QUARTERLY MARKET OUTLOOK

CETERA® INVESTMENT MANAGEMENT

Cetera®
FINANCIAL GROUP

CETERA®
INVESTMENT
MANAGEMENT

At-A-Glance

Economic data is cooling, but still in expansionary territory.

Equity valuations seem fair, but earnings growth is expected to fall next quarter.

Parts of the Treasury yield curve is inverted, yet credit spreads have not widened too much.

A balanced approach seems like the best course of action heading into the second half of the year

THIRD QUARTER 2019 OUTLOOK

Mixed Signals

The S&P 500 is in a record-long expansion, narrowly missing a couple of bear markets and up over 400% (total return) since its bottom in March of 2009. U.S. economic growth is about to hit a record in July, making it the longest expansion in U.S. history and over ten years old. This is no small feat with data going back as far as the Civil War. The unemployment rate is near a 50-year low and there are more job openings than people looking for work for the fourteenth straight month. Borrowing costs are low and, depending on one's creditworthiness and geography, a potential homeowner may even be able to get a 30-year fixed mortgage under a 4% interest rate. This begs the question, why are some economists and investors so cautious?

Economists have been analyzing slowing global growth for several years. Slower U.S. growth, especially after the strong first quarter, is to be expected, and as growth dips under 2%, recession concerns rise. While labor markets look great, economist are worried labor trends may reverse. Historically, the unemployment rate flattens at low rates before reversing course. At near full employment, the unemployment rate can't go much lower. Economic expansions don't last forever, and we are already near the longest U.S. recovery ever. While mortgage rates are relatively low, not all housing data has recovered from pre-recession levels. For instance, new building permits are still at mid-1990s levels. While the economy looks strong, it is expected to slow, and this has many economists predicting that the next recession is around the corner.

Like economists, investors also seem confused. Equity and fixed-income investors appear to have different views. Equity investors are bullish, sending equity indices back near all-time highs, while fixed income investors are bidding up bond prices, sending yields to multi-year lows and even inverting some parts of the yield curve. Longer maturity bonds in some cases yield less than shorter-term bonds. Normally we would not see bond and equity prices rise in unison. Can bond investors and equity investors both be right?

Lower interest rates create lower borrowing costs and discount rates, which can cause asset prices like equities to rise in value. This arguably has been the case with the low rates and asset prices in recent years. As long as economic growth isn't too meager, and we stay in this Goldilocks range of 'just right', perhaps we could continue with near record high equity prices and low interest rates. This may be why equity investors remain bullish. We have already been in this range for many years.

Risks are starting to mount though. If the Fed is not as dovish as investors believe, this could cause a pullback in equities. In addition, escalations in trade tensions could also rattle stock markets. With slowing economic growth, the margin of error becomes slimmer. If slow growth becomes negative growth, the Fed can't lower interest rates as much as they have in the past, because

rates are already low. In addition, federal debt relative to GDP is near World War II levels, which was the highest in the recorded history of the United States, so the potential for fiscal stimulus is also limited, assuming Congress would even be able to set aside party differences and agree on a package. Heightened risks helps to explain why fixed income investors are bidding up bond prices.

Making sense of the mixed signals is tough and slow growth may continue. After all, we have been in this environment for a long time already. We think a balanced approach is prudent in this environment. Sticking to long-term risk and return objectives is even more important. As the economy finds its direction, it is prudent not to have too much exposure to any one source of risk. With more uncertainty comes more volatility. We expect the second half of this year to be more volatile than the first half.

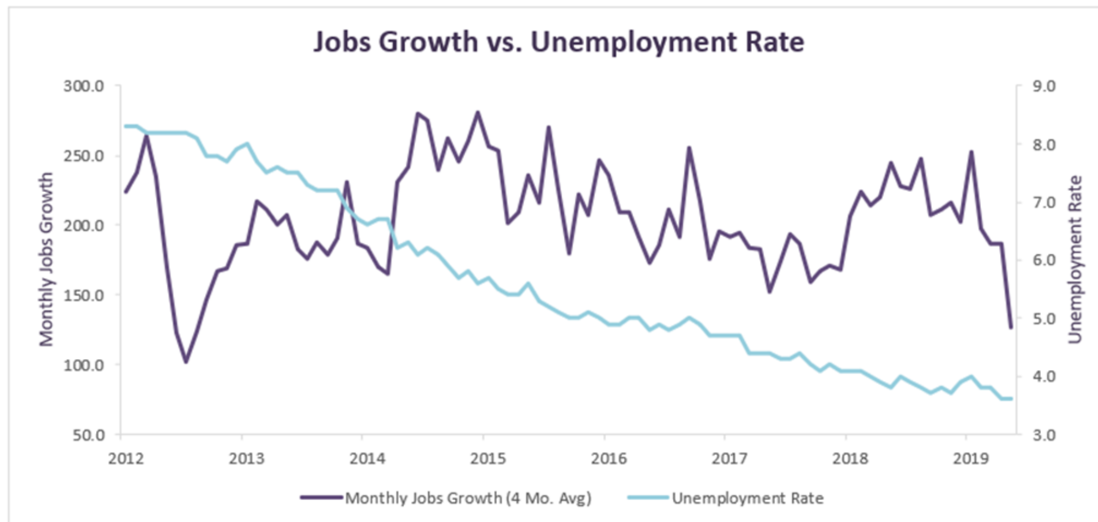
Global Economy

While the U.S. GDP surprised to the upside in the first quarter, expectations for the rest of the year are still modest. A lot of the growth seen in the first quarter is also borrowing from future growth such as rising business inventories. A large component of GDP growth last quarter was related to corporations building up their inventories in anticipation of trade escalations. Companies were looking to import goods before more tariffs went into effect. However, if the economy continues to slow down and expected demand does not materialize, companies will start slowing their production to reduce their inventories which, in turn, will reinforce an economic slowdown. We still think that this will end up being the longest economic expansion in U.S. history. We merely have to make it through July to celebrate this milestone. Recessions are a normal occurrence, and with the extended length of this expansion, investors are preparing for the next recession. We have gone nearly 10 years without two quarters of negative GDP growth and are unlikely to compete with Australia's current expansion of 28 consecutive years of growth.

Before we look at the data and analyze the recession risks, let's take a step back and contemplate what the next recession might look like. The last two recessions in the U.S. were relatively painful for equity investors and we do not believe the next decline will be as deep. Typically, recessions are short-lived. Currently, we do not see major asset bubbles that would create systemic risk in the economy, similar to the one experienced in the 2008 financial crisis, because investors are still cautious. There is also not excessive risk-taking and exuberance that we saw during the tech bubble. Another positive is that recessions in the past were due in part to excess inventories. With just in time manufacturing, which increases efficiency and reduces production time, supply issues have less of an impact than in the past. For these reasons, we feel the next recession, whenever that may be, will be relatively tame. But let's look at the data a little closer and see if a recession is on the horizon or if we can continue down this path of slow growth.

We like to look at manufacturing and non-manufacturing PMIs, which are surveys of purchasing managers, and tend to have a higher correlation to both overall economic growth and equity market returns. Rather than looking at past data, the surveys attempt to gauge what the future might look like in different sectors of the economy. U.S. managers in both the manufacturing and service sectors are less optimistic today than they were a few months ago, meaning they are less likely to hire as many employees, give raises, expand operations or build inventories. While the managers are less optimistic, the recent surveys still point to expansion and not contraction. So, while the data is trending lower, it is still signaling some growth. These weakening trends are also seen in retail sales, industrial production, leading economic indicators, and jobs growth. We are watching these trends closely. We are also watching labor markets for a reversal, trying to determine if we are hitting a bottom. While the pace of jobs growth is slowing, the unemployment rate is still grinding lower as seen in Exhibit 1.

Exhibit 1



Source: Cetera Investment Management, Federal Reserve Bank of St. Louis, and U.S. Bureau of Labor Statistics. Data as of 5/31/2019.

Abroad, growth in developed markets is already slow, but still positive. Growth forecasts for many developed countries like Germany and France are expected to be under 1%. Eurozone PMIs are mixed with manufacturing dropping into contraction territory and services rising and still into expansion territory. The biggest emerging market economy is China. Chinese manufacturing PMIs are rising and in expansion mode after the Chinese started stimulus again. While the official Chinese estimate for 2019 GDP is over 6%, economists predict the actual growth will likely be around 4.5%. The lingering trade war with the U.S. will continue to pressure the Chinese economy.

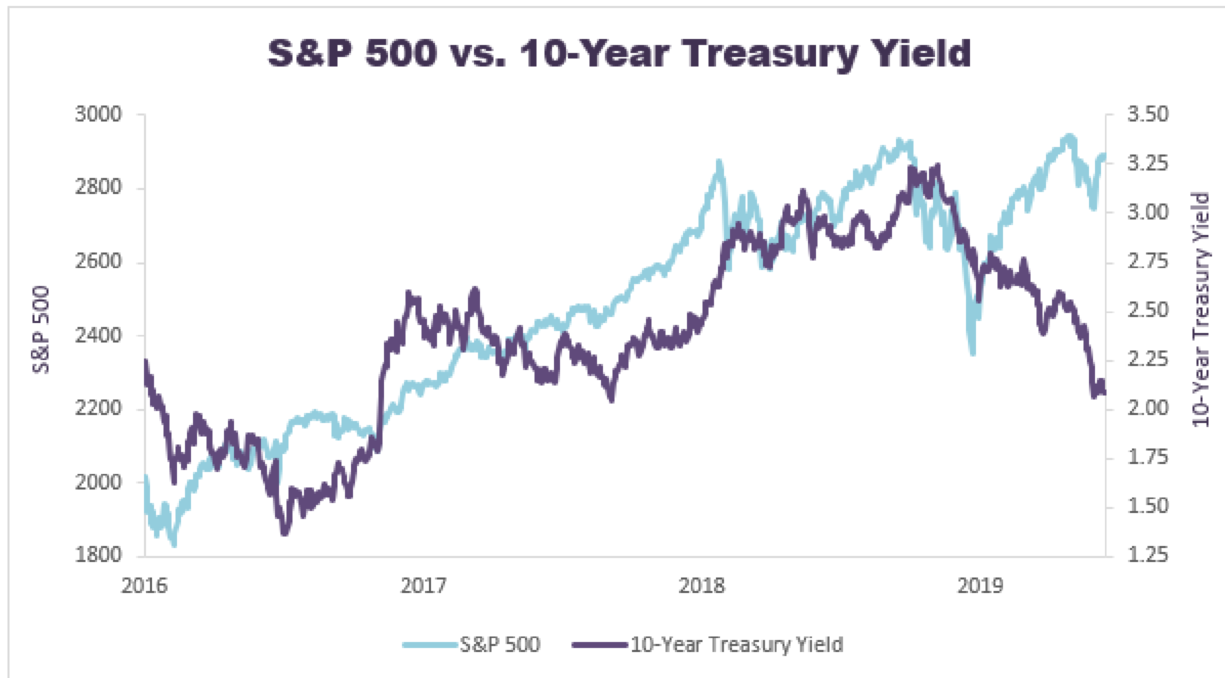
Equity Markets

Corporate earnings, which drive long-term stock returns, grew at an unsustainable pace (over 20%) after the corporate tax cuts in 2018. 2019 is expected to see low single-digit growth. With most S&P companies reporting first quarter earnings, growth was just over 2%. Unfortunately, the second quarter is expected to see negative earnings growth.

Valuations such as P/E ratios are near long-term averages for larger companies. The forward-looking price to earnings ratio is 16.2, which is below the 5-year average of 16.5, but above the 10-year average of 14.8. Smaller companies and emerging market companies are priced below their long-term averages. Additionally, value stocks are priced cheaper than growth stocks from a historical perspective.

After the equity pullback late last year, both stocks and bonds have been performing well in 2019. Bond yields move inversely to bond prices, so typically bond yields will move in the same direction as stock prices. Exhibit 2 illustrates the divergence between bond yields and S&P 500 prices: bond investors and equity investors seem to have different outlooks on the economy.

Exhibit 2



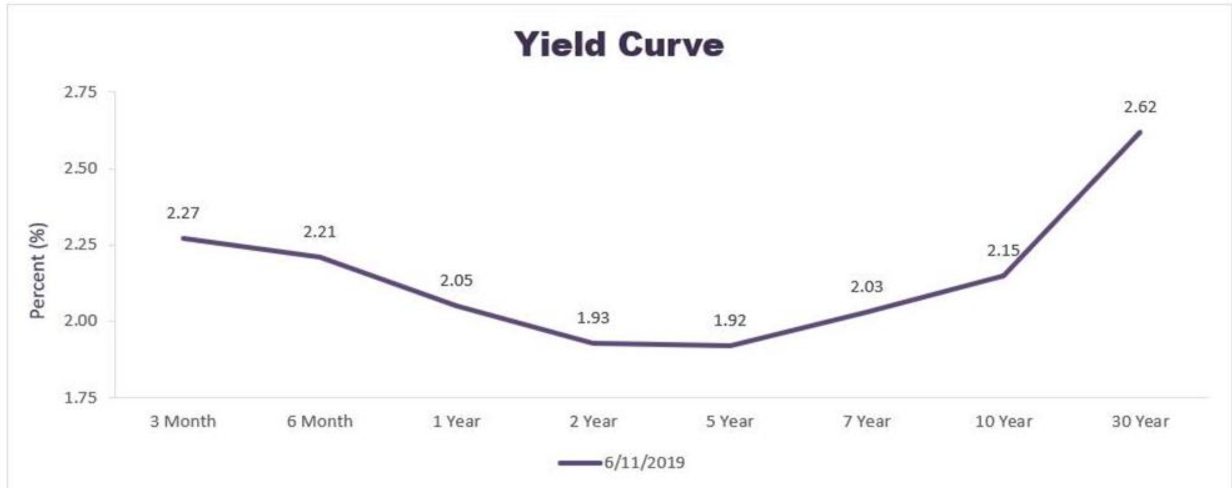
Source: Cetera Investment Management, Federal Reserve Bank of St. Louis, Department of the Treasury, Standard & Poor's. Data as of 6/17/2019.

Fixed Income

While equity investors seem optimistic, sending stock indices higher, bond investors are sending some ominous signals to markets. As seen in Exhibit 3, bond buyers have created an inverted Treasury yield curve, meaning they are buying intermediate to long-term bonds at interest rates that are lower than short-term rates. This seems counter intuitive since longer-dated bonds carry more risk and should compensate investors with more yield to take that risk. A Treasury yield curve can become inverted before a recession because investors are willing to hold longer-dated bonds that yield less interest as they think future economic growth and thus inflation will be lower in the future.

Bond investors are not entirely pessimistic though and we do point out that the yield curve has inverted at times but no recession followed. Bond investors are also giving mixed signals. While the Treasury curve is signaling a risk-off environment, bond investors that invest in more credit sensitive issues also do not seem as concerned. Credit spreads widened with the stock market sell off late last year and then tightened this year. There was a subsequent tick up, but the spread one receives for taking credit risk in high yield bonds is not pointing to a recession. In short, there seems to be a healthy appetite for risky bonds.

Exhibit 3



Source: Cetera Investment Management, U.S. Treasury Department. Data as of 6/11/2019.

Risks to Our Outlook

Adding to the mixed data coming from the economy and the mixed signals from both equity and fixed income investors, there are many other risks to consider. Growth around the world is slowing, so the impacts of trade disputes and missteps by Central Banks could easily trigger a recession. The margin of error is slimmer now. Governments around the world, including the United States, are highly leveraged even in this late cycle of economic growth. Additionally, the Federal Reserve's Fed Funds rate is still at relatively low levels, whereby the Federal Reserve officials can't lower it as much as in previous cycles to stimulate growth. We expect volatility to return to markets in the second half of this year as investors look for direction in economic data, corporate earnings, trade disputes, and central banks.

If gauging direction of the markets was not hard enough, the Fed could step in at any time to lower interest rates and, hopefully, save the day, or a trade war could escalate and send the economy into a recession. With all the conflicting data and signals, it is best to be diversified and stick to long-term risk and return objectives.

Appendix – U.S. Economic Overview

Employment	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
US Nonfarm Monthly Payrolls ('000)	May-19	75	224	270	151	196	-149	-195	18%
US Total Nonfarm Payrolls - YoY Change	May-19	1.6%	1.7%	1.7%	1.7%	1.7%	-0.1%	-0.1%	37%
U3 Unemployment Rate	May-19	3.6%	3.6%	3.8%	3.7%	3.8%	0.0%	-0.2%	100%
U6 Unemployment Rate	May-19	7.1%	7.3%	7.7%	7.2%	7.5%	-0.2%	-0.6%	100%
Quit Rate	Apr-19	2.3%	2.3%	2.2%	2.3%	2.3%	0.0%	0.1%	92%
Job Openings: Total Nonfarm ('000)	Apr-19	7,449	7,474	7,106	7,355	7,424	(25)	343	96%
Initial Jobless Claims ('000) 4 Wk. MA - Month End	May-19	218	213	220	215	218	5	-3	95%
KC Fed LMCI Momentum Indicator	May-19	1.0	1.0	1.1	1.0	1.1	0.1	-0.1	66%
Labor Force Participation Rate	May-19	62.8%	62.8%	62.8%	62.9%	62.9%	0.0%	0.0%	17%
Employment to Population Ratio	May-19	60.6	60.6	60.4	60.6	60.6	0.0	0.2	94%

Consumer	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Retail Sales - YoY Change	May-19	3.2%	3.7%	6.2%	3.6%	4.1%	-0.6%	-3.0%	29%
Vehicle Sales (Mil. Units, annualized)	May-19	17.3	16.3	17.2	17.0	17.1	1.0	0.1	76%
Personal Savings Rate	Apr-19	6.2%	6.1%	6.8%	6.4%	6.5%	0.1%	-0.6%	11%

Production	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Industrial Production - YoY Change	May-19	2.0%	0.9%	2.8%	1.7%	3.4%	1.2%	-0.8%	39%
Capacity Utilization	May-19	78.1%	77.9%	78.1%	78.1%	78.8%	0.2%	0.0%	79%
Core Capital Goods Orders - YoY Change	Apr-19	1.2%	3.8%	6.8%	2.5%	4.8%	-2.6%	-5.6%	42%

Housing & Construction	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Building Permits ('000)	May-19	1,294	1,290	1,301	1,291	1,292	4	-7	87%
Housing Starts ('000)	May-19	1,269	1,281	1,332	1,250	1,219	-12	-63	91%
New Home Sales ('000)	Apr-19	673	723	629	688	628	-50	44	98%
S&P/Case-Shiller Home Price Index (20 city) - YoY Change	Mar-19	2.6%	2.9%	6.6%	3.0%	4.9%	-0.3%	-4.0%	31%
Total Construction Spending - YoY Change	Apr-19	-1.2%	0.5%	5.8%	-0.5%	2.6%	-1.7%	-7.1%	22%

Survey Data	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
ISM Manufacturing PMI Composite	May-19	52.1	52.8	58.7	53.4	56.7	-0.7	-6.6	25%
ISM Manufacturing PMI New Orders	May-19	52.7	51.7	63.7	53.9	58.1	1.0	-11.0	21%
ISM Non-Manufacturing PMI Composite	May-19	56.9	55.5	58.6	56.2	58.2	1.4	-1.7	71%
ISM Non-Manufacturing PMI New Orders	May-19	58.6	58.1	60.5	58.6	60.6	0.5	-1.9	61%
U. of Michigan Consumer Sentiment	May-19	102.4	97.2	98.0	99.3	97.5	5.2	4.4	100%

Inflation	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Consumer Price Index (CPI) - YoY Change	May-19	1.8%	2.0%	2.8%	1.9%	2.2%	-0.2%	-1.0%	54%
Personal Consumption Expenditure (PCE) - YoY Change	Apr-19	1.5%	1.4%	2.0%	1.4%	1.9%	0.1%	-0.5%	48%
Producer Price Index (PPI) - YoY Change	May-19	1.9%	2.3%	3.0%	2.1%	2.6%	-0.4%	-1.1%	N/A
Average Hourly Earnings - YoY Change	May-19	3.1%	3.2%	2.9%	3.2%	3.2%	-0.1%	0.2%	93%

GDP	As of	Latest	Previous	1 Yr. Ago	2 Qtr. Avg.	4 Qtr. Avg.	1 Qtr. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Real GDP - QoQ (SAAR)	Q1-19	3.1%	2.2%	2.2%	2.6%	3.2%	0.9%	0.8%	67%
Real GDP - YoY Change	Q1-19	3.2%	3.0%	2.6%	3.1%	3.0%	0.2%	0.6%	95%

Other	As of	Latest	Previous	1 Yr. Ago	3 Mo. Avg.	12 Mo. Avg.	1 Mo. Diff.	1 Yr. Diff.	Percentile (10 Yrs.)
Treasury Yield Curve (10 Yr. Minus 2 Yr.) - Month End	May-19	0.19%	0.24%	0.43%	0.19%	0.23%	-0.05%	-0.24%	2%
Philly Fed Leading U.S. Index	Apr-19	1.43	1.26	1.60	1.30	1.36	0.17	-0.17	32%

Economic Indicator	Source
US Nonfarm Monthly Payrolls ('000)	U.S. Bureau of Labor Statistics
US Total Nonfarm Payrolls - YoY Change	U.S. Bureau of Labor Statistics
U3 Unemployment Rate	U.S. Bureau of Labor Statistics
U6 Unemployment Rate	U.S. Bureau of Labor Statistics
Quit Rate	U.S. Bureau of Labor Statistics
Initial Jobless Claims ('000) 4 Wk. MA - Month End	U.S. Employment and Training Administration
KC Fed LMCI Momentum Indicator	Federal Reserve Bank of Kansas City
Employment to Population Ratio	U.S. Bureau of Labor Statistics
US Retail Sales - YoY Change	U.S. Bureau of the Census
Vehicle Sales (Mil. Units, annualized)	U.S. Bureau of Economic Analysis
Personal Savings Rate	U.S. Bureau of Economic Analysis
Industrial Production - YoY Change	Board of Governors of the Federal Reserve System (US)
Capacity Utilization	Board of Governors of the Federal Reserve System (US)
Core Capital Goods Orders - YoY Change	U.S. Bureau of the Census
Building Permits ('000)	U.S. Bureau of the Census
Housing Starts ('000)	U.S. Bureau of the Census
New Home Sales	U.S. Bureau of the Census
S&P/Case-Shiller Home Price Index (20 city) - YoY Change	S&P Dow Jones Indices LLC
Total Construction Spending - YoY Change	U.S. Bureau of the Census
ISM Manufacturing Composite	Institute for Supply Management
ISM Manufacturing New Orders	Institute for Supply Management
ISM Non-Manufacturing Composite	Institute for Supply Management
ISM Non-Manufacturing New Orders	Institute for Supply Management
U. of Michigan Consumer Sentiment	University of Michigan
Consumer Price Index (CPI) - YoY Change	U.S. Bureau of Labor Statistics
Personal Consumption Expenditure (PCE) - YoY Change	U.S. Bureau of Economic Analysis
Producer Price Index (PPI) - YoY Change	U.S. Bureau of Labor Statistics
Average Hourly Earnings - YoY Change	U.S. Bureau of Labor Statistics
Real GDP - QoQ (SAAR)	U.S. Bureau of Economic Analysis
Real GDP - YoY Change	U.S. Bureau of Economic Analysis
Yield Curve - Month End	Federal Reserve Bank of St. Louis
Leading Index for the United States	Federal Reserve Bank of Philadelphia

This report is created by Cetera Investment Management LLC.

About Cetera® Investment Management
Cetera Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. Cetera Investment Management provides market perspectives, portfolio guidance and other investment advice to its affiliated broker-dealers, dually registered broker-dealers and registered investment advisers.

About Cetera Financial Group®
Cetera Financial Group ("Cetera") is a leading network of independent firms empowering the delivery of professional financial advice to individuals, families and company retirement plans across the country through trusted financial advisors and financial institutions. Cetera is the second-largest independent financial advisor network in the nation by number of advisors, as well as a leading provider of retail services to the investment programs of banks and credit unions.

Through its multiple distinct firms, Cetera offers independent and institutions-based advisors the benefits of a large, established broker-dealer and registered investment adviser, while serving advisors and institutions in a way that is customized to their needs and aspirations. Advisor support resources offered through Cetera include award-winning wealth management and advisory platforms, comprehensive broker-dealer and registered investment adviser services, practice management support and innovative technology. For more information, visit cetera.com.

"Cetera Financial Group" refers to the network of independent retail firms encompassing, among others, Cetera Advisors, Cetera Advisor Networks, Cetera Investment Services (marketed as Cetera Financial Institutions), Cetera Financial Specialists, First Allied Securities, and Summit Brokerage Services. All firms are members FINRA/SIPC.

Disclosures
The material contained in this document was authored by and is the property of Cetera Investment Management LLC. Cetera Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Cetera Investment Management and did not take part in the creation of this material. He or she may not be able to offer Cetera Investment Management portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Cetera Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about Cetera Investment Management, please reference the Cetera Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are not actively managed. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

Glossary

The S&P 500 is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The Bloomberg Barclays US Aggregate Bond Index, which was originally called the Lehman Aggregate Bond Index, is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government–related and corporate debt securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency) debt securities that are rated at least Baa3 by Moody's and BBB- by S&P. Taxable municipals, including Build America bonds and a small amount of foreign bonds traded in U.S. markets are also included. Eligible bonds must have at least one year until final maturity, but in practice the index holdings has a fluctuating average life of around 8.25 years. This total return index, created in 1986 with history backfilled to January 1, 1976, is unhedged and rebalances monthly.

Cetera®
FINANCIAL GROUP