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Investment Strategy: Perception vs. Reality

"Living with a loss is folly, taking a loss is wisdom."

. . . Lewis Owen

For years we have quoted Benjamin Graham's book *The Intelligent Investor*, which Warren Buffet has said is the best book ever written on investing. The operative quote from said book is "The essence of portfolio management is the management of risks, not the management of returns." He closes that thought by saying, "All good portfolio management begins, and ends, with this premise." My father put it much more succinctly when he said, "If you manage the downside in a portfolio, and avoid the big loss, the upside takes care of itself!" This is why investors need a good financial advisor, or portfolio manager, to manage the risk, re-balance portfolios, trim investment positions from time to time, hedge the downside at times, raise cash when appropriate, and hold investors' hands through a bottoming process like we identified between October 2008 and March 2, 2009. At the time investors had not headed our "sell signals," or managed the risk, given the Dow Theory "sell signal" of 11/21/07, or for that matter the Dow Theory sell signal of 9/23/1999 (we wrote about both of those). In fact, they were liquidating their equity holdings when they should have been buying. If they had managed the risks in either September 1999, or November 2007, their investment results would have been much better. We wrote about both of those "sell signals," as well as the "buy signals" in June 2003 and March 2009. Now Wall Street's "pretzel logic" has it that NOBODY can consistently time the stock market; and, we agree. However, if one listens to the message of the market, one can certainly determine if one should be playing hard, or not playing so hard. Verily, we think that cash is actually an asset class, which is why we are never fully invested. My father used to tell me, "To assume that the investment opportunity sets that are available you today, are as good as those that will present themselves next week, next month, or next quarter, is *naive;* and, you have to have cash to take advantage of those opportunities." Accordingly, we always have a cash reserve.

We revisit these aforementioned thoughts as we enter tax loss selling season and reflect on the old stock market axiom from Lewis Owen, "Living with a loss is folly, taking a loss is wisdom." Over the years, we have learned the hard way that when, and what, to sell tends to separate successful investors from the amateurs and drives much of a successful investment model. This is particularly true for 2018's tax-loss selling season given the recent volatility and resulting mispriced "prices of paper" (read: certain stocks).

The *causa proxima* for the volatility, since our short-term sell signal of October 2, 2018, has been evolutionary. It began with the Mueller investigation's revelations, the Chinese trade tiff, softening economic numbers, FED fright, heightened investors' fears (near record bearishness), worries about peak earnings (we have heard this for the past six quarters), and the list goes on. Consistent with this, we advise participants to carefully review their portfolios, with an eye for selling companies' shares whose fundamentals have deteriorated with little chance of improving in the intermediate to longer-term. We also like the strategy of "pruning" some shares from portfolios where "the news cannot get any better." Remember, gains can be offset with losses for tax purposes, and that the rebalancing of asset classes may be in order. In this investment review process, some participants will not do their homework as well as others and therefore sell for tax reasons perfectly good companies where the bad news is already priced in and the fundamentals are bottoming. This spells opportunities for astute investors and is exactly the kind of environment where one is able to find mispriced securities providing an excellent, low risk, buy point; and, the difference between perception and reality is where our opportunities lie!

Raymond James' analysts work diligently, attempting to determine the difference between "perception and reality" in many of the under-researched/under-owned companies. As a result, their insights and knowledge brings added value to the investment equation. This has produced some very interesting year-end opportunities from our research universe of companies, which we urge you to discuss with our financial advisors and our institutional sales folks. Three of the names that have our attention, with positive ratings from our fundamental analysts, include: Axon Enterprise (AAXN/$43.47/Outperform); Flexion Therapeutics (FLXN/$16.31/Strong Buy); and Viking Therapeutics (VKTX/$11.29/Strong Buy).

As for the stock market, so far it is pretty much as we surmised following our October 2 traders' sell signal. The bottom was made on October 29 at 2603, which Andrew Adams identified, with the subsequent rally stalling in the prescribed 2800 – 2820 zone as we thought. We wrote from there the S&P 500 (SPX/2760.17) should have a pullback and make a secondary low above the October 29 intraday low. We said if that pattern plays it would trace-out a double-bottom in the charts, which happened, and the S&P 500 has now run up to the downtrend line (chart 1). As we wrote in Friday's Morning Tack:

"The recent panic buying has used-up the stock market's very short-term internal energy and probably means the SPX will park itself around the 2730 – 2740 level for a few sessions before the upside skein resumes. This view is supported by yesterday's failure to follow through on Wednesday's Win."

Meanwhile, the Russell 2000 (RUT/1533.27) has pulled back to support (chart 2), and don't look now, but the Homebuilder Index has broken out to a new reaction high and is above its 50-day moving average (chart 3). Also confirming the upside is the Advance-Decline Line (chart 4). As for the talk that our country is headed for a recession, we point to the Present Situation Index that is suggesting no recession is in sight (chart 5) and would note recessions tend to start 26 months after the Leading Economic Index peaks; and, the LEI is nowhere near peaking. Further, U.S. Industrial Production is ramping at a record pace (chart 6). Because of the recent slowdown in some of the economic reports the odds of 2+ rate hikes in 2019 have fallen to 1 (chart 7). Given that, it's not surprising the Homebuilder Index has broken out (chart 3). We continue to like our "long the index of your choice" recommendation near the double-bottom in the charts, and while our "go long crude oil/energy" has worked only marginally, we still favor the energy space. Also, as a follow up, our recommendation of going long the Transports in late October seems to be working as the D-J Transportation Average (TRAN/5389.67) notched new reaction highs last week.

The call for this week: We are in NYC this week doing gigs for our financial advisors, seeing institutional accounts, and doing a bunch of media appearances. As we enter the month of December it is worth mentioning that according to our pals at the astute Bespoke Investment Group:

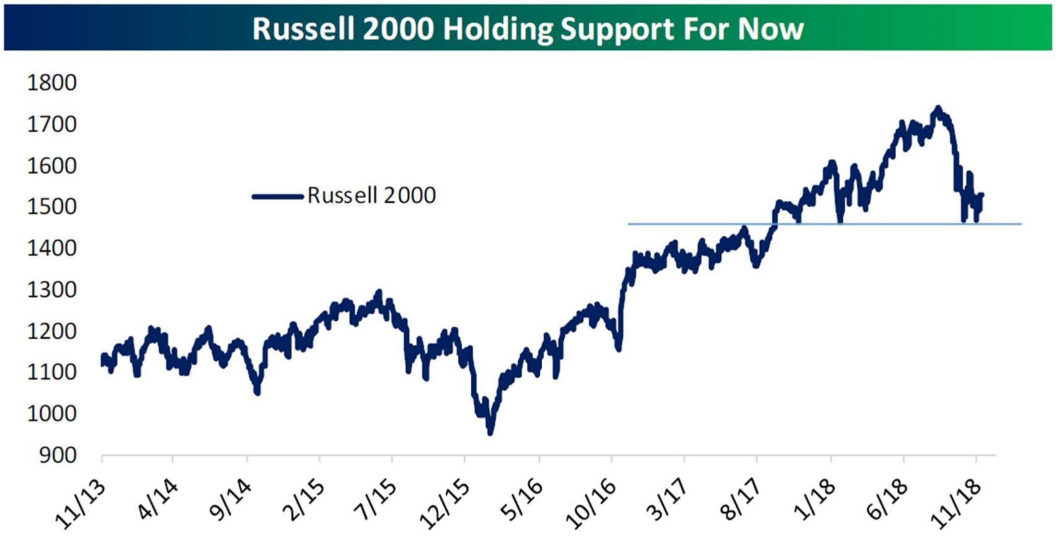
"Monday kicks off a new month and the last month of 2018 at that. With this week's rally, November was able to finish off on a positive note, and the hope is that it marked the start of the Santa Claus Rally. . . . Over the last 100 years, the Dow has averaged a gain of 1.55% in December with gains 74% of the time. In this time period, there has been no month that has been stronger or more consistent to the upside. Over the last 50 years, December is tied with April and November for being the most consistent and only trails April in terms of average gain."

As we have surmised for months, Mexico and Canada "blinked," and now China has "blinked" on the trade tiff, which is why we have been "buyers" at the October 29, 2018 lows, and again at the subsequent secondary lows around ~2631, which indeed was above the October 29 low of 2603 that we suggested would happen; QED! What continues to be amazing to us, is that most seers that never saw the decline coming, and were WAY too cautious at the subsequent "lows," which they didn't buy, are now attempting to tell you what to do now . . . amazing! This morning, well you can see what the pre-opening futures are doing.

Chart 1

Source: Bespoke Investment Group

Chart 2

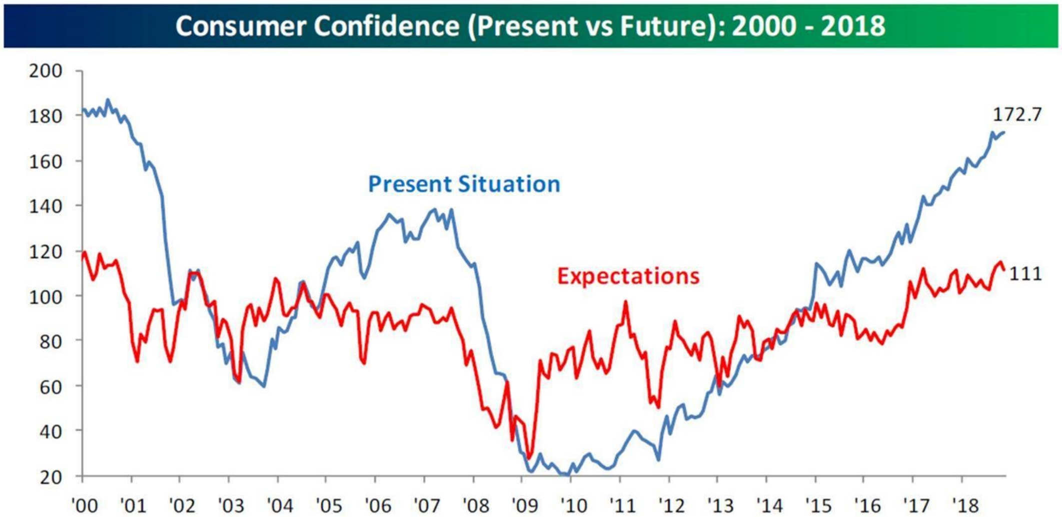


Source: Bespoke Investment Group

Chart 3

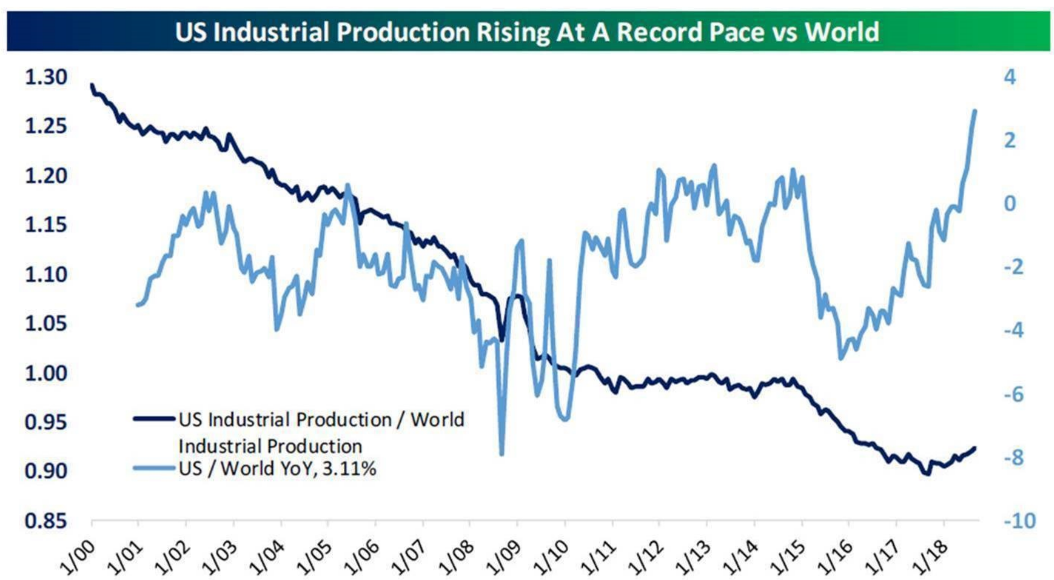
Source: Bespoke Investment Group

Chart 4



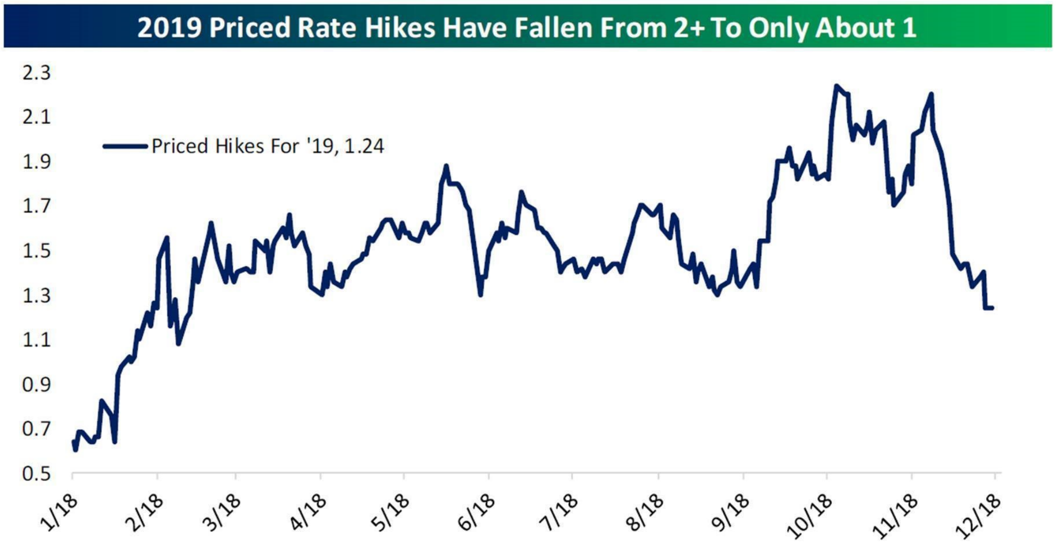
Source: Bespoke Investment Group

Chart 5



Source: Bespoke Investment Group

Chart 6



Source: Bespoke Investment Group

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Strong Buy and Outperform (Buy)	57%	72%	23%	29%
Market Perform (Hold)	38%	24%	12%	13%
Underperform (Sell)	4%	4%	2%	25%

** Columns may not add to 100% due to rounding.*

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High Risk/Growth (H/GRW) Medium to higher risk equities of companies in fast growing and competitive industries, with less predictable earnings (or losses), more leveraged balance sheets, rapidly changing market dynamics, financial or legal issues, higher price volatility (beta), and potential risk of principal.

High Risk/Speculation (H/SPEC) High risk equities of companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, significant financial or legal issues, or a substantial risk/loss of principal.

Company Name	Disclosure
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Axon Enterprise Inc., Flexion Therapeutics, Inc. and Viking Therapeutics, Inc.	Raymond James & Associates has managed or co-managed an offering of securities for Axon Enterprise Inc., Flexion Therapeutics, Inc. and Viking Therapeutics, Inc. within the past 12 months.
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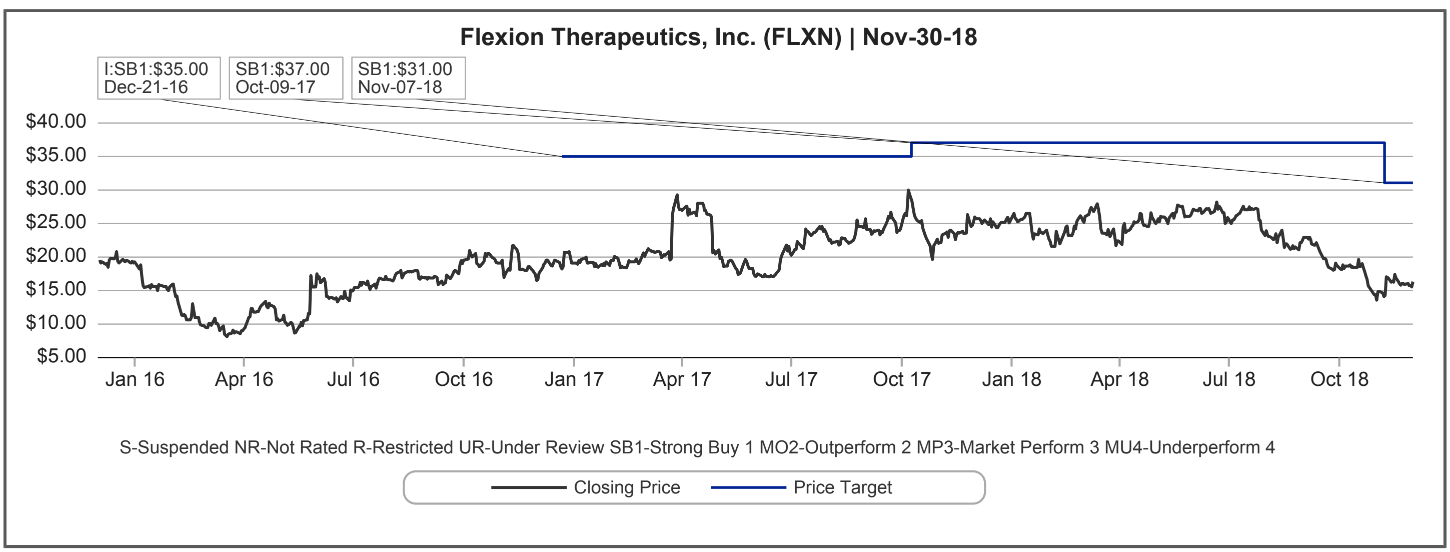

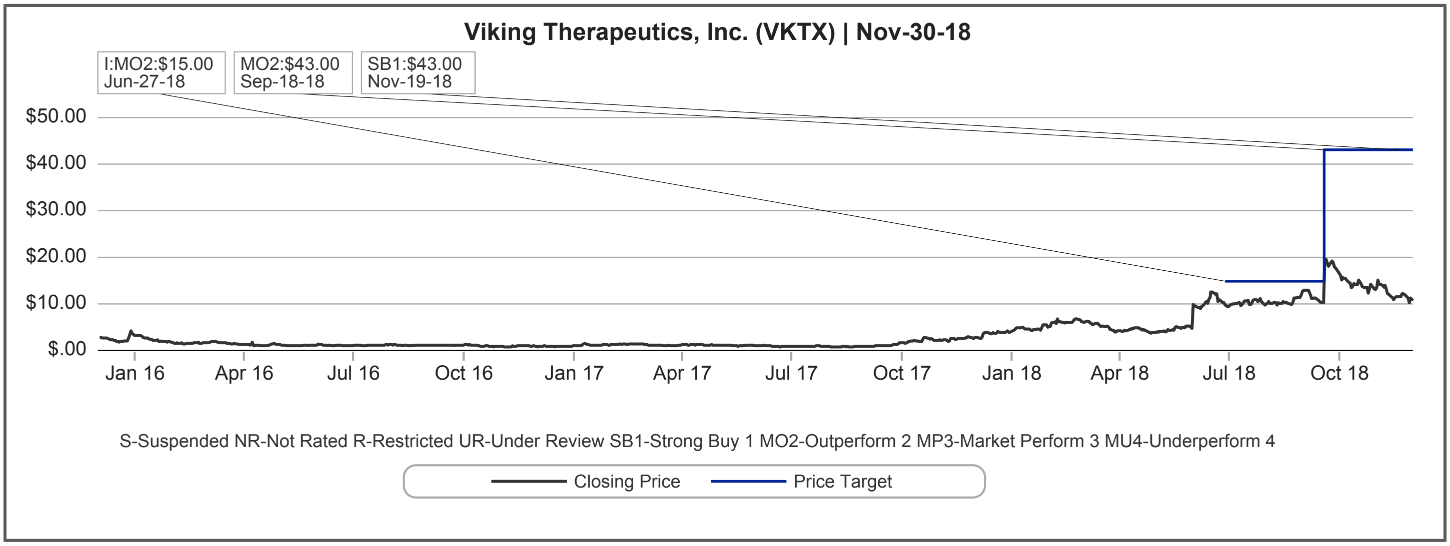

Valuation Methodology

Axon Enterprise Inc.:
For Axon, our methodology uses an analysis that culminates with the development of forward projections of earnings, balance sheet, and cash flow statements. Using these projections, we calculate measures of current and projected comparable and historical P/E multiples, EV/EBITDA, and price-to-sales ratios relative to peers (defined as companies transitioning from hardware to software, having a comparable customer base, or similar revenue profile). These calculations then form the basis for our judgments.

Flexion Therapeutics, Inc.:
We value Flexion using an equally-weighted blended discounted P/E, EV/EBIT, and EV/Sales multiple approach incorporating average multiples for each metric across a universe of mature, commercially established Specialty Pharma and BioPharma comparables.

Viking Therapeutics, Inc.:
Our valuation methodology is a discounted cash flow (DCF) analysis, which we risk-adjust with a discount rate according to the overall maturity of the company and stage of the pipeline/products.

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Company-Specific Risks

Axon Enterprise Inc.:
Competing Products
Currently, the non-lethal market is receiving significant attention because of incidences involving law enforcement officers' use of excessive force. As a result, there has been a recent surge in rapid technological advancements and emerging competing products. The further entry of competitors could lead to a decrease in Axon's market share. Although Axon does have many patents to protect against similar competing products, insufficiency among these patents would result in exposure in the market and could affect Axon's potential revenue.
Product Malfunction
Axon's products are highly sensitive to reliability: the body cameras could be capturing sensitive data and the CEWs could bedeescalating a potentially dangerous situation. Product defects could then greatly reduce the demand for Axon's products, damaging its reputation and hurting the top line.
Customer Budget

Axon's main consumer is government agencies and their demand is predetermined by budget constraints, which are typically hard to alter. Political pressure and changes in regulations directly impact the spending habits of the government, and in turn could directly impact the demand for Axon's products from law enforcement. Budgetary and political constraints toward government municipalities could lead to a delay or loss of sales, resulting in a decline in potential revenue.

Customer Funding

Some of Axon's customers use seized funds through civil forfeiture proceeding to fund the purchase of Axon's products, and changes in civil forfeiture laws may impact their ability to purchase products. Alterations in legislation could impact their ability to seizefunds or use the seized funds for purchases, limiting the amount of funds available to use for purchases, affecting the sale of Axon's products.

Litigation

CEW products are often used in aggressive confrontations that may result in serious injuries or death. Axon may be connected to these injuries through the customer's use of product,leading to a legal action brought against Axon to recover damages from said injury. Injury, wrongful death, or any other liability claim as a result of the use of an Axon product could harm Axon's reputation and affect sales.

Flexion Therapeutics, Inc.:

As an early-commercial company, the success of Flexion's product candidates is essential to future company success. Though Zilretta has generated positive Phase III trial results and has been approved by the U.S. FDA, there is no guarantee the product will reach the degree of commercial success embedded in our financial projections. Additionally, Zilretta is effectively the company's primary valuation driver, presenting heightened risk in the event of lower than expected launch trajectory.

Viking Therapeutics, Inc.:

Clinical Risk: Viking has not generated any clinical data in biopsy-confirmed NASH patients (only in MRI-confirmed NAFLD). Our entire valuation is dependent on NASH. If future clinical trials in NASH do not suggest a potential benefit in NAFLD/NASH patients, Viking's valuation would be significantly impacted.

General Competitive Risk: NASH is a very competitive field. By the time VK2809 is potentially approved and marketed, several other drugs for NASH will probably already be approved and marketed. If VK2809's therapeutic profile compares unfavorably to competitors, it may have an adverse effect on the drug's launch and sales, and consequently our valuation.

Financing Risk and the Need for Additional Capital: Viking will need to conduct additional clinical trials prior to getting VK2809 approved and generating product sales. Prior to profitability, if Viking is unable to raise capital when needed on attractive terms, the company could potentially be forced to delay, reduce, or eliminate certain programs or abandon future commercialization efforts altogether.

Sentiment Around TR-Beta Agonist Mechanism in NASH Could be Sensitive to Competitive Developments: Madrigal pharmaceuticals is also developing a TR-beta agonist for NASH and is entering Phase 3. Therefore, any negative data or developments related to MGL-3196 or the TR-beta mechanism good have negative read-through to VKTX shares.

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