Fourth Quarter 2019

GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	1.87%	1.70%	20.55%
Russell Midcap Index	1.97%	0.48%	21.93%
Russell 2000 Index	2.08%	-2.40%	14.18%
Dow Jones Industrial Average	2.05%	1.83%	17.51%
Morgan Stanley EAFE Index	2.87%	-1.07%	12.80%
DJ US Real Estate Index	1.86%	7.30%	27.91%
S&P Commodity Index	1.75%	-4.18%	8.61%
Barclays Aggregate Bond Index	-0.53%	2.27%	8.52%

INDEX RETURNS

Equity indexes rallied at the end of September to finish the quarter roughly where they started. Larger companies tended to outperform smaller companies. U.S. Large Cap stocks were up 1.70% in the third quarter and are now up more than 20% on the year. U.S. Mid Cap stocks were up 0.48% in the quarter. Small cap stocks, as measured by the Russell 2000, declined 2.40% in the quarter and are now up 14.18% on the year.

International Developed stocks outperformed domestic stocks in September. The MSCI EAFE Index was up 2.87% in September and is now up 12.80% year to date. The MSCI Emerging Markets Index was up 1.91% in September and is now up 5.89% on the year.

The Barclays Aggregate Bond Index rose 2.27% in the quarter and is now up 8.52% on the year. Emerging Market Bonds were up 1.56% in the third quarter and are now up 13.71% year to date. High Yield Bonds had a quiet quarter gaining just 1.29%, but are still up 11.56% in 2019.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy grew at a 2.0% annualized rate in the second quarter following the 3.1% rate in the 1st quarter of 2019. Early estimates for the third quarter of 2019 are in the 1.5-2.0% range. Expectations are for the economy to continue to slow down in 2019. We think the risk of a recession in early 2020 is relatively high. There are a number of economic indicators that have our serious attention.

The Leading Economic Index was unchanged in August at 112.1 following a 0.4 percent increase in July. Industrial Production rose 0.6% in August after declining 0.1% in July. The Capacity Utilization rate (which measures how much slack is in the economy) was at 77.9 percent in August which was right where it was in June and is now 1.9 percentage points below its long-term average.

Non-farm payrolls increased by 136,000 in September. The unemployment rate declined to 3.5% which is a new 50 year low. The number of unemployed Americans decreased by 275,000 to 5.8 million. In September, the labor force participation rate was at 63.2%. Initial weekly unemployment claims were 210,000 for the week ending October 5. According to the JOLTS survey, there were 7.1 million new job openings at the end of August, which is near an all-time high. This means there are more jobs available then there are unemployed Americans.

Manufacturing decreased in September to 47.8% from 49.1% in August on the ISM PMI index. New Orders, Production and Employment are all contracting. Prices are decreasing as exports and imports decline. The ISM Non-Manufacturing index was at 52.6% in September which marks the 116th consecutive month of expansion, but a decline from the August reading of 56.4%. The Manufacturing sector is beginning to drag down the non-manufacturing sector. If the Non-Manufacturing PMI drops below 50 in October, it will likely signal a recession.

Global economies are contracting. The JP Morgan Global PMI was at 49.7% in September. Any reading below 50% represents contraction in the manufacturing sector. The Euro Area is struggling at 45.7% led by France and Greece who have small economies. Germany is down to 41.7%. Emerging economies had a September reading of 51% led by India at 51.4% and Brazil at 53.4%. The trade disputes have impacted global revenues for companies and business confidence is waning. Look for weakness to continue over the next six months.

EQUITY AND BOND MARKETS

The third quarter brought volatility and additional concerns to the markets. And yet, stocks finished the quarter at roughly the same levels over the three-month period. Trade discussions with China in particular have been causing enhanced market volatility. Economic data is deteriorating domestically and abroad and is causing Central Banks to be more accommodative in their fiscal policies. The hope is to get soft landings for each economy as we move into the next recession phase of the economic cycle.

The domestic market appears to be pricing in additional cuts by the Federal Reserve with the belief that it will be the cure for the earnings slowdown that we are seeing. In fact, the estimate for third quarter earnings is a decline of 5% versus the prior year. Because of the declining earnings, we are seeing P/E ratios (chart below) in equities rise to nearly 17 times earnings in the S&P 500. This means domestic large-cap stocks are now fairly expensive.

International stocks still appear to be more attractive than domestic stocks from a valuation perspective. The ACWI ex-U.S. Index (International Index) has a P/E ratio of about 13 times earnings and a dividend yield of 3.5%. Since 2009, the S&P 500 has increased 340% compared to only 107% for international stocks. If we see a global equity correction, it appears likely that international equities would not have as much room to fall compared to their U.S. counterparts.

The bond market has benefitted from the declining rate environment. It is likely that U.S. bonds will continue to attract more interest from a global perspective as many countries, like Germany and Japan, now have negative interest rates. This makes our 1.6% 10-year Treasury bond actually quite attractive to foreign investors.

PORTFOLIO MANAGEMENT

The Investment Committee continues to look at ways to reduce any excess risk from the portfolios. We have now added two new Exchange Traded Funds to the preferred fund lineup that offer downside protection. The funds each come with a 15% downside buffer and a roughly 10% upside cap over the next 12 months. The Committee has agreed that giving up returns above the 10% level is a fair trade off for the downside 15% protection. We think adding these new positions into the portfolio will really help reduce downside volatility.

We have also been working on reducing risk on the bond side of our portfolio. Moving away from the convertible bonds and increasing exposure to intermediate bonds was a way for us to decrease correlation with equities and increase the duration in the portfolio. So far, this approach has worked great in 2019.

We feel that one of our primary jobs is to manage risk in the portfolios. We do not profess to have a crystal ball and are therefore unable to “time the market” consistently over an extended period of time. Therefore, we never even try to time the market. However, we do believe that we can make changes within the portfolio to reduce the risk, while we stay fully invested. We are very excited about the steps we have taken to protect the portfolio for a potential market correction, while maintaining our long-term investment philosophy.

FINANCIAL PLANNING

Charles Schwab and TD Ameritrade are now offering free trading for Equities and ETFs on their platforms. This ‘race to zero’, as some organizations are calling it, started a few years ago. It is likely that all of the major custodians will soon follow suit. Although this is a great benefit for our clients, the large financial institutions are able to offset their lost revenue by paying very little interest on their cash sweep accounts. This effects mainly retail clients who typically have a lot of uninvested cash in their accounts.

If your investment accounts tend to have large cash positions, you may want to look into cash alternatives. A Money Market fund might be a better option for your financial situation. For example: Charles Schwab’s normal cash account is paying 0% in interest, much like a standard bank checking account. However, the Schwab Value Advantage Money Market is paying a current yield of approximately 1.8%.

Talk to your Fee-Only financial planner today to discuss the best option for you.

Below are a few smart phone apps we think you might enjoy.

- **CamScanner**: Do you ever wish you could snap a photo of a document and convert it to a PDF? We have the answer! CamScanner turns your phone into a mobile scanner. The free account allows you to scan basic documents and convert them from a basic photo to a document that can be emailed, uploaded, etc. The platform has other paid versions with additional features.
- **Trunk Club**: Trunk Club is a personal wardrobe styling service through Nordstrom. After filling out an online style profile, you are paired with a personal stylist. You communicate with your stylist through the app to discuss the pieces you'd like to add to your wardrobe. The Trunk is shipped right to your door! You have a few days to try on items and decide what to keep. Each item ranges from $50-$300 and there is a $25 styling fee for each trunk, which is credited toward any purchased merchandise.
- **Marco Polo:** This is a video-chatting app for busy people! Unlike a normal video call, both parties don't need to be available at the same time. Marco Polo allows you to record a video message for your family and friends to watch on their schedule. This app is free on all platforms.

Company News

It has been a busy summer at Galecki! We kicked off our summer by holding a team building event with our staff and their families at the Fort Wayne Tin-Caps!

In July we participated in the Fort Wayne Corporate 5K. Brady McArdle's step-son, Carter, came in 3rd place overall! The rest of us might not have made it on the leaderboard, but we had a great time bonding as a team.

In August, Jessica Roach (who celebrated her 12-year anniversary at Galecki this summer) became a grandmother! Grayson was born on August 29th. Jessica is loving her new role as a grandparent.

As we head into the 4th quarter of 2019, we aren't planning to slow down. Alex Martin is expecting her 2nd daughter in November. We'll once again be adopting families for the Christmas season through Whitington Homes & Services. We might even find time to try curling! Please be sure to 'Like' us on Facebook to follow along on our adventures. You can also check out our new website at www.galecki.com.

Wishing you a healthy, happy, and prosperous rest of 2019!

- 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.