Trust & Investment Bulletin
Summer 2019

LCNB National Bank

It's Summertime …

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Way back in 1966, Billy Stewart sang a song called Summertime. The first line of the song is "Summertime, and the living is easy …" And it does seem that summertime is a little easier. No school for the kids and grandchildren. A bit of a slower pace, vacation adventures, family outings and more sunshine.

In this issue, we give you some insight into the type of services we offer. We also give you some practical economic detail for your summer reading enjoyment, as well as introduce you to our newest colleague.

While the pace of life has certainly increased since that summer long ago, this is still a great time to plan for those many summers and years to come. We would love to help with your investment management, estate planning, financial planning and trust needs. A conversation about proper planning now can lead to many years of "easy" living.

Yes, it's summertime, and the living is easy. Enjoy yourself and let us know how we can help. Thank you for allowing us to be of service to you and your family.

Best Regards,
Mike

Beyond the Financial Scope

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One of life's greatest challenges is to obtain access to quality, affordable wealth management services, such as investment management, financial planning, and estate and trust services. Many generations of families have come to rely on LCNB to manage their increasing complexities of wealth and to provide these functions. However, our services typically do not stop there.

Superior and comprehensive client service is our top priority, and many of our clients need assistance with non-financial matters, too. One such common example is health care. Your trust officer can work with you and your family to help arrange home health care assistance, such as services for companionship and recreation, transportation and errands, light house-keeping and cooking, and medications and specialized daily-care arrangements. We work with a wide range of health care professionals to provide quality solutions for our clients and to help them live healthier, more independent lives. It's all part of our holistic and comprehensive client relationship approach.

We are here to guide you through the moments that matter most to you and your family - financially related or not. Please do not ever hesitate to contact us if you need anything at any time.

Thank you.

Economic Summary – The Extended Cycle

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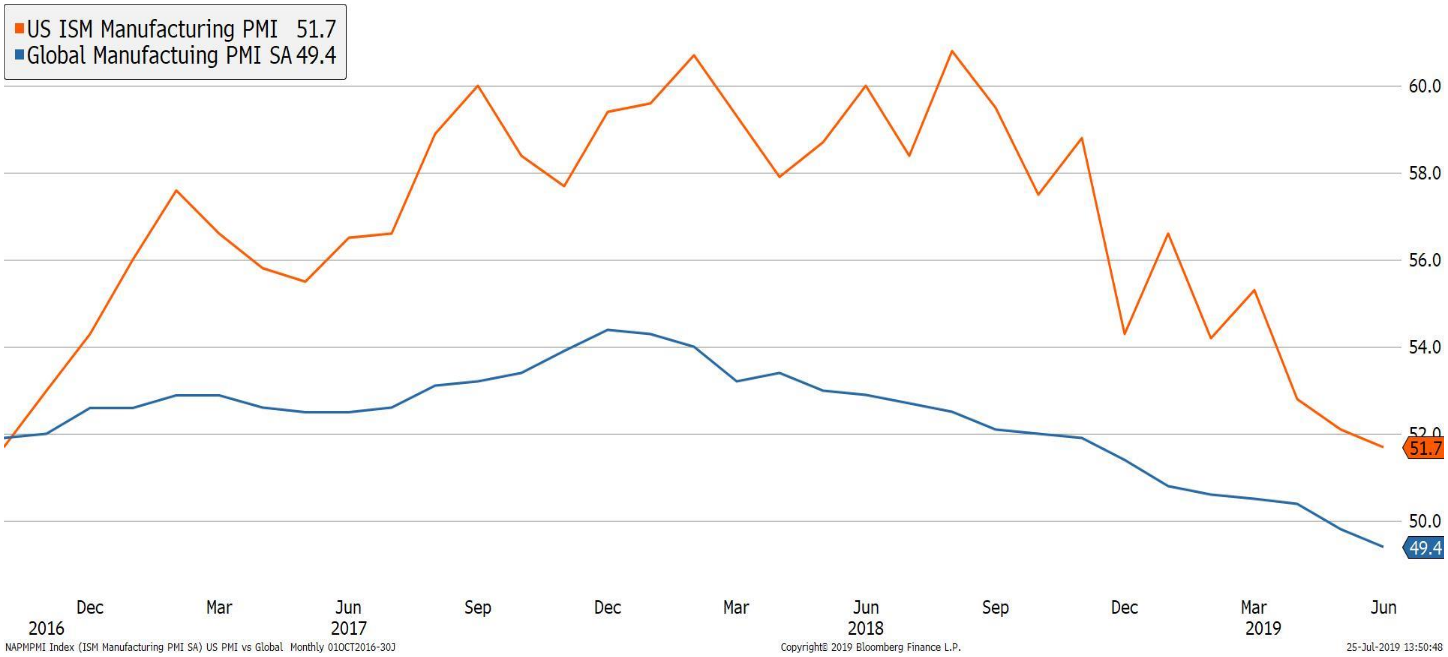
In July the economic expansion entered its tenth year, making it the longest expansion in history. While long in duration, the current expansion has been muted in terms of overall growth when compared to previous cycles. Maybe a slow and steady cycle should last longer? Last quarter we noted that the Fed was pivoting towards an interest rate cut to extend the expansion, avoid recession, and bring the economy in for a soft landing. Based on the futures market and recent Fed comments, a rate cut is all but certain at the July 31st meeting.

The domestic economic data has been mixed throughout the second quarter. An unemployment rate at 3.6% reflects a strong underlying economy. However, wage growth is somewhat tepid for the later stages of an expansion at just 3.4% according to the latest data from the Bureau of Labor Statistics. The relatively low gain in wages helps to explain the lack of inflation pressure with the latest CPI Index at just 1.8%. Also showing signs of weakness, the latest Purchasing Managers Index or PMI reading of 51.7 is down considerably from 59.9 this time last year. Any reading above 50 signals expansion, but clearly the U.S. economy is slowing.

While weakening, the U.S. economy is still outperforming many of its global peers. The most recent Worldwide PMI reading of 49.4 signals a contraction in global manufacturing. China recently posted a slower growth rate (6.2%) than was seen during the global financial crisis. Clearly the ebb and flow of global trade tensions is having an impact on the world's second largest economy. Increased tensions in Iran add to the global risks facing financial markets. In the face of rising trade tensions and slowing output, China, Europe, and Japan have all signaled a return to stimulus going forward.



In hindsight, it does appear the Fed overshot with the last couple of rate hikes in late 2018. As we noted last year, when the Fed funds rate moved above the inflation rate, the Fed went from "normalization" to a more restrictive policy. This despite any real sign of inflation at the time. If the Fed does reverse course and lower rates, will it be in time to avoid a recession? As we see on the next page, the stock market is making all-time highs and signaling a return to growth, while the bond market remains partially inverted signaling a slowdown ahead.

Equity Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
S&P 500 (Large Cap Domestic)	3.11	18.54	10.41	14.71	10.68
Russell 2000 (Small Cap Domestic)	1.02	16.97	-3.35	12.96	7.10
MSCI ACWI Ex US (International)	1.84	13.60	1.29	9.77	2.23

Equity Update – Full Steam Ahead

With U.S. and global economic data showing signs of weakness, one might expect a lower stock market. Instead, domestic equity markets are charging ahead and making new highs. The S&P 500 Index closed the quarter at 2941.76. This is a return for the quarter of 3.11% and up 10.41% over the trailing year. It seems the 20% selloff last December was just a blip on the radar and now a faint memory. Earnings for the second quarter are likely to be weaker than originally forecast. This is largely due to the slowing global backdrop outlined above. So why are equity prices charging higher?

It is important to remember that stock prices are simply the discounted value of future expected cash flows. As the discount rate is essentially just the investor's expected rate of return, as rates move higher investors pay less for stocks. This means all else being equal:

Higher Interest Rates = Higher Discount Rate = Lower Stock Prices

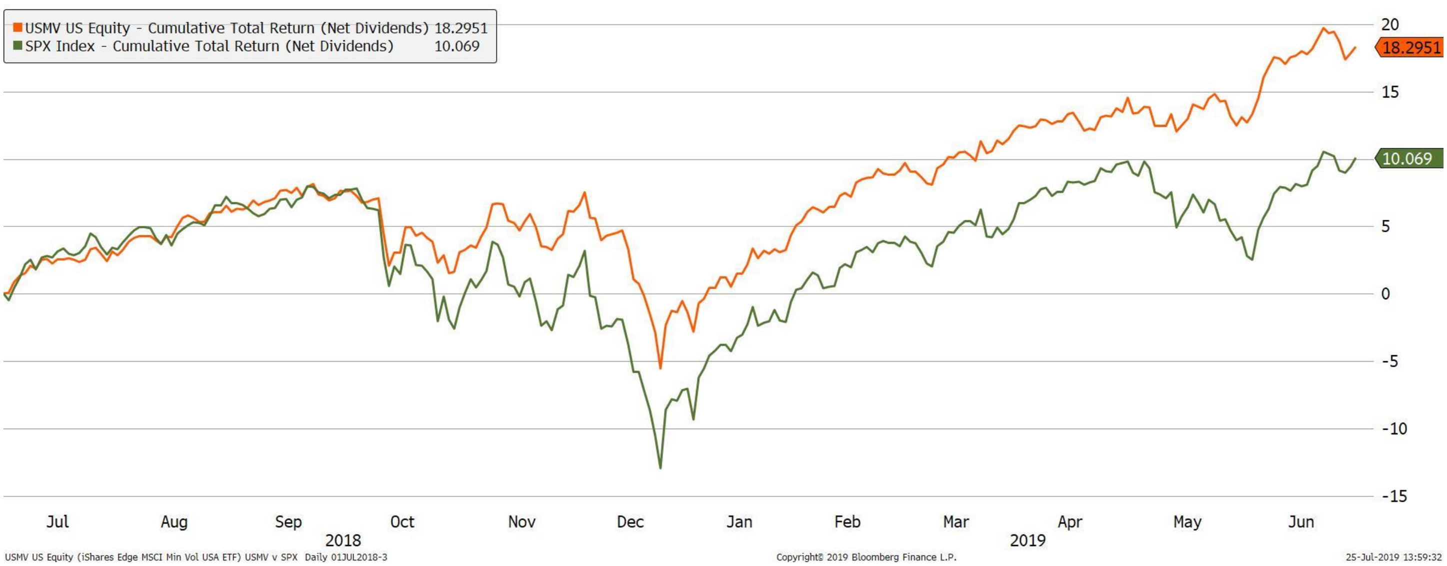
Higher Interest Rates = Slower Economy = Lower Expected Future Cashflows

Lower Interest Rates = Lower Discount Rate = Higher Stock Prices

Lower Interest Rates = Faster Growing Economy = Higher Expected Future Cashflows

The December selloff was due to a hawkish Fed that was determined to continue raising rates. Equity prices were discounting lower expected cashflows using a higher expected rate of return leading to lower stock prices. The reverse is now causing markets to move higher. Stock prices are now building in higher expected future cashflows and using a lower interest rate as the discounting mechanism. *All this assumes that the Fed and its global counterparts have returned to stimulus in time*.

While a recession is not our base case forecast, we recognize that the odds of a recession have increased. For this reason and given the strong stock market returns, we advise a bit of caution. Over the past 6 months, we have begun to add USMV (iShares Minimum Volatility) to portfolios to add some downside protection (see below). We remain neutral on our equity targets as the expansion will likely be extended. However, it is important for investors to rebalance and build appropriate levels of liquidity into their portfolios while the markets are at attractive levels.



Fixed Income Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
US T – Bill 90 Day Index	0.57	1.16	2.26	1.41	0.88
BC Municipals 5YR	1.69	4.24	5.35	2.01	2.33
BC Intermediate Government/Credit	2.59	4.97	6.83	2.04	2.40

The Correlation Conundrum

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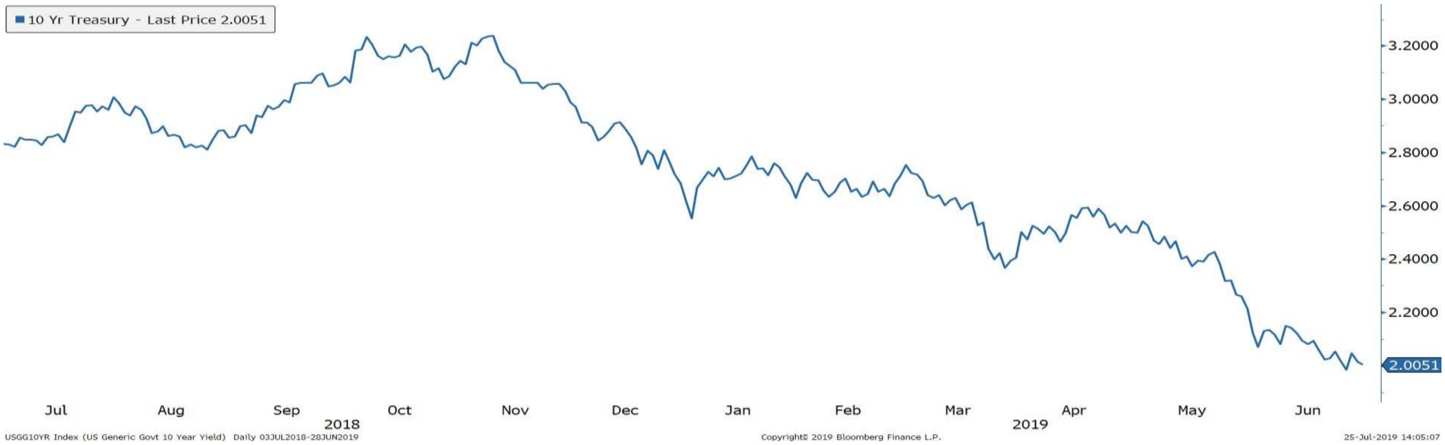
During the second quarter of 2019, the rally in the bond market continued as the 10-year treasury rate moved from 2.50% at the beginning of the quarter to 2.00% by quarters end. Year to date, emerging markets debt has increased approximately 10% making it one of the best performing sectors of the bond market. We continue our allocation to that space and feel the rally could continue. Over the first six months of 2019, we have seen a strong rally in bonds, stocks, and gold. Typically, these assets do not move in tandem over long periods of time. The bond market is signaling rough times ahead for the economy while the stock market signals optimism.

Fears of a fully inverted yield curve subsided slightly as the spread between the 2 and 10-year treasury rates widened from 17bps to 25bps. The biggest move occurred when Jerome Powell announced that the Federal Reserve may decrease the Fed Funds rate. The futures market has now priced in a 100% chance of the Fed cutting rates during the July meeting; a .25% decrease is the most likely move.

The last move we saw in the Fed Funds rate occurred in December of 2018 when the rate was increased .25% to 2.50%. At that time, many (including us) criticized the decision. Given a lack of inflation, increasing global trade tensions, and the cumulative impact of previous hikes, a pause would have been logical. Despite new stock market highs, low unemployment, and positive retail sales, the decision to cut interest rates may be the correct one in order to reverse course.



Alternative Investments Summary:	2nd Qtr	YTD	12 Month	3 YR	5 YR
Bloomberg Commodity	-1.14	3.83	-8.87	-3.58	-9.97
Dow Jones Global Real Estate	1.40	14.61	7.69	4.02	5.49
Morningstar Broad Hedge Fund TR	0.21	3.42	1.52	4.47	3.61

As I mentioned above, the rally in gold has intensified and is up 10% year to date. Oil has remained volatile and sold off 3% during the second quarter. Even with this recent decline, oil remains up 28% year to date. The strong rally in bonds had little impact on real estate and returns were only up slightly during the second quarter. We are maintaining our exposure to alternatives and continue to like MLP's (a commodity related asset) and the merger space as both tend to perform well during the latter part of the economic cycle.

Welcome to Amanda Luman!

Amanda Luman joined the Trust Department in March 2019 as an Assistant Trust Officer and Operations Assistant. Her primary duties include processing payments, scheduling various account activities, maintaining account files, and responding to client requests.

Amanda's 15 years of client service experience enable her to assist with preparing for client meetings, as well as managing client relationship milestones and coordinating our Quarterly Bulletin. Prior to working at LCNB, Amanda worked as a Tactical Incident Manager for the Nestle Corporation and studied Fine Arts Education at The Ohio State University.

In her spare time, Amanda enjoys lifting weights, traveling, and visiting museums with her husband, Corey. She and Corey reside in Mount Healthy with their mini-schnauzer, Flea; their cat, Dobby; and their rabbit, Nibbler.

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Summer Fun at Top Golf!

In celebration of the warmer months ahead, the Wealth Management department of LCNB decided to enjoy a night together of chip shots and tee-offs at Top Golf. Though most of our players aren't PGA-ready, everyone had a great time showing off their various, often hilarious golfing skills and getting to know one another better.

We look forward to more events such as these as the year continues!

We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information

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