OUT OF THE BOX

INVESTMENT COMMITTEE UPDATE

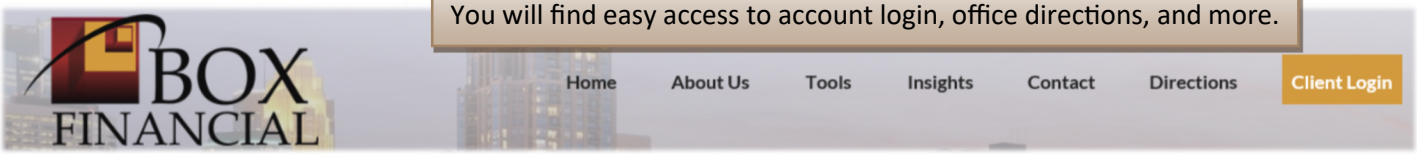
2018 Q4

Faith | Trust | Excellence | Care

Our Mission is to help people with complex financial needs experience an **EXCEPTIONAL** life.

Our Website

www.boxfinancialadvisors.com has a new look!
You will find easy access to account login, office directions, and more.



Our Investment Committee

Each quarter our Investment Committee meets to review the markets and economy. Three voting members hear from current advisors and appropriate support staff, and when necessary adjust the standard portfolios managed by the firm. Our quarterly newsletter, *Out of the Box*, represents the Investment Committee's general thoughts and conclusions behind any adjustments made.

Our Team

ROLLER COASTER FUN!

Investment Committee member, Cyrus Shabaz, hates taking his kids to Valley Fair. The long waits in slow moving, hot lines only lead to being jarred around on volatile rides ending with a headache, vertigo, and a sore back. But his kids are happy because they know where the ride will take them. All they must do is watch the track. Similarly, the economy lays the track to where the market will go. The ride will include loop de loops, sharp drops, and big turns but it will follow the tracks. Although the month of October was a wild ride, the economy should eventually take us to our destination.

ECONOMIC COMMENTARY

A look at What Was, What Is, and What Could Be

What Was

Our last update made the analogy of a hiker expectantly looking for the summit as he approaches the top of the mountain. We continue to get closer to the top of this economic cycle, but when we will reach the peak remains a mystery. We view tariff talk as more bark than bite, and its ultimate effect on our economy is minimal. Domestically, most companies appear to have taken advantage of the 2018 tax reform, and the benefits now appear to be baked into the economy after serving as an economic tailwind over the first two quarters. We remain attentive to how we can be most effective navigating this economy.

What Is

We are currently in the second longest bull run as the economy continues to run on all cylinders. GDP surprised in the second quarter at 4.2% (the fastest pace since 2014), and around 3.5% is expected for the third quarter. [S1] This GDP growth is no accident as the Trump tax cuts of 2018 has put more cash in companies' coffers and ramped up capital spending at the fastest pace in years. Third quarter earnings are estimated to grow around 19.2% from last year. [S2] Sentiment also remains high for businesses and consumers. The high confidence from consumers can be witnessed in the rise in consumer debt, especially from credit cards. Much of this consumer sentiment comes from low employment and a robust economy. Unemployment reached 3.7% which is the lowest it has been since 1969. [S3] Companies are looking for projects to be completed and are trying to find the workers to complete those projects therefore we see the unemployment next year going lower.

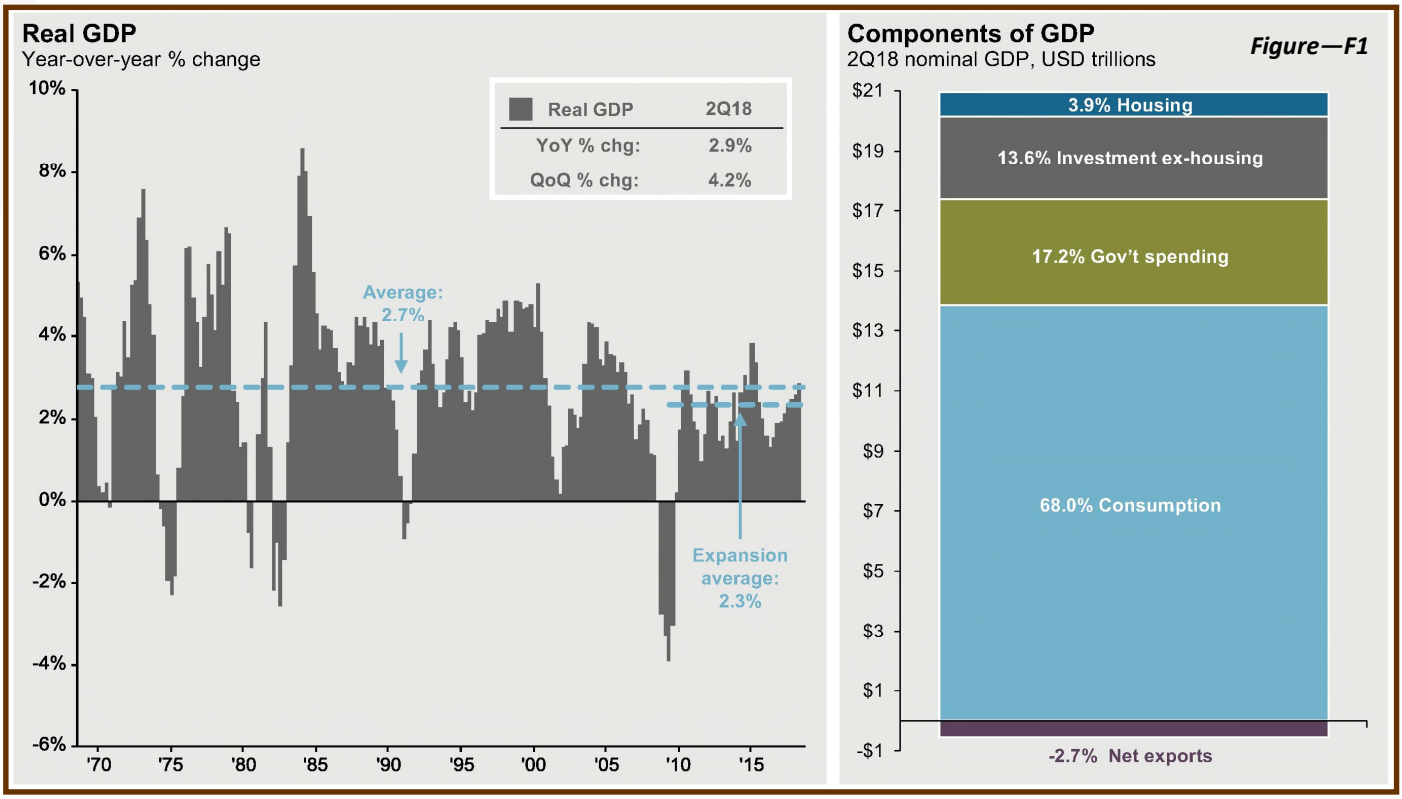
November of 2018 brought about another round of elections. Election seasons have historically brought market volatility as investors look to solve many unknowns; however, when we look historically at the four-year presidential term, the six months following these midterm elections are the strongest on average.

This optimism in the economy has been the fuel getting us through the later stages in the economic cycle, and if the optimism continues, we will continue to expect growth in the economy.

What Could Be

All indications suggest we are probably nearing the peak of this economic cycle. With that knowledge comes increased attention to events or conditions that could bring this bull market to an end. As inflation rises, we believe this could be the driving force behind an economic slowdown. Rising inflation influences the Federal Reserve's decision to raise interest rates. In the past the Federal Reserve has expressed a willingness to allow inflation to run a little hot, but they also have a mandate to keep inflation around 2%. How the Federal Reserve will handle inflation moving forward is not fully known, but the market is currently expecting two to three more interest rate hikes in 2019.

As the Federal Reserve raises rates, it also adds pressure to interest rates rising across the yield curve. Rates rising on the short end of the yield curve increases the pressure on the longer dated bonds to continue having higher rates. October 1, 2018, marked the first day of allowing the



Economic Commentary, Cont.

Federal Reserve's balance sheet to begin peeling off assets purchased during the recession of 2008-2009.[S4] Assets peeling off the balance sheet also leads to less demand in the market for bonds, pressuring rates to rise. Rising interest rates causes additional pressure on financing expenditures, slows lending to new projects, and increases prices across the country for items like housing as mortgages rise.

Rising inflation leads to consumer pain as monthly expenses creep up. The longer the Federal Reserve can keep inflation under control the longer we believe this bull market can last, but with all the cash being pumped into the economy this may be one cat that can't be put back in the bag.

On the other hand, actual prices on U.S. goods and services have generally been rising at roughly the pace expected. The metrics to measure inflation commonly are the Consumer Price Index (CPI) and Core CPI, which excludes volatile food and energy from overall CPI. CPI rose by 2.3% during the last twelve months and Core CPI was only up 2.2%..

Sources & Figures

[S1] Bureau of Economic Activity News Release — Friday, October 26, 2018

[S2] FactSet Earnings Insight — October 5, 2018

[S3] U.S. Department of Labor Data — November 20, 2018

[S4] Reuters.com *Fed Bond Unwind May Be Even Less Thrilling for Trump Than Rate Hikes*

[F1] BEA, FactSet, J.P. Morgan Asset Management & Guide to the Markets – U.S. Data as of September 30, 2018

[F2] BLS, FactSet, J.P. Morgan Asset Management & Guide to the Markets – U.S. Data as of September 30, 2018

Roller Coaster Fun!

Yes, a correction is most likely bound to come. It's healthy for a stock market and the economy to have cycles. As the economy grows inflation will ultimately tick higher, and interest rates will follow. At this point in the economic cycle, the goal is preparation. Having knowledge about the current situation is a powerful weapon when navigating perilous times. The U.S. economy is undisputedly strong and healthy, but the threat of inflation appears to be the biggest risk. Our position is very clear, a market sell-off in a fundamentally strong economic environment is not by itself a reason to abandon a sound, long-term portfolio. Box Financial Advisors thanks you for your continued trust as we take our responsibility to be ultra-aware seriously during these times. We continue to diligently watch the economy and markets to find value for our clients in each stage of the economic cycle.

P.S. Cyrus still hates Valley Fair, but he loves his kids. The markets jarring and volatile ride in October was painful, but it will end. Please don't tell his kids about Valley Fair, they still love it. Cyrus just knows to take Advil before and after the family day of fun.

MARKET COMMENTARY

Recent market activity has brought lots of volatility as managers try to position themselves for many of the issues we raised in our economic portion of this paper. However, despite the negative headlines during the third quarter of this year, the S&P 500 increase 7.2%, which was the largest quarterly gain since 2013.

As we approach the end of this cycle, we believe value stocks will begin to offer more value than growth stocks. Historically, growth stocks tend to experience more volatility towards the end of cycles while value stocks are anchored by their dividends.

Internationally, the trade wars have impacted overseas markets, especially China. The fragility of less developed economies raises serious questions for investors as tariffs continue to threaten growth.

Rising interest rates have created a headwind for bonds. Conservative bonds have felt the most pain, while more aggressive, higher yielding bonds have fared better in this environment.

While the trade wars with China continue to dominate the headlines, current valuations highlight opportunity. Emerging markets' price-earnings ratio is as low as it was in early 2009.

Will the current selling and attractive valuations bring enough attention to turn investment in this area from long time loser to new winner while U.S. markets take a breather? Time will tell.

BOX FINANCIAL
701 4th Ave S Ste 1710 | Minneapolis, MN 55415
Branch | 612.347.7809
www.boxfinancialadvisors.com