FIRST NEBRASKA Trust COMPANY

Third Quarter 2019

Quarterly Letter to Clients

By Scott A. Wendt, CFA

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Let me start with a less than profound statement: We live in extraordinary times. Our world has changed immensely in the past decade, with social, political and economic changes happening at a pace that is quicker than many folks can absorb. For the most part, we as Americans, continue to live at a standard of living that far exceeds the vast majority of the rest of the world. The “American Spirit”, the “American Way”, and the “American Dream” – all these phrases try to encompass a nation of ideals and freedoms that provide a foundation for prosperity and success. One where a “can do” attitude combined with hard work can provide a lifestyle that is fulfilling on both intrinsic and extrinsic levels.

We also live in confusing times. In spite of the marvels of technology that have made us healthier, more productive, and literally given us access to the entire knowledge base of the world in a handheld device, our ability to discern what is going on around us appears to obfuscated by the vast volumes of information we are bombarded with on a daily basis. To use the parlance of ham radio operators, it is more difficult to separate the signal from the noise – and the commotion surrounding the noise appears to be growing louder. From a 30,000-foot view, and even given softening global economic trends, the vast majority of the world is in a better place than it has been in decades.

Focusing on the past quarter, the global economy continued to show signs of weakening, due to the combination of long-term structural changes in global trade and demographics. These trends have only been magnified and distorted by the shifts in trade agreements, the imposition of new tariffs, and various imbalances in currency markets, which have all combined to add to the level of uncertainty for decision-makers. The primary global economic growth drivers are found in the two largest contributors, the US and China, both of which have seen decelerating growth, as measured by Gross Domestic Product (GDP). China, the growth engine to the world, has seen their reported GDP growth decline to 6%. With China’s private market debt at record high levels, it makes one question the Chinese government’s ability to stimulate more growth at this point in time. Of course, trade is a major concern for the Chinese, as their manufacturing economy is more dependent on trade than its trading partners.

World growth rates are further challenged by the softness in Europe, with Germany on the verge of recession and the unintended consequences of BREXIT impact on the European Union (EU).

Back in the United States, the classic signs of an impending slowdown are manifesting themselves. Labor statistics appear to be stalling, with employment gains slowing and unemployment appearing to be near trough levels of 3.5% for this "long-in-the-tooth" business cycle. Without additional labor gains, one of the primary ingredients of long-term economic growth is missing, making the reacceleration of Real GDP growth from its current level of around 2 percent much more difficult. In addition, U.S. Consumer Confidence is at its highest level since 2000, and has begun to weaken. This is being translated into slowing vehicle and home sales, two of the major drivers of the U.S. Economy. Finally, the Institute for Supply Management's Purchasing Manager's Index (PMI), a composite index of business activity that has a good track record as a leading indicator of future economic growth, has shown further weakness as it trends below the 50-point mark that historically precedes a business cycle slowdown. Additional evidence of slowing is found in many other leading economic indicators, which have peaked and begun their descent. Furthermore, GDP growth appears to have peaked in 2018 and corporate profits are beginning to decelerate – both classic precursors to an economic cycle slowdown.

While the slow deterioration of the world economy has caught the attention of most market participants, the focus in the capital markets remains on the world's central banks and whether or not they have the will, and the capacity, to respond aggressively to low real and nominal growth. With the FED abruptly reversing its policy at the beginning of 2019, moving from tightening monetary policy (by raising interest rates and slowing its Quantitative Easing (QE) program) to easing, there appeared to be an indication that there was the will to respond. Whether or not the FED has enough capacity to make a real difference in future economic activity appears to still be in debate.

Thus, the current economic environment will most likely continue to be characterized by subnormal growth, historically low interest rates, and the call for further stimulus to try to engineer a soft landing. Business leaders will be plagued by additional uncertainty, while dealing with the shifting sands of changing trade patterns, nudged in uncertain directions by the winds of tariffs and changing tax structures. The result will most likely be a bumpy ride for investors. Much like the announcement by the captain of your last airline flight, we'd recommend you keep your seatbelt fastened in case we experience any unexpected turbulence.

Fixed Income

The bond market saw healthy gains during the past quarter. As the table on the next page shows, longer maturity credits outperformed short-duration fixed income securities, while riskier corporate bonds outperformed the safer U.S. Government bonds. The 10-Year U.S. Treasury ended the quarter at a yield of 1.68%, declining 35 basis points from the 2.03% level seen at the end of the second quarter of the year. The yield curve shifted downward in roughly parallel fashion, with the short end of the curve off about 26 basis points and the longer portion declining between 35 and 45 basis points, depending on the maturity.

Corporate bonds remain expensive relative to historical norms. Credit quality remains consistent with our prior reports, with Baa/BBB bonds making up a historically large proportion of the corporate bond universe, trading with narrow spreads and with less covenant protection than traditionally expected. This implies that many companies will be vulnerable to downgrade, should their part of the economic world find itself in a slowdown.

Morningstar Bond Indexes ***As of 9-30-2019***

	Quarter	1-Year	3-Year	5-Year
US Inter Core Bd TR Bond	1.3	8.3	2.3	3.1
US Shrt Core Bd TR Bond	**0.8**	**5.4**	**1.9**	**1.8**
Corporate				
US Corp Bd TR Bond	3.1	12.6	4.4	4.6
US Inter Corp Bd TR Bond	**2.0**	**11.0**	**3.8**	**4.1**
US Shrt Corp Bd TR Bond	1.1	6.2	2.7	2.5
Government				
US Gov Bd TR Bond	2.4	10.5	2.2	2.9
US Inter Gov Bd TR Bond	1.5	9.6	2.0	2.8
US Lng Gov Bd TR Bond	5.9	20.3	3.2	5.7
US Shrt Gov Bd TR Bond	**0.7**	**5.0**	**1.6**	**1.5**

With the downward shift, the bond market is pretty much incorporating the expectation of at least a 25-basis point reduction in rates on a go forward basis. This appears to be in concert with the widely anticipated expectation that the Fed will reduce rates sometime later this year.

Stocks

The stock market saw mixed results during the third quarter of the year. Even with the uncertainty of a trade deal with China and continued signs of the U.S. Economy beginning to slow, stocks generally pushed upward, with the Dow Jones Industrial Average (DJIA) and the S&P 500 Index both ending the quarter with positive returns.

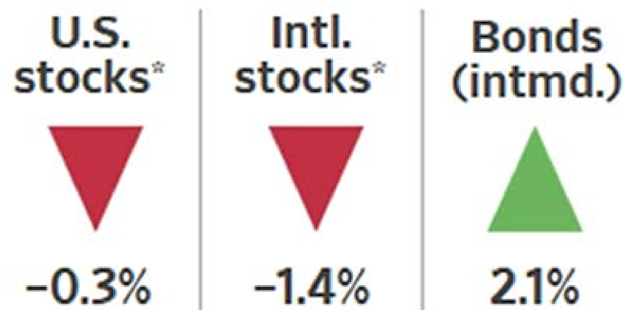
The Morningstar Performance table below displays the range of returns earned by mutual fund managers during both this past quarter and the 1-year, 3-year, and 5-year time periods. For the third quarter of 2019, the table shows a wide divergence of returns, with 2 of the 3 major indices showing positive results. Returns were wide ranging, with smaller capitalization stocks down between 0.5 and 2.4 percent, while larger capitalization stocks provided low positive single-digit returns.

Morningstar Stock Indexes *As of 9-30-2019*

Style	Quarter	1-Year	3-Year	5-Year
US Large Growth	(0.2)	3.1	17.5	13.2
US Large Val	3.6	5.7	11.3	8.6
US Mid Growth	(2.9)	3.2	14.9	10.9
US Mid Val	3.4	2.2	9.4	8.6
Other Domestic Stock Indexes				
DJ Industrial Average TR	1.8	4.2	16.4	12.3
NASDAQ Composite PR	(0.4)	(1.3)	14.4	12.0
NYSE Composite PR	0.1	(1.0)	6.7	3.7
Russell 2000 TR	(2.4)	(8.9)	8.2	8.2
S&P 500 TR	1.8	3.7	13.4	10.6

On a total return basis for the quarter, the Dow Jones Industrial Average (DJIA) increased +1.83%, while the S&P 500 was up +1.77%, slightly outpacing the other major indices. The tech-heavy NASDAQ posted a loss of -0.4%. As the Scoreboard graphic below shows, the average mutual fund saw a decline of -

0.3% for the quarter, while international funds fared worse, declining -1.4% over the same time period.[1]



Our strategy for your account continues to focus on customizing your portfolio to meet the purpose of the funds invested. The fixed income portion of your account is structured to emphasize capital preservation and stable cash, while providing a potential source of funds for future cash needs. The equity portion is constructed to provide a combination of capital appreciation and dividend income to meet the long-term objective for your account. Finding value, without sacrificing quality, in a high and rising valuation environment is increasingly challenging. Nevertheless, we will continue to be disciplined in our process, purchasing those stocks that can be bought at prices that meet our investment standards while providing an adequate margin-of-safety. Similarly, we will sell those stocks that exceed our estimate of fair value, irrespective of the gyrations of the broad markets.

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[1] Source: https://www.wsj.com/articles/bond-funds-continue-to-attract-cash-11570414321