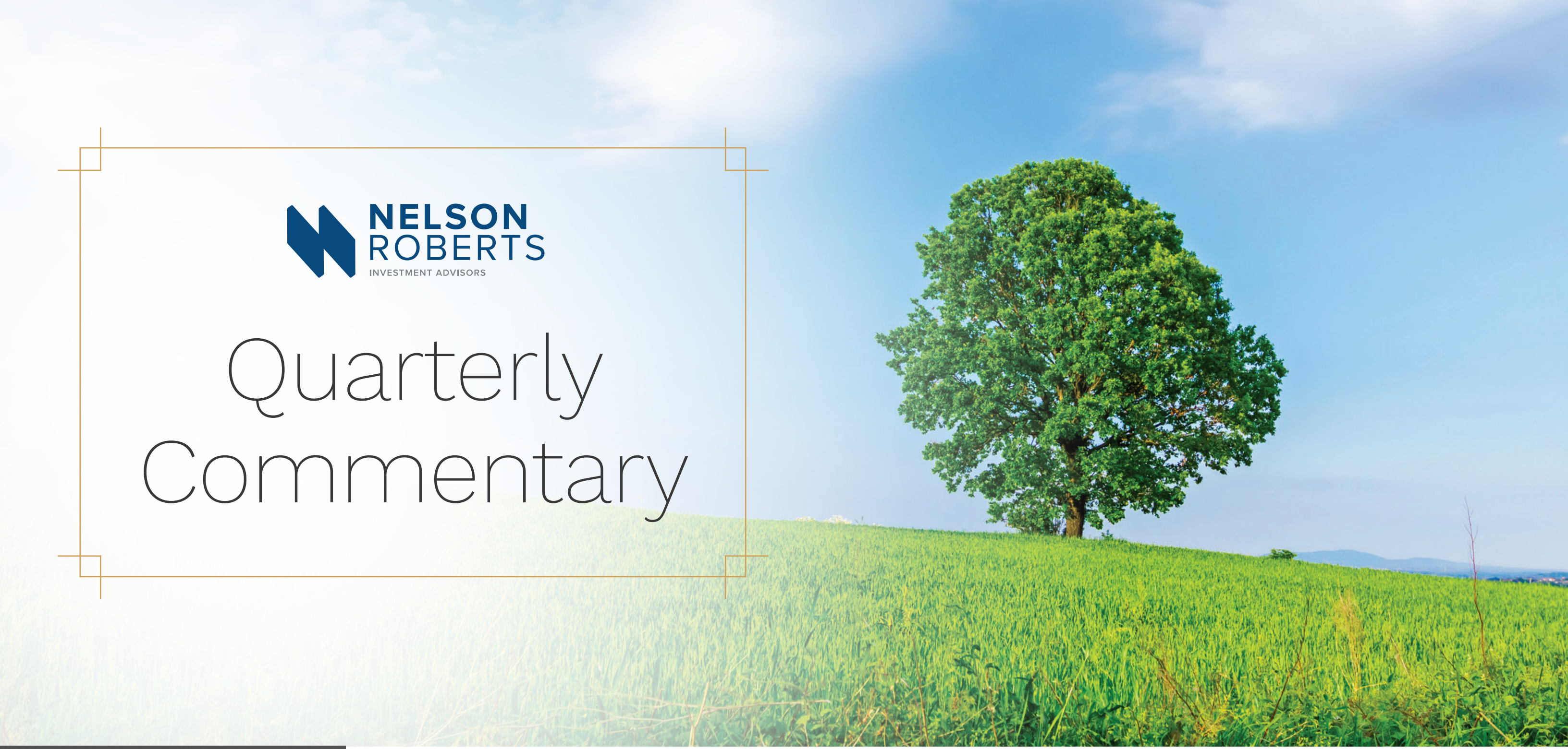


NELSON ROBERTS
INVESTMENT ADVISORS

Quarterly Commentary

2019 | Q2

IN THIS ISSUE:

ECONOMIC OVERVIEW

Expansion Outlook Extends

The generally positive market trends that began in January of this year continued into the second quarter. The S&P 500 reached a new high of 2,945 on April 30th, surpassing last September's record. In May, equities took a turn lower as President Trump ramped up trade threats against both China and Mexico. The tariffs threatened against Mexico were immigration-related, an unusual tactic that some Republican lawmakers did not support. One of our clients astutely pointed out that Trump "uses tariffs the way Teddy Roosevelt used battleships." In any case, the U.S. and Mexico eventually reached a deal on immigration and the threat of tariffs on Mexican goods was removed—for now—allowing the S&P to recover from the downturn, reaching yet another all-time high and finishing the quarter at 2,942.

The last three labor reports revealed overall healthy job growth, allaying any concerns about a slowdown in the job market after February's disappointing 20,000 nonfarm payrolls number. However, the reports also showed signs of plateauing wage growth, with average hourly earnings growth decelerating to 3.1% from 3.4% at the beginning of the year. Inflation data has also indicated softness, both in the Consumer Price Index (CPI) data and in the Personal Consumption Expenditure (PCE) data, the latter being the measure the Federal Reserve watches more closely.

The upward inflationary pressure of a tight labor market seems to be losing the battle against downward inflation pressures. Low inflation abroad, depressed commodity prices, concerns about an overall slowdown in China and ongoing trade jitters continue to keep a lid on U.S. inflation. Even real estate prices have leveled off and we are seeing signs of depressed shipping prices. This anemic inflation, along with more recent trade disruptions, has turned discussion of a Federal Reserve "pause" in its rate hike program earlier this year into an outright expectation of interest rate cuts in 2019. Although the Fed resisted pressure to cut rates at its June meeting, several policymakers expressed that they are open to cutting rates in the coming months.

Index Performance	Q2 '19	YTD
Dow Jones Industrials	3.21%	15.40%
Standard & Poor's 500	4.30%	18.54%
EAFE (international stocks)	3.93%	14.53%
Russell 2000 (small stocks)	2.09%	16.97%
Barclays Interm. Gov/Credit	2.59%	4.97%
Barclays Municipal	2.14%	5.09%

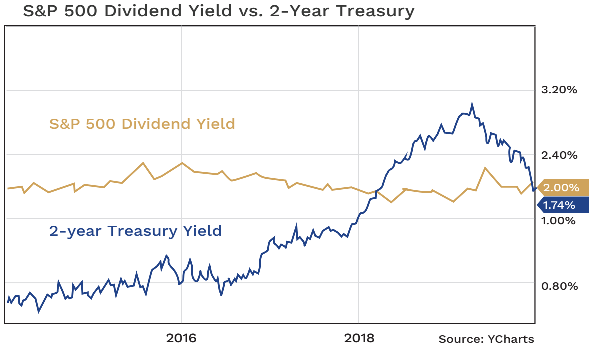
We apply rigorous analysis in asset selection so you can focus on your passion

ECONOMIC OVERVIEW

Expansion Outlook Extends (cont.)

This dramatic shift in the Fed's stance has helped drive the equity markets back up to summer 2018 levels. Despite the fact that the S&P 500 is up 18% this year, stocks are not overvalued. At a price-to-earnings (P/E) ratio of about 16.5 times forward earnings, the S&P 500 is right in line with its 25-year average valuation. 2019 has seen an impressive lineup of companies launch their initial public offerings (IPOs), with mixed overall

S&P 500 Dividend Yield vs. 2-Year Treasury



results thus far. Many of these IPOs are former "unicorns," or companies that carried valuations higher than $1 billion in the private market. Pinterest (tkr: PINS) and Zoom (tkr: ZM) have taken off since their public debuts while rideshare companies Uber (tkr: UBER) and Lyft (tkr: LYFT) have struggled to surpass their IPO prices.

It feels like there is a general apathy toward stocks, which likely suggests that we will not see much in the way of a price-to-earnings multiple expansion this year. The margin boost from the tax cut last year has played out, and most companies expect a pause in earnings growth in 2019. For these reasons, we think returns on stocks will be driven by dividends and buybacks, and we continue to look to invest in companies that are focused on returning value to shareholders this way.

Meanwhile, alongside the Fed's pivot toward rate cuts, the 10-year Treasury yield has fallen precipitously, from over 3% last fall to 2.00%. In fact, the entire yield curve dropped, and the 2-year Treasury no longer offers a yield that is higher than the S&P's dividend yield, as it had for the past year.

The current economic expansion has now officially become the longest on record. Nevertheless, we see no signs of imminent collapse, despite near-term market volatility over trade tensions. The two primary indicators we are monitoring do not point to a recession any time soon: year-over-year U.S. job growth is still well over 1% and the spread between the 2- and 10-year Treasury yields is still positive, and in fact has widened in recent weeks to about 0.30% from about 0.14% at the end of May. We have a long way to go until the 2020 election, and the inevitable food fight among Democratic candidates will no doubt provide plenty of sensational soundbites in the meantime, but this should only result in near-term headline risk until a candidate is chosen next year. We remain fully invested and focused on our pivot toward more defensive, value-oriented stocks that offer dividend income as opposed to growth companies that are more dependent on capital gains.

ASSET TRANSACTIONS

Adding Value Exposure

The choppy market in the second quarter allowed us to continue repositioning our equity portfolio. We trimmed our position in Roper Technologies (tkr: ROP) following an impressive run in the stock. We originally purchased a position in Roper in early 2016. The company employs an acquisition strategy, buying companies that have established a majority market share in a niche market. They have strict cash flow requirements for their targets, and the business model has proven very successful. In recent years, the company changed its name from "Roper Industries" to "Roper Technologies," as the company began to focus more on software-as-a-service (SaaS) companies that are technology-oriented. The focus on software companies and their recurring revenue model has paid off, boosting both organic growth and margins. However, it has also increased Roper's valuation and its volatility. We took the significant increase in the stock price as an opportunity to trim the position, though we maintain an overweight relative to the S&P 500.

In the healthcare sector, we sold our position in Allergan (tkr: AGN) in mid-April. The company faces several challenges, including the loss of patent exclusivity for Restasis, one of its key drugs, as well as increasing competition in the aesthetics space, particularly for its signature product, Botox. Allergan subsequently dropped to a low of $115 before it was announced on June 25th that Abbvie (tkr: ABBV) had agreed to acquire the company, sending Allergan shares to around $165. We redeployed the proceeds to buy a position in the large pharmaceutical company, Pfizer (tkr: PFE, see Featured Equity). Pfizer is an inexpensive value stock with a low price-to-earnings (P/E) ratio and a high dividend yield.

In the technology sector, we trimmed our position in Salesforce.com (tkr: CRM) and added to our position in Microsoft (tkr: MSFT). Salesforce, the leading cloud company, has maintained substantial growth through its expansion into ancillary services beyond its signature "Sales Cloud." However, its valuation had become stretched and we see increasing signs of competition in these services from the larger cloud providers. Salesforce has been making large acquisitions to maintain its growth, often paying top-dollar for its target companies. Although Salesforce has demonstrated success with large acquisitions in the past, we trimmed our position to reduce some of that risk. Microsoft is a less volatile stock with a lower P/E ratio and higher dividend yield that also has been executing well in the cloud market. Our target Microsoft position is now roughly in line with the S&P 500.

We purchased a small position in the Vanguard Utilities ETF (tkr: VPU). With the Federal Reserve's about-face and the rapid decline in interest rates, utilities becomes a more attractive sector. Nevertheless, we still see secular challenges for utilities companies as the trend toward energy-efficiency continues, so we purchased an underweight position relative to the S&P 500. The Vanguard Utilities ETF compares favorably to other comparable options from a risk/reward standpoint.

In the REIT sector, we purchased a position in Digital Realty Trust (tkr: DLR). Digital Realty Trust is the 8th-largest REIT in the S&P, with a focus on datacenters. In recent years, the company has focused on fast-growing ancillary services such as colocation and connection, an area that arguably has significant runway. Peer Equinix (tkr: EQIX) also focuses on the datacenter space, which we believe is attractive given the increase of data creation, but Digital Realty Trust has a lower valuation and higher dividend yield.

These changes are consistent with our goal of increasing the cash flow generated from dividends while reducing overall portfolio volatility.

> "The current economic expansion has now officially become the longest on record. Nevertheless, we see no signs of imminent collapse, despite near-term market volatility over trade tensions."

FIRM UPDATES

Nelson Roberts Investment Advisors recently marked its 15th anniversary. We are proud to have been able to serve our clients for all these years, and we look forward to decades more. Additionally, Nelson Roberts would like to congratulate Darcy Smoot and Evan Nelson, who recently became members of the firm.

WEALTH MANAGEMENT

Issues with Life Insurance

The low interest rate environment of the past decade has led to disappointing performance for certain types of life insurance policies.

Term insurance is typically the first type of insurance that most people take out, and it is generally used to insure against future loss of wages. There are two generic forms of term insurance: annually renewable term and level term. Renewable term begins with a very low annual cost that rises each year. Younger people often choose this option to save on the expense of insurance. The low cost makes it affordable when they are starting their careers and budgets are tight. Level term policies have a fixed annual premium for a set period of time, typically 10 or 20 years. Beyond age 50, premiums for both types of term insurance get increasingly expensive. After age 65, term insurance is usually more expensive than whole life. A substantial number of term life insurance policies, by some estimates as many as 99% of them, expire or are cancelled before death.

Whole life policies, also known as “permanent insurance,” are bought with the intent of keeping the policy in force until one dies. Premiums are substantially higher than term insurance premiums. Insurance companies set the premiums based on the number of years they expect the insured to live and the rate of return that the insurance company expects to earn over this period of time.

A universal life policy can be thought of as a combination of term and whole life. These have been used by irrevocable life insurance trusts (ILITs), most often by couples who buy “second-to-die” policies that that will pay out on the passing of the survivor. They typically “mature” between ages 85 and 121.

The problem with both universal and whole life policies is that the rate of return that the insurance companies have been earning is below the average return assumption that was imbedded in the policy illustrations before the 2008-2009 financial crisis. Life insurance companies typically have a very high allocation to fixed income or bonds. For example, Northwestern Mutual had 65% of their total assets in bonds as of 12/31/17.

Before 2008, bond returns historically averaged between 5.5% and 6.5%. This return assumption was part of the calculation used to produce a typical life insurance policy illustration. Since 2009, fixed income returns have averaged about half of this amount. As a consequence, the dividends that policies produce have been well below the pre-2008 projections. This has meant that policy owners have had to continue paying into their policies long after the original illustrations showed that they would be self-sustaining.

TOP 15 HOLDINGS

iSHARES S&P SMALL-CAP ETF
VANGUARD DEVELOPED MARKET ETF
AMAZON.COM INC.
ALPHABET INC.
COSTCO WHOLESALE CORP.
MICROSOFT CORP.
ILLUMINA INC.
CISCO SYSTEMS INC.
TJX COMPANIES INC.
VERIZON COMMUNICATIONS INC.
VANGUARD EMERGING MARKETS ETF
MEDTRONIC
UNITEDHEALTH GROUP INC.
LINDE
TRAVELERS COS INC.

FEATURED EQUITY

Pfizer

Pfizer (tkr: PFE) is one of the "big ten" pharmaceutical companies. It employs more than 92,400 people, operates in 125 countries and manufactures its products in 58 different facilities. Its revenues in 2018 were $53.6 billion while absorbing a $1.7 billion "loss" due to certain products no longer being patent-protected. Management believes that in-house research and development is an important differentiator, and therefore the company invested $8 billion into new medication development in 2018. An astonishing 785 million people around the world take a medication made and sold by Pfizer. International sales constitute 53% of revenues, with Japan and China being the largest markets outside the U.S. Pfizer also has a strong presence in emerging markets, where 20% of company revenues are generated.

All of the major pharmaceutical companies are subject to similar headline risk, which can range from excellent (or disappointing) clinical trial results for a new drug to political wrangling over drug prices. However, all of these companies continue to generate substantial revenues by making products that save or prolong lives. As we considered which of the "Big Pharma" stocks to add to our portfolios, we believed that the following key points made Pfizer stand out:

1. The stock was somewhat undervalued, pays one of the strongest dividends of the cohort and has successfully maintained that dividend through economic cycles
2. Pfizer has been able to grow revenues while absorbing revenue declines due to drugs coming off patent
3 The company's pipeline appears to be in good shape, with the potential to launch 3-5 new drugs or product line extensions per year over the next five years
4. Once Pfizer is through the patent loss of Lyrica (pregabalin), which occurs this year, there will be a significant decrease in patent losses over the next five years
5. Pfizer is leveraging its manufacturing expertise to make a strong push into biosimilars, with as many as five coming online in the next several years

Pfizer is focusing its efforts on six key therapeutic areas: internal medicine, vaccines, oncology, inflammation/immunology, rare disease and consumer healthcare. The company was recently re-organized into three divisions, Pfizer Biopharma, Upjohn and Consumer Healthcare. Consumer Healthcare will be operated as a joint venture with GlaxoSmithKline after the deal closes in the second half of 2019.

(The preceding information regarding the featured equity should not be construed as a recommendation to purchase the security. It should not be assumed that future returns will be profitable or will equal the historical performance. Please contact us for a complete list of holdings.)

OUR TEAM

Brooks Nelson, CFA	Evan Nelson, CFP®
Brian Roberts, CFA, MBA	Sarah Sinclair
Steve Philpott, CFP®, MBA	Erin Rodriguez
Ann Oglesby, MD, MBA	Chrissy Domingo
Darcy Nelson Smoot, CFA	

SPECIAL TOPIC

Pending Changes to Retirement Account Rules (The SECURE Act)

Changes to retirement accounts could be on the way. The House of Representatives voted overwhelmingly to pass the SECURE Act (Setting Every Community Up For Retirement Enhancement), the first big overhaul to retirement rules since 2006. The legislation is currently sitting in the Senate awaiting a vote. We will keep a close eye on the legislation and make you aware of any changes that directly affect you. Here are a few of the notable proposed changes:

Increasing the Retirement Age to 72 from 70 ½
The age cap for contributing to a traditional IRA, currently set at 70 ½, would be repealed. More people are working beyond age 70 either by choice or necessity, so savers can take advantage of tax-deferred accounts for longer to keep up with increasing life expectancies. Similarly, savers would be required to begin taking their required minimum distributions from 401(k)s and traditional IRA accounts at age 72 instead of 70 ½, giving them extra time to grow their money in tax-deferred accounts.

Annuities in 401(k) Plans
Individuals with 401(k) plans would be allowed to buy annuities through insurance companies in exchange for contracts that guarantee a monthly income stream. This is an attempt to offer working Americans a product similar to a pension that many corporations used to offer. Keep in mind that annuities can drastically reduce the growth potential of employees money and eliminate the opportunity to pass excess retirement money to heirs (unless they pay extra). Annual 401(k) statements would also be required to project how much the participants' current savings would generate over a lifetime of monthly payments.

Inherited IRAs
The ability to "stretch" an inherited IRA would be shortened. Currently, when an IRA is inherited, the non-spousal beneficiary is able to stretch the required distributions and tax payments over their lifetime. Under the new bill, non-spousal beneficiaries would be required to withdraw the full balance of the account within ten years of inheritance, accelerating the income taxes due and reducing growth potential.

New Parents
New parents would be able to withdraw up to $5,000 penalty-free from their IRA or 401(k) plan within one year of the birth or adoption of a child to help accommodate additional expenses.

Children with Investment Income
A minor's interest, dividends and other unearned income is currently taxed at the trusts and estates tax rate. This would be repealed and the "kiddie tax" would return to the parents' marginal tax bracket.

Employers without Retirement Plans
Employers without retirement plans would have the option to band together to offer 401(k) plans with less fiduciary liability concern and reduced costs.

Part-time Employees
Employers would be required to grant access to 401(k) style plans for part-time employees working 500+ hours per year who have been with the company for over 3 years.

NELSON ROBERTS
INVESTMENT ADVISORS

545 Middlefield Road, Suite 200 • Menlo Park, CA 94025 • 650.322.4000
www.nelsonroberts.com • invest@nelsonroberts.com

Past performance is not necessarily a guide to future performance. There are risks involved in investing, including possible loss of principal. This information is provided for informational purposes only and does not constitute a recommendation for any investment strategy, security or product described herein. Please contact us for a complete list of portfolio holdings.

For additional information on the services of Nelson Roberts Investment Advisors, or to receive our newsletters via e-mail or be removed from our mailing list, please contact us at 650-322-4000.

© 2019 Nelson Roberts Investment Advisors