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A Historic First Quarter Could Taper Off the Bull Run

by Clark Kendall

THE QUARTER IN BRIEF

The opening quarter of 2017 was a historic one for Wall Street as the Dow Jones Industrial Average topped 20,000 for the first time. Equities rallied through February, then lost momentum in March; even so, the S&P 500 had gained 5.53% year to date. The Federal Reserve raised the federal funds rate for the third time in a decade, in response to strengthening inflation pressure and other signals of economic acceleration. Consumer confidence remained high. Commodities had a decidedly mixed quarter. New home sales improved, while existing home sales tapered off. The U.K. took another step toward its Brexit; the U.S. left the Trans-Pacific Partnership. Wall Street kept its hopes up for tax reform and lighter business and banking industry regulation.

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DOMESTIC ECONOMIC HEALTH

As the stock market climbed, so did the Conference Board's consumer confidence index. By March, it had reached an astonishingly high mark of 125.6. The University of Michigan's household sentiment index declined from 98.5 to 96.9 across the quarter, but it remained well above its historical average of 86.0.

Factory and service sectors expanded nicely during the first quarter, according to the Institute for Supply Management. The Arizona-based organization's manufacturing purchasing manager index was at 56.0 in January, 57.7 in February, and 57.2 in March. Its service sector Purchasing Manager's Index (PMI) came in at 56.5 in January and 57.6 in February (the March number was not available at this writing). All these numbers indicate solid growth.

One other sign of economic growth, of course, is inflation. In the first quarter, it became more palpable. By February, the Consumer Price Index (CPI) had risen 2.7% in a year (the annualized advance on the core CPI was 2.2%). Producer prices were up as well. The headline Producer Price Index (PPI) showed a 2.2% yearly advance in February, with core prices gaining 1.5% over 12 months.

Currently available data shows tepid consumer spending in early 2017. Personal spending was up just 0.2% in January and only 0.1% in February. Consumer incomes, however, rose 0.5% in January, then 0.4% in February. Households sent headline retail sales 0.6% higher in January, but only 0.1% a month later. There were gains in durable goods orders in both January (2.3%) and February (1.7%).

January's Department of Labor jobs report showed the headline jobless rate at 4.8%, and the U-6 rate measuring underemployment at 9.4%; a month later, those unemployment rates were respectively lower at 4.7% and 9.2%. Hiring was strong in both January and February, with 238,000 net new jobs added to payrolls in the first month and 235,000 net new

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jobs added in the second.

All this data encouraged the Federal Reserve to make its first interest rate move of the year. On March 15, it announced a widely expected, quarter-point hike, taking the federal funds rate to a target range of 0.75-1.00%. As Fed chair Janet Yellen told the media after the policy announcement, "The simple message is, the economy is doing well." Investors who assumed the hike was coming scrutinized the Fed's dot-plot forecast for any 2017 changes; they did not find any. Two incremental rate increases are still projected before the year ends.

Elsewhere in Washington, President Donald Trump signed an executive order commissioning a review of the Dodd-Frank Act. As the first quarter ended, hearings on portions of Dodd-Frank were set to start in early April, with a chance of reform legislation being introduced in Congress during the second quarter.

"As the United States left the Trans-Pacific Partnership during the quarter, Asia-Pacific nations seeking a regional trade pact turned to Plan B-Plan B Being the Regional Comprehensive Economic Partnership."

GLOBAL ECONOMIC HEALTH

In late March, the United Kingdom formally triggered Article 50 of the Lisbon Treaty. It now has until April 2019 to negotiate the terms of its departure from the European Union. Will it retain single market access after the Brexit, so that its citizens can keep working and living in other E.U. countries without visas? Or will it make a "hard" Brexit, a divorce dictated by court decisions and/or World Trade Organization rules that would cause its people to lose E.U. citizenship rights? In April, the negotiations begin. The euro area jobless rate stood at 9.5% as of February, a low unseen since May 2009. Eurostat estimated an inflation rate of 1.5% for the euro area for March, an 0.5% decline from February.

As the United States left the Trans-Pacific Partnership (TPP) during the quarter, Asia-Pacific nations seeking a regional trade pact turned to Plan B – Plan B being the Regional Comprehensive Economic Partnership. This free trade agreement, now in negotiation, would bring China, Japan, and India into an economic accord with 13 other Asia-Pacific neighbors, including some of the region's poorest nations, such as Myanmar and Laos. Asia-Pacific manufacturing purchasing manager indices improved in the first three months of 2017, with China's official PMI advancing 0.2 points to 51.8 in March for its best reading since April 2012. Japanese and Indian factory activity also accelerated in March, with India's PMI hitting a 5-month high.

WORLD MARKETS

As of March 31, the five best YTD performers among consequential global stock indices were Argentina's MERVAL at +19.8%, Spain's IBEX 35 at +11.9%, India's Sensex at +11.2%, the MSCI Emerging Markets at +11.1%, and Singapore's Straits Times at +10.2%. There were other big quarterly gains: 7.9% for Brazil's Bovespa, 7.2% for Germany's DAX, 6.5% for Italy's FTSE MIB, 6.4% for the Euro Stoxx 50, 6.3% for the Global Dow, 9.6% for Hong Kong's Hang Seng, and 6.6% for South Korea's Kospi.

In fact, it is hard to find a marquee stock index that retreated in the first quarter. Scrutiny reveals two: the Russian Trading System (RTS) slipped 3.3%, and Japan's Nikkei 225 lost 1.1%. To round things out, China's Shanghai Composite gained 3.8% in Q1; the United Kingdom's FTSE 100, 2.5%; and the MSCI World, 5.9%.

REAL ESTATE

Mortgage rates descended in the first quarter. On December 29, the average interest rate on a conventional home loan was 4.32%, according to Freddie Mac's Primary Mortgage Market Survey (PMMS). By the March 30 PMMS, it was just 4.14%. Similar declines were seen for the average rate on the refinancer's favorite, the 15-year FRM (3.55% to 3.39%), and the average rate on the 5/1-year ARM (3.30% to 3.18%).

Census Bureau data showed new home sales rising 5.3% in January and another 6.1% in February. Resales wavered, increasing 3.3% for January and decreasing 3.7% the next month, according to the National Association of Realtors (NAR).

Regarding the sales numbers that matter most (the annualized ones), existing home sales were up 5.4% in the year ending in February; new home sales, 12.8%. In February, the median price for an existing home was up 7.7% from a year ago at $228,400. The median new home price was up at $329,900 as of December, but it had fallen to $296,200 by February.

Housing starts and building permits went in opposite directions. Starts fell 1.9% in January, then rose 3.0% a

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Is It Time to Retire your Thrift Savings Plan?

By Clark Kendall

Being a fiduciary wealth manager means two things in practice. First, I'm obligated to serve my clients' best financial interests. Second, I give big-picture advice. This could be a recommended action (where to invest, for example), or a simple word of caution: Don't.

I recently offered that word of caution to a federal employee who's nearing retirement. His plan was to leave his $1 million Thrift Savings Plan (TSP) account with the government to maintain the ease and convenience that had helped him accumulate the $1 million in the first place. He isn't the first client to tell me this, and I'm willing to bet many federal employees in and around Montgomery County are planning to leave their TSP money where it is after they retire. If you're considering doing the same, I urge you to reconsider.

Strict Limitations Can Impose Hardships

TSPs have rigid distribution rules. If you want to spend some of your money, you have one chance to take a lump sum. After that, you'll either have to agree on some monthly dollar amount or annuitize your TSP over your lifetime which will prevent your account from growing. If you don't need your money, you can let it grow until you are 70 ½ and they will calculate your Required Minimum Distribution (RMD) to send to you. However, they'll also include your Roth account balances as well which normally don't count towards RMDs. In fact, they include the Roth balance in any distribution made which means you lose out on future tax-free growth of those contributions.

Many people don't mind these rules because they like the security of a monthly payment. That's fine, assuming you have additional savings for that new car purchase or once-in-a-lifetime travel opportunities. But if the bulk of your retirement savings resides in a TSP, lump-sum withdrawals even for health emergencies, won't be available to you.

In addition, your TSP could be a burden to those you love. Surviving spouses who inherit TSP accounts are free to keep the accounts intact. But for subsequent beneficiaries, there is no "stretch" option to roll over shares to inherited IRAs; the entire TSP balance must be distributed and taxable in that year.

I recently spoke with adult children facing this scenario—their other parent, the TSP beneficiary, having passed away—and they were frustrated knowing they were about to get hit with $300,000 in taxable income putting them in the highest tax bracket. They would have preferred an inherited IRA, which would have allowed them to spread out the taxes over many years, keeping them in the lower bracket.

Consider the Costs (and Potential Losses)

Limited access to TSP funds is only part of the story. While the expenses are low because the TSP offers only a few broad index funds, your opportunity costs can be high. By limiting you to five options, you can't take advantage of the universe of products and vehicles that offer comparable rates of return with less risk. You'll also miss out on a variety of wealth management strategies—Roth conversions, penalty-free 72(t) distributions prior to age 55, qualified charitable distributions, etc.—that can significantly reduce your tax burden.

Cyber security, or a lack thereof, is another important consideration. The G Fund, where 43% of all TSP participants have 100% of their money, is worth over $200 billion. Without basic security protocols such as two-factor authentication and security monitoring (which most retail brokerages offer), the G Fund is a particularly attractive and vulnerable target.

If someone were to hack into your TSP account to steal funds, there is no guarantee you'll get it back, at least not in a timely manner. In 2011, over 120,000 TSP accounts were hacked and personal and banking information was stolen. However, IRA accounts held at any brokerage firm (Charles Schwab, TD Ameritrade, etc.) are covered by the Securities Investor Protection Corporation (SIPC) up to $500,000. If your money is stolen under their watch, they are accountable.

My Advice: Opt for Freedom and Flexibility

If there's one thing you need over the course of a 20- or 30-year retirement, its full control over your assets. You need the freedom and flexibility to enjoy opportunities as they come, and be able to pay for unexpected, large expenses.

By rolling your assets over to IRAs, you can manage, move, and spend your money as you see fit. You can still use low-cost index funds. But, you can take advantage of strategies like the ones we employ for our Middle Class Millionaire clients, to continue building your wealth, manage and potentially reduce your taxes, and ensure a tax-deferred inheritance for your beneficiaries. Most importantly, you can rest easy knowing your account is secure.

This article is featured in Montgomery Magazine's April/May 2017 issue. If you know someone who is planning on retiring from the Federal government, we would be happy to send them a copy of this article and additional retirement information.

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month later; permits advanced 4.6% for January, but retreated 6.2% in February. NAR's pending home sales index rose 5.5% to 112.3 in February after slipping 2.8% in January. Finally, January's 20-city S&P/Case-Shiller home price index arrived in late March, revealing an 0.2% monthly improvement and a 5.7% annualized advance.

LOOKING BACK…LOOKING FORWARD

On March 31, the key U.S. equity indices settled at these levels: Dow, 20,663.22; Nasdaq, 5,911.74; S&P 500, 2,362.72; Russell 2000, 1,385.92. The PHLX Housing Index was the quarter's best performer, gaining 11.96%; the Nasdaq 100 was a close second, advancing 11.77%.

Some truly remarkable things happened in the first quarter. The Dow closed at a record high for 12 straight trading days – a feat that last occurred in 1987. The blue chips also went on an 8-session losing streak for the first time since 2011. As the table below shows, the Nasdaq gained more in three months than it did during all of 2016.

Although there is uncertainty as to what the markets will do for the remainder of the year, you can rest assured that we are working in your best interest. At Kendall Capital, we will continue to utilize a combination of our five investment portfolios for our clients to prudently manage and grow our clients' assets.

% CHANGE	Q1 CHG	2016	1-YR CHG	10-YR AVG
DJIA	+4.56	+13.42	+16.84	+6.73
NASDAQ	+9.82	+7.50	+21.39	+14.41
S&P 500	+5.53	+9.54	+14.71	+6.63

Sources: barchart.com, bigcharts.com, treasury.gov – 3/31/17
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

Keep an eye out for Kendall Capital's new, informative video blogs at kendallcapital.com and YouTube! Clark or Carol will discuss relevant financial topics and how they may affect you.

How Long Should You Keep Financial Documents?

By Paola Bruening

Now that you've submitted your tax returns, you're probably wondering if you really need to keep certain documents and if so, how long? Much depends on the type of document and if you have online access, of course, but in this day and age of e-delivery and direct deposit, it makes sense to set up a system where you download statements, 1099s and W2s and save them as encrypted files on your computer or store them on flash drive. You'll always have some paper to organize in file drawers, but you can certainly reduce the volume. Here are some suggestions…

Tax returns? The Internal Revenue Service urges you to keep federal tax returns for at least 3 years which is the time frame you have to claim a credit or refund, or the time frame in which the IRS can levy additional taxes on you. This is a good guideline for state returns as well.

If you claim a loss from worthless securities or bad debt deduction, you are advised to hang onto those records for 7 years. The IRS also advises you to retain employment tax records for at least 4 years after the date that the tax becomes due or is paid – again, whichever is later.

Tax records relating to real property should be kept for as long as you hold the asset (and for at least 7 years after you sell or exchange the asset). These records can help you figure appreciation, depreciation, amortization, or depletion of the assets. You should also keep receipts and tax records related to major home improvements. These expenses can be added to the original cost of the house in order to raise your cost basis and reduce capital gains when you sell it in the long run. They're also helpful if you sell your home in the short run so you can show the buyer how much you put into the house.

Mutual fund statements? The annual statement is the one that counts. When you get your yearly statement, you can toss quarterly or monthly statements. You want to keep any records showing your original investment in a fund for capital gain or loss calculations. Your annual statement will tell you the dividend or capital gains distribution from your fund which is important when calculating your cost basis. It is important to understand that you are responsible for knowing the cost basis of mutual funds – especially if you hold them in a taxable account. Prior to 2012, the mutual fund companies were not obligated to keep track of this information. If you've been investing in a taxable mutual fund for many years, you should calculate this information to understand if you'll have a taxable gain or loss when you sell shares.

Brokerage account statements and tax documents? Here again, it's the Year-End statement that counts. It's particularly important to review the cost basis section and fill in any "Missing" entries. If you would like our help in researching historical prices, or advice on how to obtain this information please call us. Much like with mutual funds, it is ultimately your responsibility to track the cost basis of your investments and determine if you'll have a taxable gain or loss when you sell that investment. As far as filing goes, you should check with your broker firm as to how long they provide you with online access. For example, clients of Charles Schwab & Co., can request statements and trade confirmations going back 10 years and tax documents going back 9 years.

IRA statements and tax documents? It's a good idea to save your December or Year-End statement. Additionally, you want to hang onto your Form 8606, your Form 5498, and your Form 1099-R. Form 8606 is the one you use to report nondeductible contributions to traditional IRAs. Form 5498 is relevant if you make annual contributions. Form 1099-R, is the one you get from your IRA custodian showing your withdrawals.

Bank statements? The rule of thumb is 3 years, just in case you are audited. If you throw them out, you should either switch to electronic delivery or be sure to shred them.

However, if you are going through a divorce or if a creditor comes knocking, you may need to refer to your bank statements to show proof of payments. You should ask your bank how long they keep statements available to you online and what is the charge should you need them to provide you with archived statements.

Payroll documents? These days, most people are paid via direct deposit and have their paystubs emailed to them or have to log-in to a website. It's a good idea to save your last paystub for the year and your W2 for at least 7 years.

Credit card statements? These are important to review for accurate charges but you don't need to keep them unless you use that card for tax-deductible purchases. In that case, you save them or be able to access them online for up to 7 years.

Life insurance? Keep policy information for the life of the policy plus 3 years.

Medical records & medical insurance? The consensus is 5 years from the time treatment ends (or from the time medical services are rendered, with regards to insurance). Retain records for 7 years following the end of the year in

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The Pros and Cons of Using a Trust as your IRA Beneficiary

By Carol Petrov

As many of you know, the ability to Stretch the tax burden of an IRA over multiple generations is one of the best wealth management strategies you can use. When you pass away, your child or grandchild inherits your IRA account and it continues to grow on a tax-deferred basis. Your beneficiary will have to take Required Minimum Distributions (RMDs), but that amount is lower than your RMDs because it's now based on their age. Similarly, you could skip your kids all together and name your grandkids as beneficiaries to allow that account to grow even more and for a longer period of time.

> "The primary goal of naming a trust as the beneficiary of your IRA is two-fold. The trustee serves as a barrier to protect beneficiaries from making taxable mistakes and protects them from predators and creditors."

But when your children are young or even in their 20s, you may be concerned about leaving them hundreds of thousands of dollars or even millions of dollars to spend and invest how they wish. Instead, you could have an estate attorney draft documents which allow you to control what your child inherits from the grave but there are some pros and cons to consider.

The primary goal of naming a trust as the beneficiary of your IRA is two-fold. If your children or grandchildren just inherit your IRA, as the owner (assuming they're at least 18) of an Inherited IRA, they could request the entire balance be sent to them as a lump-sum distribution. They will be advised that the entire amount is taxable to them in that year, but that might not matter to them. They would waste the chance to stretch the taxes due by withdrawing just the Required Minimum amount every year and letting that account continue to grow tax-deferred. When naming a trust as a beneficiary, a trustee oversees the IRA assets, effectively serving as a barrier to such a decision. In addition, since the IRA assets are owned by a trust instead of your child, they are protected from "predators and creditors," such as current or future ex-spouses, and lawsuits.

This may sound like a no-brainer to you, but here are some potential downsides to consider. First, you need a competent estate attorney to draft your Will correctly to set up such a trust for your children. It's very important to include language that will make it clear as day that the RMDs will be calculated based on the age of the beneficiaries. It's also important to understand what happens when the trust terminates. You may have a good friend who is willing to be the trustee of this account for 10 or 20 years but perhaps not the rest of their life. So, you'll likely pick an age when your friend can close the trust and transfer the account to your adult children. You should find out from your investment firm if that transfer will be fully taxable or if your children can receive it from the trust, as an Inherited IRA. After all, they may be more responsible at 30 than 20 but they could very well have to pay a large tax bill after the trust terminates.

As an alternative, you should know that most brokerage firms will allow an adult to open an Inherited IRA account in the name of a child – much like a Custodian or UTMA account. In this case, the adult would be responsible for investing the account and ensuring the RMDs are withdrawn, which are taxable to the child. But when the child turns 21 (or whatever the age of majority is in your state) the child takes ownership of the account. Hopefully, they were counseled by their guardian or the custodian of the account (need not be the same person) to only withdraw the RMDs unless it's for a worthy cause. At least you'll ensure that the account would continue to grow tax-deferred and it'll be an effortless transfer for that friend who helped manage the account all those years.

We recommend you discuss these pros and cons with Clark Kendall or Carol Petrov and your estate attorney and feel free to call us for referrals. When deciding how to handle this issue consider these factors: ease of managing the Inherited IRA, control of the IRA and when your child can have it, tax ramifications in the near and long term.

> "Planning is bringing the future into the present so that you can do something about it now."
> -Alan Lakein

Financial Documents? *continued from page 5*

which they are claimed.

Following these simple guidelines should help you alleviate the clutter and maintain your financial statements in good shape. If you've attended one of our "You Only Die Once" workshops, you have our accordion file and should keep at least the cover page of each type of statement there so your Executor or Power of Attorney is aware of your assets and liabilities.

Brexit Is Beginning

By Jason Tkach

Last summer, the U.K. panicked the investment markets by voting, in a nation-wide referendum, to exit the European Union. There were, of course, dire predictions about the impact on the U.K. economy, which never materialized, in large part because the U.K. had not yet formally opted out of its Eurozone agreements.

At the end of March, the U.K. pulled the trigger and made the departure from the European Union official. The Queen of England delivered her royal assent, and the U.K.'s envoy to the European Union hand-delivered a letter to the office of the European Council president in Brussels invoking Article 50 of the EU treaty. This delivered formal notification of the Brexit decision, the first time this has happened in the EU's history.

Does this mean those dire predictions will finally come true? As it happens, Article 50 was intended to prevent any rash or immediate consequences of an exit from EU membership. Under the bylaws, the divorce will be negotiated, item by item, over the next two years, meaning that any change in economic circumstances will be gradual and perhaps accommodated as they happen. How gradual? Over the next several weeks, the EU's remaining 27 members will discuss their priorities in advance of the negotiations, and then hold a summit on April 29. Only then will the European Commission have a mandate to negotiate with representatives from London.

The negotiations will begin by covering Britain's obligations to the EU for its participation thus far. A bill that could total up to roughly $65 billion. The negotiations will also decide the rights of 3 million EU citizens living in the U.K., and the rights of more than 1 million Britons living and working in the Eurozone.

After that, it is speculated that the British government will seek to negotiate a broad free-trade agreement which will effectively replicate the provisions of its former membership in the European Union, as a way to protect its commercial ties with the Continent. This is where negotiations will get sticky, since France and Germany will almost certainly oppose a no-consequences exit, and they will want to protect their own economies' free-trade access to Eurozone markets. On the EU side, a simple majority of countries will decide what proposals are accepted and which are sent back to the negotiating table with one notable exception: any free trade agreement between the two sides much win unanimous approval.

This latter issue is problematic for the U.K., because it exposes each country to yet another referendum on the conditions of EU membership; the citizens of France, Germany and all the other nations would want to be involved in the final decision, which would give them yet another opportunity to voice displeasure with the EU and stir up nationalistic parties and sentiments.

Also still to be determined are budgetary considerations. The U.K.'s contribution to the governing infrastructure of the EU will have to be made up by the remaining members, whose citizens are not eager to contribute more to the increasingly unpopular entity. The British government, meanwhile, will have to create an expensive governance infrastructure to replace the EU bureaucracy in Brussels, and Parliament will have to formally repeal the European Communities Act of 1972, making EU law U.K. law. Then, parallel with the EU negotiations, Parliament will debate every aspect of the EU law and decide which to keep long-term and which to drop. That, too, will take years.

The bottom line is that nothing dramatic is likely to happen, economically and in the investment markets, for years. Throughout the two years of negotiations, the U.K. will remain a full EU member, albeit without a chance to participate in EU decision-making. Some are predicting that the discussions will last for several additional years, with extensions on the status quo until issues can be ironed out. Unpicking 43 years of treaties and agreements covering thousands of different subjects will not be an easy task.

Those investors who overreacted to the initial (and shocking) Brexit vote sold their stocks into a market rally, and there is no reason to think that those who might panic now that the trigger is finally pulled will fare any differently. Both sides in this negotiation have a stake in not having anything dramatic—particularly dramatically damaging—from happening, and they will probably succeed in making Brexit a boring exercise in bureaucratic handover.

Tips for Rollovers and Withdrawals from Employer Retirement Plans and IRAs

By Madolynn Morken

Have you recently changed jobs or retired? Not sure what to do with your retirement savings plan? If so, we suggest completing either a direct transfer to your new job's retirement plan or requesting an IRA rollover – a common and useful financial move – so you don't leave your money behind.

A direct rollover of retirement assets is routine, and can be initiated with phone call or even online through your retirement plan's website. However, there are times when an indirect rollover is necessary or more efficient. You just have to be mindful of the 60-day rule and the potential ramifications of missing the deadline. We encourage you to give Kendall Capital a call if you would like help deciding which method best meets your goals.

Rollovers between workplace retirement plans, IRA-to-plan rollovers, and plan-to-IRA rollovers, where the investment company simply sends a check for the assets to the brokerage firm that will eventually receive them, are exempt from a 60-day deadline imposed by the IRS. Also, there is no tax or penalty assessed when performing these types of transfers. They simply allow you to stay in control of your money and consolidate similar tax-deferred accounts.

Do you need to borrow from your IRA? If you happen to be in a situation where you need cash quickly but for a short period of time such as settling on a real estate deal or paying taxes, you are allowed to take a withdrawal from an IRA with no tax or penalty before you turn 59 ½. The catch is that you must return those funds within 60 calendar days or else the amount withdrawn will be subject to that penalty and treated as ordinary income for tax purposes. Therefore, it is in your best interest to return as much money as possible, if not the full amount. Keep in mind though, the IRS only lets you take advantage of this opportunity once every twelve months.

A second option to garner some quick cash is taking out a loan from your 401k plan. There will be limits on how much you can borrow from your 401k balance so you should call your 401k plan provider to learn the details. Here again, this should be a short-term loan since while you're paying yourself back, you're not adding anything more for your retirement. Also, keep in mind that if quit or lose your job, the balance of your loan will be considered taxable income and be subject to that 10% penalty if you're under 59 ½ years old.

If you are considering a rollover or withdrawal from an IRA or employer retirement plan, give Kendall Capital a call to discuss the best option for your financial future.

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