Economic Review & Outlook

THIRD QUARTER 2018

What Matters Most

The prospect of building an investment portfolio can be intimidating to many people. Television, the Internet, friends, and family are full of advice. Some will say to invest passively in index funds; others will say that knowing when to get in and out of the market is the key to investing. Many will offer stock or fund tips, citing their impressive track record as evidence, while others will tell you that prior performance is irrelevant to future outcomes. Is all of this true? If it isn't, how can you invest successfully without knowing who to believe and where to begin?

In this Economic Review & Outlook, we outline and prioritize the major drivers that can impact investment success. We feel the chance of meeting your investment goals is largely impacted by whether you consistently follow certain steps. In our experience, success is more closely linked to establishing a goals-based plan and investor behavior than tactical investment decisions. We also outline how Ronald Blue Trust can help you build a strategy that fits your needs and helps you keep on track when times are tough.

First, we cover this quarter's key economic news and review market performance.

Economic Review

Unemployment Reaches a New Low

In May, U.S. unemployment fell to 3.8%, its lowest level since 2000 and less than 0.1% from the lowest reading since 1969. In addition to higher employment, the May jobs report revealed positive news regarding job creation and wage growth, with both metrics coming in ahead of economic forecasts. As a result of this news, the Federal Reserve (Fed) lowered its unemployment forecast to 3.6% for the end of the year and 3.5% for 2019 and 2020.

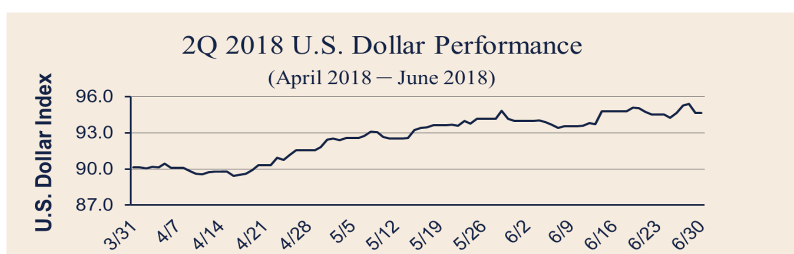
Trump Meets with Kim Jong Un

On June 12, President Trump broke new diplomatic ground by meeting in Singapore with North Korean Dictator Kim Jong Un. This was the first meeting between sitting leaders of the two countries, and the cooperative nature of the summit served as a stark contrast to recent tensions between the two nations. The meeting resulted in a joint statement that the countries would agree to pursue more peaceful relations, U.S. demilitarization of the Korean peninsula, and North Korea ending its nuclear weapons program. However, no concrete steps were outlined, and some remain skeptical of Kim Jong Un's sincerity around future cooperation.

Fed Again Raises Rates, Dollar Surges

On June 16, the Fed raised its benchmark rate (the federal funds rate) by 0.25%, the second hike so far this year. The majority of Fed members are now projecting a total of four rate hikes in 2018. The federal funds rate now stands at a target range of 1.75% to 2.00%.

Tighter monetary policy and a positive relative shift in growth outlook for the U.S. drove the dollar up strongly (+5.0%) during the quarter, as shown below.



Source: FactSet. USD performance is represented by the U.S. Dollar Index (DXY), which measures the value of the U.S. Dollar relative to a basket of foreign currencies.

Asset Class Performance

January	February	March	April	May	June	Q2	YTD
Emerging Market Stocks 8.30%	Diversified Bonds -0.90%	Commodities 2.00%	Commodities 4.40%	U.S. Stocks 2.40%	U.S. Stocks 0.60%	Commodities 5.80%	Commodities 8.70%
U.S. Stocks 5.70%	Gold -1.80%	Diversified Bonds 0.60%	Int'l Developed Stocks 2.60%	Commodities 2.00%	Diversified Bonds -0.10%	U.S. Stocks 3.40%	U.S. Stocks 2.60%
Int'l Developed Stocks 5.00%	Commodities -2.40%	Gold 0.40%	U.S. Stocks 0.40%	Diversified Bonds 0.70%	Commodities -0.70%	Diversified Bonds -0.20%	Diversified Bonds -1.60%
Commodities 3.20%	U.S. Stocks -3.70%	Int'l Developed Stocks -1.90%	Emerging Market Stocks -0.30%	Gold -1.40%	Int'l Developed Stocks -1.20%	Int'l Developed Stocks -0.80%	Int'l Developed Stocks -2.40%
Gold 2.30%	Int'l Developed Stocks -4.50%	Emerging Market Stocks -2.00%	Gold -0.50%	Int'l Developed Stocks -2.10%	Gold -3.70%	Gold -5.50%	Gold -4.60%
Diversified Bonds -1.20%	Emerging Market Stocks -4.60%	U.S. Stocks -2.50%	Diversified Bonds -0.70%	Emerging Market Stocks -3.50%	Emerging Market Stocks -4.10%	Emerging Market Stocks -7.70%	Emerging Market Stocks -6.50%

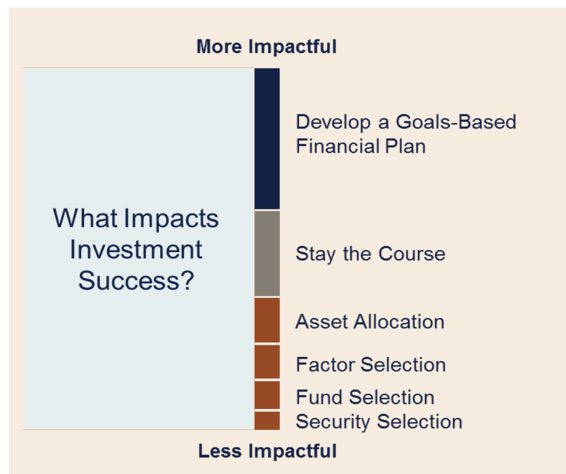
Indices used: Commodities—Credit Suisse Commodity Index, Diversified Bonds—Barclays Aggregate U.S. Bond Index, Gold—S&P GSCI Gold Index, U.S. Stocks—S&P 500 Index, Int'l Developed—MSCI EAFE Index, Emerging Markets—MSCI Emerging Markets Index. Indices do not reflect the deduction of advisory fees, transaction charges and other expenses. You cannot invest directly in an index. Past performance does not indicate future returns.

The rising dollar provided a big boost to U.S. equities versus other asset classes from mid-April through the end of June. During the quarter, U.S. stocks were up +3.4%, beating international developed (down -0.8%) and emerging market (down -7.7%) equities by a wide margin. Commodities led all asset classes with a +5.8% quarterly return, while gold was down -5.5%. Despite the Fed rate increase, bonds were only slightly down for the quarter (-0.2%). For the year, commodities now have a sizable lead as the top performing asset class, while U.S. stocks are well ahead of international equities. Emerging markets, which were the top asset class both last year and in January, are now at the bottom of the list, largely due to the recent dollar rally.

Our Perspective

Investments play a major role in our financial well-being. For many of our clients, investment accounts make up a large percentage of their net worth. The longer the investment horizon and the larger the account, the bigger the impact even a small change in returns will make. For example, in 30 years, a $1 million investment that returns 7% per year will grow to roughly $7.6 million. If the average return drops just half a percent, that final amount will decrease by nearly $1 million. Choices around asset classes, funds, and stocks can lead to a wide range of potential outcomes. Needless to say, how you choose to invest matters a great deal; the options available are nearly limitless and growing larger every day. It's no surprise that people can lose sleep over their investments!

So how should you approach this dilemma to help increase your chance of a successful outcome? You should start by prioritizing the most important decisions and focus on getting those right, as illustrated by the accompanying graphic. Below, we will outline several investment decisions you will face, ranked by importance. We believe that making wise choices on the first few decisions will likely increase your chances of becoming a successful investor by meeting your financial goals.



Develop a Goals-Based Financial Plan

By far, we believe the most important step you can take to increase your chances of successful investing is to define your goals and develop a financial plan that helps you accomplish those goals. For some, this may mean building your nest egg through saving early and often. If you feel like you have catching up to do, it is often easier for most to materially increase their savings rate than their investment return, especially without adding risk. This is even more the case in today's low yield/expensive market environment, where future returns are likely to be muted. Ultimately, the world is uncertain and investment returns are not guaranteed, but we have much more control over how much we choose to spend and save. Helping you accomplish your goals may also involve utilizing different tax or giving strategies. We believe that having a sound financial plan that takes into account your goals, time horizon, and potential investor biases can make a far greater impact than any one decision on how to invest your money.

Stay the Course

Once you establish a plan, it's important that you stay the course, especially as it relates to your investment strategy. During times of volatility, keep in mind that while markets are uncertain in the short run, they tend to trend upwards over time. Even equity markets rarely have a negative return over 10 years, and a 20-year negative return has yet to occur. In fact, even large market selloffs tend to lead to full recoveries within a few years. This is an advantage to anyone with a long time horizon who is able to ride out periods of volatility. Unfortunately, many investors attempt to time the market by guessing when to be fully invested and when to take money off the table, or abandoning their investment strategy altogether during uncooperative markets. According to various studies, this practice leads to below-average results for most investors. Though timing the market can be tempting, getting the decision wrong can lead to disastrous results. Investors can lose more return by switching investment strategies than by picking the wrong investment strategy to begin with. It's often not worth it.[1]

Asset Allocation

Your asset allocation represents your portfolio's mix of stocks, bonds, and real assets (gold and commodities). This choice will have a major impact on your portfolio's expected return and volatility, and how it will behave in various economic/market environments. While there is no "one size fits all" solution for choosing an asset allocation, you should always consider your investment horizon, return goals, and how comfortable you are with short-term volatility.

Factor Selection

While asset allocation tells you how much to put into stocks, your factor selection determines the characteristics of those stocks. Common factors to consider are *value* (stocks with lower prices compared with their book values), *quality* (stocks of companies with healthier balance sheets and income statements), and *momentum* (stocks with positive recent performance). Even investment portfolios with the exact same asset allocation can vary significantly, particularly over shorter periods of time, if they have different factor exposures. While factors tend to cycle in and out of favor, we believe that some factors (mainly value and quality) contain characteristics that should lead to better results over time.

Fund Selection

When a fund manager outperforms its benchmark, most of that outperformance will generally be linked to differences in either the fund's asset allocation or factor exposure. This is why the asset allocation and factor decisions rank higher on our priority list than specific fund selection. When it's time to pick a fund, we believe you can maximize your value by comparing what you get in terms of asset class, factor exposure, and investment process with what you pay (expense ratio and any other fees). While saving on fees is definitely a plus, it should not come at the expense of diversification or the overall portfolio characteristics (asset allocation and factor exposure).

Security Selection

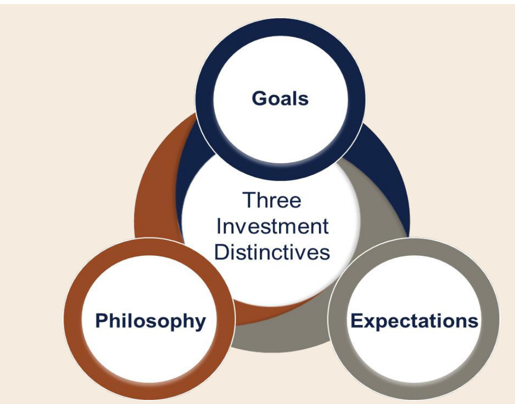
After the steps above are taken care of, the decision to buy specific stocks or bonds (securities) by your fund managers will have little impact on your overall return. This is preferable, since we do not believe in paying a premium for a trendy fund manager who hangs his hat on previously successful market calls or stock picks. Studies have found that, once factor exposure and fees are taken into account, very few managers add value through their ability to pick stocks. In fact, an overreliance on individual security selection is usually a sign of an under-diversified portfolio.

While starting at the top and working down this list is what we believe to be the most reliable way to be successful, we find that most people spend far too much time worrying about individual stocks or funds, and not enough time building a financial plan and thinking about their high-level investment goals and portfolio characteristics.

[1] To read more about the dangers of market timing, please see our Second Quarter 2018 Economic Review & Outlook.

Our Investment Strategy

At Ronald Blue Trust, we believe successful investing tends to increase the probability of meeting your cash flow needs.



And while there are no guarantees, we offer three investment distinctives to help you navigate the decisions mentioned previously: defining goals, setting expectations, and implementing our Principles-Based Investment philosophy.

Defining Goals

Many people spend years in the markets without ever pausing to consider why they are investing in the first place. Most people have financial goals, whether it's retiring by a certain age, funding a child's education, or making a large charitable gift; the problem is that many fail to tie these goals back to their investments. Before investing, you should always consider your goals, including any specific cash flow needs, and when they will occur. This is your 'why' for investing, and it underpins all of the tactical decisions to be made in your portfolio. A short-term need requires a more conservative investment portfolio, such as short-term bonds, while a longer-term goal might be better funded with global equities in order to increase growth potential.

Setting Expectations

Once your goals have been defined, we can help you set appropriate expectations for your portfolio. This is an important aspect of learning to manage your investor behaviors. In order to "stay the course" with an investment strategy over the long term, you have to be able to be satisfied with your results in the short term. Satisfaction is simply the difference between what you receive and what you expected. If your expectation is to always outperform a benchmark or never have a negative return, you may be setting yourself up for disappointment, as every investment strategy will have periods of poor performance. Difficult market environments are a given, so having a good sense of when a strategy is likely to do well and poorly can help put those periods in perspective and keep you on track.

Implementing an Investment Philosophy

While the importance of defining goals and setting expectations cannot be overstated, we ultimately need to decide which markets, factors, and funds to select. We believe successful investment management requires having a philosophy that reflects your worldview and informs your investment process, which should be intuitive and repeatable in order to increase the probability of reaching your goals. Our investment process, Principles-Based Investing, takes timeless biblical truths (such as uncertainty and human productivity), as well as academic research, and applies them to building time-based portfolios which target real (after inflation) return goals. Our asset class, factor, and fund decisions are based on our desire to invest in faster growing countries and companies at reasonable valuations, while remaining broadly diversified. While our philosophy remains consistent across all of our investment solutions, each portfolio is tailored to your needs.

In Conclusion

The many aspects that go into building an investment portfolio are not all created equal. Choosing the right market, fund, or investment philosophy matters little if you are not first able to properly budget or remain invested over time. We believe prioritizing these steps can help lead to greater investment success, as can working with us to define your goals, set reasonable expectations, and implement through our Principles-Based Investing framework. While some of these decisions can seem difficult and outcomes cannot be guaranteed, we believe that following this outline can help you invest more confidently and with greater purpose.

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