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QUARTERLY

INSIGHTS

SPRING 2019

Cloud Computing Is Transforming the World Around Us

RECESSION WATCH
The U.S. economy is late cycle, but a near-term recession is unlikely

MUNICIPAL RALLY
Tax-law changes help to propel state and local bonds

LIVING KINDLY
She was always nice, but an author wanted to be kinder as well

TIME MANAGEMENT
Strategies for getting a handle on your hectic schedule

OPENING THOUGHTS

Given that stocks can rally at unexpected moments, attempting to time the market can result in missed opportunities.

The Fallacy of Timing the Market

There's an old saying that "time in the market beats market timing," and the beginning of this year has demonstrated the wisdom of this. At the end of 2018, economic worries, fear of a trade war with China and rising interest rates caused volatility to spike in stock markets around the world, with fear of potentially deeper selling to come. At such points, the instinctive reaction can be to flee equities in the hope of avoiding trouble.

In this case, that would have meant avoiding gains, as concerns have eased and stock markets have rebounded. This is one of countless examples of how stocks can rally at unexpected moments, and it underscores the risks of market timing. Attempting to pinpoint advances and sidestep declines can result in missed opportunities. We believe a far better strategy is to develop a strategic allocation tailored to your individual needs, long-term objectives and risk tolerance.

We all know the economy has inevitable ebbs and flows, and a recession will certainly come at some point. Such downturns can be unsettling, but they are natural and even healthy in the long run. The article on page 12 explains why a recession is unlikely in the near term. Current indicators suggest a downturn could occur in 2020 or 2021, but whenever it happens, our economist notes that downturns are typically short and have little to no lasting impact.

Regardless of short-term economic conditions, our analysts believe a number of industries are poised to thrive in coming years. We spotlight a couple of those in this issue – cloud computing on page 6 and luxury goods on page 8. I also invite you to attend one of our spring client luncheons. Our speakers will offer a fascinating glance at some of the cutting-edge trends and most-promising investment opportunities that are likely to assume prominence over the next decade.

As always, I want to extend my thanks for your continued confidence and the trust you have placed in us. Please reach out to your Investment Counselor if you have questions about your portfolio or any of the topics covered in this issue. I look forward to sharing more insights with you throughout 2019.

John Armour
President

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FEATURED ARTICLE

IN THIS ISSUE

Central Bank Pivot Spurs Vigorous Rebound in Stocks

If the closing months of 2018 showed how quickly sentiment can curdle in the global equity markets, the opening months of this year demonstrated how swiftly it can rebound. The willingness of the Federal Reserve and other central banks to step back from monetary tightening provided a jolt of horsepower. The gains were aided by a sense that the gloom pervading markets last year was overblown, as the U.S. economy once again provided ballast for the rest of the world. Still, the global economy must contend with ebbing growth, particularly in China and Europe, and the markets' direction may hinge on whether economic activity reaccelerates.

The forces that have long guided the U.S. economy – low unemployment, rising wages and healthy consumer confidence – continued to hit their marks. The S&P 500 jumped 13.7% in the quarter, ending a mere 2% off its peak last September. The MSCI EAFE Index gained 10%, while the MSCI Emerging Markets Index rose 9.9%. Including their superior results during last year's selloff, defensive stocks have led the market over the past six months.

However, the signal from the Fed that it is likely to halt interest rate hikes for the rest of the year – and conclude its balance sheet reduction on an early timetable – underlined risks lurking below the surface. Despite solid numbers overall, the pace of economic activity has moderated. GDP and earnings growth are expected to slow this year, and the twin pillars of corporate tax cuts and bulked-up government spending that goosed the economy in 2018 have begun to weaken. Beyond that, the heavy debt that companies have taken on to finance stock buybacks, dividends and mergers looms as a potential millstone at a time when the recent rally has driven U.S. equity valuations back above their 15-year average.

With the U.S. already in a late stage of the business cycle, these risks led to a sharp decline in interest rates and raised concerns about a potential recession. Capital Group economists do not believe a recession is imminent, although current data suggest one could begin in 2020 or 2021. One of our U.S. economists delves into this subject in the story on page 12.

Even as the first quarter underscored the economic challenges, it also highlighted the risk of trying to time the market, as anyone who exited stocks when the outlook dimmed last year would have watched the rebound from the sidelines. In fact, history shows that missing just the first month of an equity recovery can significantly reduce overall results. Since 1990, the S&P 500 has suffered 14 corrections. On average, the index ballooned 29.1% over the following 12 months. However, a

sizable chunk of that gain came early on, with stocks jumping 9.2% in the first month.

Trade tensions aggravated China's economic woes.

The near-term prospects of the U.S. may depend in part on the rest of the world, especially China, where growth has throttled back to its lowest pace in nearly 30 years. Major segments of the economy have cooled, including housing, exports, manufacturing, consumer spending and business confidence. The deceleration stems partly from structural trends such as a declining workforce and lower productivity growth, and has been worsened by the trade dispute with the U.S.

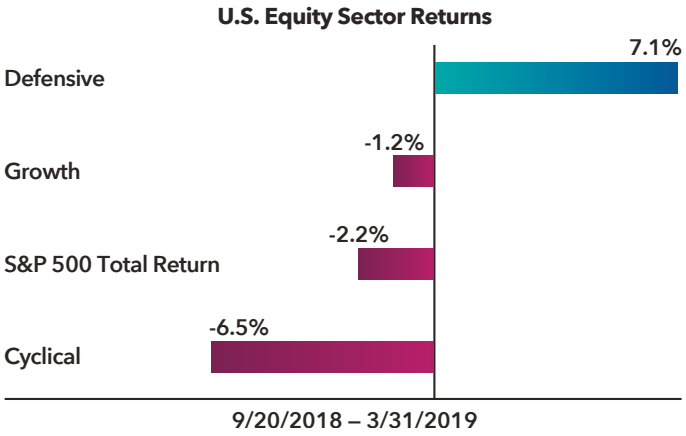
In contrast to its actions in past economic hailstorms, the Chinese government appears disinclined to initiate dramatic efforts to spur growth, according to an analysis by Capital Group's Asia economist. Policymakers fear that a cloudburst of stimulus measures could aggravate the country's daunting debt and send the housing market barreling into bubble territory. The government has taken modest steps, such as tax cuts and lower reserve requirements for banks, but those are unlikely to move the needle significantly.

Of course, China's muddied short-term prospects must be placed in the context of the country's longer-run appeal. Though China's official 6.6% annual growth rate has declined from the double-digit numbers of the past, the country's sheer size and the swelling ranks of its middle class will have a significant impact on world economic growth.

Soft demand from China has contributed to plodding growth in Europe, with Germany suffering sharp declines in industrial output, car production and export activity. The outlook has also been blurred by the political convulsions over Brexit in the U.K. Just months after phasing out a huge bond-buying program on the logic that rigorous stimulus was becoming unnecessary, the European Central Bank recommitted to some of those efforts, including a pledge not to raise interest rates this year and a renewed effort to spur bank lending.

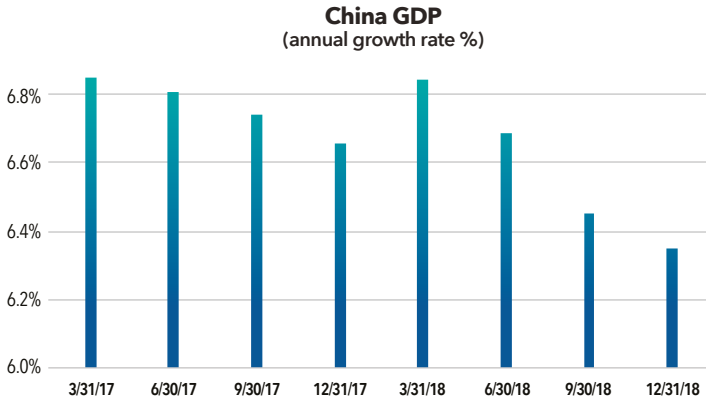
On the bright side, retail spending has been relatively strong as unemployment nears its previous cyclical low. Negative interest rates throughout the Continent limit the ECB's ability to roll out additional monetary measures to rejuvenate growth. But Capital Group's European economist believes that governments may be forced to undertake more-pronounced fiscal stimulus activities.

DEFENSIVE STOCKS HAVE LED THROUGH THE MARKET DECLINE AND REBOUND



Source: Morningstar Direct. U.S. Equity represented by S&P 500 total return index. Growth includes: Info Tech, Healthcare, Consumer Discretionary, Communication Services. Cyclical includes: Energy, Real Estate, Industrials, Financials, Materials. Defensive includes: Utilities, Consumer Staples, Telecommunication Services. Telecommunication Services was included in the defensive sector through September 30, 2018. Due to revisions by the index provider, it was moved to a new category, Communication Services, within the growth sector beginning October 1, 2018. All data as of March 31, 2019.

CHINESE ECONOMIC GROWTH IS SLOWING AMID GLOBAL TRADE TENSIONS



Sources: Refinitiv, National Bureau of Statistics of China, China Customs. As of December 31, 2018.

Industries with secular growth appear poised to do well.

Our portfolio managers are drawn to sectors that are expected to benefit from long-term trends and consumer buying patterns regardless of temporary economic conditions. For example, competitive video gaming, known as e-sports, is surging in popularity. It features multiperson video games that are often played by professionals in front of live or online audiences. Though e-sports make up a small segment of the gaming industry, there is enormous potential for advertising, ticket sales and broadcasting rights. International prospects are particularly strong.

Managers also have found value among European consumer staples companies. These businesses benefit from close proximity to the emerging world, where the number of consumers making the leap into the middle class continues to expand. Equity valuations for these companies tend to be lower than their U.S. counterparts'. More broadly, rising discretionary income in the emerging markets and elsewhere is boosting demand for a range of high-end products, including premium beverages and other branded goods.

Economic jitters caused bond yields to tumble.

Economic uncertainty drove down bond yields, with the 10-year Treasury finishing the quarter at 2.41%, a sharp decline from a recent high of 3.24% in early November, and briefly dipping below the three-month yield. Such an inversion of the yield curve has historically foreshadowed recessions.

It's unclear how much of a threat this represents. Some in the market believe the quantitative easing program the Fed deployed after the 2008 global financial crisis diminished the indicator's predictive ability. Furthermore, the magnitude of inversions matters. In the past, the Fed continued to raise rates after inversions occurred, but the central bank is currently on pause. Our U.S. economist notes that the post-inversion onset of recessions has varied from one to four years, and equity markets have typically continued to rise from the time of the inversion through the start of the recession.

Given the current unpredictability, our fixed-income investment team has taken a cautious approach and is seeking to avoid undue credit risks. Our managers have been drawn to high-quality securities to help minimize the potential effect of adverse market conditions.

Meanwhile, the municipal market has gotten off to its best start in more than a decade amid compelling supply-demand dynamics and attractive yields relative to Treasury securities. For more details, turn to the article by one of our fixed-income portfolio managers on page 10.

It's important to remember that bonds play an essential role in well-balanced portfolios regardless of shifting economic conditions. They can help to provide diversification from equities, generate income and preserve capital. That's always important but especially so in an environment of economic uncertainty around the world.

Q&A

Equity Portfolio Manager
Joyce Gordon

After a sharp drop at the end of last year, the stock market bounced back strongly in the first quarter. What are your thoughts on the economy and market?

I'm a bit surprised at how quickly the market has come back. The rebound has been due in large part to the Federal Reserve stepping back from further interest rate hikes. The Fed sees that economic growth is still positive around the world – but that it's been slowing. On top of that, geopolitical tensions are creating further uncertainty. When you get to a point like this, there can be a lot of volatility in the market, and that's what we've seen. I believe volatility will persist, and I'm positioned fairly defensively in the portfolios I manage.

There has been a lot of speculation about a potential recession. Do you see that as an imminent threat?

We know we're late in the business cycle and that a downturn is going to come at some point. But I don't see a recession immediately on the horizon. Keep in mind, of course, that it's extremely difficult to pinpoint the exact timing of economic contractions. Investors can be tempted to try to time the market, but that's a fool's game. I don't think anyone has been able to do that with any consistency.

It's also important to remember that recessions last for relatively short periods of time. More often than not, the market is appreciating and the economy is not in recession. You certainly don't want to be out of the market because you think a downturn might occur. That in itself is risky. You don't want to miss out on a gain because you're on the sidelines. You want to be invested, but you want to be more conservative when we're late in the cycle. For me, that means holding securities with good dividend yields where payouts are growing. That usually points the way toward companies with underlying earnings growth and strong prospects regardless of economic gyrations.

43 YEARS WITH CAPITAL GROUP

Joyce Gordon is a Capital Group equity portfolio manager who has a special focus on dividend-paying companies. In this interview, she shares her views on the economy, discusses opportunities in the market and outlines the importance of assessing corporate management teams.

Have you been able lately to find companies with attractive dividend yields?

It's gotten harder to find opportunities in the U.S. where a stock yields 4% or so and the company is raising its dividend. There are a handful of these but not an abundance. However, when I look around the world, that's really my sweet spot. There are more overseas companies with above-average dividends and growing dividends. These are well-managed businesses that seem to have a lot more ability to increase earnings over many years. I still have quite a few holdings in the U.S., but the incremental opportunities I'm finding tend to be in Europe and Asia.

Which industries are you drawn to at the moment?

One area is the defense sector. Unfortunately, the world is not getting safer. There is something of a built-in demand for missiles, jets and related equipment. Governments will put pressure on companies to keep pricing down, but demand is definitely there. These companies tend to pay good dividends – many in the range of 3% or so – and some businesses are raising dividends as much as 10% a year. They're well managed and have a stream of new products with important functionalities.

What are some of the key elements you look for when researching companies?

Management is extremely important, and I regularly meet with executive teams. That helps me understand what's really happening at a company. It's difficult for an executive to mislead me because I will go back in to the company in six months or a year and say, "Well, you said you were going to do this." After meeting with them several times, you know whether they do what they promise. You even get to know the personalities so well that you can read body language. If someone is always excited and then you go see them and they're kind of down, that tells you a lot.

The most important thing that I try to figure out is whether I trust what they tell me and trust them to do the right thing for shareholders. It's also important to determine if they know their business and what the risks are in their business. It sounds surprising, but I have come across a lot of managers who didn't know the risk in their own business. Are they too myopic? Is a financial company, for example, unaware of the risks on its balance sheet? It's always critical to have a thorough understanding of companies and their industries, but that's especially true at this point in the business cycle. This is the type of market where I believe Capital shines. We do the fundamental research to try to gauge which businesses have solid underlying growth and long-term staying power.

The Rise of the Cloud Is Transforming the World

Ever wonder how smartphones can perform so many functions so seamlessly, from sending email to storing photos to playing movies? Part of the answer is that cell phones are compact technological wonders. The other part is that phones often get little-noticed assists from large computers located hundreds or even thousands of miles away. These distant computers are known collectively as "the cloud," and they represent a meaningful shift in the digital ecosystem.

One of the most visible trends over the past few decades is that digital devices have gotten progressively smaller. The bulky mainframes that companies once crammed into basements and perpetually chilly computer rooms have given way to nimbler desktops and laptops. Among consumers, smartphones are a worldwide object of affection.

But although the devices themselves have slimmed down, the need for mammoth computers toiling behind the scenes is as great as ever. The swirl of data splashing around in today's digital vortex requires individuals and businesses to secure immense processing power, speed and storage. Those functions come from networks of servers located remotely – hence, the term "cloud" – and accessed over the internet.

Cloud computing is projected to surge as companies continue to migrate from legacy systems and individuals require lightning-fast speed for video and other bandwidth-heavy functions. This bodes well for the providers of cloud infrastructure services, with the market expected to balloon from less than $50 billion last year to nearly $350 billion in 2028, according to Capital Group estimates.

"The market opportunity is really enormous," says Mark Casey, a Capital Group equity portfolio manager. "Cloud computing is the most compelling long-term-growth story I know of."

Though consumers may not realize it, the cloud has become a routine element of digital existence over the past decade. Anyone who accesses email, backs up cellphone photos, signs on to social media or streams movies is probably tapping into the cloud. And such reliance on remote computers is likely to grow as everything from cars that pilot themselves to refrigerators that automatically reorder milk incorporate backstage analytical features.

"The cloud is everywhere," says Cheryl Frank, an equity portfolio manager at Capital Group Private Client Services. "If you use a smartphone, you're basically using the cloud. If you watch Netflix, you're using the cloud."

A new way to do business.

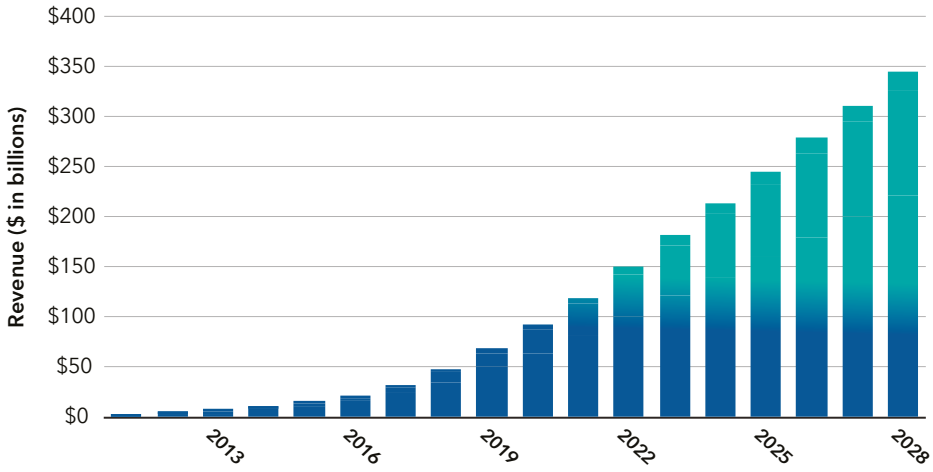
For companies that are switching from legacy systems, two of the cloud's biggest attractions are simplicity and cost savings. Businesses can essentially outsource technology – data storage, software purchases and processing muscle – just as they have many other functions. They avoid up-front outlays for hardware and software that quickly become obsolete. And there's no need for jumbo information technology departments to oversee every facet of an in-house system.

Companies also gain agility. They typically pay only for the storage capacity and computing power they use, allowing them to quickly scale up for projects or test new ideas. Cloud service providers also handle security, a critical issue in the wake of highly publicized hacking incidents at prominent companies.

Cloud providers "have literally hundreds of people, many with Ph.D.s in computer science, and the only thing they do is secure the systems from attacks by hackers," Casey says. "Almost no individual corporation has anywhere near that type of security effort."

Increasingly, businesses are also attracted by next-generation functions, such as data analytics and machine learning, that previously were impossible or prohibitively expensive. In other words, the cloud allows companies to undertake new tasks that can help their businesses grow. A consumer brand, for example, could roll out precision-targeted marketing campaigns, and a medical provider could better decode health patterns to improve treatments.

DEMAND FOR CLOUD COMPUTING IS EXPECTED TO SURGE AS COMPANIES SWITCH FROM LEGACY SYSTEMS



Source: Capital Group estimates.

"There is a shift toward creating value from the cloud rather than simply reducing IT costs," says Capital Group analyst Jessica Spaly. "Companies can do things to drive growth in their business they could not before and in many cases create tremendous value."

Cloud providers have sticky customers and recurring revenue.

Beyond ballooning demand for their offerings, the companies that provide cloud services have several advantages. The first is subscription-based business models. Instead of making one-time purchases, clients pay monthly fees for ongoing service. Those recurring charges translate to highly dependable revenue streams for cloud providers. And customers are "sticky" – once they have gone to the trouble of setting up service and migrating data, they're unlikely to switch providers.

The outlook is bright for the two basic types of cloud companies: infrastructure providers, which rent computer space and processing power, and software purveyors, which sell products such as enterprise management. Infrastructure providers have the added benefit of limited competition. A handful of companies dominate the space, and the daunting cost of buying equipment and coaxing clients to switch providers discourages would-be rivals.

Of course, there are potential risks, the biggest being a headline-generating hack or an extended service outage. The providers' security records are very good, Casey says, but a breach could badly scuff a company's reputation.

Still, the industry's prospects appear to be extremely promising as companies move more of their operations into the cloud.

"This is part of the long-term evolution of technology," Frank says. "There's a lot of growth ahead."

Trends in the Luxury Sector Favor Leading Companies

LAUREN CARTER
Lauren is an equity analyst who covers the luxury sector. Based in London, she has 12 years of investment industry experience and has been with Capital Group since 2014.

At first blush, mentioning "luxury goods" and "millennials" in the same sentence may seem incongruous. After all, high-end purchases are more closely associated with older consumers than with a cohort bred on pop-up shops and fast fashion. But though earlier generations remain a core audience, millennials are taking on greater significance. In fact, the emergence of these shoppers is one of several factors that are expected not only to propel the luxury-goods business in coming years but to boost the prospects of large companies with the size and resources needed to stand out in an evolving landscape.

The luxury industry is being paced by economic growth and wealth creation in the U.S. and other countries. This is particularly true in China, where the steady rise of the middle class is underpinning consumption. Despite short-term uncertainty about economic conditions in China and its strained trade relations with the U.S., I expect

the Asian giant to remain a powerful source of growth in coming years. Indeed, Chinese consumers have shown a greater affinity for high-end goods than their counterparts around the world.

Of course, there are risks, including the possibility of an economic downturn. Though I believe luxury goods are far more resilient to economic gyrations than is widely assumed, a deep or extended recession would undoubtedly weigh on the sector. Beyond that, not all companies will be able to make the leap to a playing field in which demographic shifts and digital marketing claim equal standing with inviting store layouts and tantalizing window displays.

Nevertheless, I believe the outlook is promising for select companies with global distribution muscle, forward-looking management and high consumer awareness. Multinational companies' large sizes give them meaningful advantages over smaller rivals, including the ability to leverage economies of scale and react to real-time customer trends. Big companies also have the resources to spend heavily on advertising. Of course, the most obvious strength of these companies is the allure of their brands, which have long track records of quality and consumer appeal.

Millennials are increasingly important.

For many years, the luxury industry succeeded with a tried-and-true strategy: Open gleaming stores in premier locations around the globe to serve as magnets for newly affluent shoppers. Destination stores will always be essential touchstones. But now that companies have achieved wide footprints, their store growth has slowed, and prominent retailers fear that piling on outposts in second-tier markets could detract from their cachet.

Instead, online sales and marketing are assuming greater prominence. Digital sales, which account for a bit less than 10% of revenue today, are expected to reach 25% by 2025. More important, the internet is estimated to influence a whopping 70% of sales through brand marketing and the closely watched pronouncements of tastemakers on social media.

An online presence goes hand in hand with branching out to a younger clientele. By one estimate, millennials will make up half of the luxury market within five years, up from roughly 30% today. That's due partly to the turning of the clock: Although the youngest millennials are 21 today, the oldest are 35, an age at which those advancing in their careers wield ample discretionary income.

The industry as a whole was slow to embrace the internet because of fear that digital marketing would detract from its aura of exclusivity or alienate its core base. That hasn't happened, as successful brands have struck a balance between attracting newcomers and maintaining the allegiance of traditional clients. Like other industries in the fast-paced digital age, the overall metabolism of the luxury sector has sped up in recent years, with brands stressing fashion creativity and marketing innovation. For example, companies now do monthly "drops," in which they unveil new inventory in stores to spark customer enthusiasm and word of mouth.

The luxury industry is resilient.

Of course, a perennial concern is the economic backdrop, as hints of slowing growth often spark worries about a potential drag on luxury sales. There's no doubt that a protracted recession with significant job losses would hurt the sector. But normal economic fluctuations have historically done minimal damage to sales because affluent consumers are insulated from short-term hiccups. Luxury stocks weakened in the second half of 2018 as concerns arose about the global economy, but share prices bounced back afterward as sales remained intact.

Despite recent economic slowing, sales remain solid in China. I expect demand to escalate in coming years as the ranks of the consumer class expand and newcomers are attracted by the social cachet and aspirational value of luxury items.

MUNICIPAL BONDS ARE OFF TO A STRONG START THIS YEAR

At this point a year ago, the outlook for municipal bonds was a bit murky. Not only were rising interest rates sparking jitters across all of fixed income, the newly revamped tax code was stirring particular apprehension in the municipal sector. In the aftermath of the U.S. tax overhaul, there was fear that lower federal rates would diminish the appeal of municipal bonds.

Fast forward to today and it's clear that municipals have more than survived – they've thrived. The sector finished 2018 with positive returns, and municipals are off to their best start in more than a decade. The gains have been paced by several factors, including favorable supply-demand dynamics and the compelling yield differential between municipals and comparable Treasury bonds. The tax revamp has even provided a boost by increasing the appetite for tax-advantaged securities in high-tax states such as California and New York.

Looking ahead, the outlook for the rest of 2019 appears bright, and I believe there are opportunities in several parts of the municipal market. Broadly speaking, the steepness of the municipal yield curve in relation to the Treasury curve offers compelling value. I am also finding opportunity in the continuing wave of consolidation among nonprofit hospitals. Finally, there are persistently attractive valuations in housing.

Tax reform has stoked municipal demand.

Far from being a drag, the tax legislation passed in December 2017 has been a tailwind for municipals. The law slashed taxes for many U.S. households but capped the deductibility of state and local taxes (SALT) at $10,000 annually. The reduction of the SALT write-off has had an outsize impact on states with high income and property taxes, and spurred demand for the tax benefits of municipals.

The Tax Cuts and Jobs Act of 2017 has been a game changer for the yield curve, which measures the difference in yields among securities of varying maturities. The uncertainty

MARK MARINELLA
Mark is a fixed-income portfolio manager specializing in municipal bonds. Based in Los Angeles, he has 33 years of investment industry experience and has been with Capital Group since 2013.

that loomed over the market before the tax overhaul prompted a flood of issuance by cities, states and other municipal entities, which were eager to sell bonds before the law took effect.

That increased the supply of bonds for a time and put downward pressure on municipal bond prices. (Recall that bond prices move inversely to yields.) Last year, by contrast, there was less issuance, which is likely to remain the case this year. The resulting combination of modest supply and strong overall demand bodes well for municipals.

The new tax law cut the corporate tax rate from 35% to 21%, diminishing the advantage of municipals for U.S. banks and insurance companies. Historically, banks and insurers have been important investors in municipals with maturities of 20 years or longer. Consequently, the steepness of the municipal curve relative to its Treasury counterpart has increased due to the reduced supply of municipal bonds and lower demand for longer-term securities.

What's the benefit of the municipal curve's relative steepness? The basic idea is that, sooner or later, the divergence between the two curves will fade as municipals feel the gravitational pull of the much larger and more liquid Treasury market.

Nonprofit hospitals can reward patient investors.

As for specific areas of opportunity, I am drawn to hospital bonds. Amid economic growth and Medicaid expansion over the past decade, many nonprofit hospitals have strengthened their balance sheets.

Our team of municipal analysts looks to distinguish among hospitals of similar credit ratings. Often, our analysts focus on regions where health care reimbursement is most favorable. There has been a multiyear hospital consolidation wave that shows no sign of receding any time soon. Large systems see mergers as a way to stay competitive and diversify. Many smaller hospitals view an acquisition as a lifeline amid tighter margins.

Each security must be assessed on its own merits, but it's fair to say that multistate health care systems can be especially attractive. That said, single-site hospitals also pique my interest if they have dominant market share and derive a high percentage of revenue from commercial insurance. Hospital bonds account for just under 10% of outstanding investment-grade municipal bonds and typically offer yields above those of the broader market.

Housing municipals offer a structural yield advantage.

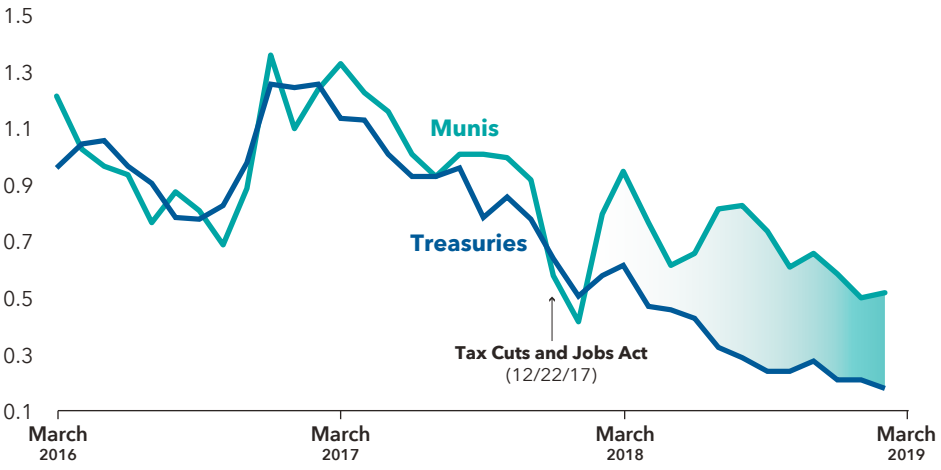
There are nearly $4 trillion in municipal bonds outstanding. In a market of this size, there are likely to be areas that are not closely researched by investors. Housing is a case in point.

My focus is on single-family housing bonds. They're issued by state and local housing authorities across the country, with their proceeds helping low-income and first-time buyers purchase homes. In many cases, the credit stories of these bonds are compelling, as the underlying mortgage pools are either federally insured or structured in ways that can reduce the risk of default.

These bonds offer attractive relative value. For very high-quality securities, it's not uncommon to see housing municipals offer about 0.75% of additional yield over similarly rated municipals from other sectors.

With the Federal Reserve indicating that it is unlikely to raise interest rates this year, the backdrop for all of fixed income is encouraging. As for municipals specifically, their current market-related appeal comes on top of their more fundamental roles. Municipals can provide tax-exempt income, preserve capital and diversify risk from other asset classes, such as equities. These are all essential components of a well-balanced investment portfolio.

THE MUNICIPAL YIELD CURVE IS UNUSUALLY STEEP COMPARED WITH TREASURIES



Sources: Bloomberg Index Services Ltd., Thomson Reuters. Steepness of yield gap between two-year and ten-year bonds. Month-end data through January 31, 2019.

Recessions Can Be Unsettling, but Their Long-Term Impact Has Been Modest

JARED FRANZ
Jared is an economist based in our Los Angeles office. He has 13 years of investment experience and has been with Capital Group since 2015.

Is a recession coming? After a bull market that just eclipsed 10 years, and an economic expansion that's lasted nearly as long, it's no surprise that I'm asked this question a lot nowadays.

The short answer is, yes, a recession is expected – but not right away. Downturns strike for a variety of reasons, most often because of imbalances that build over time and must be corrected. Though stresses are developing in some areas, they don't appear to be substantial enough to derail growth in the immediate future.

That said, recessions are a natural and necessary part of every business cycle. Despite its current vigor, the U.S. economy is late-cycle. Weakness in China and Europe, and a global tide of corporate and governmental debt, are all potential hazards. At the moment, economic indicators suggest the economy could soften in the next two years and a recession could begin sometime in 2020 or 2021.

Of course, history has shown how difficult recessions are to predict, and the U.S. economy has been remarkably resilient in recent years. The most recent example of this came late last year, when concerns about slackening global growth triggered a bruising stock market decline. Equities rebounded in the first quarter as fear subsided. As famed economist Paul Samuelson once noted wryly, "The stock market has predicted nine of the last five recessions."

The long-term impact of recessions is small.

Regardless of timing, it's important to keep a few truths in mind. The first is that economic contractions generally don't last long. A Capital Group analysis of 10 cycles since 1950 shows that downturns have ranged from eight to 18 months, with the average lasting about 11 months.

Recessions also are relatively small blips in economic history. Over the past 65 years, the U.S. has officially been in recession less than 15% of all months. And the net economic impact of most downturns is fairly small. The economy shrank less than 2% in the average downturn, compared with a 24% surge in the typical expansion. Beyond that, equity returns can actually be positive over the full length of a contraction, with some of the most powerful stock rallies occurring during the late stages of a recession.

Bear markets and recessions usually overlap at times, with equities tending to peak about seven months before the economic cycle. By the time a recession has been officially declared, equities already may have been declining for months. But just as stocks often lead on the way down, they also have led on the way up. The S&P 500 typically bottoms about six months after the start of a recession – and usually begins to rally before the economy starts humming again. This means that aggressive market timing, such as shifting an entire portfolio to cash, often can backfire. Some of the strongest returns can occur

during the late stages of an economic cycle or immediately after a market bottom. Though many factors can contribute to recessions, here's a quick look at three signals I am watching closely: corporate profits, unemployment and the yield curve of Treasury securities.

Company profits as a share of GDP usually peak midcycle for the overall economy and start decelerating long before the start of a recession. In this cycle, earnings are still at high levels from a historical perspective, but there is reason to believe they have peaked. And they are likely to come under more pressure from rising wages and inflation, the ebbing benefits of tax reform and higher costs amid global trade uncertainty. The most recent peak in corporate profits as a percentage of GDP was in 2012, meaning we already are past the average lead time of 26 months.

The U.S. unemployment rate is near a historical low and has been declining throughout the expansion. Wage growth has been well below average compared with past expansionary periods, but it has started to pick up recently – a positive for consumer spending but a potential drag on profits. The labor market is past the level that many economists consider full employment and has been for years, so there may be little room for joblessness to decline further. This is such a powerful economic driver that even moderate increases in unemployment can be a disturbing signal.

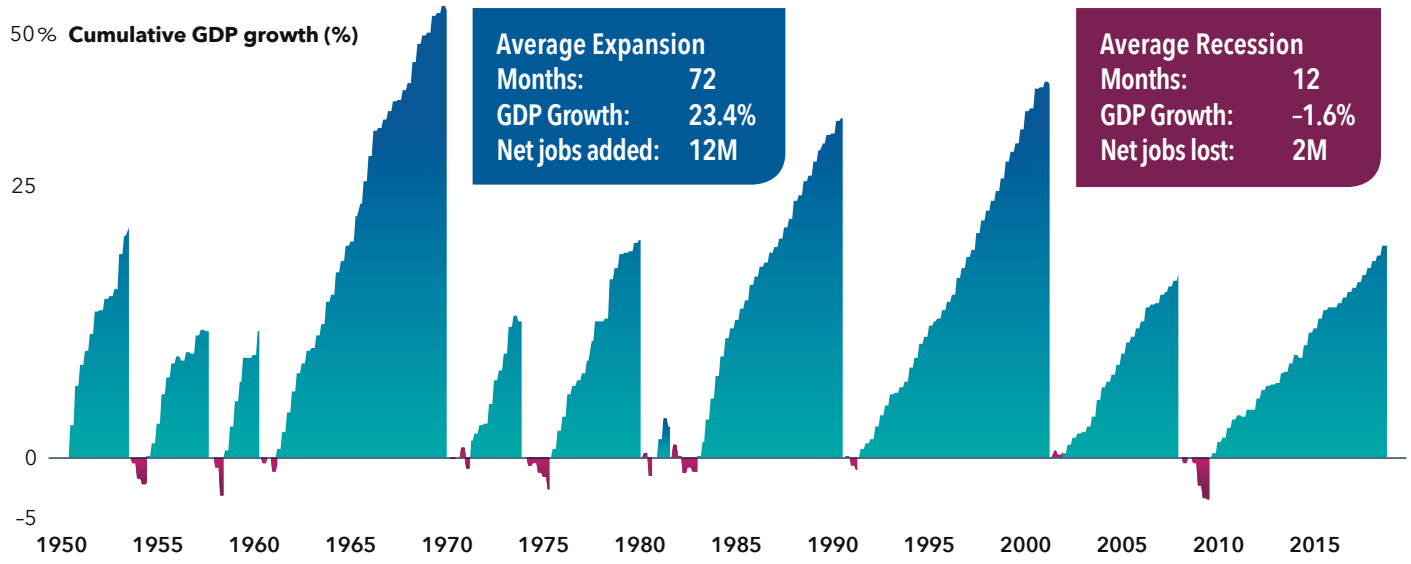
An inverted yield curve may sound esoteric, but it's a simple concept and one of the more accurate recession signals. The yield curve measures the relationship between short-term and long-term Treasury yields, and an inversion occurs when short-term rates exceed long-term rates. This can happen when short rates rise during Fed tightening cycles and long rates fall amid high demand for bonds. An inversion is bearish because it indicates that investors favor the perceived safety of long-term government bonds over riskier assets.

In December, the yield curve between two-year and five-year Treasury notes inverted for the first time since 2007. Other parts of the curve – such as the more commonly referenced two-year/10-year yields – have not inverted. However, even an inverted curve in that range is not cause for immediate panic, as there typically has been an average lag of 16 months between an inversion and the start of a recession. Moreover, there is debate about whether central bank interventions in the bond market have distorted the yield curve and made it a less reliable indicator.

These factors are just some of the ways to take the temperature of the U.S. economy. One or two negative readings can be meaningless. But several key indicators flashing red for a sustained period can foreshadow a gloomier outlook. In my view, that time has not yet arrived.

Regardless of economic conditions, it's wise to regularly review your asset allocation with your Investment Counselor to ensure that your portfolio is broadly diversified and tailored to your personal needs.

RECESSIONS ARE PAINFUL, BUT EXPANSIONS HAVE BEEN POWERFUL



Sources: Capital Group, National Bureau of Economic Research, Thomson Reuters. Because NBER announces recession start and end months rather than exact dates, we have used month-end dates as a proxy for calculations of S&P 500 returns and jobs added. Nearest quarter-end values used for GDP growth rates. GDP growth shown on a logarithmic scale. As of September 30, 2018.

Charitable LLCs Provide Another Option for Making Philanthropic Gifts

Those who make charitable donations typically do so in one of three ways: contributing directly to a charity, using a donor-advised fund or establishing a private foundation. Each of these approaches can have distinct benefits depending on the donor's philanthropic goals and financial circumstances. These remain the preferred vehicles for most people, but another mechanism, known as a charitable LLC, may be worthwhile for donors in certain situations.

As the name implies, a charitable LLC is a limited liability company. Its primary advantage is that it generally provides donors with greater flexibility and control than do traditional tax-exempt entities. LLCs are not bound by some of the regulations that typically govern more-common philanthropic vehicles, including rules on required distributions, public disclosures, investment holdings and political involvement. Among the more notable adherents of the LLC model are Facebook founder Mark Zuckerberg and his wife, Priscilla, who use an LLC as their primary philanthropic vehicle, and Laurene Powell Jobs, the widow of Apple co-founder Steve Jobs, who created an LLC known as Emerson Collective.

As with any type of charitable-gifting mechanism, LLCs involve trade-offs, and they must be examined carefully in the context of overall philanthropic and financial strategies. One of the most notable trade-offs is that LLCs are not technically charitable vehicles and do not offer tax advantages per se. In contrast to other types of vehicles, for example, donor contributions to LLCs do not provide immediate charitable deductions. Instead, deductions come later when the LLC itself disburses money. Nevertheless, the convenience and freedom can make an LLC an appealing choice for donors in some situations.

LLCs offer autonomy with relatively few headaches.

Among the most compelling features of a charitable LLC is that there is less paperwork involved – and less public disclosure required – than with other charitable vehicles. For tax purposes, an LLC is a pass-through entity, meaning that all financial activity passes through to its owner. LLCs don't have to submit annual 990-PF forms, which are public documents that list, among other facts, the compensation of top executives and independent contractors. Thus, LLCs can be particularly attractive to those seeking a high degree of personal privacy.

There are no annual distribution requirements with LLCs. That stands in contrast to family foundations, which must give away at least 5% of their net investment assets each year. LLCs also are not subject to so-called self-dealing restrictions that prohibit foundations from holding more than 20% of a single stock. That gives donors much more leeway to invest in

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a family-owned business or in entities that are considered to be speculative in nature. And unlike family foundations, LLCs are allowed to lobby government officials on behalf of their causes and make financial contributions to political campaigns.

LLCs don't have specific tax advantages.

The logistical benefits of LLCs must be considered alongside their relative disadvantages – starting with the fact that LLCs don't carry tax benefits. One of their most notable drawbacks is their lack of up-front tax deductibility. Contributions to public charities, donor-advised funds and foundations all are deductible the moment a donor makes a gift. That's not the case with an LLC; deductions apply only when the entity itself disburses money to a qualified 501(c)(3).

If charitable LLCs don't carry immediate tax benefits, why not just give directly to charities? The answer lies primarily with an LLC's intangible benefits. First, an LLC can, in effect, be the "entity" through which a family carries out its philanthropic objectives. This work might include research, due diligence and the administration of implementing multiple grants over time. A private foundation can accomplish these tasks as well but comes with additional restrictions, including the minimum distribution requirement, self-dealing prohibitions and reporting obligations.

Second, an LLC enables family members who are actively engaged with the charitable work to be compensated as employees. Finally, an LLC can be used in conjunction with direct giving, a donor-advised fund or even a private foundation, if desired. This may be especially appealing for investors who want to create a legacy with large, private holdings but prefer the simplicity of non-LLC vehicles or need the up-front tax deduction.

Of course, tax rules are complex and can have diverse applications for different individuals. It's extremely important for people considering charitable vehicles to consult with their tax and legal advisors before pursuing any strategies. Our Wealth Advisory Group can help with the decision-making process through a customized planning analysis. Please contact your Investment Counselor for more information.

Charitable Strategies	Public charity	Donor-advised fund	Private foundation	Charitable LLC
Donor controls how the gift is used	√	Limited	√	√
Donor controls the investment of the gift	X	X	√	√
Donor controls who sits on the governing board	X	X	√	√
Requires donor time, effort and management expenses	X	X	√	√
Annual distribution requirements	X	X	√	X
Entity subject to excise tax on net investment income	X	X	√	X
Entity tax return open to the public	√	X	√	X
Entity subject to self-dealing restrictions	X	X	√	X
Entity subject to political activity rules and restrictions	√	√	√	X
Timing of tax deduction for contributions	Up-front	Up-front	Up-front	At time of distribution (1)
Tax deduction limit (% of AGI) for gifts of cash (2)(3)	60%	60%	30%	60%
Tax deduction limit (% of AGI) for gifts of stock or real property	30%	30%	20%	30%
Valuation of gifts of property, other than publicly traded stock	Fair market value	Fair market value	Cost basis	Fair market value

(1) At time of distribution to charity.
(2) Gifts of stock when made in combination with cash are subject to more-restrictive limitations.
(3) 60% AGI limitation for cash gifts expires December 31, 2025.

Use Smart Time Management to Accomplish Big Life Goals

On the master list of life's unavoidable stressors, time pressures don't spark the same dread as, say, death and taxes. Then again, time-related stress is a lot more frequent than mortality and government levies. A lucky few among us seem to be gifted with a fully formed time management gene. Many others can feel snowed under by bulging to-do lists. And it's all too easy to become overwhelmed when the exigencies of daily life surpass our ability to get everything done.

The natural impulse is to try to shave moments from everyday tasks in hopes of stitching together longer blocks for more-useful purposes. But that's usually more energy-depleting than productivity-enhancing, says Laura Vanderkam, author of *Off the Clock: Feel Less Busy While Getting More Done*. Over the years, people have suggested any number of questionable time-saving methods to her, ranging from the merely pointless – microwave food for the shortest possible period recommended on the package – to the downright head-scratching – make only right-hand turns to avoid waiting at traffic lights.

"One of my favorites is, 'When answering emails, instead of writing *OK*, just type *K*,'" says Vanderkam. "I love the sheer ridiculousness of this."

Instead, experts recommend strategically allocating time in ways that prioritize big-picture life goals. This boils down to a few basic concepts: Be conscious of how you spend your days; be judicious in your commitments; and minimize exposure to the intoxicant known as the smartphone. These strategies all make intuitive sense, but they're easy to deviate from and require steady vigilance. Above all, keep in mind that your ultimate objective is to clear space for tasks with high potential payoffs, both professional and personal.

"Time management is probably either the biggest limiting factor or the biggest driver of your happiness and success in life," says Elizabeth Grace Saunders, founder of a time coaching and training company. "It's absolutely critical. Your time is your life."

Manage time by protecting it.

A first step toward better time management is realizing that it is possible to achieve a well-balanced schedule – and that

people often have more control over their daily existence than they think. There's an understandable urge to blame a hectic schedule on forces beyond your control, but "you can't just blame the world for the fact that there are a lot of things coming at you," Saunders says. Time management requires active decision-making and a willingness to say no, which can be uncomfortable but is ultimately preferable to acquiescing to every meeting request.

"If you're not strategic with your time, everyone is happy to spend your time for you," says Saunders, who has published several books, including *The 3 Secrets to Effective Time Investment: How to Achieve More Success With Less Stress*.

Start by determining which portions of your day you can control. To put it less delicately, which work-related meetings and personal obligations can you skip? Saunders partitions tasks into three mental folders: worthwhile investments of time, such as career-boosting work projects; routine obligations that must be completed but hold no payoff; and lesser chores that should chew up as little time as possible.

Identify what matters, and don't sweat the rest.

Next, let go of perfectionism. Squelch the instinct to pore over every email or fine-tune every piece of paperwork. In these instances, good enough really is good enough. Also, set up automatic time investments. If making it to the gym is important, carve out a regular block of time, perhaps in the morning before the onslaught of the day sets in. It's helpful to think through and plan your schedule in advance, preferably a few days ahead. Vanderkam devotes part of Friday afternoon to mulling over the coming week, focusing on what she wants to accomplish and how she'll pull it off.

She also recommends the time management equivalent of an annual work review. A year from now, what big-picture goals would you like to have achieved personally and professionally? Set those as lodestars, and arrange your schedule accordingly. If getting a new job or regularly making it home for dinner is important, make peace with imperfections in areas that have no long-term relevance. Adhere to a similar principle for family time, she advises. Getting the car washed is important, but probably not at the expense of time with children.

"Leisure time is too precious to be totally leisurely about," Vanderkam says.

Of course, maximizing your waking hours doesn't mean overscheduling or being unyieldingly rigid. In fact, it's important to build in a cushion to provide leeway when the unexpected inevitably happens. And don't chastise yourself for wasting time. Some amount of downtime is natural and probably healthy.

"I've wasted plenty of time," Vanderkam says. "We all do. We're human. It's not about figuring out how much time we waste. It's about making sure we are making progress on the things that matter to us."

Making the Most of Your Time

Successful time management requires active decision-making and a commitment to protect the time on your calendar. Here are some general guidelines:

- **Determine which parts of your schedule you can control**
- **Focus on important goals, and aim for less than perfect with the rest**
- **Say no to unimportant or time-consuming tasks**
- **Set automatic times for exercise and other recurring activities**
- **Avoid overscheduling**
- **Build in a cushion between meetings to avoid feeling rushed**
- **Get sufficient sleep**
- **Don't fritter away time on your cellphone**

The Benefits of Being Kind

Donna Cameron knew she was a nice person – polite, respectful and friendly. But, she wondered, was she kind? Did she venture beyond routine pleasantries? What about going out of her way for others, even if it required only a smidgen of effort? Cameron decided that she could extend herself more fully, and she recounts how she did it and what she learned in her new book, *A Year of Living Kindly: Choices That Will Change Your Life and the World Around You*.

Below, Cameron delves into the science of kindness, including the emotional and professional rewards that can accrue to those who are good-hearted and benevolent. She also offers a few suggestions for anyone seeking to put these principles into practice.

What prompted you to undertake this goal?

I've always really admired kind people – just the way you feel in their presence – and I wanted to be kind. I think I've always been a nice person, but I don't think I went the extra mile. I would set an intention to be kind and go out of my way for a short time. But then my life, my job and my stresses would get in the way, and I would let it fall by the wayside.

You make a distinction between niceness and kindness.

For some people, the difference is probably just semantic. They may view niceness and kindness as interchangeable. But I see a really large difference. I was raised in a family where I was continually told to be nice but never told to be kind. Nice is safe. It doesn't ask me to take any risk or really put myself out there. I can be nice to someone and still make judgments about them or be impatient. Kindness asks a lot more of me – to suspend judgment and accept people as they are. It's wanting to connect, help and serve.

Are there examples of kindness in action?

It could be offering to carry somebody's packages. Or allowing a car to merge in traffic. Or noticing when someone needs some attention even though you're in a hurry. I think time is a big factor. We're all overscheduled and overwhelmed, so we say to ourselves, "I know the kind thing to do would be to stop and help here, but I don't have time." An opportunity to go a little further happened to my husband and me last week at our bank. We pulled up and there was a car with the hood up, and the fellow's battery was dead. My husband went over and gave him a jump while I went into the bank.

You talk in the book about kindness being contagious.

Kind things can appear to not make that much difference. Nobody will notice if we don't do it. Nobody's going to notice if we don't allow a car to merge in traffic. But if we do it, it's going

to make a difference to that driver, and he might allow the next car to merge, and that can be contagious. Studies show that both kindness and unkindness are contagious. If we experience rudeness, whether it's direct or if we just see people behaving rudely, it causes us to behave more rudely. But the good news from science is that kindness is equally contagious. Whether we extend a kindness, receive a kindness or even merely witness one, that causes us to be more kind in our future encounters. We have a choice as to which contagion we want to spread.

Explain the importance of giving the benefit of the doubt to others.

We don't know what motivates somebody else in a given situation. Something in their life may have stressed them to the max, and they're behaving in ways they wouldn't ordinarily. If we ourselves behave rudely, we want others to give us a pass and understand that we're just having a bad day. We give ourselves a pass for these behaviors, so why can't we give other people a pass?

You make the case that accepting a compliment is an act of kindness, which seems counterintuitive.

A lot of us are really good at giving but not at receiving. That goes for gifts, compliments, a seat on the bus, whatever it might be. Maybe we don't feel we deserve a compliment or it makes us feel a little awkward. Someone gives us a compliment, and we deflect it. They say, "That's really a nice suit you're wearing," and we say, "Don't you see that I'm missing a button?" We point out a flaw, which tells the complimenter that he or she was wrong. It takes away from them the pleasure of giving a compliment.

Is there a risk that kindness will lead to being exploited or taken advantage of, even in small ways? Or that being kind makes someone come across as bland or dull?

The biggest misconception about kindness is that it's a sign of weakness. The truth is that kind people are the strongest among us because they're willing to take a risk, face the unknown and do something that other people aren't going to do. Part of the problem is that kindness generally isn't loud and overbearing. It's sort of a softer strength. But being kind doesn't mean you're a pushover, and it certainly doesn't mean you accept people's abuse. It's just the opposite. It's standing up for someone who maybe is being bullied or treated unfairly.

What are the benefits of kindness in the workplace?

There's so much research showing that in business kindness really is a competitive advantage. Kind businesses are more successful, more profitable and more productive. They have happier and healthier employees. There's been a lot of research showing that employees of companies with kind cultures perform at about a 20% higher level. One of the staggering statistics for me was that they're 87% less likely to leave their jobs. Turnover is a huge problem, and replacing employees is time-consuming and expensive.

You write that kindness has a profound effect on health.

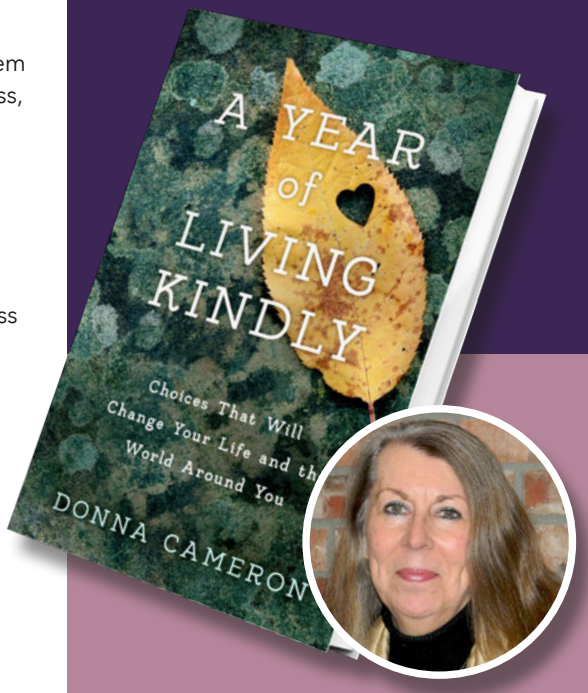
That was a surprise for me. In recent years, there have been a number of studies about the measurable effects of kindness, and there are a number of them on health. When we experience kindness, our body produces the hormone oxytocin, which lowers blood pressure, and it reduces inflammation. It fights heart disease. It slows aging. Kindness has also been shown to reduce chronic pain, increase happiness and reduce stress. Another study found that kindness helps alleviate social anxiety in people who are shy, even debilitatingly shy.

You recommend that people take a deep breath and pause in trying situations. Please explain.

A pause really lets us decide who we want to be in this moment and the next moment. It gives us the gift of grace. It's a huge skill, and not all that easy. All of these skills – withholding judgment, paying attention or pausing – sound simple. But they're not necessarily easy, and they really take some practice. They can become our default settings, but they're not something you can just turn on and off. They all take practice.

Kindness Tips

- Resolve to be 5% kinder and build from there
- Prioritize being kind over being right
- Receive compliments graciously
- Give others the benefit of the doubt
- Model kindness instead of lecturing about it
- Pause to compose yourself in tense moments



DONNA CAMERON is the author of *A Year of Living Kindly*. She has spent her career working with nonprofit organizations and causes as an executive, consultant, trainer and volunteer.

Artificial intelligence can gauge a customer's tone of voice.

Beyond recognizing spoken words, artificial-intelligence systems are increasingly able to detect emotional sentiment on automated phone calls. Newer systems can interpret vocal inflections to sense, for example, if a customer is confused or frustrated when activating a new credit card or cellphone. Among other benefits, these systems eventually will allow companies to do away with end-of-call surveys, which can annoy customers.

Young consumers should boost the industrial sector.

A rise in the number of Americans between 35 and 44 years old should help the industrial sector, which encompasses a broad grouping of companies that make everything from factory automation equipment to home security systems. After a nearly two-decade decline, the number of people aged 35 to 44 is projected to rise from 40 million today to 50 million in the next 10 years. This age group has historically been known for major purchases such as homes, cars and related products.

Ride-sharing is growing around the U.S.

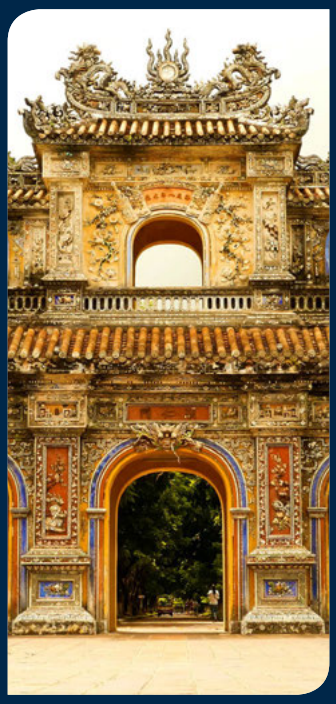
The U.S. ride-sharing industry is expected to expand by 20% or more in each of the next three years, as the potential market for these services is enormous. That should translate to strong revenue growth for ride-sharing companies. However, the long-term profitability of major providers remains a question mark as they confront ongoing challenges, such as insurance costs, driver retention and the unproven nature of the business model itself.

Labor pressures favor well-run restaurant chains.

Full-service restaurants are experiencing solid sales growth, but the strong labor market is making it difficult to hire and retain high-quality employees. That's creating wage pressures that could weigh on profit margins this year. Over the long run, this dynamic could provide a boost for well-run chains with the resources to spend on technology and store upgrades. Restaurants that make such investments can improve customer satisfaction and gain market share over time.

Vietnam offers compelling opportunities.

Though smaller and less economically developed than some of its Southeast Asian neighbors, Vietnam is being driven by a youthful and optimistic population. More than half of its citizens are under the age of 35, with broad technological proficiency, an affinity for consumer spending and low household debt. Of course, the developing nature of the country and its corporate culture require extensive due diligence of promising companies, such as banks and retail stores.



The skyline of Shanghai peers over the city's vast shopping district. See the story on page 8 for a look into how growing wealth creation in China is benefiting luxury-goods companies.

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