Private Wealth *perspectives*

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INVESTMENT MANAGEMENT • FINANCIAL AND ESTATE PLANNING • PRIVATE BANKING • FIDUCIARY ADMINISTRATION • RETIREMENT PLAN SERVICES

Friends

If your worldview were solely informed by the picture painted in the popular media, your faith in the civility of humankind would surely be waning. However, if your day-to-day experiences mirror mine, you know that people on the ground of daily life still find a way to see through their differences and find common ground. In a similar vein, every day I witness our team of professionals challenge each other, disagree and push each other out of their comfort zones in order to create the best solutions to guide our clients in their pursuit. That tension is the spirit of the comprehensive and coordinated approach we deliver for our clients.

In this edition of **Private Wealth Perspectives** you will learn of the impact of Artificial Intelligence on the economy and your portfolio, the limitations of trust versus fiduciary responsibility, and the value of an early and regular start to retirement savings. It's summer in this greatest of nations, please enjoy time with friends and family and thank you for the trust you have placed in our team.

Michael Joyce

President, Private Wealth Advisors

INVESTMENT MANAGEMENT

After Federal Reserve Chairman Powell's Christmas Eve faux pas in 2018, the language and tone of the Fed, regarding the prospects of rising short term interest rates, has become decidedly more-friendly to both stock and bond markets. As a result the Standard and Poor's 500 increased by 13.62% in the first quarter, and added another 4.29% in the second. Bond yields declined significantly; the 2-year US Treasury yield dropped from 2.49% to 1.76%, and the 10-year from 2.68% to 2.01%. Because the value of a bond changes inversely with interest rates, virtually all bond portfolios now have a gain rather than a loss. The Bloomberg Barclays Aggregate Bond Index, consisting primarily of U.S. Treasury and Agency debt, and corporate and mortgage bonds, returned 6.11% for the first six months of this year.

On July 31 the Federal Reserve reduced the Federal Funds rate by 0.25%, to 2.25%. There are different ways to view this. While some real-time indicators such as freight and packaging rates have declined, some industrial production measures continue to show declines in activity, and the economies of other countries continue to weaken, we note that the consumer in the U.S., responsible for approximately 70% of Gross Domestic Product (GDP), remains in a very healthy state overall. A very low unemployment rate, rising wages in excess of the rate of inflation, the continuation of the demand for labor outstripping its supply, and consumer confidence indexes near all-time highs should continue to provide economic momentum the rest of this year. Gross Domestic Product for Q2 was reported at 2.0%, down from the 3.1% rate in Q1 but still a reasonable, non-inflationary rate of growth, probably consistent with our capacity to grow.

Given the strength of the U.S. consumer and the domestic stock market near all-time highs, some market participants have questioned the Federal Reserve's impetus to cut rates. It wouldn't do for the Federal Reserve to be seen as a pawn of the stock market by implying a rate cut because the stock market would likely throw another tantrum (Christmas Eve was not a fun day). Nor would it do to be viewed as bowing to the Administration, which insists on lower rates because they believe the economy could be doing even better. And it might be, in my 33 years in this business, the first time the Fed made a pre-emptive reduction in rates when the economy appeared to be performing well. There is one thing to consider: The party that negotiates with the stronger hand will typically achieve more of what they want. In the middle of tense trade negotiations with China it would be problematic to have a weakening economy as a backdrop.

We've written before a fairly accurate estimation of the non-inflationary rate of GDP growth can be calculated by adding the percentage increase of people entering the work force with the percentage increase of productivity. The global demographic of aging will continue to take an increasing toll on one side of that equation, lowering the potential to grow. In the U.S., the 70-79 age group is expected to grow by 38.4% over the next decade; those 80 and over by 46.7%. In China, those figures stand at 62.3% and 40.4% respectively, and globally they are 45.0% and 38.6%. This is, and will continue to be a serious challenge to future generations, as the chance to enjoy the same standard of living as prior generations will likely be harder to achieve (if you get a chance, I urge you to re-read Stuck in 2nd Gear, penned by our colleague Travis McEowen. In it Travis makes several points regarding future growth that we continue, as a group, to take into consideration).

Regarding the productivity side of the equation, we were asked to provide and narrate a topical discussion of Artificial Intelligence (AI) for a foundation client. We've had the chance to read quite a bit relating to the subject, and saw it as an opportunity to see if and how our client's portfolios might also benefit. In short, we found that though demographic trends will pose a major challenge to our future economic expansion, advances in AI may be the key to maintaining future growth.

AI has its roots in mathematics, philosophy, and computer science (at

some point, ethics will also have to be a goal, if not already). The aim is twofold; one, to provide the means to do increasingly complex, but repetitive tasks very quickly and, two, to be able to process existing information and new information (for instance, changing the direction of a thought process with regards to incoming information or stimulus) much like a human needs to do while driving on an expressway. The former can be described by a chess match between a human chess master and a computer; having predetermined rules and being within the confines of chess pieces that can only move in certain ways, raw blazing computer chip speed can make millions of computations a second, while a human, well, is human. This isn't thought or imagination on the part of the computer, rather overwhelming computational capacity amidst predetermined rules. Game over.

The latter is the topic that's come to the fore and gains a lot of attention. More specifically, can a computer process information (learned and stored, from the past, and newly considered, as the future unfolds) like a human, by having the ability to change direction with regards to new information, and also to learn and teach itself by both disappointments and successes. The idea of an autonomous automobile is a hot topic, and perhaps the best illustration. With slight variance from state-to-state, the rules of the road are defined and can be coded, stored, and digitally accessed virtually simultaneous with the need to do so. The problem is that simply driving to work on any given day has its trials and tribulations, which are random, and can be instantaneous and potentially deadly. Random might, or can be handled by computer capacity and speed; surviving random, instantaneous, and potentially deadly situations depends on everything going right, as in optical/radar recognition, the ability to translate that recognition into a format that queries a database for like situations, resurfaces with a response, which is then translated into a mechanical response like slamming on the brakes. At the moment, autonomous test vehicles have difficulty distinguishing between a human walking in front of the car and an evening newspaper inadvertently blowing in the wind.

To the point, many years ago a picture of the inside of a General Motors assembly plant was on the cover of Barron's magazine. It reflected an enormous room full of yellow robotic welders. My first thought was of the efficiencies gained; they didn't call in sick, they couldn't demand raises or go on strike. But the second thought was also quite clear, that not one of those would ever buy a car. Efficiencies gained and a future sale lost. That hasn't proved to be true, and it is a part of why we believe the pursuit of AI and its potentialities must continue, with all due speed.

If the part of the GDP equation that relates to human effort as a contributing factor to GDP growth has a dim future, and if future generations wish to enjoy the standard of life their parents and grandparents enjoyed, productivity has to improve. Autonomous cars are but one example. Incredibly fast computer chips, parallel processing, access to large and growing databases, cloud storage which provides and improves access to those databases, advances in algorithms, and an increasing ability to couple algorithms and databases such that they become self-teaching feedback loops can be used in many applications. Such advancements would not necessarily supplant humans, but serve to increase their productivity. As robotic welding machines did not displace all automotive workers, we doubt an economic future aided by AI productivity will result in massive human displacement.

We've enjoyed an incredibly solid year thus far from an investment point-of-view, and see no immediate reason why we won't be writing the same at the end of the year. However, we continue to have almost-grave concerns over the European financial system, which could become a global systemic issue. And the European Central Bank has left them almost bereft of any meaningful response should an issue surface, unless ignoring the problem qualifies as something positive. We will continue to closely monitor this and take active measures if we feel it necessary. As always, we would communicate our actions directly.

Thank you for being a client. We appreciate your confidence in us and the opportunity to be of service and grow our relationship. Best regards…

Jamie D, Wright, CFA

Portfolio Manager, Research Director

RETIREMENT PLAN

How to get employees to save for their own retirement?

Ever heard of the saying, “You can lead a horse to water, but you can’t make them drink”? That’s what comes to mind when Employers go to the trouble and expense to put a 401(k) Plan in place for their employees and then get little or very low participation in the plan.

Employers will then typically put a matching contribution in place to further try and incent employees to save for their futures. A matching contribution will be deposited into the employee’s account that contributes to their own account first. This strategy to get employees to think about their future has been successful, but we still have a long way to go to get all employees heading to a secure financial future.

Another strategy employers can use to encourage their employees to save for their future is instituting an Automatic Enrollment feature into the plan. How does this encourage employees to participate in their retirement plans, you ask? It works on an “opt-out” instead of an “opt-in” behavior. A study by Money.com has shown employees with an auto-enrollment feature in their plan are 32% more likely to participate in their retirement plan than employees that didn’t have an auto-enrollment. If an employee has to go fill a form out to join a plan, and they think that is too much trouble or they just forget about getting it done, the same will hold true for “opting out” of a plan. Before you know it, your employees are on their way to helping themselves save for retirement.

Increasing employee participation continues to be the primary focus area for employers, with 64% (an increase from 60% in 2015) indicating this was the most important measure of an effective plan.”

If you haven’t considered changing your plan to include an auto-enrollment feature, feel free to speak with one of our Retirement Plan Advisors to increase the success of your company’s plan. Please contact us at 866-238-0082.

Jane Smith

Director, Retirement Plan Services

PERSONAL TRUST

Trust

I was at an after-hours gathering with several co-workers recently and a discussion about particularly trustworthy people we knew came up. One of our group made an observation about the difference between those who he would trust with his car and those who he would trust with his children. Basically there are some times where any responsible person will do and other times where a much higher degree of trust and confidence is required.

At First Merchants Private Wealth Advisors one of our jobs is to serve as the Trustee, Executor or Guardian for the benefit of our clients and their families. As a fiduciary, we are held to the highest legal standards and we always do everything in our power to meet or exceed this responsibility. We understand that we are responsible for more than just your car, but also for the financial well-being of your children and family.

Choosing a professional fiduciary for your will, trust or other estate planning needs is a serious decision. It is often a balance between making sure that your choice has all of the legal, tax and other skills and resources necessary to do the job, as well as someone who can get to know you and your family personally and to be able to be flexible and adaptive in their approach rather than bound by one size fits all rules. Sometimes the best solution is a combination of a trusted family member for personal issues and a professional fiduciary like First Merchants to work as a team to see that your family is supported and protected if you are not there to do so.

First Merchants has been servings as a professional fiduciary for 126 years and our mission is to partner with individuals, families and organizations to provide comprehensive solutions and personal service in their pursuit of a secure financial future. Please feel free to contact myself or one of our Wealth Advisors if you would like to learn more about how we can help protect those you love.

David Forbes

Director, Trust Administration

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