NVEST NSIGHTS

March 31, 2018

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nvest WEALTH STRATEGIES

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PULSE CHECK

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

The stock market ended the quarter much different than it began. Stocks roared in January with the S&P500 jumping more than 5% to set repeated records; until January 26th. Then, it's as though the electrician changed the direction of the wall switch. As we wrote in our March commentary, "Agitation Overdone", the current pullback is the first drawdown exceeding -5% since February 2016 (almost 2 years), or 404 trading days. The February drawdown took 10 days to erase -10%, wherein 83% of stocks declined -10% or more and the average stock gave up -14%. March vibrated back and forth, retesting the February lows. Corrections (-10% decline or more) are never comfortable, but most evolve into new rallies. The evolution process typically involves 3 components – *price, time, and emotion*. *Price* action can be quick, while *emotional* change takes *time* before playing out. It seems probable that additional *time* and the evaporation of bullish *emotion* (sentiment) are needed before the Bull run continues. An important part of any corrective process is converting optimism to pessimism. Today, we are closer than at the early-February lows, which were retested in late March/April – now almost 30% of stocks are down 20% from their highs.

For 1Q2018, the S&P500 fell -0.8 for its first quarterly loss since 2015. Most every index lost ground during the quarter. It always seems inappropriate to get too caught in daily market movements, but as I write today (first trading day of 2Q), the stock market is very unsettled. Investor confidence is getting wacked (which is a good contrarian indicator), and this is necessary to ultimately achieve a corrective low. Further, tech stocks are taking the brunt of the hit; again, this is okay as the "best performers go down last." The hit to Big Tech suggests the market's corrective process is moving forward.

So, what is your emotional "heart rate" doing – racing ahead, or beating normally? Do you need an emotional "pulse check?"

Client portfolios performed better than the markets during 1Q for several reasons. First, no client portfolio is only the stock market. A typical portfolio owns bonds and stocks. Stock exposure is diversified to own large, medium, small-size companies and foreign growth and value-style funds. Second, we de-risked the stock portfolio allocations in December (or early January in many taxable accounts) to rebalance an appreciated exposure in riskier growth-style funds (which owned more expensive tech exposure) into value-style funds. We also own foreign stock fund exposures which are helping diversify portfolio returns. Third, and important, we own active managed no-load mutual funds, with a couple of ETFs in select areas. Active managers employ security selection criteria and portfolio management disciplines that attempt to manage risk; this key attribute provides a buffer during market drawdowns. Passive index strategies (and many ETFs) that "own-it-all," experience the full movement of the markets; risk cannot be dialed up/down. Even portfolio bond allocation exposures remain de-risked, as this asset class remains a difficult area to invest for the last few years (given low interest rates). Short-term market price action may remain poor. It should be encouraging though that cross asset class action does not indicate financial panic. It is important to be reminded that 12-month returns are very attractive - double-digit positive for portfolio objectives oriented toward growth (see Benchmarking pg. 3). Long-term investing pays attractive rewards.

Most corrections prove to be buyable entry points to the next rally. Yes, there remain concerns over market multiples; valuation is generally elevated but is more attractive than at any point since early 2016. We do not view that the current "noisy news-driven" market environment will evolve into a bear market. More about the market backdrop in another article; but simply stated, the underlying economic fundamentals lend support to a resumption of the current bull market as this year progresses. There is progress in the current corrective process, but more work will occur - *time* and *emotion* adjustment is ahead, leading up to the resumption of the Bull run.

BEAUTY BESTS BEAST

Try saying "beauty bests beast" 3 times, rapidly. Now, what does this title suggest about the investment environment? The end of March was a "beast?" Alternatively, it was a "beauty" for economic data and continued restrained inflation.

The current business cycle is old, yet not as robust relative to past experience. A number of current economic and political events are creating significant worry for investors. Friction is keen between favorable economic developments ("Beauty") and those that constrain growth ("Beast"). Components making up the "beast" include tariffs; possible new regulations on FANG & Big Tech; a new Fed composition and policy direction (how fast and how much will rates rise as policy normalizes); and government partisanship - all increase uncertainty about the future. Will the "beast" prove to be too much? Alternatively, attributes of "beauty" include high consumer confidence; unemployment claims at 45-year lows; house prices rising; tax reform and lessening of government regulations; and business confidence is high. In general, we expect "beauty" will best the "beast." This is, nevertheless, a fluid backdrop for the economy and financial markets. Markets like to test a new Fed Chair, and are doing so at this time.

(continued on pg. 2)

During times of economic and market friction, market valuations undergo compression. We believe this corrective process is unlikely to progress into a severe downside event. Reason - both domestic and global economic backdrops remain solid, growing in a synchronized manner with generally low, moderate (slow rising) inflation. During 4Q2017, company earnings grew at 15% year-over-year (y/y). US company earnings are expected to expand in 1Q by that much or more. Important too, dividends increased by 9% y/y. These boosts result from strong future earnings expectations, tax cuts, record corporate cash, and business confidence. With so much global liquidity (from easy monetary policies), businesses are actively making deals to buy other businesses in pursuit of growth; deal-making is rapid during this time of market revaluation. These business actions are significant positives in the market backdrop, which should boost confidence to remain long-term about the current Bull market.

"We do not view that the current 'noisy news-driven' market environment will evolve into a bear market. …simply stated, the underlying economic fundamentals lend support to a resumption of the current bull market as this year progresses."

Not to be negative, …recessions typically do not start with interest rates and inflation low. Bull markets do not die until the yield curve becomes inverted (short interest rates would be higher than long rates); and low quality bond rates rise quickly after economic growth fears develop. In general, <u>none</u> of the recession/ bear market signposts exist today.

As the year progresses, we expect a synchronized global economic growth environment will provide an upward path for stocks, interest rates and inflation. There remains plenty of time for both the economy and bull market to run. But as we stated in the outset of 2018, it may be that the economy performs better than the stock market this year; but both should be a positive experience.

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SOME SMOKE, LITTLE FIRE (TARIFF TALK)

Since late-January, inflation, tariffs and possible trade wars are the related worry items for markets. Trade tariffs are governmental skirmishes that disrupt global economic growth by changing pricing on products and global supply chains; they are often stragflationary. Stagflation is an undesirable condition defined as slowing economic growth (stagnating) at the same time the price of products are rising (inflation). Tariffs ultimately create stagflation. No one benefits from a trade war, especially one in which the tariff imposing country is raising costs on its own consumers. This is a cause for concern, particularly if escalation builds.

"It appears investors are overestimating the potential impact of increased trade tensions and underestimating fiscal stimulus."

As bad as all that sounds, let's keep the issue of tariffs in context. In part, that is because of the way our "negative, bad-news" media does its reporting. Please note: tariff announcements are only PROPOSED – not actual; not yet in effect. Proposed tariffs are unlikely to become effective for months to come, and will be modified/adjusted before. Tariffs will not be instituted while negotiations occur. Trade tensions will be a long and hard negotiation process that will "sound" angry. And, no one wants the path of trade wars. While not many of us endorse Trump's style or methodologies, it appears he is always negotiating in pursuit of what he believes is pro-growth (even when actions appear the opposite, like via tariffs).

Since mid-March, the stock market has reacted with negative mood to *proposed* tariffs against China and others and probable retaliation. Two-thirds of this market correction took place after the first headline crossed on March 13. It is interesting though to look at the numbers – the economic impact of recent fiscal policy actions. It appears investors are *overestimating* the potential impact of increased trade tensions and *underestimating* fiscal stimulus In December, tax cuts of $200 Billion were passed and are estimated to boost economic growth; fiscal spending will add another $100 Billion in growth; AND repatriation of foreign earnings by companies will bring $500 Billion back to the USA. That adds up to $800 Billion of extra money to boost economic growth in 2018. On the other hand, tariffs of $37 Billion are a subtraction to growth by comparison (see chart pg. 3). We are not yet hearing about negotiations beginning between China and the US; but tough negotiations will assuredly occur. We only hear news of harsh words with threats by both sides (and Trump's twitter does not help). Look at NAFTA – it started off sounding terrible, but the renegotiation process is progressing. Negotiations may provide a better business position for the US in various areas of trade, and thereby benefit economic conditions in 2018 and beyond.

Financial markets are reacting to the threat of greater escalation in the short term. We sincerely hope all the noisy news does not impact business confidence. During an unsettled time, investors can benefit from the market corrective process that adjusts market valuations lower. That means buying stocks "on-sale."

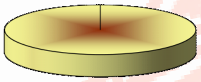
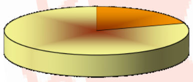
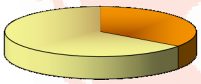
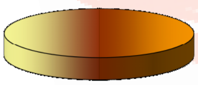
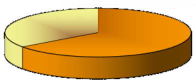
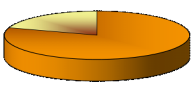
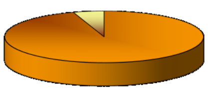
One last thought – recall our February commentary, "Super Bull". During the 3 super Bull cycles since the 1920s, there were 18 declines of -7% or more, with the 3 biggest declines being -17%, -19%, and -21%. These market corrections created emotional moments that caused investors to "feel" the bull market was dying. Bull market runs are not straight up, or gradual upward paths. They incorporate up/down variations which often provide a corrective "pause that refreshes." We suspect the current correction, dramatized by tariff wars, is a news distraction that provides attractive opportunity for long-term investing. It's probably more smoke, than fire.

ANNOUNCEMENTS:

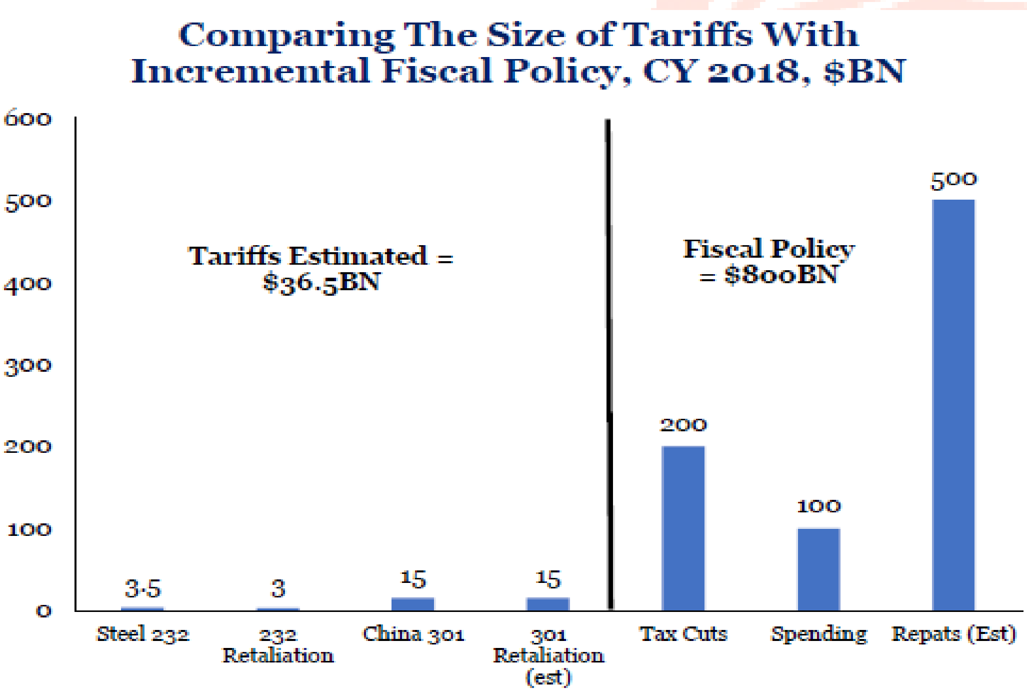
- Early April - 2Q 2018 fees collected. Detailed 1Q'18 performance reporting delivered
- April 17 - Deadline to file personal income taxes; Traditional and Roth IRA contributions for 2017 tax year not accepted after this date.
- May 28 - Memorial Day; banks and financial markets closed
- June 30 - End of 2nd Quarter.
- Our ADV Part 2A & B as required by the SEC & Ohio (and other states) is available to you anytime upon request.

BENCHMARKING AS OF MARCH 31, 2018

Summary of index portfolio returns compiled by Nvest Wealth Strategies, Inc.

	INDEX PORTFOLIO	STOCK/BOND ALLOCATION		TOTAL RETURN THROUGH 3/31/2018			
				1ST QTR	12 MTHS	3 YEARS	5 YEARS
	Capital Preservation	0% / 100%	*Cumulative*	-0.3%	0.8%	3.1%	4.8%
			Annualized		0.8%	1.0%	0.9%
	Income	20% / 80%	*Cumulative*	-0.3%	3.4%	7.3%	14.8%
			Annualized		3.4%	2.4%	2.8%
	Balanced Conservative	35% / 65%	*Cumulative*	-0.3%	4.8%	9.5%	20.3%
			Annualized		4.8%	3.1%	3.8%
	Balanced	50% / 50%	*Cumulative*	-0.3%	6.8%	12.9%	28.9%
			Annualized		6.8%	4.1%	5.2%
	Balanced Growth	65% / 35%	*Cumulative*	-0.3%	8.8%	16.2%	37.1%
			Annualized		8.8%	5.1%	6.5%
	Growth	80% / 20%	*Cumulative*	-0.3%	10.8%	19.7%	46.9%
			Annualized		10.8%	6.2%	8.0%
	Aggressive Growth	95% / 5%	*Cumulative*	-0.3%	12.1%	21.9%	52.9%
			Annualized		12.1%	6.8%	8.9%

The index returns reflect returns of various mutual fund averages compiled by Morningstar and allocated as follows: Capital Preservation: 90% Bond Average, 10% Treasury Bill Index; Income: 80% Bond, 10% Large Cap, 3% Mid Cap, 2% Small Cap, 5% International; Balanced Conservative: 65% Bond, 15% Large Cap, 5% Mid Cap, 3% Small Cap, 7% International; Balanced: 50% Bond, 24% Large Cap, 7% Mid Cap, 4% Small Cap, 10% International; Balanced Growth: 35% Bond, 30% Large Cap, 9% Mid Cap, 6% Small Cap, 15% International; Growth: 20% Bond, 38% Large Cap, 12% Mid Cap, 8% Small Cap, 17% International; Aggressive Growth: 10% Bond, 40% Large Cap, 15% Mid Cap, 10% Small Cap,



Tariff fears are dominating market sentiment, but the tariffs, even as proposed, are dwarfed by 2018 fiscal stimulus.

The pressure these worries are imposing on financial markets creates an opportunity to invest at more attractive valuations than at any time in last two years, so long as business confidence does not deteriorate.

SELECTED MUTUAL FUNDS - TOTAL RETURN PERFORMANCE SUMMARY

As of March 31, 2018

BOND FUNDS - TAXABLE	STYLE	1ST QTR	YTD	12 MTHS	3 YEARS	5 YEARS
Taxable Short-Term Bond Average		*-0.3%*	*-0.3%*	*0.8%*	*1.1%*	*1.0%*
Taxable Intermediate Bond Average		*-1.3%*	*-1.3%*	*1.3%*	*1.3%*	*1.8%*
Wells Fargo Ultra Short	AS	0.1%	0.1%	0.9%	0.9%	0.7%
AC Alternatives Market Neutral Value	AS	-1.9%	-1.9%	-2.4%	1.6%	2.1%
Vanguard Short Federal	HS	-0.4%	-0.4%	0.0%	0.5%	0.6%
American Century Short Duration	HS	0.0%	0.0%	0.9%	1.1%	0.9%
Pioneer Short-Term Income	HS	0.1%	0.1%	0.8%	1.2%	1.2%
PIMCO Low Duration	HS	-0.2%	-0.2%	1.1%	1.1%	0.9%
Vanguard Short-Term Investment Grade	HS	-0.5%	-0.5%	0.7%	1.4%	1.5%
American Century GNMA Income	HI	-1.2%	-1.2%	-0.2%	0.3%	0.8%
Diamond Hill Corporate Credit	LI	0.3%	0.3%	5.0%	5.9%	5.3%
Miller Convertible	LI	0.3%	0.3%	5.5%	4.1%	6.5%
BOND FUNDS - TAX EXEMPT						
Tax-Free Intermediate Bond Average		*-1.1%*	*-1.1%*	*2.1%*	*1.7%*	*2.1%*
Vanguard Muni Limited Term	HS	-0.2%	-0.2%	0.7%	0.9%	1.0%
T. Rowe Price Tax Free S/I	HS	-0.4%	-0.4%	0.3%	0.6%	0.8%
Vanguard Muni Intermediate Term	HI	-1.1%	-1.1%	2.0%	1.8%	2.3%
Vanguard Ohio Long-Term	HL	-1.4%	-1.4%	3.5%	2.9%	3.5%
STOCK FUNDS - DOMESTIC						
S&P 500 Index		*-0.8%*	*-0.8%*	*14.0%*	*10.8%*	*13.3%*
Equity Fund Average		*-0.4%*	*-0.4%*	*12.3%*	*7.5%*	*10.4%*
Schwab Large Cap Growth	LG	1.7%	1.7%	19.8%	11.2%	15.3%
Parnassus Endeavor	LG	-2.5%	-2.5%	12.2%	12.5%	16.0%
T.Rowe Price Dividend Growth	LV	-0.7%	-0.7%	12.8%	10.0%	12.4%
Goldman Sachs US Equity Dividend & Premium	LV	-1.5%	-1.5%	8.9%	8.9%	10.7%
Sit Dividend Growth	LV	-1.4%	-1.4%	12.3%	8.9%	11.0%
Hennessy Focus	MG	-2.4%	-2.4%	11.4%	6.8%	11.6%
John Hancock Disciplined Value Mid-Cap	MV	-0.5%	-0.5%	10.2%	8.8%	13.4%
SPDR S&P600 Small Cap Growth	SG	2.4%	2.4%	14.6%	11.4%	14.2%
Neuberger & Berman Genesis	SB	0.7%	0.7%	13.0%	9.7%	11.1%
Diamond Hill Small-Cap	SV	-1.0%	-1.0%	8.6%	5.4%	8.6%
Wells Fargo Small-Cap Value	SV	-2.0%	-2.0%	8.0%	10.9%	7.5%
STOCK FUNDS - INTERNATIONAL						
Morgan Stanley EAFE Index (Foreign)		*-1.5%*	*-1.5%*	*14.8%*	*5.6%*	*6.5%*
Oakmark International	LV	-2.8%	-2.8%	15.3%	7.1%	8.7%
John Hancock International Growth	LG	3.2%	3.2%	26.8%	10.3%	10.6%
Thornburg Developing World	LG	-0.6%	-0.6%	24.1%	6.1%	3.5%
Harding Loevner International Small Company	SG	1.3%	1.3%	24.7%	10.6%	9.2%
Hennessy Japan	LB	1.4%	1.4%	26.8%	14.8%	15.2%
STOCK FUNDS - SPECIALTY						
Salient-Forward Select Income (REIT)	MV	-6.5%	-6.5%	-6.0%	1.2%	3.9%
Neuberger Berman Real Estate Securities	MV	-5.7%	-5.7%	1.8%	2.8%	5.9%

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NVEST NSIGHTS

ANNUITIES: FREE LUNCHES & MAGIC BULLETS

If you are at the doorsteps to retirement, you might regularly receive invitations to enjoy a free lunch/dinner as part of an "educational" seminar on various retirement, estate planning, or trust topics. Often these invitations are made extra enticing by featuring a fancy restaurant for the presentation. Yet as the saying goes, few of us believe these meals/events are without any strings attached; we know there will be some "catch" or pitch of a product or service.

One topic we regularly encounter with new clients approaching us for help is in the area of annuities. While there are advantages and disadvantages to these complex products, in our experience, they are often sold without full and adequate explanation. While we prefer and advocate the use of more customizable, and traditional investment structures (wherein you retain full control of your time horizon, investment options, and access to money), we would stop short of saying or suggesting that annuities are never appropriate. So let's objectively review one of the most misunderstood financial products available.

- Annuities create a tax-sheltered structure for which assets/investments can appreciate in value without being subject to current interest, dividends, or capital gains taxes.
- Annuities avoid probate and account values are paid direct to beneficiaries at death.
- Annuities can provide a guaranteed monthly income.
- Most contracts are subject to initial loss of access to your principal in the first 7 years (on average) called surrender penalties.
- Some annuities (especially variable) have significant annual fees and expense structures, which are not always properly disclosed
- Investment options and features may be complicated.
- As an annuity account grows tax deferred, withdraws are sourced from accumulated earnings first and treated as ordinary income just like distributions/withdraws from your 401k and IRA.
- 10% Penalty (in addition to tax on earnings) applies to withdrawals before age 59 ½.

While annuities are conceptually appealing on the surface, as Paul Harvey said, "Now for the rest of the story". Usually not understood is that the growth – combination of interest, dividends, capital appreciation is taxable as ordinary income upon withdraw. This tax treatment causes many people to ultimately feel like money accumulated in personal annuity contracts is less flexible/accessible than if it were held in a traditional personal brokerage account. When considering participation in retirement accounts (IRAs, 401k/403b, etc.) and including annuities, one can find themselves over-loaded into tax deferred accounts which could create a ticking "tax bomb" and lack of asset flexibility.

Many individuals in retirement defer taking withdrawals due to the tax treatment on appreciated annuity contracts. As a result, we see the next generation inherit a "tax bomb" surprise. If instead they invested their savings into a personal brokerage account, their inheritance would receive a step-up in basis at the death of the owner (such that non-spouse beneficiaries would inherit assets without a significant tax implication).

Long story short: annuities are complicated, and do not offer a free lunch or magic bullet - a mantra that seems to apply to most any and all areas of life. Understanding the full story, and in the case of annuities their attributes and tax treatment is important when giving consideration to asset location and/or the order of withdraws needed by elderly loved ones. Keep in mind, many annuity features/attributes can be achieved or produced via traditional investment account structures. In addition, there are strategies that can convert money accumulated inside of annuity contracts into other products/assets (such as long-term care for example), that may be more beneficial and tax efficient to both contract owners and their beneficiaries. Don't hesitate to ask us to review any annuity contract that you or your family own at an upcoming meeting; we will offer you an objective analysis, opinion and options.

WELCOME, DAVID MILLER!

As shared in our recent monthly commentary, we are excited to announce David Miller, ChFC, CLU joining Nvest Wealth Strategies. Dave began working with us in February, and brings 35+ years of experience serving individuals as a financial advisor and carries personal risk management expertise. His background compliments our existing capabilities and he will be focusing on financial planning, risk management, and new business development. Please join us in welcoming Dave.