MarketView

Fourth Quarter 2018

GS Investments

GS Investments, Inc.

Largest Stock Holdings

12/31/2018

Securities	Pct.
Microsoft Incorporated	2.25%
Boeing Company	2.16%
Berkshire Hathaway Class B	2.14%
VISA Incorporated	2.06%
Walt Disney Company	1.95%
Apple Incorporated	1.92%
Intel Corporation	1.86%
Home Depot Incorporated	1.83%
PepsiCo Incorporated	1.81%
Stryker Corporation	1.76%

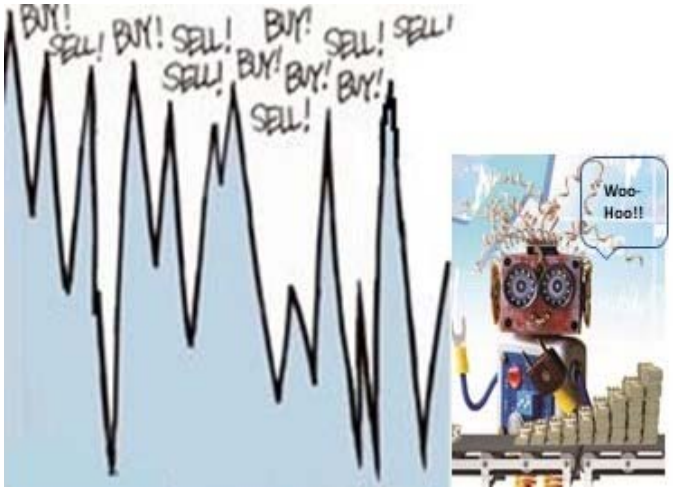
The rise of the Machines

"Electronic traders are wreaking havoc in the markets." So says Leon Cooperman, the billionaire stock picker who founded hedge fund Omega Advisors.

Behind the broad, swift market slide in the 4th quarter of 2018 is an underlying new reality: Roughly 85% of all trading is on autopilot controlled by machines, models, or passive investing formulas - and void of fundamental research and intuition. This has created unprecedented market volatility that is riling investors everywhere.

Behind the models employed by the "quants" who build and deploy them are algorithms, or investment recipes, that automatically buy and sell based on pre-set inputs. In early December, stocks were dumped. In the week following Christmas, they bought a good number of them back.

Since peaking in late September, the S&P 500 index fell nearly 15% before rallying 10% in the last week of December to finish at -4.4% for the year. Specifically, the Monday of Christmas Eve saw the Dow Jones Industrial Average post its worst single-day point loss in its history. Two days later, the S&P 500 index posted its largest point gain in its history. The benefit for most investors during this three day period was a big, fat zero.



The question at hand is whether or not discernable value is being created here. While there may be some, our contention is that any value created is realized by only a select few, specifically those who own and run the machines and the large pools of funds which they direct. The average investor is left to writhe in frustration while the machines send the market rocketing forward and then back, over and over again. These dramatic moves are exacerbated by leverage and the lack of an "uptick" rule (a rule that allows the machines to sell stock short, in unimpeded fashion), frightening investors everywhere.

As many of you know, we are investors and not fast-traders. We seek to buy good companies at reasonable prices, looking to hold them over the long term until we believe they become overvalued or there is fundamental change in the trajectory of the company. The recent volatility has not changed our fundamental view of our holdings, but we note that the overall market has be-

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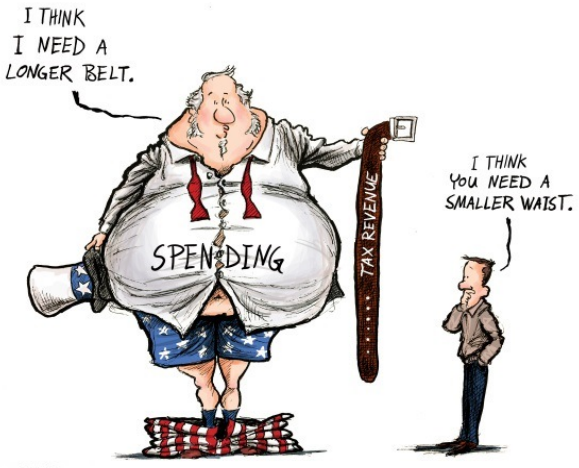
Price Changes in the S&P 500 Index
10/2/18 - 1/4/19

Starting Date	Number of Trading Days	S&P 500 Value	Percent Change
10/2/2018		2,903	
10/2/2018	7	2,728	-6.03%
10/11/2018	5	2,809	2.97%
10/16/2018	9	2,641	-5.98%
10/29/2018	6	2,813	6.51%
11/7/2018	12	2,632	-6.43%
11/23/2018	6	2,790	6.00%
12/3/2018	15	2,351	-15.73%
12/26/2018	4	2,507	6.64%
1/2/2019	1	2,448	-2.35%
1/3/2019	1	2,532	3.43%

come less expensive. According to FactSet, S&P earnings are expected to rise 21% in 2018 over the prior year, yet the market was down just over 4%. This resulted in stocks prices 25% lower than they were a year ago.

Tax Cuts, Revenues and Deficits Revisited

For the past two years, we have been told by academic pundits and media "experts" that tax cuts, if implemented, would result in reduced revenue to all governmental entities. Subsequently, we were told, deficits and debt would expand, likely in dramatic fashion. Although it is early, we can see that these people are at least half-right. Deficits have continued to expand, adding to debt levels. What about revenue (tax receipts)? Interestingly, the Federal government collected record tax revenues of $252,692,000,000 in October, the first month of fiscal 2019. It is true that some of this may be due to the repatriation of funds from overseas but we think that, over time, the tax cuts will continue to provide more, not less, revenue to the governmental entities that take them in.



If tax cuts equate to higher, not lower, tax receipts, then we are left to surmise that expanding deficits are more accurately attributable to spending behavior than they are to tax cuts. For those of you that have been reading our newsletters over time, this is exactly what we have said all along.

Further evidence is cited in a recent article in the Wall Street Journal. The State of Illinois, for example, is forecasting a $1.2 billion deficit and a $7.5 billion balance in unpaid bills, this despite instituting a $5 billion personal and corporate tax hike in 2017.

They are not alone. The State of Connecticut is facing a $1.7 billion budget deficit despite multiple tax increases over the past few years.

A further problem with the "increased taxes result in increased revenue" argument, is exemplified by the State of New York. In 2016, the State lost roughly $8.6 billion in income as companies and individuals chose to leave the state and move to where the taxes are lower.

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California may suffer a similar fate as pension costs alone are expected to rise more than 50% in the next five years. We believe that it is highly unlikely that the State will be able to raise taxes high enough to offset its obligations. Perhaps California should examine how to decrease its spending instead.

Focus on the consumer

More often than not, the consumer drives the economy, the economy drives earnings and earnings drive stock prices. If this continues, our contention is that the market, by year's end, will be higher than it was at the beginning of the year. Is it our blind devotion to optimism that prompts us to say this? A look at some recent economic statistics provides support for our contention. First, retail sales posted their biggest increase in six years, jumping 5.1%. Second, holiday online sales increased 19.1% over 2017 sales. Third, the largest U.S. retailer, Amazon, indicated that it had the best holiday sales in its history. These are hardly signs of a weak or tapped-out consumer.

With that said, some economists have pointed to a rise in consumer debt, contending that the strength in retail sales, to a large extent, had been financed. In short, the average consumer was extended and future economic viability was in question.

What about the prospects of an "extended" consumer? While consumer debt has increased, the personal savings rate is strong at 6.2%. This is double the rate that it was during both the recessions of 2009 (3.1%) and 2001 (4.9%).

Pundits have also cited the current household debt figure of 98% of disposable income as a concern regarding the consumers long-term viability. Further examination shows that this is actually near its lowest level since 2002 and nowhere near the 2007 peak of 131%, hardly a weak or "stretched" consumer. In fact, the higher savings rate and lower dependency on debt shows a consumer who is in a good position to continue to spend during soft patches in the economy.

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Notable Election-Related Quotes

"There is no worse tyranny than to force a man to pay for what he does not want merely because you think it would be good for him."
Robert A. Heinlein

"We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."
Winston S. Churchill

"We should reduce total government spending as a percentage of the economy. Some would rather focus on the deficit so they can take us away from the focus on spending as a percentage of the economy."
Grover Norquist

"The U.S. stock market now trades inside black boxes, in heavily guarded buildings in New Jersey and Chicago."
Michael Lewis

"Everyone has the brainpower to make money in stocks. Not everyone has the stomach. If you are susceptible to selling everything in a panic, you ought to avoid stocks altogether."
Peter Lynch

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Add to these an environment with relatively low interest rates, low inflation and low energy prices and it is possible to envision strength in consumer spending for the foreseeable future. If true, it should equate to higher stock prices.

Apple and the value of an advisor

One of our largest holdings, Apple, has been in the headlines lately with its dramatic sell-off over the past two months. While the company's slowing growth in iPhone sales and the Chinese market have been widely publicized, we feel the market has overreacted. The company currently has $120 billion in cash and trades at a mere 10x forward earnings, ex-cash. Although we trimmed the position in 2018 at higher prices, we will look to again purchase shares in client accounts at lower prices.

With the markets as volatile as they have been over the past few months, we would like to highlight what we feel is the "value" of having an investment advisor. Although what we do is far from perfect, we hold fast to our market disciplines in volatile times, allowing us to avoid the majority of the "emotional" mistakes that can drive investors to long-term underperformance.

We greatly value your business and the trust you have placed in us to handle your investment affairs.

GS Investments 20 Years & Growing

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GSI Tenets

GS Investments

GS Investments, Inc. is an investment management company specializing in individual and institutional asset management. Privately owned and operated, GS Investments, Inc. is run by its owners, Glenn H. Steinke, C.F.A., John G. Steinke, M.B.A. and Greg Cunningham.

Glenn Steinke, CFA brings over 45 years of investment management experience to the business. Previous capacities include Vice President and Senior Investment Officer with a major pension fund ($1.8 billion under management) and Senior Vice President with a major Minneapolis-based financial institution ($3 billion under management). Glenn is a graduate of the University of Minnesota.

John Steinke MBA offers a broad financial services background with 24 years of portfolio management experience and 7 years of banking experience including capacities as a Vice President of a $50 million bank and as a private banking office for a large, Minneapolis -based financial institution. John received his BA from Concordia College (Moorhead) and his MBA from the University of Minnesota.

Greg Cunningham Prior to joining GS Investments, Greg spent 15 years at Minneapolis-based Ameriprise Financial, a national leader in financial planning with over 2 million retail clients and $300 billion in assets. Here he worked with the Chief Investment Officer in support of the international and domestic hedge funds and with the President and General Manager of RiverSource mutual funds. Greg is a graduate of Gustavus Adolphus College in St. Peter, MN.

Sheri Ritchie brings over 25 years of financial services experience to the business. Previous capacities include client service and support positions with Dean Witter and Kemper brokerage firms and a Minneapolis-based investment management firm. Sheri is a graduate of the University of St. Thomas.

GSI Investment Philosophy

GS Investments, Inc. utilizes a balanced approach for the majority of its accounts although each account is tailored to the individual needs of each client. Taxable or tax-exempt bonds are used along with a common stock component. The division between bonds and stocks is determined by the personal objectives of each client. A need for income and a willingness to assume risk are also determinants of an account's bond/stock mix.

GS Investments, Inc. emphasizes the purchase of quality securities and employs a long-term investment style, as market timing, frequent shifts in asset allocation and interest rate forecasting are not consistent with the firm's philosophy. In-depth market analysis and many years of experience support this approach.

GSI Fixed Income Strategy

GS Investments, Inc. emphasizes a staggered maturity approach when purchasing bonds. Individual security investment grades and call protection are considered when making these investments. Quality grades of "A" or higher are favored with tax-exempt issues. Government bonds are dominant among taxable securities.

GSI Equity Strategy

GS Investments, Inc. favors stocks emphasizing quality and growth. Appropriate cyclical growth stocks and small capitalization growth stocks are used periodically as well. Additionally, GS Investments, Inc. believes that a growth oriented philosophy tends to result in less frequent trading and lower tax payments (for taxable accounts) on realized capital gains. This provides a lower cost approach for the client.

GSI Client Communication

GS Investments, Inc. emphasizes client communication. Written investment objectives as well as periodic oral and written reports are used to heighten the understanding between the client and investment manager. In addition, easy to read, detailed reporting is provided by state-of-the-art investment software in order to inform the client of portfolio progress.