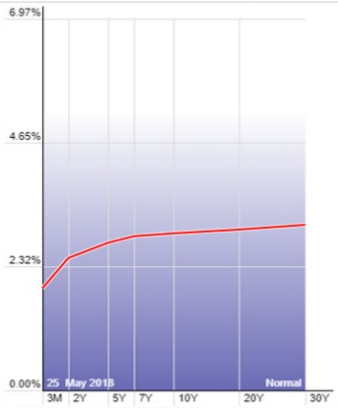
GBA Financial

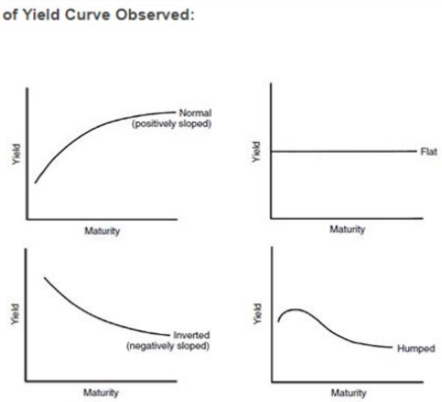
Monthly Newsletter

June 2018

COMMENTARY

Very rarely are things in the economy or financial markets clear cut and we must use the mosaic theory to help guide us when looking at the road ahead. One of the better economic indicators that has helped signal a recession or stock market correction over the last 25+ years has been the shape of the yield curve. The yield curve is a line on a graph plotting the difference between yields for debt of different maturities. Let's take a look at the graph (yes, there's a lot going on but hang with us) and walk through a few different things. First, let's start off in the bottom right part and talk about the four different types of yield curve positions: 1) Normal Yield curve – shorter duration bonds have a smaller yield than longer duration bonds. Think of a mortgage loan where typically the 15-year mortgage has a lower interest rate than a 30-year loan. You're more likely to default over 30-years on a house payment than over 15-years and as such the bank wants more interest to offset this risk. 2) Inverted Yield curve – is the opposite of normal yield curve with shorter duration bonds having a larger yield than the longer duration bonds. 3) Flat Yield curve – all duration bonds pay the same as each other. 4) Humped Yield curve – intermediate-term bonds have a higher yield than both short and long duration bonds.





To the left of the four different types of yield curve positioning shows us where we the current yield position is at. I think we can all agree that from the looks of that chart we are in a 'normal' yield curve which is very typical as we are in the 'normal' position a majority of the time. Where this indicator starts to become really

ECONOMIC HIGHLIGHTS

S&P 500	2,705.27
DJIA	24,415.84
NASDAQ	7,442.12
OIL	$67.04/barrel
GOLD	$1,304.70/ounce
10-YEAR TREASURY YIELD	2.82%
UNEMPLOYMENT	3.8%
GDP	2.2% (1st Qtr. 2nd Est.)
CONSUMER PRICE INDEX (CPI)	+0.2% (12 month change: +2.5%)
CORE CPI	+0.1% (12 month change: +2.1%)

Employment Situation - the labor market continues to tighten which hasn't lead to wage growth (yet). Unemployment crossed the four percent mark and came in at 3.9 percent.

ISM Manufacturing Index - the conditions in national manufacturing have cooled some as of late, but still are bullish. We are watching to see if this is a small pullback in numbers or a turning point that could signal issues for the economy.

Trade negotiations/war - The US continues to make headline news surrounding the on again, off again trade talks with China & in slapped our closes allies with the steel and aluminum tariffs. Is this more saber rattling from the White House to move trade negotiations along? Either way, it's the White House is playing with fire

interesting is when we start seeing the curve become flat (not flattening) and then become inverted. An inverted yield curve typically happens when the Fed is pushing up rates (the Fed is better at controlling and manipulating the short end of the yield curve) to fight against inflation. Without jumping fully into the weeds, the top two charts show the yield curve and the S&P 500. When the yield curved flattened enough and then became inverted, the stock market reacted negatively all four times. Two of the times were major correction and the other two saw minor corrections. Will this indictor hold true the next time the yield curve becomes inverted? Time will tell, but we won't be ignoring it when it happens.

Our long-term view (multiple years) for equity markets is still bullish and we believe we are in the middle part of a secular bull market and with the previous two secular bull markets lasting 17 years we could be in for a nice ride if this one plays out similarly. We continue to maintain our bullish stance in the intermediate-term (9-15 months), but have moved from bullish to cautiously bullish. The economy is still very strong and corporate earnings have been solid for the last few quarters, but as we look farther out towards the second half of 2019 we suspect the tight labor market and Fed tightening to put pressure on the economic growth which could lead to a recession and downturn in the stock market. Recessions and market downturns are unavoidable, but the silver lining is that when recession and market downturn happen inside a secular bull market, they have not been as bad as they have been in secular bear markets. In the short-term (weeks to months) we see market volatility coming back after reaching historically low levels 2017. In fixed income we are maintaining our over weights in International Emerging Markets, High Yield bonds and Floating Rate bonds. We are under weight in U.S. Government Bonds and Mortgage-Backed Securities. Our research team is constantly evaluating our products and tactical position inside both our fixed income portfolio and equity portfolio, looking at both larger trends and short-term opportunities. With daily monitoring to accounts on an individual basis, we continue to rebalance accounts when they fall too far from their equity-to-fixed income ratio.

MARKET TRACKER

Index	3 Mo	1 Yr	3 Yr	5 Yr
S & P 500	0.19	14.38	10.97	12.98
MSCI EAFE	-1.82	7.97	4.33	5.93
BARCAP AGG BOND	0.61	-0.37	1.39	1.98

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