Quarterly Playbook

3rd Quarter 2019

Current Financial Planning and Investment Themes
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"Success is measured by your discipline and inner peace" – Mike Ditka

Over the past year, this market has certainly tested our thinking at times but through discipline and planning, our inner peace remains. Our "Nervously Optimistic" description is still intact, with the preponderance of data still affording us overall optimism, yet headlines and attitudes generate an overhang of nervousness that would otherwise be enthusiasm…

US Economics

The success of our economy is rolling on! 1st Quarter GDP posted an amazing 3.1% growth rate, dissuading fears about an economic slowdown. This is particularly impressive since the 1st quarter typically is the weakest quarter of the year. Nevertheless, the drum beat of negativity amongst news media continues. This mostly comes from the "trade tensions" with China and other countries. The reality is, the formula for GDP subtracts net imports. So, if we are importing less, this bodes well for GDP growth. The tariff effects should present themselves in the inflation data, since these would potentially drive up prices among the items imported. However, inflation remains persistently low, even falling a bit from 1.8% in December to 1.5% in April. The Fed has even lowered their inflation expectations in a dramatic fashion, falling from 1.8-2.2% in the March projection to 1.4-1.8% in June. You may be able to argue that the uncertainty around the tariffs may slow business expenditures, but that has yet to be seen. Meanwhile the other side of economic analysis, the labor market, remains extremely strong as well! The unemployment rate (official, U-3) pushed down even further to 3.7% in June from 3.8% in March and the U-6 unemployment rate (broader definition including part-time) followed by moving down to 7.2% in June vs. 7.3% in March. Finally, the labor force participation rate fell a bit to 62.9% in June vs 63% in March, coming off a recent high of 63.2% in February. Incorporating all of these factors, we are holding steady with a prediction of 2.6-2.9% GDP growth for full year 2019, meaningfully above trend!

US Equity Markets

Unfortunately we are still waiting on an "official" US-China trade deal. It seemed as if both sides have mostly agreed to terms and were ready to sign when the issue of enforcement caused them to put down their pens. This caused the equity markets to pull back and spurred additional concern from investors. Our take was that this was simply "noise" and that it would be almost be completely out of the markets by the middle of June, which proved to be accurate. Still, the absence of a trade deal may be restricting the upside even if it is no longer pulling equities down. From a valuation standpoint, most metrics are running above average with the exception of the relative attractiveness of equities vs. bonds. We believe that the TINA (There Is No Alternative) argument allows equities to grind higher in the short run. Additionally, we believe the chances are good for a re-acceleration of earnings later in the year.

US Fixed Income

Since our last playbook, the bond market defied our expectations of stable pricing and experienced a boost in pricing driving yields down significantly. This has caused great YTD returns across the board. However, we believe that pricing is a little bit expensive and would recommend taking steps to capture the high pricing while it lasts as we expect yields to float back up by the end of the year. From a yield curve perspective, we saw longer–term rates uniformly move lower while shorter term rates remained somewhat anchored by the Fed funds rate. It is largely expected that the fed will actually lower rates by at least 25 basis points by the end of July, and we agree. This will take some pressure off of the yield curve inversion that we spoke about last quarter.

International Markets

Both international stocks and bonds have been experiencing strong returns at this point in the year. We expect the equity rally to remain in sync with the US and grind higher through the rest of the year. From an international fixed income standpoint, we think that pricing is somewhat expensive and should come off of their highs, but only slightly since global central banks are pressing yields lower. In fact, the negative yields we noted last quarter have pushed even lower. At the time of this writing, German, French and Japanese bonds all have negative yields through 10 years. Furthermore, the economic prospects for the majority of investable countries around the world are still beleaguered.

Real Estate

So far, REITs have had the best performance of the major asset classes to date. A combination of high cash flow, insulation from trade issues, and an overall strong US economy have real estate investments in high favor. Our view is that this backdrop remains intact, but pricing has gotten ahead of itself. While we don't see any price declines in the near future, the upside may be limited for the near term. All in all, we expect real estate to grind higher in step with US equities through the remainder of the year.

Legislative Affiars

Not much happening in Congress lately, besides the pre-2020 election theatrics. Speaking of the 2020 election, we are keeping an eye on the candidate field, which isn't easy since there are 24 Democrats vying for the chance to face-off against President Trump. We are sure to see a lot of drama unfold as the year goes on, but it is too early to even guess at the top 3 likely opponents. In the meantime, we are still waiting on the SECURE Act to get on the President's desk as well as a finalized trade resolution with China. The major issue to keep our eyes on though is the debt limit that is projected to require a raise in the debt ceiling this September to avoid another government shutdown.

Interest Rates & the Fed

The expectation, and an overwhelming one I might add, is that the Fed is going to reverse course and actually cut rates by the end of July. Recent remarks have all but confirmed the likelihood of a rate cut, but we will have to wait and see. Fed fund futures are pricing in a 100% chance there will be a rate cut in July. The only question is will it be only 25 basis points or will it be 50 basis points. To be sure, the market will not react favorably if there isn't a rate cut. You don't have to look too far back, just to the last quarter of 2018, to see the market reaction when the prevailing communication from the Fed was that they didn't care what the market had to say. In this case, however, we believe that the Fed will quietly understand that the market is telling them that the current Fed funds rate of 2.50% is past neutral when the 10-year US treasury is yielding far less, around the 2.10% range. The Fed also probably recognizes that the high Fed funds rate is a primary cause for inverted yields at the short–end of the curve. Publicly though, we expect them to blame their decision to cut rates on some obscure pocket of economic weakness, reassure us that the overall economy is in good shape, and justify it because inflation is nowhere close to being a problem.

Financial Planning Corner

DID YOU KNOW YOU CAN SELL YOUR LIFE INSURANCE POLICY?

Previously, when a client no longer had a need for life insurance, the only answer was to discontinue the policy. Now it can be worth additional cash, here are some things to know:

- **You won't get the full face value.** A 2010 report from the U.S. Government Accountability Office found that sellers received about 13 percent to 21 percent of the value of their policies.

- **When you sell:** You will make the buyer the new policy owner, and the buyer will start paying your premiums. When you die, the new owner will receive your death benefit.

- **Buyers don't want every policy**. Buyers may be looking for people over the age of 65 with chronic or terminal illnesses. If you're young and healthy, your policy won't be as attractive to a buyer.

- **You may have tax complications.** Your settlement is likely subject to income taxes whereas the death benefit of a life insurance policy is tax free to your beneficiaries.

- **It isn't your only option.** If you're selling because you need cash, you may have other options, such as taking a loan against your life insurance policy, accelerating your payout date or selling the policy to a family member. However, keep in mind that these options also have pitfalls and should be discussed with a financial adviser.

- **Understand the law.** Your life insurance policy has rules about selling, and your state laws regulate the process. Make sure you understand these before you try to sell. If you don't fully understand, an independent financial adviser can help sort things out.

- **Don't take the first offer.** There are no set values for life insurance policies, and the offers you receive from buyers can vary widely. Review several to make sure you're getting the best deal.

- **Talk to a tax expert.** Consult an accountant to see what tax liability and eligibility changes you will face after the sale.

We're here to help. If you have questions about this or any other topic, call us at (855) AFS-4545.