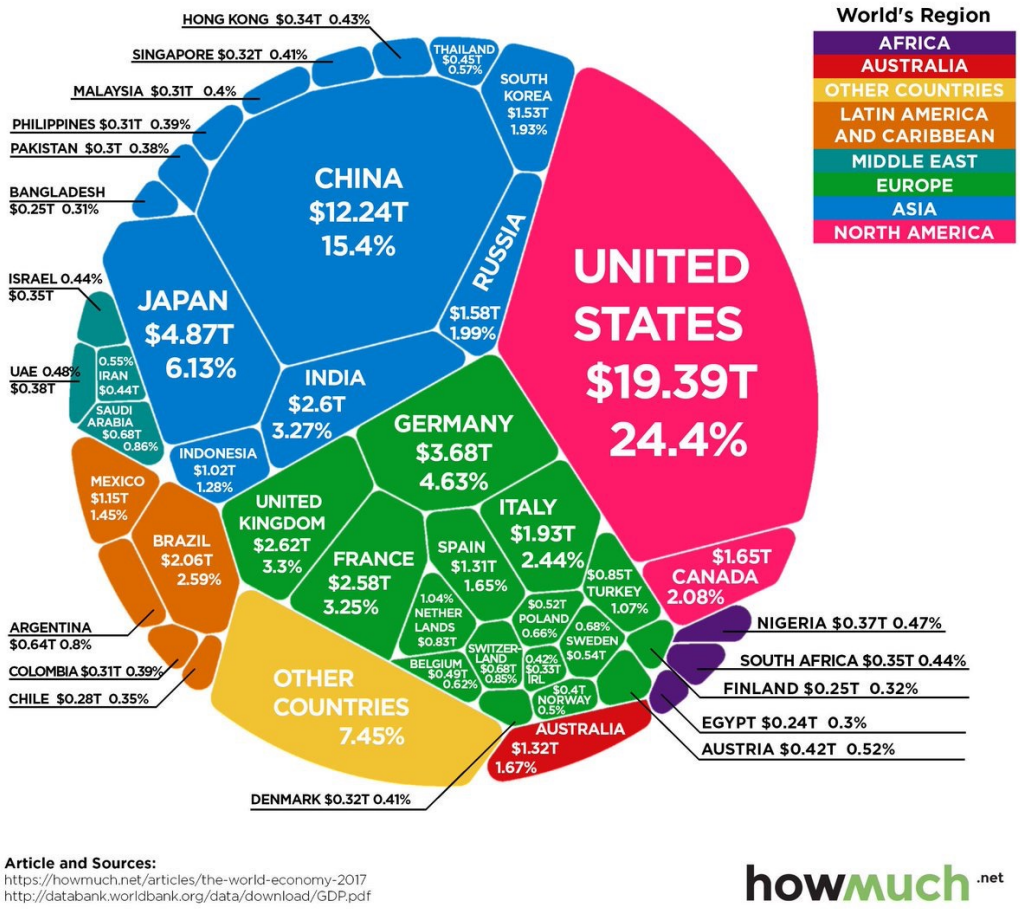
LEARNING TO LIVE WITH A TRADE WAR. WE ARE ALL TIED TOGETHER.



I like pictures that help put things in perspective. I especially like it when someone else creates the picture. The above graphic is one example. Now, if you are like me, at first glance you may be asking yourself, "What in the Wide Wide World of Sports (an old movie reference) is that?" **What it shows are the economies of the world and their size compared to each other.** The economies are grouped by continent or area. So, Asia is blue, with China being the main player. Asia is slightly larger than Europe which is depicted in green. And North America, which is in pink, includes the largest economy in the world (the good old USA)…but North America is second to Asia in terms of size. I'll reference this pie chart as we look to the future.

As the second half of the year approaches, we first want to say **thank you**. We are honored and privileged to have your trust and confidence.

The Pinnacle Financial Group

The Rearview Mirror — 4Q18 Bad…1Q19 Good

So, what has occurred in the last few months to get us to where we are?

Growth	👍	US GDP growth dipped to a 2.2% q/q annualized pace in 4Q18, making two consecutive quarters of deceleration. The slowdown continues to manifest itself in economic data. Still, consumer confidence and sentiment appear strong, and auto sales have rebounded. 1Q19 GDP was a surprisingly high 3.2%.
Jobs	👍	Payroll gains varied widely in 1Q19, resulting in an average gain of 180,000 jobs gained per month in the first quarter. The unemployment rate ended the quarter at 3.8% and is currently 3.6%. Wage growth may have peaked already, but is likely to remain solid.
Profits	😐	After 3 incredibly strong quarters, profit growth slowed to 3% y/y in 4Q18. Earnings growth is still expected to moderate in 2019, as the effects from the tax cut diminish and margins come under pressure as interest rates and wages rise.
Inflation	😐	Inflation has drifted lower in the last few months, primarily due to lower oil prices. We expect inflation to hover around 2% until the end of the year, though we do expect oil prices to rise (and thereby gas prices) by the end of the year.
Rates	😐	The Federal Reserve maintained its target range for the federal funds rate at its March meeting. It provided clarity that it did not plan to raise rates in 2019 which spurred on the market. This also led many to think the Fed may even cut rates. However, with the economy growing at 3.2%, this is very unlikely.
Risks	👎	1. Unresolved trade tensions may exacerbate a slowdown in global growth. 2. Finding employees, and the right employees, could restrict growth in the future. 3. Corporate debt is rising, and its quality is declining.
Investment Opportunities	👍	1. Stocks are fairly valued relative to history and may have room to run in this late cycle. 2. International exposure is warranted given the long-term growth prospects and cheaper valuations. Being targeted is wise.

The Bottom Line:

The US economy has shown resilience in 1Q19 with GDP growth of 3.2% despite concerns over tariffs and trade policy. Europe has grown, but only at .4%. The market wants to see the Fed continue to be accommodative, which makes borrowing money inexpensive and fuels growth. However, the Fed is worried about inflation. We think there is still an opportunity for growth, but we are likely in the late innings of the ballgame.

The Outlook: Our Crystal Ball

The Elephant in The Room: The US/China Trade Negotiations

- The current negotiations between the US and China regarding trade have been going on for quite some time…and we do not see an agreement for months to come. We hope we are wrong.
- China is unwilling to change how it subsidizes state-owned companies, and the US will not relent on issues such as thievery of intellectual property rights. Ironing out these details can take time.
- We live in a global world and the economies of the largest countries are tied closely together. The ripple effect is pronounced. The negotiations between the US (world's largest economy) and China (world's 2nd largest) effect not only those two countries, but all the major players depicted in the graphic on page 1. Europe, who has lagged in the economic recovery, has been adversely effected. And, we see that continuing until an agreement is reached (assuming it is a positive agreement).
- This is the story of 2019. Even though the US economy has shown strength and resilience, the tariffs almost certainly will restrict future economic growth. We do not expect 3.2% growth to continue. But, can the US economy remain strong enough to give President Trump the leverage he needs in negotiations? Or, will China gain an upper hand by waiting things out and betting that the political pressure and calendar are working in its favor?
- Call us stubborn, but we believe a deal is likely later this year. China's President Xi can't afford public dissent over lost manufacturing jobs, and President Trump can't afford to lose support in the Farm Belt and key electoral states.

The Bottom Line:

The US and China will reach an agreement eventually, but it may be a long and rocky ride for the markets. While the trade deals are being negotiated, we believe if you are in the equity markets, the US continues to be the place to be. Once agreements are made and trade friction declines, we will be taking advantage of the attractive valuations in International and targeted Emerging Market equities.

The US Markets: Autumn Has Arrived

- The history of the US business cycle is one of long summers (expansion) and short winters (recession). Since 1960, the US has experienced 616 months of expansion and only 93 months of recession.
- Equally significant, the economy has become more stable over time, causing the length of expansions to increase. The current economic expansion is now in its 10th year, making this the 2nd longest since the beginning of the 20th century.
- We believe we are presently late in the economic cycle. The US economy is now metaphorically in the midst of a transition from a particularly hot summer to a more temperate autumn. Economic growth should moderate to a 2% to 2.5% pace this year. Remember, slower growth does not mean recession.
- We believe the acceleration of growth shown in 2018 due to the tax cuts has started to fade. It is reasonable to assume that while growth may be moderating, the expansion could go on for many years. This backdrop suggests that we are perhaps in the earlier months of Fall, in which the economy may experience a more temperate environment for longer.

The Bottom Line:

The "autumn" of economic growth has started, and the next two years may remind us of the tranquility that Fall brings: a prolonged period of calm weather before winter approaches. We will be looking to rebalance portfolios where appropriate to be sure we have an adequate amount of risk while adding some safety for winter.

We Welcome Your Referrals!

The International Markets: The Struggles Continue

- In 2017 and early 2018, the catchphrase seemed to be "synchronized global growth." All major economies appeared to be growing. That catchphrase has changed to "global slowdown." Global GDP has declined from 3.8% in mid-2017 to 2.6% at the end of 2018. We believe the trade war has had a large effect on this.

- You'll notice in the chart on page 1 that Germany is Europe's largest economy. Germany's strength is its exports and it is a strong trading partner with China. The China/US trade dispute has effected Germany's economy, which has been growing at a mere 0.4%.

- While we have witnessed a "global slowdown", we do not project a pending global recession. Again, the US usually leads and the world usually follows, and as stated above, we do not project a recession in the US for a few years. What we do see in the International markets is "global stability." Sentiment has improved overseas and this can be a major driver to long-term growth.

- We do see opportunity in specific areas and countries. Some of these opportunities will be seen over the longer term with the emergence of the Emerging Markets (EM) consumer. In the last 20 years, the middle class of some EM countries has grown tremendously in size, and this story is set to continue over the next decade as well, especially in countries like China and India.

- The growth of the middle class in both China and India is one of the reasons that their respective GDPs have been growing around 6-8% per year. Compare this to the US who grew at 3.2% last quarter, and that number surprised on the upside!

The Bottom Line:

Thinking longer term, we do not believe it is wise to give up on International markets. Given where the earnings and valuations are currently for International stocks, there's reason to believe they will outperform the US over the next decade.

Asset Class Views

Equity vs. Fixed Income	👍	We remain moderately overweight equities, largely driven by the attractive valuations compared to fixed income. Additionally, the trajectory for earnings expansion, while slowing, still appears broadly intact.
International Equities	👎	We maintain conviction in our underweight stance towards International Equities. Geopolitical tensions in Europe are a primary concern. We believe both the US and Emerging Markets remain more attractive.
US Equities	👍	We continue to believe that US growth will remain healthy and the expansion has some runway ahead. However, we have chosen to moderately reduce our overweight where appropriate.
Emerging Market Equities	👍	We see growing opportunity for the Emerging Markets portion of our portfolios, particularly within certain areas and countries. A potential tailwind can occur from any resolution in US and China trade talks and a stable outlook for the US dollar.
Smart Beta	👍	The benefits of smart beta holdings remain tied to their diversification potential and our continued tactical view that momentum stocks and the minimum volatility factor seem well-positioned in the current environment.
US Treasuries	😐	Following a rally on the long end of the US Treasury curve, and a sharp pivot in forward guidance from the Fed, we prefer the short end of the curve.
Other Fixed Income	😐	As with Treasuries, we view fixed income as a wise diversification tool at this point. Equities remain more attractive, but fixed income is becoming more important as a hedge.

Again, we thank you for your trust and confidence. It is our commitment to provide you with the insights and advice that will not only help you today, but most importantly, put you on the right path toward your future objectives.

We wish you all the best for the remainder of 2019 and beyond.

Every Best Wish,

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In addition to the normal risks associated with equity investing, narrowly focused investments typically exhibit higher volatility because of the non diversified nature of the portfolios.

The statements in this Economic Outlook are the opinions and beliefs of the author when the commentary was made and are not intended to represent that person's opinions and beliefs at any other time. The main risks of international investing are currency fluctuations, differences in accounting methods; foreign taxation; economic, political, or financial instability; lack of timely or reliable information; or unfavorable political or legal developments.

Who We Serve:

Our clients seek solid financial planning advice with a continual relationship with our firm. We specifically focus our wealth planning and investment management services on an exclusive number of clients. The types of clients we work with are People in Transition, Families, and Savers hoping to "Live a Life of Significance."

We Welcome Your Referrals!