ALL STAR FINANCIAL

Build Wealth. Retain Wealth.

QUARTERLY
REVIEW & PREVIEW

FOURTH QUARTER 2018
VOLUME 25 ISSUE 4

Markets Slide in the 4th Quarter – We've Seen This Movie Before!

What once seemed to be a resilient stock market finally succumbed to the uncertainty of rising interest rates, trade tensions, plunging oil prices, a government shutdown and indicators of slowing global economic growth in the 4th quarter. The end result was the worst year for stocks in more than a decade.

The S&P 500 began the year with a quick 6% rise into late January, only to drop 10% from that high by early February. The index rose through the middle of the year, fueled by strong corporate earnings. By the end of the 3rd quarter, the S&P 500 was up 10.6% for the year. As interest rates continued to rise and projections of future earnings declined, stock indexes began to slide as well, with broader markets dropping 10% to 25% during the quarter.

The technology-heavy NASDAQ Composite Index, led by the so-called FAANG stocks (Facebook, Amazon, Apple, Netflix, Google) dropped more than 25% from its peak in the 4th Quarter. This drop placed the index into bear market territory, which is defined as a drop of at least 20% from its peak. Even though Emerging Market stocks were the worst performing asset class the first three quarters of 2018, they held up better than most other parts of the market during the tumultuous 4th quarter.

Despite the extreme volatility experienced in the markets (71 days +/- 1% or greater), underlying fundamentals of the U.S. economy remain strong. GDP growth is expected to average 3% in 2018, unemployment remains below 4% and inflation is still relatively low at 2.2%. The Federal Reserve (the Fed) continued to push short-term interest rates higher, ordering up its fourth rate hike of the year in December. It's an indication of the Fed's belief in the continued strength of the economy. Yet continued monetary tightening creates some worry for investors about the future pace of economic growth.

As we look ahead to 2019, investors will focus on how the U.S. economy behaves in a higher interest rate environment. Corporate earnings growth is likely to level off, which the market has anticipated for some time. If companies continue to invest and profit margins can be preserved, the fear-driven decline we experienced in the 4th quarter may prove to have been overdone, similar to other double-digit corrections we've seen throughout this prolonged economic recovery.

Bob's Corner

Patience Without Compromise

You should not be worried. **Look at this as an opportunity!**

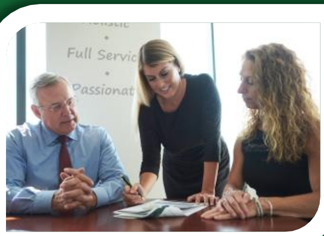
After experiencing 7 major market declines over the past 31 years, I have learned many things. The two biggest have been:

1. **If you have not taken chips off the table – now is not the time!**
2. **When FEAR is driving investor decisions to sell – BUY!**

Our current investment environment certainly has the feeling of a correction – a short term, emotionally-driven pull back with a key disconnect: fear and worry is running high with economic fundamentals remain reasonably strong.

"Patience without compromise will win the day!"

As always, we want to **THANK YOU** for trusting All Star Financial. 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 Winning Streak Continues

Despite the market's woes, December marked the 114th consecutive month of economic expansion in the U.S., dating back to the end of the Great Recession in March 2009. It represents the 2nd longest recovery on record, but it has also been significantly slower than most other expansions. Total cumulative Gross Domestic Product (GDP) growth is just above 17% over the course of the recovery, far below the typical 40% to 50% we experience in most recoveries.

Economic growth reached an annualized rate of 3.4% in the 3rd quarter to follow up on a 4.2% increase in the 2nd quarter. Economists anticipate a rise of 2.7% for all of 2018.

The Fed appears to hold the keys to the economy going forward. In December, the Fed raised the Fed Funds target rate for the 9th time over the past three years, to a range of 2.25% to 2.50%. This latest rise came despite pressure from the Trump administration to hold the line on rates.

The Fed's mandate is to control inflation and employment. Recent data allowed the Fed to continue on a path of increasing interest rates. In October, consumer prices rose for the 6th consecutive month, up 0.3%. Yet the core inflation increase over the past 12 months stands at a modest 2.2%. The persistently low unemployment rate (3.8% for the past three months) also reflects the current strength of the economy.

Looking Ahead

We anticipate economic growth will slow in 2019, as GDP is expected to rise by only 2.3% for the year. This does not necessarily indicate that a recession is imminent.

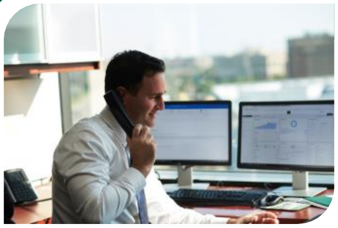
In fact, most economists agree that the risk of a recession in 2019 is low. An analysis by the Federal Reserve Bank of New York predicts less than a 16% probability of a recession occurring in the next 12 months.

Quote of the Quarter:

"Just keep moving forward."

– Oksana Masters

Bond Markets



A Wild Ride

Investors were closely watching the flattening of the yield curve (the difference between short-term and long-term bond yields) for much of the quarter. At the end of the 4th quarter, the spread between 10-year and 2-year Treasury securities narrowed to just 20 basis points (0.20%). A flattening yield curve is as an indicator of a looming recession, perhaps 12 to 24 months out. This likely contributed to the selloff experienced by stocks in December.

As a result of the sudden drop in interest rates at the end of the quarter, the Barclays U.S. Aggregate Bond Index ended positive, returning 1.6% for the quarter. For the year, the bond index was flat however, at 0.01%. The price of a 10-year Treasury note declined 2.3% over the past year. Heading into the 4th quarter, High Yield bonds had been the leading performer among fixed income investments. That changed in the closing months of 2018, when High Yield bonds lost 4.7%, ending the year down -2.1%. The Asset backed securities sector (Barclays ABS) was the best performing fixed income sector in 2018 with a 1.77% return, followed by short duration government bonds (Barclays US Treasury 1-3 Yr) at 1.56%. Floating rate bonds (S&P/LSTA Leveraged Loan) also provided some stability, gaining 0.44% for the year.

Global bonds generally underperformed U.S. bond markets in 2018. The Barclays Global Aggregate Bond Index declined by -1.2% for the year. Although yields are higher for developed and emerging market bonds, the dollar's strength hurt the U.S.-based investors.

Looking Ahead

Despite the late 4th quarter rebound for the broader bond market, the environment remains challenging. At the same time, December's turbulence in the stock market was a reminder of the benefits of being diversified. In such difficult times, bonds can help preserve capital. We believe tactical bond allocations to short duration corporate bonds, as well as floating rate bonds, will benefit returns on the fixed income portion of our portfolio, while the expectation of continued strength in the dollar will create headwinds for international bonds.

Domestic Stock

Approaching Bear Market Territory

A bear market is defined as a drop of 20% or more from the peak price of a security or index. The S&P 500 Index closed on Christmas Eve just a fraction of a percent short of an official bear market, then recovered modestly in the closing days of the year. However, the NASDAQ Composite Index declined by more than 23% from its peak, and the small-cap Russell 2000 index was down 26% from its high point. Investors troubled by rising interest rates, trade wars and slumping oil prices fled stocks for the safe havens of bonds and cash.

In 2018, Growth stocks outpaced Value stocks by more than 6%, but in the 4th quarter, the Russell 3000 Growth Index lost -16.3% while the Russell 3000 Value Index declined only -12.2%. Small-cap stocks, which fared better the first three quarters of the year, were hard hit in the 4th quarter. This may have been due to rising interest rates creating concerns for more highly leveraged small cap firms. The Russell 2000 Index fell -20.2% in the quarter, compared to a drop of -13.8% for the large-cap Russell 1000 Index. For the year, Small-Cap stocks returned -11.0% compared to -4.8% for Large-Cap stocks.

Only the Health Care (+6.5%), Utilities (+4.1%), and Consumer Discretionary (+0.8%) sectors ended the year with positive returns. The worst performing sectors were Energy (-18.1%) and Materials (-14.7%). As oil prices fell, the Energy sector fell 23.8% in the 4th quarter alone.

Looking Ahead

After the drama of the 4th quarter, a major question is how much of the fear factor will impact investor sentiment at the start of 2019. A key benefit of December's sharp declines in stock prices is that valuations now look far more attractive for U.S. equities. A year ago, the forward-looking price-to-earnings (P/E) ratio for the S&P 500 was above 18 as investors were optimistic from the tax reform act. At the end of 2018, the P/E ratio for the index stood at a far more reasonable 14.4, a 20% discount from a year earlier. While various issues are likely to continue to create concerns, earnings tell a more favorable story. S&P 500 companies project earnings growth of between 5% and 8% for 2019. If that threshold is met and interest rates and liquidity remain on course, the U.S. stock market may have room to grow after the recent correction.

International Markets

Non-U.S. Stocks Struggle, But Beat US Stocks in Q4

Equity markets outside the U.S. have lagged domestic stock performance for most of 2018. International stocks held up better than U.S. stocks in the 4th quarter, but still suffered significant declines. The MSCI All-Country World Index (ex-U.S.) was down -12.8% for the quarter, compared to a -13.5% drop for the S&P 500. However, total returns for the year were -14.1% for international stocks compared to -4.4% for U.S. markets. Foreign markets suffered from protectionist policies implemented by the Trump administration and slower growth in Europe and Asia.

China remained a significant risk factor, following up a strong 2017 (+56%) with a decline of -18.9% in 2018. Emerging Markets held up better in the 4th quarter. MSCI Emerging Markets Index declined -7.5% for the quarter compared to Europe's decline of -12.7%. For the year, however, Emerging Markets (-14.6%) modestly underperformed Developed Markets (-13.8%) in Europe and Asia.

All-Star's international equity investments slightly outperformed the MSCI All Cap World Index in the 4th quarter, declining -12.4% compared to -12.7% for the MSCI All Cap World Index. Part of our advantage came from having a 9% to 19% allocation in emerging market stocks, which held up better during the 4th quarter. With valuations remaining attractive, we'll continue an overweight allocation to non-U.S. equities.

Looking Ahead

The start of 2018 was built around the story of continued synchronized global economic growth. But increasing concerns about the risk of a recession and the threat of heated trade wars have overtaken the conversation. Yet the economic fundamentals remain solid for long-term investors. Valuations continue to be a big part of the story for international stocks, although their advantage over U.S. equities narrowed in the last three months. Emerging markets now trade at 10.5x earnings, MSCI World at 13.5x earnings and S&P 500 at 14.4x earnings. If recession fears subside, we believe international equities remain more favorably positioned over the long run.

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

Fourth Quarter

Market Index	4th Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	-11.31	-3.48	12.93	9.70
S&P 500	-13.52	-4.39	9.26	8.50
Russell 2000	-20.20	-11.02	7.36	4.41
S&P Mid Cap 400	-17.28	-11.09	7.66	6.03
Russell 3000	-14.30	-5.25	8.97	7.91
S&P Global BMI	-13.13	-9.68	7.02	4.72
MSCI EAFE	-12.54	-13.80	2.87	0.53
MSCI Emerging Mkts	-7.47	-14.59	9.25	1.65
NASDAQ Composite	-17.29	-2.84	11.10	10.97
Barclays US High Yield Bond	-4.53	-2.08	7.23	3.83
Barclays US Aggregate Bond	1.64	0.01	2.06	2.52
Barclays Global Aggregate Bond	1.20	-1.20	2.70	1.08
JPM Emerging Bond Diversified	-1.26	-4.26	5.15	4.80
Barclays US Government Bond	2.54	0.88	1.41	1.99
Barclays US Credit Bond	0.01	-2.11	3.16	3.22

*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

2018 was a challenging year for investors, one that marked the return of significant short-term market volatility and a period where virtually all asset classes struggled. Despite heightened fears about the economy, the basic underlying fundamentals remain strong. Economic growth has been solid, unemployment is low, and corporate earnings continue to expand (although at a slower rate).

At the same time, equity valuations have become far more attractive. This sets the stage for potential opportunity in the year ahead. However, the environment is likely to remain somewhat volatile given the continued economic uncertainties (trade tensions, slower global growth, rising interest rates) that exist at the outset of 2019. As the 4th quarter proved, diversification can help moderate the impact of short-term market swings while helping you stay on the path toward achieving long-term investment goals.

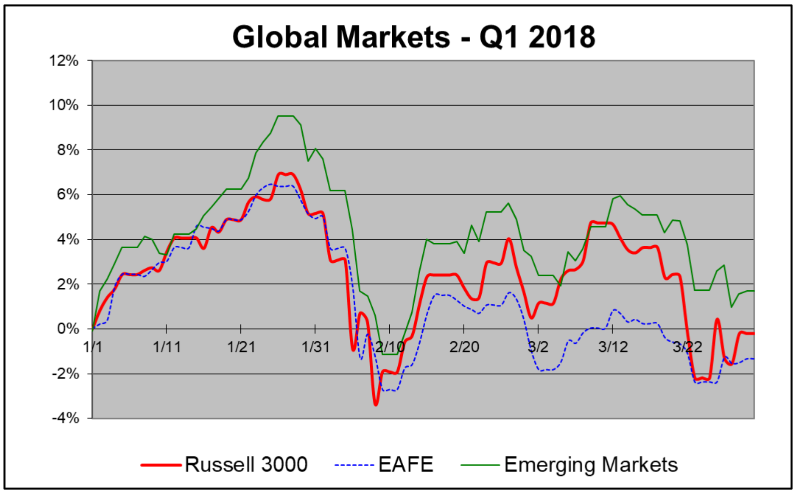
"It's not how much you make, it's how much you keep!"

-Bobby K

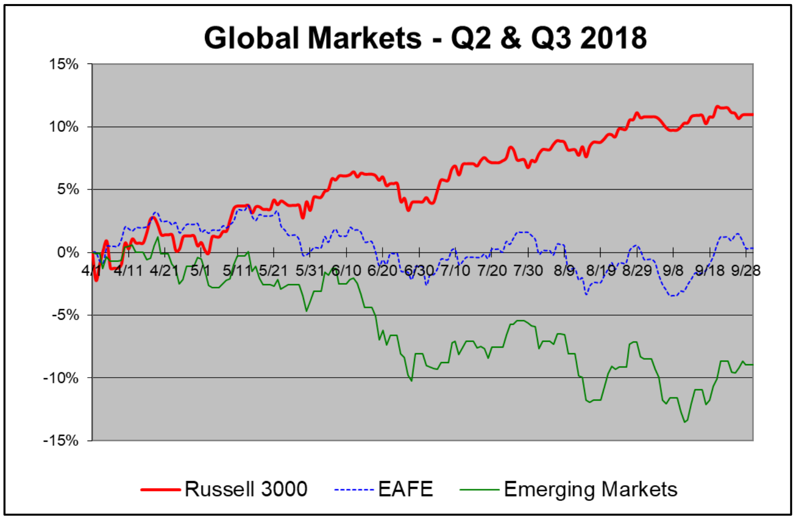
2018: The Beginning, Middle, and End

The market performance in 2018 can be characterized by three very distinct phases.

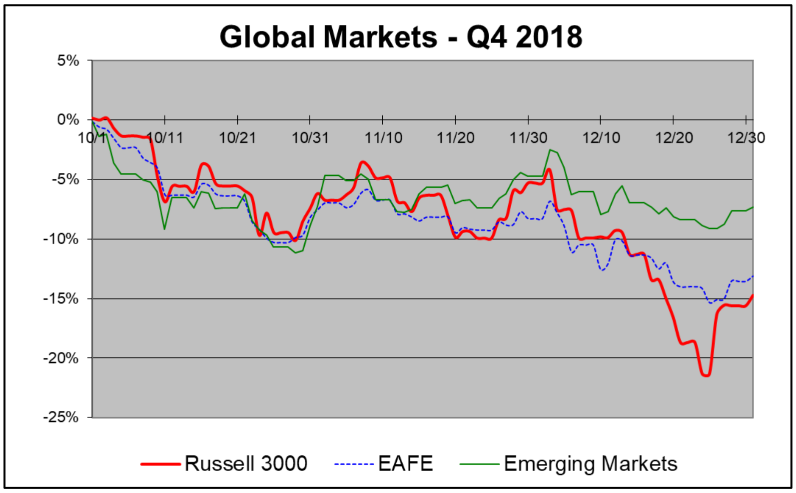
Quarter 1: 2018 continued where 2017 ended, with surging stock prices based on global growth and tax reform. In the first 15 trading days, stocks gained over 6%, with Emerging Markets stocks gaining nearly 10%. Then a higher-than-expected inflation reading sparked a 10% selloff into early February. By the end of the quarter, all major equity indices were relatively flat.



Quarter 2 & 3: The middle of the year began in early April when trade concerns flared as the Trump Administration presented its plan to implement tariffs with many of the United States' major trade partners. This caused U.S. stocks to rise 10% during the middle six months of the year and all other major asset classes to remain flat or decline. Emerging Market stocks were the hardest hit while declining by 10%. European and Developed Asian markets were flat.



Quarter 4: The global stock markets reached their intra year high in the first few days of October. From there, stocks declined sharply however as rising rates, dropping oil prices, slower global growth, and more trade concerns drove investors out of riskier assets into assets with more downside protection. Diversification was effective in the 4th Quarter as bonds were positive and non-U.S. stocks finally outperformed!



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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 – Pizzeria Lola

Looking for an exquisite artesian pizza place? Well, look no further than Pizzeria Lola located on Xerxes Ave. in Minneapolis! For our fans of the Food Network Channel, you may have seen this neighborhood restaurant on Guy Feiri's "Diners, Drive-Ins and Dive." Using a wood-fire copper pizza oven imported from France, Pizzeria Lola offers a selection of pies including classic favorites such as pepperoni, sausage, cheese and margherita as well as unique Pizzeria Lola signatures like the Korean BBQ, Lady Zaza and the Sunnyside. In addition to their variety of pizzas they offer sharable salads, sides and desserts! Like Guy Feiri, we are sure you'll love Pizzeria Lola! *Please note that seating fills up quickly and they do take reservations!

Recipe of the Quarter – Almost-Famous Broccoli-Cheddar Soup

By: Food Network Kitchen | Makes: 4 servings | Prep: 30 min | Cook: 40 min

Ingredients:

- 6 tablespoons unsalted butter
- 1 small onion, chopped
- 1/4 cup all-purpose flour
- 2 cups half-and-half
- 3 cups low-sodium chicken broth
- 2 bay leaves
- 1/4 teaspoon freshly grated nutmeg
- Kosher salt and freshly ground pepper
- 4 7 -inch sourdough bread boules (round loaves)
- 4 cups broccoli florets (about 1 head)
- 1 large carrot, diced
- 2 1/2 cups (about 8 ounces) grated sharp white and yellow cheddar cheese, plus more for garnish

Directions:

1. Melt the butter in a large Dutch oven or pot over medium heat. Add the onion and cook until tender, about 5 minutes. Whisk in the flour and cook until golden, 3 to 4 minutes, then gradually whisk in the half-and-half until smooth. Add the chicken broth, bay leaves and nutmeg, then season with salt and pepper and bring to a simmer. Reduce the heat to medium-low and cook, uncovered, until thickened, about 20 minutes.
2. Meanwhile, prepare the bread bowls: Using a sharp knife, cut a circle into the top of each loaf, leaving a 1-inch border all around. Remove the bread top, then hollow out the middle with a fork or your fingers, leaving a thick bread shell.
3. Add the broccoli and carrot to the broth mixture and simmer until tender, about 20 minutes. Discard the bay leaves. Puree the soup in batches in a blender until smooth; you'll still have flecks of carrot and broccoli. Return to the pot. (Or puree the soup in the pot with an immersion blender.)
4. Add the cheese to the soup and whisk over medium heat until melted. Add up to 3/4 cup water if the soup is too thick. Ladle into the bread bowls and garnish with cheese.

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

Meet Our Team

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