connieHORSTKOTTE, CFP®

Quarterly Economic Update
Third Quarter 2018

For the third quarter of 2018, the bull market seemed unstoppable. Regardless of the quarter's concerning short-term events, investors quickly looked beyond those risks and pushed stock prices higher. In February of this year, the markets dipped roughly 10%, but this quarter many major equity indexes moved to all-time highs.

The Dow Jones Industrial Average set an all-time high in September and ended the quarter with an over 9% advance. The S&P 500 index also reached an all-time high in September and finished the quarter with a gain of over 7%.

The S&P 500 posted a six-month winning streak between April and September. This is after recovering from the correction seen in February and March, and during a period that included fears of a trade war. This marks only the sixth time since 1928 such a streak took place between April and September, according to Bespoke Investment Group. Robust economic growth and strong corporate earnings have contributed to the rise in equity markets. They have also offset concerns of tighter U.S. monetary policy and fears of a global trade war. This current six-month winning streak is the 27th highest overall dating to 1928.***(Source: CNBC.com 10/2018)***

MONEY RATES
(as posted in Barron's 10/1/2018)

	LATEST WEEK	YR AGO
Fed Funds Rate (Avg. weekly auction -c)	**1.92%**	**1.16%**
Bank Money Market -z	**0.20%**	**0.12%**
12-month Cert -z	**0.76%**	**0.40%**

c- Annualized yields, adjusted for constant maturity, reported by the Fed Reserve on a weekly average basis. z – Bankrate.com (Source: Barron's; bankrate.com)

Although equities are high and investors should be cautious, much of the economic data for the quarter seemed reasonable. Currently, wage growth is at its highest level since 2009. Retail sales showed growth of over 7% this year and U.S. consumer confidence hit its highest level since 2000. The U.S. unemployment rate stood at 3.9% through August 2018 and approximately 201,000 jobs were created in August. The monthly average of initial jobless claims is at the lowest level since 1969. Against this remarkably strong growth backdrop it's not surprising that US equities have delivered attractive returns.
(Source: JP Morgan 10/1/2018)

Zach's Research reported that equity markets this quarter were fueled by a strong performance by U.S. corporations in the second quarter of 2018. Impressive fundamentals of the U.S. economy, a strong labor market and the government's deregulation measures have enabled investors to overcome trade related concerns, geopolitical conflicts and inflationary expectations.
(Source: NASDAQ.com 10/1/2018)

From a broad overall perspective, the bull market that began in 2009 is now approaching 10 years (the second longest bull market ever). This year investors have already seen a correction, but market historians site that age does not kill a bull market. Today, equities are not cheap and even the savviest of investors need to have a watchful eye on risk. As financial professionals, we try to make our best forecasts and look for a probability of success understanding we face an uncertain future. Remember, short-term interest rates have risen and cash equivalent yields are still historically low.

Interest Rates Are Still in the Spotlight

The Federal Reserve on Wednesday September 26th, raised interest rates for the third time this year and signaled it will raise rates again in December. Rates are now at their highest level since the fall of 2008. The Federal Reserve's recent interest-rate hike was the 8th increase since the end of 2015. Over nearly three years, the fed-funds rate has risen from 0.25% to its current range of 2.00% - 2.25%. During this same timeframe, the 10-year Treasury yield has more than doubled to more than 3%.

The Fed continues to project three rate increases next year and one more in 2020. This would bring rates into what is considered restrictive territory — more than enough to slow the economy.

The bond market seems to be priced as if more rate hikes are coming. Recently, the yield on the 10-year Treasury note has risen slowly but steadily.

Some of the ways rising interest rates can affect the private sector include:

- Rising mortgage rates and higher mortgage payments reduce home affordability and turnover.
- Slowing home sales and reduced re-financings hurt spending on renovations and remodeling.
- Rising interest rates hurt auto affordability and sales.
- Consumer, mortgage and corporate loans that are variable rate are hurt by climbing interest rates.
- Corporate capital spending is partially dependent on borrowings. Higher borrowing costs could lead to lower capital spending.
- Rising interest rates could impede corporate profit margins, overall profits and earnings per share

Key Points

1. **Equity Markets made new highs this quarter.**
2. **The bull market is almost 10 years old.**
3. **The Fed raised U.S. Fed Fund rates to 2.00 - 2.25% in September and is planned to raise rates again in 2018.**
4. **Based on historic Price/Earnings (P/E) ratios, equities look expensive.**
5. **Market volatility is back and investors need to continue to be cautious.**
6. **Focus on your personal goals and call us with any concerns.**

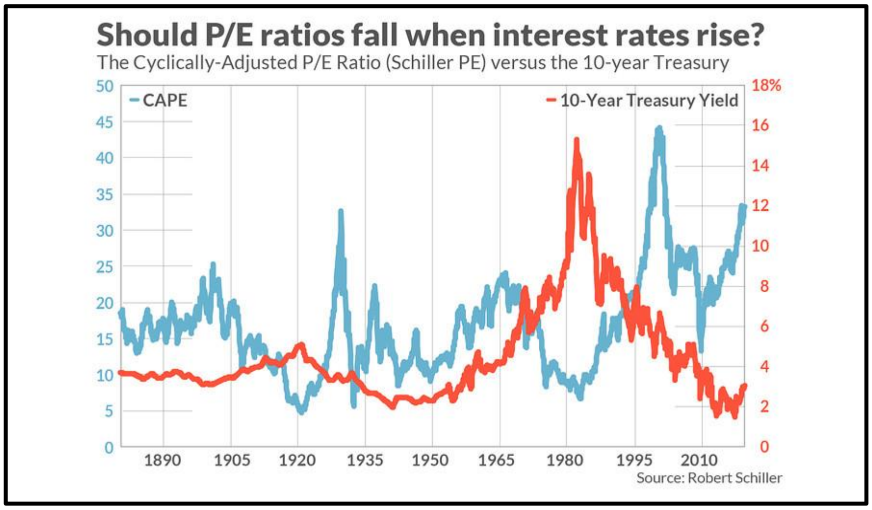
- Debt is often issued by corporations in order to buy back stock and pay dividends. Advancing rates reduce a company's return on investment on those buybacks.

For now, higher short-term interest rates seem likely, so investors still need to keep a watchful eye on interest rates.

Interest Rates and P/E Ratios

According to some analysts and advisors, higher than historical Price Earnings (P/E) ratios were once justified by low interest rates. In December 2015, when the Federal Reserve began its current round of rate hikes, the P/E ratio stood at 16.0 (according to FactSet, when calculated on earnings estimates over the subsequent 12 months). Today, the comparable P/E stands at 17.5.

On September 25th, Nobel Prize winner and legendary Yale Professor Robert Shiller, stated on CNBC that, "earnings are volatile". He cautioned that a bear market could come without warning. Shiller said, "The market could go up for years. I'm not very able to predict turning points. I do think it's risky now. This is a risky time, especially investing in the U.S. – the most expensive country in the world".



A big question for investors is, if low interest rates justified higher P/E ratios, as the bulls have argued for much of the last decade, consistency would require them to argue that with interest rates rising, P/Es should now be lower. A landmark finding in an older issue of the Journal of Portfolio Management states, the "obvious" conclusion to draw is that "when P/Es are high (low), forecasted 10+ year real stock returns are low (high), regardless of starting interest rates."

As interest rates move, we will need to carefully watch corporate earnings to monitor how they perform.

Tariffs

A big and obvious near-term risk to the global economy is the potential for a further escalation in trade tariffs emanating from the U.S., and the subsequent retaliation. As of the quarter's end, the U.S. is imposing tariffs on about $250 billion of imports from China, and China has retaliated with tariffs on about $110 billion of U.S. exports to China. The current tariff rate on all of China's exports to the U.S. is scheduled to increase in January if a deal cannot be reached. Trade negotiations also had good news this quarter. A new deal to replace the North American Free Trade Agreement (NAFTA) was signed. Tariffs and trade issues could affect equities, so investors need to continue to monitor them. ***(Source: JPMorgan 10/1/2018)***

What Should an Investor Do?

The mere mention of October is sometimes enough to frighten some investors. Newer investors can wonder, "What's the big deal?" It all comes down to perspective. Five of the stock market's worst 10 days ever happened in October, including 1987's more-than 20% single day drop. Overall, October is a pretty average month for the market, but it has one of the higher incidences of volatility.

In their *Market Review and Outlook for September 2018*, NASDAQ.com sites that despite, "warning signs, the economic and corporate outlook in the U.S. remains constructive and equities are in a bull market. Fiscal stimulus, deregulation, and generational tax reform are fueling the U.S. economy and driving global outperformance. Concerns exist with persistent Fed tightening, a flat yield curve, a strengthening dollar, trade with China, and an overseas slowdown which may come home to roost at some time, but for now the U.S. is performing and consumers are spending." In their report, they suggest that "Advice from a securities professional is strongly advised."
(Source: NASDAQ.com 10/1/2018)

According to market analysts, the outlook for the year-end remains mixed. Some professionals on Wall Street forecast the S&P 500 will end the year slightly higher than its current level — up 1.7%, to be precise, according to the average forecast of strategists surveyed by CNBC. On the flip side, among other prognosticators who are very concerned, there's near-daily talk of an imminent market crash.
(Source: NerdWallet.com 9/28/2018)

Investors should always put their primary focus on their own personal goals and objectives. When equity markets become volatile sometimes even the best investors become not just concerned, but unnerved. It's important to keep perspective when markets are volatile. It is very important that you understand your situation and your financial plan. Letting your emotions drive your decisions can be costly. Here are some strategies that money managers think about when making decisions.

- Always allocate your investments to match your risk tolerance.
- Add money to your investments regularly, if possible, and try to increase your additions during downfalls.
- It's nearly impossible to always time the market right (sell when you think the markets at its peak), so have a strategy.

- Accept that volatility is inherent to investing, but not something to stress about for long-term investors.
- Consider avoiding or ignoring nightly financial news and always try not to make any emotional decisions.

While CDs and money market funds offer the highest level of safety, they still are offering low returns. Full market risk is not appropriate for most investors even though today's traditional fixed rates might not help many investors to achieve their desired goals. Most investors attempt to build a plan that includes risk awareness. Many times, this can lead to safer but lower returns. Traditionally, bonds have been used as a hedge against market risk, but with interest rates projected to rise investors need to be extremely cautious.

We focus on YOUR personal goals and Strategy.

Our main goal, as always, is continually understand our client's goals and to match those goals with the best possible solutions.

Our advice is not one-size-fits-all. We will always consider your feelings about risk and the markets and review your unique financial situation when making recommendations. If you would like to revisit your specific holdings or risk tolerance please call our office or bring it up at our next scheduled meeting.

We pride ourselves in offering:

- ✓ consistent and strong communication,
- ✓ a schedule of regular client meetings, and
- ✓ continuing education for every member of our team on the issues that affect our clients.

A skilled financial advisor can help make your journey easier. Our goal is to understand our clients' needs and then try to create a plan to address those needs. Should you need to discuss your investments, please call us.

Please share this report with others!

This year, our goal is to offer services to several other clients just like you! If you would like to share this report with a friend or colleague, please call Connie at (310) 325-7550 and we would be happy to assist you!

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Sources: Barron's, FactSet, JP Morgan, Nerdwallet.com, NASDAQ.com, CNBC, The Wall Street Journal;