QUARTERLY REVIEW & PREVIEW

THIRD QUARTER 2018
VOLUME 25 ISSUE 3

Trade Tensions Lead to a Gap in Returns Across the Globe

One hallmark of 2018 will be the return of tariffs as a major policy initiative. President Donald Trump has imposed significant tariffs on products imported into the U.S. from China, the European Union, Canada and Mexico. To date, imports valued at $245 billion have been affected. Many nations have retaliated with their own tariffs. Economists and corporate leaders have been scrambling to determine the impact and costs of these new trade restrictions.

The latest trade tensions divided the global markets. In the 3rd quarter, U.S. equity markets rallied to all-time highs while international and emerging market stocks struggled. Overseas markets appeared to be gripped by the fear of slower growth in anticipation that export activity will decline in the new trade environment. Many international markets are also facing headwinds on the value of exports caused by the strengthening of the U.S. dollar.

Support for U.S. stocks came in large part from continued growth in corporate profits. 2nd quarter earnings on the S&P 500 were 24.9% higher than a year ago. 3rd quarter earnings growth is projected to be in the still impressive 17% to 20% range. The combined effects of the recent reduction in the corporate tax rate and the continued use of stock buybacks by many publicly traded companies helped boost earnings. Earnings growth projections for 2019 are in the more modest 7% to 10% range.
Technology stocks have been the primary force in the stock market in 2018. The highly popular, so-called “FAANG” stocks (Facebook, Amazon, Apple, Netflix and Google) are up 37% through the first three quarters of the year, making up 57% of the gain in the S&P 500. While the productivity and growth of technology companies has been impressive, investors should exercise caution. Conditions are somewhat reminiscent of the technology bubble that occurred in the early 2000’s that ended in a significant correction.

In March 2019, the current bull market will celebrate its 10th anniversary. As we near that milestone, investors need to be thoughtful about their asset allocation strategies and stay focused on structuring their portfolios to meet their specific goals. All Star Financial’s value discipline and long-term focus seeks to strike the right balance between growth, diversification and capital preservation.

Bob’s Corner

Cheers to 30+ More Years

All Star Financial continues to grow after 30+ years, and we owe a sincere **THANK YOU TO OUR VALUED CLIENTS!** We are so blessed to have clients who believe in our value-based, service-minded wealth management discipline. It was just five years ago that we were a team of six and now we have grown to over a dozen employees.

We are extremely happy with how our “First Annual” Client Celebration Event turned out and want to thank everyone who attended! Additionally, we want to make sure that you put September 13th, 2019, on your calendar for our 2nd Annual. We can’t wait to see you there!

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

The Economy Keeps Its Streak Alive

September marked the 111th consecutive month of economic expansion in the U.S., dating back to the Great Recession that ended in March 2009. It is the 2nd longest recovery on record. Despite its duration, it has been a far more tepid economic expansion compared to most. Cumulative Gross Domestic Product (GDP) growth during this recovery is barely above 16%, far below growth rates of 40% to 50% during the recoveries in 1981 and 1990.

There was encouraging news in the 2nd quarter as Real GDP grew at a 4.2% annualized rate, its highest level since 2014. We anticipate growth of close to 3% for all of 2018.

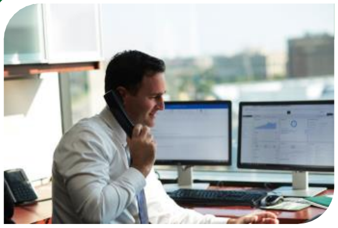
The Federal Reserve (the Fed) is focused on keeping the economy on a smooth track while still keeping inflation in check. The Fed raised the Fed Funds rate one-quarter of a percent in September, to 2.25%. It was the third increase this year with hints of another bump possible in December. The Fed Funds rate is now at its highest level since the end of 2008.

As for inflation, Consumer Price Index (CPI) increased 0.2% in August, rising for the 5th consecutive month. However, the 12-month increase in the Core CPI (CPI excluding the volatile food and energy sectors) declined from 2.4% to 2.2%. The Fed is watching the potential inflationary risks of a strong job market, rising commodity prices and the impact of trade disputes.

Looking Ahead

A telling detail that emerged after the Fed's September meeting was a change in long-standing language from its policy stance on interest rates, removing the term "remains accommodative." It reflects the Fed's recent interest rate hikes and the potential that it could happen three more times in 2019 and at least once in 2020. In so doing, the Fed is positioning rates with the intention of slowing the economy as a way to keep inflation in check.

Bond Markets



The Yield Curve Flattens

The margin between yields on 10-year and 2-year U.S. Treasury securities reached its narrowest point since 2007. With the 10-year yield at 3.06% at the end of the quarter, the yield on 2-year Treasuries stood at 2.80%, barely more than a 0.25% difference. This illustrates how the yield curve has been flattening, often considered an indicator of a looming recession.

The Barclays U.S. Aggregate Bond Index was generally flat for the quarter, returning just 0.07%. For the year, the bond index has declined -1.60%, significantly below the 10-year U.S. Treasury notes, 0.60%. High-Yield bonds are performing better than other parts of the domestic bond market, with a gain of 2.44% in the 3rd quarter and 2.52% year-to-date.

Global bonds have generally underperformed U.S. bond markets in 2018. The Barclays Global Bond Index was down -0.92% in the 3rd quarter and is down more than -2.37% year-to-date. Developed and emerging market bonds are generating higher yields than U.S. bonds, but the strong dollar has detracted from returns for U.S. investors.

In an environment that remains challenging for bonds, All-Star's portfolio generally held up well. Our portfolio gained 1.2% during this period. Key to the performance of our overall mix of bond holdings was a significant allocation to domestic floating rate bonds, which were up 1.37% during the 3rd quarter.

Looking Ahead

Even in what will likely continue to be a difficult environment for bond investors due to rising interest rates, bonds continue to play an important diversification role. We believe our tactical bond allocation to floating rate bonds will continue to offer favorable opportunities. However, if the dollar strengthens further, it will continue to create headwinds for international bonds.

Quote of the Quarter: *"If everyone is moving forward together, then success takes care of itself."*

– Henry Ford

Domestic Stock

More Records Set

The S&P 500 Index broke through to new all-time highs in September. Investors reacted positively to strong earnings growth, but also appear prepared for a more normal earnings growth cycle in 2019. Key to investor expectations today is the hope that a recession is not on the immediate horizon. The recent surge for stocks came after a partial "reset" of stock prices helped return equities to more reasonable valuation levels in the middle of the year.

The past year has seen Growth stocks significantly outpace Value stocks, by more than 16%. The trend continued in the 3rd quarter. The Russell 3000 Growth Index was up 8.88% compared to a 5.39% return for the Russell 3000 Value Index. After racing ahead in the first half of the year, Small-Cap stocks trailed Large Caps in the 3rd quarter, due in large part to the performance of the FAANG stocks. The Russell 2000 Small-Cap Index returned just 3.58% compared to 7.42% for the Large Cap Russell 1000 Index. By the end of September, Large Cap stocks outpaced Small Cap stocks year-to-date by a narrow margin. The focus early in the year was on potential fallout from trade tensions, and smaller companies seemed more immune to that. But as interest rates have risen, smaller firms are feeling more of an impact due to their leveraged balance sheets.

The technology sector continues to set the pace, with the S&P information technology sector up 20.6% year-to-date. Cyclical stocks, represented by the S&P Consumer Discretionary sector index, are also among the leaders with the same strong returns, 20.6%, year-to-date. In the third quarter, the S&P healthcare sector gained on the leading sectors as it was the strongest sector, with an impressive 14.5% gain, leading to a 16.6% return so far in 2018. The lagging sectors during the quarter were Real Estate (-2.65%), Financials (-2.2%) and Materials (-2.09).

Looking Ahead

Stock valuations remain a concern. The price-to-earnings (P/E) ratio for the S&P 500 increased from 16.1x at the end of June to 16.8x at the end of September. The simmering trade war remains a concern, particularly if China and other countries find suppliers and customers in other markets. That could have a more significant impact than many anticipate today. If it ultimately triggers higher inflation and more dramatic interest rate increases by the Fed, it could fuel greater market volatility.

International Markets

Trade Dispute & A Strong Dollar Drag Down Performance

Non-U.S. equity markets experienced notable volatility as the Trump administration implemented protectionist policies and proposed additional ones. As was the case in 2015 and 2016, international equities have lagged the U.S. market in 2018. Most prominent was the MSCI China Index, which declined -7.5% during the quarter and is down -9.12% in 2018. The MSCI Emerging Markets Index was down -1.09% for the quarter and -7.68% for the year. Slower than expected economic growth combined with a stronger U.S. dollar created significant downward pressure on Emerging Market equities.

Developed Market stocks in Europe managed a 0.80% gain during the quarter, compared to a 3.68% gain in Japan. As markets digest the implications of a trade war between the U.S. and China, some anticipate that Europe and Japan may ultimately benefit from the conflict, while China and the U.S. may find themselves looking for new suppliers.

All-Star's International equity portfolio declined 2.6%, compared to a gain of 4.3% for the benchmark MSCI All Cap World Index. We lost ground due to a larger-than-average holding in Emerging Markets stocks, particularly in China, which struggled during the quarter. We remain committed to our tactical allocation to non-U.S. equities, especially Emerging Markets based on long-term cyclical observations and fundamental valuations.

Looking Ahead

The early-year optimism about international equities was based on expectations of continued synchronized global growth. The situation has changed, however, as prospects for an extended trade war heated up. While this created some market volatility, the long-term economic impact is less clear. We believe that the fundamental direction of the emerging economies have not changed. Investors with a long-term focus will be rewarded in international stocks. P/E ratios of non-U.S. equities stand at 12.9x compared to 14.3x on a historical basis. Whereas, U.S. equities have a current P/E of 16.8x compared to 15.9x historically. The relative valuations continue to create a compelling opportunity for investors.

Sources: All economic data is from JP Morgan's Guide to the Markets, September 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.

Performance Update

Third Quarter

Market Index	3rd Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	9.63	20.76	20.49	14.57
S&P 500	7.71	17.92	17.30	13.95
Russell 2000	3.58	15.25	17.12	11.07
S&P Mid Cap 400	3.86	14.22	15.67	11.91
Russell 3000	7.12	17.59	17.07	13.46
S&P Global BMI	3.81	9.50	13.44	8.67
MSCI EAFE	1.35	2.74	9.23	4.42
MSCI Emerging Mkts	-1.09	-0.81	12.36	3.61
NASDAQ Composite	7.41	25.19	21.69	17.72
Barclays US High Yield Bond	2.40	3.05	8.15	5.54
Barclays US Aggregate Bond	0.02	-1.22	1.31	2.16
Barclays Global Aggregate Bond	-0.92	-1.32	1.98	0.75
JPM Emerging Bond Diversified	1.87	-2.94	5.70	4.63
Barclays US Government Bond	-0.57	-1.57	0.26	1.34
Barclays US Credit Bond	0.89	-1.10	2.98	3.40

*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

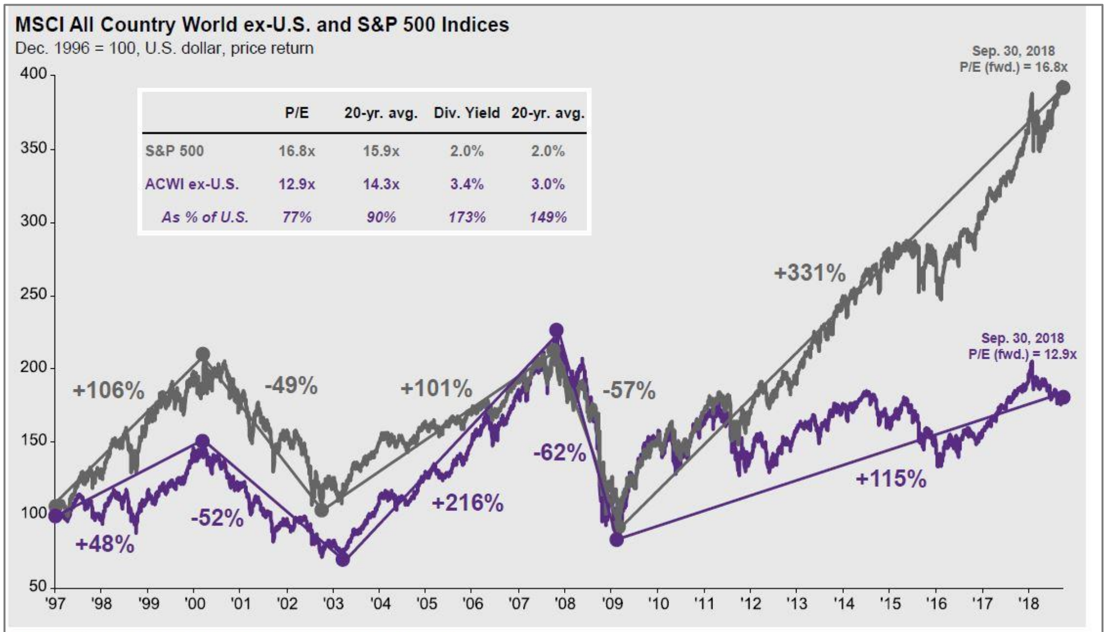
The markets in 2018 have been driven in part by fear and uncertainty. The fallout from the "trade war" has been particularly felt in global markets. By contrast, strong corporate earnings helped reinvigorate U.S. markets. Yet the fundamentals in Europe and Asia remain strong and we find relative valuations to be extremely compelling in overseas equity markets compared to the U.S.

At the same time, there are risk factors at play in the market, including currency movements, inflation threats and rising interest rates. The Fed is likely to continue pushing interest rates higher to try to keep inflation in check. This could, however, add to the strength of the dollar, which puts some pressure on corporate earnings. The overall earnings outlook remains generally positive. As uncertainties escalate, investors will want to remain appropriately diversified to stay on track to achieve their long-term investment objectives.

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

-Bobby K

International Equities & Bonds Change Trajectory in 2018



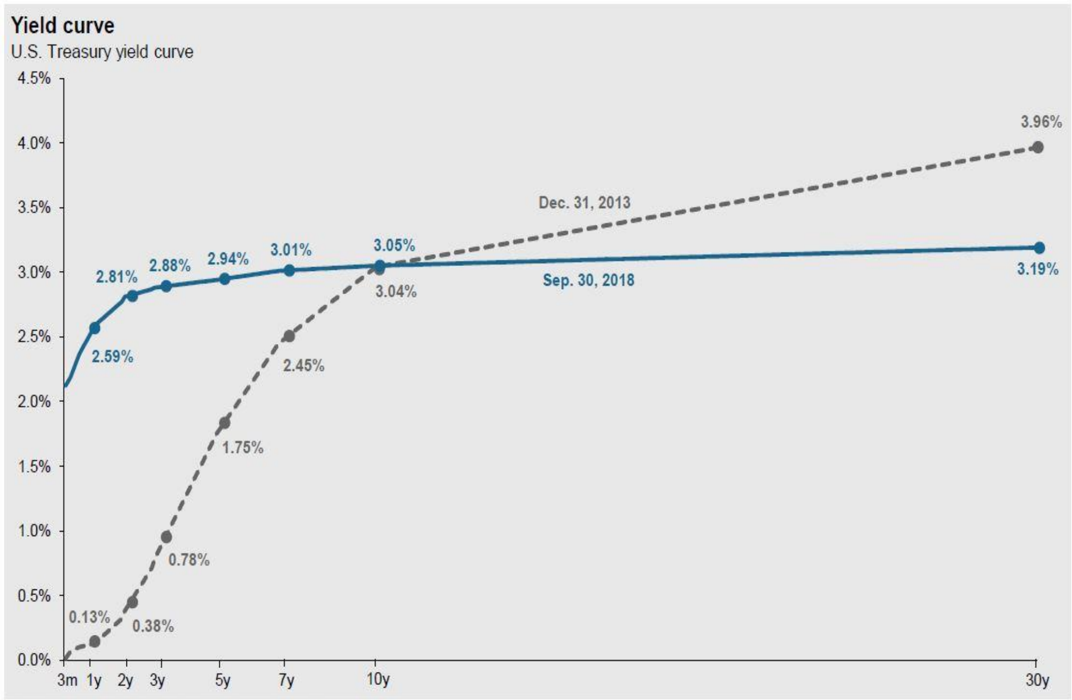
	P/E	20-yr. avg.	Div. Yield	20-yr. avg.
S&P 500	16.8x	15.9x	2.0%	2.0%
ACWI ex-U.S.	12.9x	14.3x	3.4%	3.0%
As % of U.S.	*77%*	*90%*	*173%*	*149%*

Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
Forward price to earnings ratio is a bottom-up calculation based on the most recent index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on price movement only, and do not include the reinvestment of dividends. Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by FactSet Market Aggregates. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – U.S. Data are as of September 30, 2018.

J.P.Morgan

The gap between the U.S. and international equity returns continued its significant divide in Q3. Since March of 2009, U.S. stocks have increased 331% compared to 115% in non-U.S. markets. As a result, U.S stocks are trading above their historic valuations and non-U.S. stocks are trading at a discount. However, the threat of a trade war and slower growth continue to put downward pressure on global stocks. If either factor begins to dissipate a serious rebound may be in order.

The yield curve has experienced a significant "flattening" in 2018. As recently as 2013, the difference between the 3 month and 30-year treasury was almost 4%. At the end of September 2018 that gap was only slightly above 1%. This narrow margin reflects that the economy is improving, and interest rates are rising; however, investors are still maintaining sufficient demand to keep the 30 year treasury rate low. A flatter yield curve ultimately inverts where long-term yields are less than short-term, a classic recession indicator.



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of September 30, 2018.

Build Wealth. Retain Wealth.

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 of the Quarter – Alma

Alma is a Minneapolis treasure! Located in a historic building within one of Minneapolis's first neighborhoods, Alma offers an exceptional dining experience of contemporary American cooking. First, try one of their unique signature cocktails, or for wine lovers, Alma offers a wine pairing option to complement your meal. Next, each dinner includes a three-course meal of seasonally inspired dishes that are extraordinary and full of flavor. Ready for dessert? Alma offers dessert and cheese a la carte. With so many options, Alma is sure to please any palate.

Can't get enough of Alma? Check out their café that offers a casual breakfast, lunch and dinner menu!

Recipe of the Quarter - Streusel Apple Bread

By: Midwest Living | Makes: 12 servings | Prep: 30 mins | Bake: 55 mins | Stand overnight

Ingredients:

- **2** cups all-purpose flour
- **1** cup chopped cored apple
- **1/2** cup butter, softened
- **1** cup granulated sugar
- **2** eggs
- **1** teaspoon vanilla
- **1** teaspoon baking soda
- **1/2** teaspoon salt
- **1/3** cup sour milk* or orange juice
- **1/3** cup chopped cranberries
- **2/3** cup chopped walnuts
- **1/3** cup packed brown sugar
- **2** tablespoons all-purpose flour
- **1** teaspoon shredded lemon peel

Directions:

Grease bottom and 1/2 inch up sides of a 9x5x3-inch loaf pan; set aside. In a small bowl toss 2 tablespoons of the 2 cups flour with the apple; set aside. In a large mixing bowl beat 1/2 cup butter with an electric mixer on medium speed for 30 seconds; gradually beat in granulated sugar until combined. Beat in eggs and vanilla. Combine remaining flour with baking soda and salt; add to beaten mixture alternately with milk* or orange juice. Stir in apple mixture, cranberries and 1/3 cup of the walnuts. Spoon into prepared pan, spreading evenly.

In a medium bowl combine brown sugar, 2 tablespoons flour, lemon peel, 1 tablespoon melted butter and remaining nuts; sprinkle evenly over batter in pan. Bake, uncovered, in a 350 degree F oven for 55 to 60 minutes or until a toothpick inserted near the center comes out clean.

Cool in pan on wire rack 10 minutes. Remove from pan and cool completely on wire rack. Wrap and store overnight at room temperature before slicing.

*For sour milk: Place 1 teaspoon lemon juice or vinegar in a 1 cup glass measure; add milk to equal 1/3 cup. Let stand 5 minutes.

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

Meet Our Team

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