As of 3/31/2019

# Q2 2019 Spectrum Investor® Quarterly Newsletter

SPECTRUM[SM] INVESTMENT ADVISORS

## IN THIS ISSUE



## UPCOMING EVENTS

*Spectrum Investor® Retirement Plan Investment Seminar*
***June 19, 2019***
*Ingleside Hotel*
*Pewaukee, WI*
*Co-Sponsored with the Wisconsin Institute of CPAs*

## IN THE NEWS

*Spectrum was named a*

***2019 Winner for Milwaukee's Best and Brightest Companies to Work For®***

*by the National Association for Business Resources*

*Spectrum is one of 49 winners out of 350 nominations. An independent research firm evaluates each company's entry based on key measures in various categories.*

## WEEKLY MARKET UPDATES

*Visit our website at* ***www.spectruminvestor.com*** *under Resources & Links and click on Investment Resources*

*Our ADV Part 2A & 2B and our Privacy Notice can be found on our website*

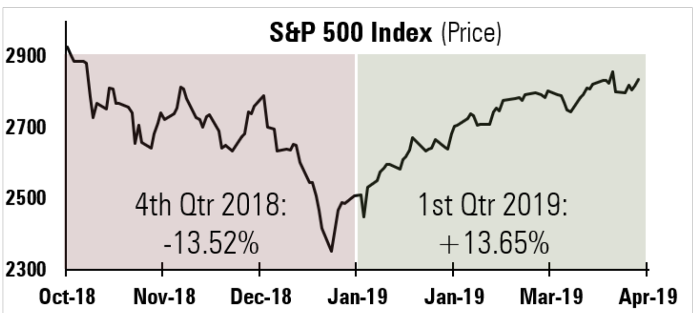
# Economic Update


**James F. Marshall**
President

**Jonathan J. Marshall**
Chief Investment Officer


The S&P 500 followed up its worst quarter since 2011 with its best quarter since 2009, rising 13.65% in the first three months of 2019. Risk assets across the board, from small cap stocks to high yield bonds, real estate and natural resources stocks were all broadly higher as measured by their respective indexes.

**V-shaped rebound for the S&P 500 Index**




Source: Morningstar: Cannot directly invest in an index. Please see benchmark disclosures on page 5 of this newsletter.

**The true risk tolerance test.** The last six months are a dramatic reminder of why we constantly stress the importance of choosing an appropriate asset allocation. Our goal is to help investors align their goals with emotional and financial tolerance for the ups and downs that come with investing.

The dramatic decline and rebound occurred as the pace of growth in the global economy is slowing down. In the fourth quarter, investors worried that higher interest rates from the Federal Reserve and economic harm related to the US-China trade war would push a slowing US economy closer to recession. In January, those fears were quickly calmed as the Federal Reserve said it would be **patient** with any further rate increases. Though a deal could not be reached between the US and China by the March 1 truce deadline, both sides agreed to extend the truce as talks have been progressing with a sense of urgency for an agreement.

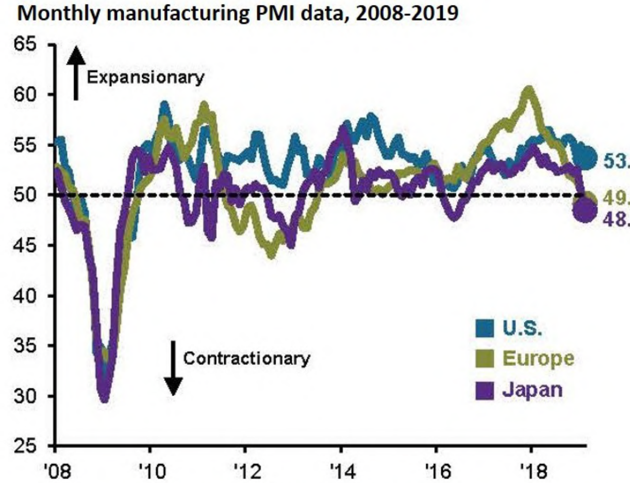
**Fed on hold.** On March 20, the Federal Reserve announced that they believe the current federal funds rate is now in the range of neutral, meaning interest rates tend to neither stimulate, nor restrain the economy. This is a significant shift for the Fed marking the end to the "normalization" process, which removed record low interest rates that were in place to recover from the 2008-2009 financial crisis. The Fed raised rates nine times, each 0.25%, from 2015 - 2018, for a total of 2.25%.

The Fed said they will hold at current levels until the outlook for jobs and inflation clearly calls for a change in policy. Not only does this mean the Fed will be slow to the next hike, it also means that the next move could be a rate cut. The possibility of a rate cut gives investors more confidence that the Fed will take supportive action if growth continues to slow.

**Slowing more than expected.** The bottom line is that growth in the US and abroad (particularly China and Europe) is slowing more than expected. The IMF (International Monetary Fund) lowered its expectation for global growth in 2019 from an estimate of 3.9% a year ago, to 3.3% as of April 2019. So far this slowdown has been felt the most in manufacturing, particularly in Europe and Asia. It's expected that much of the fall in manufacturing is a result of trade conflicts as those countries who depend on trade most (Japan, Korea, Germany and Taiwan - all export powerhouses) are those who are showing the largest declines.

**Growth is slowing but not stalling**

**Monthly manufacturing PMI data, 2008-2019**




*Source: JPMorgan Asset Management, Markit PMI data. PMI: Purchasing managers index is a survey of business managers regarding sales, employment, inventories and prices. Data as of February 2019.*

**Is the economy about to stall or is it just slowing down?** According to **Dr. David Kelly**, Chief Market Strategist of JPMorgan Asset Management, by July 2019, this expansion will be the longest since the Civil War. The tax cut in 2018 has permanently raised the level of consumer spending in

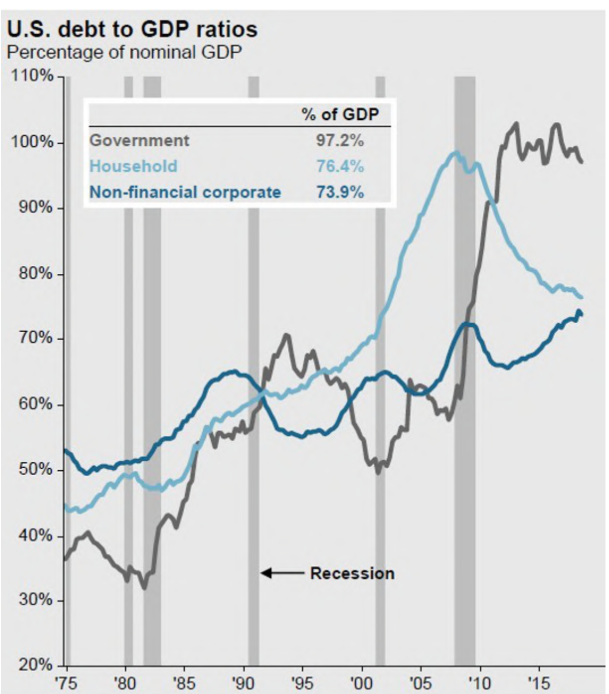
## Quarterly Economic Update Continued

America, but has not permanently raised the growth rate of real consumer spending. The Fed hasn't moved too fast or too far. In past rate hike cycles, the Fed has raised rates 2.4% per year. Today's rate hiking cycle averaged 0.75% for the past three years, about 1/3 as fast as previous rate hike cycles. Without any shocks, such as surprise inflation or an all out trade war, Dr. Kelly sees our economy continuing to grow at about a 2% pace, and not stalling.

Housing, which was one of the first sectors to slow in 2018, is starting to show improvement as mortgage rates have dropped sharply thanks to the fall in the 10-year Treasury rate. The 10-year Treasury was over 3% late last summer, vs. 2.41% as of 3/31/19.

**Corporate earnings.** Corporate earnings for S&P 500 companies are expected to be down 4.2% in the first quarter on a year-over-year basis. It would be the first decline in earnings since the second quarter of 2016 (FactSet Earnings Insights). Investors, however, will be paying much more attention to any clues about future earnings, as expectations are for earnings to be stronger by the fourth quarter 2019 and are projected to grow by 11% for the calendar year of 2020.

**Corporate debt.** Non-financial corporate debt is now at 73.9% of US GDP, which is the highest level in more than 40 years. One of the reasons for the high levels of debt is companies borrowed more to take advantage of the low rates as the Fed was raising rates. Low interest rates are the key difference, making the debt payments more manageable. Like the inverted yield curve, high corporate debt is not likely to cause a recession, but it is a signal for caution.




*Source: JPMorgan Asset Management, Bank for International Settlements (BIS), FactSet. Guide to the Markets – U.S. Data as of 3/31/19*

**Inverted yield curve.** The 3-month Treasury yield exceeded the 10-year Treasury yield (an inverted yield curve, short-term rates being higher than long-term rates) on March 22, 2019, following the Fed announcement that rates hikes were on hold. As we have discussed in the past, an inverted yield curve has been one of the best signals of a coming recession, inverting prior to every downturn since 1950. Only once in 1966 has this signal ever warned of a downturn that didn't materialize. However, the traditional yield curve comparison for an inversion is the 2-year Treasury minus the 10-year Treasury. This has not yet inverted and remains on a thin margin of about 10 to 20 basis points. Regardless of at which point the yield curve inverts, for a signal to be valid it has to persist for months, not weeks. As of April 10, the 3-month (2.43%) and 10-year Treasury (2.48%) are no longer inverted, but remain extremely close.

If the inverted yield curve is supposed to mean the market is signaling an impending recession, we would also expect signals that show up in widening spreads between the yield on junk bonds (sensitive to economic growth) and treasury bonds. But, not only are spreads below average, they have been narrowing, not widening.

If the yield curve inversion is right, stocks would be likely to rise for some time according to Marko Kolanovic from JPMorgan. Stocks historically produce some of the strongest returns following an inversion. In the past eight inversions, stocks had a median rise of 16% over the 11 months after the inversion before the market topped (*Fidelity Monitor & Insight*, April 2019).

The yield curve inversion is partly being attributed to the state of ultra-low interest rates around the globe. Through March, 29% of global government debt has a negative yield, including Germany and Japan where quantitative easing by central banks has helped push yields down. This has created high demand for US Treasuries, also pushing our yields down as the Federal Reserve has been raising interest rates (JPMorgan Asset Management).

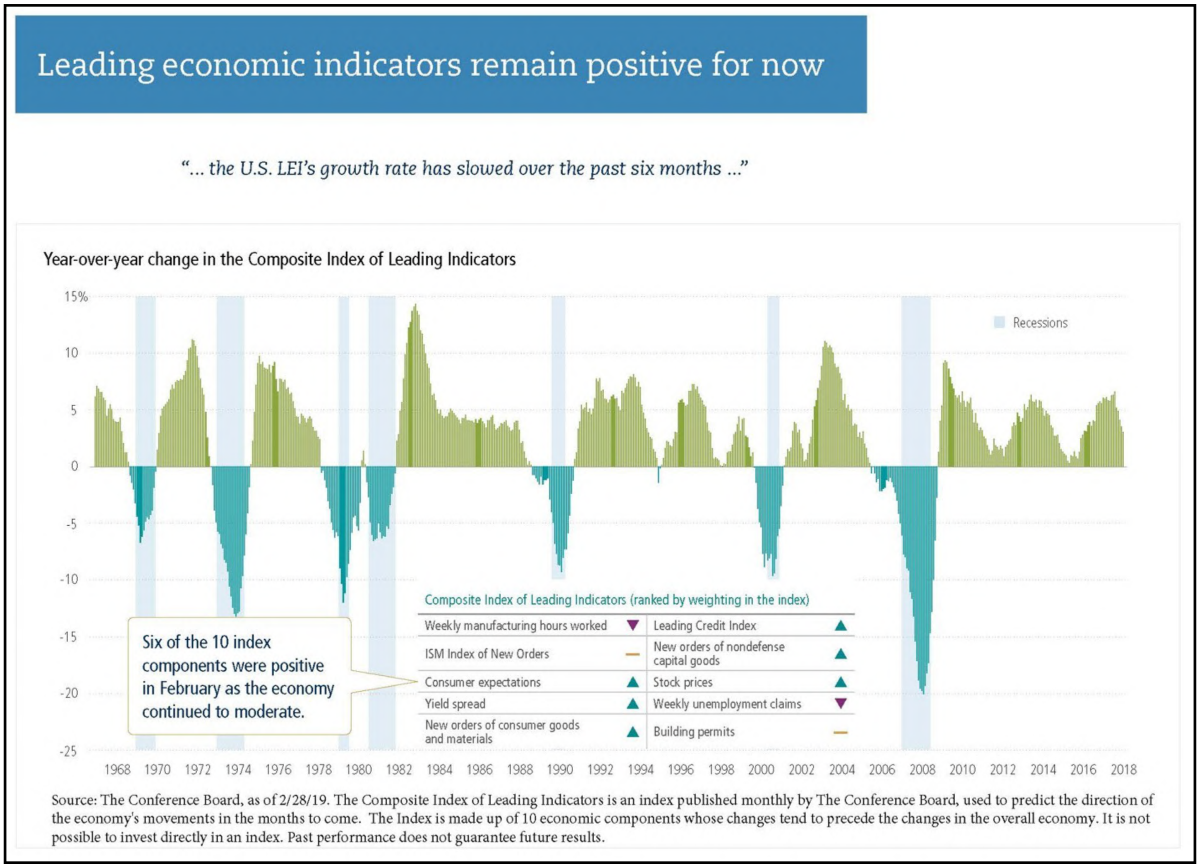
The inverted yield curve is also a reflection that the market expects there is a significant chance for a rate cut by the Federal Reserve. According to the CME FedWatch Tool, as of April 2, 2019, the futures market is pricing in a nearly 50% chance of a rate cut before the end of 2019. However, a survey at the Federal Reserve shows that none of the 17 FOMC members are forecasting a rate cut.

**Brexit and US-China Trade Negotiations.** Both of these issues are likely to have lasting impacts on the global economy. The European Union has yet to lose a member nation of this size and it could set a precedent for any future considerations of leaving the union. On April 10, the EU and UK agreed to extend the negotiation period through October 31, 2019. While it is important to both sides for the deal to be fair, the uncertainty will remain a headwind for both the UK and EU.

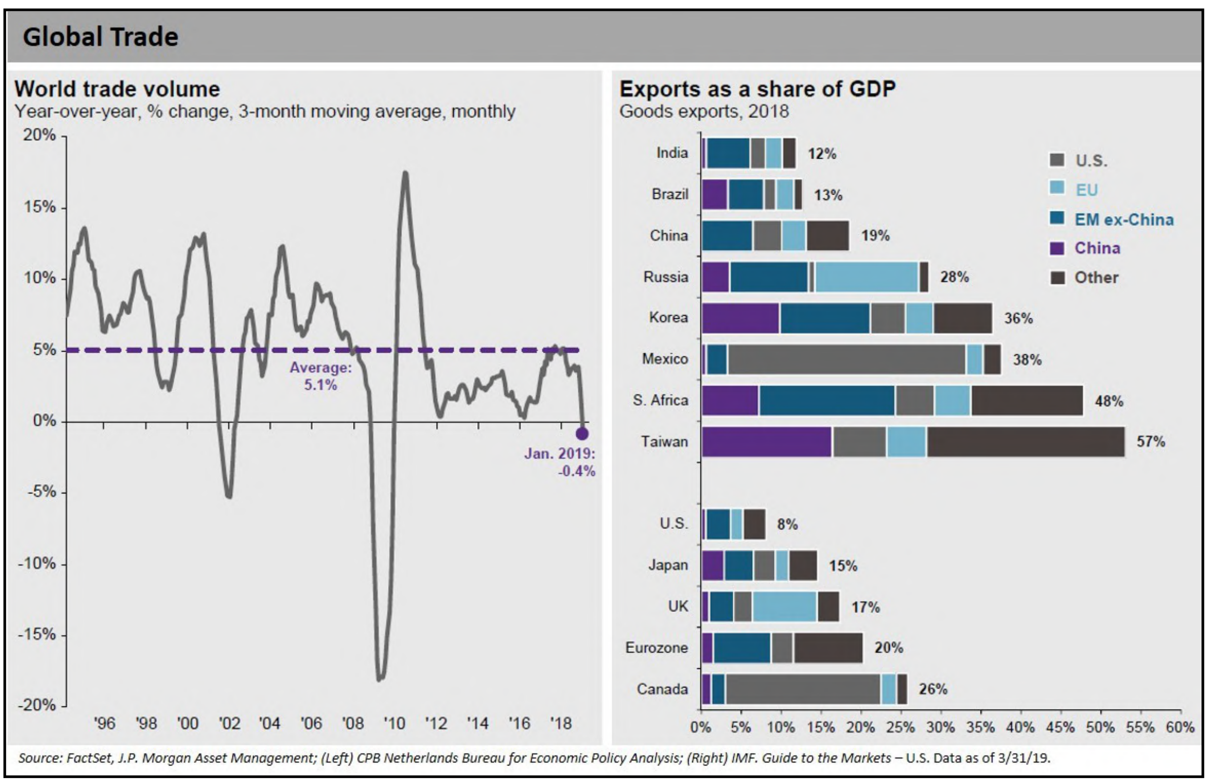
The US and China also missed their original March deadline. With both sides working toward an agreement, no formal deadline has been announced. According to Dr. Kelly, the current administration does not want to run an election campaign with a trade war still looming. Dr. Kelly believes there is a high probability a deal with China will be made well before the US elections in 2020. China is also motivated to make a deal as their economy continues its gradual slowdown and battle with high debt. What favors the US is a lower dependence on trade. The US only exports 8% of GDP versus China's exports at 19% of GDP.

**What to do now.** While the stock market is off to a great start in 2019, clear signs of caution remain. Historically, the third year of a Presidential term (2019) is the strongest year for stocks in the four-year election cycle. With the Fed on hold, moderate oil prices, and corporate earnings expected to rebound in the fourth quarter 2019, we suggest staying the course. However, we do not think this is the time to be extending risk. We continue to suggest that if you are within 15 years of retirement, and over 60 percent in equities, you may want to confirm that your allocation aligns with your goals and risk tolerance. **For more on the markets**, visit www.spectruminvestor.com, under "Resources and Links" to read weekly reports from Dr. Kelly of JPMorgan and several other economists. Please see benchmark disclosures on page 5 of this newsletter.

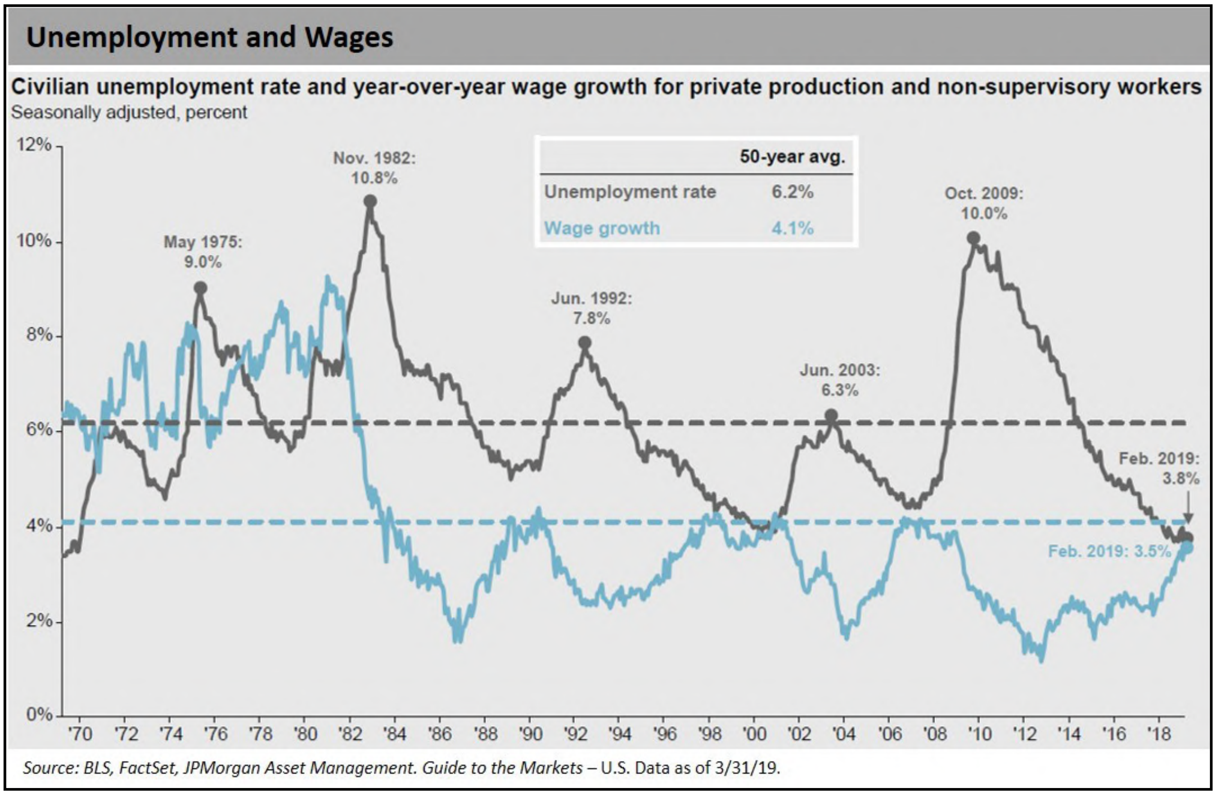
**Leading Economic Indicators (LEI):** The LEI chart below provides insight into the underlying drivers of US economic activity. The LEI reading turned negative (turquoise declining bars) prior to each of the past seven economic recessions (shown by the light blue shaded areas). The recent positive readings (green bars) tell us that the U.S. economy continues to grow at a healthy pace and that a recession is unlikely in the next 18-24 months.



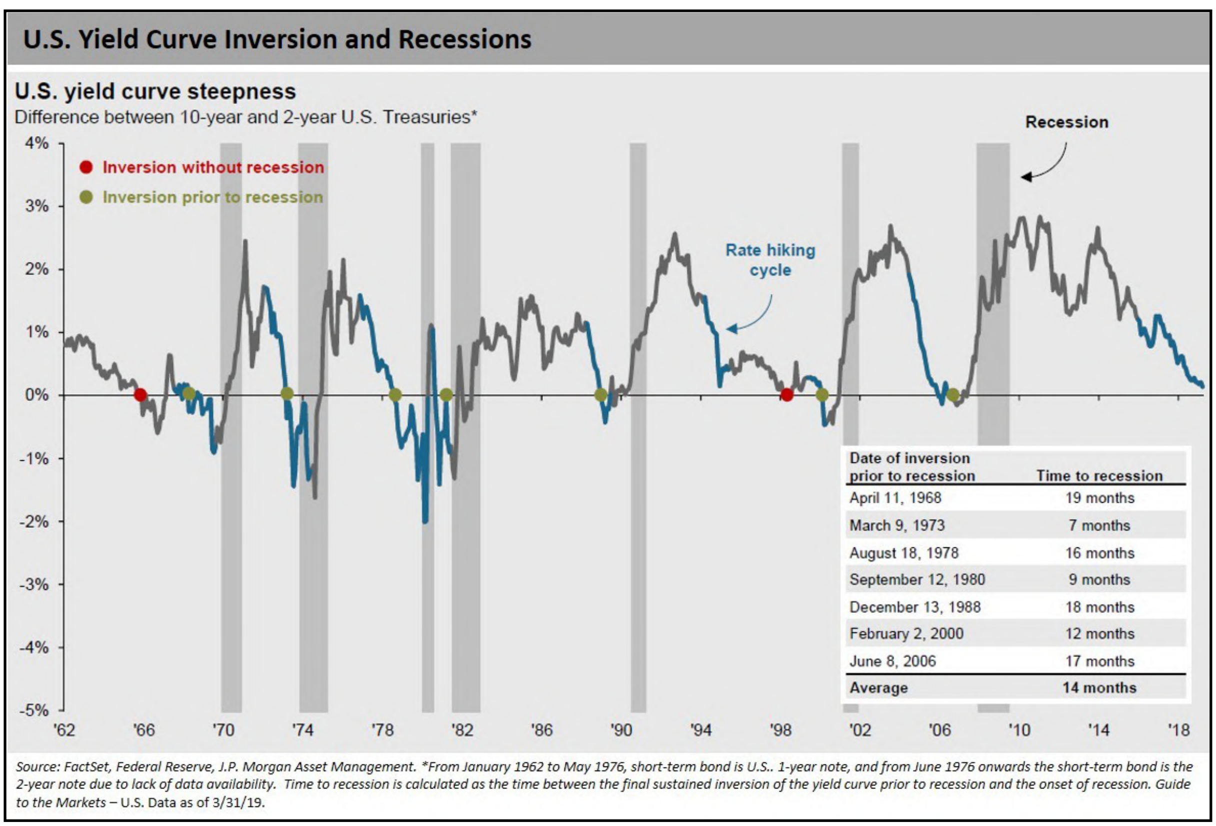

**Global Trade:** Trade tensions, especially between the US and China, are putting downward tension on global trade volume. Economic global growth could slow further if no deal is reached. Countries whose economies have been hit hard by trade tensions are the four export powerhouses: Germany, Japan, Korea, and Taiwan, as you can see by the chart on the right below. Not shown on the chart is Germany's exports, which as a share of GDP, is nearly half.



**Unemployment and Wages:** As the below chart indicates, when unemployment and wage growth come close to intersecting, the Fed has to put the pedal to the medal and raise interest rates multiple times, which they have done, with nine rate increases. The Fed closely watches the unemployment rate, at 3.8% and wage growth, at 3.5%. Although the Fed has signaled that they will be patient, a continued rise in wages may force future rate hikes.




**Inverted Yield Curve:** The 3-month Treasury and 10-month Treasury inverted on March 22, 2019. However, the 2-year vs. 10-year Treasury has yet to invert, but is extremely close. Once the yield curve inverts, to be valid it needs to stay inverted for months, not weeks. Should the 2-year and 10-year Treasuries invert and remain that way for months, the average time from that point to a recession is 14 months. Historically, when the yield curve inverts, the 10-year Treasury is at 6% - 7.5%. On March 22, 2019 the yield curve inverted with the 10-year Treasury at 2.44%.



# In Other Words

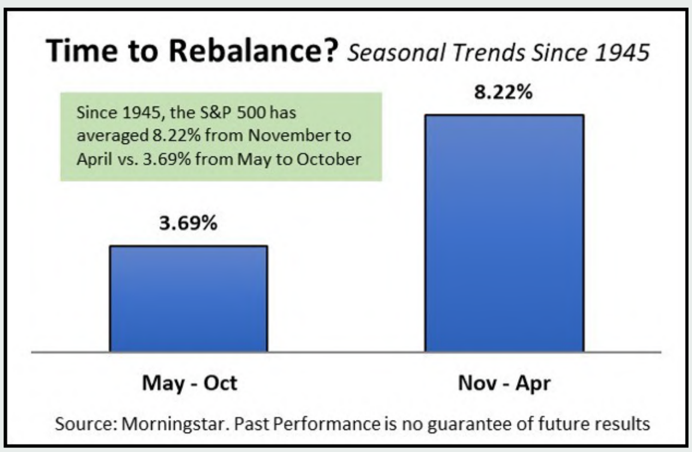
## Spring Cleaning for Your Financial Closet

**Angie Franzone** | Newsletter Editor

It's been a particularly rough winter for those of us in the Midwest this year; record breaking snowfall, a polar vortex, and a lying ground hog. The bleakness of this winter may have driven many of us to consume more than usual, thus making the annual spring cleaning of our closets a little more depressing when the realization sets in that there's not much from last year that fits anymore. Although it may be easier just to try squeezing into what we already have from last year, it's bound to be uncomfortable and anxiety inducing.

The same can be said for your financial closet; particularly the retirement plan section. It's possible that the asset allocation that fit your risk tolerance last spring has grown in some areas and is no longer the right fit for you. From March 31, 2018 to March 31, 2019, the Dow Jones Industrial Average has grown 6%, meaning that the percentage of stocks in your portfolio could be higher than you're comfortable with. One thing you should definitely not do is try to make that portfolio fit because it just seems easier to do nothing than to make an adjustment. This is where rebalancing comes in.

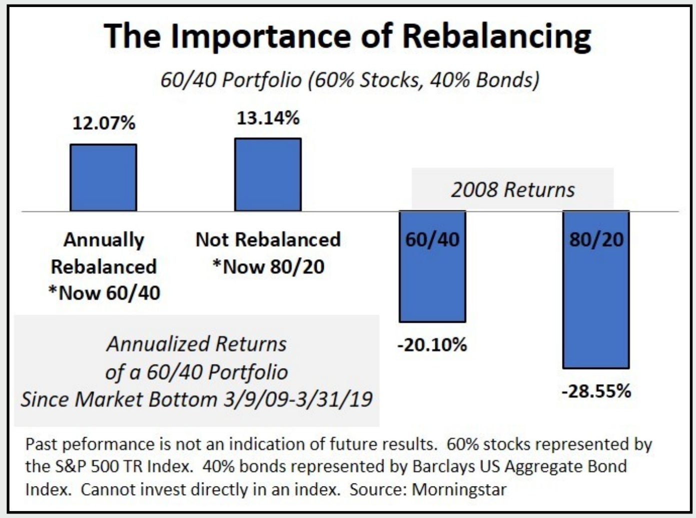
Quick refresher on what rebalancing is: over time, market fluctuations can change your asset allocation in such a way that it becomes out of sync with your risk tolerance. For example, when stocks rise or fall, the percentage of assets you have in stocks rises or falls accordingly. In order to keep the amounts of stocks, bonds and cash in your portfolio consistent with your original percentages, you should consider rebalancing annually, which restores your portfolio to the mix you intended it to be. By taking this important step in risk control, your investments are more likely to line up with your goals.




While past performance is not an indication of future results, historically speaking, late April and early May are generally good times to rebalance your portfolio, with November 1 through April 30 being a stronger period than May 1 through October 31.

Although rebalancing does not ensure you get a better return, it does help to reduce the volatility of your investments. As illustrated in *The Importance of Rebalancing* chart, if you had never rebalanced a portfolio of 60% stocks and 40% bonds since the market bottom on 3/9/09, your portfolio as of 3/31/19 would be 80% stocks and 20% bonds. Although it is true that if you hadn't rebalanced your return would be higher, is a 0.87% higher return worth a portfolio that takes on a higher level of risk than you're comfortable with?

If a portfolio that no longer fits your target allocation isn't enough to convince you, take a look at what would have happened if you had not rebalanced in 2008 when the stock market crashed. You would have lost 8.45% more than if you had kept your portfolio in check by rebalancing. Can you tolerate an additional 8% loss for a less than 1% gain?




Out of all the things in the world we can't control, the weather, the stock market, our waistlines (okay, we can control that, but it's hard!) the one thing we do have control over is our risk level. You can be proactive in reviewing your investment allocation on an annual basis to make sure it is still in line with your long-term goals or to make any necessary adjustments due to changing life events. Not only will it help you to sleep at night knowing you're appropriately invested, it will also help keep you from making reactive decisions based on emotion when the stock market goes down.

If you need assistance determining whether the contents of your financial closet fit you the way they did last spring, please call and talk to one of our advisors, and don't worry, they'll focus on financial advice and not fashion advice.

---

***Benchmark Disclosures: Morningstar Category Averages:*** *Morningstar classifies mutual funds into peer groups based on their holdings. The Category Average calculates the average return of mutual funds that fall within the category during the given time period. The following indexes and their definitions provide an approximate description of the type of investments held by mutual funds in each respective Morningstar Category. One cannot invest directly in an index or category average.* ***Large Cap Growth: S&P 500 Growth Index****–Measures the performance of growth stocks drawn from the S&P 500 index by dividing it into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Intermediate-Term Bonds: Barclays US Agg Bond Index****–Measures the performance of investment grade, US dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS, ABS and CMBS.* ***Large Cap Blend: S&P 500 Index****–A market capitalization-weighted index composed of the 500 most widely held stocks whose assets and/or revenue are based in the US.* ***Large Cap Value: S&P 500 Value Index****–Measures the performance of value stocks of the S&P 500 index by dividing into growth and value segments by using three factors: sales growth, the ratio of earnings change to price and momentum.* ***Mid Cap Value/Mid Cap Growth: S&P MidCap 400 Index****–A market cap weighted index that covers the complete market cap for the S&P 400 Index. All S&P 400 index stocks are represented in both and/or each Growth and Value index.* ***Mid Cap Blend: S&P MidCap 400 Index****–Measures the performance of mid-sized US companies, reflecting the distinctive risk and return characteristics of this market segment.* ***Small Cap Blend: Russell 2000 Index****–Measures the performance of the small-cap segment of the US equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.* ***Small Cap Value: Russell 2000 Value Index****–Measures the performance of small-cap value segment of Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.* ***Small Cap Growth: Russell 2000 Growth Index****–Measures the performance of small-cap growth segment of Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values.* ***Foreign Large Cap Blend: MSCI EAFE NR Index****–This Europe, Australasia, and Far East index is a market-capitalization-weighted index of 21 non-US, developed country indexes.* ***Real Estate: DJ US Select REIT Index****–Measures the performance of publicly traded real estate trusts (REITs) and REIT-like securities to serve as proxy for direct real estate investment.* ***Natural Resources: S&P North American Natural Resources Index****–Measures the performance of US traded securities classified by the Global Industry Classification Standard (GICS) as energy and materials excluding the chemicals industry and steel but including energy companies, forestry services, producers of pulp and paper and plantations. Past performance is no guarantee of future results.*

SPECTRUM INVESTMENT ADVISORS

# Spectrum Wealth Management

## Qualified Charitable Distributions

**Brian White, CFP®** | Wealth Manager

Spring is a time for all of us to put away the snow shovels/snow blowers (knock on wood!), and think about spring cleaning. By the time you read this newsletter, you should be done with or filed an extension for your 2018 income taxes. Whether you're thanking the IRS for a refund or cursing them for an amount owed, you're probably ready to move on. Before you do, let's look at a way to reduce your taxable income for this next year through a Qualified Charitable Distribution.

The Pension Protection Act of 2006 introduced the Qualified Charitable Distribution or QCD. This provided individuals a way to donate to a 501(c)(3) organization directly from their Individual Retirement Account (IRA). Eventually this provision was made permanent on December 18, 2015 through the Protecting Americans from Tax Hikes of 2015 (PATH Act).

**How does it work?**

If you're over the age of 70 ½, you can make a payment directly from your IRA to a qualified charitable organization. The IRA must be a Traditional, Rollover or Inherited IRA. Certain SEP and Simple IRAs (inactive plans only) are also eligible for the QCD. The maximum annual QCD is $100,000 per year, per person.

**Why should I do it?**

The very simple answer for this is that IRA owners are able to move funds out of their IRA to a qualifying charity **income, tax free**. In a normal traditional IRA distribution, the funds come out of the IRA and are taxed at ordinary income rates. With a QCD, the funds come out of the IRA, but are NOT taxed.

A QCD also counts towards your Required Minimum Distribution (RMD). For example, Jane Doe is 72 and has an IRA with a balance of $500,000 on December 31, 2018. At this balance and with the IRS standard life expectancy tables, Jane's RMD is just over $19,500. If she uses the QCD to donate $18,000 to ABC Charity (a qualified 501(c)(3) organization), she only needs to withdraw an additional $1,500 to satisfy her RMD by the end of the year.

Let's say that Jane has income from other sources and doesn't need the $19,500 to live on. In that case, she may be looking for ways to reduce that income. If she's already making contributions to ABC Charity, this definitely works in her favor. Her taxable income is reduced by $18,000 and ABC Charity still benefits from her gift.

**Do I need to itemize my deductions to take advantage of the QCD?**

No, you can still take the standard deduction and utilize the QCD. The standard deduction amount for 2018 is $12,000 for individuals and $24,000 married filing jointly. This has jumped significantly from 2017 and has caused many people to take the standard deduction instead of itemizing. There are many other factors affecting income taxes, including tax credit changes and personal exemptions. As always, contact your tax advisor with any questions you may have.

**Other important considerations:**

- The QCD cannot be done from a 401(k), 403(b) or other active company-sponsored retirement plan. The funds must come from an IRA account.
- QCDs do not apply to funds that are coming from non-deductible contributions (again, consult your tax advisor).
- Charities do not include private foundations, supporting organizations or donor-advised funds. They must be a qualified 501(c)(3) organization.
- Funds must flow directly to a charitable organization. The IRA owner cannot take possession of the funds, then write a check to the charity.

We would encourage anyone over 70 ½ to review their personal situation to determine if the QCD is suitable. As always, be sure to consult your tax advisor.

# Spectrum Investor® Update

| Morningstar Category Averages | 1st Qtr | 1 Year | 3 Year |
|---|---|---|---|
| Intermediate-Term Bond | 3.13% | 3.98% | 2.39% |
| Allocation 50%-70% Equity | 8.93% | 3.94% | 7.49% |
| Large Cap Value | 11.27% | 4.44% | 9.98% |
| Large Cap Blend | 12.93% | 6.79% | 11.78% |
| Large Cap Growth | 15.65% | 10.64% | 15.30% |
| Mid Cap Value | 12.91% | 0.68% | 8.55% |
| Mid Cap Blend | 13.91% | 2.21% | 9.60% |
| Mid Cap Growth | 18.21% | 8.12% | 14.15% |
| Small Cap Value | 12.16% | -2.58% | 8.26% |
| Small Cap Blend | 13.30% | -0.08% | 10.09% |
| Small Cap Growth | 16.98% | 7.67% | 15.86% |
| Foreign Large Blend | 10.22% | -5.21% | 6.55% |
| Real Estate | 16.21% | 16.89% | 5.86% |
| Natural Resources | 11.75% | -5.02% | 7.82% |

Source: Morningstar, 3 yr return is annualized. Morningstar classifies categories by underlying holdings and then calculates the average performance of the category. Past performance is not an indication of future results. Returns in **Blue** = Best, Returns in **Red** = Worst. Please see Benchmark Disclosures on page 5.

**DOW: 25,929** **10 Yr T-Note: 2.41%**
**NASDAQ: 7,729** **Inflation Rate: 1.9%**
**S&P 500: 2,834** **Unemployment Rate: 3.8%**

Data as of 3/31/19 unless otherwise noted. The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors. The S&P 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. Barrel of Oil: West Texas Intermediate. Inflation Rate: CPI. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index. Indices cannot be invested into directly.

*To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.*

***IRS Indexed Limits for 2019:***
*401(k), 403(b), 457 Plan Deferral Limit is $19,000.*
*Catch-up Contribution limit is $6,000. Source: www.irs.gov*