Investment Manager Meetings Recap Commentary

This quarter, the Strategic Income Group Investment Committee met with the following companies: Cboe Vest, JPMorgan Chase, Legg Mason, Transamerica, Resource Real Estate Opportunity REIT, Oppenheimer, New York Life Investment Management/ MainStay Funds, and Franklin Templeton Investments.

In addition to meeting with these companies, the committee reviewed research from many other companies and outputs from our technologies to determine the most appropriate investments and advice for our clients.

Strategic Income Group Current Views (Q3 2018)

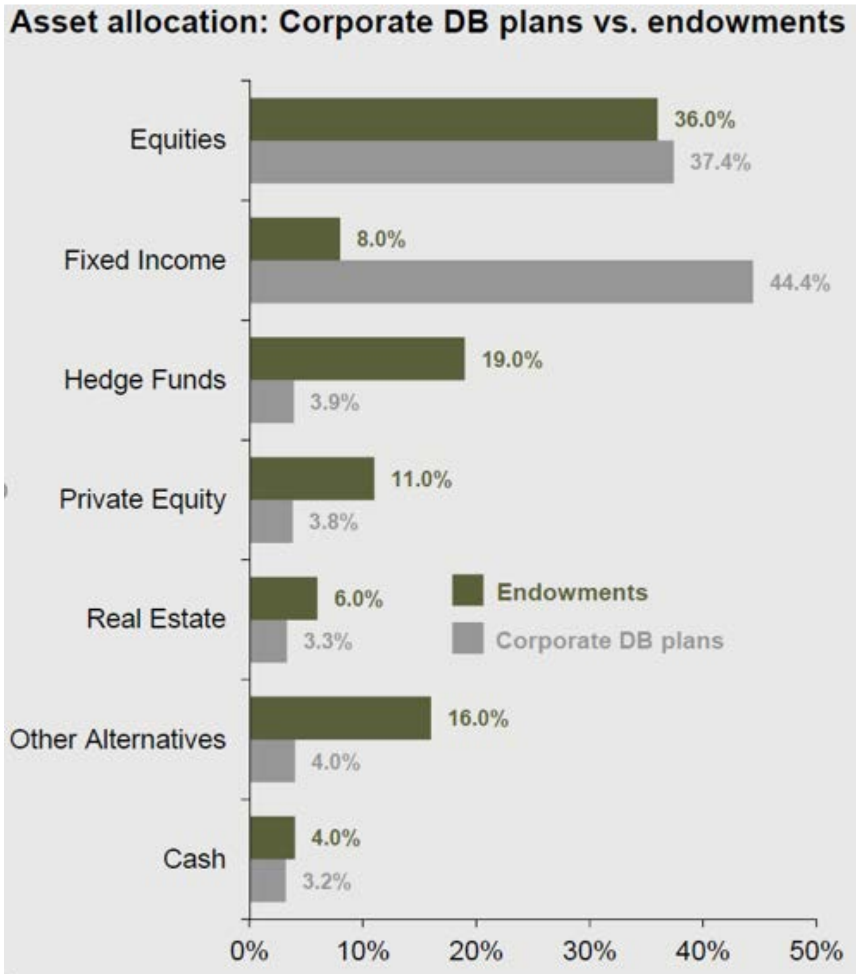
		Bearish	Slightly Bearish	Neutral	Slightly Bullish	Bullish
Capital Market Outlook				X		
		Underweight	Slightly Underweight	Neutral	Slightly Overweight	Overweight
Equities	U.S. Large Cap			X		
	U.S. Mid Cap			X		
	U.S. Small Cap			X		
	International				X	
	Emerging Markets					X
Fixed Income	U.S. Government		X			
	U.S. Investment Grade Corporate		X	←		
	U.S. High Yield		X			
	International			X		
Alternatives					→	X
Cash					X	

Please Note: These are 12- to 18-month views from the published date of the applicable commentary. Arrows represent movement from Q2 '18.

Capital Market Outlook

This quarter, we had two changes to our capital market outlook. With the Federal Reserve expected to continue increasing rates, we have moved our *U.S. investment-grade corporate bonds* view from *neutral* to *slightly underweight*. Our view is that as interest rates continue to increase, the total return on most bonds will likely be less than their coupon due to price volatility.

The other change to the capital market outlook was moving *alternatives* from *slightly overweight* to a full *overweight*. As you can see in the chart on the next page, endowment asset allocation now has over 50% of its holdings in hedge funds, private equity, real estate and other alternative investments. We continue to see increased opportunity in this space as most of these types of investments are not directly linked to the daily movements of the markets. The Investment Committee believes that adding a 10% to 20% allocation to alternatives enhances the portfolio, especially during a time period where most assets have historically elevated valuations.

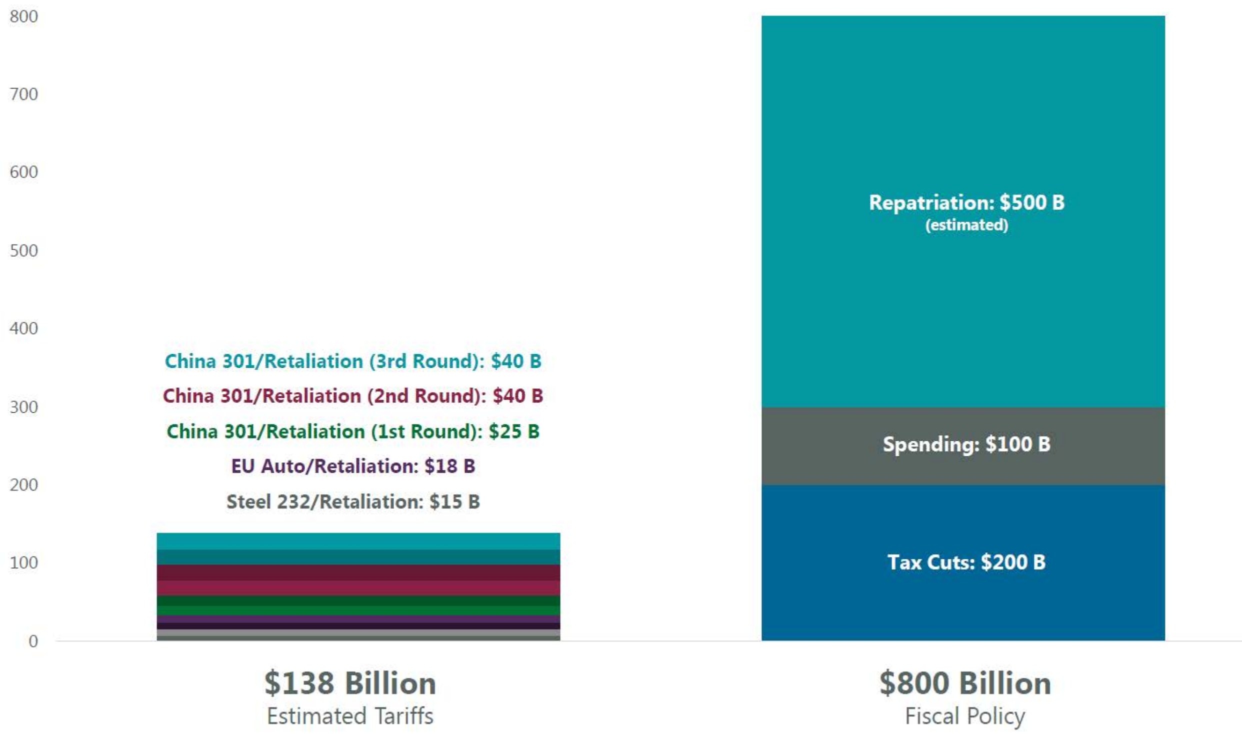


(JPMorgan Chase, Guide to the Markets, 3Q 2018)

Tariffs, Tariffs, Tariffs

Tariffs have been the talk of the media lately. On days when the market is down, it seems that the talk of tariffs is a likely reason for the down day. This has caused much confusion regarding the actual impact of tariffs on the markets and economy. It is important to understand that not all tariffs are negative to the United States. In fact, U.S. exports to China make up less than 1% of U.S. GDP (ClearBridge Investments, January 2018).

While some tariffs are a negative factor or a headwind for the economy, they are still less of a headwind than the tailwind that was created with the new tax plan and other fiscal policy stimulants. As you can see from the chart on the next page, the fiscal tailwinds drastically outweigh the headwinds created by tariffs.



Why Is the U.S. Doing Tariffs Anyways?

The U.S. has been the largest economy in the world for decades. In 2000, the U.S. comprised 31% of the world economy. From 2000 to 2016, the U.S. decreased over 19% to end with only 25% of the world economy while China increased over 275% since 2000 going from 4% to 15% of the world economy.

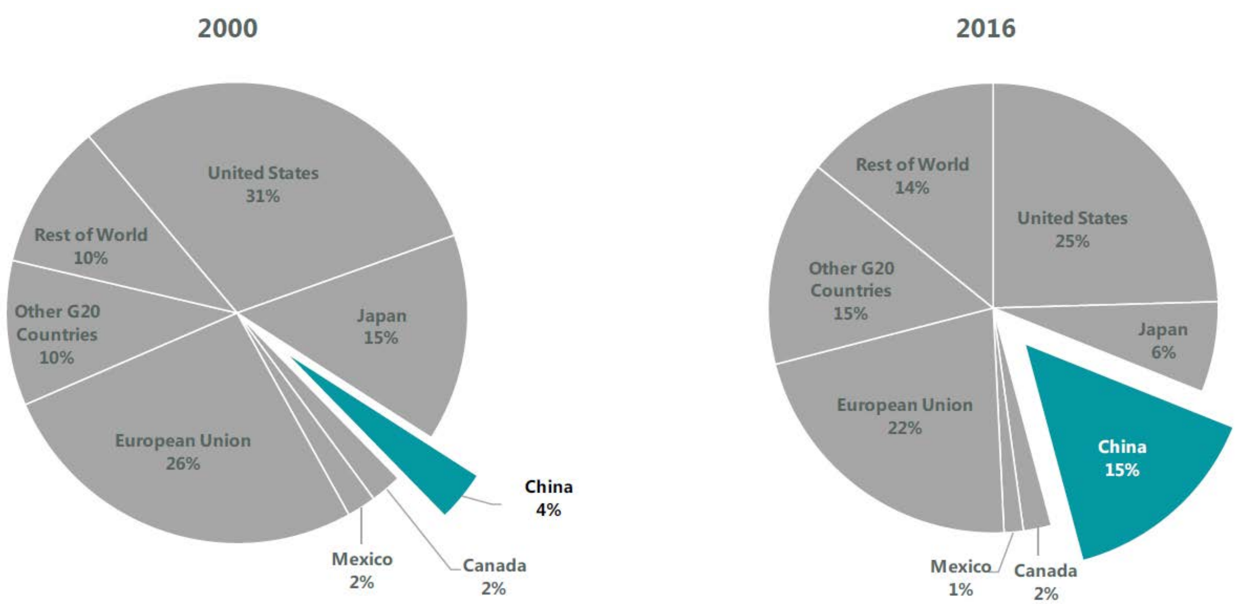
This is a drastic increase and can have major impacts over the next decade. Part of this increase comes from the rise of the middle class in China.

The other major impact is tariffs. Over this time there has been a tax of 25% on all U.S. goods sold in China while only a tax of 2% on all Chinese goods sold in the U.S.

Not from a political view but from a purely economic perspective, if the U.S. wants to hold its place in the world economy, some type of change to the current policy needs to happen.

There is a significant difference between policies that have been implemented versus policies that have been tweeted.

As an investment committee, we make our decisions on actual polices and not headline risks that are here today and gone tomorrow.



(World Bank, December 2017)

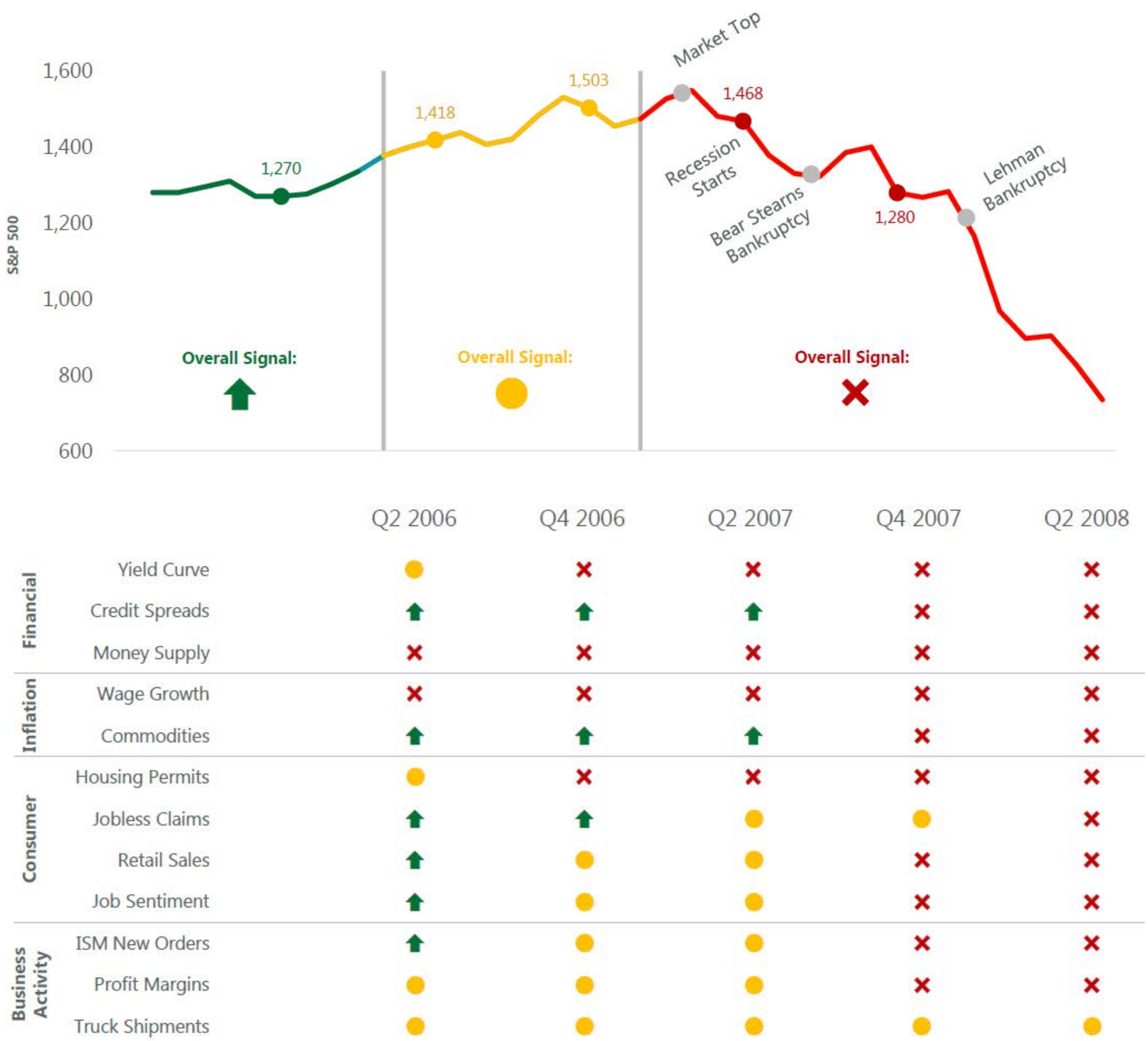
Still No Recession in Sight

The Investment Committee continues to review the leading economic indicators as they shine the best light into where the economy is heading. One of the new companies we met with this quarter had a great chart showing these indicators as you can see to the right.

		Second Quarter 2018	First Quarter 2018
Financial	Yield Curve	⬆	⬆
	Credit Spreads	⬆	⬆
	Money Supply	⬆	⬆
Inflation	Wage Growth	⬆	⬆
	Commodities	⬆	⬆
Consumer	Housing Permits	⬆	⬆
	Jobless Claims	⬆	⬆
	Retail Sales	⬆	⬆
	Job Sentiment	⬆	⬆
Business Activity	ISM New Orders	⬆	⬆
	Profit Margins	●	●
	Truck Shipments	⬆	⬆
	Overall Signal	⬆	⬆

⬆ Expansion ● Caution ✖ Recession

As you can see, we have 11 of the 12 indicators in the expansion phase. What makes this chart more impactful is when we compare it to our last recession that started in December 2007.



In the months leading up to the market turning over, several economic indicators were showing signs of slowing down prior to the actual market top and recession. The S&P 500 hit its pre-recession high on October 10, 2007 and the economy entered recession in December of 2007. We can have several economic indicators at non-expansion levels but still not be in a recession.

This does not give us a perfect crystal ball on when the market will decline or how much it will decline in the future, but it can give us great insight into where we are in this current market cycle. Currently, with 11 of the 12 indicators in the expansion phase, from our point of view and what we have seen in the numbers, a recession still appears to be more than 18 to 24 months away.

In Closing

The economy and markets are two separate things. It is great to see that the economy is still in such good shape. We continually get questions asking when the market will start to go down as it has been going up for nine years. Bull markets do not die of old age. They are usually killed by the Fed.

> “There is a significant difference between policies that have been implemented versus policies that have been tweeted. As an investment committee, we make our decisions on actual polices and not headline risks that are here today and gone tomorrow.”
>
> — Michael Gauthier, CFP® of the Strategic Income Group Investment Committee

The economy is still strong and while we believe that money can still be made in the markets between now and the next recession, normal market corrections of 10% to 19.9% that happen on average every year during a bull market are still likely. If the economic indicators are still reading this positively, we would view any type of sell-off or correction as a buying opportunity.

Interesting Facts

- Since 1948, no recession has started in the third year of a presidential administration (ClearBridge Investments).
- For the first time in 10 years, the GDP growth rate is higher than the unemployment rate (Zacks Investment Research).
- The number of millennials in China is larger than the millennial populations of the U.S., Canada, and Western Europe combined (ClearBridge Investments and VisualCapitalist.com).
- The U.S. Leading Economic Indicator Index (LEI) still points to solid growth, but the current trend which is moderating indicates that economic activity is not likely to accelerate (The Conference Board).
- Average hourly earnings grew 0.4% in August, which meant they were up 2.9% from a year ago — the largest 12-month increase since the economic recovery started in mid-2009 (FT Advisors, September 2018).
- The U.S. imports 22% less oil today than it did a decade ago (Department of Energy, August 2018).
- The mortgage giants Fannie May and Freddie Mac, which received $187 billion of taxpayer aid from the U.S. Government, have now paid back over $271 billion (Treasury Department).

Are You an Accredited Investor?

1. Do you have an annual income of $200,000 (or $300,000 for joint income) for the last two years with the expectation of earning the same amount or higher in the future?

2. Do you have a net worth exceeding $1 million (excluding the value of your primary home)?

If you meet these criteria, you are considered to be an Accredited Investor. This allows you to have access to special investments not available to all investors. The Strategic Income Group Investment Committee has researched and screened out specific opportunities that might be right for you. Please contact your adviser to learn more.

Did You Know?

Strategic Income Group has an official financial planning process called "The Three Phases of Wealth" designed to help you wherever you're at in your financial journey.

Visit http://strategicincomegroup.com/start/ to learn and set some financial goals!

Questions?

If you have any questions whatsoever regarding our investment manager meetings or any of the notes, give us a phone call or stop by our office:

Strategic Income Group
Ph. (480) 466-7070

East Valley Location:
2330 W. Ray Road, #3
Chandler, AZ 85224

West Valley Location:
20542 N. Lake Pleasant Road #119
Peoria, AZ 85382

StrategicIncomeGroup.com

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Certified Fiduciary Services provides a variety of estate and trust administration services that complement Strategic Income Group's offerings. Clients enjoy seamless financial services with the two companies working together.

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What Are Investment Manager Meetings?

At Strategic Income Group, we believe in reviewing detailed investment research. Every 90 days we set aside a week during which around 7 to 10 investment managers give us recommendations on our current portfolios as well as share their firms' current views on the market and economy. This recap is our commentary on the most recent meetings.