ANALYTICS INVESTMENT ADVISORS, LLC

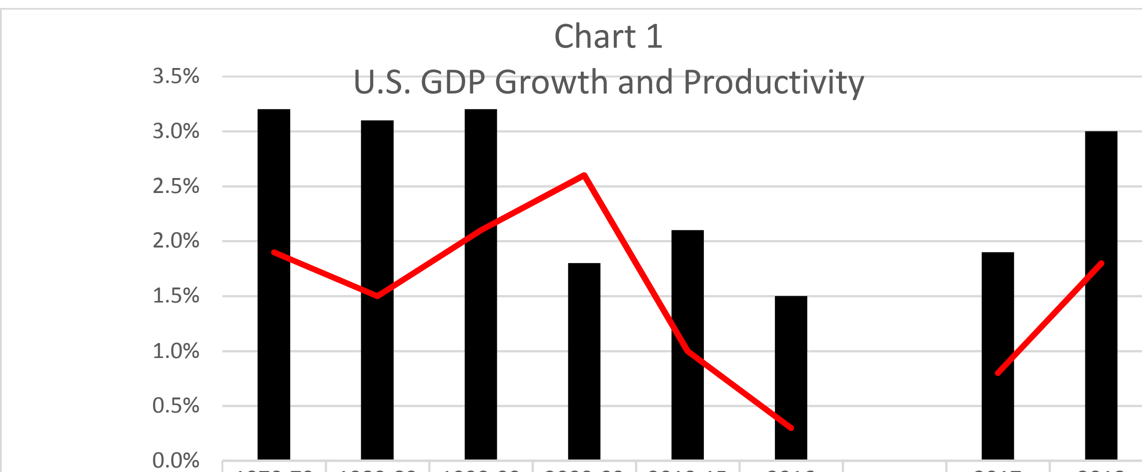
U.S. Economy and The Federal Reserve

"The U. S. economy, unless it's disrupted by a major policy mistake, is on its way to 2.5% to 3.0% growth this year." [1]

Richard C. Hoyt
April 4, 2019

What?

- The U.S. Economy GDP growth was 3.0% in 2018[2], compared to 1.9% in 2017 (Chart 1).
- The 30 year average GDP increase for three successive 10 year periods between 1970 and 1999 was 3.1% (Chart 1).
- Productivity increased from .8% in 2017 to 1.9% in 2018, 137% (Chart 1).
- The average yearly productivity between 1970 and 1999 was 1.8% (Chart 1).
- The White House Council of Economic Advisors recently concluded that economic growth averaging 2.8% reached under President Trump's policies the past two years is sustainable over the next decade.[3] This supposition is consistent with GDP and productivity outcomes between 1970 and 1999 (Chart 1).



	1970-79	1980-89	1990-99	2000-09	2010-15	2016		2017	2018
GDP	3.2%	3.1%	3.2%	1.8%	2.1%	1.5%		1.9%	3.0%
Productivity	1.9%	1.5%	2.1%	2.6%	1.0%	0.3%		0.8%	1.8%

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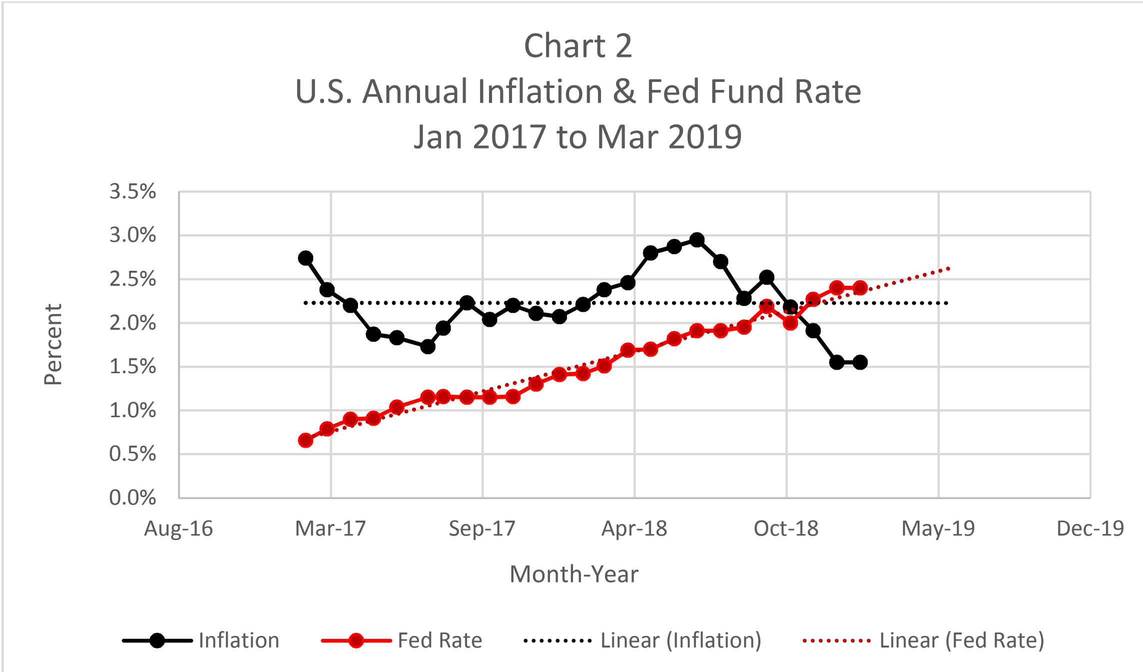
[1] Mohamed El-Erian, Chief Economist Allianz, *Newmax*, Tuesday, March 26, 2019 6:29 PM. This opinion is shared by Stephen Moore and Louis Woodhill: see; "The Fed Is a Threat to Growth", Opinion, Dow Jones and Company, March 13, 2019, and James Bullard, president of the Federal Reserve Bank of St. Louis who opposed the rate hike last year and stated: "The Fed is bordering on going too far and possibly tipping the economy into a recession"

[2] Includes 4Q18 GDP adjustment to 2.2%.

[3] Kevin Hassett, *Newsmax*, March, 20, 2019 1.32 PM.



Source: U.S. Bureau of Economic Analysis

- The Federal Reserve auto pilot rate increases in 4Q2018 were inconsistent with declining inflation since June of 2018, a continuation of which became a serious concern to investors resulting in the late December market slump.
- Since then Chairman Powell and other Federal Reserve officials have sought to deliver a more nuanced message addressing the absence of inflationary pressure.[4] [5] [6]

Why?

- Productivity is the biggest factor in the U. S. economy's ability to raise Americans' living standards; i.e., when companies can produce more goods and services without increasing factor inputs, profits grow, workers benefit from lower prices, higher wages and more job opportunities (Charts 1 & 2). "The year's end inflation was down below the Federal Reserve's target and falling, the decline providing proof that the supply-side benefits offset increases in demand in 2018."[7]

How?

- If one assumes away "*a major policy mistake"* it is improbable that there will be a recession in 2019, which augers in favor of staying invested in ETFs that replicate general market indices, and/or those sectors that are likely to outperform e.g., technology and healthcare.

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[4] Michael S. Duffy, "Fed's Bullard Sees No Need for Rate Move", *Dow Jones*, March 22, 2019, "The baseline story right now is that any weakness in the U.S. economy is likely transitory and that growth will resume in the second quarter and the rest of this year".

[5] Binyamin Applelbaum, "Fed Officials Lean Toward Hike Pause", *New York Times*, January 10, 2019; Charles Evans, president Federal Bank of Chicago, "I feel we have good capacity to wait and carefully take stock of incoming data and other developments, and that 2019 will be another good year".

[6] Binyamin Applelbaum, op. cit. "Eric Rosengren, president Federal Reserve Bank of Boston, "At this juncture with growth somewhat above potential GDP growth and consistent with economic forecasts, I believe we can wait for clarity before adjusting policy".

[7] Kevin Brady and Lawrence B. Lindsey, "Tax Reform Is No Sugar High" *Wall Street Journal*, March 27, 2019 7:03PM ET. See also, AIA, LLC Commentary, "The U.S. Economy and the Stock Market", January 5, 2019, p. 3 for additional rationale of Say's Law.

Performance Summary

- **Cautious Strategy**: Cautious investors seeking better than nominal returns, but with low risk and emphasis on preservation of wealth (Risk Score: 111-200).
- **Moderate Strategy:** Prudent investors desiring a portfolio designed to accomplish medium to long term financial goals and an investment strategy which accounts for taxes and inflation. Calculated risk is acceptable to achieve good returns (Risk Score: 201-290).
- **Assertive Strategies 1 & 2:** Assertive investors with sufficient income to invest mostly for capital growth. Higher volatility, moderate risk, and more aggressive investments are acceptable to accumulate wealth over time (Risk Score: 291-390).
- **Aggressive Strategy:** Aggressive investors intending to compromise portfolio balance in pursuit of higher long-term returns. Security of capital is secondary to potential wealth accumulation (Risk Score: 391-450).

	2012-2018 Avg.*	**YTD* 03/29/2019**	**AUM**	**Beta**	**R^2**	**SD**	**Sharpe** Ratio**
S&P500 (SPX)	**10.91%**	**13.06%**					
Barclay US TR	**1.78%**	**2.94%**					
Cautious	9.88%	11.15%	1%	.89	93	9.88	1.12
Moderate	10.58%	14.95%	13%	1.08	92	12.11	1.40
Assertive 1	12.04%	17.12%	56%	1.25	95	13.82	1.24
Assertive 2	15.88%	20.84%	10%	1.52	90	17.22	1.40
Aggressive	17.27%	29.21%	20%	2.13	91	23.96	1.30

*Net Average Return, Portfolio Center, Schwab Portfolio Technologies. Fees are negotiable and range between 50 and 125 basis points.
** Risk Statistics, Morningstar Advisor Workstation; most recent 3 years, computed quarterly.

Beta	Expected change in portfolio return per 1% change in market index return.
R^2	Percent of variation in regression equation explained by the independent variable (S&P500).
SD	Standard deviation of the dependent variable (Net Return).
Sharpe Ratio	Reward-to-Variability Ratio; i.e., portfolio return above risk free rate of return divided by standard deviation (RVAR).

	2012	2013	2014	2015	2016	2017	2018	2012-18
Assertive1	17.1%	38.4%	16.9%	2.9%	-5.6%	22.4%	-7.8%	12.0%
S&P500	13.4%	29.6%	11.4%	-0.7%	9.5%	19.5%	-6.2%	10.9%
MSCI World	11.2%	23.7%	3.2%	-2.0%	5.0%	20.1%	-0.7%	8.6%