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September 30, 2018 Quarterly Report

As the daylight continues to get shorter at a quicker pace, we are excited about seeing the season change from the heat of summer to the crispness of fall. This is the time of year for evaluations and changes in many aspects of our lives. As a firm, we would like to let you know that we have made some changes to our Form ADV Part 2 disclosure brochure, which can be found on our website: www.chrysalisim.com.

This is also the time of year for harvesting and evaluating our investments. If there is volatility in the markets, it usually occurs during the fall months, thus we are always more vigilant during this season than any other time of the year.

We have been students of fundamental analysis and value investing for our entire career and firmly believe in the framework of the paradigm first taught by Benjamin Graham and David Dodd, and subsequently passed on to Warren Buffet. We also recognize the influences that technical analysis has on market dynamics. Simply, technical analysis, such as the Dow Theory founded by Charles Dow, is a method of forecasting the direction of prices using primarily price and volume.

There are 2 technical indicators that we have been following for some time that warrant further discussion: Hi-Lo Logic Index and Three Steps and a Stumble

Hi-Lo Logic Index

Developed by Norman Fosback, the High Low Logic Index is the lesser of the number of new highs or news lows, divided by the total number of issues traded (either for that day or week).

The basis behind this indicator is that the closing prices of a large number of stocks will result in either new highs or new lows, but usually not both at the same time. When a high indicator occurs (for example 5% of companies closing at new highs and 5% of companies closing at new lows), it means that market internals are inconsistent with stocks establishing new highs at the same time that many stocks establish new lows, and is considered “bearish” for stock prices. When a low indicator occurs, it means that there is a uniform market, and is considered “bullish” for stock prices.

Consequently, we have been monitoring this indicator for many years, aggregating the weekly NYSE and Nasdaq numbers together. Since the end of June 2018, the number of stocks that hit new lows exceeded the number of stocks that hit new highs, and surpassed our set high indicator benchmark of 5%, 10 out of the 15 weeks. This bearish indicator alone does not mean a change is imminent; however, most corrections have been preceded by readings above 5%.

Hi-Lo Logic Indicator

	New Highs	New Lows	Issues Traded	Lower
9/28/2018	379	545	6444	**5.88%**
9/21/2018	477	440	6434	**6.84%**
9/14/2018	596	533	6415	**8.31%**
9/7/2018	544	405	6393	**6.34%**
8/31/2018	710	227	6412	3.54%
8/24/2018	708	262	6416	4.08%
8/17/2018	464	587	6413	**7.24%**
8/10/2018	582	421	6411	**6.57%**
8/3/2018	478	450	6421	**7.01%**
7/27/2018	577	360	6418	**5.61%**
7/20/2018	523	289	6393	4.52%
7/13/2018	601	234	6389	3.66%
7/6/2018	389	299	6366	4.70%
6/29/2018	371	521	6409	**5.79%**
6/22/2018	717	341	6370	**5.35%**

Three Steps and a Stumble

Created by a 1930's technical analyst by the name of Edson Gould, the "Three Steps and a Stumble" rule has an outstanding record of projecting a stock market decline. The rule states that "whenever the Federal Reserve raises either the federal funds target rate, margin requirements, or reserve requirements three consecutive times without a decline, the stock market is likely to suffer a substantial, perhaps serious, setback."

On September 26th, the Fed raised its benchmark interest rate for the third time in 2018.

Over the last century, there were four familiar bull markets, known as:

- The Soaring Twenties (1921-1929)
- Construction Years (1950-1959)
- New Paradigm (1990-1999)
- New Millennium (2003-2007)

At the peak of those bull runs however, once the Fed engaged in their third rate hike, each run ended in an either abrupt correction period or eventual tightening cycle. The timing of the end of a bull market following the third interest rate hike is not strongly correlated. While some bull markets end within months of the third interest rate hike, others have taken years before the bull market fully ran its course.

In light of the current bull market cycle, in March 2018, four assumptions were made, pending the Fed's decision to raise rates for a third time this year:

1. If markets begin to "stumble" after the third hike, this could create limited downside that may mimic the New Paradigm of the 1990's.
2. There could be 30 months of a bull run for the market to arrive at its final "summit", similar to the New Millenium.
3. Additional hikes may continue to be 25 basis points for the foreseeable future.

4. The federal funds rate could peak at around 4%

Reconciliation

These indicators, both the Hi-Lo Logic Indicator and Three Steps and a Stumble do not have enough certainty to make decisions alone; however, both of these are indicating that further attention is warranted to where we currently stand within the investing cycle.

The issue that we face is how we reconcile the bells of the technical indicators with the booming economic indicators. For example, the last report from the Conference Board's Leading Economic Index (LEI) increased to 111.2 well above the previous peak measured in 2006. "The leading indicators are consistent with a solid growth scenario in the second half of 2018 and at this stage of a maturing business cycle in the US, it doesn't get much better than this," said Ataman Ozyildirim, Director of Business Cycles and Growth Research at The Conference Board.

Perhaps, given the strength of the economic indicators and the warning signs of the technical indicators, we may truly be looking at the end of the bull cycle.

Index Returns

Index	Q2 2018	Q1 2018	Q4 2017	Q3 2017	5 Year Annualized
*MSCI ACWI ex-US	0.03%	-3.59%	-1.76%	4.65%	1.00%
S&P 500	7.71%	3.43%	-0.76%	6.64%	14.07%
Russell 2000 Value	1.60%	8.30%	-2.64%	2.05%	9.88%
BBgBarc US Agg	0.02%	-0.16%	-1.46 %	0.39%	2.02%

Data provided by MorningStar Office
*MSCI ACWI ex-USA PR USD is the Price Return of the Morgan Stanley Capital International Index excluding US based companies

Summary

Economic indicators continue to report impressive results; however, some technical indicators are beginning to flash some signs requiring further diligence. It certainly feels like we are towards the later innings of the bull market ball game. We are prepared to make adjustments as needed.

Should you have any questions please feel free to call me directly at 314-726-5500 or email at bgrunzinger@chrysalisim.com.

Sincerely,

Robert J. Grunzinger, CFA CPA (inactive)
President Chrysalis Investment Management, LLC