viewpointe

A Horizon Trust & Investment Management Publication

HORIZON

ISSUE NO. 63, FIRST QUARTER 2019

“It's not the load that breaks you down, it's the way you carry it.” *- Lou Holtz*

The general mood of the U.S. equity and fixed income markets took a turn for the worse during the fourth quarter. Increasing investor anxiety finally managed to overcome the solid economic backdrop. Fears of what could potentially go wrong lowered investor expectations. These lower expectations reverberated through both the equity and fixed income markets, leading to significant developments on both fronts. In this edition of ***Viewpointe,*** we discuss recent developments and provide our outlook for 2019. We also highlight some recent changes that were made to our model portfolios as well as some changes that are being considered. We conclude with a few pointers regarding maintaining your financial records.

Economic Review - Fear of the Unknown?

Despite the fact the U.S. economy remains on solid footing, the general mood amongst financial commentators and the average investor is somber at best. It seems as though everybody wants to focus on everything that could go wrong, while paying little attention to those things that are going right. This wall of worry has grown as the year progressed, creating an environment that negatively impacted investment asset classes pretty much across the board. While in terms of losses, investors have seen much worse, the breadth of asset classes failing to deliver positive returns is noteworthy. Equities pretty much across the board, fixed income, commodities and real estate all provided investors lackluster returns on a year-to-date basis.

So why are investments providing such low returns while the U.S. economy is on track to experience the strongest growth in over a decade? For the most part it comes down to fears of what the future may hold. Odds are you heard the old saying that the markets are “forward looking.” In other words, markets are impacted by what they anticipate will happen in the future. Two items that are creating anxiety regarding their potential impact on future economic growth are Federal Reserve (Fed) policy and trade tensions with China.

Fed policy is important due to the direct impact it has on interest rates. Accommodative policy occurs when the Fed takes steps to lower interest rates. Tighter policy occurs when the Fed takes steps to increase interest rates. Simply put, the Fed lowers interest rates to stimulate economic growth and increases interest rates to slow economic growth. In the midst of the Great Recession, the Fed lowered interest rates to historic levels. Since 2015, the Fed has steadily implemented policy to increase rates. Recent developments in fixed income markets are signaling that investors want the Fed to slow down. Many investors fear that if the Fed continues to tighten aggressively in 2019, the tighter monetary conditions could derail economic growth. This is why investors are studying every Fed related comment to determine what the Fed will do in 2019.

While we view overly aggressive monetary policy as a risk for economic growth in 2019, we are encouraged by recent Fed commentary coupled with relatively moderate inflation. We believe the Fed will be in a good position to reduce the rate hike pace in 2019, opting out of increasing rates at two or more of their meetings.

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Assuming this to be the case, we anticipate fears of overly aggressive monetary policy will subside and in turn decrease the downward pressure on investment returns.

While we believe Fed policy concerns will subside, finding a long-term fix on the trade front will likely be harder to come by. While the U.S. has made progress in negotiations with Canada, Mexico and Europe, China remains the sticking point. Unfortunately, the issue with China goes beyond trade and really comes down to national security. China has made a business practice out of intellectual property theft. Whether this takes place through requiring foreign corporations to provide their trade secrets to conduct business within Chinese borders or through direct spying and hacking activities, China has made a great deal of progress catching up on the technology front.

While such activities had been ignored for many years, China's quest to become a dominant player on the world stage has changed the way many countries view their business practices. Many including the U.S. are concerned how China may use much of the intellectual property they have acquired to project power both within and outside their region. These concerns came to the forefront with the unveiling of the China Initiative 2025, where China expressed their goal of becoming the dominant player in artificial intelligence and robotics by 2025. Many fear that if China is successful in their pursuit, it will greatly increase their ability to project military power. All in all, these national security concerns make it less likely that we will come to a long-term solution on the trade front unless intellectual property is incorporated into the overall agreement. Reaching an agreement on this front will be elusive at best given the fact China views technological advancement as pivotal in positioning themselves as a world power.

With that said, we do not rule out a few short-term fixes that provide temporary relief. We, however, see these fixes as simply providing temporary relief to U.S. corporations until they have sufficient time to move their supply chains out of China. This leaves us with a situation where trade concerns are likely to ebb and flow for some time to come. This will undoubtedly add to material shifts in economic growth projections making it more difficult to navigate the investment landscape.

In conclusion, we are anxious in regards to economic growth in 2019. On the positive front, we expect Fed concerns to subside and fiscal policy to carry us through the first half of the year. In addition, unemployment levels remain historically low while consumer and business sentiment remain relatively high. Also, it is important to note that presidents historically have found ways to stimulate the economy following the mid-terms to improve their chances for re-election. All of these things bode well for economic conditions in 2019.

Unfortunately, crafting a long-term solution with China may prove elusive. In terms of a temporary fix, it is hard to tell when and to what scale such a fix comes into play. Thus far, fiscal stimulus has been successful in counterbalancing the tariff drag. Current stimulus will subside around mid-2019. We are concerned this is about the time when the tariff drag starts to heat up. In addition, the contentious relationship between the Democrats in the House and President Trump makes the passage of future stimulus less likely. With all of these hurdles in place it becomes hard not to project a slowdown in economic growth from current levels. At the present time we are hopeful that this simply means reverting back to 2%. We are monitoring the situation carefully to determine if this will be the case, or whether a slower growth environment is more likely.

Fixed Income Commentary -

Positioning for a Pause?

The Federal Reserve raised the Fed Funds Rate for the fourth time this year at their December meeting. This increase came despite the fourth quarter equity market sell-off, an economic slowdown overseas, an inversion in the U.S. Treasury yield curve and pressure from President Trump. Overall, the Fed's commentary remained rather bullish, pointing out that U.S. economic activity has been rising at a strong rate. Despite the bullish commentary the Fed slightly lowered their median estimate for 2019 gross domestic product growth from 2.5% to 2.3%.

It is important to note the Fed did trim the number of rate hikes they foresee in 2019, from three to two. This implies the Fed plans on staying put at some of their meetings in 2019, moving away from the quarterly pattern of hikes they implemented in 2018. While investors took comfort in indications the Fed intended to slow their rate hike strategy, anxiety remained as to the Fed's bullish outlook for the U.S. economy. Ultimately, while the Fed slightly tempered their economic outlook, the markets initial reaction was that they remained too optimistic. In short, the Fed's announcement did little to calm aggressive policy concerns.

While we were disappointed by the Fed's bullish tone, we remain hopeful the Fed was simply positioning themselves to gradually ratchet down growth expectations rather than making an abrupt change all at once. Also, it is important to note the Fed is likely struggling making growth projections given the uncertainty that revolves around trade negotiations with China. It is funny when you think about it. The Fed, with an army of analysts and economists, seems to be struggling

with the same issue as we are. That issue being what is going to happen in trade negotiations with China in 2019. The outcome of these negotiations plays a material role in what level of growth we experience. When viewed in this light it becomes clear why this issue has become such a major topic of discussion. It also becomes clear why the unpredictability of the outcome has created such a high level of anxiety.

Equity Commentary - The China Problem

Equity markets significantly deteriorated during the fourth quarter in response to growing economic concerns both at home as well as globally. Negative performance was widespread impacting all the major equity markets. While large-cap, mid-cap, and small-cap U.S. stock indices were down across the board, large-cap stocks held up the best on a year-to-date basis. Overall, U.S. stocks held up well versus their foreign counterparts with developed international and emerging market indices falling well into double digit negative territory. In short, the fourth quarter was a rough patch for equity investors.

While in the previous edition of ***Viewpointe*** we pointed out that U.S. stocks had limited upside based upon valuations, we did not anticipate as large of a drop as what occurred. With trading days numbered it is looking like a low single digit return is the best we can hope for and may prove to be out of reach based upon the steady flow of negative headlines. It is important to note we started the year with a below consensus view of mid to high single digit equity returns. Roughly halfway through the year it appeared that we underestimated equity performance. Ironically, here we are as the year winds down and it appears our forecast was overly optimistic.

Ultimately, we blame recent underperformance on the trade headwinds more so than fears of an overly aggressive Fed. Unfortunately, the uncertainty on the trade front with China makes it extremely difficult to forecast domestic equity performance for 2019. It is hard to gauge with any level of certainty what will ultimately come to fruition regarding trade with China in 2019. Fortunately, both sides have reason to at least come to a temporary agreement addressing some of the contentious issues. From President Trump's perspective, his re-election prospects would greatly improve if it was viewed that he had made material progress in reaching a deal with the Chinese. From the Chinese perspective, a deal could help them reinvigorate an economy that is slowing to levels where it may not be able to produce enough work to satisfy its massive population. Recent progress makes us hopeful that a short-term agreement may be a possibility in the near future. Unfortunately, the best we can say on this front is that we are keeping our fingers crossed.

In the event the Fed pauses and we see a meaningful agreement on trade with China, we would anticipate a solid positive return year for equities. In the event we do not make meaningful progress on the trade front, but experience a Fed pause, we would anticipate equity performance to be low to slightly negative. In the event we do not make meaningful progress on the trade front and the Fed moves forward without pausing, we would anticipate a negative equity return for the year. Unfortunately, while we are confident the Fed will pause, it is difficult to say what progress will be made in the negotiations with the Chinese.

Asset Allocation - Treading Lightly

We did not rebalance our Lakepointe Classic portfolios during the fourth quarter. While our equity position appreciated from late June to the end of September, so did our fixed income position. This kept us within a comfortable range of target. The equity markets then sold off quickly in early October followed by a choppy downward trend ever since. During this time period we decided to wait to rebalance, since a rebalance would have resulted in bringing our equity position back up to target while equities were still in a downward trend. In addition, we typically try to avoid rebalancing in December since equity funds pay capital gains distributions during the month, which have to then be reinvested. In short, we currently contemplate a rebalance sometime in January aimed at bringing our Classic portfolios back to target.

We do not anticipate making any changes on the equity side of our Classic models with this rebalance. We still believe an overweight in U.S. large-cap stocks is the best strategy. While we are looking for an entry point to increase our international equity exposure, we do not believe current conditions justify such a move. On the Classic fixed income front we are developing an alternative strategy in the event we see economic fundamentals start to shift downward and lower credits come under pressure. This strategy would consist of increasing our portfolio duration and migrating toward U.S. debt. We believe this would benefit us in the event interest rates drop and credit risk increases. We see this as a distinct possibility in the event economic conditions deteriorate.

On the Premier front, we also made some changes to our Political Activism individual stock portfolio in August as well as November. While August's changes were broad, November's changes were minimal. In August, we replaced several individual stocks with new names and brought several other names closer to a 2% target weighting. In November, we simply replaced two individual stocks with two new individual stocks. On the individual fixed income front our preference still remains with brokered certificates of deposit.

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Financial Planning -

Maintaining Your Financial Records

An important part of managing your personal finances is keeping your financial records organized. Whether it is a utility bill to show proof of residency or a Social Security card for wage reporting purposes, there may be times when you need to locate a financial record or document- and you will need to locate it relatively quickly. By taking the time to clear out and organize your financial records, you will be able to find what you need exactly when you need it.

What should you keep?

If you tend to keep stuff because you "might need it someday," your desk or home office is probably overflowing with nonessential documents. One of the first steps in determining what records to keep is to ask yourself, "Why do I need to keep this?"

Documents you should keep are likely to be those that are difficult to obtain, such as:

- Tax returns
- Legal contracts
- Insurance claims
- Service contracts
- Warranty contracts
- Proof of identity

On the other hand, if you have documents and records that are easily duplicated elsewhere, such as online banking and credit-card statements, you probably do not need to keep paper copies of the same information.

How long should you keep your records?

Generally, a good rule of thumb is to keep financial records and documents only as long as necessary. For example, you may want to keep ATM and credit-card receipts only temporarily, until you have reconciled them with your bank and/or credit-card statement. On the other hand, if a document is legal in nature and/or difficult to replace, you will want to keep it for a longer period or even indefinitely.

Some financial records may have more specific timetables. For example, the IRS generally recommends that taxpayers keep federal tax returns and supporting documents for a minimum of three years up to seven years after the date of filing. Certain circumstances may even warrant keeping your tax records indefinitely.

Out with the old, in with the new.

An easy way to prevent paperwork from piling up is to remember the phrase "out with the old, in with the new." For example, when you receive this year's auto insurance policy, discard the one from last year. When you receive your annual investment statement, discard the monthly or quarterly statements you have been keeping. In addition, review your files at least once a year to keep your filing system on the right track.

Finally, when you are ready to get rid of certain records and documents, do not just throw them in the garbage. To protect sensitive information, you should invest in a good quality shredder to destroy your documents, especially if they contain Social Security numbers, account numbers, or other personal information.

Where should you keep your records?

You could go the traditional route and use a simple set of labeled folders in a file drawer. More important documents should be kept in a fire-resistant file cabinet, safe, or safe-deposit box.

If space is tight and you need to reduce clutter, you might consider electronic storage for some of your financial records. You can save copies of online documents or scan documents and convert them to electronic form. You will want to keep backup copies on a portable storage device or hard drive, and make sure that your computer files are secure.

You could also use a cloud storage service that encrypts your uploaded information and stores it remotely. If you use cloud storage, make sure to use a reliable company that has a good reputation and offers automatic backup and technical support.

Once you have found a place to keep your records, it may be helpful to organize and store them according to specific categories (e.g., banking, insurance, proof of identity), which will make it even easier to access what you might need.