MarketView

Third Quarter 2019

GS Investments

Negative Interest Rates are Not a Real Positive

Borrowers have been paying interest on debt as far back as the time of the ancient Samarians. For the first time in history, things really are different this time. Currently, over $17 trillion in tradable bonds worldwide pay a negative interest rate. For example, a person buying $1,000 in ten-year German bonds would expect to get back less than $950, ten years from now. Nearly a third of all global bonds carry a negative interest rate and nearly half of government and corporate bonds pay less than 1%. Here in the U.S., the 10-year bond pays just over 1.5% and the 30-year rate dropped below 2% for the first time in history. It is hard to fathom who would buy bonds that lock in a loss, but pension funds and insurance companies are mandated to purchase a certain portion of bonds for their portfolios. Those saving for retirement may also hold these bonds as they fear taking on greater equity risk. European and some Asian central banks are buying up debt as well to stimulate their low growth economies. Finally, aggressive investors are bidding up these bonds further in hopes for capital gains. Luckily, negative rates have not shown up in U.S. markets, but low rates are affecting the ability of balanced portfolios to produce returns close to historical norms. U.S. Pension funds that for decades assumed 8.5% returns now are having a hard time achieving recently lowered 7.5% hurdle rates. To hit a 7.5% return rate, a portfolio with 40% in bonds yielding 2%, would need to achieve stock market returns of greater than 11% over an extended period of time. As a comparison, the average return on the S&P index has been just under 8% since its formation in 1957 . We have been opportunistically buying high quality bonds as rates fluctuate higher, using preferred stocks, and in some cases high yield dividend stocks to increase returns. However, it is safe to assume overall portfolio returns may be more subdued until interest rates move higher.

Higher Savings

Prior to the 2008 financial crisis, the U.S. savings rate was 3.7%. In the immediate aftermath of the recession, the savings rate rose to 6.5% in 2010 as people tried to repair their personal balance sheets. This follows a typical pattern where consumers feel good at economic peaks and spend down savings, then pull back from spending in the aftermath of a recession. However, through the first 9 months of 2019, the savings rate increased to 8.1%, according to the St. Louis Fed. There seems to be a structural shift in behavior. According to Paul Ashworth, Chief Economist at Capital Economics, part of this can be explained by the tax cut. There was a 1% increase in the savings rate, beginning with the first month in which taxes were reduced. There are also indications that millennials, having seen the impact of the recession on people's personal finances, are more likely to save for emergencies and put money away for retirement. A study by the investment firm UBS found that the millennial generation is the most financially con-

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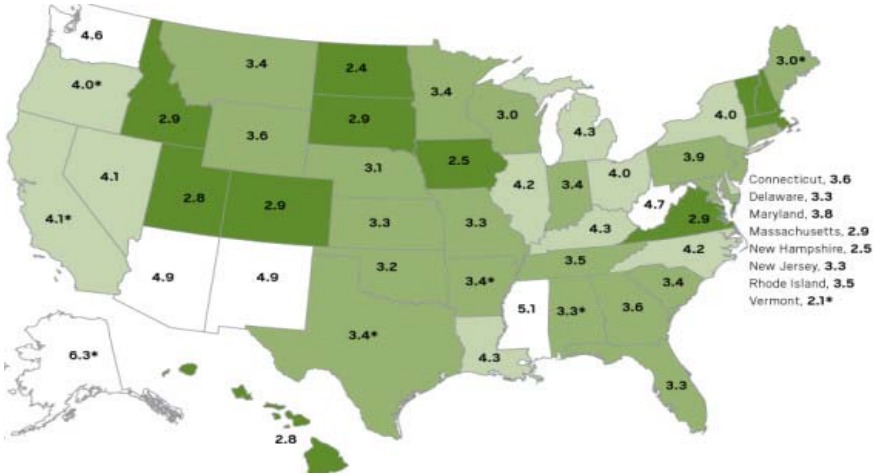
servative since the great depression. Finally, a survey by TD Ameritrade found that many individuals close to retirement are cutting back on expenses and increasing savings, despite the low interest rate environment, in order to make up for stock market losses from 2008-2009.



Unemployment hits 50-Year Low

Good news on the labor front; the unemployment rate dropped to 3.5%, the lowest rate since 1969. The unemployment rate for those with a college degree stood at 2% while those without a high school diploma dipped to 4.8%, the lowest on record. Additionally, average hourly earnings grew at 2.9%, ahead of the 1.7% inflation rate. Increases in employment, hours worked, and wages per hour, have led to higher household incomes. In addition, wages since the beginning of 2018 have increased faster at the lower levels than those in the top quintile. This is a slight reversal of decades-long trends. Those in the top quintile (households earning more than $130,000), earn 52% of all income. This is up from 50% in 2000, but down slightly since 2017.

Despite the good labor news, forecasted GDP growth is expected to slow to 1.9% from the 3.1% rate in the first quarter. Contributing to the slowdown is the political uncertainty in Washington, China trade concerns, an increase in consumer's saving rates, and huge production declines at two of the country's largest manufacturers (Boeing due to the 737 MAX grounding and GM due to its labor strike).

The job market and increased wages have been a big help to the economy. Furthermore, we expect GM and Boeing production to soon return. As such, we are cautiously optimistic for at least a trade truce, and see increased consumer savings as a buffer against any further slowdown. That leaves political uncertainty as the one wild card, but we don't think that will be enough, on its own, to end the economic recovery now in its 10th year.

Who Owns Stocks in America?

Mark Zuckerberg holds more than $65 billion in Facebook stock, but at 35 years old he is an outlier. The reality is that the people who own most of the stocks in America, quite frankly, are "old" people. According to the Federal Reserve, households headed by people over the age of 55 own 73% of the value of all domestically owned stocks and they own the same percentage of America's total wealth as well.

GS Investments, Inc.
Largest Stock Holdings
9/30/2019

Securities	Pct.
VISA Incorporated	3.41%
Apple Incorporated	3.29%
Home Depot Incorporated	3.28%
Microsoft Incorporated	3.22%
Stryker Corporation	3.00%
Boeing Company	2.99%
Walt Disney Company	2.93%
Honeywell International	2.80%
Berkshire Hathaway Class B	2.79%
American Tower REIT Corporation	2.64%

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The average net worth for households aged 65-74 is $1,066,000, while those in Zuckerberg's age group of 35-44 average is $288,700. With 72% of all stocks held in pension plans, 401(k)s, IRA's and annuity contracts, all of which are vehicles for retirement savings, this disparity makes sense. Older people have spent a lifetime saving for retirement and have experienced decades of growth in their accounts. Those in their 30's and 40's however, are often in the early innings of the retirement saving process. At the end of the day, almost all Americans benefit from a rising stock market. Even the young will benefit as eventually they will become the wealthy old people.

China or the U.S.

If you were to pick between investing in China or the U.S. over the next several decades, which would you choose? Ignoring the currency, accounting standards, and political risks of investing in China, many may say China would be the place to invest. They would argue the GDP growth in China is too much to pass up, but would that be right? Long-term GDP growth is a function of productivity, population growth, and the labor participation rate. We will weigh each of these factors as we consider an answer.

Productivity is the most important of these and with all the Chinese investments in plant and equipment, we have seen tremendous productivity growth over the years. However, according to Bloomberg, non-financial corporate debt in China now stands at over 150% of GDP; this compares to less than 30% of GDP in the U.S. In general, Chinese corporations have overinvested and are finding it financially challenging to make the kinds of investments they have made in the past. At the same time, manufacturing is beginning to move to lower wage markets such as Viet Nam and Malaysia. Therefore, even though productivity growth is still higher in China versus the U.S. it is slowing dramatically, while at the same time the U.S. is seeing a slight uptick.

While labor force participation rates affect GDP, growing participation rates also lead to higher growth. China's participation rate has historically exceeded that of the U.S., but here again the trend is changing fast. According the Bureau of Labor Statistics, the U.S. labor force participation rate peaked in 2000 at 67.3%. It now stands at 63.2%, having moved up slightly over the last 4 years. Meanwhile, China's participation rate has plummeted from nearly 78% in 2000 to around 68% this year. It is expected to continue its decline.

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That leads us to the biggest difference between the two countries; population growth. China has 1.4 billion people in its country. However, due to declining birth rates and decades of the "one child rule", its population is expected to decline by 75 million over the next 30 years and an incredible drop of 270 million or nearly 20% of its population by the year 2065. The U.S., on the other hand, is expected to be one of the fastest growing populations on the planet, adding 110 million people over that same period. In fact, the U.S. is the only country in the developed world that is expected to have significant population growth. This is due primarily to the influx from immigration. Over 60 million immigrants have arrived in the U.S. since 1965. This compares to virtually none in China over that same period. Outside of the U.S. and Pakistan, all the other high-growth counties lie in Africa, most of which are not investible at this point. At the same time, several European countries are expected to lose up to half their populations by 2100.

While huge investments in productivity gains, population growth, and high labor participation rates have helped deliver an economic miracle in China, those trends are slowing considerably. China's overall economic growth could overwhelmed by a rapidly aging and dramatically shrinking population.

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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.