WEALTH MANAGEMENT GROUP

RAYMOND JAMES®

July 11, 2019

Dear Client,

A market, be it stocks, currency, beanie-babies or bitcoin, is nothing more than the intersection of aggregate demand and supply of something. The more information available to buyers and sellers, the more "efficient" a market is. In a perfectly efficient market, nobody can have any information edge on anyone else. Stocks are said to be very efficient. The Nobel prize winning Efficient Market Theory holds this to be true, implying that it is impossible to beat the market, and therefore anyone who strives to do so is a naïve sap who likes overpaying for something that is "free"—market returns.

In the real world, it is a bit more complicated than this. The S&P 500, widely regarded as "the market" for the millions of people pouring money into index funds, is not static. For one, it is not equal weighted, meaning that a handful of stocks have an outsized influence on its performance. Two, the relative performance of its eleven industry components by definition impact the weighting of the different industry groups. Suppose it wasn't the S&P 500. Let's say it was January of 2000 and we created the S&P 2: two stocks, 50% AMZN, 50% GE. If you would have invested $20,000 into this index fund, today you would have $300K: $297K of AMZN and $2500 of GE. For a new investor today buying the S&P 2, you would really just be buying Amazon. Since every new dollar going into an index fund must be invested exactly as the stocks are weighted in the S&P 500, by definition the big get bigger. The same holds true for industry groups. Today the largest component of the S&P 500 is technology at 20%. Back in the early 1980s, during the heyday of Big Oil, the largest industry weighting was energy. An index investor back then was making a big bet on oil—right before crude collapsed to an all-time low in 1986. It pays to pay attention to what you own.

People forget this, but from January of 2000 to August of 2012—a dozen long years--the S&P 500 went absolutely nowhere.# You basically earned your 2% dividend. Indexing was dead. Contrast that with the ten year period ending in February of this year. The S&P 500 returned over 15% per year compounded, including dividends. At that rate money doubles about every five years. Clearly this is unsustainable. Many strategists a lot smarter than me are predicting much more modest returns going forward. In a recent Barron's interview, Barry Bannister, head of institutional equity strategy at a large regional firm said this:

"We have a model that is very forward looking, based on valuation and ownership of equity by the household sector, and it is saying with a fairly high degree of certainty that over the next ten years, the S&P 500's total return would be only 3% or 4% per year, including 2% from dividends."*

He goes on to say something we have been saying for some time, that going forward individual stock and industry selection is going to have a much greater impact on returns. In other words, in a soft market, actively managed portfolios will be rewarded to a greater extent than they have in the recent past. Furthermore, managers who have the flexibility to shift from growth investing (which has been in favor for many years) towards value investing (very out of favor) will shine.

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As we peer into what the future holds for the remainder of 2019 and towards 2020, what potential land mines might we encounter? First and foremost, despite all the smiles and photo ops last weekend at the G20, the trade war with China (and the world for that matter) is far from over. The dustup with Mexico last month reveals that trade policy is now a multiuse tool which is not limited to economic matters. The geopolitical calculus has been scrambled in a very unpredictable way. Tensions are simmering with Iran, and could boil over with an accident or a miscalculation. Instead of just A and B, businesses must now have a plan C and D. Markets are learning to price in this new risk. Global bond yields are falling as investors seek safe places to store cash. The Fed is looking at signs the economy might be softening, and telegraphing a series of rate cuts. Of course no one knows for certain which, if any of these factors might derail the bull market and strong economy.

At GBR, we believe that a somewhat concentrated portfolio of exceptionally good companies will out - perform a broad index over a long period of time, and provide tax flexibility we can tailor to each individual client. Mid-year is an excellent time to re-evaluate your equity exposure and risk tolerance. This has truly been a remarkable year so far for the major stock markets. As the fourth quarter of last year showed us, this can change quickly. If the drop in the market last fall made you queasy, this is a good time for a gut check. *Most people hate losing money much more than they like making it.* If your risk tolerance or financial situation has changed recently, we encourage you to reach out to us to discuss your equity allocation. We look forward to helping you navigate the ever-changing waters ahead.

On a bittersweet final note, this will be the last quarterly letter with the "B" still part of GBR. Our longtime colleague and friend Joseph Brady, after 42 years in the financial business, will be retiring at the end of August. We will miss Joe's wry sense of humor, pleasant demeanor and sharp contrarian eye. We wish Joe and Joanne a healthy, active retirement, where they can spend their time visiting their sons Sean and Scott in Denver, and son Greg Brady, now commanding General for NATO, Mideast, and North Africa Air and Missile Defense, United States Army, Kaiserslautern Germany.

Regards,

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#Tomson Reuters
*Barron's 7/1/2019

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