All Star Financial
Build Wealth. Retain Wealth.

QUARTERLY

REVIEW & PREVIEW

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The World Grows Together – The Story of 2017

Global equity markets expanded in 2017 as investors continued to benefit from "synchronized global growth." It rarely happens, but all 45 countries tracked by the Organization for Economic Cooperation and Development saw their economies grow in 2017. This type of synchronized growth has not occurred since 2007, just prior to the financial crisis[1]. Thirty-three of those 45 economies are projected to accelerate again in 2018. Also encouraging was that the world manufacturing index expanded to an 80-month high, despite the threat of increased tariffs and President Trump's expressed desire to revise existing trade deals.

These positive forces helped extend the bull market, now ranking as the 2nd longest since 1900. The S&P 500 is up more than 295% since March 2009 and gained more than 20% in 2017. Corporations continue to see revenue and profitability rise, which is supporting lofty valuations.

A key driver of global growth is the continuation of low interest rates and quantitative easing policies from the world's central banks. For the first time since 2006, none of the major central banks initiated monetary subsidies in 2017. Until now, the world's central banks have combined to purchase $25 trillion in financial assets ($4.5 trillion in the U.S.) since the financial crisis began. Most economists agree that these strategies have played a key role in the growth economies are experiencing today.

As we prepare for 2018, it will be critical to weigh the dynamics driving global growth against the risk factors that could cause a recession. We will continue to stay disciplined in our value driven asset allocation process to identify investment opportunities.

BOB'S CORNER

Long-term investment success starts with setting proper expectations of what qualifies as a competitive return and while effectively mitigating risks by understanding valuations. There are some key potential hurdles that exist as we enter 2018:

- Fed interest rate hikes
- Changes in interest rates globally
- Potential confrontation in the Korean Peninsula

Investors should be prepared for the likelihood that the significant returns generated in the current bull market can't continue indefinitely. You should expect lower returns in the future. The only question is timing. That is why we focus on opportunities that still have room to run while also providing some downside protection should the market temporarily turn negative. For those reasons, international equities have been the pillar of our portfolio for the last few years. That worked to our clients' advantage in 2017 and we are confident our process will identify new opportunities that will continue to add value in the years to come.

It has been a great year, and we want to **THANK YOU** for trusting your financial future to the All Star Financial Team. We truly **CARE** about you, and we are committed to continuing to go the **EXTRA MILE** to help you and your family reach your financial goals.

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

The 102-Month Streak

December represented the 102nd consecutive month of economic expansion in the U.S., following the financial crisis and Great Recession. Only the expansions of 1990-2001 and 1960-1969 lasted longer. The other side of the story, however, is that this recovery has exhibited the slowest rate of growth of any post-World War II expansion. Average Gross Domestic Product (GDP) growth year-over-year has been a tepid 2.2%.

In 2017, however, the rate of growth accelerated. The economy grew at an annualized rate of 3.2% in the 3rd quarter, the fastest rate in more than two years. It was the second consecutive quarter of 3%+ growth. Also encouraging was that the unemployment rate dropped to 4.1% and wages rose 2.3% over the past year.

Even though inflation risk is always a concern, it has remained "mysteriously low," (a phrase used by outgoing Federal Reserve Chair Janet Yellen) throughout this recovery. The benchmark for inflation, the Consumer Price Index, did finally rise to 2.2% for the 12 months ending in November.

Looking Ahead

As we try to determine where the economy goes from here, two key factors will come into play. One is how well the economy responds to additional interest rate hikes we anticipate from the Fed in 2018. The other is the potential impact of the new Tax Cuts and Jobs Act signed into law in late December.

The tax bill represents the most far-reaching overhaul of the U.S. tax system since 1986. The headlines of the law are the reduction of the corporate tax rate to 21% and the revision of the individual tax brackets. The other provisions of the law seemingly were included to "pay" for the corporate tax reduction and the slight reduction to the highest individual rates. The law creates winners and losers among sectors and income brackets. According to the Tax Policy Center, a bipartisan thinktank, 95% of households will pay less tax in 2018 under the new reforms[2]. Additional money to spend every month will certainly create short term benefits due to incentives for corporations to spend and earn. The question is whether adding this fuel to the growth phase of the economic cycle will increase the acceleration of the economy in the short-term, but result in a steeper recession at the end of the cycle.

Bond Markets

Rates Rise Again as the Yield Curve Flattens

The defining trend of the bond market this year was a flattening yield curve. The 2-year Treasury note started the year yielding 1.25%, and ended 63 basis points **higher**, at 1.88%. The 10-year Treasury yield ended the year virtually flat, at 2.41%. At the same time, the yield on the 30-year Treasury bond **declined** from 3% to 2.74%.

The Barclays U.S. Aggregate Bond Index gained 0.39% for the quarter and 3.53% in 2017. U.S. Government bonds gained 0.05% for Q4, but still generated a 2.29% return for the year. High Yield bonds were the best performing sector, up 0.47% in the 4th quarter and 7.49% for the year. Global bonds also generated impressive numbers, rising 1.08% for the quarter and more than 7.38% in 2017.

All Star's bond portfolio produced positive returns in a complex fixed income environment. For the year, the portfolio returned 6.2% utilizing a mix of investment grade, high yield corporate and diversified global bonds. We also tempered interest rate sensitivity with a focus on shorter duration and floating rate bonds.

Looking Ahead

The primary concern about a flattening to inverted yield curve is that it may be a leading indicator of a recession. Under normal conditions, short-term rates are lower than long-term rates. An inverted yield curve is the opposite – with long-term rates coming in lower than yields on shorter-term instruments. The last seven recessions, dating back to 1960, have been predicted by the existence of an inverted yield curve.

The Fed is walking a tightrope as it tries to manage this outcome. If inflation remains close to the manageable 2% levels, the Fed can hopefully take a cautious approach to raising short-term rates to try to avoid an inverted yield curve scenario.

Quote of the Quarter:

"The business of life is the acquisition of memories. In the end that's all there is."

-Downton Abbey (Carson)

Domestic Stock

High Returns with Low Volatility

The bull market continued to run in the 4th quarter as U.S. equity market hit 40+ all-time highs. The S&P 500 gained ground on global markets in the 4th quarter, rising 6.64% and ending the year up 21.83%. Along with generating average annual returns of more than 10% the last three years, the S&P 500 has also experienced historically low volatility – the lowest in 53 years (with a standard deviation measure under 7%). This is comparable to a level of volatility typically seen in the bond market. The S&P 500 moved up or down on a daily basis by at least 1% on only 8 occasions in 2017, compared to 48 and 71 occasions in 2016 and 2015, respectively. Wow!

The gap between performance of Growth and Value stocks was the largest since 2009. The Russell 3000 Growth Index jumped 29.59% while the Russell 3000 Value Index generated a mere 13.19% return for 2017. Large-Cap stocks outperformed Small-Caps during the year as well. The Small-Cap Russell 2000 Index returned 14.65%, but lagged the 21.83% return of the Large Cap S&P 500 Index.

Technology stocks gained steam in the 4th quarter, rising more than 8.5% and ending the year with a 34.57% return. Two sectors that should benefit from the tax reform bill, Financials and Consumer Cyclical stocks, each gained 10%+ during the last quarter. Utilities were the only negative performer in the quarter, down 1%, while energy finished the year down 2%.

Looking Ahead

Sector performance is likely to be a major focus in 2018, as the tax reform package seems to single out winners and losers. Another factor where tax reform has played a role has been in market valuations. The price-to-earnings (P/E) ratio of the S&P 500 currently stands at 25 times earnings on a *trailing* 12-month basis[3]. This is substantially higher than the average of 18 times earnings and nominally higher than where it stood at the end of 2016 (24x). With corporate tax cuts in place, most firms should be positioned to boost after-tax earnings. That will be critical to fuel further market gains.

One potential benefit of tax reform could be increased discretionary spending by consumers. The Tax Policy Center estimates that the average household with incomes ranging from $47,000 to $200,000 will save anywhere from $1,200 to $8,000 in taxes[2]. If consumers and corporations reinvest their tax savings into the economy, that could lead to greater growth. At the same time, it could also trigger higher wage growth and inflation and lead to more rate hikes by the Fed, which will eventually put a damper on the economy and the market.

International Markets

Countries Helping Countries

From 2012 to 2016, international stock markets lagged U.S. markets, but that trend reversed in 2017 as major economies across the globe began growing together. Several factors, including a strong tailwind from U.S. GDP growth and low global interest rates played an important role. The MSCI All Cap World Index (ACWI, ex-U.S.) gained 5% in the 4th quarter and 27.19% in 2017. Pacific and European markets were major contributors, gaining 24.64% and 25.51% respectively.

Emerging markets were the best performing major asset class in 2017. The MSCI Emerging Markets index gained 7.44% in the 4th quarter and rose 37.28% for the year. China's equity market led all major economies with a 54.07% return in 2017. The worst performing overseas market was Russia, achieving only a 5% gain this year.

All-Star's international equity investments outperformed the MSCI ACWI benchmark in 2017, gaining 30.7% compared to 24.2% for the index. The key factor was our emerging market component, which soared a whopping 43.7%. Our tactical approach of combining passive and cost-efficient index ETFs with actively managed mutual funds proved successful in providing efficient risk-adjusted returns for our model portfolios.

Looking Ahead

International equity markets present both opportunities and risks in 2018. If the synchronized economic growth story continues, overseas equity markets are positioned to continue performing well as they still offer more relative value than U.S. stocks. Although the strong performance in 2017 has increased the valuations ratios of international equities, they are not above historical averages. European equities are valued at 15 times earnings, which is right at their long time average. Emerging Market equities, which some argue are better valued using price-to-book are currently at 1.8 times book value, which is also at its average.

It also appears that structural reforms brought about by Brexit are improving the potential for continued growth in European markets. That confidence, in addition to the welcomed inflation, is a large reason for positivity across the Eurozone. The largest risk factor facing the global markets is whether a reduction in quantitative easing strategies and potential interest rate hikes will have a negative impact on economic growth. These policies would look to reverse the historically low interest rate environment and bring monetary policy to a more normalized level.

Sources: All economic data is from JP Morgan's Guide to the Markets, December 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 –stats.oecd.org 2 – www.taxpolicycenter.org 3 – Wall Street Journal

MARKET PERFORMANCE UPDATE

Fourth Quarter

Market Index	4th Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	10.96	28.04	14.00	16.66
S&P 500	6.64	21.78	11.01	16.17
Russell 2000	3.34	14.62	9.69	14.59
S&P Mid Cap 400	6.25	16.21	10.74	15.37
Russell 3000	6.34	21.08	10.75	15.97
S&P Global BMI	**5.85**	**24.64**	**9.93**	**11.75**
MSCI EAFE	4.23	24.98	7.72	7.87
MSCI Emerging Mkts	7.44	37.19	9.16	4.35
NASDAQ Composite	6.55	29.57	14.37	19.87
Barclays US High Yield Bond	0.47	7.49	6.35	5.78
Barclays US Aggregate Bond	0.39	3.53	2.26	2.08
Barclays Global Aggregate Bond	1.08	7.38	1.97	0.76
JPM Emerging Bond Diversified	1.16	10.23	7.12	4.58
Barclays US Government Bond	0.05	2.29	1.43	1.25
Barclays US Credit Bond	1.05	6.16	3.65	3.18

SUMMARY & OVERVIEW

2017 was a year in which economies and equity markets marched upward throughout the year. Most notably, European and Asian markets finally accelerated after several years of underperformance relative to the U.S. markets. These strong returns also came with historically low volatility, a fantastic combination. Even as central banks raised interest rates, bond investors also experienced above-average returns.

As we look forward to 2018, inflation risk will be a key focus. If growth continues and potentially accelerates due to the stimulus of the tax package, the Fed could be forced to quicken the pace of interest rate hikes. If growth is more stable, it could lead to another solid year for investors.

Diversification, as always, remains essential. The low volatility experienced in recent times will not last forever. This may be a good time to re-evaluate your risk tolerance.

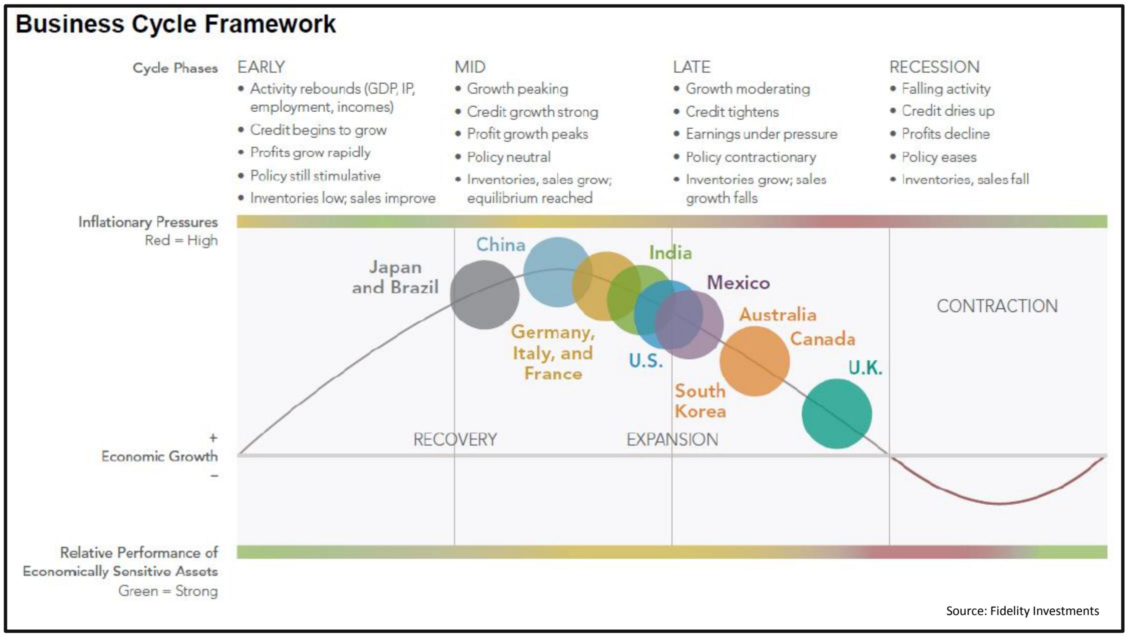
"It's not how much you make, it's how much you keep!"

-Bobby K

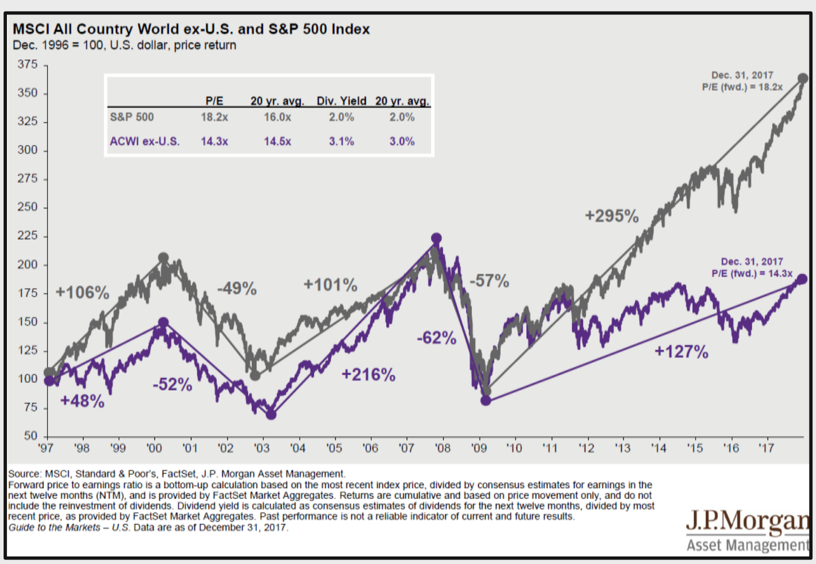
Diversification, asset allocation, and value investing do not assure or guarantee better performance and cannot eliminate the risk of investment loss.

Global Synchronized Growth

The story of 2017 was that every major economy grew together. We fundamentally believe that investing decisions can be made within context of where economies are at within the economic cycle. As shown below, each major ecomony is either in the expasion phase of the cylce or just nearing the crest as is the case for Japan and Brazil. This is a unique occurance that has been described as “global synchronized growth.” This trend will likely persist into early 2018 and until tighter financial conditions exist throughout global economies. (inflation and higher interest rates).



It is our opinion, as the world continues to experience economic expansion in 2018, international equities continue to provide a better opportunity to investors. As shown in the graph below, non-US equities outperformed US equities by 6% in 2017. However, the gap in returns since 2009 is still over 150%. As a result, the relative valuation supports our theme. US stocks (S&P 500) are trading at 18.2x projected earnings compared to the 20 year-average of 16.0x. Meanwhile, non-US equities are trading at 14.3x projected earnings with a 20-year average of 14.6x. A possibility of “mean reversions” where returns begin to normalize would result in significant over performance for non-US equities. This is also supported by earnings growth observed in the past two years as Emerging Market, Japanese, and European Earnings have accelerated closer to the trajectory in the U. S.



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:
Café Lurcat

Nestled in Loring Park, Café Lurcat provides an exquisite dining experience just blocks away from the Walker Art Museum and Downtown Minneapolis. Their menu consists of classic American cuisine made from fresh artisanal ingredients. Some of their specialties include a crisp Apple, Cheese and Chive Salad; Roasted Cauliflower; and Miso Sea Bass. Looking for something sweet? Café Lurcat offers amazing Warm Cinnamon Sugar Doughnuts! No matter the occasion, Café Lurcat provides excellent service and incredible food!

Are you in Florida for the winter? Check out the D'Amico Family's Lurcat location in Naples, Florida!

Super Bowl Appetizer:
Spinach Artichoke Stuffed Mushrooms

Ingredients

- Whole Portobella Mushrooms
- 1 8 oz package cream cheese
- ½ box frozen spinach, thawed and well drained (approximately 5 oz)
- 1 can artichokes, quartered and drained (14 oz)
- ¼ cup mayonnaise
- ½ cup parmesan cheese
- ½ cup mozzarella cheese
- red pepper flakes (to taste)

Instructions

1. Clean and hull mushrooms with melon baller.
2. Combine all other ingredients in mixer and mix well.
3. Spoon mixture into hulled mushrooms.
4. Top with a light sprinkle of mozzarella cheese.
5. Bake at 350 degrees until tops are browned. (About 25 minutes.)

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