Financial Advisory Service, Inc.

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FAS Monthly Economic and Market Update

February 2020

As of January 31, 2020

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Economic Conditions

U.S. GDP increased at an annual rate of 2.1% in Q4 2019, according to the advance estimate from the US Department of Commerce which was in line with GDP growth from the third quarter of 2019. All in all GDP increased by 2.3% in 2019 year-over-year – a slight slowdown compared to the 2.9% growth we saw in 2018. As referenced in previous updates, consumption continued to be the main driver for growth in 2019, although slowdowns in exports due to trade tensions and nonresidential fixed investments such as business structures and equipment were primary contributors to the deceleration in growth last year.

The recent outbreak of coronavirus (2019-nCoV), declared by the World Health Organization as a global health emergency, has led to lower estimates of 2020 Q1 global growth. It has been cited by several companies as a headwind on earnings in their Q1 outlooks – most notably by tech companies with global supply chains such as Apple. Despite the outbreak of 2019-nCoV, other economic data has come in fairly strong. The Labor Department reported the U.S. economy added 225,000 jobs in January, surpassing expectations by 65,000. Wages grew at a 3.1% rate, also exceeding estimates. While the pandemic could, and most likely will, be a headwind for growth in Q1, we should continue to see markets propped up by expectations of a dovish Fed and improved growth expectations.

Market Conditions

Index Returns	Jan '20	YTD
S&P 500	(0.16%)	(0.16%)
DJIA	(0.99%)	(0.99%)
NASDAQ	1.99%	1.99%
MSCI EAFE	(2.16%)	(2.16%)
Barclays Aggregate	1.92%	1.92%

The markets began 2020 on a positive note, continuing the upward trend from 2019 amid optimism on global trade and encouraging economic data. The gradual melt up, which ultimately led to new record highs, came to a halt with the news of the coronavirus outbreak, bringing back memories of the SARS outbreak earlier in the century. Markets pulled back and turned negative for the year and most major indexes finished the month in the red. The S&P 500 and Dow Jones were down 0.16% and 0.99%, respectively. The NASDAQ Composite proved to be more resilient and ended the month up 1.99%. As fear and uncertainty set in, investors flooded into fixed income, driving the 10-year treasury yield back down toward 1.5% and sending prices upward. The Barclays US Bond Aggregate ended January up 1.92%.

Stocks were quick to rebound in early February after The People's Bank of China did what they (and all central banks) do best – inject liquidity into the financial system. The PBOC injected $240B into the market in an effort to reduce panic selling and stabilize the market. U.S. markets recovered two weeks worth of losses from the coronavirus news in a matter of three days in early February and set record highs yet again in the days following.

Dividend Investing

Over the last 10+ years we have seen an unprecedented steady rise in equity markets which has lead to several all-time highs in the past several years. Alongside that rise in equities has also been an unprecedented rise in bond prices, and in turn, an unprecedented fall in interest rates. After peaking at close to 3.25% in late 2018, we witnessed the 10-year treasury rate come back down to three year lows and saw the 30-year Treasury rate fall below 2% for the first time in history. As we have discussed in the past, a consistently low rate environment has created a dilemma for retirees and conservative investors who require income for retirement but also can't afford to take on too much additional risk through increased equity exposure. A potential solution some have turned to is shifting some of their assets into dividend paying stocks to try to increase income distributions while keeping volatility lower than it otherwise would be by reallocating to broad equities.

There is no such thing as a free lunch and dividend investing absolutely comes with its fair share of risk; dividend stocks are still stocks. However, investors who may have some excess capacity with their risk budget – or alternatively, investors who want to take risk off the table without reallocating to fixed income – may turn to dividend stocks to increase their overall yield. When implementing a dividend strategy there are several basic guidelines to keep in mind in order to mitigate

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your risk, with the number one rule being that it's not all about the yield.

Dividend yield is a function of the cash flow you receive relative to the price you pay for the stock. A $100 stock that pays a $5 dividend has a 5% dividend yield. If the price were to fall to $90 the yield would rise to 5.55%. What was the reason for the 10% drop in the stock that caused the yield to rise? Was it a product of an overall pullback in the market or is there a fundamental reason behind the drop in price? Likewise, if another stock is yielding upwards of 8%, is it due to a few bad quarterly earnings reports which caused the price to fall or is the company maybe paying more out in dividends than they can afford? And if they are, is that payout rate sustainable? A company's dividend payout ratio is calculated by taking the dividend per share divided by earnings per share. A high payout ratio means a company is paying out a large portion of their profits in dividends, which often is not sustainable. A high yield can be a factor of a low price, a high payout ratio, or both. It is important to not get caught in a yield trap and buy stocks solely for yield.

Consistency is another important factor when investing in dividend stocks. Companies like Proctor & Gamble, Coca-Cola and Exxon may not be the highest yielding dividend payers, but they have track records of 50+ years of not only consistent, but also increasing dividends. In a market full of

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Dividend Investing

uncertainties, it pays to have consistency in your portfolio by owning solid, well managed companies whose dividends can be counted on more than others in times of market volatility. While there is no guarantee these long-tenured dividend payers won't cut or eliminate their dividends in times of market stress, owning a handful of companies with long histories of consistent dividends as your foundation can help mitigate some of the risk.

Dividend stocks are not immune to volatility – they are still stocks and they will more often than not rise and fall alongside the broader market. Additionally, when these companies distribute cash to shareholders it means they are not reinvesting all profits back into the business, meaning these names may not keep pace with larger growth names in the market. The idea is that the steady stream of income should help dampen the volatility of your equity sleeve while at the same time provide you with the potential for long-term growth. Just like any other investment strategy, it takes patience and discipline, which means refraining from panic selling during times of volatility. Dividend yield should not be the only factor when analyzing an investment. Just as with any other investment opportunities, the underlying fundamentals should drive investment decisions. Investing in strong companies may lead to strong dividends, but a strong dividend is not necessarily indicative of a strong company.

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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Past performance is not indicative of future returns. Prices and values of investment vehicles will rise and fall as broad market conditions change. Investors' portfolios may fluctuate, to varying degrees, in tandem with market conditions. Diversification neither guarantees returns nor does it eliminate the risk of a portfolio decreasing in value. Equity securities tend to be more volatile than bond/fixed income products and carry greater risk factors than that of fixed income products. Smaller capitalization equities (i.e. mid and small caps) typically involve more risk than that of larger capitalization stocks. Political, economic, and currency risk are all risks subsumed under the additional risk factors of investments in international securities, to include those in both developed and emerging markets. In addition, political conditions in emerging markets can tend to be more volatile than in those of developed markets.

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 January 31, 2020 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.