Second Quarter Report 2018

LUCIEN, STIRLING & GRAY ADVISORY GROUP℠

"Smart Decisions About Serious Money"

MEET OUR TEAM

Thomas Twombly
President

Mark Ward, CFP®, ChFC®
VP and Chairman, IPC

Bleckley Dobbs, CFP®, RICP®
Director of Financial Planning

Glenda Summers, CFP®
Sr. Advisor Associate

Cass Grange
Sr. Advisor Associate

Megan Poore
Sr. Advisor Associate

Chris Vasquez
Financial Services Professional

CONTACT US

4005 Guadalupe
Austin, Texas 78751

Phone: 512-458-2517
Fax: 512-458-3120

www.lsggroup.com

A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

Years ago, I heard a story. The original version is long lost to me now, so I apologize for not giving appropriate credit to the original author here, but its message captured my attention. Ever since, it has shaped my thoughts about the importance of principled leadership, a courageous long-term perspective, and fostering shared values to overcome the internal struggles with which we all contend. For reasons that are becoming more urgent to me by the day, I feel compelled to recreate it here:

There was an elder chieftain of a proud and noble people who had lived for many decades. In that time, he had guided his nation successfully through countless days of challenge and hardship. As the seasons inevitably turned, he had also been present with them through many other days of happiness and abundance. Over time, with patience and persistence, his people had prospered, and the chief himself was blessed with many children, and eventually many, many grandchildren too.

One afternoon he gathered all his grandchildren together and led them on a walk into the forest, to a mountain meadow that had been a sacred meeting place for generations. He sat them down in a broad semi-circle at the center of the meadow, around a well-worn stone that had served as a council seat for him, and for many of his forebears through the ages. After a long pause, he said to them: "A terrible fight is going on inside of me," as he tapped his chest with the fist of his right hand. "It is a fight between two wolves. One wolf is the wolf of fear, anger, arrogance and greed. The other is the wolf of courage, kindness, humility, and trust." The children sat silent and still, listening intently to their grandfather's words. After a pause he continued, "This fight is to the end, for only one wolf can win." He slowly swept his eyes across the expectant faces in front of him, silently connecting for a moment with each of them. "And the same fight that is going on inside of me, is also going on inside of you, and inside the heart of every man and woman who walks this earth." Their eyes widened as they pondered his words. After a short while, his youngest granddaughter slowly stood up, and then softly asked the chief, "Grandfather, which wolf will win the fight?" He looked at her for a long moment, the gentle lines of many years of hard-won wisdom showing around his deep brown eyes. Then he said quietly, "The one you *feed*."

Beliefs matter. They impact our expectations and they inform our behavior. They shape outcomes for ourselves and for others. They can profoundly influence long-term results, in both good ways and bad. Be mindful of them. Our beliefs are powerful.

For proof, recall the famous experiments conducted on school-aged children in the 1970s, and the stunning juxtaposition created among a group of perfectly intelligent kids who were randomly separated into two different classes, and then falsely led to believe that one class was uniquely gifted, while the other class was irredeemably below-average. After a few days with teachers who had been fed similarly false beliefs about their respective student's innate capabilities, each class was then tested. Both displayed clear test results that confirmed those baseline expectations. Ouch.

For another example, consider Roger Bannister, the first human ever to run a mile in under four minutes. For generations before him, that barrier was believed to be impossible to breach, and perhaps even fatal for a human being to attempt. Yet after Bannister finally shattered that belief on May 6th, 1954, the record was broken again by another sprinter within only 45 days. Since then more than 1,400 others have broken through a limitation what was once thought completely impregnable, and the capacity of human athletic ability continues to expand to this day.

There is no doubt, life can be very hard. Success can be difficult and elusive. Every single day is full of risks, and nothing is guaranteed. All the time we are faced with uncertainty, doubt, and limiting fears that we might never have enough, that we're not truly prepared for the challenges we face, and that we may come up woefully short in just about everything we do. Every setback we experience, and every "failure" we suffer through can feed those fears to the point where they become overwhelming. Unchecked, they breed anger, distrust, feelings of scarcity, arrogance and greed.

I have felt those emotions. I still feel them at times - as an individual, as a husband, as a father, as a son, as a brother, as an advisor, as a business owner, as a leader, and as an *investor* in all those endeavors. You're the same. The fight that is going on inside of me is going on inside of you, too.

The only consistent antidote I have ever found is to surround myself purposefully with good people; friends, clients and colleagues I like, trust and respect, and with whom I experience fulfillment in sacrificing my own selfish impulses in favor of a greater, long-range, mutual success. Then to do my dead-level best to serve *their* interests with courage, kindness, humility and trust. And with the deep conviction that with patience, discipline and faith in the future, it will pay off for all of us. As long as we keep feeding the right wolf, I have every reason to believe it will.

Thank you, again, for your confidence and trust.

Thomas G. Twombly

President

INVESTMENT COMMENTARY

Despite plenty of turbulence in both financial markets and the global political sphere, the second quarter of 2018 provided positive outcomes for our clients. Given the sense of uncertainty that has marked the mood of financial markets for much of 2018 so far, we are not displeased with these results.

The recent quarter was a period that reinforced the value of long-range discipline and broad diversification. Asset classes that hadn't drawn much attention for quite some time, such as small-cap US stocks, have more recently risen to strong leadership positions as burgeoning tariff and trade worries have recently tempered the long-running enthusiasm for their larger brethren. At the same time, other asset classes that had garnered lots of enthusiasm in recent years, such as emerging market equities, have declined notably for the first half of this year due to volatility in currency markets and worries about rising populism and protectionism around the globe.

In the United States, the current economic news could hardly be more robust. The unemployment rate of 3.8% that was reported in May broke through a multi-decade low point that was previously set almost eighteen years ago. More recent reports confirm that unemployment in the US remains near its lowest point since 1969, far below the 50-year average of 6.2%. With the current pace of job growth increasing, and with corporate profits benefiting greatly from the effects of deregulation and tax cuts, it's not inconceivable that unemployment could reach as low as 3% sometime in the next 9 months. That would be a record that hasn't been seen since the 1950s. Our economy has now grown for 109 consecutive months, making this one of the longest expansions in history. Though more than a few pundits point to this statistic as an indicator of an impending recession, it should be noted that this has also been the most gradual expansion in the modern era, as the embedded chart from JP Morgan on page 3 illustrates. Most economists still see little sign of the wide-ranging excesses and imbalances that have typically signified recessions in the past, so it's not inconceivable that this expansion could continue for quite some time to come.

Nevertheless, there are still any number of concerns to keep an eye on, and several issues that continue to keep investors feeling unsettled. Chief among those is the tough trade rhetoric taking place between the United States and China, as well as with many of our historical allies. Though the actual implementation of tariffs so far has proven to be much less severe than the talk, financial markets hate uncertainty, and the recent effects of that uncertainty have been evident. For one, the value of the US dollar has increased notably since mid-February, rising by more than 7% against a basket of foreign currencies as global investors have sought the perceived safety of owning US Government securities over those of other nations.

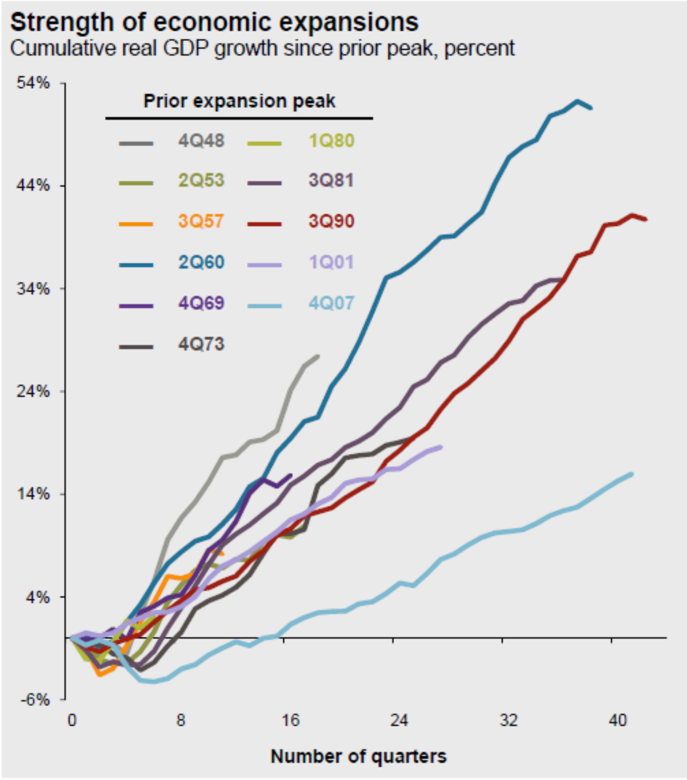
Among other effects, this has created a headwind for non-US equity investments in recent months, particularly those in emerging market countries. More modest allocations we maintain for client portfolios in those asset classes resulted in a notable drag on overall results for the quarter and for the year thus far, as the MSCI Emerging Market Index dropped by -7.86% in the second quarter. This completely erased the modest gains it had posted in the first quarter and resulted in a loss of -6.5% for the first half of 2018.

The stronger dollar has had the additional effect of making US-made products more expensive to foreign consumers. As a result, US companies with substantial markets outside of our borders have experienced similar headwinds for sales of their goods and services to other parts of the world. Because the largest companies tend to have the biggest global reach, the tempering effects of a strengthening dollar have been reflected most in large-cap indices, where otherwise strong domestic profits continue to buoy investor enthusiasm.

The contrast has been most evident in the recent results posted by small-cap and mid-cap US stock indices, where many of the component companies sell primarily to US-based consumers and have more limited exposure to foreign markets. Profit projections have been more attractive in these asset classes recently, and there has been a resulting flow of investor money towards smaller companies in the last few months. The small-cap Russell 2000 index increased by +7.8% in the second quarter compared to a +3.4% rise in the large-cap S&P 500. Our clients benefited from allocations we have long maintained with money managers who specialize in small and mid-sized companies, and it is gratifying to see that diversification provide a valuable counter-balance during a time that left many feeling perplexed and unsure.

On a final note, two years ago, on July 8, 2016, the yield on the 10-year US Treasury note reached 1.36%, its lowest rate in history since US Treasury securities first began trading in 1790. On June 30, 2018 the yield closed at 2.85%. The upward pressure on interest rates is likely to continue, and bond allocations overall are likely to provide lackluster total returns for foreseeable future. As a result, we will continue to keep bond holdings in the lower range of normal allocations. Nevertheless, bonds offer valuable diversification from equities that should never be ignored. They typically experience far lower volatility than stock investments and have the added benefit of paying regular income. With short-term interest rates now gradually rising, we expect short to intermediate-term, higher quality bonds to comprise most of the fixed income allocations held in client portfolios.

If you have any questions about your personal situation, or if you would like to discuss our perspective, we encourage you to please give us a call.



Source: BEA, NBER, J.P. Morgan Asset Manageme t. *Chart assumes current expansion started in July 2009 and continued through June 2018, lasting 108 months so far. Data for length of econon c expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/ ycles/ and reflect information through June 2018. *Guide to the Markets – U.S.* Data are as of June 30, 2018.

Please Join Us for Our Annual Women, Wine & (net)Working Event

Thursday, September 20th
5:30 – 7:30PM
4005 Guadalupe Austin, TX 78751

Join hosts Glenda Summers, Megan Poore, Cass Grange, and Chaney Barton-Nichols along with other accomplished Austin women for an evening of wine, cheese, soda and great conversation. Promote yourself, your business, or your organization - and make a few new friends! Don't forget to bring along your business cards!

RSVP at 512-458-2517 or info@lsggroup.com

General Market Results

	2nd Quarter	YTD	One Year	Three Year	Five Year	Ten Year
CPI	0.40%	1.63%	2.28%	1.64%	1.42%	1.36%
Barclays Agg Bond	-0.16%	-1.62%	-0.40%	1.72%	2.27%	3.72%
S&P 500	3.43%	2.65%	14.37%	11.93%	13.42%	10.17%
DJI	1.26%	-0.73%	16.31%	14.07%	12.96%	10.78%
S&P 400	4.29%	3.49%	13.50%	10.89%	12.69%	10.78%
Russell 2000	7.75%	7.66%	17.57%	10.96%	12.46%	10.60%
NASDAQ	6.33%	8.79%	22.31%	14.62%	17.15%	12.60%
MSCI EAFE	-0.97%	-2.37%	7.37%	5.41%	6.93%	3.33%
MSCI EM	-7.86%	-6.51%	8.59%	5.98%	5.39%	2.60%

LUCIEN, STIRLING & GRAY ADVISORY GROUP
"Smart Decisions About Serious Money"

4005 Guadalupe Austin, Texas 78751
Phone: 512-458-2517 Fax: 512-458-3120
www.lsggroup.com