ALL STAR FINANCIAL

Build Wealth. Retain Wealth.

QUARTERLY
REVIEW & PREVIEW
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Recession Coming? We Need It!

What Is A Recession?

The word recession has been showing up more in the news and headlines throughout the last few months. For many, the word creates fear and anxiety because of experiences with deep and painful recessions in the early 2000s and the Great Financial Crisis in 2007-2009. However, recessions come in all shapes and sizes. Some can be significant and prolonged but the global economy has experienced many recessions that are short and shallow as well.

Most people may generally define a recession as the economy slowing down, people losing their jobs, and things just getting tougher for businesses overall. To further define a recession, economist Julius Shiskin established a general rule of thumb in 1974 that a recession is defined as a period of two or more consecutive quarters of declining Gross Domestic Product (GDP). A healthy economy grows over time, so two quarters of declining output suggests there must be underlying problems in an economy. This has been the most readily used definition over the years.

In the United States, however, the National Bureau of Economic Research (NBER) is the organization that officially determines the start date and end dates of U.S. recessions. They have their own definition; "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales." This definition proved meaningful in 2020 when the NBER declared the economy experienced a recession that lasted only 2 months, a shorter period than what Shiskin's definition would allow to declare a recession.

Why Is A Recession Necessary Now?

Just like a forest needs a good forest fire to clear out dead brush and become healthy once again, a recession is part of the normal economic cycle. After years of growth, economies can overheat and accumulate pockets of waste, speculation and inefficiency that a recession can correct. It has been over 10 years since our last recession. To get back to a more efficient and "healthy" economic cycle (when a recession happens about every 5 years) it is imperative for this to happen.

Since the Great Financial Crisis that ended in 2009, the U.S. economy grew for 10 consecutive years heading into 2020. With the introduction of the COVID-19 pandemic, global governments infused trillions of dollars of stimulus to keep the world out of a significant depression. Those stimulus dollars on the back of the 10 consecutive years of growth put kerosene on that fire. The result is the historically high inflation we are experiencing today. That inflation has been exacerbated by supply chain issues created by the Ukrainian conflict and China's zero COVID policy. The primary weapon at the disposal of governments and central banks to combat this inflation is to increase interest rates, which in turn increases borrowing costs and tightens liquidity, which leads to slower economic activity. That recession, however, may be the lesser evil of persistent inflation that deteriorates consumers buying power over time.

What Should Investors Do About It?

BE PREPARED. BE DISCIPLINED. BE PATIENT.

It is said that in recessions and bear markets that by the time they happen it is too late. Heading into these times you need to control what you can control. For long-term investors it is to avoid the emotions of greed and fear and focus on the short-term demands on cashflow and liquidity. Cash is king and investors should ensure they have enough access to liquidity to weather the storm so that they can avoid selling risky assets after they have declined. Diversification, therefore, is paramount. Selling everything or rushing to buy (i.e. timing) has proven to be an ineffective strategy. Instead, focus on your long-term goals and stay the course!

Bob's Corner

"It's Not How Much You Make, It's How Much You Keep!"

In order to live this mantra, you/we have to: get ahead of the game, be early to the game, and play a game of discipline, process and patience. As Q2 ended we recorded many record downturns in both the bond and equity markets. Almost two years ago we spoke about this paradigm shift that bonds were going to experience as rates (after a 35-year decline) would bottom and start to rise. As expected, this led to negative total returns for bonds. **We were ahead of the game!**

At that time we found alternatives that benefited your portfolios' total returns tremendously. Bonds are down -10% to -14% over that time period, relative to our alternatives of +4% to -5%. Much less than the -14.2% return of the Bloomberg US Aggregate Bond.

Not long after, we also reduced growth exposure in favor of more value, reducing your risk substantially. And finally, we did not make any significant changes this quarter, as equity market hit bear market numbers.

- ☑ **Get Ahead of the Game** – Anticipated paradigm shift
- ☑ **Be Early to the Game** – Purchased hedged equities 18-24 months ago
- ☑ **Stay Disciplined** – As measured by overvalued P/E ratios
- ☑ **Process and Patience** – We already did it!

Remember, try not to be emotional! Greed and fear are your worst enemy.

– Bobby K.

BUILD WEALTH. RETAIN WEALTH.

All Star Financial 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

Inflation Still High As Fed Struggles To Catch-up

- The annual inflation rate continues to be remarkably high, and the latest Consumer Price Index (CPI) reading was 8.6% in May, which was the highest since December of 1981.
- Several central banks across the world have raised their interest rate policy this year. At their June meeting, the Federal Reserve raised its benchmark interest rate 0.75% to 1.50–1.75%. The most aggressive hike since 1994.
- The American economy contracted, on an annualized basis, -1.6% in Q1, 2022. It is the first contraction since the pandemic-induced recession in 2020.
- ***While the prospects of a recession are rising, the more prevalent fear is that high inflation will remain with us for the near future, which may cause longer-lasting economic concerns. We believe that the Fed will follow through with its commitment to restoring price stability and that we will experience continued rate hikes going forward.***

Domestic Stocks

Bear With Us As Markets Drop

- The S&P 500 fell into bear market territory with a -16.1% drop in the second quarter, and it was the worst first half of the year since 1970. The tech-heavy Nasdaq Composite fell -22.3% in Q2.
- Valuations declined during the quarter and current S&P 500 forward P/E ratio fell from 19.8 to 15.9, or -20%. The 25-year average P/E ratio is16.8.
- The Value style of the Russell 3000 continued last quarter's outperformance vs. the Growth style, -12% vs. -21%.
- ***The global economic outlook and the investment landscape is, to say the least, uncertain. Recession, lower future growth expectations, bear markets and increased geopolitical tensions are just the beginning of the list of uncertainties. We believe these are all critical issues that will remain for the foreseeable future.***

Bond Markets

Yield Volatility Spikes

- Q2 fixed income markets experienced significant negative performance as fixed income assets fell in price and yields rose. The US Aggregate Bond Index declined -4.7% and the Global Aggregate index fell -8.3%.
- The volatility of US Treasury yields spiked significantly to levels that has not been seen since the height of the global financial crisis in 2009.
- The 2-year ranged widely from 2.33% to as high as 3.44%, then closing the quarter at 2.88%. The 10-year Note range was 2.33% to 3.49%, ending the quarter at 3.01%.
- ***There has been no place to hide this year as both equity and fixed income markets across the globe have declined sharply. The culprit is clear, global inflation. This persistently high inflation, with levels not seen since the 1980's, is creating concern about current and future growth trends. We believe that central banks will continue to raise interest rates to curb inflation.***

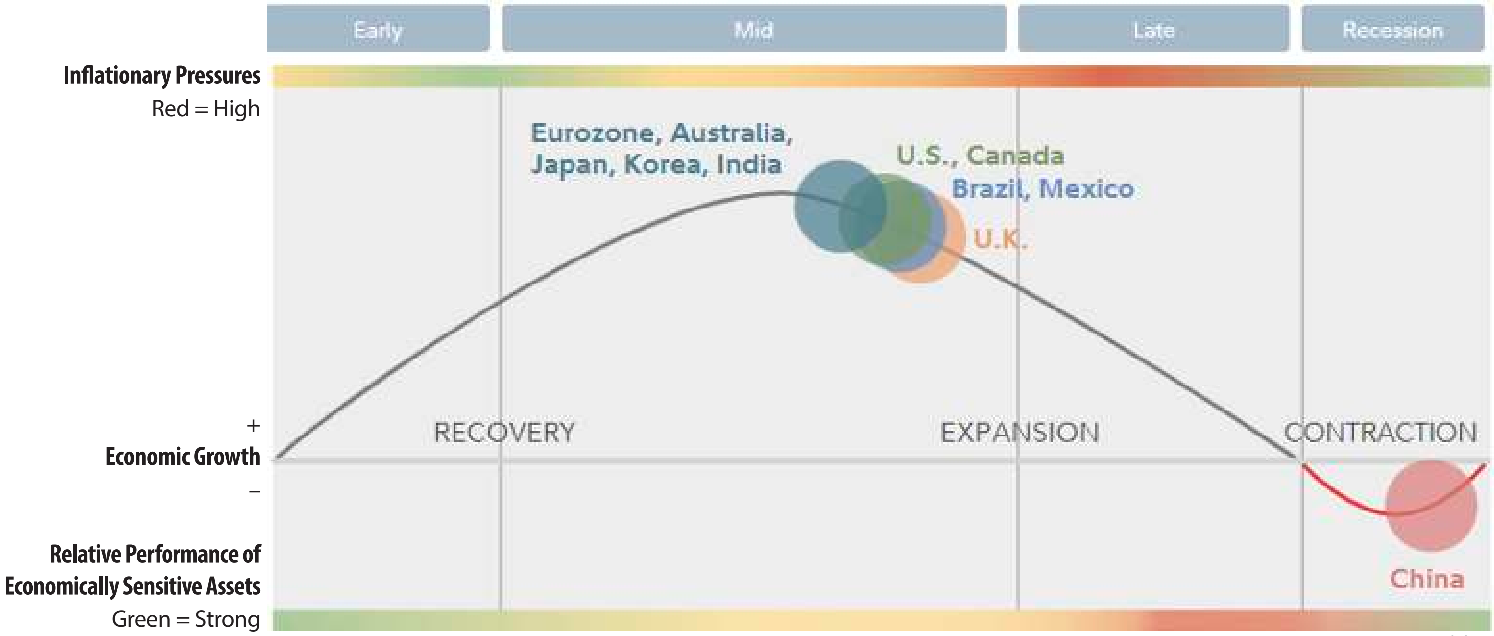
International Stocks

International Equity Markets Decline Less Than Domestic Equity Market

- Despite the ongoing war in Ukraine and high inflation, international equity markets (MSCI ACWI ex-US Index) declined 3% less than the domestic equity markets (Russell 3000 Index), -13.7% and -16.7%, respectively. Emerging markets (MSCI EM Index) declined the least at -11.4%.
- From a style perspective, the MSCI ACWI Ex US Value and Growth index lost -11.9% and -15.7%, respectively.
- Looking at valuations, the current MSCI ACWI ex-US forward P/E ratio is 11.7, a 27% discount to the current S&P 500 P/E ratio.
- ***The war in Ukraine and the Chinese COVID lockdown remains two highly uncertain issues facing international investors. However, we continue to believe that there are pockets of relative valuation opportunities internationally and that a globally diversified and defensive positioning is prudent.***

Sources: All economic data is from JP Morgan's Guide to the Markets, June 2022 (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.

The Economic Cycle – Where Are We?

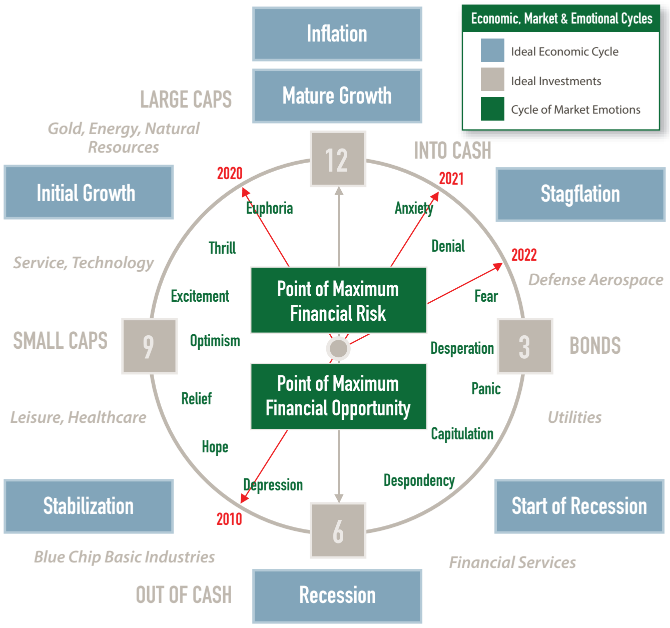


Source: Fidelity

The economy usually has four parts to every cycle –

1. Early Growth (stabilization)
2. Mid Growth (initial growth leading to mature growth)
3. Late Growth (stagflation/contraction leading to the start of a recession)
4. Contraction (start of and into a recession)

Our Economy is slowing down and this contraction will more than likely lead us into a recession. We really need to go through a full, legitimate cycle to be healthy again. As you can see, China is already into the first phase of a recession due to its zero COVID case policy, while the rest of the world is just past the peak of growth and now heading to contraction.



The All Star Financial Clock

To gauge where we are in the cycle and to ascertain how that impacts investment decisions, All Star Financial uses this "economic clock" shown to the left. This clock shows the emotions, risks, and opportunities that coincide with the different phases of the cycle.

The clock shows that we were in an expansion mode (stabilization, initial growth and mature growth) for over 10 years. A normal full cycle from 12 o'clock (mature growth) to recession at 6 o'clock and back to midnight on average usually lasts 4-6 years. This explains why we were long overdue for a recession!

Performance Update

Second Quarter 2022

Market Index	2nd Qtr	YTD	1 Year	3 Year	5 Year
MSCI ACWI All Cap NR	-15.8	-20.5	-16.6	6.0	6.7
MSCI ACWI Ex USA NR	-13.7	-18.4	-19.4	1.4	2.5
Russell 3000 TR	-16.7	-21.1	-13.9	9.8	10.6
S&P 500 TR	-16.1	-20.0	-10.6	10.6	11.3
DJ Industrial Average TR	-10.8	-14.4	-9.1	7.2	10.0
Russell MidCap TR	-15.4	-19.5	-14.6	6.9	7.0
Russell 2000 TR	-17.2	-23.4	-25.2	4.2	5.2
NASDAQ Composite TR	-22.3	-29.2	-23.4	12.2	13.5
MSCI EAFE NR	-14.5	-19.6	-17.8	1.1	2.2
MSCI EM NR	-11.4	-17.6	-25.3	0.6	2.2
Bloomberg Global Aggregate TR	-8.3	-13.9	-15.3	-3.2	-0.6
Bloomberg US Government TR	-3.7	-9.0	-8.8	-0.8	0.8
Bloomberg US Credit TR	-6.9	-13.8	-13.6	-1.0	1.2
Bloomberg US Agg Bond TR	-4.7	-10.3	-10.3	-0.9	0.9

*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.

Q2 2022 in Summary

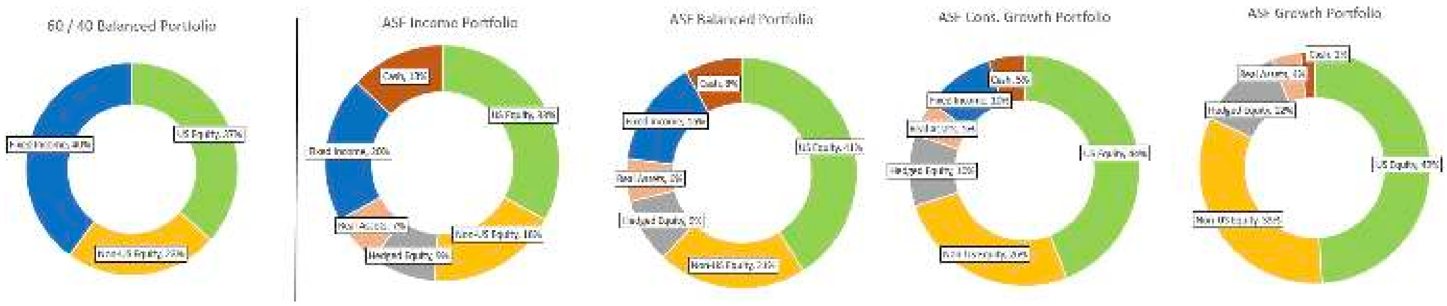
We are currently in unprecedented economic times. After a decade of low inflation, low interest rates, and modest growth our economy was confronted with a global pandemic. To avoid a depression, governments around the world pumped trillions of dollars into the economy. Unfortunately, the consequence was a significant spike in demand for goods and services that is resulting in a 40-year high inflation rate. The Fed is doing what it can to slow demand through raising interest rates but is behind the curve and that means we may have higher than expected rate hikes in the near future. That could mean more volatility for investors and a continuation of the markets struggle to find solid ground. With that in mind, we believe investors need to focus on a few things that they can control:

1. Ensure you have access to sufficient liquidity (cash and home equity lines of credit) to satisfy short-term (12 months) spending needs.

2. Stay diversified. With so much uncertainty, holding a variety of investments is the best approach. Even with all asset classes in a negative position, a lesser negative is good.

3. Focus on your long-term objectives. The daily swings in the markets can distract us from the ultimate goal. Don't let short-term emotion lead to the wrong investment choices!

The 60/40 Portfolio vs. The ASF Models



For decades, diversification has often been simplified by discussions of a 60% equity / 40% bond portfolio. For years, companies like Vanguard have propagated that a simple index approach can solve the diversification problem. The past 12 months would disagree. Above, you can see the asset allocation of the All Star Financial (ASF) models compared to a simple 60/40 portfolio. We believe that it has taken more creativity and proactive allocations to solve this complex investment environment. As a result, you can see we have decreased our allocation to fixed income (blue) and added alternatives such as hedged equity and real assets to provide enhanced diversification. So far, it has been effective. As shown below, the index 60/40 portfolio has declined 15.7% the past 12 months. The ASF Balanced portfolio, which has over-time had comparable risk, has only declined 13.3% over the same time period. We believe the remaining phases of this cycle will require creativity, patience, and a focus on diversification for investors to win the race!

Investment Growth

Source: Morningstar Direct

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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.

Farewell Paula Zilka

With great sadness and great happiness, we want to share with you all that our beloved Paula has decided to retire from All Star Financial and move full-time to South Carolina.

About ten years ago Paula began her journey with All Star Financial as a client. Getting to know Paula, her determination and strong work ethic, Bob decided to offer her a job as his assistant… and the rest is history!

As you all know, Paula wore many hats at All Star Financial including managing the day-to-day operations of our office, making sure that everything was running smoothly and the needs of our clients and advisory team were always being met. In addition, Paula also planned and executed our wonderful Client Celebration Event annually.

Although Paula truly loved her daily interactions and conversations with our clients over the past seven years, she ultimately made the decision to retire and move permanently to South Carolina to live with her fiancé, Erik. She will now have the ability to fully immerse herself in her new community and spend more time with her family and new grandbaby, Graham!

Paula always went above and beyond for our clients and team, and we are so excited for her to enjoy this next chapter of her life. Thank you, Paula, for your incredible contributions to our team. We will certainly miss you, and hope you enjoy your future adventures with your family during your retirement!

5th Annual Client Celebration Event

We are happy to announce that we have started the planning process for our 5th Annual Client Celebration Event that will take place in-person again this year! Please **SAVE THE DATE** and plan to attend this exciting event on **Friday, September 23rd at 5:00pm.** Once again this event will be held at The Minikahda Club overlooking Lake Bde Maka Ska and the beautiful downtown Minneapolis skyline. For those of you who have joined us in the past for this event, we are excited to welcome you back. And for those of you who have not yet had the opportunity to attend, we are excited for you to experience this special night! Email invitations will be sent out later this summer, and we are limited to 200 guests for this event, so please be sure to RSVP as soon as you receive your invitation to secure your spot. We look forward to celebrating with all of you in the fall!

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

Meet Our Team

Robert Klefsaas, CFP, AIF, CFDA® – CEO, Senior Wealth Advisor
Brian Senske, MA, CPA (inactive) – CFO, COO, Senior Wealth Advisor
Matt Berhow CFP®, AIF® – Senior Wealth Advisor
Sam Sexton CPA, CFP® – Senior Wealth Advisor
Mark Potter, CPA – Associate Advisor
Elliot Syverson – Associate Advisor
J. Alexander Källebo, CFA® – Portfolio Manager
Matt Muller – Junior Associate/Trader
Amanda Giliotti, JD, CPA – Director of Tax Services
David Osterberg, CPA – Tax Advisor
David Engelsgaard, CPA – Tax Specialist
Alan Shaw, EA – Tax Manager
Joleen Giliotti – Tax Advisor & Operations Coordinator
Ani Ahmed – Tax Preparer
Linda Davis – Tax Assistant
Lucelia Husby – Client Service Associate
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Jennifer Penner– Executive Admin

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