MarketView

Fourth Quarter 2018

GS Investments

What 'Inning' are we Really In?

Much has been made about the strength of the U.S. economy over the last year or so. The fear on 'the street' is that the economy is overheated (4%+ GDP growth and 20%+ growth in Standard and Poor's 500 earnings) and will inevitably force the Federal Reserve (the Fed) to raise short-term interest rates in an effort to curb inflation. Recent volatility in the equity markets reflects this action.

According to Edward Lazear, former Chairman of the President's Council of Economic Advisers, we may not be at the end of the current economic cycle, rather in its 'later innings.'

Mr. Lazear predicates his opinion on three points. First, he argues, is the rate of job creation. His premise is that the number of jobs created must keep pace with population growth in order to reach true, full employment. He, like many other economists, uses the employment-to-population (EPOP) ratio. With a current ratio of 60.4% and a monthly population growth average of 227,000, 137,000 jobs must be created every month to reach full employment. Given the 3-month average job growth of 190,000, more jobs are being created each month than are needed to absorb the average monthly population growth. This slack in the economy, Mr. Lazear points out, is more indicative of an economy that is still in the recovery phase.

Second, Lazear points out, the EPOP will remain below its prerecession peak due to the aging population and the high number of retirees (the Baby Boomer generation). One needs only to compare the average, annual population growth (227,000) to the average, annual number of jobs created (190,000), to see that this is currently true.

Third, Lazear argues that wage growth (2.8%) is currently less than the Fed-adjusted productivity growth rate of 3.3% (1.3% productivity growth + the Fed's target 2% inflation rate). All in all, this makes a strong case for muted wage and inflation growth, at least for the foreseeable future. If wage inflation is truly contained and economic growth remains strong, we likely have yet to see a peak in the equity markets.

GS Investments, Inc.
Largest Stock Holdings
9/30/2018

Securities	Pct.
Apple Incorporated	2.44%
Microsoft Incorporated	2.24%
Boeing Company	2.23%
VISA Incorporated	2.14%
Honeywell International	2.02%
Berkshire Hathaway Class B	2.01%
Home Depot Incorporated	2.00%
Walt Disney Company	1.94%
Stryker Corporation	1.74%
iShares Trust MSCI EAFE (Europe, Asia and Far East)	1.71%

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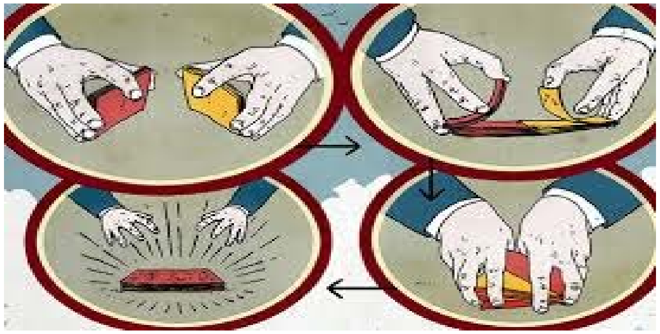
Reshuffling the Index - Again



About one year ago, Standard and Poor's added a sector to its index in order to separate out Real Estate. Therefore, Real Estate became the thirteenth sector in the Standard and Poor's common stock universe.

Recently, another sector was added, one that may have a significant effect on the Index as a whole. The Communications Services sector was created and now includes stocks like Alphabet, Disney, and Facebook. They joined AT&T, Verizon and Century Telephone making the sector larger, while making other sectors like the Information Technology sector become smaller. Subsequently, the Information Technology sector will drop from roughly 25% to 20% of the S&P 500 Index. The Communications Services sector and Consumer Discretionary sector will each represent approximately 10% of the Index.

So, what's the difference? Why is this change significant? First, these changes affect presentations in our quarterly statements as we categorize common stock holdings according to S&P 500 sectors. Second, in managing the common stock portion of our client portfolios, we weight our positions according to S&P sectors; some over-weighted, some under-weighted and some equal-weighted.

Also, many Exchange Traded Funds and other sector-managed funds will have to reshuffle their holdings in order to align them with the new sectors. This requires a good deal of trading on behalf of sector-based mutual fund and ETF managers to rebalance their portfolios. Some of this trading may have been done in anticipation of the change, some during and after, but shifting could be causing market movement and some turmoil. Only after rebalancing is over will we know the effect of the sector shift.

Rising Insert Rates - Is a Recession on the Horizon?

The Federal Reserve has been gradually raising interest rates in ¼ point increments since December, 2015. Since that move, it has taken additional actions to manage economic growth and rising inflation. Third quarter domestic growth has yet to be reported, but estimates are now in the 4% plus range; this follows 4.2% in the second quarter. Also, inflation has ticked above the Federal Reserve's 2% target and caused the bell-weather ten-year U.S. Treasury bond to jump over the 3% yield threshold. These, combined with several other factors (low unemployment, rising oil prices, tariff fears, mid-term elections, October seasonal fears, computer trading, etc.) spooked

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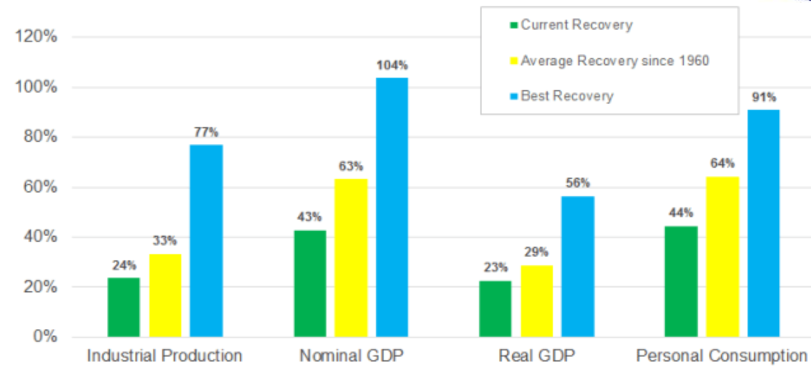
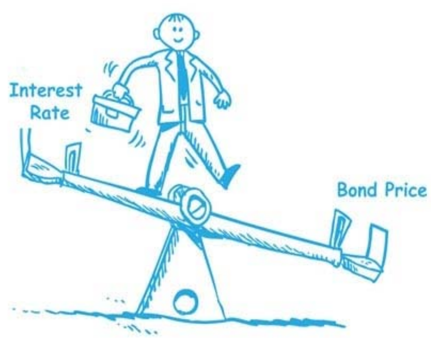
equity markets over the past week, sending them down sharply before they rallied a bit by week's-end. We think the sharp downward move in stock prices is overdone, and it may be argued that such a correction is healthy; a cleansing of upward movement experienced so far this year. We feel our domestic economy remains healthy with signs of continuing growth. This should translate to upward movement in corporate earnings at above average rates. For 2018, corporate earnings should advance 20+%; 2019 looks like 10+%. Federal Reserve chairman Powell forecasts continued growth for the domestic economy, this despite a gradual rise in interest rates implemented by the Federal Reserve this year and next.



Source: Federal Reserve Bank of St. Louis, Armbruster Capital Management

One source of support for our point of view is a recent publication entitled "The U.S. Economy: 8 more years of expansion?" It was written by a Chartered Financial Analyst (CFA) using data from the Federal Reserve Bank of St. Louis. It notes that the current expansion has been slower than other expansions going back to 1960, so the reasoning is the expansion could be longer in duration. The evidence is graphically displayed to the right.

This expansion has taken time to gain traction due to fear from the financial crises, disruption in the banking sector, tightening of regulatory requirements and many other restraining factors. The adrenalin shot to the economy of lower corporate and personal taxes and looser regulatory requirements has resulted in growth picking up from the 2% range to roughly 4% as we write. Growth is not expected to rise dramatically from here. A 3% growth rate going forward is possible though, resulting in continuing support for higher corporate earnings and stock prices. We are not suggesting that there will be another 8 years of economic expansion, rather that the current expansion could be longer-lasting than normal due to its slow start.



INTEREST RATES AND BOND PRICES

As interest rates rise, bond prices go down. So, valuations of bonds in client portfolios move lower during periods of rising interest rates, such as we are seeing now. Lower valuations are simply a function of rising interest rates, not bond quality concerns. We expect the bonds we purchase to pay their face value amount at maturity. So far this year when combining price change of bonds with interest paid (total return), the benchmark measure we use is down 1.7%. To help offset such a decline, we have been using more U.S. Treasury bills in client accounts. We still stagger bond maturities but maintain shorter durations due to rising interest rates.

In taxable accounts, the interest payments from U.S. Treasury securities are not taxed at the state level. They are however, taxed at the Federal level. U.S. Treasuries are high quality, extremely liquid and provide a satisfactory in-

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come return for our clients. Because they are purchased at a discount to face value, they carry no coupon. The difference between the discounted purchase price and payment at maturity is considered the income factor or yield. Typically, U.S. Treasury bills have a maturity of one year or less.

Notable Election-Related Quotes

"Politicians are like diapers. They both need changing regularly and for the same reason." - Author unknown

“Always vote for principle, though you may vote alone, and you may cherish the sweetest reflection that your vote is never lost.” - John Quincy Adams.

“A vote is like a rifle: its usefulness depends upon the character of the user” - Theodore Roosevelt.

”It has been said that democracy is the worst form of government except all those other forms that have been tried from time to time.” - Winston Churchill

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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.