QUARTERLY

REVIEW & PREVIEW

THIRD QUARTER 2017
VOLUME 24 ISSUE 3

Rally continues in 3rd quarter – how long can it continue?

Investors capitalized on continued positive trends in both the stock and bond markets through the 3rd quarter. 2017 remains on pace to deliver above-average returns from nearly all major asset classes. Even so, realistic investors and professionals are asking a similar question – **when and how will this rally end?**

We believe there are a number of risks that could provide the catalyst for an end to this nine year bull market, including:

- **North Korea** – nuclear and ballistic missile threats from Pyongyang may be risks to global peace. The perception of a catastrophic incident or even a small military action could cause investors to pursue "risk-off" trades that put significant selling pressure on global equities.

- **Policy roadblocks in Washington** – the Republican Congress and President Trump continue to struggle to fulfill key election promises. Following their failure to pass a healthcare package, Congress is now pursuing tax reform with infrastructure spending still on the sidelines. Both initiatives may be critical to spur faster economic growth. The post-election equity rally may not have enough legs to hold itself up if policymakers fail to meet investor expectations.

- **The Federal Reserve** – in September, Fed Chair Janet Yellen and the Federal Open Market Committee announced plans to start scaling back its $4.5 Trilion balance sheet created through Quantitative Easing programs after the financial crisis. This action will ultimately limit liquidity in the bond markets. Combined with increases in the Fed Funds rate, the Fed is creating tighter conditions and a higher cost of doing business for the economy.

These and other potential risk factors will be considerations as investors weigh their options at the end of 2017 and as 2018 gets underway. With global equity markets gaining over 17% through the first nine months of 2017, investors must stay disciplined and understand how to mitigate these risk factors by effectively diversifying their portfolios.

BOB'S CORNER

"HISTORY IN THE MAKING?"

It was almost exactly 10 years ago (10/9/07) that the U.S. equity market (S+P 500) peeked for the last time before it fell 55% to 60%, on fear of what might happen as a result of the mortgage meltdown. After the "Great Recession", it took 5.5 years (3-28-13) before the U.S. equity markets made a new high. From its bottom, the U.S. equity market is now up 260%+, yet there are three sectors (Financial, Telecom, Energy) that have yet to regain their values from the prior peak. As we enter into our 9th year of the recovery, this run is already making history as the 3rd longest bull market since 1900. Will we see another meltdown? **We do not think so!** We do believe however that we are ripe for a correction and have prepared the portfolios to weather a storm. After selling 12% to 16% of our U.S. equity exposure in December of 2016, and putting that money to work internationally, we have more international equity exposure than domestic equities for the first time in my career.

We continue to believe that focusing on finding **value** in the markets is the best approach!

BUILD WEALTH. RETAIN WEALTH.

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

The Economy

99 months of expansion

September marked the 99th consecutive month of economic expansion in the U.S. after the end of the financial crisis and Great Recession. Only two expansions have lasted longer – 1990 to 2001 and 1960 to 1969. This recovery is also notable for exhibiting the slowest rate of growth of any expansion in the post-World War II period. Average Gross Domestic Product (GDP) growth year-over-year has been a tepid 1.3%.

But in the near term at least, GDP growth is picking up. The economy grew at a 3.1% annualized rate in the 2nd quarter, the fastest rate in more than two years. The unemployment rate stood at 4.2% in September with wages rising by 2.5% over the past year. The level of future growth will depend on the ability of the economy to overcome the likelihood of rising interest rates and the potential tailwind of the tax cuts now under consideration by Congress.

Inflation remained modest, with the core Consumer Price Index rising just 1.7% for twelve months ending in August, below the Federal Reserve's inflation target of 2%.

Looking Ahead

Given the unexpectedly modest inflation numbers, the Federal Reserve held off on raising short-term interest rates in the 3rd quarter, but it did not sit tight. At the September meeting of the Federal Open Market Committee, it was decided that the Fed would begin to trim its $4.5 trillion of assets on its balance sheet by allowing bonds it had purchased as part of its Quantitative Easing initiative to mature without reinvestment. This marks a new phase in Fed policy, with the potential to "tighten" financial conditions and ultimately slow economic growth. This could become a factor investors need to watch closely in the months to come to see if Fed actions curtail economic growth.

Quote of the Quarter:

"Success is all about persistence and doing the right thing for the long term."

-Bruce Rauner

Bond Markets

Rates rise late in the quarter

Bond yields fluctuated throughout the quarter, with the yield on 10-year Treasury dropping to 2.03% in early September before ending the quarter modestly higher than its 2.30% level at the end of June. The selloff in the bond market that triggered higher rates occurred after the Fed announced its plan to trim its balance sheet.

The Barclays U.S. Aggregate Bond Index gained 0.85% for the quarter. Government Bonds managed to rise just 0.38% during that time, and have generated a net return of -1.56% over the past 12 months.

High Yield bonds continue to outperform other domestic bonds, rising 1.98% in the 3rd quarter and advancing 8.89% over the past year. Global bonds have been another source of solid yield and total return. The Barclays Global Bond Index returned 1.76% for the quarter and more than 6% so far in 2017.

All Star's bond portfolio generated positive returns in what has been a complicated bond market in 2017. Year-to-date, our bond positions returned 6.2%, utilizing a mix of investment grade, high yield corporate, and diversified global bonds. We also benefited from a focus on shorter duration and floating rate bonds to lessen interest rate sensitivity, a strategy we intend to continue as we anticipate rates moving higher and the dollar weakening.

Looking Ahead

Although the Federal Reserve has lifted the Fed Funds rate from 0% to 1.25% since late 2015, real yields (10-year Treasury bond yields minus the inflation rate) that are determined by the market have remained constant. Fed members have indicated that we could see as many as 11 rate hikes in this cycle. The market, however, is only pricing in a total of 6. This difference between action and expectation is the primary reason that we continue to see a flattening yield curve, where long-term interest rates remain low while shorter term rates rise[1].

Domestic Stock

How much longer can this Bull run?

Key measures of the U.S. equity market continue to top new records. With each passing week, a steadily rising market and common sense tell us we're getting closer to a correction. Since the last bear market hit bottom (in March 2009), the S&P 500 has seen 7 significant corrections of 5% or more. The average span between corrections has been 16 months. We are currently 19 months beyond the last correction (a decline of 13%), which ended in February 2016.

Growth stocks, as measured by the Russell 3000 Growth index jumped 5.93% while the small cap Russell 2000 Growth followed right behind in Q3, gaining 6.22%. The large cap Russell 1000 Index trailed with a 4.48% return while mid-cap stocks were up 3.47% and the Russel 3000 Value index lagged the broader market, gaining only 3.27%.

Technology stocks continued to set the pace as they have for much of the year. The sector gained 7.9% during the quarter and is up 26% in 2017. Energy stocks rebounded from a slower start to the year with a 7.2% return in the 3rd quarter. Financial stocks rose 6% in the three-month period and Healthcare continued to roll, rising 3.5% over three months, pushing it to a more than 20% gain year-to-date.

Looking Ahead

One measure of market value, the price-to-earnings (P/E) ratio on the Standard & Poor's 500 Index, was 24.1 on *trailing* 12-month earnings at the end of Q3. This is substantially higher than the historical average of 18 times earnings[2]. Investors need to determine whether future corporate earnings, potentially subsidized by proposed tax reform, can support these lofty valuations. One of the major proposals in the current tax reform plan includes reducing corporate tax rates from 35% to 20%. Yet economists estimate that even with this plan in place, corporate earnings will only experience limited improvement, as many firms will use a portion of tax savings to boost investment in people and capital expenditures.

Winning themes throughout the nine-year bull market have been passive investing (index funds and ETFs) and growth investing. The soaring popularity of so-called FAANG stocks (Facebook, Amazon, Apple, Netflix, Google) has provided a strong tailwind for passive investors. Growth stocks generally benefited from the momentum carried by these and other stocks. As we near the latter stages of the current recovery, we expect both trends to reverse themselves. That suggests active investing (utilizing actively-managed funds or ETFs) and value investing may be in favor in the years to come.

International Markets

Global growth continues amidst geopolitical risks

Global synchronized growth has been one of the big stories of 2017, and the primary driver of equity markets around the world. European and Asian developed markets are both enjoying solid growth and equity markets have performed well in both regions. The MSCI Europe Index has showed gains of more than 21% in 2017 and the MSCI Japan Index is up more than 14% year-to-date.

Emerging markets have been the best performing asset class so far in 2017. The MSCI Emerging Markets index gained 7.8% in the 3rd quarter and has returned more than 27% for the year. China's equity market alone has gained more than 43% in 2017.

All Star's international equity investments have outperformed the benchmarks year-to-date, gaining 24.9% year-to-date at the end of Q3. Our developed Europe and Japan investments gained 19.7% while our emerging market focused investments had a total return of 33.3%. Our tactical approach of combining passive and cost-efficient index ETFs with actively managed mutual funds have proven successful in providing efficient risk-adjusted returns in our model portfolios.

Looking Ahead

Emerging markets are on pace for their best performance in eight years. There has been limited volatility in this asset class in 2017, a rarity for one that typically experiences sharp price fluctuations. Yet there is uncertainty both in Emerging Markets and Developed Europe as corporate earnings strength is likely to be tested and we prepare for the possibility of a stronger dollar. Still working in favor of world markets are attractive valuations relative to domestic equities. With forward price-to-earnings ratios (P/E) of 14.8 and 12.5, respectively, Europe and emerging market valuations are still significantly cheaper than the U.S. equity market *forward* P/E ratio of 17.7. Geopolitical risks are always a concern, but may be more of a factor for U.S. markets, particularly given the uncertainty with North Korea.

Sources: All economic data is from JP Morgan's Guide to the Markets, September 2017 (https://am.jpmorgan.com/us/en/asset-management/gim/per/insights/guide-to-the-markets/viewer#/share-by-email) and all rate of return data is from Morningstar.com, unless otherwise noted by citation: 1 – @TimmerFidelity 2 – Wall Street Journal

PERFORMANCE UPDATE

The 3rd Quarter

Market Index	3 rd Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	5.58	25.45	12.35	13.57
S&P 500	4.48	18.61	10.81	14.22
Russell 2000	5.67	20.74	12.18	13.79
S&P Mid Cap 400	3.22	17.52	11.18	14.43
Russell 3000	4.57	18.71	10.74	14.23
S&P Global BMI	**5.42**	**19.37**	**8.29**	**11.03**
MSCI EAFE	5.40	19.10	5.04	8.38
MSCI Emerging Mkts	7.89	22.46	4.90	3.99
NASDAQ Composite	6.06	23.68	14.41	17.27
Barclays US High Yield Bond	1.98	8.88	5.83	6.36
Barclays US Aggregate Bond	0.85	0.07	2.71	2.06
Barclays Global Aggregate Bond	1.76	-1.26	1.30	0.48
JPM Emerging Bond Diversified	2.63	4.61	6.50	4.91
Barclays US Government Bond	0.38	-1.56	2.01	1.25
Barclays US Credit Bond	1.35	1.96	3.87	3.23

*The above after-fee annualized total returns, betas, and alphas represent All Star Financial composite model performance. Your portfolio's actual returns, betas, and alphas may differ depending on your specific holdings and timing of cash flows.

Diversification, asset allocation, and value investing do not assure or guarantee better performance and cannot eliminate the risk of investment loss.

All Star Financial works on a "best efforts" basis and does not promise or guarantee any results. Past performance does not represent future results.

SUMMARY

&

We believe strong corporate earnings, low unemployment, and low inflation may provide a tailwind to the US and global economy for the next few quarters. Those factors, however, do not change the simple fact that this current bull market in U.S. equities is historic in its length.

Also worth watching are external events such as North Korea, policy success or failure in Washington and Fed tightening. We continue to proceed with caution with the understanding that all good things will come to an end.

Even though international equities have outperformed domestic equities nearly 2 to 1 this year, we still believe international is the best value!

We will continue to emphasize investments with fair valuations while seeking to enhance diversification. More than ever, these factors will be key to achieving success over the long term.

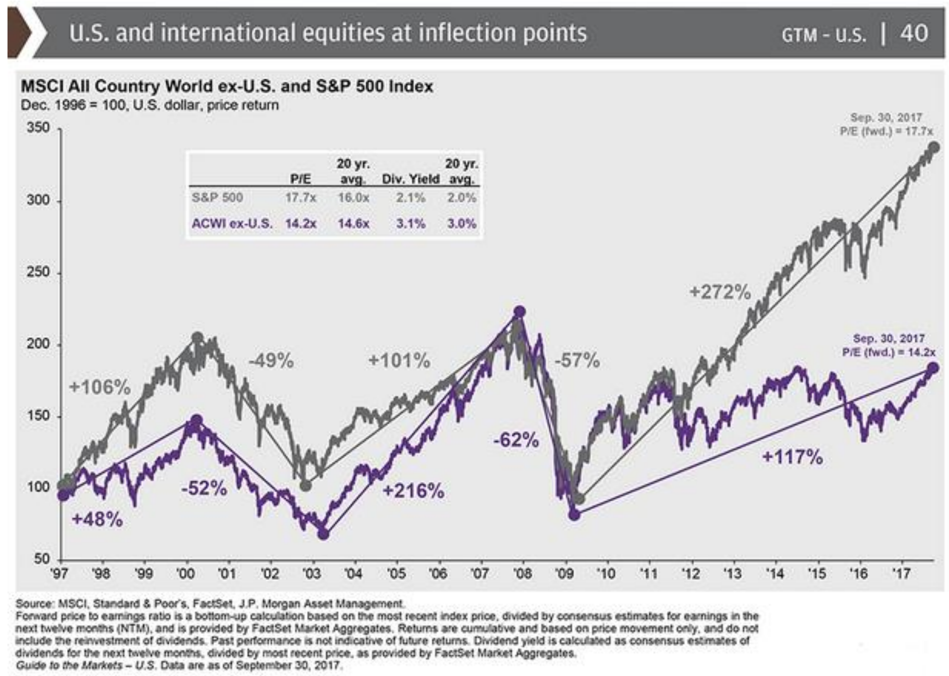
"It's not how much you make, it's how much you keep!"

-Bobby K

International Equities

U.S. Equities have dominated the 9 year bull market rally, thus far, gaining 272% since March of 2009. International equites have lagged (up 117%), but have outperformed in 2017. Fundamentals and history suggest that Internationals may outperform through the end of the cycle. As shows on the graph, the two equity asset classes tend to normalize at the end of a cycle. We call this trend "mean reversion." If history repeats itself during this cycle, there could be significant room to run for these non-US equities.

Valuations also support this theme. US stocks (S&P 500) are trading at 17.7 trailing P/E, 20% above their 20 year average. Meanwhile, the non-US equity index (ACWI ex-U.S.) is trading 3% **below** its 20 year average P/E. This demonstrates that not only is their potentially greater upside in the asset class, but there is also a higher floor.



CYBERSECURITY

In September, Equifax announced that an unauthorized third party gained access to personal data of as many as 143 Million Americans. This data breach is a game changer. Equifax is one of the four designated credit bureaus that is charged with tracking and reporting on consumer credit. For that reason, the company has a signfiicant amount of personal information without consumers actively engaging with the company. In other words, just because you are not a "customer" of Equifax does not mean that you are unaffected. We sent an email to clients in September to notify them of some steps they could take in response to the breach. There has been new information released since that initial email that further clarifies consumer options.

1. **Multi-point Authentication** – some websites that you visit on a daily basis (emails, banks, credit cards, etc) allow for multi-point authentication. Although inconvenient at times, signing up for a multi-point authentication process is the best way to ensure that someone is not logging into your accounts. This authentication requires that each time you log in, a separate pin or code is sent via text or email that is combined with your password to grant access to the account. This process would require a hacker to have access to your phone or email to enter an account.

2. **Manage your passwords** – change your passwords so that you are not consistently using one password (or variation) across several accounts. Hackers typically will cross-refernece common websites with your username and pasword once they gain access to one.

3. **Sign up for Credit Monitoring Service** – Equifax is offering their serivce for free for 12 months. Life Lock is also an option. The best benefit of these monitoring servces is the $1 Million of identify theft insurance.

4. **Freeze your credit –** To prevent a hacker from opening credit accounts on your behalf, the only certain method is to contact the four credit bureas (Equifax, Experian, TransUnion, Innovis) and put a "freeze" on your profile. This will prohibit financial institutions from inquiring about your credit to open new accounts. There is a small fee to establish and remove the freeze.

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
Lucia's

Nestled in Uptown, Minneapolis, Lucia's offers a fabulous farm-to-table dining experience! Since 1985, Lucia's has offered locally sourced brunch, lunch and dinner. Their menu includes a variety of starters including; Berkshire Ham, Bean & Lentil Soup, Blistered Shishito Peppers and Wild Brown Shrimp, as well as a variety of entrees including; Limousine Beef Shortrib, Seared Coho Salmon and Duroc Pork Chop.

In addition to their exceptional farm-fresh dining menu, Lucia's also has a robust wine bar and bakery. Whether you are looking for a sweet treat at brunch, or a night on the town wining and dining – Lucia's has it all!

Ashley's Crock Pot Taco Soup

Ingredients
1 (15 oz.) can black beans, drained and rinsed
1 (15 oz.) can pinto beans, drained and rinsed
1 (14.5 oz.) can petite diced tomatoes, drained
1 (15.25 oz.) can sweet corn, drained
1 (10 oz.) can green enchilada sauce
2 (14 oz.) cans chicken broth
1 (1 oz.) packet taco seasoning
1 Tablespoon cornstarch
2 Tablespoons water
1/2 pound lean ground beef

Serves: 6 to 8.

Instructions
Add all beans, tomatoes, corn, enchilada sauce, chicken broth and taco seasoning to a large crock pot. Stir to combine. Cover with lid and cook on low heat 3 to 6 hours. (If you're leaving this in while at work keep it on the warm setting for 8 hours.) Mix together the cornstarch and water to create a slurry. Add to the soup in crock pot and stir. This will help thicken the soup. Brown and crumble the ground beef in a large skillet until thoroughly cooked. Drain grease. Add beef to crock pot and stir to combine. Serve soup warm with shredded cheese, tortilla strips, sour cream, avocado etc. Enjoy!

CONTACT US

3800 American Blvd. W.
Suite 620
Minneapolis, MN 55431

Phone: 952.896.3820
Fax: 952.896.3819
Toll free: 888.809.7901

asf@allstarfinancial.com
www.allstarfinancial.com

Meet Our Team

Robert Klefsaas, CFP®, AIF®, CFDA®	CEO, Senior Wealth Manager
Brian Senske, MA	CFO, COO, Senior Wealth Manager
J. Alexander Källebo, CFA®	Portfolio Manager
Matt Berhow CFP®, AIF®	Senior Wealth Manager
David Osterberg, CPA	Tax Advisor
Brady Mickolichek CFP®	Associate Wealth Manager
Carl Ermisch, AIF®	Analyst & Paraplanner
Paula Zilka	Operations Manager
John Shevlin	Account Executive
Kaitlin Buckley	Client Service Associate
Ashley Kading	Executive Assistant
Bill Ristvedt	PCWM
Zhaoren Chen	Intern #99

Advisory services are offered through All Star Financial, a SEC Registered Investment Advisor.