QUARTERLY
REVIEW & PREVIEW

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Calm Markets Continue to Trend Higher in 2nd Quarter

Long-term trends were the dominant focus for investors in the 2nd quarter of 2017. One of the most notable aspects of the period was an all-time low in market volatility. The most recognized measure of volatility, the VIX Index on the Chicago Board of Options Exchange, closed at its lowest level since it was established in 1993. At the same time, the Dow Jones Industrial Average, NASDAQ Composite and Standard & Poor's 500 indices again topped all-time records. Should these themes sound an alarm for investors?

Investors managed to overcome a number of distractions in the geopolitical climate, most notably out of Washington. An expected flood of legislative initiatives related to health care policy, tax reform, and infrastructure investments failed to materialize in the opening months of the Trump administration. The lack of legislative action was contrary to investor expectations. The investigations related to alleged Russian meddling in the 2016 election took center stage instead.

Yet the domestic equity market persevered, driven primarily by the performance of technology stocks. The technology-heavy NASDAQ Index gained 4.2% during the quarter and is up more than 14.7% so far in 2017. Most of that can be attributed to the so-called FAANG stocks (Facebook, Apple, Amazon, Netflix and Google). These five stocks make up a majority of the total return of that index and have dramatically outperformed the rest of the market so far this year. The five FAANG stocks have accounted for 6.1%, or 42.0%, of the 14.7% year-to-date return for the NASDAQ Composite Index.

Equity markets in Europe and across emerging markets continued to perform even better than the U.S. stock market. Both gained more than 6% for the quarter and have year-to-date gains of 13.8% and 18.4%, respectively. By comparison, the Russell 3000 Index covering Large, Mid and Small Cap stocks (92% of the market cap) rose only 3.0%. From a valuation perspective, overseas stocks appear positioned to continue to outperform U.S. markets going forward.

BOB'S CORNER

We are excited to **welcome** three great professionals to our team. When I promised one of my first clients 30 years ago that I would be there for him in the end, I meant it! He is now 88 and I am 57. I will make sure it's not just me, but it's WE – the All Star Financial Team - that will be here for you and your children. We have grown from six teammates six years ago to twelve. Here is a bit of background on our newest teammates:

Matt Berhow, CFP®, AIF®: Matt comes to All Star Financial as a Senior Wealth Manager after being on staff with another wealth manager in town for the last 15 years. Matt and his wife, Rachel, have three children Eden (6), Gabby (3) and Grant (3).

Brady Mickolichek, CFP®: After starting his own All-State Insurance Franchise, Brady most recently worked for Ameriprise and helped coach advisors. As an Associate Wealth Manager, you will see him as the associate advisor in meetings with me and Brian as he continues to learn how we advise our clients.

Kaitlin Buckley: As an 11-year veteran of the banking industry, Kaitlin is now our Client Service Associate and has a goal of becoming a client facing wealth manager.

We are excited for you, our clients, to meet these new teammates!!

BUILD WEALTH. RETAIN WEALTH.

All Star is passionate about providing a safer way to a successful retirement for people who are serious about their money but uncertain about how to nurture it.

The Economy
A Mature Stage

The data continues to reaffirm the view of many economists that the U.S. economy is in the late cycle of its 8+ year recovery. During the first half of the year, the unemployment rate dropped from 4.8% to 4.3%, the lowest level since the boom times of the late 1990's. Wage growth has improved also, rising 2.4% over the past year.

Gross Domestic Product (GDP) growth remains steady but has declined over recent quarters. Given that we are late in the economic cycle; significant future growth will likely require changes to government policy such as tax reform and infrastructure spending. President Trump's stated goal of a 4.0% annual GDP growth appears unrealistic for a variety of reasons. Economists point out that to sustain such growth levels, labor force participation would need to match levels last seen in the 1960's and 1970's and productivity levels topping the post-war 1950's boom. This seems unlikely given the country's aging demographics, and politicians who are not playing nice in the sandbox.

After showing modest increases earlier in the year, inflation retreated in the 2nd quarter. The inflation rate dropped from an annualized rate of close to 2.4% in March to 1.8% at the end of May, below the Federal Reserve's target rate of 2.0%. Declining consumer prices may also reflect a cooling of the economy. Despite retreating inflation data, the Fed chose to raise the Fed Funds rate at its June meeting, the third-rate hike since December, and the fourth time since December 2015.

Looking Ahead

The Fed's rate decisions appear to indicate a belief in the continued ability of the U.S. economy to grow. Encouraging signs include low unemployment, strong manufacturing and housing data and reasonable growth in consumer spending. If policymakers in Washington can come to agreement on key legislation, it could help give the economy the needed boost. The Fed is likely keeping an eye on policy moves in Washington as it determines whether to continue pushing short-term interest rates higher.

Quote of the Quarter:

"We make a living by what we get, we make a life by what we give."

-Winston Churchill

Bond Markets
Bond Markets Don't Follow the Fed's Lead

While the Federal Reserve continues to see encouraging economic signals, bond investors appeared to take a different stance. The yield on the benchmark 10-year U.S. Treasury note started the period at 2.38%, moved up to 2.41%, but ended the quarter at 2.30%. Investors may see the recent decline in inflation as a signal of potential weakening in the economy.

The Barclay's Aggregate U.S. Bond Index rose 1.5% in the quarter, while the Barclay's U.S. Government Bond Index gained 1.2%. However, the government index is still down 0.1% over the past year.

High-yield bonds continued to be one of the leading sectors in the market. For the quarter, high-yield bonds rose 2.1%, and have enjoyed a 4.4% gain over the past year. Emerging market bonds were flat during the 2nd quarter, but are up 6.2% for the past 12 months.

In what has been a challenging bond market, All Star Financial's bond portfolio continues to generate solid returns. Our bond portfolio has gained 4.2% in the first six months of 2017. A mix of investment grade corporate, high yield and diversified global bonds helped overcome the complications present in this year's environment. We also added value by focusing on shorter duration bonds. The portfolio continues to be positioned in anticipation of interest rates moving higher over the remainder of the year.

Looking Ahead

The Federal Reserve has raised the Fed Funds rate from 0.25% to 1.25% since December 2015 with no noticeable negative ramifications on the economy or equity markets. Yet the bond market has held its own, particularly so far this year, with yields across the board remaining relatively steady. An important development in recent quarters has been the continued flattening of the yield curve, with shorter-term rates rising while mid and long-term yields stayed the same. A flat yield curve has historically been a prelude to an economic recession. Economists and the Fed will be paying close attention to see if the flattening trend continues.

Domestic Stocks

Can the Bull Market Keep Rolling?

U.S. equity markets have already turned in an outstanding year in just the first six months, continuing to set new records. With each passing week, underlying fundamental data and common sense tell us we are closer to our next correction. Since the market's bottom in March 2009, the S&P 500 has experienced seven significant corrections of 5.0% or more. The longest span between those corrections was 16 months. The last time we saw such a pullback (-13.3%) was in February 2016, 16 months ago.

The momentum we have seen this year appears to be based in part on positive economic data and anticipation of a fiscal stimulus at the Federal government level. Another major factor, particularly in recent quarters, is the improvement in corporate earnings. S&P 500 companies reported year-over-year profit growth of 15.5% in the 1st quarter. Revenues are up more than 7.0% in the past year. The best earnings performance was turned in by Technology, Financial and Materials sectors, all generating earnings growth of close to 20.0%.

Large-cap stocks and Growth stocks continued to outperform the rest of the domestic equity market in the 2nd quarter. The large-cap Russell 1000 Index returned 3.0% in the 2nd quarter. Small-cap stocks (as measured by the Russell 2000 Index) lagged modestly, returning 2.5%. The Russell 3000 Growth Index gained 4.7% for the period, far outpacing the Russell 3000 Value Index return of 1.3%.

Looking Ahead

It is interesting to note that the trailing price/earnings (P/E) ratio for the S&P 500 dropped from 24.5 at the end of the 1st quarter to 24.1 at the end of the 2nd quarter, even though stocks continued to move higher. The concern is that this still remains well above the historical average P/E ratio of 18. Can future corporate earnings justify these lofty valuations? The ability of Healthcare and Technology sectors to continue to drive overall earnings growth or for other sectors to contribute more is one possibility. Another is the level of success on legislation out of Washington, particularly as it relates to much-anticipated tax reform. Economists project that lowering the corporate tax rate to 15.0% will result in only a 7.0-8.0% increase in corporate earnings, as some of the savings will be reinvested in growth. A primary concern is that the market is losing confidence in the likelihood that a meaningful tax reform package will make it through Congress anytime soon.

International Markets

Synchronized Global Growth

In prior newsletters, we've noted the divergent paths that monetary policy and economic growth have taken across the world's economies. But in the 2nd quarter, it appeared that the global economy began to experience a relatively steady and more synchronized expansion. Economies in most developed countries are in the mature stages of economic recovery (mid-to-late stages). Europe's major economies don't appear to be as far along in their cycle as we are in the U.S.

Steady growth in developed markets has had a positive impact on the performance of emerging markets. So has China's improved growth trajectory. Its recovery is giving a boost to trade activity, commodity prices and manufacturing across Asia. Yet critics are concerned about China's advancing debt-to-GDP ratio, now at 283%. It is feared that this may inhibit the ability for China to maintain its rapid rate of growth.

Global equity market returns were fantastic in the 2nd quarter. The MSCI Europe Index gained 7.4% while the MSCI Emerging Markets Index logged a 6.3% return. Emerging markets are up more than 18% in 2017. The exception to strong global performance in the 2nd quarter was Latin America, losing 1.7%.

Looking Ahead

For some time, we've mentioned that valuations in overseas markets have been far more attractive than those of the U.S. market. Recent outperformance by non-U.S. markets has narrowed the valuation gap slightly. In fact, P/E ratios of most foreign markets now exceed historical averages, but not to the extent that we've seen in U.S. stocks. International markets as a whole should have more room to run than U.S. markets. If the global economy continues to advance in a synchronized manner, international equities should be positioned to continue to outperform U.S. stocks in the late stages of this economic cycle.

PERFORMANCE UPDATE

The Second Quarter

Market Index	2nd Qtr	1 Year	2 Year	3 Year
DJ Industrial Average	3.95	22.12	12.97	11.01
S&P 500	3.09	17.90	10.73	9.61
Russell 2000	2.46	24.60	7.80	7.36
S&P Mid Cap 400	1.97	18.57	9.61	8.53
Russell 3000	3.02	18.51	10.02	9.10
S&P Global BMI	**4.49**	**19.74**	**7.52**	**5.42**
MSCI EAFE	6.12	20.27	3.94	1.15
MSCI Emerging Mkts	6.27	23.75	4.32	1.07
NASDAQ Composite	4.16	28.30	12.31	13.02
Barclays US High Yield Bond	2.17	12.70	7.01	4.48
Barclays US Aggregate Bond	1.45	-0.31	2.79	2.48
Barclays Global Aggregate Bond	2.60	-2.18	3.20	-0.35
JPM Emerging Bond Diversified	2.24	6.04	7.90	5.38
Barclays US Government Bond	1.17	-2.18	1.85	1.99
Barclays US Credit Bond	2.35	1.84	4.66	3.40

SUMMARY & OVERVIEW

The first half of the year has been very productive for all asset categories: Domestic Bonds (+2.3%), International Bonds (+4.4%), Domestic Stocks (+8.9%) and International Stocks (+13.8%). Stock investors have experienced historically low volatility. International markets have shown significant upside as growth has synchronized around the globe and investors are recognizing their true value.

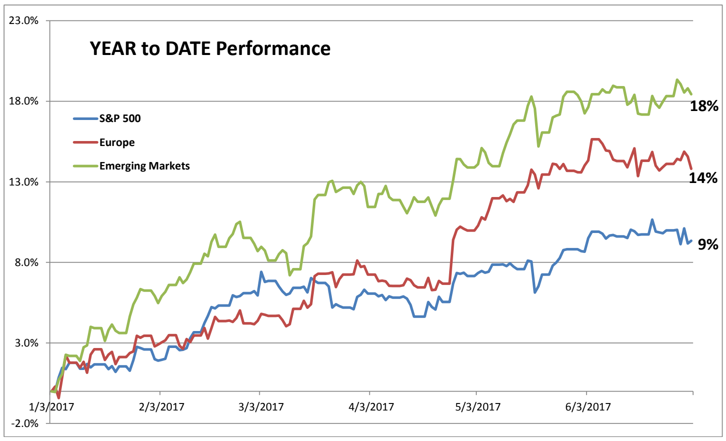
Investors should be prepared for a less predictable and more volatile environment in the near future. As we position our portfolios going forward, we will continue to focus on valuations and enhancing diversification (taking chips off the table) will continue to drive our process. DIVERSIFICATION remains the key to winning for long-term investors.

"It's not how much you make, it's how much you keep!"

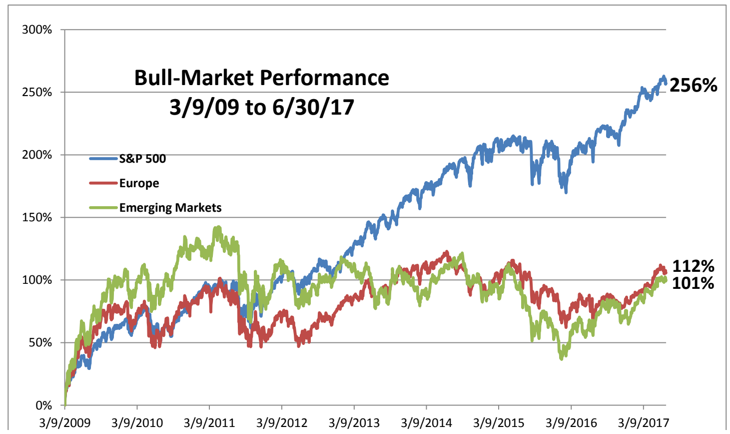
-Bobby K

Four Insights on International Equities

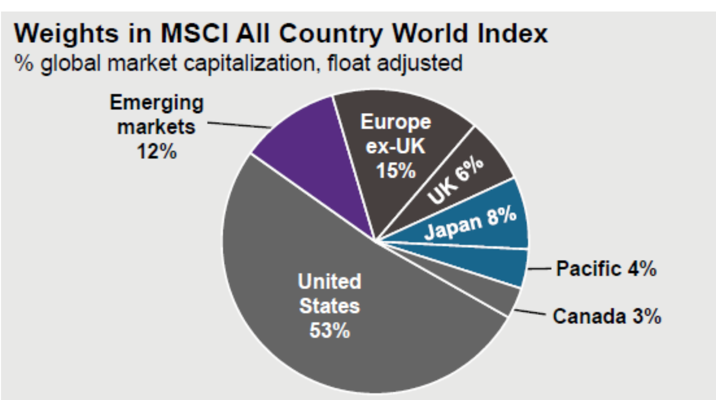
2017 Performance: Over the past several years, we have continued to talk about why we believe international equities have been undervalued and underappreciated in their role within a diversified portfolio. We continue to believe that international equities will still have more upside than domestic stocks. In the 1st half of 2017, you can see the out performance. Emerging markets (+18%) and International Developed Equities (+14%) substantially outperformed U.S. equities (+9%) (*See below*).



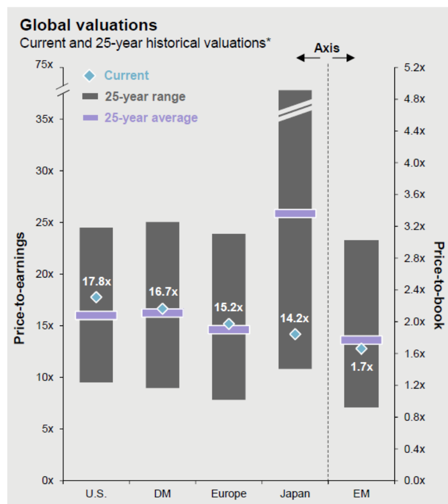
Relative Bull-Market Returns: Even after their solid performance thus far in 2017, we feel there is still additional upside for international equities as domestic equities may have reached their peak. As you see in the graph below, since the beginning of this 8+ year bull-market (March of 2009), broad Large Cap U.S. equities have drastically outperformed the international equities by about 2.5 times. In our view, this leads us to believe that if earnings in Europe and emerging economies can begin to grow close to that of the U.S., there is still significant upside in international equity returns.



Global Market Weights: Statistics and buying patterns show that investors across the globe have a "home bias" to investing. U.S. investors are no different. As demonstrated in the pie chart below. Even though U.S. equity market accounts for just over half of all global equities, the average U.S. investor has a 70/30 split to their portfolios and has less of an allocation to non-U.S. stocks. We believe that global trends and future growth potential should result in a more balanced approach to global investing. Investors' strategic asset allocation should ultimately align more with the "all country" approach. For the first time in 30 years, our models now have almost a 50/50 split between U.S. exposure and international.



Valuations: The discipline of finding value is the driving force behind our continued commitment to international equities. Previously in the newsletter we looked at valuations by using **historical** Price to Earnings (P/E) ratios. In the chart below, you can see that **forward** looking P/E ratios have the same trend. U.S. equities are priced *further* above their 25-year average than Developed, Europe, and Emerging International Markets. U.S. equities have a forward looking P/E ratio of 17.8 compared to the historical average of 15.2, while non-U.S. equities are priced closer to their historical averages or below in the case of emerging markets. Still room to run!



OUR MISSION IS TO HELP YOU ACHIEVE YOUR DESIRED STANDARD OF LIVING AND FINANCIAL PEACE OF MIND.

The experienced All Star team of professionals is dedicated to understanding your individual needs and objectives, offering a comprehensive wealth management platform that is designed with one purpose in mind — to serve you, our valued client.

JUST FOR FUN

Restaurant Recommendation

Adele's Frozen Custard

Summer is finally here and best way to enjoy the beautiful Minnesota sunshine is with a sweet treat! Nestled in Excelsior, Minnesota, Adele's Frozen Custard offers a variety of delicious custard treats. From frozen custard waffle cones, decadent sundaes and delicious custard pies, Adele's is sure to capture your sweet tooth!

Looking for a little more? Make a meal out of it! Adele's also offers fresh deli sandwiches in addition to all your barbeque favorites including hot dogs, brats and BBQ pork sandwiches.

For all your sweet treat needs make sure you stop by Adele's Frozen Custard - before Summer 2017 melts away!

Josef's Smoked Baby Back Ribs

Ingredients

- Rack of Baby Back Ribs
- Your Favorite Pork Rub (make a little extra for later)
- Mustard
- Your Favorite Barbeque Sauce (Optional)
- ¼ cup of Apple Juice
- Honey
- Butter
- 3 Wood Chunks, or 3 Handfuls of Wood Chips
- Aluminum Foil

Directions

- Cover ribs in mustard & pork rub, and allow to sit in fridge for 8+ hours
- Preheat grill for 250°F indirect
- When grill is up to temperature, add the wood chunks or wood chips
- When smoke is consistent, add ribs to grill, meat side up (bones facing down)
- Smoke ribs for 2.5 hours, rotating them 90° every 30 minutes
- After 2.5 hours, use 2 layers of aluminum foil and put the butter, honey and extra rub on one side of the aluminum foil
- Wrap the ribs with the aluminum foil, meat side face down, in the butter, honey, and rub and add the apple juice just before tightly wrapping everything together
- Put wrapped ribs back onto grill for 1 hour, meat side down
- After one hour, unwrap the ribs
- If you choose not to glaze ribs, take off of grill. Optional step is to glaze ribs with your barbeque sauce by saucing ribs and putting them back onto the grill for 20 minutes, bone side down
- After glazing is done or if you choose not to glaze the ribs, take ribs off of the grill and let sit for 5-10 minutes to let the juices set

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