ITASCA BANK & TRUST

ECONOMIC OUTLOOK AND INVESTMENT POLICY

Q3 2019

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	The Atlanta Fed's GDPNow forecast for second quarter U.S. GDP growth improved from 1.17% on May 31 to 1.50% on June 30.
Federal Funds Rate	Fed funds futures markets indicate an 81% probability of at least 0.50% worth of Federal Reserve rate cuts before September 30.
Inflation	Price pressures across the economy should remain subdued for the remainder of 2019 given moderate trends in commodity prices and wage gains.
Employment	U.S. small business hiring plans have rebounded in recent months after registering significant declines in January and February.
Consumer Confidence	Recent market highs, a strong labor market and a pause in the U.S.-China trade dispute should continue to support healthy consumer sentiment.
Oil	An extension until March 2020 of OPEC and its allies' production cuts should moderate any downward oil price momentum in coming quarters.
Housing	A nearly 0.75% decline in the average U.S. 30-year fixed mortgage loan rate in the first half of 2019 could boost a sluggish housing market.
International Economies	The IMF reduced its global growth forecast for 2019 to 3.3% from 3.5% citing escalating trade policy uncertainty and unknowns surrounding Brexit.

FIXED INCOME

	MINIMUM		NEUTRAL		MAXIMUM
FIXED INCOME		●			
Core Bonds			●		
TIPS				●	
Non-Investment Grade			●		
International	●				

CURRENT OUTLOOK

We believe a moderate underweight to fixed income relative to the mid-point of our strategic range remains reasonable given our view that no clear signs of an imminent economic contraction are present and the low level of yields across most of our fixed income investment universe. While it seems likely that the Federal Reserve will cut its benchmark rate by up to 0.50% in the second half of 2019, we view the slowdown in growth driving the rate cuts as most likely transitory. Trends in credit spreads appear benign to us as well, especially compared to periods before the beginning of the two most recent recessions. We continue to see limited appeal in the broad international fixed income asset class.

EQUITIES

	MINIMUM		NEUTRAL		MAXIMUM
EQUITIES			●		
Large Cap			●		
Mid Cap				●	
Small Cap			●		
Developed International		●			
Emerging Markets		●			

CURRENT OUTLOOK

Our equity allocation warrants a neutral stance relative to the mid-point of our strategic range. Current valuations of most global equity indexes are not extended relative to historical ranges and most major global central banks currently exhibit an easing tendency. Yet, in our view, unresolved trade disputes, economic slowdowns in China and Europe and expectations for a soft patch in U.S. corporate earnings growth in the middle of 2019 justify a more cautious stance than we had in 2018. We believe a majority of our concerns would likely have a disproportionate effect on international economies. As such, an underweight to developed market international equities remains appropriate until we see durable signs of improvement in trade policy negotiations and economic momentum in both China and Europe.

ALTERNATIVES*

	MINIMUM		NEUTRAL		MAXIMUM
ALTERNATIVES*				●	

	CAP PRES	IWSG	BAL	GWSI	GROWTH
Global Real Estate			●	●	●
Global Infrastructure		●	●	●	●
Hedged Equity	●	●	●	●	●
Arbitrage	●	●	●		
Strategic Income	●	●	●	●	

CURRENT OUTLOOK

Elevated volatility in equity markets bookended 2018, headlined by a near 20% drawdown in the S&P 500 Index from late September to late December. A sharp pivot by the U.S. Federal Reserve to a neutral, and now an easing, bias helped propel both equity and bond prices in the first half of 2019. Yet, we anticipate a reemergence of volatility across asset classes in the second half of 2019 with limited upside in both equity and bond prices. As such, we believe an overweight to alternative investments able to provide enhanced diversification for multi-asset class portfolios remains sensible. It is our view that U.S. government bonds are fairly valued, while the broad equity asset class is increasingly exposed to trade policy uncertainty and a deceleration of economic growth outside of the U.S. As such, we have constructed diversified alternatives portfolios, as seen in the table to the left designed to decrease the risk profile of our five investment objective-based portfolios (CAP PRES, IWSG, BAL, GWSI, GROWTH).

The above minimum/neutral/maximum recommendations represent MainStreet Advisors' current positions relative to our Strategic Asset Allocation ranges. Views expressed have a 6-12 month horizon and are those of the MSA Investment Committee.
*Cap Pres: Capital Preservation, IWSG: Income with some growth, Bal: Balanced, GWSI: Growth with some income

Itasca Bank & Trust Co.
Together we'll shape the future