USI Advisors, Inc.

MARKET & LEGAL UPDATE

JUNE 2019 REVIEW

CORPORATE OFFICE:

95 Glastonbury Blvd.
Suite 102
Glastonbury, CT 06033
860.652.3239

USI Consulting Group is an affiliate company of both USI Advisors, Inc. and
USI Securities, Inc.

USI CONSULTING GROUP OFFICES:

350 Fifth Avenue
Suite 3700
New York, NY 10118

900 South Gay Street
Knoxville, TN 37902

312 Elm Street 24th Floor
Cincinnati, OH 45202

50 Cabot Street
Needham, MA 02492

2400 East Commercial Blvd
Suite 600
Fort Lauderdale, FL 33308

5200 N. Palm Ave
Fresno, CA 93704

5990 Greenwood Plaza Blvd, Bldg #2, Suite 250, Greenwood Village, CO 80111

2711 N. Haskell Ave
Suite 2000
Dallas, TX 75204

601 Union Street, Suite 1000, Seattle, WA 98101

222 S. Riverside Plaza, Suite 630, Chicago, IL 60606

8049 Corporate Center Drive, Charlotte, NC 28226

725 RXR Plaza
East Tower
Uniondale, NY 11556

USI Advisors, Inc.
www.usiadvisorsinc.com

"Markets Boom for First Half, but Risks Loom"

Thanks to some progress on the trade impasse between the U.S. and China and a more accommodating Fed shifting policy to possible rate decreases in the second half of 2019, the S&P 500 rebounded in June and had its best first half to start the year since 1997. The previous month's 6% decline was due to escalating trade tensions between the U.S. and China, as well as tensions between the U.S. and Mexico. These escalating trade tensions put downward pressure on already slowing global growth, which in turn, resulted in steep declines in U.S. bond yields during the quarter.

Global equity prices advanced between 6-7% in June with the anticipation of the U.S. and China making progress on the trade impasse. At the end of June, the Group of 20 Summit in Japan provided an opportunity for President Donald Trump and President Xi Jinping to meet and renew the talks that stalled in May. Following the meeting, Washington agreed to hold-off on tariffs on $300 billion of Chinese goods and remove some of the trade restrictions on Huawei Technologies, a Chinese telecommunications behemoth. Beijing in return would buy more American farm products, which is much needed by the industry. The U.S. farming industry has been hit hard, not only by trade tariffs, but record wet weather in 2019, which severely hampered the crop season. In addition, the U.S. was satisfied with the steps Mexico was taking to curb Central American migration across its borders. The U.S. threatened in May to impose escalating tariffs on all $360 billion of imported goods if Mexico did not address the issue.

Significant hurdles remain in completing a trade deal between the U.S and China. The U.S. Commerce Department imposed restrictions on Huawei in May and considers it a national security threat sponsored by Beijing. Cybersecurity and intellectual property theft are key U.S. issues in making a trade deal with China and U.S. Bi-partisan parties do not want Huawei to be a bargaining chip on making a deal. However, the restrictions on Huawei could cost more than $30 billion in lost revenue according to its founder, Ren Zhengfei and the ban adversely impacts the global supply chain. U.S. technology sales to the Chinese mammoth topped $11 billion last year and Taiwanese chip manufacturers and Japanese electronics heavily rely on Huawei for business.

The trade rhetoric influenced the Fed in delaying a possible cut at its June meeting until after the G-20 Summit. However, with trade uncertainty still lingering, Fed Funds futures point to a nearly certain 0.25% reduction after the July 30-31 meeting. The Fed is under pressure to reduce rates with longer-term Treasuries, such as the 10-year at 2%, below the Fed Funds rate set between 2.25% to 2.5%. Otherwise known as an inverted yield curve, the bond markets have been signaling that with slowing global growth, a rate cut is necessary to mitigate a recession. The 10-year Treasury Yield declined by 0.5% during the quarter and fell by more than 1% since the fourth quarter, its largest decline since 2011.

	June 2019	YTD 2019
Dow Jones Industrial Average	7.3%	15.4%
S&P 500	7.1%	18.5%
NASDAQ (price change)	7.4%	20.7%
MSCI Europe Asia Far East (EAFE)	5.9%	14.0%
MSCI Emerging Markets	6.2%	10.6%
Bloomberg Barclays High Yield	2.3%	9.9%
Bloomberg Barclays Aggregate	1.3%	6.1%
	June 28 2019	May 31 2019
U.S. 10-Year Treasury Yield	2.00%	2.14%

While U.S. GDP growth was strong for the first quarter, it is expected to decline to 1.5% during the second quarter. In addition, according to Fact Set, companies set to report Q2 earnings are expecting an overall earnings decline of 2.6%. It would be the first time since the beginning of 2016 with two consecutive quarters of earnings declining. Equity prices are also getting more expensive, with the current price-earnings ratio of the S&P 500 slightly above its five-year average, but a few percentage points above its ten-year average. Overseas, ECB President Mario Draghi signaled that the central bank could provide stimulus as early as July to jump start the economy. Finally, geopolitical friction between the U.S. and Iran, as well as between Hong Kong and China, are being closely monitored as key market risks.

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LEGAL UPDATE | SEC Issues Regulatory Package and Interpretative Guidance

On June 5, 2019 the Securities and Exchange Commission (SEC) issued a regulatory package referred to as Regulation BI Best Interest, together with some interpretative guidance. The new regulations have a compliance effective date of June 30, 2020 and the interpretative guidance is effective as of the date of publication in the Federal Register.

Regulation BI Best *Interest:* Under the new regulations, the SEC imposes a new standard of conduct on broker-dealers and investment advisers who provide personalized advice and recommend securities or investment strategies to "retail customers." The Best interest standard of conduct requires broker-dealers and investment advisers to act in the best interest of the "retail customer," where they may not put their financial interests ahead of the interests of "retail customers."

The definition of "retail customer" applies to any natural person who receives a recommendation for the natural person's account, including the account of an individual plan participant. **The definition does not extend to cover employer-sponsored retirement plans and the fiduciaries of such plans.** The determination of a "recommendation" is subject to a facts and circumstances analysis, but does include recommendations to roll over or transfer assets in an employer-sponsored plan to an IRA and taking a retirement plan distribution for the purposes of opening a securities account.

Form CRS *Customer Relationship Summary:* In accordance with the new rules, broker-dealers and investment advisers must deliver a summary to retail customers at the beginning of their relationship and provide updates as appropriate. The summary will address service, fees and costs, conflicts of interests, legal standards of conduct, and any disciplinary history.

Interpretative Guidance on Adviser's Fiduciary Duty: In addition to the two aforementioned regulations, the SEC also issued its interpretation of the fiduciary standard of conduct that is applicable to all investment advisers under the Adviser's Act. Through this interpretative guidance, the SEC reaffirms, and some cases clarifies, the federal fiduciary duty an investment adviser owes to its clients. Generally, the fiduciary duties include 1) full disclosure to clients of material facts relating to the advisory relationship, and 2) avoidance of conflicts of interests with clients, and at a minimum, full disclosure of any material conflicts that could affect the advisory relationship.

Regulation Best Interest may face legal challenges just as the Department of Labor's (DOL) Fiduciary Rule did. The DOL is expected to issue a new proposed fiduciary rule by the end of the year. Any new fiduciary rules issued by the DOL will be applicable to investment advisers who provide advice to plan sponsors of ERISA retirement plans.

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An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

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