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January 11, 2019

Please enjoy our 2018 4th quarter newsletter, including:

- Market commentary
- A Primer on Factor Funds/Factors Rewarded Over Time
- Top Three Questions for your Accountant
- "Phillips Financial in the Community" highlighting a Phillips Associate and his or her community involvement. This issue we focus on Rick Phillips and The Nature Conservancy in Indiana

A Review of Fourth Quarter 2018

In the January 2018 edition of this newsletter, we reported stellar results for the year 2017 across all asset classes.

Our market report for 2017 ended with the caveat that we certainly couldn't predict a continuation of positive performance for 2018 but reiterated our core belief that a diversified portfolio will best ensure that your long-term investment goals can be realized.

As we now look back on 2018, we see in stark contrast to 2017 that almost all asset classes reported negative returns for the year. The fourth quarter reflected a classic "correction" with all major domestic equity indexes down by over 10%, including the widely followed S&P 500 Index which reported a negative total return of 13.5% for the quarter. In spite of gains through September, the S&P 500 posted a total return of negative 4.4% for the year, ending a run of nine straight years of positive returns.

2018 was also noted by a return of market volatility, concentrated in both the first and fourth quarters of the year. Most notable was the recent activity on the days before and after Christmas, with the S&P 500 Index falling over 2.7% on December 24th and then recovering by almost 5% on December 26th.

Volatility of the markets will always be with us as we pursue our long term investment goals. Keep in mind that headlines are often made of the absolute change in an index during the course of a single trading day. For example, the Christmas Eve day decrease was the 16th largest point drop in S&P history and the recovery on the day after Christmas was the largest point increase ever. In percentage terms, however, these two days were nowhere near the top 20 of all time.

In 2018 there was no escaping negative equity market returns. Domestic equities fared slightly better than international and emerging markets. Large caps out-performed mid and small caps for the second year in a row and value stocks continued to be out-of-favor relative to more growth oriented equities. On balance, though, as we look at returns over longer time horizons, equity market performance has generally been quite acceptable and probably exceeds most expectations for future total returns. In particular, the cumulative 10-year performance levels have been outstanding. However, we are still measuring 10-year performance from a low point reached in March 2009 during the Great Recession/Financial Crisis. Beginning in the second quarter of 2019, 10 year-performance will likely become more measured as it begins to include the entirety of the recent historical bull market we have experienced.

Typically we can expect fixed income performance to provide some balance to any adverse equity market performance. In 2018, due to rising interest rates, many fixed income assets produced flat to negative total returns. The benchmark 10-year Treasury note ended the year at 2.68% versus 2.41% at the beginning of the year. Total returns for funds which follow the Bloomberg Barclays US Aggregate Bond Index, which includes US Treasuries along with other taxable securities, was essentially flat for the year after considering reinvestment of dividends and fund expenses. As was the case for equities, longer term performance is positive. Importantly, due to much lower volatility when compared to equities, fixed income allocations also provide an important diversification benefit to most portfolios. For 2018, diversification to international fixed income also benefited portfolios. The non-US equivalent of the Bloomberg Barclays US Aggregate Bond Index, produced a positive total return of 3.16% versus a negligible 0.01% for the US based index.

As we look ahead to 2019, many of the same geo-political risks from 2018 such as trade/tariff issues, along with declining levels of corporate profit growth, a slowing of the global economy in general and talk of the possibility of a mild recession on the horizon could continue to dampen equity returns. Likewise, any further increase in interest rate levels could continue to dampen fixed income returns.

What we do know with much more certainty is that by taking the long view, avoiding rash actions, and being diversified across asset classes and the factors that drive asset performance will best ensure your investment goals can be realized. Your Phillips Financial Adviser is always available to help you stay on track in working toward achieving those goals.

Index	% Last Quarter Return 10/1/18-12/31/18	% Year-to-Date Return 1/1/18 – 12/31/18	% Cumulative 1 Year Avg. 1/1/18 – 12/31/18	% Cumulative 3 Year Avg. 1/1/16 – 12/31/18	% Cumulative 5 Year Avg. 1/1/14 – 12/31/18	% Cumulative 10 Year Avg. 1/1/09 – 12/31/18
Bloomberg Barclays US Aggregate Bond Index	**1.64%**	**0.01%**	**0.01%**	2.06%	2.52%	3.48%
S&P 500 Index	-13.52%	-4.38%	-4.38%	9.26%	**8.49%**	13.12%
S&P 500 Value Index	**-12.04%**	-8.95%	-8.95%	7.23%	6.06%	11.21%
S&P Mid Cap 400 Index	-17.28%	-11.08%	-11.08%	7.66%	6.03%	**13.68%**
S&P Small Cap Index	-20.10%	-8.48%	-8.48%	**9.46%**	**6.34%**	13.61%
S&P Small Cap 600 Value Index	**-20.54%**	-12.64%	-12.64%	8.56%	5.13%	12.37%
MSCI EAFE Index	-12.54%	-13.79%	-13.79%	2.87%	0.53%	6.32%
MSCI Emerging Markets Index	-7.47%	**-14.58%**	**-14.58%**	9.25%	1.65%	8.02%
Wilshire REIT Index	**-6.93%**	**-4.84%**	**-4.84%**	**2.06%**	**7.87%**	12.19%
Bloomberg Commodity Index	**-9.41%**	-11.25%	-11.25%	**0.30%**	**-8.80%**	**-3.78%**

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.

A Primer on Factor Funds

If you read about current trends in investing you may have heard about factor funds. Our feature article is designed to provide a brief overview of this investment strategy, which is both a relatively new and an old strategy.

Very simply, a factor is a characteristic or attribute of a security that correlates with above average performance over an extended period of time. Factors include company characteristics like size and quality, as well as stock characteristics like value (inexpensive relative to earnings), and stocks that are currently experiencing "momentum" in the growth of their price. A factor investing strategy would involve selecting stocks that display one or more of these characteristics.

Factor funds can be constructed to achieve different results – some are designed to reduce volatility. Others are designed to achieve somewhat better performance than the general market without increasing risk. Factor funds can be found for the US and international stock markets as well as for the bond market.

Some funds track just one factor. These have been around for a long time, like small company funds and value funds. We have always used such funds in most of our investment portfolios. So in effect, we have been involved with factor investing all along.

A somewhat newer approach is to integrate and track several factors in one fund or index (multi-factor funds). Sophisticated computer technology allows for the inclusion of several factors on a dynamic, structured, basis. Such funds are often constructed to replicate the performance of a multi-factor index, like the MSCI USA Diversified Multiple-Factor Index.

How does a multi-factor index select stocks? The MSCI USA Diversified Multiple-Factor Index starts with a parent index of large and mid-size stocks. Each stock receives a rating based on its size, quality, value characteristics, and momentum. Stocks are then selected for the index based on this combined rating as well as other constraints (maintaining an appropriate mix of industries for example) so that the total index reflects the risk characteristics of the parent index. Every six months the stocks are re-evaluated, and changes are made to the composition of the index accordingly. A multi-factor fund tracking a comparable index would make changes accordingly.

So why the primer on factors now? Our Investment Committee has been reviewing and researching the trends in factor investing. We believe adding some of these multi-factor funds will provide additional diversification and perhaps a little outperformance over a long period of time. They are slightly more expensive than pure index funds. While factor funds may appear to be a departure from index investing, the factor funds we will use follow a very structured process that replicates factor indices, like the MSCI USA Diversified Multiple-Factor Index. Furthermore, the primary index funds we have always been using (for example S&P 500 and total international index funds), will remain the cornerstone of our portfolios.

It is important to understand this is a "tweak" and not an overhaul of our investment strategy. As such, we will not likely use them to replace funds with significant gains in taxable accounts. We may also introduce them gradually as we rebalance and invest excess cash. As we meet with you, we will start to exchange portions of the current funds for the targeted mix of factor funds, taking into consideration tax implications. Your investment advisor will be in touch with you as these changes become appropriate for your portfolio. As always, if you have questions or would like to discuss your portfolio, please contact your investment adviser.

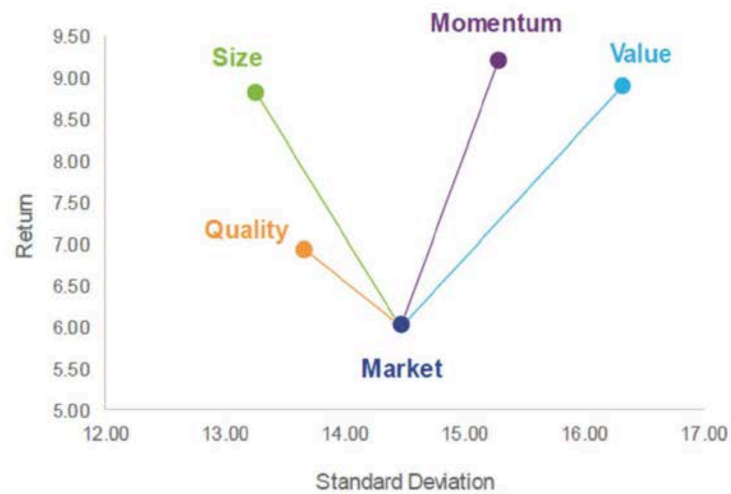
6920 Pointe Inverness Way, Suite 230 | Fort Wayne, IN 46804
P: (260) 420-7732 | T: (888) 420-7732 | F: (260) 420-5553 | www.1Phillips.com

Factors have been rewarded over time

LOWER SIZE	VALUE	QUALITY	MOMENTUM
Smaller companies	Inexpensive stocks	High earnings quality stocks	Stocks on an upswing

Annualized Risk & Return
(12/31/1998-6/30/2018)

Factor	Return	Std. Dev.
Size	8.84%	13.26%
Quality	6.93%	13.66%
Value	8.91%	16.33%
Momentum	9.23%	15.28%
Market	6.03%	14.47%



Source: Morningstar Direct as of 6/30/18. Size: MSCI USA Risk Weighted Index, Quality: MSCI USA Sector Neutral Quality Index, Value: MSCI USA Enhanced Value Index, Momentum: MSCI USA Momentum Index, Market: MSCI USA Index. Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results. This analysis contains back-tested index data. Data for time periods prior to the index inception date is hypothetical and is provided for informational purposes only to indicate historical performance had the index been available over the relevant time period. For more information see appendix.

Top Three Questions for Your Accountant

It's that time of year again: tax season! As you wrap up 2018 taxes and begin preparations for the upcoming year, these are questions you might discuss with your accountant as he/she completes your 2018 tax return.

1) Am I maximizing the tax benefit of my charitable contributions? Are there more tax-favored ways to contribute than I am currently doing?

2) Am I optimizing my tax bracket? Is there some aspect of tax bracket management that might reduce or smooth my total tax liability over the long term? Keep in mind that right now we are enjoying a low tax rate system, relative to recent historical rates. The rates will revert back to pre-2018 brackets after 2025 unless there is additional tax legislation before then.

3) Are there strategies to simplify how I am paying my taxes? For example, if you are paying quarterly estimated taxes, is there a way to absorb these estimated amounts by withholding more from your paycheck or your IRA distributions?

Your Phillips Financial adviser is happy to discuss these items with you as well, but keep in mind that we will direct you back to the accountant for his/her blessing!

Phillips Financial in the Community: Rick Phillips and The Nature Conservancy in Indiana

Rick Phillips, CEO and founder of Phillips Financial, is involved in numerous charitable causes and organizations. He encourages that spirit across the company. "I hope that I lead by example," said Rick. "Our whole organization has modeled itself after Ian Rolland's philosophy at Lincoln of community engagement and philanthropy. We really value that at Phillips and believe that we demonstrate our concern for our clients by our involvement in our community."

Of the many things he's involved with, Rick chose to highlight his work with The Nature Conservancy, Indiana Chapter, of which he is past chair, for this issue of the newsletter.

The Nature Conservancy is a national organization that has worked to protect land and waterways since 1951. Historically its focus has been on land acquisition for protection and preservation, though it has evolved also to be a collaborative science-based research organization. Rick said, "I've been impressed with how diverse the people of the Indiana chapter are: politically, but also professionally, from farmers to legislators to business people. We work in a non-politically partisan way to promote science and principle-based decisions about Indiana's natural resources."

Rick explained that The Nature Conservancy, Indiana Chapter [https://www.nature.org/en-us/about-us/where-we-work/united-states/indiana/] is considered one of the strongest chapters in the country. "It's highly regarded because of its financial stability but also because of its use of the foremost technology to collect data on earth-changing trends. For example, Indiana was one of the largest contributors to pesticide pollution in the Mississippi River, but research and data collection done here are showing the rest of the country the value of cover crops and other farming advancements to protect our rivers. Really neat science stuff!"

The Indiana Chapter partners with Fort Wayne area organizations like ACRES Land Trust [lhttps://www.acreslandtrust.org] and The Little River Wetlands Project's Eagle Marsh [lhttps://www.lrwp.org/eaglemarsh] to protect our local natural resources and prevent the advancement of invasive species. "Our watershed has some unique issues, such as being a key spot for stopping the invasion of the non-native Asian carp into the Great Lakes. There are lots of lakes and small riverways near here, like small lakes up by Pokagon and Fish Creek near Hamilton, that are protected and are key research areas for indicating water quality in our area."

"I was recruited to the board by Ian in 2008," said Rick. "I had been a regular contributor because I loved the idea of land trusts. I've always loved the outdoors. My involvement has allowed me to travel the state and see amazing places that many people don't even know exist – some of them, you can't even believe you are still in Indiana. I'm trying to hike all of the land trust trails in the state this year."

A highlight of his involvement with The Nature Conservancy was the re-introduction in 2016 of wild bison to the Kankakee Sands Prairie Restoration Project [https://www.southshorecva.com/discovernewtoncounty/bison/]. (Yes, bison are native to Indiana – see our State Seal.) "A herd of 23 bison were introduced to the area with almost 2,000 acres of restored native prairie land to roam. Almost all bison have some cattle genes, but we got these from a herd that is known to be the closest genetically to pure wild bison. The Kankakee Sands' herd doubled in size within a year and is doing great. You can visit and see the bison from a protected viewing area in the preserve."

"The Nature Conservancy, Indiana is really focused now on ways to get kids involved," Rick explained. "I was outside all the time as a kid – which most kids just don't do that anymore. It's important to give them the spaces and opportunities to have those great real-world experiences with nature."

As The Nature Conservancy's mission says, "Our vision is a world where people act to conserve nature for its own sake and its ability to fulfill our needs and enrich our lives." Visit the Indiana Chapter's website [https://www.nature.org/en-us/about-us/where-we-work/united-states/indiana/] to learn more.

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.

Bloomberg Commodity Index. An index managed by Bloomberg to provide a diversified, economically rational and liquid benchmark for commodities as an asset class. The index is currently composed of the prices of 22 exchange traded futures contracts on physical commodities.