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October 9, 2018

Please enjoy our 2018 3rd quarter newsletter, including:

- Market commentary
- What about those bonds?
- Did you know?; The Consumer Credit Law
- "Phillips Financial in the Community" highlighting a Phillips Associate and his or her community involvement. This issue we focus on Jo Mejia and David Hamel and Habitat for Humanity of Greater Fort Wayne

A Review of Third Quarter 2018

Domestic U.S. equity market returns continued their positive momentum from the second quarter through the end of the third quarter. The widely followed S&P 500 Index reached an all-time high in September and finished the quarter with a year-to-date total return of 10.56%. International markets, however, were more mixed. International developed market returns were positive for the quarter while still slightly negative on a year-to-date basis. Emerging markets continued to post negative returns during the quarter. The MSCI Emerging Markets Index now reflects a negative return of 7.68% year-to-date. After many years of under-performance, commodities have rebounded nicely over the last year due largely to an increase in crude oil prices.

2018 is once again shaping up to be a year where portfolio diversification really matters: domestic performance trends versus international and emerging; likewise, equity market performance versus fixed income.

Within the U.S. equity markets we also see some underlying differentiation based on the various factors that can drive returns. For example, small-cap stocks have out-performed larger capitalization stocks this year and over the last ten years. Global trade and tariff issues have had more impact on the current performance and outlook of the latter than the former. Even within the benchmark S&P 500, some stocks and sectors have clearly been impacted by trade and tariff concerns, while others, particularly in the technology sector, have continued to have strong earnings momentum. When also coupled with other firms with quality operations, earnings and balance sheets, these stocks helped propel the S&P 500 to recent record levels and strong total returns.

As interest rates continue to rise modestly, we see the impact on fixed income returns.
The Bloomberg Barclays US Aggregate Bond Index posted a negative 1.60% total return year-to-date. However, as described in the article on bonds and bond valuations in this issue of our newsletter, there is typically a long-term positive trade-off when fixed income positions are held and maintained during a period of rising interest rates. Ultimately, higher interest rates will positively impact future yields as underlying securities mature and can be reinvested at the higher interest rate levels. If interest rates continue to rise, we would expect to continue to see downward price movements and, as a result, some negative total returns; but, importantly, more current income potential as well.

Why are interest rates rising? Two general schools of thought prevail, both related to a strong economy. One, the Federal Reserve continues to systematically raise the federal funds rate given continued signs of a strong economy and a desire to ensure that the rate of inflation remains low. As the federal funds rate moves up or down, typically other borrowing costs change directionally as well: US treasuries, corporate bonds, mortgage loans and other forms of consumer credit. Secondly, as equity markets continue to perform at record levels, investors have become more comfortable with the economy and risk/return profile of equities versus fixed income. Here is where the basic law of supply and demand comes into play: in order to attract investors into fixed income, offered interest rates need to be higher.

As always, the good news for prudent investors and clients of Phillips Financial is that both diversification and patience pay off in the long run. Your adviser stands ready to help you better understand and continue to follow sound investment principles to achieve your long- term financial goals.

Index	% Last Quarter Return 7/1/18-9/30/18	% Year-to-Date Return 1/1/18 – 9/30/18	% Cumulative 1 Year Avg. 10/1/17 – 9/30/18	% Cumulative 3 Year Avg. 10/1/15 – 9/30/18	% Cumulative 5 Year Avg. 10/1/13 – 9/30/18	% Cumulative 10 Year Avg. 10/1/08 – 9/30/18
Bloomberg Barclays US Aggregate Bond Index	0.02%	-1.60%	**-1.22%**	**1.31%**	2.16%	3.77%
S&P 500 Index	**7.71%**	10.56%	17.91%	17.31%	**13.95%**	11.97%
S&P 500 Value Index	5.86%	3.51%	10.06%	14.13%	10.88%	9.62%
S&P Mid Cap 400 Index	3.86%	7.49%	14.21%	15.68%	11.91%	12.49%
S&P Small Cap Index	4.71%	**14.54%**	19.08%	**19.41%**	13.32%	**12.86%**
S&P Small Cap 600 Value Index	2.61%	9.94%	14.37%	18.63%	12.11%	11.79%
MSCI EAFE Index	1.35%	-1.43%	2.74%	9.23%	4.42%	5.38%
MSCI Emerging Markets Index	**-1.09%**	**-7.68%**	-0.81%	12.36%	3.61%	5.40%
Wilshire REIT Index	0.72%	2.25%	3.99%	7.08%	9.25%	7.38%
S&P GSCI Commodities Index	1.34%	11.84%	**22.91%**	3.17%	**-10.01%**	**-9.24%**

Source: Standard & Poor's, Bloomberg, Morgan Stanley Capital International, Wilshire Associates, Fidelity Investments, BlackRock, Inc.
Green = best performing asset class
Red = worst performing asset class

Index returns are for illustrative purposes only, and do not reflect any management fees, transaction costs or expenses. The performance of an unmanaged index is not indicative of the performance of any particular investment. It is not possible to invest directly in any index. Past performance is no guarantee of future results.

What About Those Bonds?

You open your Fidelity statement or check out your balances online and notice your bond positions have gone down in value. How can this be? Aren't bonds supposed to be safe? Didn't my adviser say my bond funds are invested in "investment grade" bonds?

In the investment world, nothing can be described as completely safe. But those bonds going down in value may not be quite as risky as you think.

To understand what is happening with your bond funds, it's helpful to first understand how bonds work. Here is a basic introduction.

When a bond is issued, the issuer (a company or government) is borrowing money from the purchaser (you or a bond fund). A set amount is borrowed, $10,000 for example, for a particular amount of time, let's say 5 years. This is called the face amount. An interest rate is set, 2% for example, and the purchaser receives a payment every 6 months to compensate them for the use of their money. In this example, you receive $100 every 6 months.

Unlike many types of loans like a mortgage or a car loan, with a typical bond the issuer pays nothing back on the actual principal until the bond is due, in 5 years. At that time, the entire face amount is paid back to the purchaser.

For five years, then, you have received $200 per year ($1,000 total) and at the end of that time you get your $10,000 back. These terms are contractual. The bond issuer can't decide to change the interest rate or pay you less than the face amount on the "maturity date." The only way the issuer can avoid these terms is if it goes bankrupt or suffers some other undue financial hardship, and gets a court ruling that it can delay the payments or pay less. If a bond is rated "investment grade" that means it is considered unlikely that a financial hardship will affect the issuer in this manner.

That seems pretty safe, right? The problem comes if you, as the owner of the bond, decide you want to sell the bond before the maturity date. Now you have to find a buyer for it (your next-door neighbor for example). Your neighbor has no obligation to buy that bond from you. If he/she can find a better bond, paying a higher interest, he/she won't be inclined to buy your bond, right? What if you are really desperate to sell that bond? You could offer it for $9,500 for example. Now it might be more appealing.

What happens when interest rates in general start to move up? A new $10,000 bond might be offered paying 3%. No one wants to buy your 2% bond if it is very similar to a new one paying 3%. But if you hold your bond to maturity you will receive the face value for it, and you will continue to receive the interest payments that are contractually required until maturity. If you decide to sell it at $9,500 as in the example above, you will be out $500 plus the remaining interest payments.

In the bond market, bonds are being valued every day, based on the current interest rate environment. If interest rates are moving up, as they have been doing this year, most bonds will go down in value. If you own bond funds, this will be reflected in the value of those funds in your brokerage accounts. You will see it on your statement, or even on a daily basis if you go online and review your positions.

The good news is that as interest rates increase, those bond funds are buying new bonds as deposits are made into the fund and as existing bonds mature. Those higher rate bonds start to pay more interest, and the value of those newer, higher coupon bonds, hold their value better in the new interest rate environment. Two things happen in your brokerage account: (1) the interest associated with those bond funds starts to increase and (2) the value of the funds increases as well, if all other things are constant (no withdrawals or additions, no other market factors, etc.).

So, what should you do in a rising interest rate environment? Talk to your adviser about your particular situation, but don't be surprised if he or she answers with "stay the course." Now just may be a good time to buy bonds (or bond funds) that may be down in value. Buy low, sell high. That's how Phillips Financial's rebalancing system works. We sell portions of positions that have had great price appreciation and move the proceeds to positions or asset classes that have gone down in value.

As always, we encourage you to call your financial adviser whenever you have questions about your portfolio. He or she is in the best position to help you determine what adjustments, if any, will serve your best interests at the time.

Did You Know?: The Consumer Credit Rule

As of September 21, 2018 consumers will no longer need to pay to "freeze" their credit files at the three credit-reporting agencies (Equifax, TransUnion, and Experian). This is part of the Economic Growth, Regulatory Relief and Consumer Protection Act signed by President Trump in May.

6920 Pointe Inverness Way, Suite 230 | Fort Wayne, IN 46804
P: (260) 420-7732 | T: (888) 420-7732 | F: (260) 420-5553 | www.1Phillips.com

Consumers will also be allowed to "thaw" their files - temporarily or permanently - without a fee. A freeze prevents anyone from accessing your credit files to fraudulently open an account in your name. Credit experts recommend this as a way to protect your information from credit fraud and identity theft. Though do keep in mind that this also means you can't apply for new credit (like a car loan), until you have thawed the freeze on your files with the use of a personal identification number.

This change - the first in over 15 years - to the consumer credit law saves consumers some money (each transaction used to cost the consumer $30). Unfortunately, you do still need to contact each of the three credit-reporting agencies separately to let them know if you want to freeze, or thaw, your credit files. Instructions can be found on the website of each credit-reporting agency's website. Equifax: https://www.equifax.com/personal/ ; Experian: http://www.experian.com ; TransUnion: https://www.transunion.com

Phillips Financial in the Community: Jo Mejia and David Hamel and Habitat for Humanity of Greater Fort Wayne

Jo Mejia and David Hamel have organized Phillips' company-wide volunteering day with Habitat for Humanity.

Mejia is Phillips' Communications Coordinator. She and her husband are active in travel and recreational sports with their four children. Hamel has been a paraplanner with Phillips since 2016. He and his wife are busy outside work with family time and raising their young son.

Hamel originally chose Habitat for Humanity for the firm's participation in the 2017 United Way Day of Caring. Hamel said, "At the University of Saint Francis, I had a professor who was chair of Habitat's board of directors. From him I learned a lot about the organization and what they stood for. I was excited to see they were a project option for us in the Day of Caring. It ended up going very well and everyone enjoyed it so much that we all decided to work directly with Habitat for our future volunteer efforts."

Habitat for Humanity of Greater Fort Wayne https://www.habitatgfw.com is "a Christian housing ministry uniting volunteers and local investors with hardworking families seeking to achieve the dream of homeownership." For 30 years it has helped hundreds of families in Allen, Huntington and Wells counties obtain safe, stable and affordable homeownership. Its vision is "a world where everyone has a decent place to live."

This year, Mejia coordinated the volunteer day for the entire firm. "I reached out to the Community & Faith Engagement Manager who put me in touch with all the right people and we found a date that was good for them and us - one in which they could accommodate and supervise a group of our size. I also arranged to bring in enough breakfast, snacks and lunch to feed us and the construction crew we worked with."

"Before any work gets started that day, they talk about the safety rules and explain what Habitat actually does," said Hamel. "Many people think that they just give people in need free houses, but that's a misconception. There is an application process and once someone is selected they actually get to help design their home. It is not just given to them -- they are required to take financial literacy classes, volunteer for 300 hours on their house and other houses, and other requirements. Once the home is complete they have a mortgage with a discounted rate and an affordable payment plan."

Mejia said, "My favorite part of volunteering with Habitat for Humanity is seeing the whole office out from behind our computers with hammers and paintbrushes, sweating and getting dirty. To see all of these important people I work with taking time out of their demanding schedules, making this ministry and our community a priority for a day, hits my soft spot pretty hard."

Hamel concurred, "The biggest thing to me is being able to help others and to see the progress that you help make. The things that we have helped with the past two years have not only been a great learning experience, but they've provided a sense of humility that can be hard to find in everyday life. I have a desk job, so I don't get to work with my hands at work and can only do so much at home. I now (sort of) understand what goes into different construction jobs and have a new appreciation for physical laborers."

Habitat for Humanity of Greater Fort Wayne welcomes people from all walks of life to volunteer. Learn more at https://habitatgfw.volunteerhub.com

Definitions and Disclosures:

Bloomberg Barclays Aggregate Bond Index. An index managed by Bloomberg to track the general performance of the domestic taxable investment grade bond market.

S&P 500 Index. An index that measures the large-capitalization sector including roughly 500 leading companies representing over 80% of the largest market capitalization in the U.S. equity markets. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P 500 Value Index. Contains those securities from the S&P 500 Index with lower-than-average sales and growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.

S&P MidCap 400 Index. An index that measures the mid-capitalization sector including roughly 400 leading companies representing about 7% of the U.S. equity market. It is a capitalization weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P SmallCap 600 Index. An index that measures the small-capitalization sector including roughly 600 leading companies representing about 3% of the U.S. equity market. It is a capitalization-weighted index from a range of securities chosen by Standard & Poor's for liquidity and industry group representation.

S&P SmallCap 600 Value Index. Contains those securities from the S&P SmallCap 600 Index with lower-than-average sales and earnings growth rates and that generally reflect lower price-to-earnings and price-to-book ratios.

MSCI EAFE Index. An index developed by Morgan Stanley Capital International Inc. as an equity benchmark for performance of publicly traded securities in developed international markets.

MSCI Emerging Markets Index. An index developed by Morgan Stanley Capital international Inc. as an equity benchmark for performance of publicly traded securities in emerging markets.

Wilshire REIT Index. An index developed by Wilshire Associates to track the general performance of Real Estate Investment Trusts (REITs) traded on domestic equity markets.

The S&P GSCI Commodities Index. An index developed by Standard & Poor's and Goldman Sachs that is based on a production-weighted basket of principal physical commodities that reflects the level of commodities prices at a given time and is designed to be a measure of the performance over time of the market for these commodities.

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6920 Pointe Inverness Way, Suite 230 | Fort Wayne, IN 46804

P: (260) 420-7732 | T: (888) 420-7732 | F: (260) 420-5553 | www.1Phillips.com

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