GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	0.62%	3.43%	2.65%
Russell Midcap Index	0.69%	2.82%	2.35%
Russell 2000 Index	0.72%	7.75%	7.66%
Dow Jones Industrial Average	-0.49%	1.26%	-0.73%
Morgan Stanley EAFE Index	-1.22%	-1.24%	-2.75%
DJ US Real Estate Index	4.07%	7.78%	1.41%
S&P Commodity Index	1.36%	8.00%	10.36%
Barclays Aggregate Bond Index	-0.12%	-0.16%	-1.62%

INDEX RETURNS

On the surface, the major domestic equity indexes are showing a recovery in the second quarter. The S&P 500 was up 3.43% for the three month period. However, it is important to note that these are market weighted indexes and not all areas within the index did well. For example, the Russell Top 200 Growth was up 7.83% in the quarter while the Russell Top 200 Value was down 2.41%. Growth has continued to outperform in 2018.

A big story in the second quarter was the performance of small cap stocks. The Russell 2000 index was up 7.75% in the second quarter raising its year-to-date return to 7.66%.

The Dollar has strengthened recently and subsequently hurt international returns. The MSCI EAFE Index declined 1.24% in the quarter and is now down 2.75% on the year. Emerging markets declined 7.96% in the quarter and are now down 6.66% on the year with Brazil down 25% just in the last three months.

The bond market is beginning to struggle with the Federal Reserve rate increases. The Barclays Aggregate Bond Index was down 0.16% in the quarter and is now down 1.62% on the year. EM Debt is down 5.97% YTD.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy grew at a 2.0% annualized rate in the first quarter following the 2.9% rate in the 4th quarter of last year. Early estimates for the second quarter are in the 3.0-3.5% range. Expectations are that economic growth will accelerate in the second half of 2018. Lower household tax rates should increase discretionary consumer spending and lower corporate tax rates should lead to more capital improvement spending from companies. This all points towards solid economic growth for the remainder of the year. 2019 could be a different story as the Fed continues to raise rates and we move closer to a yield curve inversion.

The Leading Economic Index increased in May by 0.2% to 109.5 following a 0.4% increase in April and a 0.4% increase in March. Industrial Production dropped 0.1 percent in May after rising 0.9 percent in April. The Capacity Utilization rate was at 77.9 percent in May which is still 1.9 percentage points below the long-term average.

Non-farm payrolls increased by 213,000 in June and the unemployment rate rose to 4.0%. In June, the civilian labor force grew by 601,000 and the labor force participation rate increased by 0.2 percentage points. This means that more people are now entering the workforce. Roughly 4.5 million Americans graduate with a college degree or higher each year. Initial weekly unemployment claims were 231,000 for the week ending June 30. According to the JOLTS survey, there were 6.7 million job openings in April which is now higher than the number of unemployed Americans.

Manufacturing increased in June to 60.2% from 58.7% in May on the ISM PMI index. This marks the 110th consecutive month of expansion. The ISM Non-Manufacturing index was at 59.1% in June which marks the 101st consecutive month of expansion. The Business Activity Index was at 63.9% and the New Orders Index was at 63.2%. All data points towards further economic expansion in the second half of 2018.

Global economies continue to expand at an impressive pace. The JP Morgan Global PMI was at 53.0 in June. Any reading above 50 represents expansion. The Euro area is at 54.9 led by Germany and the UK who are at 55.9 and 54.4 respectively. Emerging markets continue to surge with a June reading of 51.2 led by Taiwan at 54.5 and India at 53.1. Assuming no major trade disruptions, look for further global expansions in 2018.

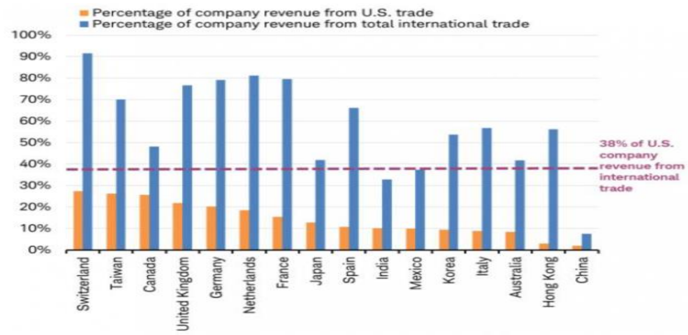
EQUITY AND BOND MARKETS

There have been some positive outcomes for the markets in 2018. A reduction in the corporate tax rate to 21% increased forward looking P/E ratios instantly and stocks became fairly valued almost overnight relative to their 20 year averages. In addition, the new household tax brackets increased discretionary spending for many individuals. With the employment rate at 4.0% and earnings rising, stocks should be poised to move higher.

However, there are also some headwinds. The first headwind has been the market's historical performance in mid-term election years. On average, the S&P 500 declines 17% prior to the elections. We have not yet reached this average in 2018. The good news is that the S&P 500 on average has gained 32% a year following this pullback.

Mid-Term Election Years Drawdown
Followed by Solid Gains

The second headwind is the rising dollar and concerns over trade tariffs. Roughly 38% of revenue for S&P 500 companies comes from international trade. A disruption in this revenue could cause significant pain for equities here in the U.S. In addition, the Dollar has been rising recently versus other currencies. When this occurs, it makes our goods more expensive for international consumers, thereby making it more difficult for us to compete on a global scale. Many countries derive a large percentage of their revenue from outside of their borders. Switzerland is over 90%, with roughly 28% coming from the U.S. China only derives about 8% of its revenue from international trade and of that, only about 2% comes from the U.S.



PORTFOLIO MANAGEMENT

There have been four major themes so far in 2018. First, earnings have improved dramatically due to the corporate tax cut. Second, The Dollar has surged recently putting pressure on international sales and international investments. Third, the Federal Reserve continues to increase the Fed Funds Rate thereby flattening the yield curve. And finally, trade tariffs and protectionism have moved the markets on a daily basis as it tries to figure out the potential implications.

Although economic conditions continue to look promising, the headwinds of the trade concerns, strengthening U.S. Dollar and the flattening yield curve have our attention. In addition, this bull market and economic expansion began in 2009 which makes them both 9 years old. The average expansion lasts about 4 years.

Therefore, we are watching the indicators closely. We do not feel that it is the right time to start chasing recent strong performers (Small Caps and Large Growth). This is the time to stay true to our core diversification strategy. We are willing to give up some upside gains if we can add a little downside protection. We remain fully invested with a defensive tilt. If the yield curve inverts later this year or early in 2019, we could become more defensive.

FINANCIAL PLANNING

There is a new 20% deduction for business owners that was created with the recent Tax Cuts and Jobs Act signed in December of 2017. This deduction is being referred to as Qualified Business Income Deduction (QBI), Section 199A, and the 20% Deduction. The objective of the change was to create parity between the rates for C-Corporations (non-pass through entities) and pass through entities (S-Corps, Partnerships, LLCs, etc.).

While on the surface this new deduction sounds fantastic for many business owners, there are certain types of businesses that may not be eligible for it. For example, accountants, financial services, health care professionals and attorneys are types of businesses that have been specifically excluded from the deduction if the owner's income exceeds certain levels.

The new tax law also has several sections of it that are ambiguous. The AICPA (American Institute of Certified Public Accountants) and other professional organizations have asked the IRS for clarity on many of these issues. It is important to remember that this is a Federal deduction and it does not require states to adopt the same regulations. Many of our clients will be impacted by this new deduction and we will be discussing this in meetings in the second half of this year. Andy Young, CPA

Here are some smart phone apps that we think you might enjoy. Please let us know if you have any new apps that you would like to share with everyone.

- **<u>GroupMe</u>**: The GroupMe application allows users to create different Groups to easily text, chat, share photos and videos, share location and direct message. Pictures and Videos are saved in the gallery. Works great for Apple and Android users and is free to download and use.
- **<u>Open Table</u>**: The Open Table application allows users to discover, reserve and manage restaurant reservations virtually anywhere. Explore thousands of restaurants, view photos, menus and reviews. This is a great app to use while traveling or in your own town. This is a free application.
- **<u>Spotify:</u>** The Spotify app has changed the music industry. Listen to any song for free on your PC or iPad. There is a $10 per month fee for your mobile phone. Listen to full albums, or create playlists. Songs can be streamed instantly or downloaded. It has a small learning curve to navigate the full features. But once you learn how to use it, the app is well worth the fee.

Company News

Samantha Schnurr

Sam Schnurr joined Galecki Financial Management earlier this year as a Client Service Representative. She performs Cash Flow and Risk Management analyses and assist clients with ongoing service needs. Sam will be working primary with the clients of Andy Young, CPA, CFP® and Chloe Blythe, CFP®.

Sam graduated from Indiana University ï Purdue University of Fort Wayne. She earned her Bachelorõs Degree in Economics and Public Policy, as well as an Associates Degree in General Business Sciences. Sam enjoys outdoor adventures, spending time with her friends and family, and reading. Galecki is very pleased to welcome her to our team.

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com.