Fiduciary Financial Group

Q3'2019 Market Update

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Outline

- FED Update
- Leading Economic Indicators
- Employment
- GDP
- Deficits & Debt
- Stock Valuations
- Real Estate
- Interest Rates

In Summary

We like to give the talking points first, in case this is more data than our readers want to consume

- The FED is reacting to concerns of a global slow down (and one domestically) via two recent reductions in interest rates. So far, the expectation of those cuts lead to stock market gains while the actual cuts haven't produced additional stock gains.

- The Conference Board Leading Economic Indicator Index was mildly positive for the quarter depicting an economy that is [STILL] expanding albeit slowly.

- The labor market remains strong with steady wage inflation (2.9%), 50-year low unemployment rates (3.5%) and increases in participation (63.2%).

- The rate of GDP growth declined noticeably in Q3'2019.

- Deficits are increasing at an accelerating pace. This *will* be a drag on future economic growth, particularly if interest rates rise, on an ever-increasing mountain of debt which will eat further into our government's discretionary expenditures budget. With less discretionary government spending, economies suffer (all else being equal).

- Academically respected stock market valuation metrics are stretched leading most institutional money management firms (Vanguard & Blackrock to name a few) to publish return outlooks for the next 10 years that are WELL below historical averages for stocks in the US.

- On a national scale, home prices are just now catching up to 2007 peaks after adjusting for inflation – this, despite drastically lower borrowing costs (now vs 2007) as reflected in 30-year fixed rate mortgages averaging well under 4%.

- It appears we have a backlog of new homes that still need to be built if you look at housing starts relative to population growth. After the great recession, building went ice cold. This put our country in the position of needing to make up a lot of ground (in terms of new home construction) to create a balance of supply and demand and thus more sustainable home price inflation. The shortage of building (one could argue) has been a driver in the the deterioration of home price affordability across the country – that is coupled with historically low wage growth over the last decade.

- Home price appreciation and rental appreciation are very out of balance. It's our best guess that rent inflation should outpace home price inflation in the near-term barring major regulation to contrary which could further distort the relationship between the two (think rental control in San Francisco).

- Interest rates are being manipulated by both US and foreign governments in a way we've never seen. The result – we are in uncharted territory making the use of history as our guide for future investment decisions more difficult.

FED Update Layered Over S&P 500 Performance

Stocks recovered sharply in Q1 & Q2'2019 with the expectation of rate cuts but have stagnated since the last 2 have been carried out. This is another testament to the market baking in expectations of what WILL happen before it happens.

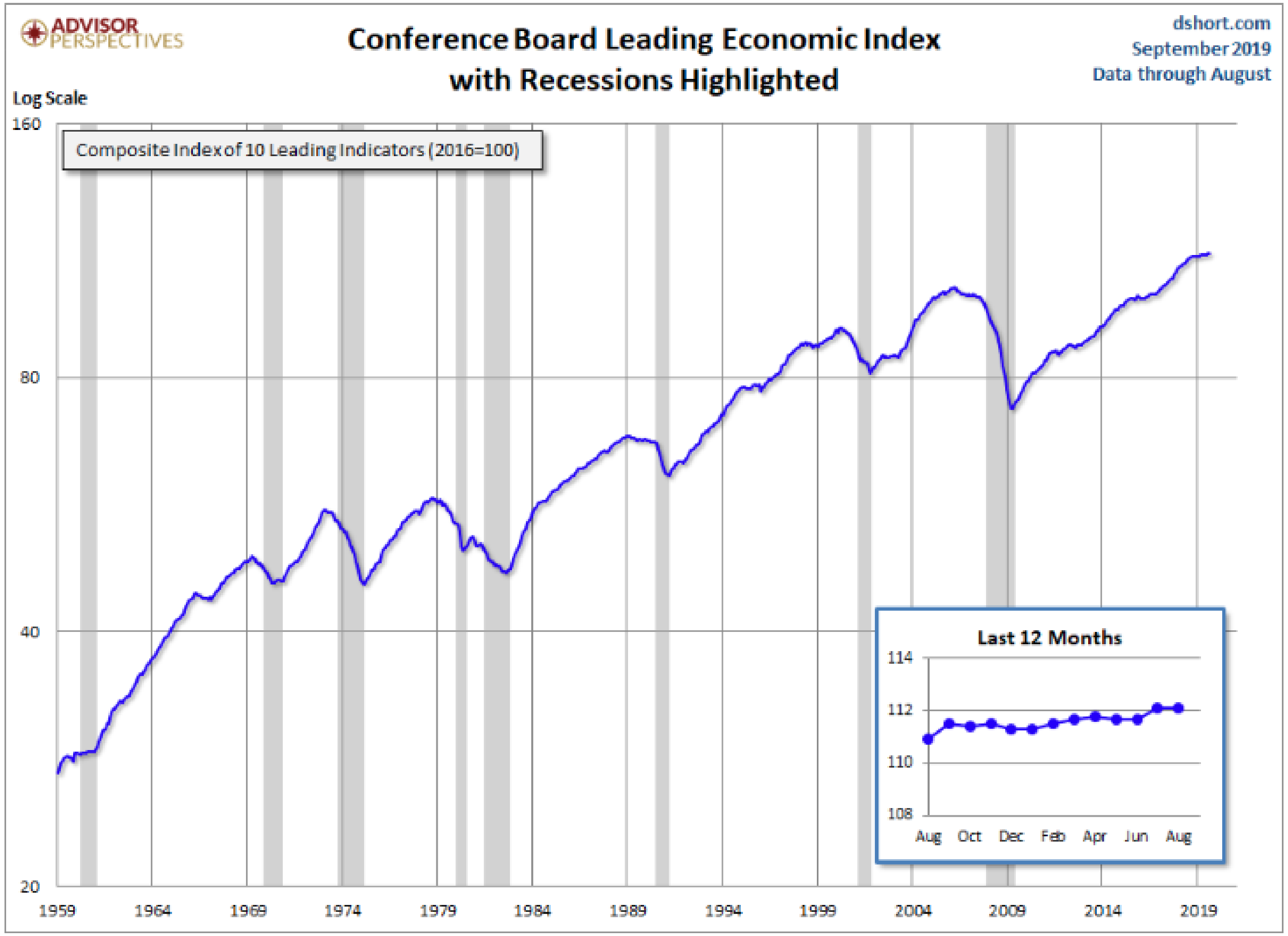
Question - If we have further rate cuts to stave off a recession, will they have a diminishing ability to prop up the stock market?

Leading Economic Indicators

- ***Historical graph***

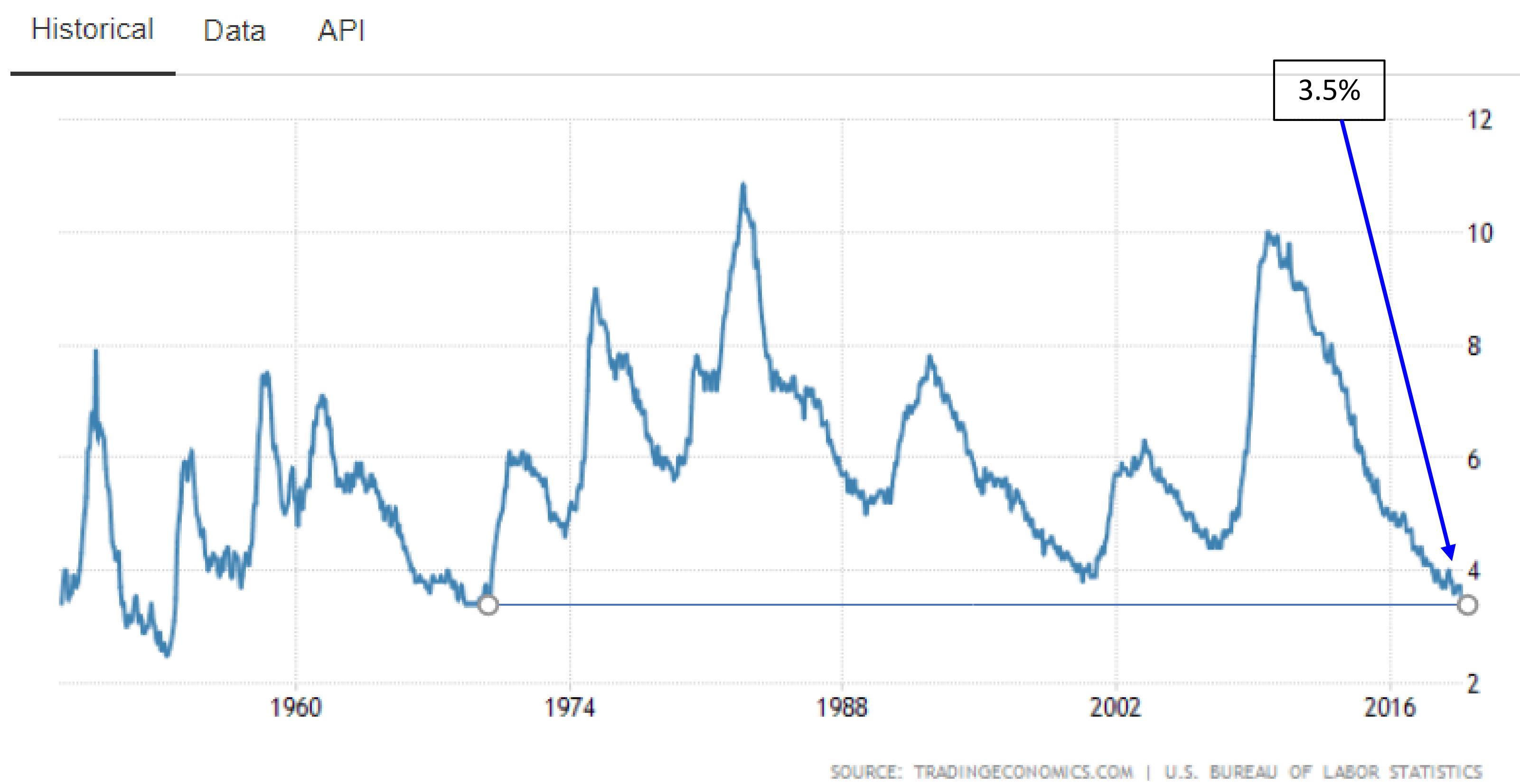
- ***FFG Commentary:*** September's release shows minor improvements from June although the main components of the LEI are a mixed bag:

  - Non-Farm Employment modestly higher (+)
  - Industrial Production growth flat-lined (-)
  - Real Retail Sales continued to increase (+)
  - Real Personal Income crept higher (+)



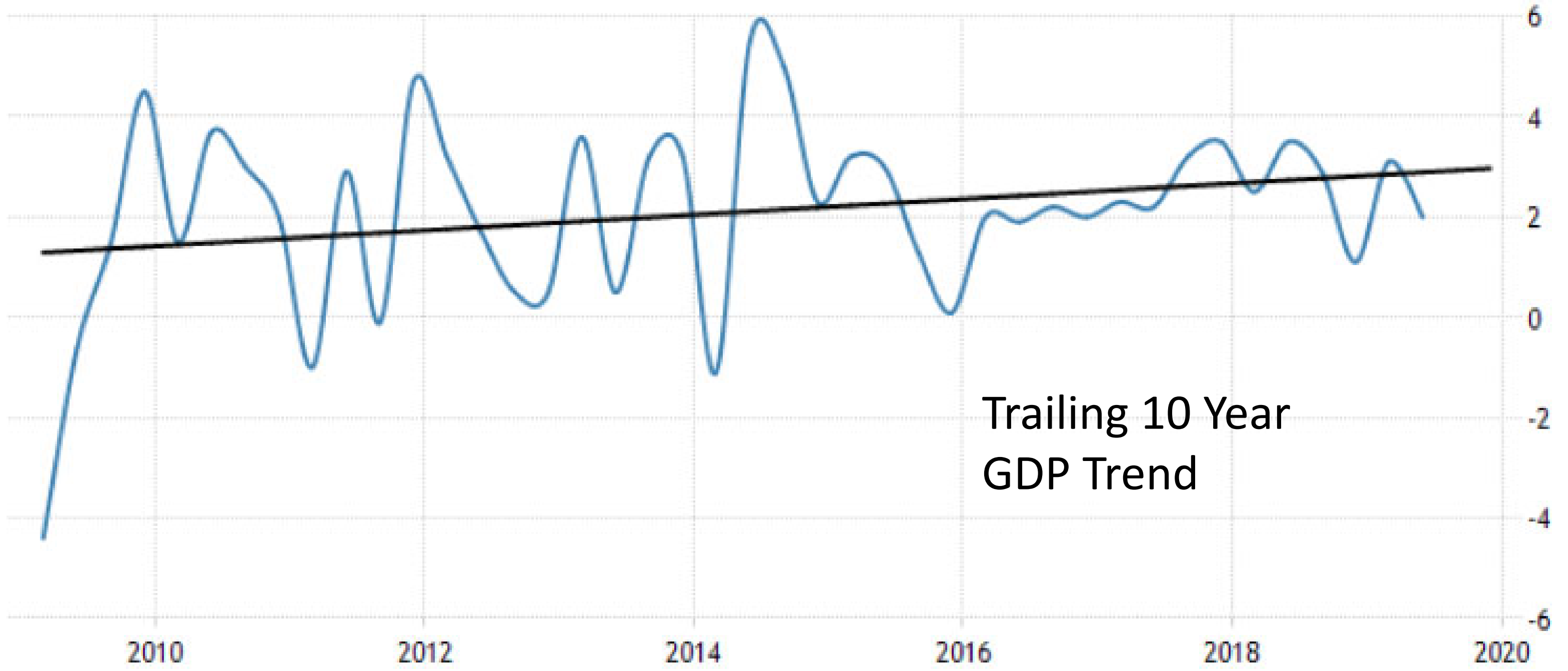
Employment

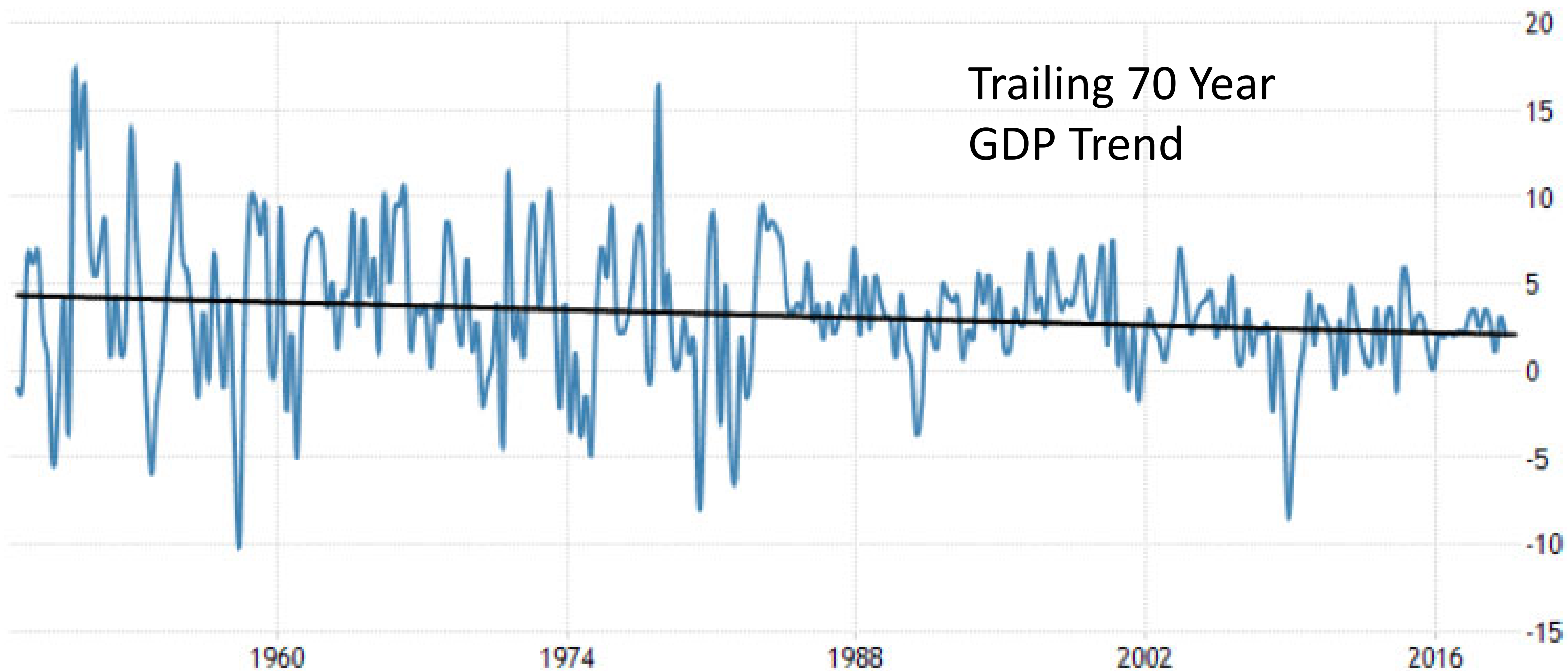
- The September 2019 jobs report was released on 10/4/2019 showing unemployment at a **<u>50-year low</u>** of 3.5%. (+)
- Labor Force Participation also ticked up (albeit very modestly) to 63.2%
- Avg hourly earnings in the private sector increased 2.9% YOY in Sept'19



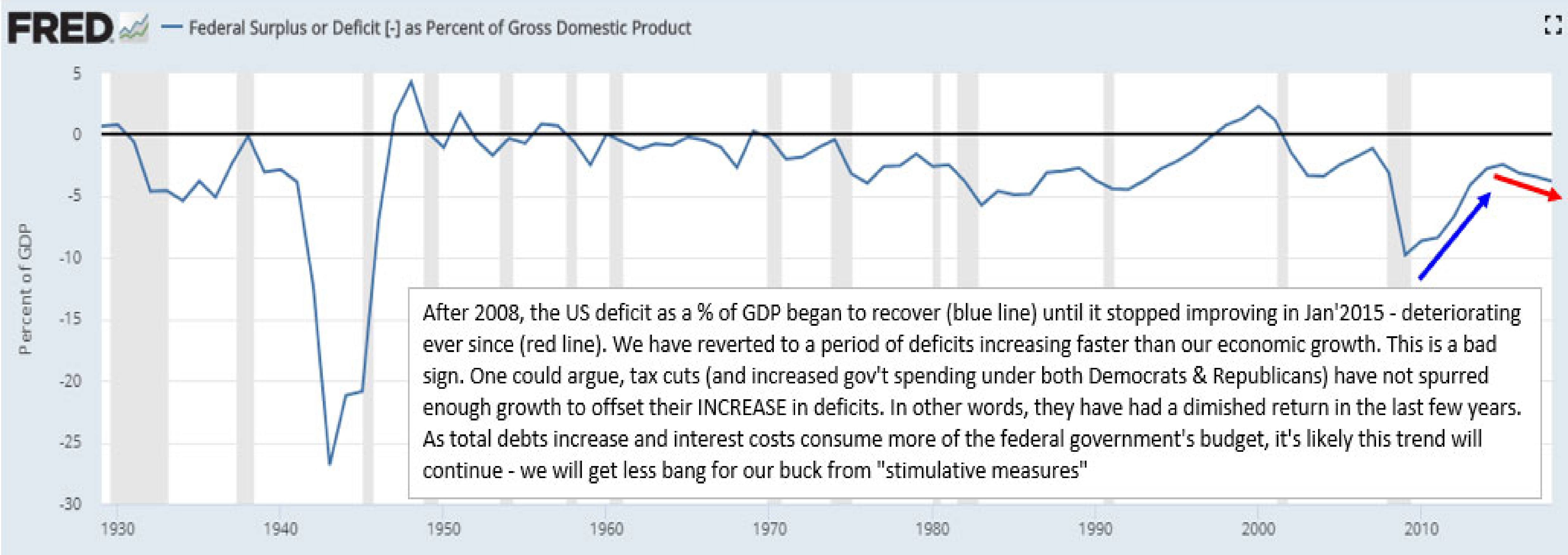
GDP: Short-Term vs. Long-Term Trends

FFG Commentary: *At the mid-point of the year, the GDP growth rate had moved positive above it's 10-year historical trend. Over the summer, GDP dropped significantly (a full 1%) from 3.1% YOY in June, to only 2% YOY in September. This is in line with the long-term declining trend in GDP growth rates observed over the last 70 years and pushed us back below our 10% average YOY growth rate coming out the 2008 recession.*





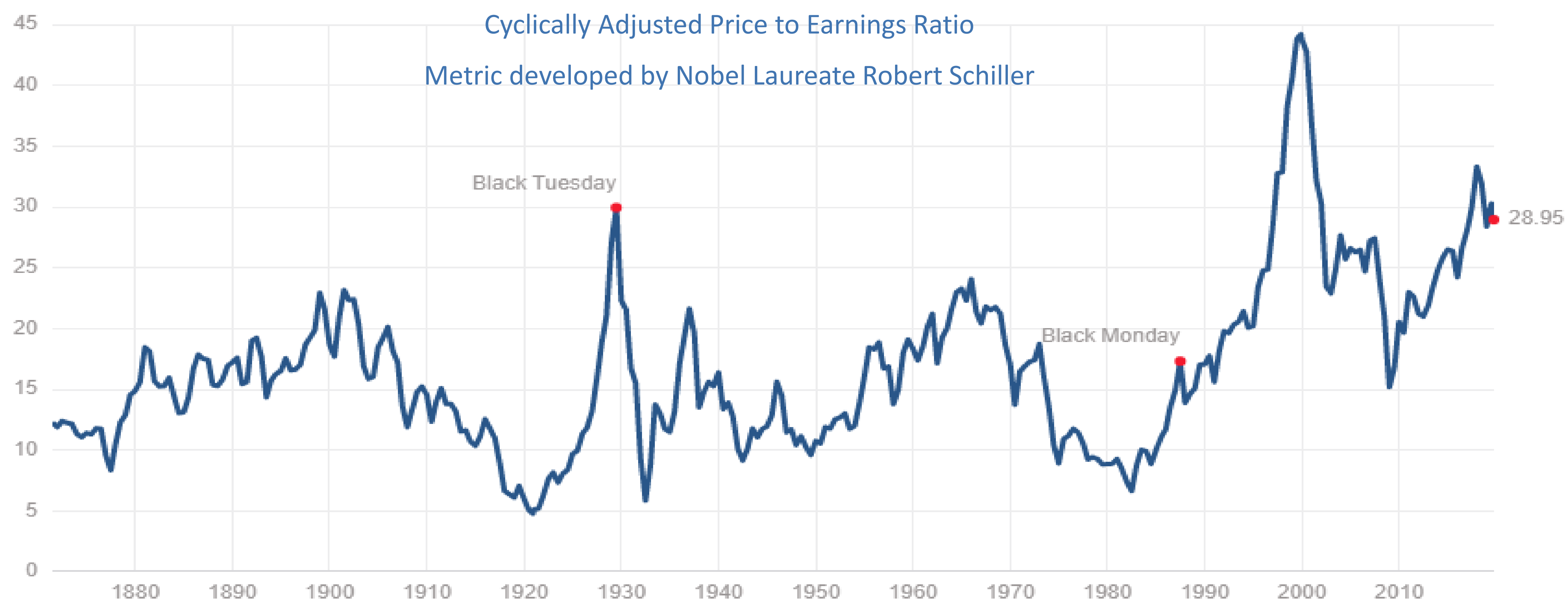
Deficits & Debt?
Do They Matter?



Valuations

FFG Commentary: *This chart looks at what investors are paying for their share of a stock markets last 10 year's worth of earnings. This has been well received in academia (vs. just looking at last year's earnings) because it factors in the cyclicality of earnings of the business cycle with economic expansions (higher profits) and contractions (lower profits). The CAPE ratio is now even with that of Black Tuesday (1929) and only once surpassed in the 2000s during the tech bubble.*

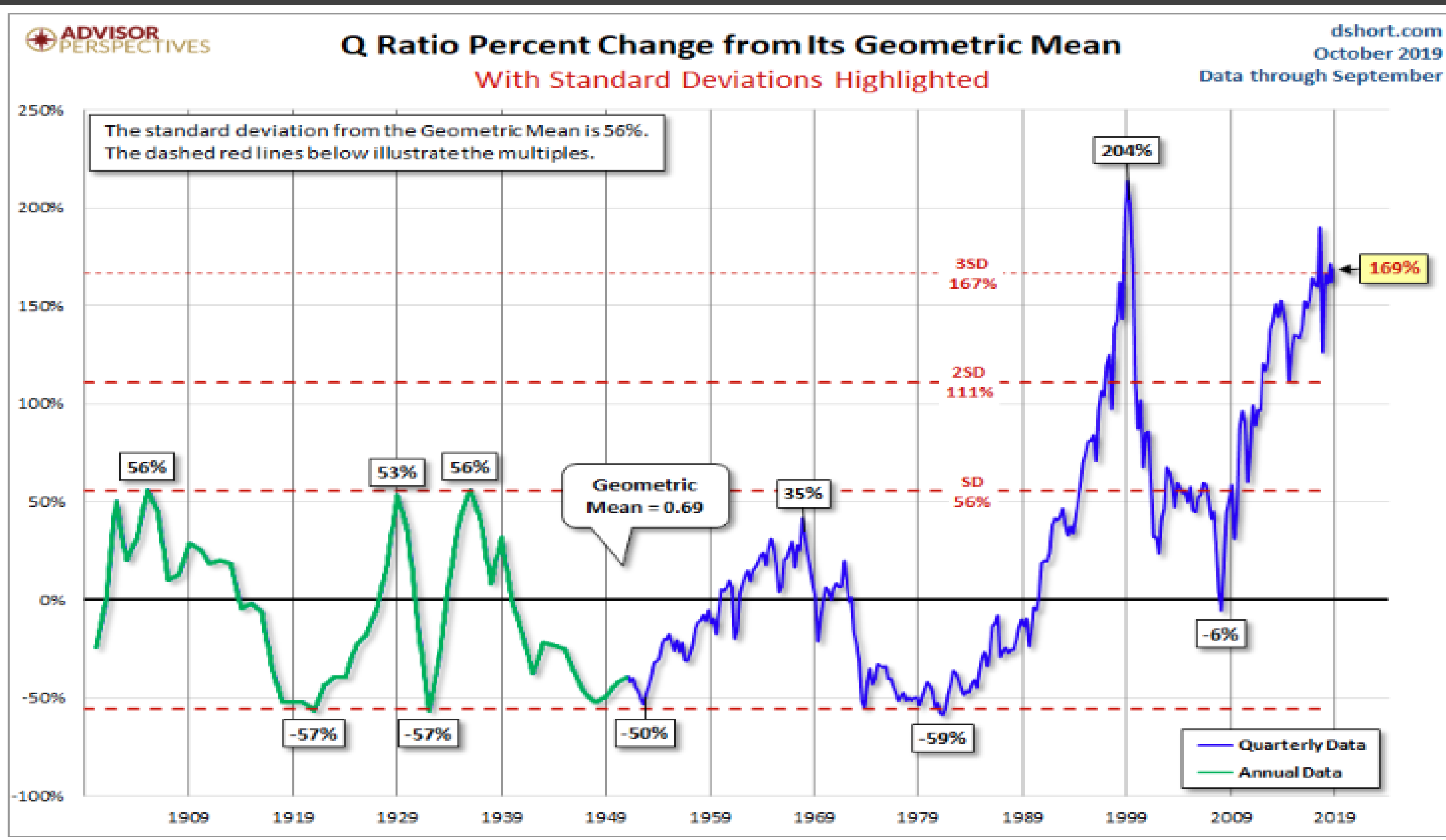
Comparison to Last Quarter: *Since our last publication, the stock market is slightly cheaper (4%) using this metric albeit still very expensive on a historical basis.*



Valuations

FFG Commentary: *James Tobin, also a Nobel Laureate economist, developed a ratio to look at the aggregative market value of companies in the stock market relative to their "replacement cost" as determined by their balance sheet. The higher the ratio, the more the market is trading at a premium to all the aggregate companies' replacement costs.*

Comparison to Last Quarter – *this ratio now sits at a level 3 standard deviations above its historical norm – eclipsed only in 2000 and more recently in late 2018.*

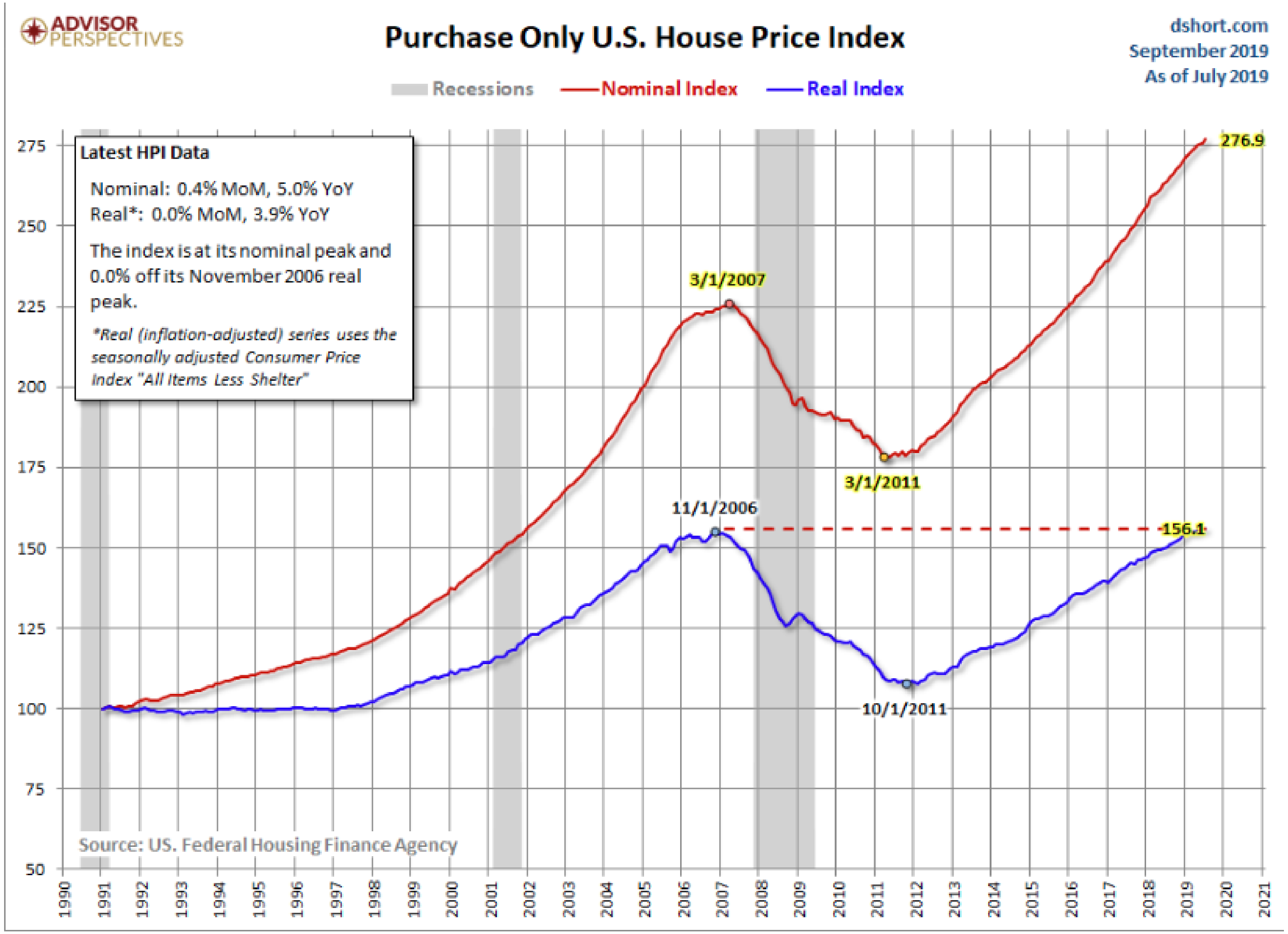


Real Estate

FFG Commentary (residential)

- There is often talk of “another real estate bubble” in light of prices eclipsing their 2007 peaks in many areas of the country. But, on an inflation adjusted basis, we are still just even with 2006 levels on an inflation adjusted basis according to the Federal Housing Finance Agency.

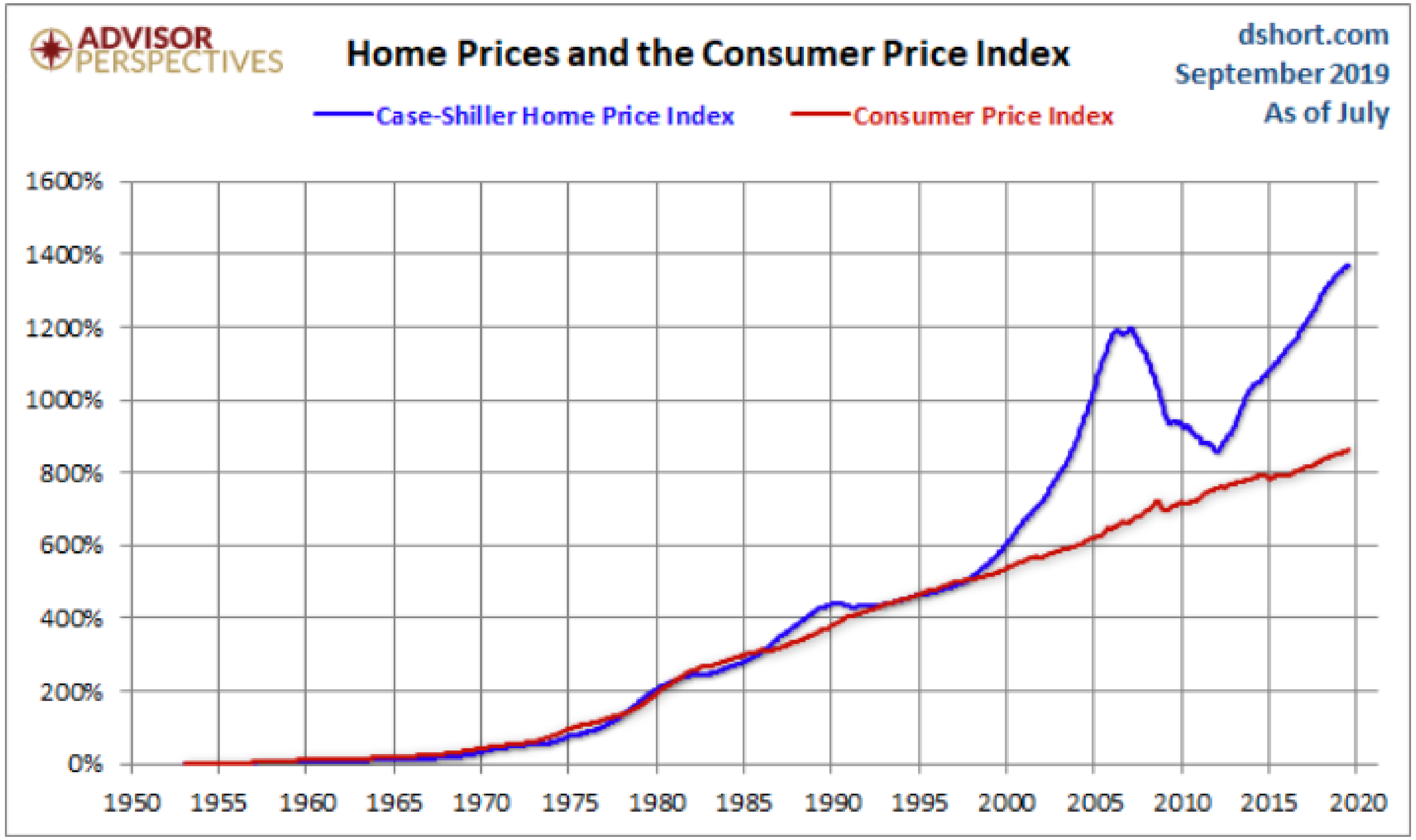
these are nationwide figures, specific locations vary



Real Estate (continued)

FFG Commentary (residential)

- From a point of parity in the mid 1990s (when home price inflation and core inflation were similar) house inflation has far outpaced core inflation making housing overall less affordable for people than it has been in decades past.
- **Conclusion?** Go easy on those millennials living in mom's basement
- *These are nationwide figures, specific locations vary*

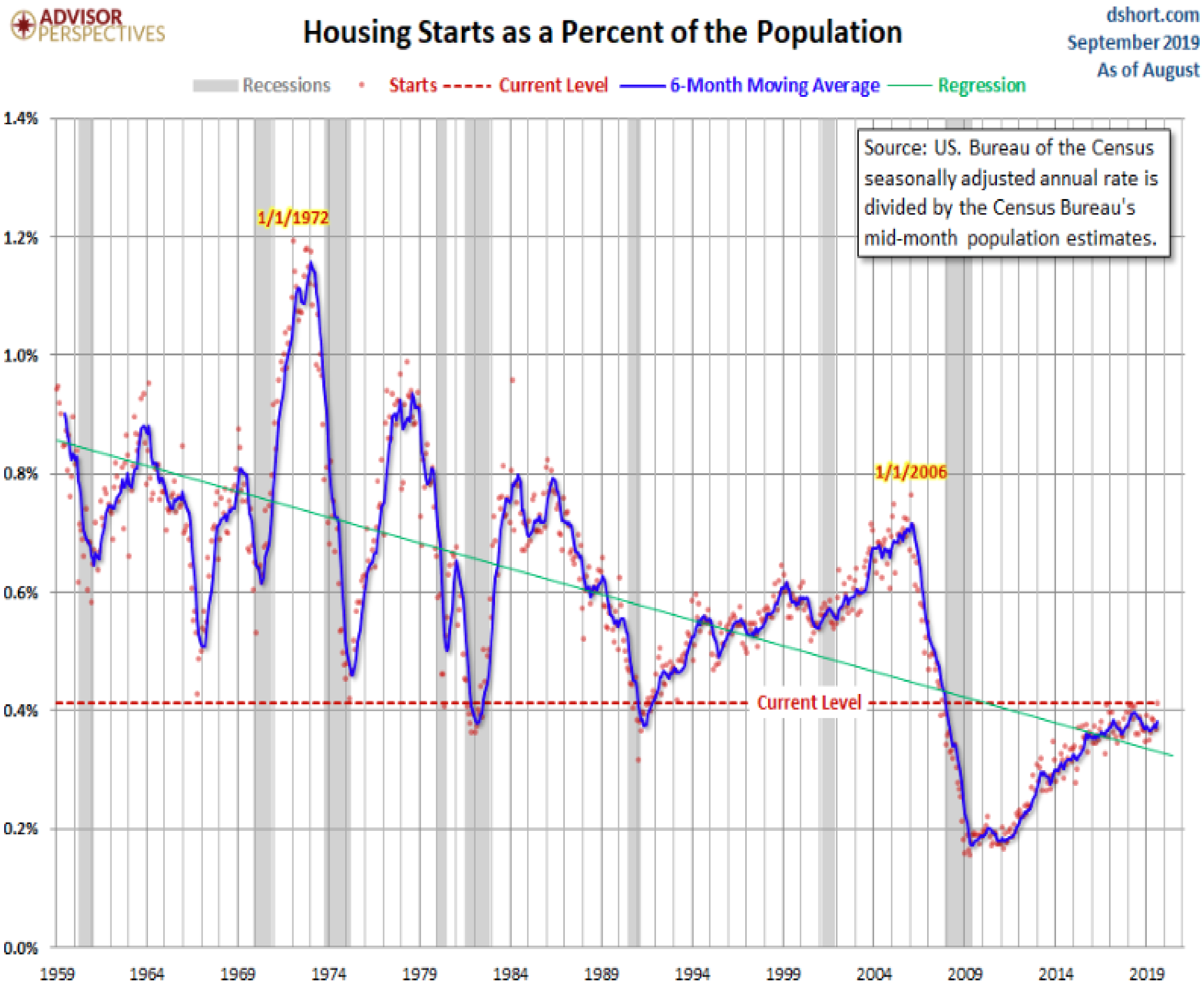


Real Estate (continued)

FFG Commentary (residential)

- Housing starts as a % of the population are still at very low levels looking at the last several decades. This supports the argument that home prices (and home builders) still have room to run as there is a lot of “pent up demand” for new homes – particularly with the largest demographic block of society (millennials) moving into the homeownership stage of life.

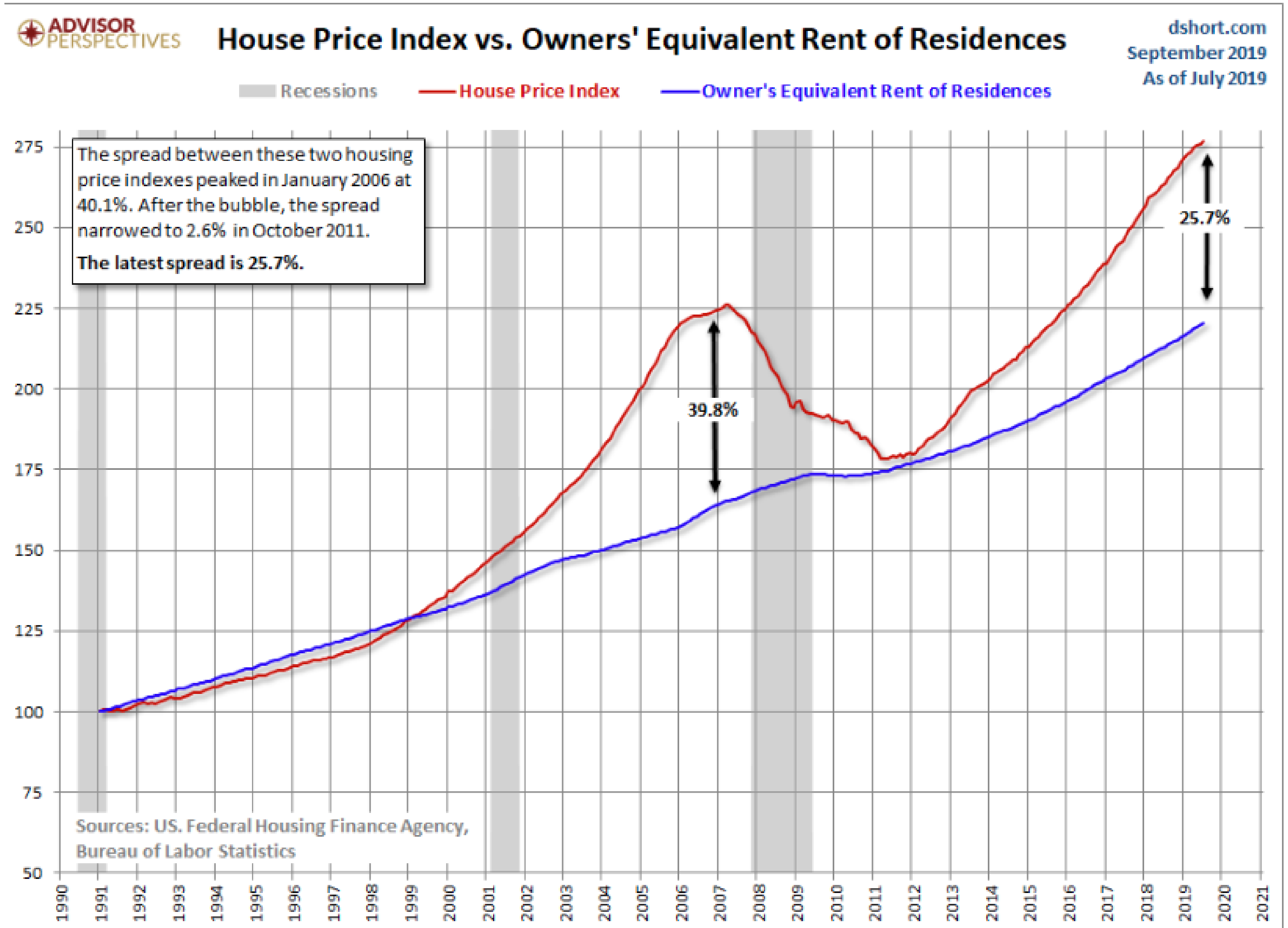
- *These are nationwide figures, specific locations vary*



Real Estate (continued)

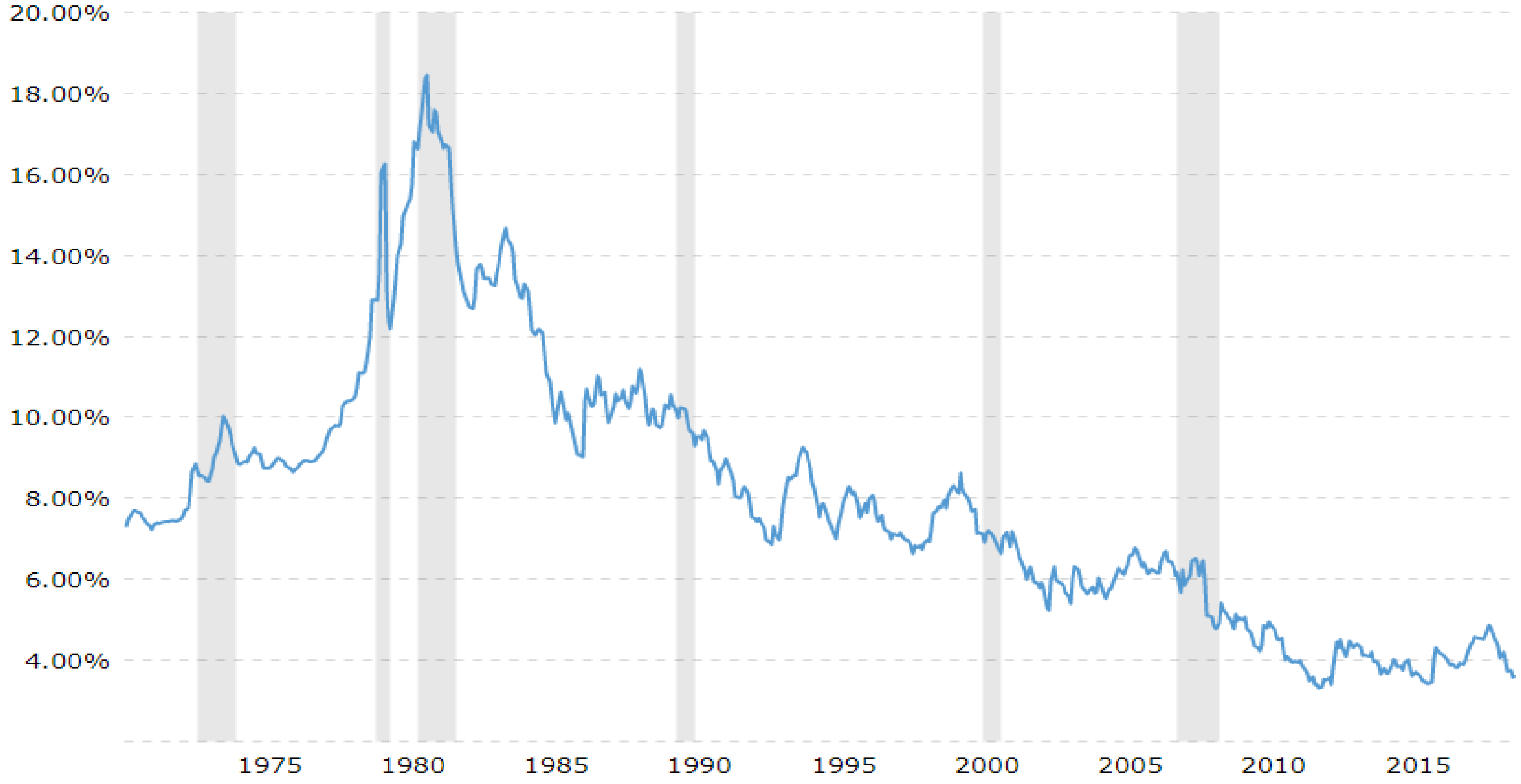
FFG Commentary (residential)

- This chart looks at the correlation between rents and home prices. As we can see, home price growth has far outpaced rental growth since 2012. In general, home price inflation and rent inflation should see a similar pace of increase over time. This chart might indicate that rent increases should outpace home price increases in coming years so the relationship between the two can normalize. We saw this happen in the last "real estate bubble" in 2007 when the two converged until 2012.
- *These are nationwide figures, specific locations vary*



Interest Rates - Mortgages

30 Year Fixed Rate Mortgages since 1971



https://www.macrotrends.net/2604/30-year-fixed-mortgage-rate-chart

30 Year Fixed Rate mortgages hit their lowest level since 2016 and are flirting with their lowest level since 1971.

For homeowners planning to stay put for the next 3+ years, you may want to analyze if a refinance to lock in a long-term low-rate is right for you.

Interest Rates - Treasuries

10 Year United States Treasury Yields Since 1870

https://www.multpl.com/10-year-treasury-rate

10 Year Treasury bonds now trade at essentially the lowest levels in over 140 years. *While for Americans it often seems that rates couldn't possibly go lower, it's important to note that over $15 TRILLION worth of bonds trade at NEGATIVE yields around the globe.* In other words, $15 TRILLION has been lent out by investors with the clear expectation that they will lose money at maturity. *This has never happened.*

Relative to German and Japanese sovereign bonds, our treasuries still offer more potential (currency risk excluded).

This is the epitome of uncharted territory.

Returns Appendix

2019 Returns, and Trailing 10-Year Global Benchmark Annualized Returns

Category	Ticker Symbol	Description	YTD'2019	Trailing 12 Months	Trailing 10 Years
Major World Stock Indices	SPY	S&P 500	19.0%	2.5%	13.3%
	DIA	Dow Jones	15.8%	2.0%	13.5%
	MDY	Mid Cap Stocks	15.5%	-3.7%	12.4%
	IWM	Small Cap Stocks	11.9%	-9.5%	11.4%
	QQQ	Nasdaq 100	22.2%	1.5%	17.6%
	IWF	Large Growth Stocks	21.9%	2.3%	14.9%
	IWD	Large Value Stocks	15.9%	2.0%	11.4%
	IEV	European 350	12.2%	-2.1%	4.4%
	EWJ	Japanese Stocks	12.1%	-3.8%	5.3%
	GXC	Chinese Stocks	6.3%	-4.7%	5.2%
	INDA	Indian Stocks	0.1%	2.5%	N/A
	EEM	Emerging Market Stocks	5.1%	-2.7%	2.7%
Bonds Indices	AGG	US Broad Bonds	8.7%	10.6%	3.6%
	IAGG	INTL Broad Bonds	9.5%	11.6%	N/A
	EMB	Emerging Markets Bonds	13.2%	11.5%	6.2%
	TFI	National Municipals Bonds	7.1%	9.1%	3.9%

Category	Ticker Symbol	Description	YTD'2019	Trailing 12 Months	Trailing 10 Years
Benchmark Funds	AOR	Growth (~65% Equity)	12.4%	3.8%	7.6%
	AOM	Moderate (~45% Equity)	11.2%	5.9%	6.0%
	AOK	Conservative (~30% Equity)	10.6%	7.0%	5.1%
USA Industry Sectors	XLY	Consumer Discretionary Stocks	22.1%	3.8%	17.8%
	XLP	Consumer Staples Stocks	22.9%	16.9%	12.8%
	XLE	Energy Stocks	3.5%	-22.0%	3.5%
	XLF	Financial Stocks	17.0%	1.3%	10.9%
	XLV	Healthcare Stocks	4.5%	-5.1%	14.1%
	XLI	Industrial Stocks	19.5%	-2.0%	13.7%
	XLB	Materials Stocks	14.2%	-0.7%	9.1%
	RWR	Real Estate Investment Trusts	23.1%	16.1%	12.8%
	XTL	Telecommunications Stocks	4.5%	-11.9%	N/A
	XLK	Technology Stocks	30.1%	7.0%	16.6%
	XLU	Utilities Stocks	24.8%	26.8%	12.5%
Tangibles	DBC	Broad Commodities Index	4.1%	-16.8%	-3.6%
	GLD	Gold Bullion	14.6%	23.4%	3.5%

Data as of market close - 10/1/2019 - pulled from morninstar.com >> performance by ticker symbol

MLA Format Citations & Source References

Slide 4: finance.yahoo.com >> SPY >> 10/2/2019 >> 1 yr chart

Slide 5: Mislinski, Jill. " Conference Board Leading Economic Index Unchanged in August." *Advisorperspectives.com*, 19 Sept. 2019, https://www.advisorperspectives.com/dshort/updates/2019/09/19/conference-board-leading-economic-index-unchanged-in-august..

Slide 6: "United States Unemployment Rate." Trading Economics, 4 Oct. 2019, https://tradingeconomics.com/united-states/unemployment-rate.

Slide 6: Mislinski, Jill. "September Jobs Report: 136k New Jobs." Advisor Perspectives, 4 Oct. 2019, https://www.advisorperspectives.com/dshort/updates/2019/10/04/september-jobs-report-136k-new-jobs..

Slide 6: Economic News Release Table B-3. Bureau of Labor Statistics, 4 Oct. 2019, https://www.bls.gov/news.release/empsit.t19.htm.

Slide 7: United States GDP Growth Rate. Trading Economics, 26 Sept. 2019, https://tradingeconomics.com/united-states/gdp-growth**.**

Slide 8:. Federal Reserve Bank of St. Louis and U.S. Office of Management and Budget, Federal Surplus or Deficit [-] as Percent of Gross Domestic Product [FYFSGDA188S], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/FYFSGDA188S, October 4, 2019.

Slide 9: Shiller, Robert. *Shiller PE Ratio*. Multpl.com, 2 Oct 2019, www.multpl.com/shiller-pe.

Slide 10: Mislinski, Jill. "The Q Ratio & Market Valuation." Dshort.com, Advisor Perspectives, 1 Oct. 2019, https://www.advisorperspectives.com/dshort/updates/2019/10/01/the-q-ratio-and-market-valuation-august-update.

Slide 11: Mislinski, Jill. " FHFA House Price Index: Up 0.4% in July." Dshort.com, Advisor Perspectives, 24 Sept. 2019, https://www.advisorperspectives.com/dshort/updates/2019/09/24/fhfa-house-price-index-up-0-4-in-july.

Slide 13: Mislinski, Jill. "New Residential Housing Starts Up in August." Dshort.com, Advisor Perspectives, 18 Sept. 2019, https://www.advisorperspectives.com/dshort/updates/2019/09/18/new-residential-housing-starts-up-in-august.

Slide 12: Mislinski, Jill. "S&P/Case-Shiller Home Price Index: Inflation-Adjusted Indexes Down MoM." Dshort.com, Advisor Perspectives, 24 Sept. 2019, https://www.advisorperspectives.com/dshort/updates/2019/09/24/s-p-case-shiller-home-price-index-inflation-adjusted-indexes-down-mom.

Slide 14: Mislinski, Jill. " FHFA House Price Index: Up 0.4% in July." Dshort.com, Advisor Perspectives, 24 Sept. 2019, https://www.advisorperspectives.com/dshort/updates/2019/09/24/fhfa-house-price-index-up-0-4-in-july.

Slide 15: 30 Year Fixed Mortgage Rate - Historical Chart. Macrotrends, 2 Oct. 2019, https://www.macrotrends.net/2604/30-year-fixed-mortgage-rate-chart.

Slide 16: 10 Year Treasury Rate – Historical Chart. Multpl.com, 2 Oct 2019, www.multpl.com/10-year-treasury-rate.

Slide 17: Data for each ETF return pulled from Morningstar.com >> performance as of market close on 10/1/2019 – due to a recent formatting change in the Morningstar website, we were unable to pull data as of 9/30/2019 on 10/2/2019 when we built this table. As such, returns are off from true quarterly return points by 1 market day.

Disclosures

Investing involves risk including the possible loss of principal. Fiduciary Financial Group is a FEE-ONLY Registered Investment Advisory Firm in the States of Idaho, California, & Georgia. Nothing in this presentation is intended to be investment, legal, or tax advice which we reserve for clients of the firm who have executed an appropriate client / advisor agreement.

For questions on source data, please reference our citations or email Richard Davey at richard@ffgwealth.com or call 208-319-3557