ALL STAR FINANCIAL

Build Wealth. Retain Wealth.

QUARTERLY

REVIEW & PREVIEW

FIRST QUARTER 2019
VOLUME 26 ISSUE 1

Markets Bounce Back, But Where Do They Go From Here?

The 1st quarter of 2019 was a welcome contrast from the previous quarter for investors. After losing 14% in the 4th quarter and suffering its worst December since the Great Depression, the Standard & Poor's 500 rebounded in the first three months of 2019, returning just under 14%, logging its best January since 1987.

The 1st quarter rebound was an indication that the panic that set in during the end of 2018 was unfounded. While the sharp recovery in January and early February leveled off, the market's positive momentum managed to hold through the quarter. The key question for investors now is **"where do we go from here?"** We believe that three inter-related factors are likely to determine the next stage for the markets:

1. **Corporate earnings** - Determining whether a stock is properly valued ultimately comes down to earnings expectations. In 2018, following the Trump Tax Reform, earnings of S&P 500 companies rose 22%. In 2019, earnings growth is expected to be just 4%. Any changes to that forecast, either up or down, will likely be reflected in the market.

2. **Interest rates** - Markets have responded favorably to the Federal Reserve's (the Fed's) decision to hold the line on short-term interest rates. The Fed has indicated no rate hikes are likely in 2019. Any decision to resume rate hikes would likely have negative ramifications for stocks.

3. **Global Growth & Trade** - Brexit, trade wars and slower growth in China are all factors affecting the global economy. As global leaders in the United Kingdom, Europe and Asia try to manage their own economies through a period of slower growth, all eyes turn to the U.S. and China. Efforts are underway to negotiate a new trade deal, which could have broad implications for importers and exporters across the globe.

Bob's Corner

The Yield Curve Explained

Since March of 2009, the market and our economy have continued to expand to historic levels and lengths. One of the alternatives that the Federal Open Market Committee (FMOC; The Fed) has to control economic growth/inflation, is to raise short term interest rates to make the cost of borrowing more expensive and hence slow the economic engine down. When investors have little confidence in the near-term economy (a recession is in sight), they see long term bonds as an acceptable option to the more volatile equity markets. A recession lasts on average about 18 months, so 2 to 5 year bonds are in demand. This demand reduces interest rates for the long side, while the Fed is raising rates on the short side to attack investors because the demand has wained. Hence an inverted yield curve. (See Page 4, Graph #1).

"Bond markets are smart animals, listen and learn."

The yield curve inverted before the 1981, 1991 and 2001 recessions, and predicted the 2008 financial crisis two years earlier!

As always, we want to **THANK YOU** for trusting All Star Financial!

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

117 Months of Expansion

As the economy's winning streak continues, now reaching 117 months dating back to 2009, it is now the second longest recovery on record. If it continues through the summer, it would become the longest U.S. economic expansion of all time. Despite its duration, this recovery also has been disappointing in terms of cumulative Gross Domestic Product (GDP) growth compared to most expansions. Total cumulative GDP growth is less than 20%, compared to the 40% to 50% growth rates for recoveries in 1981 and 1990.

For all of 2018, GDP growth came in at 2.9%, the best since 2015. An initial read on 1st quarter 2019 data won't be out until late April, but economists project that U.S. GDP will slow a bit, to 2.4% for 2019 as a whole.

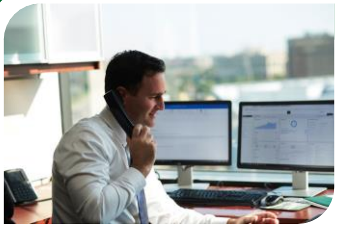
The Fed appears to hold many keys to the economy. In December, it raised rates for the 9th time in three years, contributing to the stock market selloff. On December 24, 2018, the Fed met and swiftly changed course and indicated that it plans to hold rates steady throughout 2019. This more accommodating commentary was just what investors needed to hear. When the market opened up three days later the fears were calmed, and stocks roared back.

The Fed's mandate is to control inflation and maintain strong employment. It appears to be succeeding on both fronts. Over the past year, the inflation rate has risen just 1.5%, based on the benchmark Consumer Price Index. The economy's strength continues to be reflected in the unemployment rate, lingering in the 4% range.

Looking Ahead

After 10 years of an economic recovery, a slowdown seems reasonable to expect. We believe the question is not whether the economy will slow down, but rather when it will occur and how long it will last. A recession analysis by the Federal Reserve Bank of New York estimates about a one-in-four probability of a recession in the next 12 months. This is up about 10% from three months previous.

Bond Markets



The Yield Curve Inverts!

At the end of March, the yield on the 3-month Treasury bill moved above the yield for the 10-year Treasury note, the first time that has happened since 2007. The occurrence of such an "inverted" yield curve is considered a common indicator of a looming recession. On average, over history, a recession has begun 6-to-24 months after a yield curve inversion.

This alters the risk-reward dynamic for investors. If an investor is anticipating a downturn in the economy and equities, demand for 2 to 5-year bonds as a flee to safety lowers the long-duration bond yields.

The Barclays U.S. Aggregate Bond Index was positive for the quarter, returning 2.9%. Over the past 12 months, the index has increased 4.5% as interest rates have again been falling. High-yield bonds recovered after a decline at the end of 2018, generating a return of 7.4% in the 1st quarter.

Global bonds underperformed U.S. bond markets in the 1st quarter. The Barclays Global Bond Index gained 2.2%. Even though yields are higher in most global markets, a strong dollar has detracted from returns earned by U.S. investors in overseas bonds.

Looking Ahead

With interest rates lingering near historically low levels, the environment remains difficult for bond investors. A focus on yield and duration will likely generate the best opportunities from a risk-reward perspective. If the stock market continues its rally, corporate bonds and high-yield bonds appear attractive. However, if the yield curve is the "canary in the coal mine" about a potential recession, the demand for longer-duration Treasuries is higher and more likely the place to be. For this reason, the All Star bond portfolio is comprised of floating rate, intermediate, and multi-sector bond allocations to smooth out returns in various environments.

Domestic Stock

The Big Bounce

In the 1st quarter, U.S. stocks enjoyed their best three-month performance since 2009. This big bounce was almost exactly the opposite of what occurred in the previous quarter, with the broad measure of the market, the Russell 3000 Index, returning 14.0%. The Russell 3000 Growth Index gained 16.2%, compared to 11.9% for the Russell 3000 Value index. The wealth was shared as small-cap stocks also rebounded from a difficult 4th quarter. The Russell 2000 Small-Cap Index rose 14.6% during the 1st quarter, compared to 14.00% for the Russell 1000 Large-Cap Index.

Technology stocks resumed market leadership in the 1st quarter, gaining 19%. The high-profile technology names referred to as FAANG (for Facebook, Amazon, Apple, Netflix and Google) led the way. Industrials (+17.2%) and Energy (+16.4%) were also big contributors. Healthcare, one of the market leaders of recent years, lagged with a gain of 6.6% for the quarter.

Looking Ahead

Valuations (based on price/earnings or P/E ratios of stocks) should continue to be a guide for investors in determining where the market goes from here. At the end of 2017, the P/E ratio for the Standard & Poor's 500 (based on future earnings) was above 25x, much higher than the 25-year historic average of 16.2x earnings. At the end of 2018, with the market in retreat, the P/E ratio tumbled to 15x. That represented a 40% discount to where the market was trading at the start of 2018. It created a good buying opportunity for investors. Now the P/E ratio is back above historical averages, at 16.4x earnings. The market is looking for a new direction and, as we stated earlier, investors will want to closely watch these developments to set proper expectations for stocks from this point.

Quote of the Quarter:

"Individual commitment to a group effort - that is what makes a team work, a company work, a society work, a civilization work."

-Vince Lombardi

International Markets

A Rebound for Stocks Across the Globe

The "V-shaped" recovery experienced by U.S. stocks in the 1st quarter also carried across much of the globe. International stocks did not experience the significant decline that US stocks did in December, however, they did not rebound as quickly in Q1. The MSCI All-World Index (not including U.S. stocks) gained 10.43% in the 1st quarter, lagging the 13.7% return generated by the S&P 500.

China continues to contribute to significant volatility in international markets. After a scorching 54% return through all of 2017, China fell hard amidst President Trump's threats of a trade war. The MSCI China Index declined 18.9% in 2018, but it recovered some of that lost ground, with a return of 17.7% in the first quarter of 2019.

European stocks (+10.8%) slightly outperformed the MSCI Pacific stocks (+8.5%) and MSCI Emerging Market stocks (+9.9%) in the 1st quarter. Uncertainties around Brexit, the United Kingdom's planned exit from the European Union, led to efforts by the European Central Bank (ECB) to stimulate economic growth.

All Star's international equity investments outpaced the return of the MSCI All-Cap World Index in the 1st quarter, generating a gain of 10.7%. Our allocations to Emerging Markets and specifically the relative performance of our underlying managers in the Emerging Markets asset class helped our portfolios outperform.

Looking Ahead

Compared to U.S. stocks, valuations for international stocks remain compelling. P/E ratios stand at 12x for Emerging Market stocks and at 13x for Developed Markets compared to 16x for U.S. stocks. As is often the case, the key questions center around earnings and how they will change in the coming year. In China, slower growth is making headlines, but the government is trying to find ways to stimulate the economy. In Europe, Brexit remains a daily soap opera and most believe a united Europe would encourage more economic growth. Yet beyond the vast array of uncertainties, international stocks still represent an attractive investment opportunity thanks to dividend yields that exceed those of U.S. stocks. Dividends may play an increasingly important role in the total return formula for stocks going forward.

Sources: All economic data is from JP Morgan's Guide to the Markets, March 2019 (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

First Quarter 2019

Market Index	1st Qtr	1 Year	3 Year	5 Year
DJ Industrial Average	11.81	10.09	16.38	12.21
S&P 500	13.65	9.50	13.52	10.91
Russell 2000	14.58	2.05	12.93	7.05
S&P Mid Cap 400	14.49	2.59	11.25	8.29
Russell 3000	14.04	8.77	13.49	10.36
S&P Global BMI	12.27	1.75	10.57	6.31
MSCI EAFE	9.98	(3.72)	7.28	2.33
MSCI Emerging Mkts	9.91	(7.41)	10.69	3.68
NASDAQ Composite	16.81	10.64	17.98	14.29
Barclays US High Yield Bond	7.26	5.94	8.57	4.68
Barclays US Aggregate Bond	2.94	4.48	2.03	2.74
Barclays Global Aggregate Bond	2.20	(0.38)	1.49	1.04
JPM Emerging Bond Diversified	6.95	4.22	5.79	5.44
Barclays US Government Bond	2.10	4.20	1.07	2.15
Barclays US Credit Bond	4.87	4.90	3.48	3.61

*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

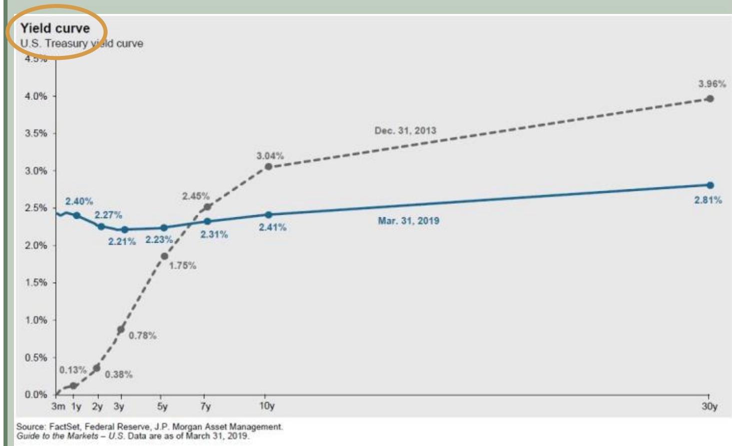
Investors have to be pleased with the continued resilience the market has shown in the face of negative headlines and lingering uncertainty about the direction of the global economy. The 1st quarter resulted in a sterling recovery for stocks. In the meantime, concerns about the potential for a slowing economy continue to confront investors.

We will be keeping a close eye on the three factors mentioned earlier – earnings, interest rates and global growth and trade, as we seek signals of what might lie ahead for the markets. The value of maintaining a well-diversified portfolio and an opportunistic approach to investing will likely prove valuable in the coming months. Given investors' recent propensity to react to headlines, it is reasonable to anticipate that markets will be subject to periods of continued volatility in the near term. Striking the right balance with your own investments and maintaining a long-term perspective will help you stay on track regardless of how future events rattle the markets in the short run.

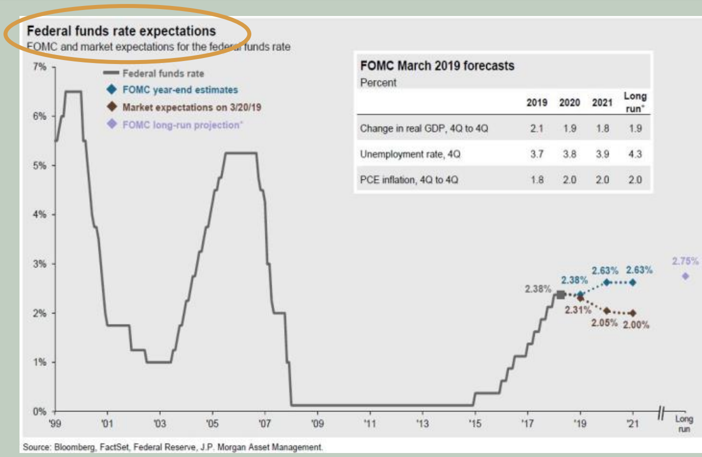
"It's not how much you make, it's how much you keep!"

-Bobby K

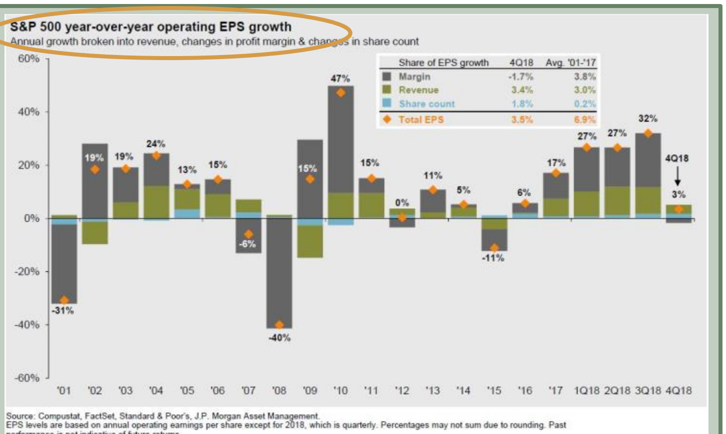
Where will "the market" go from here?
A few charts to tell the story…



Graph 1 - At the end of March, the yield on the 3-month Treasury bill moved above the yield for the 10-year Treasury note, the first time that's happened since 2007. The blue line reflects the curve on March 31st, 2019. You can observe the "kink" in the curve, where the yields invert. The graph above also displays a more "normal" yield curve from March of 2013, as the dotted line. This curve is upward sloping, with short duration bonds having very low yields relative to the longer 30-year duration bond.



Graph 2 - Interest rates during this economic cycle have remained significantly lower than previous cycles. The chart shown above displays the Federal Funds rate between 2000 and 2019 and reflects where the market (purple dotted line) and the Fed (blue dotted line) think rates will go in the future.



Graph 3 - Earnings growth or decline is one of the primary drivers of equity valuations. The chart above shows the earnings growth from 2001 to Q4 2018. You can observe that 2018 was a fantastic year for Earnings growth, with quarterly increases in the first three quarters above 25% (thank you to the reform). In the 4th quarter, earnings per share grew 3%, yet the domestic stock markets declined over 14% during the quarter in anticipation of what earnings *might* be in 2019.

Graph 4 - The chart above displays the relative performance of domestic equities compared to international equities over the past 21 years. In prior cycles, the two asset classes had performance that ultimately converged. In the current cycle that began in March of 2009, the performance divide has been significant. The US equity market has increased 319% in the past 10 years, compared to international markets increase of 108%. This divide reflects, what we believe to be opportunities for international stocks.

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 – St. Genevieve

Located in South Minneapolis, Saint Genevieve offers a mix of old world and contemporary French inspired cuisine. To start, their knowledgeable staff will offer you a wide variety of wine and champagne, as well as some delectable starters including their famous frites, oysters or deviled eggs. For the main course, they offer a variety of French inspired dishes including Beef Tartare, Parisienne Gnocchi, Tartine Madame, Mussels Bouillabaisse and Rabbit Ballantine. Finally, Saint Genevieve offers an ever-changing variety of freshly made desserts to complete an excellent meal. They also offer a delightful brunch menu! If you are craving authentic French Style Cuisine, St. Genevieve is the place to for you!

Meet New All Star Team Member – Sam Sexton, CPA, CFP®

All Star Financial announces the addition of Sam Sexton, as a Senior Wealth Manager. Sam will be providing clients with comprehensive wealth management services such as retirement planning, investment management, tax planning, philanthropic and estate planning.

"Sam is passionate about partnering with individuals and families to identify and align their life and financial goals," said Bob Klefsaas, Founder and CEO. "He is going to be an excellent addition to our growing team."

Mr. Sexton has over 9 years of experience in evaluating and advising clients with complex financial circumstances. In his most recent role, Sam provided comprehensive wealth management advice to clients around the Twin Cities metro area and northern Minnesota for CliftonLarsonAllen. Additionally, Sam holds a bachelor's degree in accounting from St. John's University and is a CFP® Practitioner, Certified Public Accountant (CPA), and Personal Financial Specialist. He also belongs to the Financial Planning Association and the American Institute of Certified Public Accountants.

Sam lives in Edina with his wife, Lindsey, and two children, Royce and Romy. His personal interests include spending time with his family, traveling, staying active (lifting and running), exploring the Minnesota outdoors, camping and spending time at the lakes. Sam is involved with Junior Achievement of the Upper Midwest, an organization that partners with schools to teach financial literacy.

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

Meet Our Team

Robert Klefsaas, CFP®, AIF®, CFDA®	CEO, Senior Wealth Manager
Brian Senske, MA, CPA (inactive)	CFO, COO, Senior Wealth Manager
J. Alexander Källebo, CFA®	Portfolio Manager
Matt Berhow CFP®, AIF®	Senior Wealth Manager
Sam Sexton CPA, CFP®	Senior Wealth Manager
David Osterberg, CPA	Tax Advisor
Brady Mickolichek CFP®	Associate Wealth Manager
Paula Zilka	Operations Manager
Kaitlin Buckley	Wealth Management Associate
Lucelia Husby	Client Service Associate
Ashley Kading	Executive Assistant
Zhaoren Chen	Portfolio Analyst
Linda Davis	Tax Assistant
Bill Ristvedt	PCWM

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