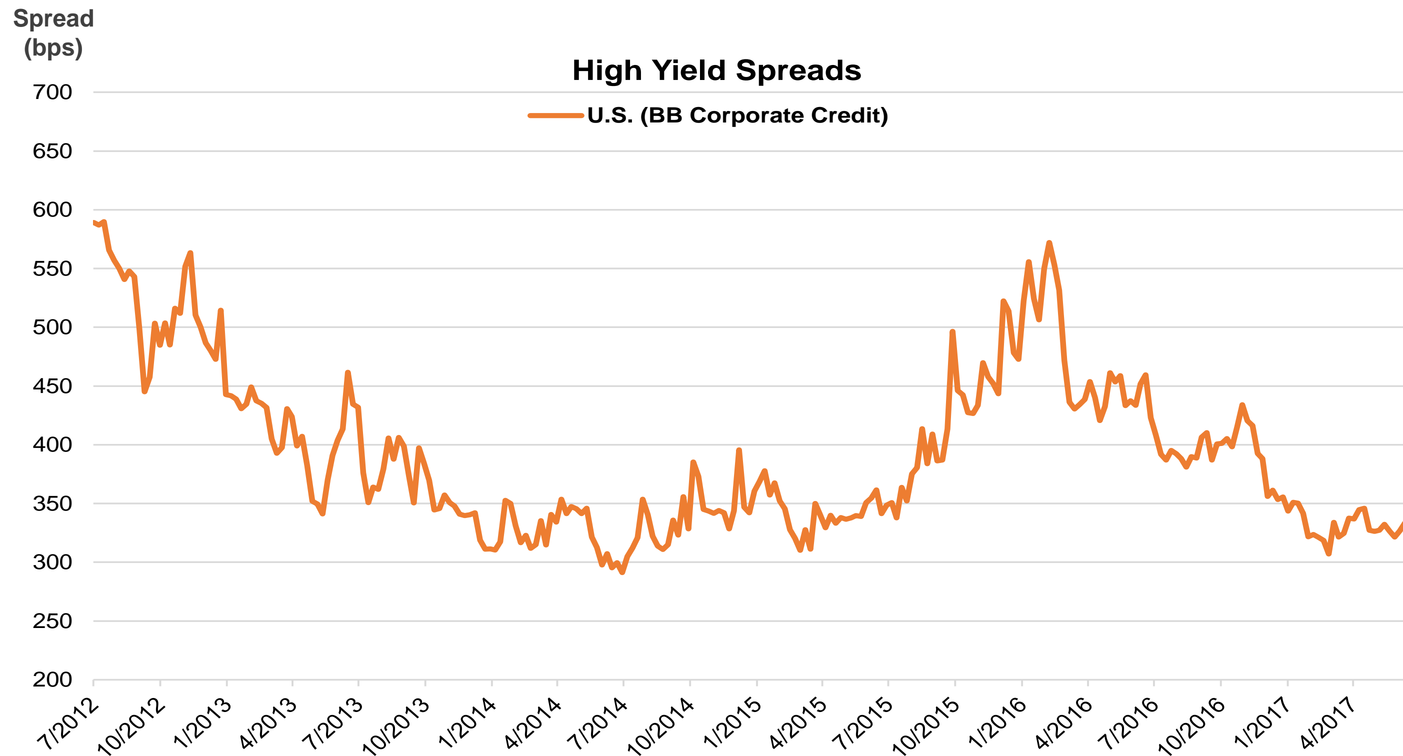
- *Yields remain near historical lows across maturities of U.S. treasury bonds*
- *Risk in longer maturities as Fed shrinks balance sheet*
- *Yield pick-up is still available for corporate bonds, although security selection is key*
- *OCM is focused on quality credit bonds up to approximately 10-year maturities, providing enhanced yield, while avoiding undue interest-rate risk*



As of 6/27/17. "Credit" represented by A-rated U.S. bonds and "High Yield" by BB-rated U.S. bonds

Stick to Quality

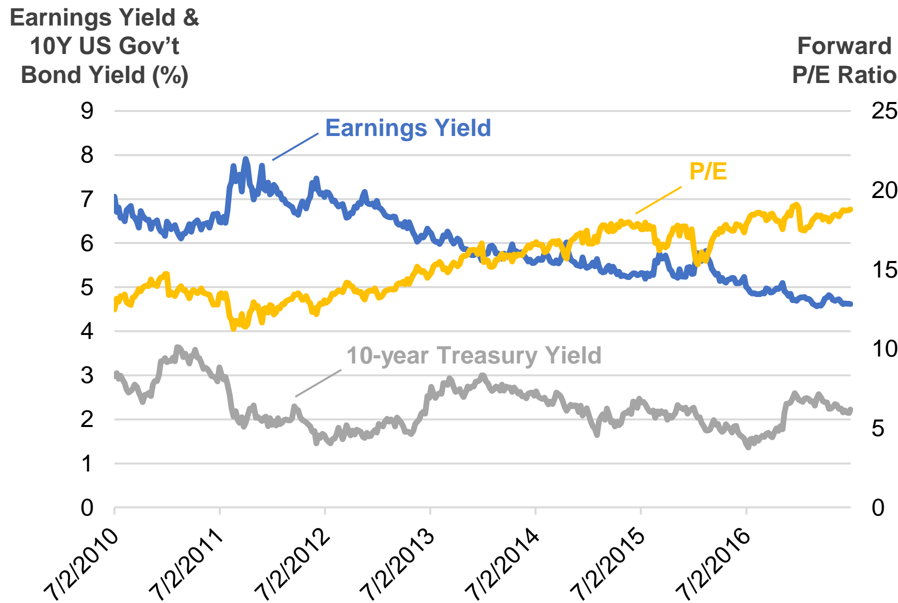
- *Central Bank stimulus has driven high yield corporate bond spreads to historical lows*
- *Investors are earning a relatively small premium for lower-rated credit risk exposure*
- *Overweight investment grade bonds; only increase exposure to lower rated bonds, if and when the reward for doing so increases*

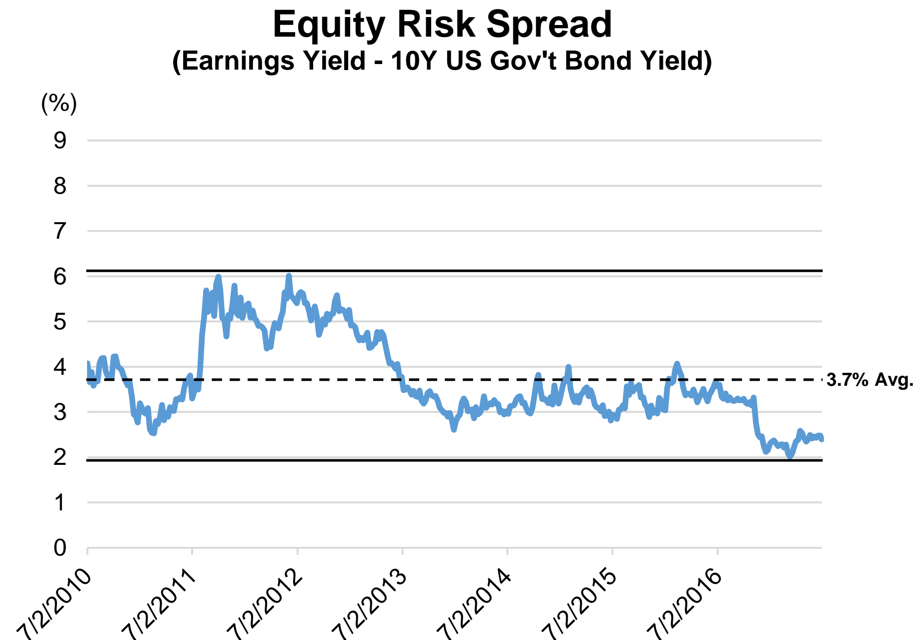


The U.S. is represented by the 5 Year CDX High-Yield Credit Default Swap Index (U.S. BB Corporate Credit). Time period is from 7/6/12 to 6/29/17. Spread, measured in basis points, reflects the yield differential from high yield (BB) bonds to AA rated credit, both at 5-year constant maturity (BB Yield – AA Yield = Spread).

U.S. Stocks Remain Fairly Valued

- *Price-to-Earnings ratios (P/E) have expanded as stock prices have rallied in recent years, while earnings yields (E/P) and U.S. 10-year bond yields have decreased*
- *Since 2010, the average difference between S&P 500 earnings yields and the 10-year U.S. bond yield has been 3.7%*
- *The current difference of 2.4% puts stocks at the lower end of the normal valuation range*

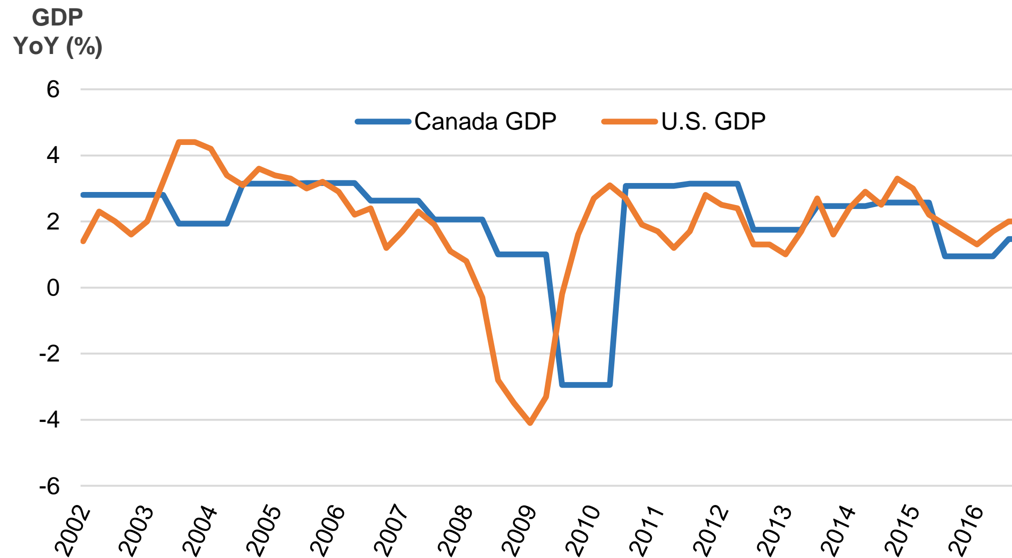




The gray line is the US Government 10-year yield index. The yellow line is the Bloomberg 12-month forward estimated P/E ratio of the S&P 500 index. The blue line is the earnings yield of the S&P 500 index. The Equity Risk Spread represents the difference between the earnings yield of the S&P500 and the 10-yr U.S. Treasury. Time period is from 7/2/10 to 6/28/17.

Economic Growth Healthy - U.S. & Canada

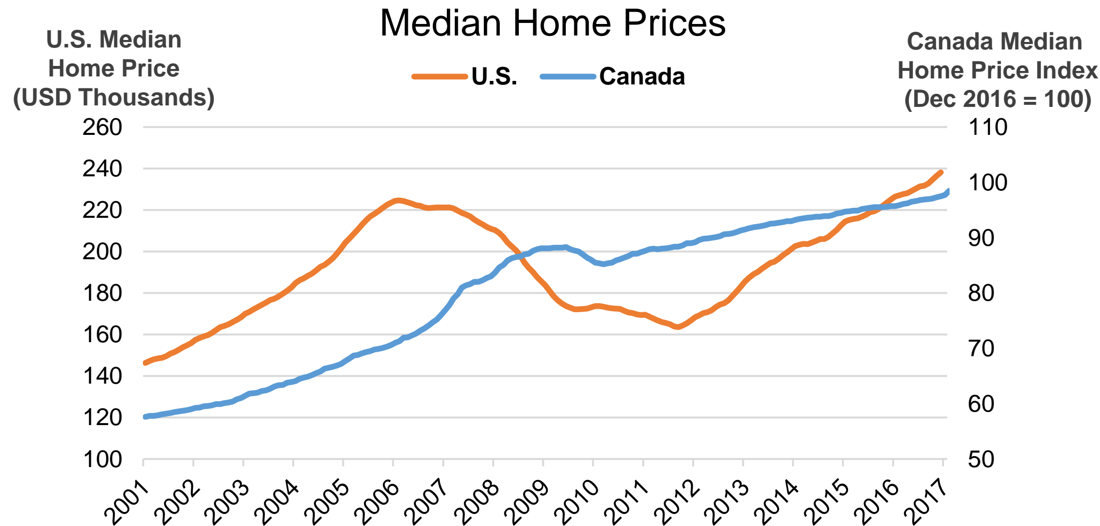
- *U.S. GDP growth is good and U.S. employment improves; U.S. Fed policy may soften and even turn dovish if growth slows or if inflation and/or wage growth is weak*
- *Lower taxation, less regulation and other stimulative policies could boost growth if legislative reform is passed in the U.S., although progress appears less certain for meaningful change to occur going into mid-term elections*
- *Canadian GDP has shown some weakness amid lower oil prices*



U.S. GDP is represented by the U.S. chained 2009 dollars YoY (%) GDP index. Canada GDP is represented by the Canada Real GDP (Annual YoY (%) index). Time period is from 6/30/2002 to 3/31/2017.

U.S. & Canada Home Prices Buoyant

- *U.S. and Canadian home prices have been on an upward march and are well above highs seen pre-2007/2008*
- *Rising home prices have been buoyed by low mortgage rates, rising employment and healthy economic growth*
- *Higher interest rates might impact mortgage rates, construction and home prices*



U.S. home prices are represented by the rolling 12-month average of the U.S. Existing Home Sales Median Price index. Canada home prices are represented by the Canada New Housing Price Index. Time period is from 4/30/2000 to 5/31/2017.

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July 31, 2017