NVEST NSIGHTS

June 30, 2018

IN THIS ISSUE:

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TARIFFS UNTIL THE MARKET SHAKES

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

The US economy is still growing and will enjoy its 10th anniversary in July. Shortly, it will become the longest expansion on record. Its progress helped unemployment reach its lowest in 18 years, at 3.8%. And, the second quarter should produce double-digit earnings growth again, for the 3rd consecutive quarter. So far, the US economy and corporate earnings provide the underlying fundamentals to support the current bull market growing older (since 3/9/2009 or 112 months, or 9.3 years). US consumer confidence remains solid which is important since consumers drive about 70% of the US economy.

In the past, we talked of a synchronized global economic recovery providing support for a synchronized global stock market advance. Yet, since President Trump started threatening tariffs on January 26, plus the Fed's continued pursuit to raise short-term interest rates, the world stock market is undergoing rotation – the US stock market is minimally up YTD, while Europe, China, and Emerging Markets are down (Japan is modestly up). Plainly stated, it could be argued that tariffs de-synchronized the global economy and stock markets. The stock market advance is still working through its correction process as most stocks remain below their January 26 highs. Recall, the US stock market produced a small loss in 1Q after starting with the strongest beginning weeks in history. The 2Q reduced the magnitude of the correction with a +3.4% advance, bringing YTD performance (June 30) to +2.6%. Some economists predict the US economy grew over +4% in 2Q, and will again grow above-trend in 3Q. *The Fed offers a median estimate of almost +3% for the full 2018, almost +2.5% in 2019 and +1.8% in the long run*. With inflation slowly rising to a 6-year high, it is just reaching the 2% Fed target; expected CPI is not on a runaway track. The recent stronger economic growth outlook may in part be attributable to tax reform (passed in December 2017), plus expectation for additional fiscal infrastructure spending (physical infrastructure such as roads, bridges, etc. is at its oldest age since the 1960s), and new capital expenditures by businesses.

Tariff rhetoric is hitting economic and stock markets of Europe, China, and emerging economies harder than the US – those foreign economies are soft and their stock market corrections are approaching -20% declines. Markets are essentially signaling that foreign economies would be the bigger loser if such tariffs are enacted. Recall, a correction amounts to a drawdown from the market peak of -10% or more – involving *price* + *time* + *sentiment*. From January 26, the S&P declined intra-day -12% and ended off more than -10% on February 8th. The *time* component of the correction is still progressing as a new market high is not yet established, plus investor *sentiment* is slowly dropping (less bullish) but not "washed out" enough. *Time* has a way of washing out *sentiment* as investors get wary of little or no market advance. Thus, maybe the synchronized global economic advance is off the table due to tariff banter and a rising US dollar, which is the result of rising short US interest rates by the Fed.

Also, it is worthy to monitor the impact of tariff talk on the US economy. There is evidence that continuing tariff banter is causing uncertainty, contingent planning, and even shifting production by American businesses from one country to another to minimize the effects of tariffs. Some businesses are also reporting higher prices and delivery delays. If tariff debates run too long, it is reasonable to see a softening outlook emerge; such will dampen the stock market outlook.

If that were not enough, we are just a few months away from mid-term Congressional elections. Since 1950, stock market performance is usually soft and sideways during such years. Markets do not produce much return for the effort through the summer into October, with market returns tending to be back-end loaded (see chart on bottom of page 3). Meaning, the market resumes its upward performance as the mid-term election year process occurs. The mid-term election influence is not too surprising considering how a change in congressional composition can create new political uncertainty.

We'll offer more about the Fed and interest rates in the article (pg 2) – "Tightening Until Something Breaks." Suffice to say, the prospect of the Fed raising interest rates 2 more times in 2018 and more in 2019, is also putting stock investors on guard. There is worry the new Fed will tighten too much and/or too fast.

Client portfolios are pursuing a tactical mix that recognizes the older age of the economy and bull market; yet it is important to be aware that cycles don't need to "die of old age." The underlying fundamentals still support a further advance and additional time. We are pursuing more conservative investment strategy in tactical allocations for both bond and stock exposure. Specifically, we are emphasizing areas with lower, cheaper valuations (better long-term return prospects with less downside risk). Value-style stocks are hugely more price and risk attractive than growth.

Despite the recent soft return experience from foreign stocks, we expect their lower relative valuation provides good future return opportunities if/as tariff talk concludes at some future time. Also in 2Q, we further modified the tactical structure in bond exposures via an increased short maturity focus. Pursuing a de-risking tactical mix with stocks in particular, we are observing portfolios generating smoother returns, both up/down, when compared to the S&P500 index. Remember though, no client portfolio is 100% the S&P500 index – we own bonds and stocks – large, medium and small-size company stocks, even foreign. That's certainly not comparable to any domestic index.

(continued on pg. 2)

"In general, we remain constructive on the economy and markets. US fiscal stimulus substantially outweighs the trade/tariff hit, when/if implemented."

In general, we remain constructive on the economy and markets. US fiscal stimulus substantially outweighs the trade/tariff hit, when/if implemented. We are also taken by Warren Buffett's recent comments about the strong economy, "If we are in the 6th inning, we have our sluggers coming to bat." It appears there is growth in both the economy and company earnings to support upside this year and next. Investors appear in need of believing a growing economy and company earnings are sustainable in light of rising interest rates before another new market high is achieved. It is not anticipated that the market will get a "power boost" via rising market multiples (P/Es); interest rates may cap multiple expansion. Further, this environment probably favors stock picking and sector rotation as important strategies for the active manager, rather than passive strategies that "own it all" (including highly leveraged companies without earnings). We are encouraged to remain long-term invested. This bull market will probably enjoy more time to run and grow older. And don't be surprised if 2018 provides better economic growth than that earned by the stock market. 1984 and 1994 were both years of stronger economic growth than stock market performance (see charts on pg. 6). And, when *time* progressed, 1985 and 1995 both showed strong market advances.

TIGHTENING UNTIL SOMETHING BREAKS

Donald Rumsfeld was quoted saying, "There are things we know. We also know there are known unknowns; that is to say, we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know." It's this latter category that tends to make for difficult times…in markets.

There is little question (things we know) that the current strength of the US economy warrants further "normalization" of interest rates. The economy is doing fine – growing with benefit of tax reform with low inflation. The key question is whether the Fed will overtighten – too much and/or too fast (known unknown)? Usually when the economy is reflecting strong GDP growth with rising inflation, the Fed needs to act by raising short interest rates to rein inflation from rising too fast. If the newly comprised Fed is committed to its current tightening path, it looks set to tighten into a yield curve inversion and increase the possibility that over-leveraged players get in trouble – a weak link in the chain breaks. Before inverting though, the curve flattens. Currently, the yield curve is flattening with longer maturity bonds offering interest rates not much higher than rates on short maturity bonds.

"The yield curve flattening experience of today is closely watched by market strategists. ...if the new Fed does not slow, but progresses too fast and/or too much, then tightening could cause something to "break."

Interest rate policy is like turning a light dimmer switch (not on/off switch). Off is when the yield curve inverts (short rates higher than long rates); or economic growth "dims" to off. When the dimmer is on, the more turning up of the dimmer is like the Fed providing lower attractive interest rates which "brighten" the economy "aglow." [By the way, stocks tend to perform well as the curve flattens.] The Fed is underway in "turning down the dimmer" on the economy as it raises rates.

The yield curve flattening experience of today is closely watched by market strategists. The "term premium", higher rate earned on longer bonds occurs because investors expect to earn higher yields on bonds that mature further out in time because of uncertainty to/from various risks (economy, inflation, politics); the curve also indicates the collective outlook for inflation and interest rates is years out. Thus, when long rates are flat with short rates, or if they go negative (below) short rates, the collective market opinion is the Fed is making a policy error. Monetary policy affects the economy with a lag. History reveals that an inverted yield curve (short term rates are higher than long rates) creates an economic recession and often a bear market in stocks. The current flattening yield curve shares the collective perspective that inflation and interest rates are expected to remain low for many years into the future. If the new Fed does not go slow, but progresses too fast and/or too much, then tightening could cause something to "break". A negative term premium means a policy mistake occurred.

Recall the Fed economic outlook, cited in the earlier article; those growth prospects look slow, not fast. If that is the Fed's own outlook, we hope they are also concluding to take it easy and slow with "normalization". Plus, higher interest rates make the cost of financing the US government debt obligation ever more expensive. Did you know that over 50% of the US $15 Trillion debt, with an average interest rate of 1.8%, matures in 3 years or less? If it is refinanced at higher rates, it means the US debt burden grows faster. Larry Kudlow recently stated at a news conference in Washington, "My hope is that the Fed, under its new management, understands that more people working and faster economic growth does not cause inflation. My hope is that they understand…and move very slowly." A flat yield curve is okay; an inverted curve is not welcomed.

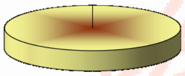
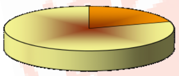
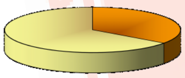
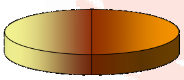
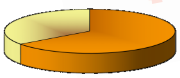
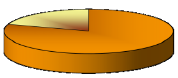
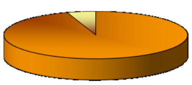
What's our best guess? The corrective process that began in January is ongoing, and we are reluctant to get bearish. We are watchful bullish. The US economic environment is still supportive; yet tariff rhetoric introduces slowing influences that could impact business optimism. Combining the two commentary thoughts within Nvest Nsights this quarter, there are two watch points: the *Fed tightening until something breaks*, and *tariffs until the market shakes*. Of these two, the former worries us the most, longer-term. We are historically reminded about 1984 and 1994 - strong economies and slow markets to be followed by 1985 and 1995. Maybe 2018 (strong economy and slow market) is the bridge for 2019 when stocks advance faster than the economy. Keep watchful and stay invested.

ANNOUNCEMENTS:

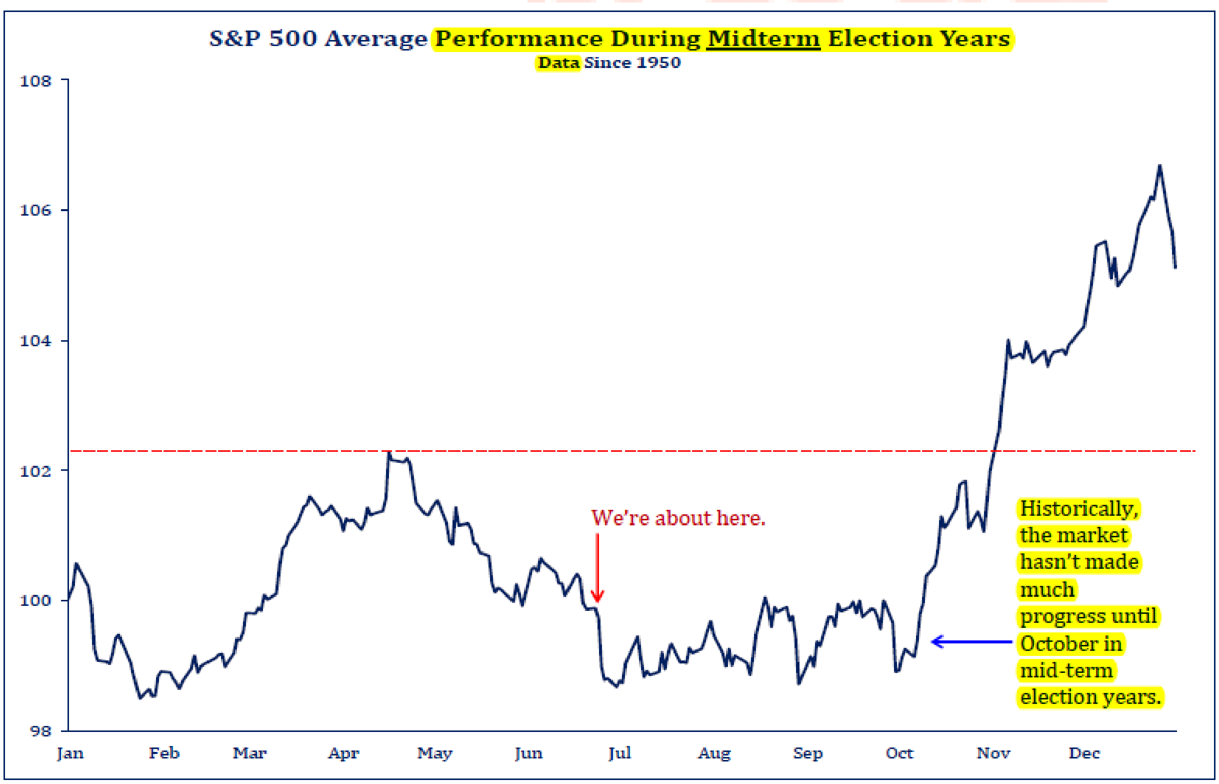
- Early July - 3Q 2018 fees collected. Detailed 2Q'18 performance reporting delivered
- September 3 - Labor Day; banks and financial markets closed
- September 30 - End of 3rd Quarter.
- Our ADV Part 2A & B as required by the SEC & Ohio (and other states) is available to you anytime upon request.

Benchmarking as of June 30, 2018

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

	Index Portfolio	Stock/Bond Allocation		Total Return Through 6/30/2018				
				2nd Qtr	YTD	12 Mths	3 Years	5 Years
	Capital Preservation	0% / 100%	*Cumulative*	0.3%	0.0%	0.5%	3.5%	6.1%
			Annualized			0.5%	1.1%	1.2%
	Income	20% / 80%	*Cumulative*	0.7%	0.4%	2.9%	8.0%	16.1%
			Annualized			2.9%	2.6%	3.0%
	Balanced Conservative	35% / 65%	*Cumulative*	0.9%	0.6%	4.1%	10.5%	21.5%
			Annualized			4.1%	3.4%	4.0%
	Balanced	50% / 50%	*Cumulative*	1.3%	1.0%	6.0%	14.2%	30.0%
			Annualized			6.0%	4.5%	5.4%
	Balanced Growth	65% / 35%	*Cumulative*	1.6%	1.2%	7.8%	17.7%	38.1%
			Annualized			7.8%	5.6%	6.7%
	Growth	80% / 20%	*Cumulative*	2.0%	1.7%	9.8%	21.8%	47.8%
			Annualized			9.8%	6.8%	8.1%
	Aggressive Growth	95% / 5%	*Cumulative*	2.2%	1.9%	11.0%	24.2%	53.8%
			Annualized			11.0%	7.5%	9.0%

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, 20% International. You cannot invest in these indexes or averages and all above indexes/averages include a 5% allocation to the Treasury Bill Index, reflecting a nominal level of cash. The level of diversification represented by these benchmark averages may be materially different than actual client accounts; therefore, clients may experienced different levels of performance volatility. Past performance is no guarantee of future results.



Selected Mutual Funds - Total Return Performance Summary

As of June 30, 2018

Bond Funds - Taxable	Style	2nd Qtr	YTD	12 Mths	3 Years	5 Years
Taxable Short-Term Bond Average		*0.3%*	*-0.1%*	*0.4%*	*1.2%*	*1.3%*
Taxable Intermediate Bond Average		*-0.2%*	*-1.6%*	*-0.4%*	*1.7%*	*2.2%*
Wells Fargo Ultra Short	AS	0.4%	0.6%	1.0%	1.0%	0.8%
AC Alternatives Market Neutral Value	AS	-0.2%	-2.1%	-0.9%	1.1%	2.0%
Vanguard Short Federal	HS	0.2%	-0.2%	-0.1%	0.6%	0.8%
American Century Short Duration	HS	0.3%	0.3%	0.6%	1.2%	1.2%
Pioneer Short-Term Income	HS	0.3%	0.4%	0.7%	1.3%	1.2%
PIMCO Low Duration	HS	-0.2%	-0.4%	0.4%	1.1%	1.3%
Vanguard Short-Term Investment Grade	HS	0.2%	-0.4%	0.1%	1.5%	1.7%
American Century GNMA Income	HI	0.2%	-1.1%	-0.5%	0.6%	1.4%
Diamond Hill Corporate Credit	LI	1.0%	1.3%	3.8%	6.0%	5.6%
Miller Convertible	LI	-0.1%	0.3%	4.2%	3.8%	6.2%
Bond Funds - Tax Exempt						
Tax-Free Intermediate Bond Average		*0.8%*	*-0.3%*	*1.1%*	*2.3%*	*2.9%*
Vanguard Muni Limited Term	HS	0.7%	0.5%	0.6%	1.2%	1.3%
T. Rowe Price Tax Free S/I	HS	0.5%	0.2%	-0.1%	0.9%	1.1%
Vanguard Muni Intermediate Term	HI	0.8%	-0.3%	1.0%	2.4%	3.1%
Vanguard Ohio Long-Term	HL	0.8%	-0.6%	2.0%	3.5%	4.4%
Stock Funds - Domestic						
S&P 500 Index		*3.4%*	*2.7%*	*14.4%*	*11.9%*	*13.4%*
Equity Fund Average		*3.7%*	*3.4%*	*13.4%*	*8.7%*	*10.7%*
Schwab Large Cap Growth	LG	5.9%	7.7%	21.1%	13.4%	16.0%
Parnassus Endeavor	LG	1.6%	-0.9%	7.9%	12.5%	15.3%
T.Rowe Price Dividend Growth	LV	2.4%	1.6%	10.8%	11.0%	12.3%
Goldman Sachs US Equity Dividend & Premium	LV	2.9%	1.0%	9.6%	9.2%	10.6%
Sit Dividend Growth	LV	0.9%	-0.4%	10.1%	9.5%	10.8%
Hennessy Focus	MG	3.0%	0.6%	11.3%	8.0%	11.3%
John Hancock Disciplined Value Mid-Cap	MV	-0.8%	-1.2%	7.3%	9.1%	12.5%
SPDR S&P600 Small Cap Growth	SG	8.9%	11.6%	22.3%	14.3%	15.4%
Neuberger & Berman Genesis	SB	3.8%	4.5%	14.9%	10.9%	11.6%
Diamond Hill Small-Cap	SV	1.5%	0.5%	9.3%	6.0%	8.1%
Wells Fargo Small-Cap Value	SV	6.1%	4.0%	12.3%	12.7%	9.9%
Stock Funds - International						
Morgan Stanley EAFE Index (Foreign)		*-2.6%*	*-3.8%*	*7.3%*	*5.1%*	*6.0%*
Oakmark International	LV	-5.0%	-7.7%	3.1%	5.7%	6.8%
John Hancock International Growth	LG	-1.5%	1.6%	14.3%	8.9%	10.3%
Thornburg Developing World	LG	-6.9%	-7.4%	7.0%	3.3%	3.0%
Harding Loevner International Small Company	SG	-2.0%	-0.8%	10.1%	9.2%	9.3%
Hennessy Japan	LB	0.9%	2.2%	18.4%	14.0%	14.9%
Stock Funds - Specialty						
Salient-Forward Select Income (REIT)	MV	4.3%	-2.5%	-2.9%	3.4%	5.1%
Neuberger Berman Real Estate Securities	MV	5.6%	-0.4%	4.8%	8.3%	7.6%

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YOUR "FAMILY LOVE LETTER"

Did you ever write and share your "family love letter?" It's probably safe to say that each of us is aware of tragic situations where a loved one died at too young an age, maybe suddenly and unexpectedly. These experiences are shocking, and it is natural to catch yourself wondering how those closest to the deceased will be cared for or work through the situation. Loved ones often find they are ill-prepared to attend to many aspects of another's life.

On the topic of estate planning, we are regularly encouraged to plan properly for a sudden incapacitation and/or death. Unfortunately, the focus begins and ends with the execution of proper documents, titling of assets, and naming beneficiaries to various financial accounts. Often overlooked however, is ensuring that appropriate family members and decision makers can access adequate information about their loved one's assets, liabilities, and intentions. And, even if deliberate thought was given to these matters, is information available and quickly accessible?

For example, how many children know where a parent wants to be buried? It can also be problematic trying to locate and access important digital documents for many of life's activities. In this day, many of our important aspects of life are often stored and maintained exclusively in digital format on computers and devices. Recently, we learned of two different individuals losing someone close and experiencing great challenge trying to discover the deceased's mobile devices were password protected and memories contained therein (priceless photos, videos, emails, etc. – not to mention important documents) might be inaccessible forever, unless the password could be successfully guessed. The inability to make basic decisions because of the lack of this important information often adds to challenging life events.

Enter the "family love letter". Such a document is intended to be a thoughtful disclosure of all information that would be helpful to a trusted family member, particularly when a typical will or other legal documents lack the "digital" fine points of life. We offer several component sections to include in your "family love letter:"

I. Advisors & Assets: list your trusted financial professionals and contact information, including investment advisors, estate planning attorneys, and accountant. List primary physicians, bankers, and key institutions to help. Asset inventory of where accounts are held - include in this sections any notes that help decision makers understand what objectives were being pursued and why certain accounts are in place.

II. Financial Information: inventory of business interests, outstanding liabilities, credit cards, personal guarantees, leases, and recurring subscriptions. Provide an overview of core monthly income and expenses (budget) can also be extremely valuable in the event that the incapacitated individual handled much or all of the financial affairs of the family. Frequent flier miles are regularly overlooked, but may be transferrable; also debts/money owed to you by others should be included.

III. Insurance & Benefits: life insurance, long-term care, and health insurance policies should note the related contact persons for each. Beneficiary designations should also be reviewed and kept current per your latest estate documents/plan.

IV. Documents and Other information: aside from the standard inventory of estate planning documents (wills, trusts if applicable, legal business and medical powers of attorney, marriage license, passports, birth certificates, etc), this is where you can share the specific location of all such items and how to access. Do you maintain a safety deposit box? What bank, box number, and where the key can be found? Do you have a personal safe - how is it accessible? Also document important passwords such as your primary computer, mobile devices, and email passwords (often password recovery utilizes email).

V. Final wishes: document areas and desires of your life that would not be crystal clear from any of the above. What is most important to you; what is your family mission statement; and how would you want to be remembered? Experienced estate/probate attorneys share that your wishes, spelled out in writing, are critical for settling family disputes and inheritance issues.

Thus, it probably goes without saying that any document like this is meant to be shared with a trust loved one upon completion, and not just locked away. Be very careful, sharing this information only with those you unequivocally trust (spouse, designated administrator of estate, etc). Sharing a copy with more than one person may protect against unauthorized alteration.

As this brief topic discussion hopefully illustrates, estate planning is not just for the wealthy or avoidance of probate and/or a death tax. Rather, an important goal of planning should be to provide a legacy for loved ones; sharing about passions you care most about. If you have questions in this area, or would like to receive a more comprehensive template from which to build your "love letter", please contact us. While few among us enjoy discussing these topics, some thought and planning will enhance what we believe is every person's utmost goal… achieving "financial peace of mind."

TWO HISTORICAL ANALOGUES WORTH CONSIDERING…
1984 & 1994

Both 1984 and 1994 were reset years… the S&P marked time in a narrow range, but earnings were up big the economy was strong, and the multiple contracted. The next years – 1985 and 1995 – both saw very strong market returns.