nvest nsights

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Delivering financial peace of mind.

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A GREAT STORY NEVER TOLD

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

Following a tug-of-war market experience during the first 6 months of 2018, stocks surged ahead during the 3Q with the S&P500 up +7.2%. It was the fastest advance since late 2013. Combined with the first half, the accumulation brings the YTD rise to just over +10%. Company earnings and economic growth are rising at the fastest pace of this current cycle and expanding the current Bull Market run, yet these facts remain a great story never told. Few want to acknowledge this Bull Market is now the longest running ever. Also, few will acknowledge that the current economic rebound will shortly become the longest running ever. This current run approaching 10 years remains unloved for a variety of reasons, including the fact that many investors experienced 2 Bear Markets in 15 years. Those two experiences eroded investor portfolio values and family wealth, and wreaked havoc with investor confidence. In reality, the only situation where the length of this economic rebound and/or market advance is cited is when stating its age as a compelling reason to anticipate the current trends must soon end. Many continue to hold a keen aversion to owning risk assets even today.

A survey of *professional* investors, taken at 3Q-end offers additional perspective on "unloved:"

- Stock market performance expectations through year-end are minimal; nominal at best. And return expectations offer a dim view and higher bond yields through the end of 2019.
- Investors are most worried that the Fed will overdo-it as it normalizes (raises) rates.
- Another fear relates to a brewing trade battle with China.
- A recession is somewhat unlikely in 2019, but viewed as increasing toward 2020, and a higher expectation by 2021.
- Professional investors maintain a more positive expectation for US/domestic stocks, expecting outperformance compared to Europe, Japan, and/or Emerging Markets. Again, performance expectations are subdued.

Entering the 4Q with strong corporate earnings and economic growth, we expect that the current rally and Bull Market should keep going. This backdrop is a key factor why investors should look past the continuing trade spat between the US and China. The economic backdrop provides the Bull Market's foundational support.

How though, should one personally think about investing when entering the home stretch of 2018? And, how should 2019 be approached? It's concerning to read so many investors, including professionals, are skeptical, cautious, and guarded about investing. Investors see the shot clock running, and no one wants another bear market experience. Can history offer any advice or guidance? History shares it can be tough to "fight" the upward performance tendency found in the final 3-months of the year. During the last 25 years, the S&P500 gained an average of +5% over the final 3 months; 80% of the years produced a positive returns. Second, mid-term election years can produce an increase in volatility, but 4Q performance is often stronger than a typical year (uncertainty is removed regardless of who wins). Third, when the markets conclude a strong 3Q, history indicates the action bodes well for market performance through the next 3 and 6 months. Last of all, be aware that 4Q often provides some market leadership reversion (in October-November), as laggards can work. One should not ignore 4Q historical market action.

In August, our monthly commentary was titled, *Extremist*. Recall that it cited the market action and performance over the last year or so, revealing a big contrast between what is working very well and just okay. It shared that growth style stocks were significantly outperforming value. It also revealed that foreign stocks were a portfolio performance drag since year-end. And, diversification used to manage risk was slowing overall portfolio performance due to tactical exposures that include large and small, value and growth, and international. Concentrated exposure to growth provided the highest returns.

From a valuation standpoint, the opposite perspective is also extreme. Domestic stocks, which more investors favor, are more expensive than foreign. Value is decidedly more attractive (for risk) than most growth stocks. In essence, valuations are stretched between many competing assets. Investors can expect that the performance divergence between growth and value should normalize - they generally travel a similar chart path.

The extremist perspective offers that when two historically linked items move apart in almost opposite direction, they only diverge so far before abruptly reverting back to normal paths. Almost like the image of a shark's mouth opening wide. Once opened wide, it ultimately snaps closed quickly. Extremist markets cause some investment strategies to advance slowly while others shine. Some asset types become expensive (maybe irrationally exuberant), while others are undervalued (irrational exasperation). When both asset types are used in a portfolio for diversification, the performance results often look soft or slow compared to the "market." Key to remember though, the jaws will close; out-of-favor styles will revert to their mean (value/foreign for example will perform well again). It is only a matter of time before "style" shifts, which no one can correctly anticipate. Thus, diversification does provide benefit, because it manages risk. As top performing investments become expensive, it is appropriate to rebalance their exposures. Failure to rebalance or manage risk can cause portfolio values to undergo wild or bumpy rides when high-priced styles move out of vogue; long-term performance can be rocked. It is important to own various investments to diversify risk and smooth investment portfolio values. (continued on pg. 2)

A great story is being told. The current Bull Market is advancing because of fundamental (economic conditions and rising corporate profits) support. To fully experience it, we advocate being a long-term investor - being "time in the market." Nvest adjusts the tactical strategy over time, due to valuation differences between styles – domestic and foreign, growth and value, even small, medium and large. Portfolio tactical strategy changes are generally small, gradual and reversible. All are designed to manage risk.

"The current Bull Market is advancing because of fundamental (economic and rising corporate profits) support. To fully experience it, we advocate being a long-term investor…"

FLYING ON ONE ENGINE

A September 28th Reuters headline, "Flying on one engine, global growth exposed to turbulence" creates a good analogy about the current global economic environment. The US may be responsible in part, when in January the Administration started tariff talk. Financial markets were immediately rattled. Growth in many European, Asian and Emerging Markets started to slow, with some even stalling. Like engines on a jet plane, one engine stalls and can strain another. Soon, the plane is flying on only one engine. The US is increasingly the main engine behind the global economy. And, the biggest economy is under scrutiny as some consider the current economic boost is due to fiscal stimulus and tax cuts, making it too on borrowed time. As one economist wrote, "When the downturn in the US economy starts, the effects (on share prices, interest rates, capital flows, emerging countries, exchange rates, global trade and global growth) will be pronounced. This downturn… is inevitable as the US is returning to full employment." In essence, the jet (world economy) will soon lose its one engine (US), and then bad things can be expected. The world's economic conditions are divergent – the US doing well, while elsewhere (in many instances) conditions are soft.

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WEALTH STRATEGIES

Recent strong US economic growth and company earnings powered the stock market in 3Q. But this rally comes at a cost with US stocks being increasingly expensive compared to other major indexes around the world; valuations and recent performance are stretched. US stocks trade at a 12% premium to foreign (22 developed markets and 24 emerging markets). That's the biggest gap since 2009, and makes it hard to imagine that the divergence in valuation is sustainable. Nearly 50% of investors believe the divergence in the global economy will end with US growth decelerating. Another 28% think the divergence will end because growth in Europe and Asia will accelerate. The US is basically leading the world in growth (economic and company earnings), while other areas of the world look more attractively priced. But, what if….?

Here in the US, the economic outlook is polarized by opposing views. One camp offers – *economic growth is reaching its zenith* after a slow grinding 9+ year expansion via zero-rate interest policy. The peak in economic growth (and thereby peak in company earnings and stock prices) is at hand as the Fed pushes forward to normalize interest rates; because the yield curve is flattening (may invert); and trade tensions escalate. These factors can collude to pull the stock market lower (the last jet engine fails). Across the divide, to the opposing view – *economic growth is on firm footing*, consumer confidence is at fresh highs, corporate profits are strong and will continue because of tax cuts/reform, repatriation of foreign earnings, and other fiscal spending stimulus. This backdrop would advocate a continued lift of stocks and portfolio values. So, which is it?

"The US treasury yield curve is now in the hands of the Federal Reserve - too much more upward adjustment to interest rates, too fast, could quickly alter the pace of domestic growth."

This confusion leads many investors to hide - avoid being too risky until uncertainty (economic and political) becomes more clear. Please recall, tax reform boosted and will keep economic growth strong, providing above historical trend growth near 3%. Domestic interest rates are rising, echoing that view (meaning Fed will further raise rates). The risk of a global trade war appears receding, for now. Just Sunday the US said "Goodbye NAFTA! Hello USMCA!" with the announcement of a modernized trade agreement between the US, Mexico, and Canada. This change comes at a time when the US economy is booming. And when the US does well, its two closest trading partners should also prosper. At the same time, inflation is expected to remain managed and low; not accelerating too fast.

The US Treasury yield curve is now in the hands of the Federal Reserve – too much more upward adjustment to interest rates, too fast, could quickly alter the pace of domestic growth. The Fed recently concluded its "negative real interest rate" policy (keeping interest rates below inflation). As it institutes additional rate increases, the Fed enters a new era of "normal real rates" with interest rates at/above inflation. The Fed needs to keenly avoid a policy mistake of raising interest rates too much above the inflation rate. Such action, if raised too fast, too much, could cause the current flat yield curve to invert – a condition wherein short maturity bond rates are higher than long maturity bond rates - and initiate an economic downturn and end of the current Bull Market. It appears the US economy can take higher rates as it continues to grow at 3% or more; but it is uncertain if the financial markets can.

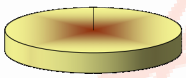
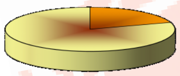
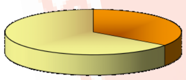
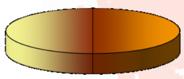
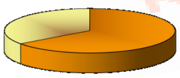
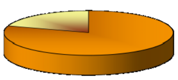
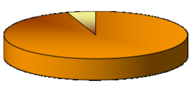
We continue to watch the economic and interest rate environment closely. Stocks should be powered past trade talks, though continuing tariff and trade-spats with China may make the financial markets shake (see interesting related chart on the bottom of page 3). Fed policy must be slow and careful to avoid tightening until something breaks - a policy mistake. Client portfolios are invested to benefit from a continuing run of the current Bull Market. We monitor divergent valuations of asset types to guide our tactical strategy – risk is "dialed down." That means owning more exposure to attractive undervalued asset types than expensive ones. We believe the market divergences will revert to normal relationship, and we expect this strategy provides better risk/return characteristics for the long term.

ANNOUNCEMENTS:

- Early October - 4Q 2018 fees collected. 2Q'18 performance reporting delivered
- October 8 - Columbus Day; bond markets and banks closed
- November 12 - Veteran's Day; bond markets and banks closed
- November 22 - Thanksgiving Day
- December 25 - Christmas Day
- December 31 - Last Day of 4Q
- Our ADV Part 2A & B as required by the SEC & Ohio (and other states) is available to you anytime upon request.

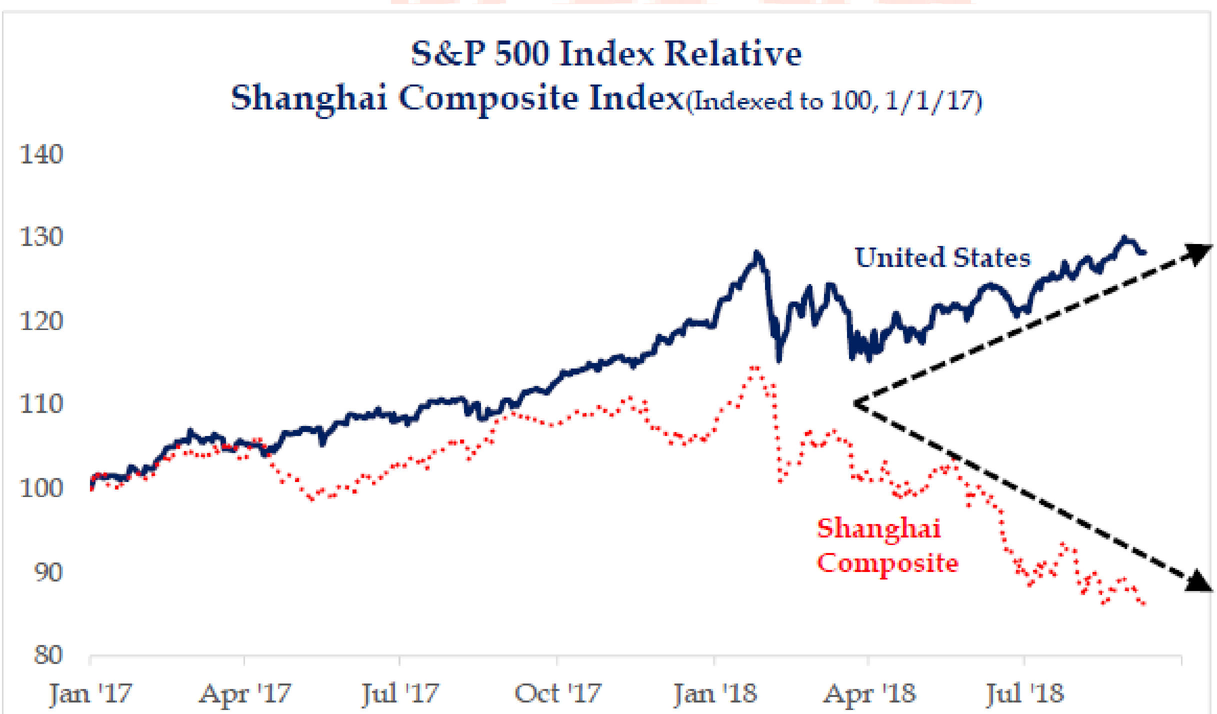
BENCHMARKING AS OF SEPTEMBER 30, 2018

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

	INDEX PORTFOLIO	STOCK/BOND ALLOCATION		TOTAL RETURN THROUGH 9/30/2018				
				3RD QTR	YTD	12 MTHS	3 YEARS	5 YEARS
	Capital Preservation	0% / 100%	*Cumulative*	0.5%	0.6%	0.6%	4.0%	6.0%
			Annualized			0.6%	1.3%	1.2%
	Income	20% / 80%	*Cumulative*	1.3%	1.7%	2.9%	11.7%	15.1%
			Annualized			2.9%	3.8%	2.9%
	Balanced Conservative	35% / 65%	*Cumulative*	1.7%	2.4%	4.1%	15.8%	20.1%
			Annualized			4.1%	5.0%	3.7%
	Balanced	50% / 50%	*Cumulative*	2.4%	3.5%	6.1%	22.2%	28.0%
			Annualized			6.1%	6.9%	5.1%
	Balanced Growth	65% / 35%	*Cumulative*	2.9%	4.3%	7.7%	28.4%	35.2%
			Annualized			7.7%	8.7%	6.2%
	Growth	80% / 20%	*Cumulative*	3.6%	5.5%	9.8%	35.5%	44.2%
			Annualized			9.8%	10.7%	7.6%
	Aggressive Growth	95% / 5%	*Cumulative*	3.9%	6.1%	10.9%	39.9%	49.4%
			Annualized			10.9%	11.8%	8.4%

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.

Trade War?
When it comes to the ongoing exchange of words between the United States and China, financial markets seem to be saying the United States holds the stronger hand. Trade-related tensions with other countries appear to be resolving more amicably, but between the world's two largest economies the situation is still quite volatile.



Selected Mutual Funds - Total Return Performance Summary

As of September 30, 2018

Bond Funds - Taxable	Style	3rd Qtr	YTD	12 Mths	3 Years	5 Years
Taxable Short-Term Bond Average		*0.5%*	*0.5%*	*0.4%*	*1.4%*	*1.2%*
Taxable Intermediate Bond Average		*0.2%*	*-1.4%*	*-1.1%*	*1.7%*	*2.2%*
Wells Fargo Ultra Short	AS	0.7%	1.2%	1.4%	1.3%	0.9%
AC Alternatives Market Neutral Value	AS	-0.6%	-2.7%	-1.8%	0.8%	1.6%
Vanguard Short Federal	HS	0.1%	-0.1%	-0.3%	0.5%	0.7%
American Century Short Duration	HS	0.6%	0.9%	0.7%	1.4%	1.2%
Pioneer Short-Term Income	HS	0.4%	0.8%	0.8%	1.3%	1.2%
PIMCO Low Duration	HS	0.4%	0.0%	0.0%	1.4%	1.2%
Vanguard Short-Term Investment Grade	HS	0.6%	0.2%	0.2%	1.6%	1.7%
American Century GNMA Income	HI	-0.2%	-1.3%	-1.5%	0.3%	1.2%
Diamond Hill Corporate Credit	LI	1.3%	2.6%	3.7%	7.2%	5.5%
Miller Convertible	LI	1.0%	1.3%	3.3%	6.5%	5.3%
Bond Funds - Tax Exempt						
Tax-Free Intermediate Bond Average		*-0.2%*	*-0.4%*	*-0.1%*	*1.8%*	*2.9%*
Vanguard Muni Limited Term	HS	0.0%	0.5%	0.0%	0.9%	1.2%
T. Rowe Price Tax Free S/I	HS	-0.2%	0.0%	-0.6%	0.5%	1.0%
Vanguard Muni Intermediate Term	HI	-0.2%	-0.5%	-0.2%	1.8%	2.9%
Vanguard Ohio Long-Term	HL	-0.3%	-1.0%	0.5%	2.7%	4.4%
Stock Funds - Domestic						
S&P 500 Index		*7.7%*	*10.6%*	*17.9%*	*17.3%*	*14.0%*
Equity Fund Average (Morningstar Mgr Agg US Core EW)		*5.0%*	*8.1%*	*13.8%*	*15.0%*	*10.9%*
Schwab Large Cap Growth	LG	8.5%	16.8%	25.2%	19.1%	16.1%
Parnassus Endeavor	LG	5.4%	4.4%	9.8%	17.4%	15.2%
T.Rowe Price Dividend Growth	LV	7.2%	8.9%	15.3%	15.9%	12.8%
Goldman Sachs US Equity Dividend & Premium	LV	5.0%	6.0%	10.9%	13.3%	10.9%
Sit Dividend Growth	LV	6.8%	6.3%	13.5%	14.4%	11.5%
Hennessy Focus	MG	2.5%	3.1%	8.9%	10.9%	10.2%
John Hancock Disciplined Value Mid-Cap	MV	3.6%	2.3%	7.4%	12.5%	11.7%
SPDR S&P600 Small Cap Growth	SG	7.0%	19.3%	23.9%	20.1%	14.4%
Neuberger & Berman Genesis	SB	6.9%	11.7%	18.1%	16.2%	10.8%
Diamond Hill Small-Cap	SV	1.7%	2.1%	6.0%	8.5%	7.0%
Wells Fargo Small-Cap Value	SV	-3.0%	0.9%	4.0%	17.5%	7.5%
Stock Funds - International						
Morgan Stanley EAFE Index (Foreign)		*0.7%*	*-3.1%*	*1.8%*	*10.0%*	*4.1%*
Oakmark International	LV	-0.9%	-8.5%	-6.3%	10.5%	4.0%
John Hancock International Growth	LG	0.5%	2.1%	6.7%	11.4%	8.5%
Thornburg Developing World	LG	-2.4%	-9.6%	-3.7%	8.6%	1.7%
Harding Loevner International Small Company	SG	-0.1%	-0.8%	4.0%	12.4%	7.0%
Hennessy Japan	LB	6.1%	8.5%	21.0%	20.7%	14.4%
Stock Funds - Specialty						
Salient-Forward Select Income (REIT)	MV	2.7%	0.2%	-0.9%	5.5%	6.0%
Neuberger Berman Real Estate Securities	MV	0.4%	0.0%	3.8%	7.7%	8.2%

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RE: Request Current Disclosure Form ADV Part II

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PERSONAL FINANCE SPOTLIGHT: THE BEST LAID PLANS…

Steve Henderly, CFA, Nvest Wealth Strategies, Inc.

It's often said that "no matter how carefully something is planned, things may still go awry". The saying is adapted from a well-known line in the Poem "To a Mouse" by Robert Burns. Perhaps Mr. Burns was in the process of retirement planning when crafting this poem? Regardless, its cautionary tone can be applied. As we work with clients helping them articulate and achieve financial goals, there are a number of areas that can be underestimated relative to actual spending.

- Helping family: several quarters past, we discussed this topic in "When Helping Hurts" (highlighting the moral hazard and personal risks that can be created by regularly helping able-bodied adult children) – that topic remains one of the most common potholes hit by clients. Those comments aside, you may be willing to slash your own expenses in retirement if times get tough, but what will you do if your children get in a bind? Saying "no" is hard. Also of critical importance, we regularly see a deficiency in the size of personal (non-retirement) account savings. Personal savings is a more tax-efficient source to utilize than retirement accounts when considering financial assistance. But be careful, as utilizing personal money to provide assistance reduces your own flexibility down the road; this should be carefully considered before offering assistance.
- Periodic Big-Ticket Purchases: it is easy to forecast what financial life *should* look like on a "normal" monthly basis. Yet few of us are disciplined - or perhaps "lucky" enough - to experience lots of "normal months" or years. Life happens! Folks often meticulously estimate day-to-day expenses but forget to factor in the periodic, but mostly predictable expenses like a new car, new furnace, or roof. Failure to build-in a cushion or allowance for these big-ticket purchases can result in actual Annual Spending Rates that run well ahead of projections and create emotional anxiety. It is also these big purchases and "lumpy" cash needs that can blow holes in a financial plan if one did not save post-tax during working years to supplement retirement saving. Lumpy withdraws from retirement accounts can quickly push one into a higher tax bracket and require larger distributions than if taxes were not due on the amount distributed. A better approach is to utilize personal money and/or spread withdraws for larger purchases over a multi-year period.
- Entertainment: many retirees assume that with kids out of the home and a mortgage paid off, their household budget will enjoy a dramatic trimming. Yet when retired, the desire to travel, visit adult children (and perhaps grandchildren), or pursue other hobbies results in a much higher leisure budget than during the working years. From our observations, leisure spending does not begin to meaningfully taper back until closer to age 80 or beyond, depending on health.
- Health care: even when insured by Medicare, folks are often shocked by the cost of health care. The average married couple in their late 60s can expect to spend $13,000+/year in medical related expenses when including deductibles, medicines, and etc. Prescription drugs are one source of surprise. Another revelation facing affluent retirees is that Medicare premiums are higher for couples whose gross income exceeds $170k. Again, if all your retirement savings is held in retirement accounts, your ability to manage taxable income below the threshold may be constrained.
- Long term care: this is perhaps the most costly unexpected expense in retirement. The biggest challenge relates to the nearly impossible ability to know who will require long-term care: 15% of folks will spend more than $250k on long-term care-related expenses during retirement years; while roughly 50% of retirees won't spend anything at all. Married couples are at greater risk because of the increased probability of a long-term care event relating to joint lives, and also because of the impact such spending can have on the assets available to the surviving (and possibly still very healthy) spouse.

Living a long life - it is no mystery that the longer one lives, the more savings (personal and retirement) they will require. Often folks worry about dying young; but when it comes to retirement planning, the focus often becomes living too long and managing the consumption of savings!

From where we sit, underestimating spending in key areas is a BIG deal because forecasting incorrectly can mean the difference between a comfortable retirement and one that is a struggle. Further, while we take care to offset the potential for over-optimistic assumptions - by utilizing conservative rates of investment growth relative to the inflation of expenses and impact of taxes on distributions from traditional retirement accounts - this writing hopefully further illustrates why savers are very wise to be deliberate about building financial flexibility. Specifically, this means making after-tax, personal (non-retirement) saving an important priority – just as important as contributions to your retirement plan/accounts. The best, most "bulletproof" financial plans are those that feature not only pre-tax retirement monies, but also a meaningful non-retirement investment balance, that when added together translate to a low-sustainable spending rate from the outset of your retirement years.