Doug Kinsey
Artifex Financial Group
2305 Far Hills Avenue, Suite 206
Dayton, OH 45419
855.752.6644
doug.kinsey@artifexfinancial.com

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March 2019

Market Update
(all values as of 02.28.2019)

Stock Indices:

Dow Jones	25,916
S&P 500	2,784
Nasdaq	7,532

Bond Sector Yields:

2 Yr Treasury	2.52%
10 Yr Treasury	2.73%
10 Yr Municipal	2.14%
High Yield	6.49%

YTD Market Returns:

Dow Jones	11.10%
S&P 500	11.08%
Nasdaq	13.52%
MSCI-EAFE	8.94%
MSCI-Europe	9.79%
MSCI-Pacific	7.50%
MSCI-Emg Mkt	8.82%
US Agg Bond	1.01%
US Corp Bond	2.57%
US Gov't Bond	1.12%

Commodity Prices:

Gold	1,314
Silver	15.56
Oil (WTI)	57.21

Currencies:

Dollar / Euro	1.13
Dollar / Pound	1.32
Yen / Dollar	110.69
Dollar / Canadian	0.76

Macro Overview

U.S. equities continued to defy negative sentiment and sanguine market readings as tepid economic data advanced stocks higher in February. Equities posted their best first two months of the year since 1991, rebounding from the volatile fourth quarter of 2018. Gross domestic product (GDP), the primary measure of U.S. economic growth, expanded at a 2.6% annualized pace for the fourth quarter of 2018. Despite negative sentiment and market turmoil towards the end of the year, consumer spending and business investment continued to gradually expand.

GDP as well as other economic indicators that were not released during the government shutdown were posted in early February, a month past its scheduled release. It is expected that additional lingering data will continue to be released throughout March, helping to shed light on the economy's current stance.

According to Federal Reserve data, declines in stock values, as which occurred in late 2018, have a far greater impact on middle and upper income earners now relative to 30 years ago. Middle America now has many of the same investment opportunities that only the very wealthy had decades ago.

A key housing report, which was delayed due to the government shutdown, revealed that new housing starts in December 2018 fell to the lowest monthly level since September 2016. Economists believe that the slowdown may have been in response to the market pullback in December as well as continued weakness in the housing sector.

Trade tensions with China eased as a March 1st deadline was extended by the President, with discussions between U.S. and Chinese negotiators continuing into March. Another notable deadline looms in Europe as the exit of Britain from the EU, known as Brexit, approaches on March 29th.

Comments by the Fed Chair, Jerome Powell, hinted that the Federal Reserve has become increasingly concerned with stock prices and market volatility. Some economists believe that the Fed slowed its pace of rate increases in order to alleviate further market turmoil following December's rout.

Federal government offices and agencies avoided a second shutdown following a Congressional compromise on border security. The prior shutdown at the beginning of the year lasted 45 days, which hindered businesses reliant on governmental permits and authorizations.

The IRS reported that for 2018 tax returns filed as of February 22, 2019, the average federal tax refund was $3,143, slightly above the average refund of $3,013 for the same period last year. This tax season is the first year where the 2017 tax cuts have become fully effective, including revisions to withholdings and standard deduction levels. According to data from the IRS and the Tax Foundation, American taxpayers had $140 billion less withheld from their paychecks in 2018.

Sources: Fed, BLS, IRS, EuroStat, Bloomberg

485,000 WORKERS WENT ON STRIKE IN 2018...THE MOST SINCE 1986

Rates Hold Steady......For Now – Fixed Income Overview

The Fed intends to stop reducing its balance sheet this year, which influences the rise in rates, but still remains devoted to raising rates when economic data deems it. The markets interpret this strategy as a mixed signal, whereas the Fed may be unsure as to what direction the economy may actually head. The yield on the 1-year Treasury has been trending higher than the yield on the 5-year Treasury, creating what is know as an inversion, perhaps indicating slower economic growth.

Global government yields dipped to their lowest levels in months, with the German 10-year bund (bond) reaching near zero percent and the Japanese 10-year government bond falling below zero percent. Nearly $11 trillion of global debt securities reached negative yields in February, representing a reaction to slowing global growth and the Fed's current hold stance. (Sources: Federal Reserve Bank, U.S. Treasury)

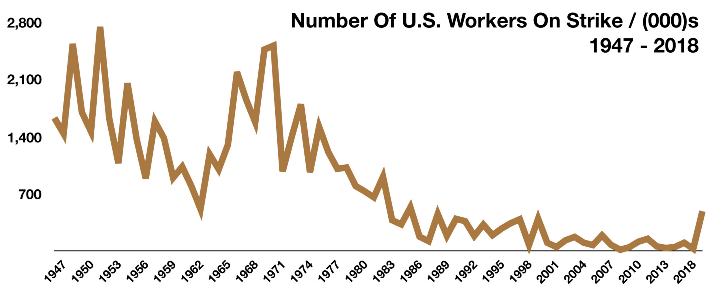
Stocks Post Early Gains – Equity Update

The S&P 500 posted its best two-month start for the year since 1991, with the information technology, energy, and industrial sectors leading the index. Volatility was mostly absent in February following several weeks of heightened market swings that drove uncertainty.

Stocks were bolstered by the expectations of a formalized China trade deal and the shift in stance by the Fed to hold off raising rates. Sentiment in Europe has become more uncertain as negative yields on various bonds have become negative, meaning that economic growth expectations have weakened. As a key trading partner, the European Union (EU) comprised of 28 countries, has become an integral component of U.S. trading activity. Some analysts have noted that prices may have risen faster than growth expectations over the past two months, meaning that there will be greater emphasis on earnings over the next few weeks. (Sources: S&P, Bloomberg, Reuters)

2018 Saw An Increase In Striking Workers – Labor Market Overview

As occupations and trades evolved over the decades in the United States, so have the workers that have been on strike. The Bureau of Labor Statistics monitors and tracks the number of idle workers on strike nationwide, known as work stoppages.



For over 200 years, strikes in the United States have usually evolved from a specific group of workers or labor group. This past year, educational service workers including teachers and office staff for schools, accounted for over 90% of all workers on strike in 2018. Other industries whose employees were also on strike in 2018 included healthcare, hospitality, and information. Incidentally, 2018 saw the most number of workers strike since 1986. Workers in America have been going on strike since the days of the Thirteen Colonies. Among one of the nation's earliest strikes was the chimney sweepers' strike of 1763, which occurred in Charleston. Other significant strikes that happened during the 1700's included tradesman such as tailors, printers, weavers, and river pilots. The 1800's saw numerous occupational strikes as well, many of which have become obsolete, such as shoebinders, bookbinders, cigar makers, cloakmakers, and pullmen.(Source: BLS)

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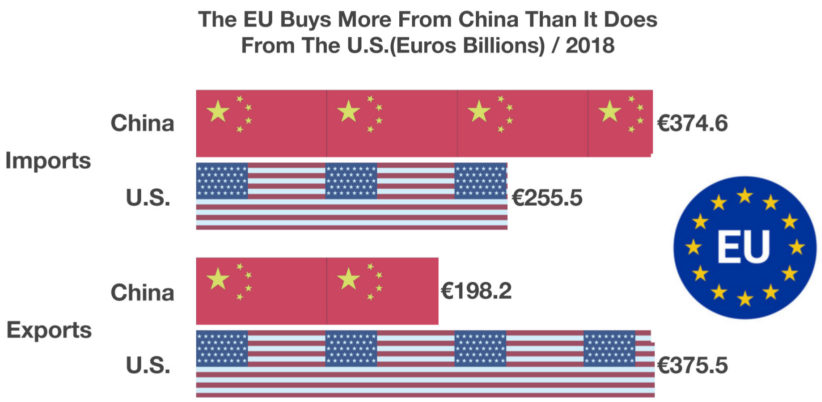
UNREIMBURSED MEDICAL EXPENSES MUST EXCEED 10% OF AGI IN ORDER TO DEDUCT

Europe Buys More From China Than It Does From The U.S. – International Trade

Over the years, Chinese exports have inundated not only the United States, but the European Union (EU) as well. Similar to the trade imbalances with the U.S., the EU also has trade imbalances with China. China has become a significant influence on the EU and its trading characteristics, garnering more trade expansion than with the U.S. China is now the EU's second-largest trading partner behind the United States, while the EU is China's largest trading partner. The U.S. represents about 17% of the EU's total trade, while China currently makes up about 15% of the EU's total trade.



The EU, like the U.S., wants to ensure that trade with China is fair, respects intellectual property and meets its obligations as a member of the World Trade Organization (WTO). The majority of the imports into the EU from China include consumer goods, machinery, shoes, and clothing. The bulk of exports from the EU to China are automobiles, planes, and chemicals. (Sources: U.S. Department of Commerce, EuroStat, CIA Factbook)

Tax Rule Changes To Be Aware Of When Filing – Tax Planning

This tax season is the first year where all of the changes and provisions passed under the Tax Cuts & Jobs Act are affecting both individual taxpayers and companies with broad changes for deductions and tax rates. The changes, effective January 1, 2019, affect most every tax payer filing as an employee or self-employed business owner. Some of the tax provisions enacted by the new tax act will be temporary, while others permanent. Affecting essentially every taxpayer is the increase in the standard deduction, which is meant to simplify the tax preparation process by replacing itemized deductions with a larger standard deduction.

A provision in the tax code known as indexing will affect 2019 Tax Brackets & Rates, which is essentially an inflation adjusted modification to account for rising inflation trends. For 2019, income brackets increased by roughly 2% across all income levels. Income brackets for capital gains have also increased slightly for 2019. With personal exemptions eliminated under the new tax law, a larger single standard deduction was devised in order to streamline returns for taxpayers. Standard deduction amounts increased slightly for 2019. For both employees and self-employed individuals, IRA and Qualified Plan contributions have increased as well for 2019.

Other significant changes occurring for 2019 include:

Estate Tax Exemption increases from $11.18 million to $11.40 million in 2019.; Elimination of the ACA penalty for not having health insurance becomes effective ; Unreimbursed medical expenses must exceed 10% of AGI in order to deduct; Alimony is no longer deductible for the payor and no longer taxable for the recipient for divorce decrees issued after December 31, 2018.(Sources: https://taxfoundation.org, IRS.gov)

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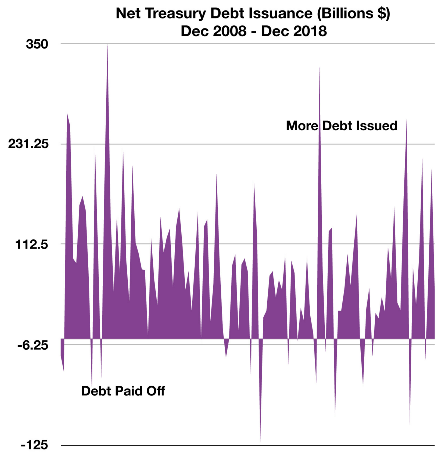
IT IS ESTIMATED THAT NEW DEBT ISSUANCE FOR 2019 WILL BE $1.4 TRILLION

Global Uncertainty Drives Demand For U.S. Treasuries – Fiscal Policy

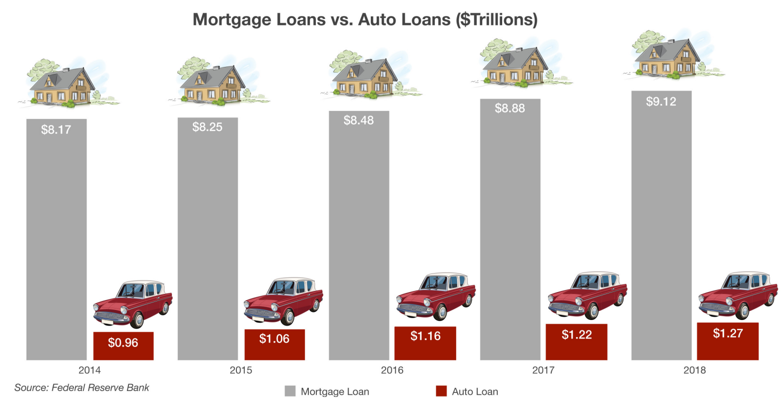
The prospect of an increasing deficit has led to an increase in debt issuance by the Treasury due to an expected shortfall of tax revenue. The Treasury issues debt in order to fund the ongoing operations of the U.S. government. Some of the recent tax measures passed by Congress are expected to reduce revenues while increasing spending, which will in turn be funded by issuing new Treasuries. The debt management process is comprised of both the issuance of new debt and the retirement of preexisting debt. Should the Treasury issue more debt than it is retiring, there is a net increase in the amount of debt outstanding.



Over the past 18 years, the Treasury has issued an average of $505.4 billion of debt each month, while also retiring or simply paying off an average of $454.8 billion every month. This deficit has been a subject of constant political debate. A heightened supply of Treasuries follows tax cuts and increased government spending, along with growing entitlement payments and higher service costs for government debt. The Treasury Department's total net new issuance in 2018 amounted to $1.34 trillion, more than double the 2017 level of $550 billion. It is estimated that new debt issuance for 2019 will be $1.4 trillion, then range from $1.25 trillion to $1.4 trillion over the next four years. Despite the increased flood of new government debt supply, demand has surprisingly kept up as an insatiable demand from abroad continues to drive investors to the liquid and transparent market of U.S. government debt.(Sources: U.S. Treasury Department)

Consumers Opt For Auto Loans Rather Than Mortgages – Consumer Credit

Data released by the Federal Reserve Bank of New York found that Americans have been borrowing more for automobiles and less for homes. While new mortgages fell to their lowest levels since 2014, car loans have been steadily increasing. A weakening housing sector along with tepid wage growth has affected mortgage demand over the past few quarters. Consumers who have been discouraged by a slowing housing market have instead stayed put and purchased new home goods and cars with their improving credit. Auto loans have been making up a faster growing segment of consumer debt than mortgages. Mortgage loans still make up the single largest debt payment for consumers nationwide, with auto payments the second largest. (Source: fred.stlouisfed.org)



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Shifting Strategies in the Pacific

Volatility exhibited by equity prices during the first month and a half of 2019 has diminished somewhat over the past two weeks. Price advances have paused in recent days, but the uptrend in place since the beginning of the year remains intact. At the end of February, the US' DJTMI is ahead by approximately 12% for the quarter. International and Emerging Market indexes have also advanced but to lesser degrees. The MSCI EAFE is up 10% and the MSCI Emerging Markets Index has gained 9% since December 31, 2018.

Stable conditions in the bond markets and a strong 4th quarter 2018 GDP report are further confirmation that the US economy continues to expand in spite of gathering slowdowns internationally. Net yield changes since the quarter began through February 28 are mixed and less than 10 basis points at all points on the Treasury yield curve.

Trade talks with China to end the tariff war that started last year, perhaps the greatest potential impediment to a resumption of strong Chinese economic growth, are reportedly yielding progress, but to date no details of agreements, beyond increased agricultural product purchases from the US, have been revealed.

Presidents Trump and Xi are scheduled to meet face to face this month. The two leaders hope to hammer out a deal to satisfactorily address US concerns about intellectual property theft and forced ownership participation by Chinese entities in US ventures domiciled in China. US equity markets have risen and fallen with each hint of progress or setback in the ongoing talks but with US economic expansion still very much alive, these short-term market bounces and declines have become little more than noise within a larger uptrend.

While the immediate concern of markets is the ability of the US and China to return to a more stable and less punitive trade relationship, another aspect of China's policies that concerns the US is its attempt to extend hegemony deep into the Pacific, which since WWII, in concert with Australia and Japan, has been largely an American sphere of influence. Pacific expansion is a key component of an overall initiative dubbed "China 2025" by the Chinese government. This refers to the target date by which China projects it will have become the world's leading economic power.

The potential for material economic transformation occurring in the Western and Central Pacific as a result of China's outreach is growing. In the aftermath of the Cold War, many of the island nations that were stepping stones to US victory in WWII have retained previously established US military installations. The security and well-being of island groups and nations such as Samoa, the Cook Islands, Fiji and the Marshall Islands, to name few, have been dependent on cash flowing from Washington DC as economic aid and compensation for hosting US bases. In the past decade, China has stepped up efforts to increase its economic presence in these same areas, which it considers a natural sphere of influence.

As the threat to the US from the former Soviet Union diminished post the Cold War, China's desire to exert greater control over the West Pacific Rim began to grow. The island economies are relatively small, so that infusions of Chinese cash either directly from the government or through increases in tourism has drawn the attention of these economies westward and away from the US.

Why is this important? Part of the WWII era agreements between the US and Pacific island nations stipulated the right to establish and maintain a US military presence to the exclusion of any other power[1]. The existence of a defensive buffer to our west during the Cold War was a strategic imperative, but in the decades since the collapse of the Soviet Union, the US has assigned lesser importance to the region, which has opened the door to greater Chinese influence. "...with China rising and great power competition heating up, these islands have gained renewed strategic prominence...given their small size and economic challenges, these Pacific microstates ultimately offer a low-cost opportunity for China to grow its influence and challenge U.S. strategic dominance [in the Pacific]. "[2]

Existing agreements between the US and the islands are nearing expiration and domestic political winds are blowing against paying for renewals, creating an opportunity for China to step into the breech and replace financial aid previously flowing from Washington. While overtures are still in their early stages, the goal is clearly to supplant US dominance in the region and to create new Chinese client states.

"As times change, however, these island countries will draw more attention from the giant that lies to their west, especially as Beijing's assistance comes with fewer strings attached, in contrast to Washington's demands that local states engage in good governance and improve efficiency. For the moment, China's outreach to many Pacific islands remains in its infancy, but the low cost — and long-term rewards — of such overtures mean the region will be the focus of Beijing's interests for decades to come."[3]

Clearly, obtaining trade concessions from the Chinese is becoming exponentially more important in view of the economic and military expansion being pursued by their government. The tariff leverage the US has used to bring China to the trade negotiating table has so far been effective. The Chinese economy's rate of expansion has slowed significantly over the past several quarters and equity indexes in Hong Kong and the mainland have reflected the pressure.

But in order to redirect US attention back toward the developing military encroachment in the Pacific, it is necessary to reach an agreement on trade that will diminish the time and effort being expended trying to protect American corporations that seek to do business in China. The next several months will be critical to this process. Whether the US cedes its strategic presence in the Pacific to the Chinese is a critical foreign policy decision for the current and future administrations.

World equity markets continue to enjoy strong positive returns as 2019 progresses, with the caveat that price declines are inevitable. As a seasonally weaker period for equities in the US approaches, maintaining the discipline to focus on long term plans and goals will, as always, be the best means to assure financial success. Short term progress or retreat tied to the ebb and flow of Chinese/US trade negotiations will likely continue until and unless an agreement is reached and implemented. Investors are well advised to look beyond the day's news rather than to be swayed by shifting emotional responses to developments.

Byron A. Sanders
Investment Strategist

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[1] "China Sets a Course for the U.S.'s Pacific Domain." www.stratfor.com, February 22, 2019.

[1] Ibid.

[1] Ibid.