

# STRATEGIC *Insights*

## Section 1: Market and Economy

This quarter, the Strategic Income Group Investment Committee met with the following companies: Fidelity, Wildermuth, Blackstone, CNL Securities, BlackRock/iShares, and Prudential. 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.

### Capital Market Outlook

As we are closing in on the beginning of the fourth quarter, the U.S. equity markets have been able to push aside and brush off the apparent risks in the economy and are trading at near all-time highs. While this helps statements look somewhat better, the consensus of our investment managers as well as the Strategic Income Group Investment Committee is neutral (with a slight lean towards slightly bearish) for the next 12 to 18 months.

There are several factors that typically do better in the later stages of the economic cycle — more on this in a bit. As it relates to equities, the committee is bearish on U.S. small-cap stocks and has downgraded emerging market equities to neutral. There were two more downgrades on international fixed income and cash both moving from neutral to slightly bearish.

### Taking Pulse of the Risk Indicators

Strategic Income Group Current Views (Q4 2019)		Bearish	Slightly Bearish	Neutral	Slightly Bullish	Bullish
Capital Market Outlook				X ←		
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 Q3 2019.

As seen to the right, ClearBridge Investments consolidates the top 12 leading economic indicators. There is a clear signal of a slowdown in growth in the U.S. As different areas of our economy continue to slow, the Federal Reserve has started a new easing cycle where they are lowering rates or tapping on the gas pedal in order to stimulate additional growth in the economy.

Of the economic indicators, 4 of the 12 are cautionary, 2 are recessionary, and 6 are still expansionary. This does not signal a recession yet. Our experts are still telling us



that late 2020 or sometime in 2021 for a recession is still a more probable time frame. There are, however, some potential risks that could accelerate this time frame — as well some potential solutions that could allow the

U.S. to start to re-accelerate and grow for several more years.




### Consumer, Corporate Profits, and Tariffs

On the positive side, the U.S. consumer is very strong. Wages have been increasing at an annualized rate of 3.5%, which is the highest in over a decade. The unemployment rate of 3.7% is an all-time low, personal savings rates are up, and overall household debt servicing is at a multi-decade low, now under 10% vs. 13.2% in fourth quarter of 2007. All of these numbers are indicating that the U.S. consumer is well-equipped to handle even a more prolonged slowdown in the economy.



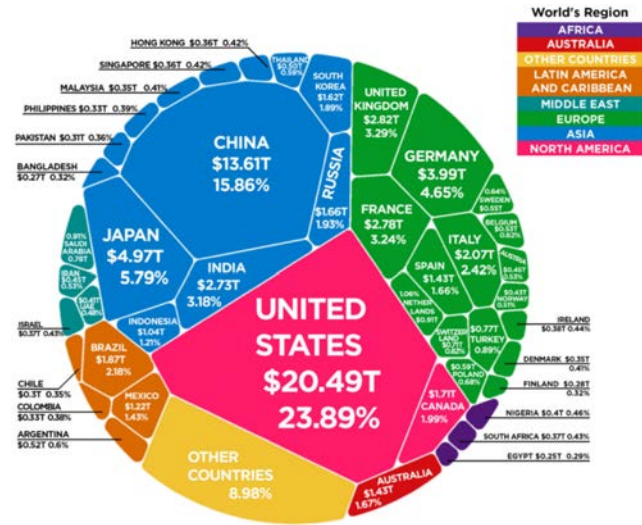
When it comes to companies, corporate profit margins have been very healthy for the last nine years. The concern is that tariffs are starting to have an impact on corporate profits. Higher labor costs and high employment is causing a battle for good workers which could cause profits to start to get squeezed. This creates additional uncertainty on the direction of corporate profits, creating the opportunity for more volatility as it is becoming less clear

		June 2019	First Quarter 2019
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	↑	↑
<b>Overall Signal</b>		●	↑

 Expansion    
  Caution    
  Recession

if companies will be as profitable over the next few years as they have been in the last nine years.

Tariffs have continued to headline the news over the last several months. We do not see this issue going away as we feel that there is not likely to be a resolution until mid-2020. When you look at the size of the economies of both the U.S. and China as seen in the chart to the right, you can see that this tariff issue is a battle of the heavyweights. The U.S. is still the largest economy in the world as measured by GDP coming in at almost 24%. China, on the other hand, is solidly in second place making up almost 16% of the world economy. It is very hard for the two largest economies in the world to battle it out on trade issues without having any spillover into other smaller countries.

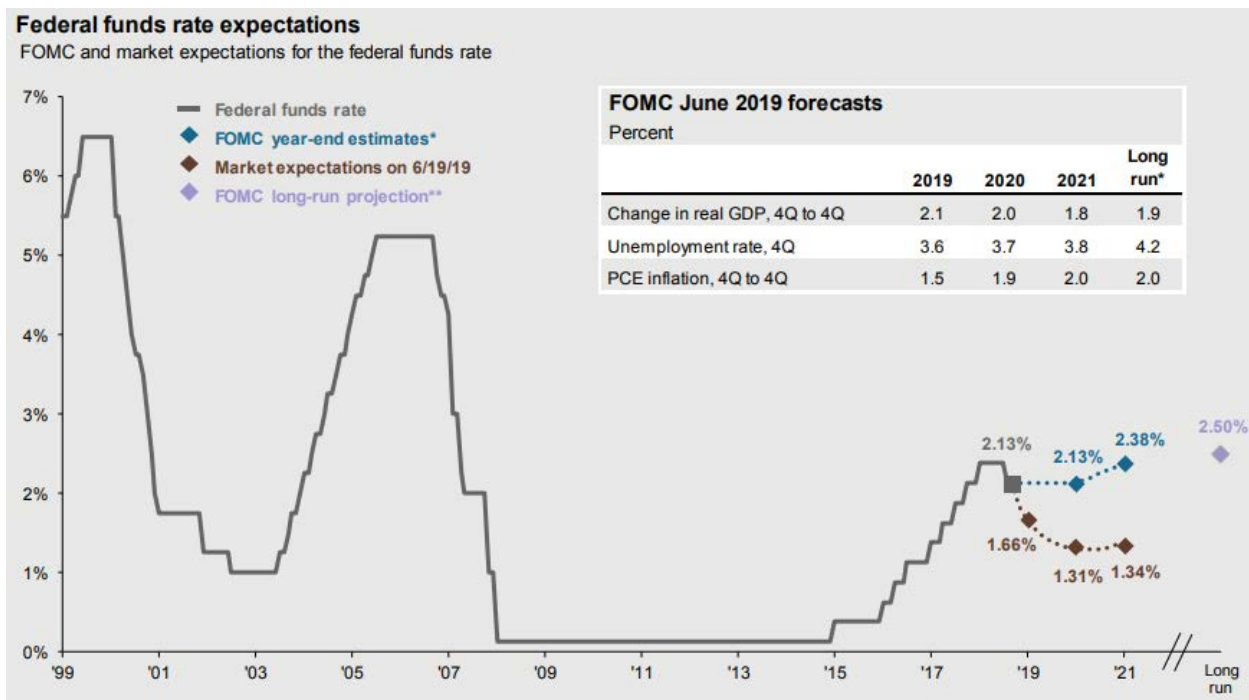


Ultimately, we see three potential outcomes of these trade discussions:

1. Trade truce: deal gets made and growth re-accelerates
2. Trade uncertainty continues: economies muddle through
3. Trade war: more tariffs and a possible recession

Any uncertainty creates the opportunity for volatility to return.

### Can the Fed Pull Off a Soft Landing?



The Federal Reserve has changed their stance quickly in the last three months. Their communication around the first rate cut was more of an “adjustment” to now a full-blown rate easing/lowering cycle. This is a big movement in the consensus over a short time period. Many of the experts that we are talking with are expecting one or two cuts before the end of the year, with another two to even four cuts next year. Prudential went as far as saying the Fed rate will get back down to zero. This would be a large stimulus towards adding growth into the economy.

So, what does all this mean . . .

There are still a lot of positives in the economy: strong consumer, low rates, Fed easing, decent profit margins, low unemployment, low inflation . . .

The risks are there and increasing, however: profits starting to get squeezed, tariffs, trade issues, geopolitical risks, headline risks, presidential election, Iran/Saudi Arabia oil issue . . .

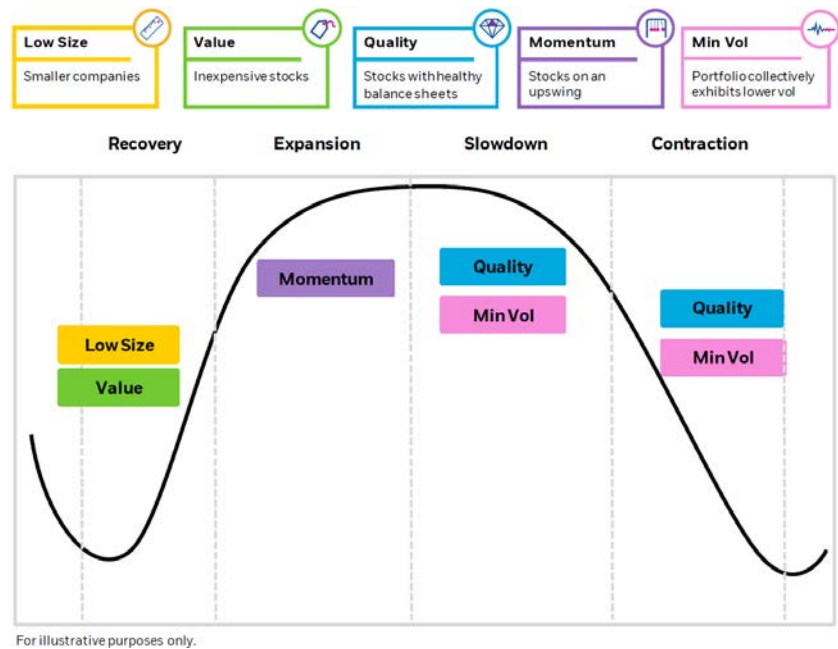
It all adds up to *slow growth*.



*Section 2: Practical Applications*

**How to Invest in the Late Cycle**

All these positives and negatives that add up to slow growth do not mean you should run for the hills with your cash in hand. The committee also does not believe in a “set-it-and-forget-it” investment strategy. Instead, history has shown us that the best thing to do as the business cycle matures is to be rotating out of those investments that were more favorable in the earlier part of the cycle to investments that historically perform better during this phase of the business cycle.



This would suggest that we would reduce the allocation to small-cap equities, reduce international, as well as increase the quality of the equities that you own. Companies that are larger in size and typically have stronger balance sheets and good business models are able to weather late cycle storms with reduced volatility and even increased performance.

The committee has adjusted our Strategic Portfolios to reflect this belief and will continue to rotate in this direction over the coming months and quarters.

**In Closing**

Over the last 50 years, from the moment the 2-year and the 10-year yields inverted (which happened in August 2019), it took on average 21.3 months until the start of the next recession. During this time the S&P 500 was positive on average 12.7%. While an inverted yield curve is not 100% accurate in predicting recessions, it is 100% accurate in predicting economic slowdowns.

The Strategic Income Group Investment Committee is very comfortable with where the Strategic Portfolios are invested at this stage of the business cycle. We continue to favor illiquid alternatives and will continue to watch for opportunities and reason to continue rotating the portfolios. In addition, the committee continues to watch the risk metrics and is ready to become even more risk-averse if and when needed.

To dive deeper into how your investments impact your financial plan, please schedule a meeting with your CERTIFIED FINANCIAL PLANNER™ professional by calling (480) 466-7070.

Discipline is the key to success!

### ***A Note Regarding Investment Rotation***

1. As the Fed lowers rates, increase duration.
2. Favor U.S. over international.
3. Late cycle favors large-cap over small-cap.
4. Increase the quality of equities — stronger balance sheets creates more stability.
5. Increase allocation to alternatives and private/illiquid investments.
6. Be prepared to decrease risk in equities if risk in market spikes.

### **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.

## Interesting Facts

- The U.S.A. has 121 companies in the Fortune Global 500 rankings for 2019 compared to 119 companies from China. Twenty years ago (1999) the U.S.A. had 181 companies in the Fortune Global 500 rankings while China had just 5. The rankings are based on annual revenue. (Source: Fortune)
- Of the 10 recessions since 1950, the average length is 11 months. (Source: National Bureau of Economic Research)
- 59% of all imports coming into the U.S. in 2019 (as measured by the dollar) are subject to a trade tariff imposed by the United States. 75% of all imports coming into China in 2019 (as measured by the dollar) are subject to a trade tariff imposed by China. (Source: Global Trade Alert)
- The number of American retail stores that have closed YTD through 8/31/19 is 8,051. This year's store closures are on pace to exceed the all-time record of 8,139 store closures from 2017. (Source: Coresight Research)
- Lenders foreclosed on 57,499 homes in the first 5 months of 2019, down 43% from 100,958 foreclosures in the first 5 months of 2018. (Source: ATTOM Data Solutions)
- The world's most valuable sports franchise is the NFL's Dallas Cowboys, worth an estimated \$5 billion. The Cowboys generate \$365 million of operating income per year, or \$1 million a day. (Source: Forbes)
- 9/10 of investment-grade debt that is positive yielding is domiciled in the U.S.A. (Source: Prudential)
- 9% of euro junk bonds have a negative yield. (Source: Prudential)



### *Are You an Accredited Investor?*

1. Did you have an annual income of \$200,000 (or \$300,000 for joint income) for the last two years and have 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 advisor 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 <https://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:

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## Certified Fiduciary Services

Strategic Income Group's wholly owned subsidiary company, Certified Fiduciary Services, Inc., is here to serve you and your family.

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.

Visit [CFSArizona.com](http://CFSArizona.com) to learn more today!



If you need help with your tax return or need to file an extension, Strategic Tax is here to help.

**(480) 466-7070**

## Strategic Income Group Investment Committee

**Chad Manberg, CFP®**, Chairman

**Michael Gauthier, CFP®**, Vice-Chairman (past Chairman 2013–2018)

**Bob Stamm, CFP®**, Member

**Martha Cortez, FPQP™**, Member