Fiduciary Financial Group

2019 Mid-Year Update

www.ffgwealth.com

Outline

- FED Update
- Leading Economic Indicators
- Employment
- GDP
- Deficits & Debt
- Valuation
- Why Cash Alone Isn’t Safe in Long-Run

FED Update

FFG Commentary: *We are clearly back in the environment of "bad news is good news for the stock market". Bad news = dovish FED which = higher asset prices.*

17 Oct. 2018

FED Minutes:

3 Rates Hikes in Store for 2019

- Stock market continues to trend lower

19 Dec. 2018

Fed Chairman Powell: Okay, not three, but definitely two rate hikes in 2019

Stocks continue to trend downward

30 Jan. 2019

Powell:

Conditions have weakened somewhat. There is no need to raise rates for foreseeable future.

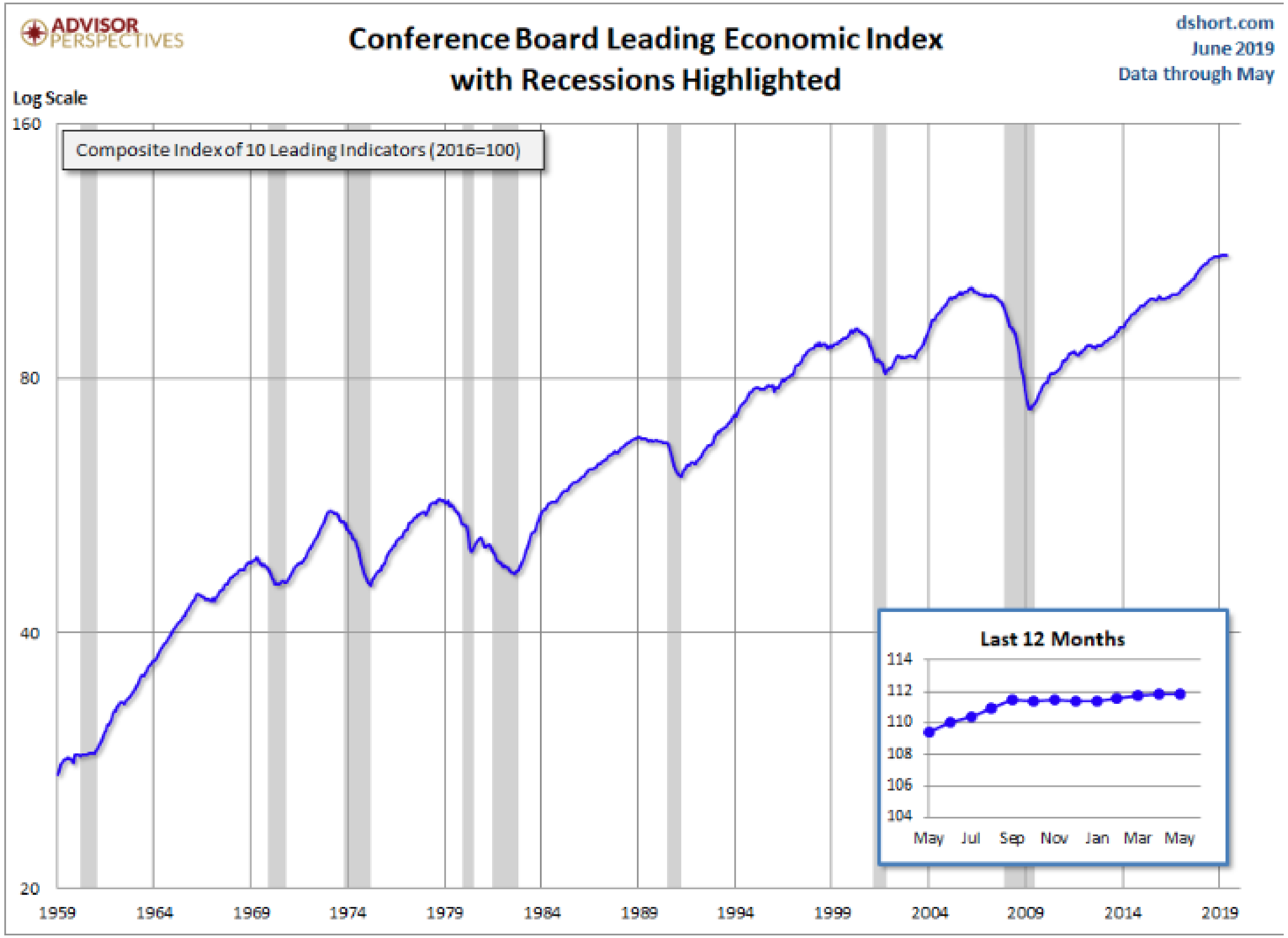
- Stocks pop and rates plummet!

Leading Economic Indicators

Historical graph

FFG Commentary: *Gray bars are recessions… note how the LEI index tends to level off and fall before recessions have occurred. The LEI has remained relatively strong although flattening some in recent months.*

Source: *advisorperspectives.com*



SOURCE: https://www.advisorperspectives.com/dshort/updates/2019/06/20/conference-board-leading-economic-index-unchanged-in-may

Leading Economic Indicators

What is the Conference Board LEI?

About *The Conference Board Leading Economic Index*® (LEI) for the U.S.

The composite economic indexes are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components.

The ten components of The Conference Board LEI of the U.S. include:

1. Average weekly hours, manufacturing
2. Average weekly initial claims for unemployment insurance
3. Manufacturers' new orders, consumer goods and materials
4. ISM® Index of New Orders
5. Manufacturers' new orders, nondefense capital goods excluding aircraft orders
6. Building permits, new private housing units
7. Stock prices, 500 common stocks
8. *Leading Credit Index™*
9. Interest rate spread, 10-year Treasury bonds less federal funds
10. Average consumer expectations for business conditions

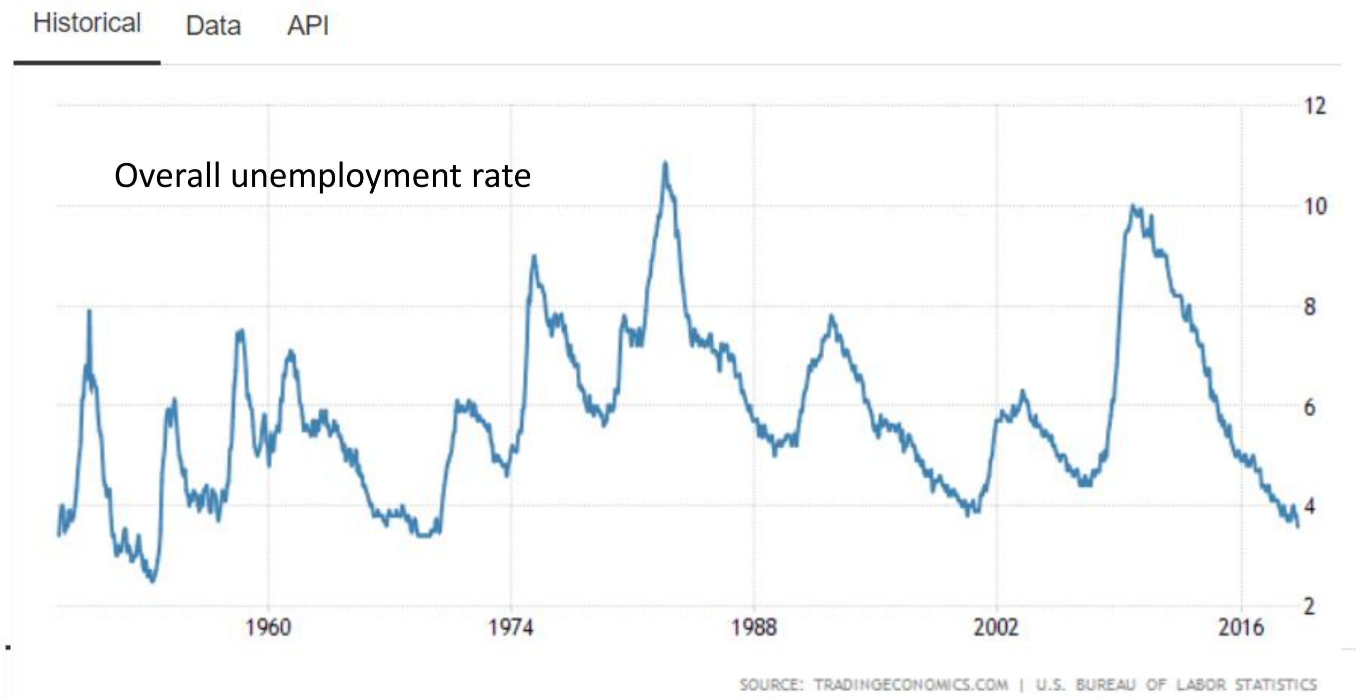
***FFG Commentary –** we have not seen a drop in the LEI yet like we did before the 2000 and 2008 recession although the LEI has leveled off in recent months. This is worth paying careful attention to in case we get a drop in the July LEI release.*

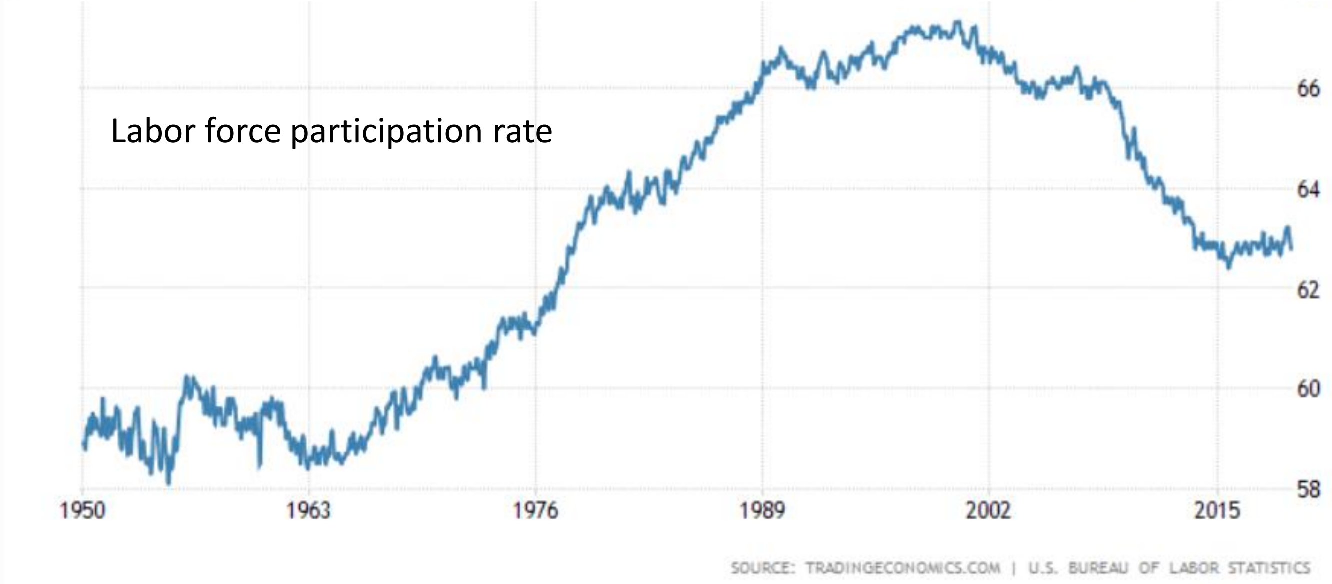
Employment

Headline #s vs. Participation Rates

FFG Commentary: *Unemployment can't go much lower at sub 4% but participation remains concerning. Does it indicate people are just giving up on finding jobs? Are they simply not qualified? Lets look at job openings on the next slide:*

Source- *tradingeconomics.com*





Employment

Historical Graph of Job Openings

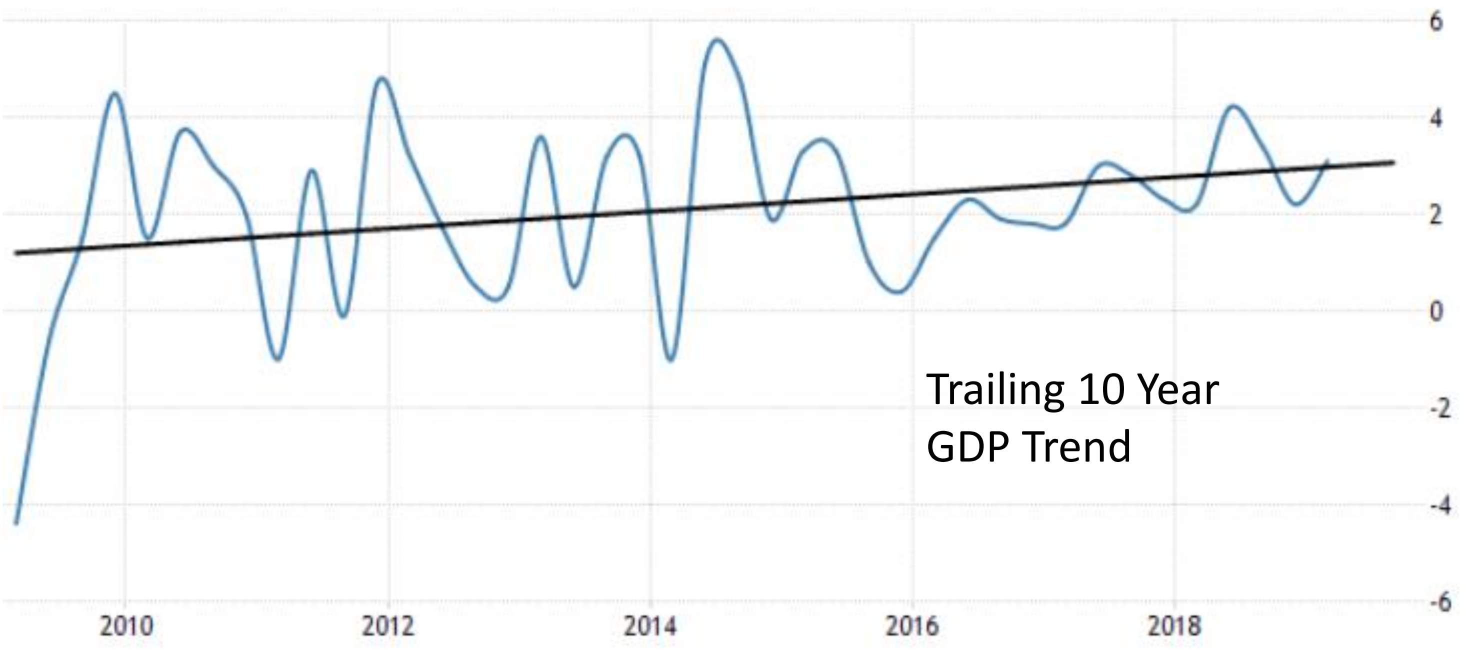
FFG Commentary: *It's troubling to see over 7,000,000 unfilled jobs when we have ~6,000,000 unemployed workers in the US according to the US Bureau of Labor Statistics June Report. This illustrates the "talent gap" often referred to in the news. The talent gap limits productivity which in turn may reduce GDP and future economic growth.*

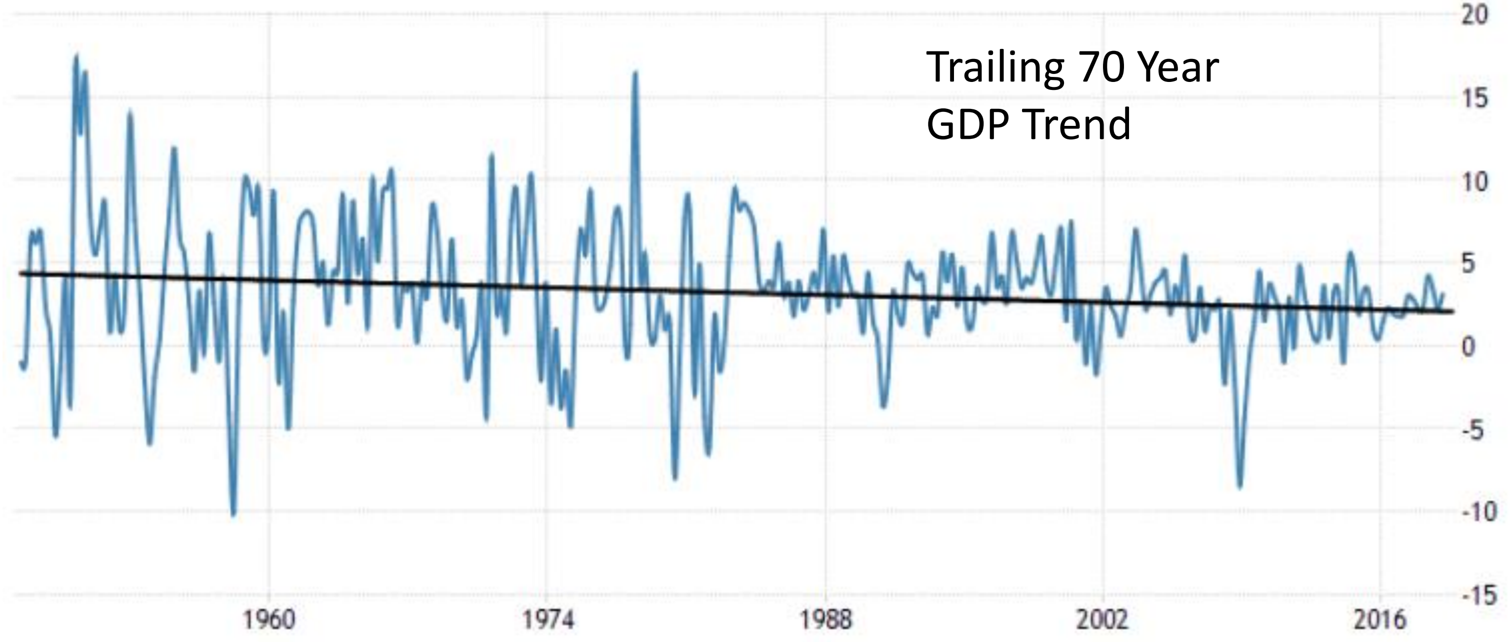
Source- *tradingeconomics.com & Bureau of Labor Statistics*

GDP: Short-Term vs. Long-Term Trends

FFG Commentary: *GDP in the last 10 years has trended positively since the great recession, but the overall trend dating back to the 1950s is a declining rate of growth. A primary concern for us – how can stock markets (or real estate) continue their century long avg rates of return of ~10% (often cited) if the new normal for GDP growth in times of economic expansion is only low single digits?*

Source- *tradingeconomics.com*



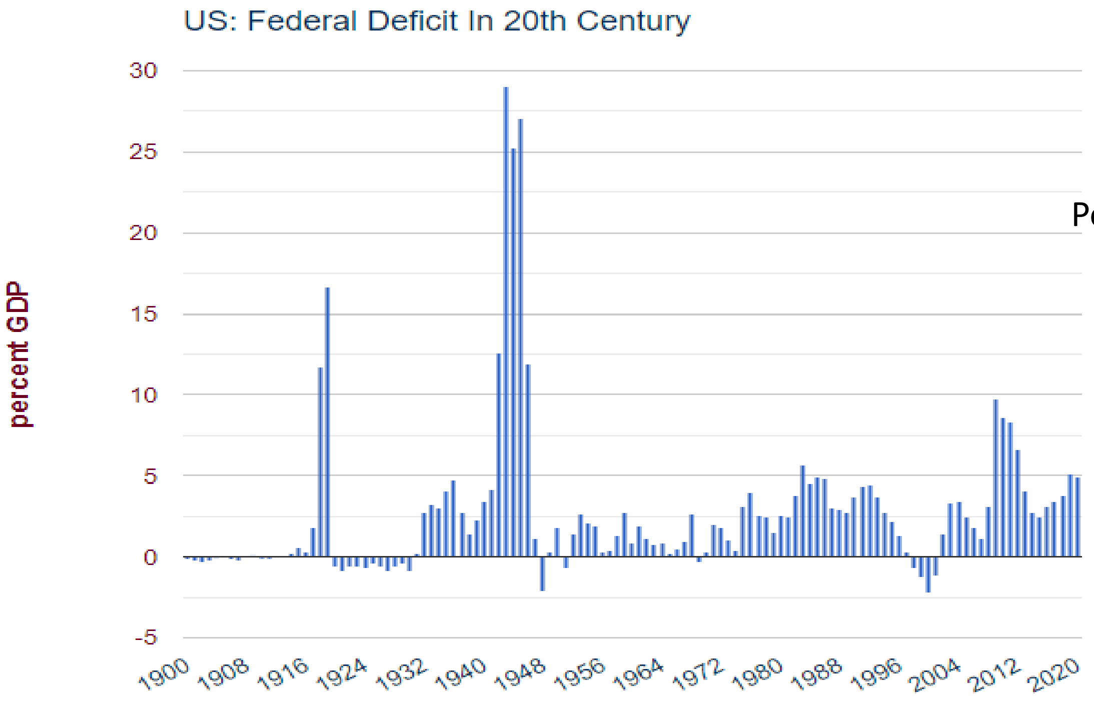


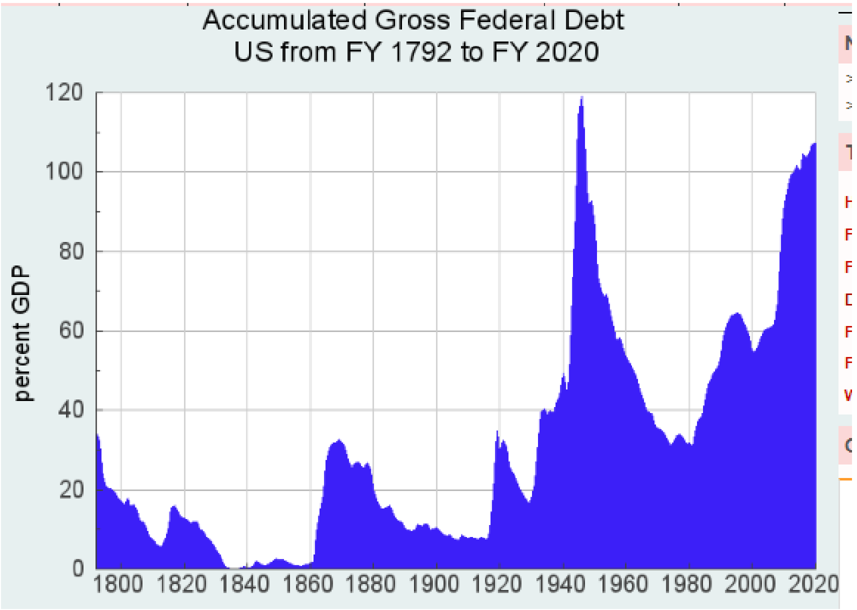
Deficits & Debt: Do They Matter?

Debt = Accumulated Deficits

FFG Commentary: *While our recent annual deficits as a % of what we produce (GDP) are high but that not scary relatively to history , it's the accumulation of deficits (debt) as a % of what we produce that's more concerning and only [barely] eclipsed once in the last 100 years during the mid 1940s as we financed WW2.*

Why Is This Important? *The larger our debt as a % of GDP, the more sensitive our economy will be to interest rates. Even small increases in interest rates on a large mountain of debt, create even larger deficits going forward as interest expense rises (same affect with small increases in household credit card balances over time).*





<u>US FED Debt - $22 Trillion</u>

Population of United States = 327 Million People

Federal Debt per Person = $67,000 (not a typo)

<u>US FED Debt - $22 Trillion</u>

Est. Annual Interest Expense

- @ 2.0% - $440 billion
- @ 3.0% - $660 billion

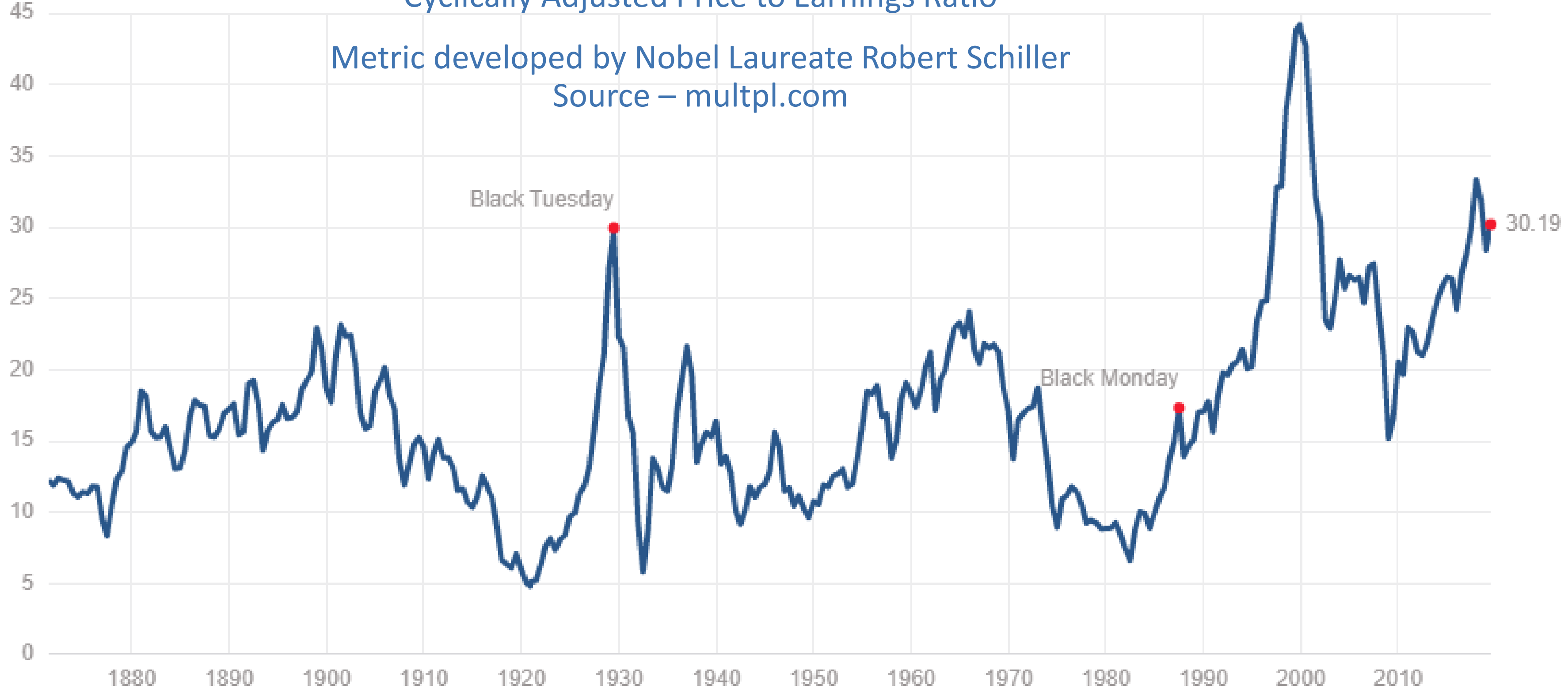
- 1% Rate Increase = $220B increase in ANNUAL interest expense with total yearly federal spending budget of ~$4 Trillion. Over 5% more of annual spending eaten up by interest costs. <u>*This is a problem that must be dealt with sooner rather than later.*</u>

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.*

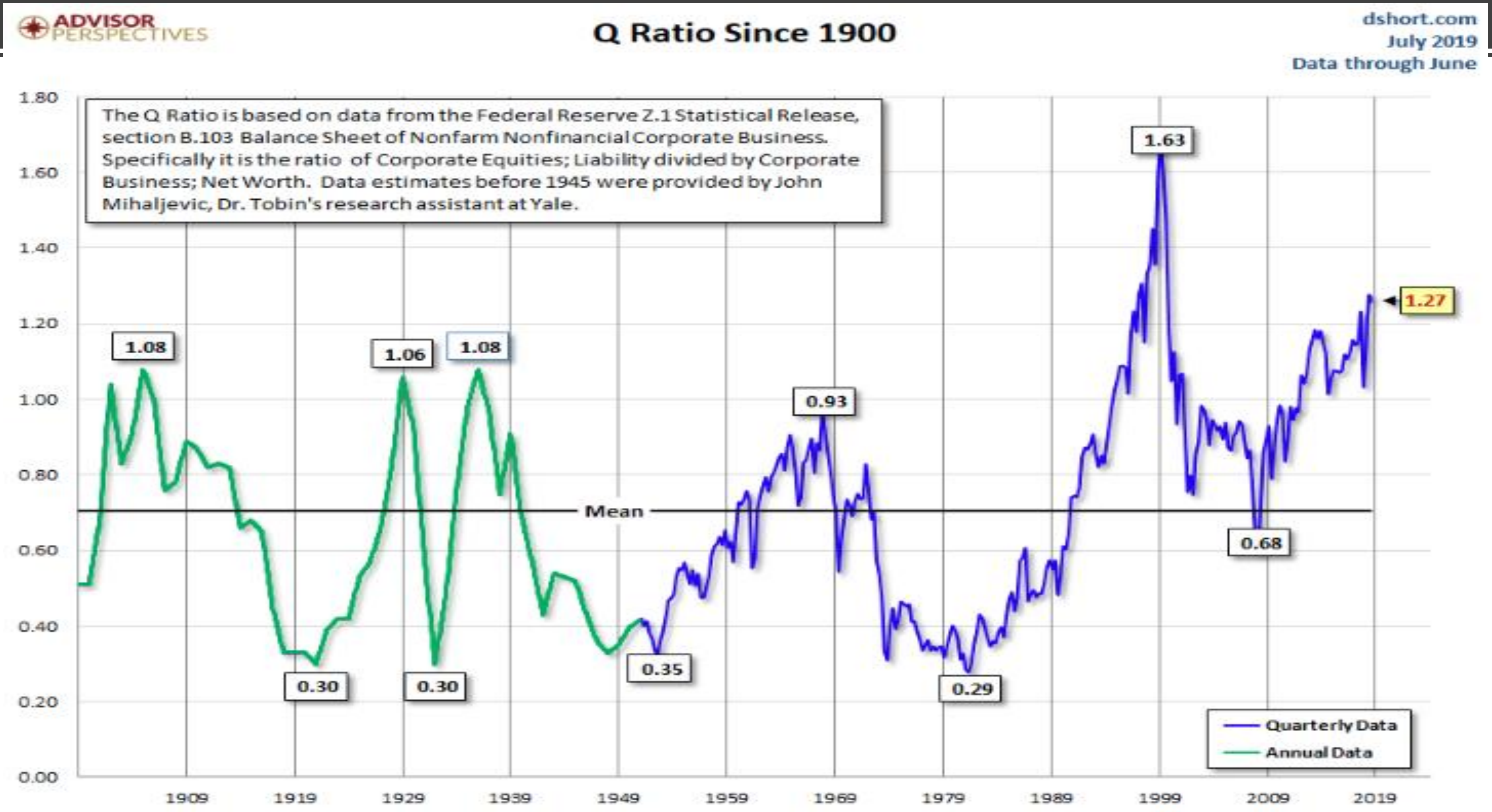
Cyclically Adjusted Price to Earnings Ratio

Metric developed by Nobel Laureate Robert Schiller
Source – multpl.com



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. Again, we've only seen higher ratios in one instance, the 2000 tech bubble.*



Daunting Times – But We Aren't Saying Hide In Cash & Here's Why

By most "signals", it's at troubling time for investors:

- Leading economic indicators appear to be plateauing
- Unemployment rates seem to only have one direction to move (up)
- Long-term GDP trends are slowing
- Deficits and Total Debt are swelling, and finally (and most importantly)
- Valuations (by almost any long-term measure) are above normal by a statistically significant amount

<u>SO WHY INVEST AT ALL?</u>

(Let's assume for the sake of simplicity that the alternative to "investing" is holding cash or short-term United States Treasury Bills)

- Cash has it's own inherent risks. What is cash other than a future promise to pay from our own government? Based on previous slides, can we ever really pay our debts off without further currency debasement (printing more money)….? Probably not.
- If more money is printed, each dollar is worth less.

<u>WHILE A HEALTHY CASH ALLOCATION IS IMPORTANT, YOU MUST OWN THINGS THAT HAVE INTRINSIC VALUE APART FROM CURRENCY</u>

What Has Intrinsic Value?

<u>Bonds (i.e. Loans)?</u> Bonds are typically denominated in a currency. The most common currency being GREENBACKS. If you own a bond (a loan to an individual, company, or government), you only have something of value if the currency printed on the bond is valuable when you are repaid. <u>Bonds' intrinsic values are entirely dependent on the currency in which they are denominated.</u>

<u>Stocks?</u> A stock is an ownership stake in a company. You as a stockholder, are entitled to a share of the company's future profits.

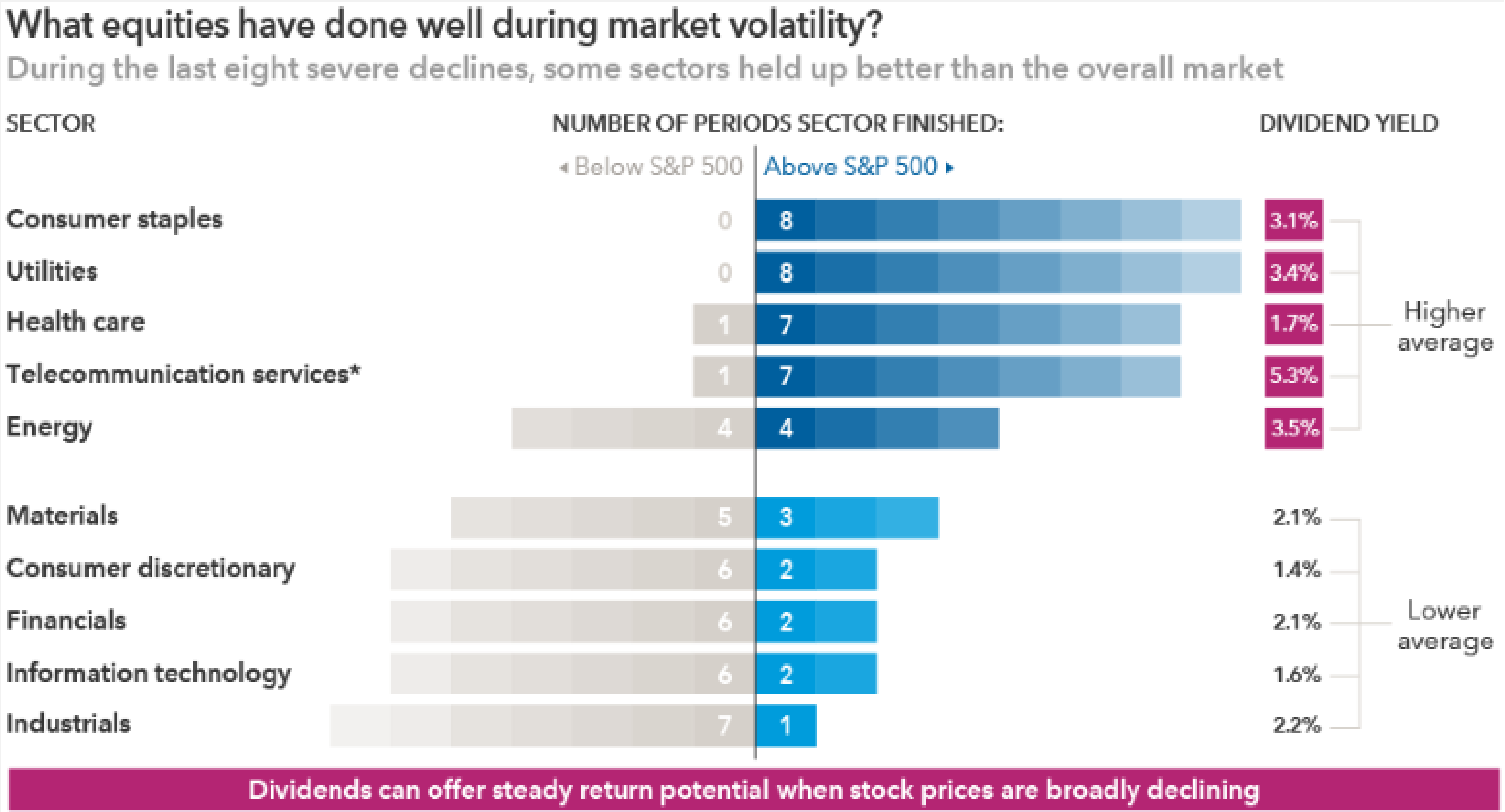
- ***Question*** – if the dollar was worthless tomorrow, would Coca Cola stop making money? Well, as long as people are buying bottled beverages, the answer is probably no, so your stocks have INTRINSIC VALUE apart from any specific currency. If Gold was the currency of the day, Coca Cola could still sell their beverage products in exchange for it, or bitcoin, or sea shells, etc.

<u>Real Estate?</u> Owning real estate [typically] entitles you to it's use or the ability to rent it's use to someone else. Again, no matter the currency, real estate will always have value because we humans will always need shelter.

<u>Annuities?</u> Again, most annuities are denominated in currency. If the currency that you are being repaid in under the terms of the annuity contract devalues, your payments become less valuable. Some annuities have inflation protection which mitigates inflation risk to some degree.

<u>Commodities?</u> We will always need things like rubber, copper, lithium, sugar, grain, etc. No matter the currency, these tangible assets have value.

Where to Hide?



Source >> Capital Group, FactSet as of 12/31/2018. Includes last eight periods that S&P 500 declined by more than 15% on a total return basis.

Our Conclusion

- While it’s a volatile time, don’t forget that cash too has SIZEABLE risk. You can’t just hide here. Further, when thinking about “getting out of stocks” don’t forget the phrase “Don’t Bet Against the Fed”. The FED has been, and looks to be interested in continuing VERY accommodative policies to support the stock market.
- True diversification is as important as it has ever been.
- Investments with intrinsic value, while more volatile in the short-term, have some important diversifying powers that offset inflation risks inherent in cash and bonds.
- A portfolio comprised solely of bonds and stocks is not adequately diversified. It may have been in the past when higher interest rates prevailed, but now, with artificially suppressed rates, stocks and bonds have become more correlated. Other assets must be mixed in to your portfolio.
- While the US is by far the largest economy in the world by GDP with the largest stock, bond, and currency markets by size, we can’t ignore the need for exposure to foreign stocks, bonds, currencies, and real estate markets if we want more effective diversification.

Returns Appendix

Q4'2018, 1st Half 2019, and Trailing 10-Year Global Benchmark Annualized Returns

Category	Ticker Symbol	Description	Q4'2018	1st Half 2019	Trailing 10 Years	10-Year Standard Deviation Higher # = Higher Volatility
Major World Stock Indices	SPY	S&P 500	-13.5%	18.4%	14.6%	12.7%
	DIA	Dow Jones	-11.3%	15.3%	14.9%	12.4%
	MDY	Mid Cap Stocks	-17.3%	17.8%	14.3%	15.2%
	IWM	Small Cap Stocks	-20.2%	16.9%	13.5%	17.4%
	QQQ	Nasdaq 100	-16.8%	21.7%	19.0%	15.3%
	IWF	Large Growth Stocks	-15.9%	21.4%	16.1%	13.3%
	IWD	Large Value Stocks	-11.7%	16.2%	13.0%	13.0%
	IEV	European 350	-12.8%	15.7%	6.7%	16.7%
	EWJ	Japanese Stocks	-14.3%	7.6%	5.3%	12.9%
	GXC	Chinese Stocks	-10.6%	12.5%	6.6%	20.7%
	INDA	Indian Stocks	2.8%	7.1%	N/A	N/A
	EEM	Emerging Market Stocks	-7.6%	10.2%	4.9%	17.8%
Bonds Indices	AGG	US Broad Bonds	1.6%	6.1%	3.8%	2.9%
	IAGG	INTL Broad Bonds	1.8%	6.2%	N/A	N/A
	EMB	Emerging Markets Bonds	11.7%	-1.7%	7.1%	6.9%
	TFI	National Municipals Bonds	1.9%	5.3%	4.4%	4.4%

Category	Ticker Symbol	Description	Q4'2018	1st Half 2019	Trailing 10 Years	10-Year Standard Deviation Higher # = Higher Volatility
Benchmark Funds	AOR	Growth (~65% Equity)	-7.5%	11.9%	8.6%	8.1%
	AOM	Moderate (~45% Equity)	-4.7%	10.0%	6.6%	5.7%
	AOK	Conservative (~30% Equity)	-3.2%	9.0%	5.6%	4.1%
USA Industry Sectors	XLY	Consumer Discretionary Stocks	-15.2%	21.3%	19.6%	15.0%
	XLP	Consumer Staples Stocks	-5.0%	15.9%	12.7%	10.8%
	XLE	Energy Stocks	-23.6%	13.0%	5.3%	20.0%
	XLF	Financial Stocks	-13.1%	17.1%	13.0%	17.4%
	XLV	Healthcare Stocks	-8.7%	8.0%	15.3%	12.6%
	XLI	Industrial Stocks	-17.3%	21.3%	15.7%	16.2%
	XLB	Materials Stocks	-12.2%	17.1%	10.9%	18.5%
	RWR	Real Estate Investment Trusts	-6.6%	16.5%	15.2%	16.6%
	XTL	Telecommunications Stocks	-17.1%	7.9%	N/A	N/A
	XLK	Technology Stocks	-17.3%	27.0%	17.6%	14.9%
	XLU	Utilities Stocks	1.3%	14.6%	12.0%	11.8%
Tangibles	DBC	Broad Commodities Index	-18.5%	9.2%	-3.5%	16.0%
	GLD	Gold Bullion	7.5%	9.7%	3.7%	16.5%

Data pulled from www.morningstar.com >> performance >> trailing returns as of 6/30/2019.

MLA Format Citations

Slide 4: Mislinski, Jill. “Conference Board Leading Economic Index Unchanged May.” *Advisor Perspectives*, Dshort, 20 June 2019, www.advisorperspectives.com/dshort/updates/2019/06/20/conference-board-leading-economic-index-unchanged-in-may.

Slide 5: “Global Business Cycle Indicators.” *The Conference Board*, 20 June 2019, www.conference-board.org/data/bcicountry.cfm?cid=1.

Slide 6 – Chart 1: “United States Unemployment Rate.” *Trading Economics*, 5 July 2019, tradingeconomics.com/united-states/unemployment-rate.

Slide 6 – Chart 2*:* “United States Labor Force Participation Rate.” *Trading Economics*, 5 July 2019, tradingeconomics.com/united-states/labor-force-participation-rate.

Slide 7*:* *“*United States Job Openings.” *Trading Economics*, 7 July 2019, tradingeconomics.com/united-states/job-offers.

Slide 8: *United States GDP Growth Rate*. Trading Economics, 27 June 2019, tradingeconomics.com/united-states/gdp-growth.

Slide 9: Chantrill, Christopher. *Debt & Deficit Facts*. US Government Spending, 9 July 2019, www.usgovernmentspending.com/debt_deficit_history.

Slide 10: Shiller, Robert. *Shiller PE Ratio*. Multpl.com, 5 July 2019, www.multpl.com/shiller-pe.

Slide 11: Mislinski, Jill. “The Q Ratio & Market Valuation: June Update.” *DShort*, Advisor Perspectives, 2 July 2019, www.advisorperspectives.com/dshort/updates/2019/07/02/the-q-ratio-and-market-valuation-june-update.

Slide 14: Franz, Jared, and Darrell Spence. *Sharpen Your Awareness: 9 Ways to Prepare for next Recession*. The Capital Group, www.americanfunds.com/ria/insights/upgrade_the_core.html.

Disclosures