Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

March 2019

As of February 28, 2019

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Economic Conditions

The US economy grew at an annual rate of 2.6% in the fourth quarter of 2018 according to a report released by the US Department of Commerce. This was in line with expectations which we discussed last month of a growth rate between 2.2% and 3%. GDP increased 2.9% in 2018, a modest increase compared to 2017 growth of 2.2% and was primarily driven by fiscal stimulus (i.e. tax cuts). However those benefits may have shown signs of peaking in late Q4 as both consumer spending and business spending fell in December, albeit some of the declines could be attributed to the government shutdown. However the GDP report was followed by several other negative reports as the ISM Manufacturing Index and Manufacturing PMI (purchasing managers index) fell to their lowest levels since 2016 and 2014, respectively. And this wasn't unique to just the US as PMIs were down in China, Japan and the European Union in February. PMI is a leading indicator of business conditions and therefore an indicator of economic health as it provides insight into how much suppliers must produce to meet consumer demand. A reading above 50 translates to business expansion and a reading below 50 represents contraction. Japanese, Chinese and European PMIs were all below 50 in February. The Fed maintained their dovish positioning as Fed Chairman Jay Powell displayed concern over trade policy, retail sales and overseas growth during his congressional testimony last month.

Market Conditions

Index Returns	Feb '19	YTD
S&P 500	2.97%	11.08%
DJIA	3.67%	11.10%
NASDAQ	3.44%	13.52%
MSCI EAFE	2.33%	8.94%
Barclays Aggregate	(0.06%)	1.00%

The post-Christmas rally continued on through the month of February as nearly all major market indexes showed positive gains for the month. The S&P ended the month up almost 3% and as of the end of February was up 18.4% from the bottom on Christmas Eve last year. The Dow Jones and NASDAQ returned 3.67% and 3.44% last month respectively. Mid and small cap indexes are up over 20% each after being down double digits in 2018. The Russell 2000 Small Cap Index is up 16.8% year-to-date and up 24.4% from it's trough in late 2018. Markets as a whole look to be approaching, if not already at, fair value. The S&P 500 is currently trading at 16.4x forward earnings compared to around 14x at the end of 2018.

International markets began the year strong as well, coming off their double digit losses from 2018. Equities in the Eurozone increased on the news that the European Central Bank may restart its long-term refinancing operations (LTRO) which offers low interest rate loans to banks to stimulate lending (similar to QE). The rally was somewhat stunted by weak economic data coming out of the European Union which we discussed on the previous slide.

The Façade of Rolling Returns

"Past performance is not indicative of future returns." This is the classic disclaimer for all marketing material, presentations, commentary and statistics for any information disseminated relating to investing. Yet still we as investors tend to cling to and make decisions based off of historical performance. Last year the S&P 500 was down 6.24% and small and mid caps were down double digits. Common knowledge along with any pundit you see on television would tell you not to concern yourself with short-term volatility and to look at long-term averages such as the S&P 500's average annual return over the last ten years, which is 13.12% – arguably a great number.

However if we were writing this newsletter last year the ten-year average annual return for the S&P 500 would have been 8.49% meaning that in one year the average annual return over the previous ten years increased by over 50%. The reason for this is because 2008 – a year in which the S&P was down 37% – rolled off of the ten-year calculation. Likewise, the 20-year average annual returns for the S&P 500 – 5.62% as of the end of 2018 – fell by over 20% after last year in which it was 7.19% as of the end of 2017 due to 1998 (a 28%+ year) rolling off and 2018 being added into the calculation. The point we are trying to make here is that even long-term averages can be significantly skewed by outliers, both on the upside like 2013 (an up year of 32%) and on the downside like 2008.

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The Façade of Rolling Returns

This doesn't mean we should completely throw out and cease to rely on long-term averages as guidance because, as the saying goes, while history may not repeat itself, it often rhymes. Naturally the shorter the time frames you study, the more volatility you will see in the averages. For example, taking returns data for the S&P 500 all the way back to 1928, the rolling three-year average annual return has been negative on 15 different occasions, the five-year rolling average annual return on 11 occasions, and the ten-year on four occasions. Over the past 90+ years the rolling 20-year average annual return has never once been negative. It also, however, has not been as low as it is today since the late 1940s.

The main takeaway here is to manage your expectations. While historical performance and risk figures can provide a nice guidepost for expected returns in the future, we must not anchor ourselves to past performance. The next ten years of returns are most likely going to be significantly different than the previous ten years of returns in which we experienced a record long bull market and record low volatility. And we should note that "averages" are vastly different than year-to-year returns. Over the past 92 years the S&P 500 has averaged a 10.16% annual return. The number of times the actual annual return of the S&P 500 was within two percentage points of its average is **SIX**. This means over 93% of the time the annual returns for the S&P in a single year don't even come within two percentage

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The Façade of Rolling Returns

points of its long-term average.

Investing for the long-term is an obvious goal for investors. We should never make investment decisions based on short-term data. But we should also take into consideration what the long-term numbers are telling us and not always take return data – or any data for that matter – at face value. There are countless factors that affect returns and there is no way to truly avoid downturns in the markets. This is why a well constructed, diversified portfolio structured to fit your long-term objectives and overall risk tolerance is so important, along with open lines of communication with your adviser in order to monitor and continually review the scope of your plan while making adjustments as needed.

Disclosures & Index Definitions

Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

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Investments in bonds will be subject to credit risk, market risk and interest rate risk. Interest rates will have an inverse effect on prices of bonds. Bonds of lower credit ratings, also known as High Yield bonds which hold a rating of less than investment grade (BB+ and below), will have greater risks attached than will those of investment grade bonds and will experience greater volatility.

All dates are as of February 28, 2019 unless stated otherwise.

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Index Definitions

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.