QUARTERLY

REVIEW & PREVIEW

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Corporate Earnings Thrive Amidst an Uncertain Backdrop

Global uncertainty was the overriding theme in the 2nd quarter, as both equity and bond markets tried to adjust to a more unsettled environment. The irony was that this occurred at the same time that corporations were generating historic earnings growth. While investors tried to focus on the positive profit picture, there were plenty of distractions.

Most notable was the heated rhetoric related to tariffs between the U.S., China and several other trading partners including Europe, Canada and Mexico. The Trump administration implemented tariffs with the goal of protecting manufacturing jobs in the U.S. Of greater concern was discussion of more significant tariff actions down the road. In response, other countries followed suit and threatened retaliatory measures. Speculation around what might occur in the future led to a volatile period for stocks.

Profit growth for U.S. companies soared in the 1st quarter. In a sense, this lived up to expectations set by investors during the run-up in value that stocks enjoyed in 2017. At that time, we suggested that markets were "borrowing from the future," generating performance that was based on future earnings growth. Stock valuations climbed throughout 2017 as stock prices got a jump-start on projected earnings. In the first half of 2018, earnings began to catch up, but the market's more tepid response to the latest economic data resulted in a reset of valuations during Q2.

The U.S. economy is transitioning to a late-cycle growth phase, with continued expectations of solid earnings reports, contained inflation and interest rates in a reasonable range. But with the Federal Reserve tightening monetary policy, we will likely continue to see pressure on bond investors.

Around the world, the theme of synchronized global growth that was prominent in 2017 appears to be a blissful memory. European firms are missing their growth targets and the European Central Bank indicated it will hold the line on interest rates for another year to help keep economic growth on track. Japan and China are on similar paths.

The biggest international story revolves around increasing trade disputes. The headlines touting a potential "trade war" will continue to add a level of uncertainty to the markets. It is likely to heighten investor fears and contribute to already increased market volatility for both stock and bond investors.

BOB'S CORNER

A short six months ago we were talking about unprecedented returns for both the U.S. and International Equity Markets. The amazing part of 2017 was the low volatility that produced these phenomenal returns. The number of days that the U.S. Equity Market went up or down 1.0% or more was a paltry – **8 TIMES**. In 2017, we had three major themes that helped to promote this upside:

1.) Synchronized Global Growth
2.) Tax Reform – 95% of America Benefits
3.) Anticipation of a new presidency

Through June 30th, 2018, we have seen **36 DAYS** when market volatility has been greater than 1.0% up or down.

In 2018, we have three major themes that have helped create the uncertainty that has caused an increased volatility:

1.) New President – Unpredictable statements
2.) Trade Tariffs – Good or Bad? Uncertain!
3.) U.S. interest rates increasing vs. Europe/Asia still declining or flat

International equities have hurt our portfolio in the short term, but we still believe in their relative value and in the long-term, patience is the key.

As always, we want to **THANK YOU** for trusting your financial future to the All Star Financial Team. Our team puts your interests first and we are committed to going 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

108 Months of Expansion

June marked the 108th consecutive month of economic expansion in the U.S., dating back to the end of the Great Recession in March 2009. This now represents the 2nd longest recovery on record. While long in duration, cumulative GDP growth during this recovery has been significantly lower than in many other periods of economic expansion. Total cumulative GDP growth over the entire recovery is barely above 15%, far below growth rates in the 40% to 50% range in recoveries that began in 1981 and 1990.

Economic growth in the 1st quarter met consensus expectations, with real Gross Domestic Product (GDP) growth ending at 2.0%. Economists expect things to pick up, with an overall growth rate of 3.0% projected for 2018.

A key factor will be the level of business spending. Company earnings have been bolstered with the recent cut in the corporate tax rate from 35% to 21%. Capital expenditures should increase as companies reinvest savings and "repatriate" cash that was held overseas. Economists expect to see this occur later in the year, with business spending rising by 7.0% in 2018, surpassing 2017's 5.3% rise.

Inflation remains a concern. In May, the Consumer Price Index (CPI) generated its largest 12-month gain since 2012, at 2.8%. CPI has now exceeded the 2.0% level for nine consecutive months, beyond the target the Federal Reserve tries to maintain. The trade dispute, a strong job market that may push wages higher and rising commodity prices are all factors the Fed is watching. It raised interest rates in June and indicated it plans to do so twice more in 2018.

Looking Ahead

A recession is inevitable, but the timing is being closely managed. A New York Federal Reserve model indicates an 11.1%[1] chance of a recession in the next 12 months. This is an indication that we are nearing the end of the expansionary phase of this cycle and entering into the late stages. Of course, other factors such as trade issues, business and consumer spending and the pace of interest rate hikes could all have a bearing on the end date for this long period of economic expansion.

Bond Markets

A Flatter Yield Curve

Bond yields experienced significant movement during the first half of the year. The yield on the 10-year Treasury began the year at 2.4%, then topped the 3.0% mark in May before settling down to 2.86% at the end of June. In the meantime, the yield curve continues to flatten. At the end of the quarter, the gap between yields on 2-year and 10-year Treasuries was just 38 basis points (0.38%), the lowest since 2007.

The Barclays U.S. Aggregate Bond Index was down slightly for the quarter, returning -0.16%. For the year, the bond index is down 1.62%. The price of a 10-year Treasury bill has declined 2.6% in 2018. High-Yield bonds have held up better than the rest of the domestic bond market with the U.S. High Yield index netting a gain of 1.0% in the 2nd quarter.

Global bonds have generally underperformed U.S. bond markets in 2018, with the Barclays Global Bond Index down -1.46% in 2018. The stronger U.S. dollar has detracted from net returns earned by U.S. investors from global bonds.

All Star's bond portfolio generally weathered this challenging environment well, outperforming major bond indexes during the quarter. Our portfolio suffered only a modest decline of 0.7% during the period. Allocations to floating rate and global bonds added value as long- and short-term rates rose across the bond spectrum.

Looking Ahead

The environment remains challenging for bond investors. In the current market, many are looking to bonds as a way to diversify and temper the risk we've experienced in a volatile equity market. For investors who are relying on bonds as a way to preserve capital, it is essential that they approach today's environment with their eyes wide open. Expect interest rates to continue to trend higher, which will put pressure on bond values. We anticipate that rate changes will be modest however, barring some major economic event that alters the current course.

Quote of the Quarter:

"Growth is never by mere chance; it is the result of forces working together."

- James Cash Penney

Domestic Stock

Earnings Growth Lives Up to Previous Expectations

The combination of more favorable corporate tax rates and solid economic growth in the United States and overseas late in the economic cycle helped corporations generate significant earnings growth. Profit expansion reached a 7-year high, increasing at a 24.5%[2] annualized rate in the 1st quarter. Revenue levels were up nearly 9.0%, also considered a solid result. It is notable however, that the anticipation of such impressive financial results has been priced into the performance of stocks going back to 2017. That is part of the reason why U.S. stock market performance this year is modest (S&P 500 is up just 2.4% this year).

Over the past 12 months, Growth stocks have outperformed Value stocks by over 15%. That trend continued in the 2nd quarter of 2018. The Russell 3000 Growth Index ended positive up 5.9%. The Russell 3000 Value Index also increased, but by only 1.7%. Surprisingly, small cap stocks continue to outperform large cap stocks. The Russell 2000 Small-Cap Index increased 7.8% during the quarter, while the Russell 1000 Large Cap Index increased by 3.6%. In the first half of the year, small-cap stocks outperformed large-cap by almost 5.0%. This is primarily caused by the perception that smaller companies are not as exposed to international trade as larger multi-national corporations.

The performance of a select group of sectors helped drive the market's positive performance. Technology stocks continued to thrive, gaining 7.1% in the 2nd quarter and now up 10.9% for the year. Consumer Discretionary stocks were up 8.2% in the quarter and have gained 11.5% year-to-date. The top-performing sector in the 2nd quarter was the worst performing in the 1st quarter. Energy stocks rose 13.5% in Q2 after losing nearly 6.0% in that 1st quarter.

Looking Ahead

The combination of strong earnings growth and less than spectacular stock market performance has had an impact on stock valuations. This year, the forward-looking price-to-earnings (P/E) ratio for the S&P 500 has dropped from 19.5x at the market peak in January to 16.1x at the end of the 2nd quarter. There is much speculation about the direction of stocks from this point. Investors know that 1st quarter earnings results are not sustainable. In 2019, earnings are expected to return to modest levels at 7.0%. Entering into an 11th year of a bull market in 2019, investors will have to evaluate if companies can continue to grow if the burden of a potential trade war and tightening financial conditions will result in muted growth.

International Markets

Trade Talks Tempers Returns

Equity markets outside of the U.S. became increasingly volatile as protectionist policies of the Trump administration were proposed or implemented. The general consensus is that restrictions on global trade will not benefit global economic growth. Not surprisingly, the stock market in China, the country which may have the most to lose if trade tensions escalate, saw significant declines in the 2nd quarter. This dragged down returns for emerging markets. The MSCI Emerging Market index declined by 7.9% during the quarter. Compounding the damage was the impact of a stronger dollar, which detracts from returns in overseas holdings. Latin American stocks were significantly impacted as well during the quarter, declining 17.6%. Developed markets were down modestly, with European stocks declining 1.3%.

All Star's international equity investments underperformed the MSCI World ex USA index in the 2nd quarter, declining 4.2% compared to -0.75% for the index. Our Emerging Markets holdings, which represent 9.0% to 19% of our portfolio, were hit hard during the quarter. We remain committed to our tactical allocation to non-U.S. equities based on both short-term and long-term relative valuations and cyclical observations.

Looking Ahead

There was optimism about the prospects for international equities when the year began. This was based on the expectation of continued synchronized economic growth across most countries. The situation has changed, and the prospects of a heated trade war have overtaken the conversation. While the proposed and enforced duties and tariffs have created some market volatility, the potential impact on economic growth is likely to be limited, both in the U.S. and abroad. The bigger picture tells a more important story. Earnings growth and valuations in non-U.S. equity markets still look attractive. P/E ratios of non-U.S. equities (ACWI ex US) stand at 13.0x forward-looking earnings, compared to 14.4x on a historical basis. This indicates a favorable opportunity persists in global markets, with the U.S. equities more expensive with a current 16.1x P/E vs. 20-year average of 15.9.

Sources: All economic data is from JP Morgan's Guide to the Markets, June 2018 (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 –www.newyorkfed.org 2 – www.nadqaq.com

PERFORMANCE UPDATE

Second Quarter

Market Index	2nd Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	1.26	16.32	14.07	12.96
S&P 500	3.43	14.38	11.93	13.42
Russell 2000	7.75	17.58	10.96	12.46
S&P Mid Cap 400	4.29	13.51	10.89	12.69
Russell 3000	3.89	14.79	11.58	13.30
S&P Global BMI	0.79	11.64	8.87	10.15
MSCI EAFE	-1.24	6.85	4.90	6.44
MSCI Emerging Mkts	-7.96	8.21	5.60	5.01
NASDAQ Composite	6.61	23.62	15.95	18.54
Barclays US High Yield Bond	1.03	2.62	5.53	5.51
Barclays US Aggregate Bond	-0.16	-0.40	1.72	2.27
Barclays Global Aggregate Bond	-2.78	1.36	2.58	1.50
JPM Emerging Bond Diversified	-3.54	-1.60	4.63	5.15
Barclays US Government Bond	0.10	-0.63	1.02	1.48
Barclays US Credit Bond	-0.88	-0.65	2.86	3.37

*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 & OVERVIEW

Investors have been forced to adjust to a more volatile environment in 2018. The second longest bull market in the history of U.S. stock trading is clearly feeling its age. After a negative 1st quarter, stocks have now returned to positive territory. Yet risks clearly remain including the potential for higher inflation that might force the Federal Reserve to quicken the pace of interest rate hikes. If that occurred, it could dampen earnings growth. As already mentioned, the heated rhetoric over trade is an additional concern.

On the positive side, the fact that stock valuations have re-set to more reasonable levels indicates some room on the upside for equities. Still, investors should be prepared for further volatility in the 2nd half of 2018. A broadly diversified portfolio that incorporates the essential asset classes is likely to be the most effective approach to help keep investment goals on track.

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

-Bobby K

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.

Restaurant Recommendation: *The Bachelor Farmer*

Located in a historic brick-and-timber warehouse in the North Loop of Minneapolis, The Bachelor Farmer offers an exquisite farm-to-table dining experience. Their menu includes fresh and simple food that honors Minnesota and the surrounding Northern region. Their kitchen team sources the best ingredients available, which means buying from local farmers. Additionally, The Bachelor Farmer uses organic products whenever possible and also grows their own herbs and vegetables on their rooftop farm, which was the first of its kind in Minneapolis. For those who love pork chops, The Bachelor Farmer offers Chop Night every Monday evening with some of best pork chops in Minneapolis - they are truly incredible!

Recipe of Quarter: *Individual Key Lime Pies*

Ingredients:

Lime Curd:

1 cup lime juice
2 cups sugar
2 sticks unsalted butter
14 eggs

Crust Layer:

1/3 cup sugar
12 whole graham crackers
1/3 cup unsalted butter, melted

Topping:

1 1/2 cups whipping cream
1/2 cup powdered sugar
Lime zest, for garnish

Directions:

Total time: 2 hr 30 min
Active: 40 min
Yield: 12 servings

For the lime curd: Combine the lime juice, sugar and butter in a medium saucepan and cook on a low flame until the butter melts. Beat the eggs, add to the saucepan and stir until combined. Bring to a simmer. Stir constantly and cook until the mixture is a thick and creamy consistency, 5 to7 minutes. Pass through a mesh strainer. Chill for 2 hours in the fridge.

For the crust: Add the sugar and graham crackers to a food processor. Pour in the melted butter and pulse to combine.

For the topping: Whip the cream with the sugar until stiff. To assemble, layer the crumb mixture into the bottom of a serving cup, followed by the lime curd. Top with the whipped cream mixture and garnish with lime zest.

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