Portfolio Update

This month Jason looks at the current macro-economic environment and the process, indicators and expert opinions we follow.

Our model portfolios posted solid advances in the month of June. We remain underweight equities compared with our maximum allowable weights as per the asset allocation table below. The last column notes % underweight equities. Our basket of companies continues to perform well while the balance of our portfolios is populated with negatively correlated assets such as gold, silver, cash and government bonds.

Portfolio	Bonds	Cash	Precious Metals	Equities	Max Equity	Difference
HW Income & Growth	27.2%	21.0%	5.6%	39.7%	50%	-11.3%
HW Moderate Growth	18.3%	15.2%	6.5%	53.5%	70%	-16.5%
HW Growth	11.9%	2.0%	4.1%	82.1%	100%	-17.9%

This month we are going to talk about the 'R' word. Yup; RECESSION. While this is a 4-letter word for some, it's actually a 9-letter word (bad joke I know!) and not to be feared. At Hillside, we are committed to leading with informed opinions and collaborating with experts for concentrated learning. This means we are constantly assessing the current macro-economic environment and paying specific attention to economists and money managers who have a proven history of calling changes in economic activity.

No system is perfect, and no analyst is perfect however we are looking for themes, trends and changing data which drives our decisions. In this newsletter we will:

1) Highlight a few of the indicators we follow.
2) Highlight a number of the analysts/economists we follow.
3) Tie this into our current positioning and outlook.

Indicators

On the first of every month, we engage in a disciplined process where we analyze a suite of indicators that gives a sense for the current state of liquidity and economic activity.

Liquidity

It is often said that liquidity drives markets. Liquidity speaks to the amount of money sloshing around in the system. When liquidity is increasing, this generally leads to rising risk asset prices and vice versa. We analyze three indicators which cover the near, mid and long-term time horizons. Our long-

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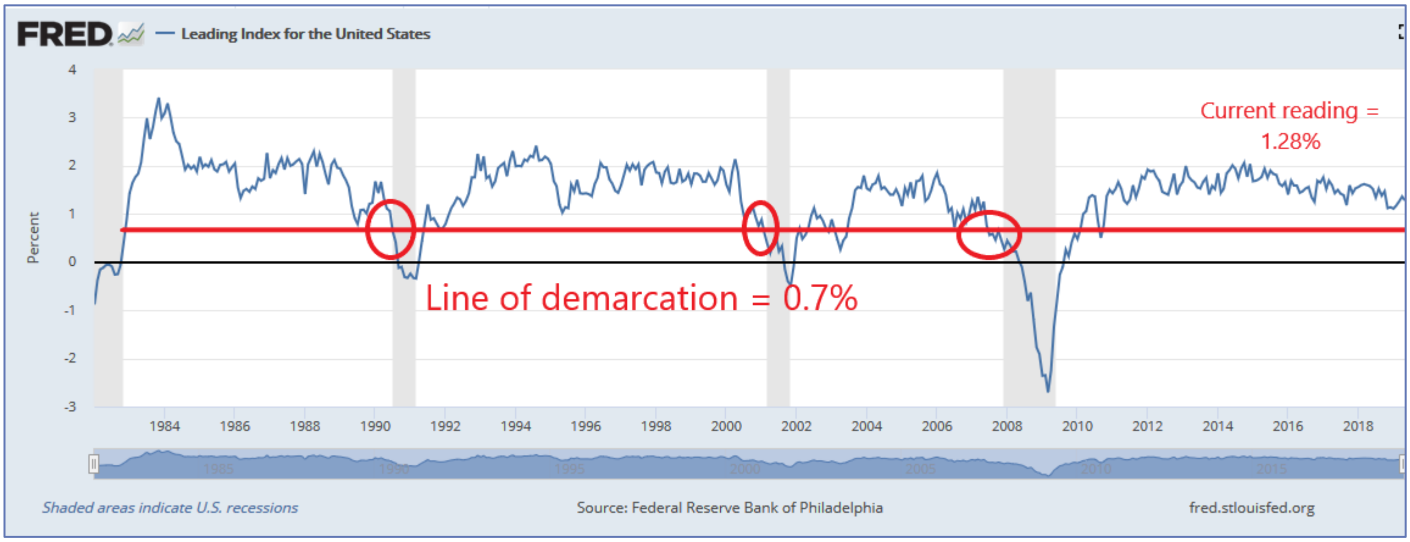
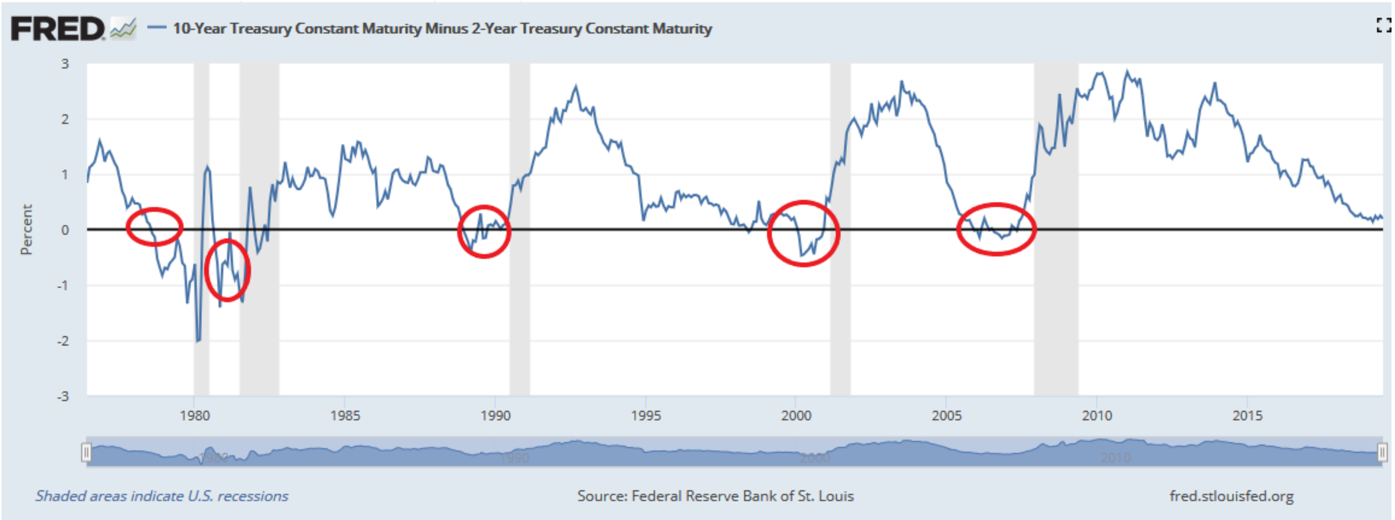
term liquidity indicator is the Leading Index for the US. It is released monthly by the Philadelphia Fed. There are many liquidity components that make up this indicator. For those of you who wish to dive into the gory details please click here. It's a highly effective long-term cyclical liquidity indicator. A falling blue line means cyclical liquidity conditions are tightening. Tightening liquidity is general bad for risk assets. The key level to watch is 0.7%. The grey shaded areas of the chart are recessions and generally if the index crosses below 0.7% there's a strong chance a bear market is on the way. Currently, while the line is falling, (albeit slowly) we are still reasonably above 0.7%. **In short, this indicator is suggesting that long term liquidity conditions are tightening but that a bear market is not staring us in the face.**



Recession

The yield curve is an excellent predictor of economic activity. A 'normal' yield curve is upwards sloping meaning that rates rise as we move out maturity dates. We can see this when looking at bank GIC rates. They are generally less for the 1-year GIC than the 5-year. During times of slowing economic conditions, the yield curve can invert and long-term yields fall below short term yields. An inverted yield curve has predicted 12 of the last 13 recessions; to say this is an effective indicator is an understatement! Below is the '10-year, 2-year' yield curve which is the difference between the 10-year treasury and 2-year treasury yields. Once again, the grey shaded areas are recessions. We can see that for the past 5 recessions back to the early 80s, the yield curve had inverted prior. There are certain areas of the curve that are presently inverted and the 10/2 is very close as we can see below. **In short, this indicator, historically has been a very good predictor of economic downturns and the current signal, while not yet inverted is certainly flashing warning signs.** If you'd like to learn more about the yield curve, please click here. We should note that the situation is similar in Canada for both indicators highlighted.



The above two indicators in conjunction with the others we follow paint a mixed but deteriorating picture of economic activity. It should be noted, that we experienced similar conditions in 2012 and 2016; both were soft patches which ultimately were resolved without a recession. We may again dodge a more serious downturn but to our knowledge the central banks haven't cured the business cycle and thus we continue to monitor the situation closely.

People we read/follow:

At Hillside, we are constantly reading and learning from experts in our field. These include, economists, academics, analysts, portfolio managers and economists. We focus on those who correctly warned of the 2007-2008 recession as most didn't. Below, in no particular order, is a list of such individuals/organizations:

1) David Rosenberg
2) John Mauldin
3) Steve Blumenthal
4) John Hussman
5) Hoisington Investement Management (Dr. Lacy Hunt)
6) Macro-Ops
7) Gary Shilling
8) Albert Edwards
9) Economic Cycle Research Institute (Lakshman Achuthan)
10) Crescat Capital

The majority of these individuals/organizations are noting that economic activity is slowing. However, these represent but a few of market observers. Most participants seem to think 'this time is different' and the central banks will engineer a 'soft landing.' While we generally avoid the opinion game, let's just say we aren't convinced.

Summary

At Hillside, we recognize and honour our responsibilities. This means that we're going to tell it how it is and not sugar coat the message. We are 9 years into what is now the longest recovery on record. As noted in previous letters, we are surely closer to the next recession than we are removed from the last. We are erring on the side of defense at this juncture. We will look to harvest profits while adding securities and assets can rise should the general equity markets drop. These include government bonds, cash and precious metals. We remain data dependent and look forward to a time when we can take our equity weights to max weight. However, our process, indicators and expert opinions all suggest this is not such a time.

Personal Note

Sabrina and I are looking forward to spending quality at our cabin on Bowyer Island in Howe Sound with our family. Viktor (8), Danny (6), Charlie (3) and Henry (almost 1!) certainly keep us on our toes. We are fortunate to have a spot where they can run wild in the forest and comb the beaches.

I wish you all an enjoyable and safe summer. We will return with our next newsletter in September.

June Performance Results

An overview of our three portfolios to date.

Performance to June 28, 2019	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	Inception**	Added Value vs. Benchmark**
HILLSIDE MODERATE GROWTH*	**11.92%**	**1.16%**	**12.81%**	**4.87%**	**10.82%**	**10.63%**	**+8.5%**
MG Benchmark[1]	*6.78%*	*0.44%*	*7.16%*	*1.74%*	*5.05%*	*2.13%*	
HILLSIDE GROWTH*	**15.31%**	**1.31%**	**16.39%**	**-2.06%**	**10.52%**	**9.54%**	**+3.66%**
HG Benchmark[2]	*11.15%*	*0.93%*	*11.70%*	*5.07%*	*9.61%*	*5.88%*	
HILLSIDE INCOME & GROWTH*	**10.38%**	**1.39%**	**11.11%**	**5.45%**	**8.54%**	**8.1%**	**+6.15%**
IG Benchmark[3]	*6.79%*	*0.6%*	*7.02%*	*2.31%*	*3.88%*	*1.95%*	

Past performance is not an indication of future returns.
** Performance is presented gross of fees.*
***Inception: Sept 2, 2014. Results beyond 1 year are annualized.*
[1] MG Benchmark: 30% TSX | 35% Universe Bond | 20% S&P Pref | 15% TSX Small Cap
[2] HG Benchmark: 50% TSX | 25% S&P500 | 25% TSX Small Cap
[3] IG Benchmark: 25% TSX | 55% Universe Bond | 20% S&P Pref
Source: SIACharts.com

The performance presented in this portfolio report is hypothetical and does not represent a specific client account. Details regarding actual returns of an investment account are available from the client's advisor.

Performance is calculated using month-end market values of the model portfolio. Since we use a model portfolio to calculate performance there are no client-initiated cash flows (deposits/withdrawals) to account for. Performance is calculated by dividing the change in the model portfolio's market value by the model portfolio's market value at the beginning of the performance period. Also, all income generated by the portfolio's holdings are held within the model portfolio in cash and is accounted for in the portfolio's month-end market value - this results in a total return measure of the model's performance.

Returns for periods less than 1 year are shown as periodic returns while returns for periods greater than 1 year are annualized. Returns do not include fees and actual returns experienced by an investor may differ from those shown. Past performance is not a guarantee of future results.