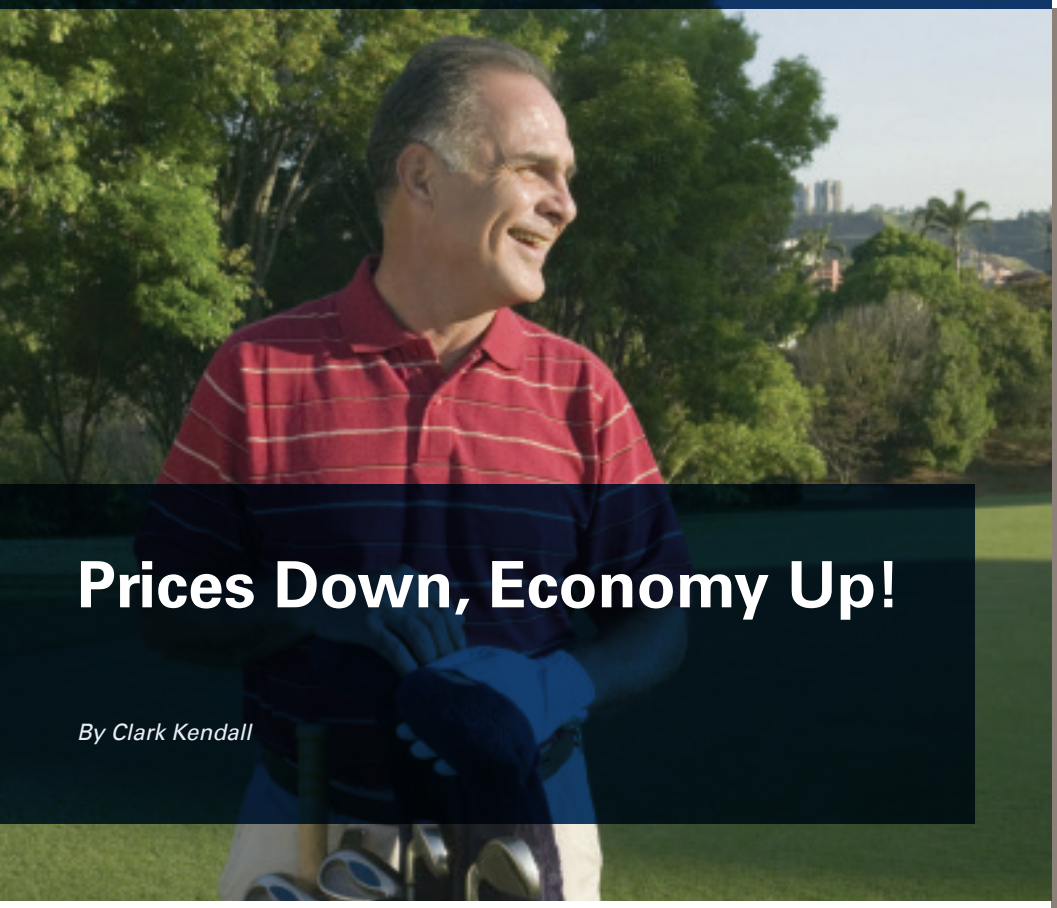
December 2018 |

# FIDUCIARY PULSE



## Prices Down, Economy Up!

*By Clark Kendall*

### Quarter in Brief

Wall Street saw many ups and downs in the last three months of 2018. The fourth quarter ended with bulls and bears competing for control of the market and with the S&P 500 suffering a 13.97%, three-month loss. The Federal Reserve sent mixed signals about its implementation of monetary policy normalization, to the frustration of investors. No real progress was made in resolving the U.S.-China trade war, and the Brexit appeared to reach a standstill. The price of oil dropped sharply. The housing market gained a bit of momentum as home prices and mortgage rates both declined. The quarter was quite newsworthy, but its major headlines raised some questions about the direction of the markets.

### Domestic Economic Health

On the whole, the economy looked quite good in the fall. Consumer spending increased 0.8% for October and 0.4% for November, with retail sales up 1.1% in the tenth month of the year and 0.2% in the eleventh. Retailers benefited from a great holiday sales season: on an annualized basis, consumer purchases made between November

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and December 24 were up 5.1% compared to the same period in 2017.

Consumer confidence indices declined from strikingly high levels but were still notably strong. The Conference Board index hit 137.9 in October, 136.4 in November, and 128.1 in December. Having its best year since 2000, the University of Michigan's monthly consumer sentiment gauge came in at 98.6 for October, 97.5 for November, and 98.3 for December; it averaged 98.4 for 2018.

Both the service and factory sectors were booming, according to the Institute for Supply Management's monthly purchasing manager indices. ISM's non-manufacturing index was above 60 in both October and November (60.3, then 60.7); its manufacturing index rose from 57.7 in October to 59.3 in November.

How was the jobs picture? Nonfarm payrolls expanded with 237,000 net new jobs during October; the November gain was 155,000. During both months, average yearly wage growth was at 3.1%. The main jobless rate held at 3.7%; the underemployment (U-6) rate moved north from 7.4% to 7.6%.

Inflation was advancing just 2.2% a year by November; the 12-month increase had approached 3% as recently as July. Falling fuel costs helped tame inflation pressure. As a result, the average non-supervisory worker saw his or her inflation-adjusted income rise 1.0% in the 12 months ending in November, the most since 2016. On the wholesale front, producer prices jumped 0.6% in October, but rose only 0.1% during November. (Speaking of producers, indutrial production was up 3.9% year-over-year in November; overall durable goods orders rose 0.8% for November after a 4.3% fall during the prior month.)

In late December, the Bureau of Economic Analysis stated the economy had expanded 3.4% in the third quarter, revising its previous estimate of 3.5%. With growth like that, it not be surprising that the Federal Reserve made its fourth rate move of the year in December, taking the target range on the federal funds rate to 2.25-2.5%. Top Fed officials sounded alternately dovish and hawkish during the fourth quarter. In October, Fed chair Jerome Powell commented that interest rates were "a long way" from neutral, irritating Wall Street. A month later, both he and Fed vice chair Richard Clarida remarked that the benchmark interest rate was close to a "neutral" level. December's rate increase came with a relatively hawkish dot-plot, projecting two more hikes in 2019.

The U.S. and China did little to address the tariffs they had imposed on each other earlier in the year. At the start of December, both nations did agree to a 90-day truce on introducing new import taxes. Even so, the U.S. was slated to hike tariffs on as much as $200 billion of Chinese imports as the year began.

> **Patience, in fact, may be an investor's greatest friend this quarter and year.**
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## Global Economic Health

Overseas, manufacturing economies in the east and west seemed to be slowing down. In fact, December marked the eighth consecutive month of a downward trend in weighted average Markit flash PMI readings of U.S., Japan, and European Union member countries. The mean factory PMI reading among those nations was the poorest in two years last month. China's economy slowed in each month of the quarter, according to a Bloomberg Economics tracker, which cited reduced consumer demand for goods and services as much as the impact of tariffs. In November, the nation's official factory PMI sat at 50.0, the break-even point between sector growth and contraction.

In Q3, China's annualized gross domestic product was expanding at a 6.5% pace; in Q1, the annualized GDP reading had been at 6.8%.

The European Union (and the world) waited for the Brexit to proceed. U.K. leaders, however, spent the quarter debating if it should unfold according to the deal that Prime Minister Theresa May had presented to the European Union. By December, May's deal faced almost certain rejection in Parliament. There were three other options: another national referendum on the Brexit, a no-deal Brexit that would leave big businesses with headaches, or a "managed," no-deal Brexit with some bilateral trade arrangements put in place. The deadline for the Brexit was still set for March 29. On December 13, the European Central Bank confirmed that its longstanding, asset-purchase program

would wrap up at the end of 2018. Interest rate hikes could be in the ECB's plans this year; euro-area consumer prices have been rising only about 1% annually for the past six years. Real, annualized GDP for the euro area through the first three quarters of 2018 was just 1.2%, a pace far off the 2.7% GDP seen in 2017.

## World Markets

As bearish sentiment mounted in Q4, marquee equity indices steadily descended. Most of the 13-week declines were sizable: in the west, France's CAC 40 slid 13.89%; Germany's DAX, 13.80%; the United Kingdom's FTSE 100, 10.41%. In the east, India's Sensex lost just 0.44%; Hong Kong's Hang Seng, 6.99%; Japan's Nikkei 225, 17.02%; Australia's All Ordinaries, 9.74%; China's Shanghai Composite, 11.61%. To our north, the TSX Composite retreated 10.89% in Q4. MSCI's Emerging Markets index fell 7.85% during the quarter; its World index tumbled 13.74%.

## Commodities Markets

While equities had a dismal quarter, some commodity futures posted significant Q4 gains. Take cocoa, which advanced 16.04%, and palladium, which rose 12.32%. Sugar improved 7.41% in Q4; gold, 6.61%; silver, 4.86%; soybeans, 2.68%; corn, 1.90%. The U.S. Dollar Index added 1.62%. At the closing bell on December 31, gold and silver were respectively worth $1,284.50 and $15.54 per ounce on the COMEX.

What notable commodities lost value in the quarter? Here is a list. Platinum fell 3.22%; coffee, 3.78%; wheat, 4.55%; natural gas, 4.70%; cotton, 6.59%; copper, 6.63%; RBOB gasoline, 37.41%; WTI crude, 37.54%. WTI crude ended Q4 at just $45.83 a barrel on the NYMEX

## Real Estate

While the real estate market cooled off in 2018, the pace of home buying began to improve in the fourth quarter. By the estimations of the National Association of Realtors, existing home sales rose 1.4% in October and 1.9% in November. Perhaps sellers were lowering prices to meet prospective buyers on their turf. By November, NAR noted a median sale price of $257,700, which was merely 4.2% higher than in November 2017.

A dip in mortgage rates could also have been a factor. In the last Freddie Mac survey of 2018 (December 27), the average interest rate for a conventional home loan was 4.55% nationally; it had been 4.72% three months earlier. (Rates on 15-year, fixed loans and 5/1-year, adjustable loans were respectively at 4.01% and 4.00% in the December 27 survey, compared with 4.16% and 3.97% in late September.)

Even so, NAR's pending home sales index measuring monthly housing contract activity showed declines of 2.6% in October and 0.7% in November. New home purchases fell 8.9% in October. (We do not yet know about November new home sales, as the release of that Census Bureau report was delayed due to the federal government shutdown.

Home builders broke less ground in October, then started more projects (and took out more permits) in November. Census Bureau data showed housing starts down 1.6% for October, up 3.2% a month later; building permits were down 0.4% in the tenth month of the year, but up 5.0% in the eleventh.

| MARKET INDEX | Y-T-D CHANGE | Q4 CHANGE | Q3 CHANGE |
|---|---|---|---|
| DJIA | -5.63 | -11.83 | 9.01 |
| NASDAQ | -3.88 | -17.54 | 7.14 |
| S&P 500 | -6.24 | -13.97 | 7.20 |
| | | | |
| **YIELD** | **12/31 RATE** | **1 MO AGO** | **1 YR AGO** |
| 10 YR TIPS | 2.69 | 3.01 | 2.40 |

## Looking Back… Looking Forward

The fourth quarter is often hot for stocks, but this past one was ice cold. Equity investors grew concerned about the Federal Reserve's plans for 2019, the evident economic deceleration in China and Europe, and a narrowing spread between long-term and short-term Treasury yields that risked becoming an inversion. The S&P 500 closed out 2018 at 2,506.85; the Dow Jones Industrial Average, at 23,327.46; the Nasdaq Composite, at 6,635.28; their quarterly performances are noted in the table below. The CBOE VIX volatility index surged 109.74% in the quarter to 25.42.

If you are wondering how the small caps fared, the short answer is: even worse than the big three. The S&P SmallCap 600 lost 20.43% in Q4; the Russell 2000, 19.39%.

The fourth quarter of 2018 was the poorest quarter on Wall Street in 11 years. Was the welcomed, large-cap rebound at the end of December a hint of better times ahead? Earnings season is about to start, and it might be just what the Street needs; before it begins, investors may tread cautiously. Wall Street cannot "resume normal programming" fast enough for some market participants, but the path toward stability may not be an easy one; the volatility seen in December may take weeks to moderate. In sum, 2019 presents investors with many more uncertainties than 2018 did, and patience will be required to contend with them. Patience, in fact, may be an investor's greatest friend this quarter and year.

# The Evolution of Financial Rights and Equality for Women

*By Carol Petrov*

In recent years, there's been a lot of publicity around sexual harassment, and the MeToo movement seems to have brought us to a new age for women and their ability to exercise their legal rights, especially as it pertains to the work environment. But it is worth noting just how discriminatory our society, and others, have been toward women even in fairly recent times. The evolution of women's rights however, particularly in terms of financial equality, is remarkable and eye-opening.

Here are some legal mile markers for women you may be surprised to learn. Until 1839, no state allowed women to own property in their own names. Before the 1974 Equal Credit Opportunity Act, banks routinely required single, widowed, or divorced women to bring a man along to cosign any credit application they made. In fact, a client recently shared with me that when she and her husband applied for a mortgage, the bank only considered half of her reported income. Until 1981, husbands were legally permitted to keep their wives in the dark about their family finances and were allowed to unilaterally take out second mortgages on property owned jointly with their wives. And lastly, until the 2009 passage of the Lilly Ledbetter Fair Pay Restoration Act, women were not able to sue for the differences in discriminatory pay between their income and comparable men's income if more than six months had passed. Now, I realize women have only had the right to vote since 1920 but clearly it took an awful long time to gain some financial equality. Heck, we still haven't ratified the Equal Rights Amendment which passed in Congress back in 1972! We need one more state to ratify the amendment in order to get the 75% state approval but that hasn't stopped women from moving forward and creating a path to success for their daughters.

## Where we are today

It's hard to fathom that some of these barriers ever existed considering where we are now. Currently, women are earning 57% of all bachelor's degrees, make up 47% of the US workforce, and control 51% of personal wealth in the U.S. But, with more power and more opportunity, comes an even bigger need and responsibility for women to be well-informed, agile, and forward thinking.

## How financial advisors can provide value beyond your portfolio

With the increased number of women in charge of their own finances, it is a great opportunity for financial advisors to provide support in ways people may not expect from the person or team they hire to manage their wealth. Here are some areas in which your advisor can help you beyond investments:

### • Financial literacy

Getting a better understanding about money takes work, but it doesn't have to be overwhelming. With the right attitude and education, women can feel empowered and confident about their financial future. In addition to general financial education, there are constantly new issues that arise which may affect a person's wealth and future planning. An advisor can regularly keep you informed of these and evaluate if it impacts you.

For example, with ever-changing laws, it is important for people to stay on top of financial current events. Two recent examples are in the 2018 Tax Act affecting alimony payments and new deductions for business owners. Essentially, for new divorce agreements, the alimony payment is no longer considered income to the recipient and therefore, no longer tax-deductible to the payor. For business owners, no matter how small, they may be eligible to receive a new 20% deduction on their business income. In some cases, this may change how you file your taxes with your spouse as their income may reduce the eligibility of the business owner spouse.

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## • Stress relief and peace of mind

A financial advisor can be very valuable during tumultuous times, not just to help understand your accounts but also to have some emotional support. At Kendall Capital, we do this in various ways:

• Guide newly widowed or divorced clients through the daunting realization that their future is not how they pictured it would be. With our help, they don't have to do it alone.

•Take the time to thoroughly explain how their accounts work and describe the roles or responsibilities the client may have. This is especially important as an elderly parent gradually needs help from a child or trustee.

• Share ideas, strategies, and offer recommendations during transitional periods. Sometimes these major changes lead to opportunities which weren't previously available.

• Introduce clients to other professionals like accountants and estate attorneys to build them a new team who looks out for their best interests.

## • Build community

It is common for women to seek community. With more and more women in charge of their own finances, many alone as they age or as circumstances change, it is important for them to find this community or their "village." A financial advisor can introduce a client to other clients who are in similar situations, or simply share wisdom or their own experiences which may be comforting. It is always helpful and important to connect with others who have been in your boat.

## • Reassess and inspire

When our clients are faced with life changes or challenges, we help them reassess their future and form a new dream of what it may look like. We encourage clients to embrace this new chapter in life and feel they are now more in control of their financial future. For example, one client comes to mind who was in the process of finalizing her divorce. She was a successful professional who was ready to enjoy the money she worked so hard to earn and save, but wanted our guidance since her husband had previously handled their finances. Some of her goals were to donate to charities and travel to Europe, things her ex-husband wouldn't do. She also lamented that it was so hard to get her kids all together and thought it would be nice if she could organize a vacation for them all. It took a little time, but with our encouragement we helped her understand she really could afford to do those things and enjoy her retirement in a few years. Now, she is finally able to feel that all of her hard work has paid off and cherishes the quality time with her kids.

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## Kendall Capital is here to help

Male or female, young or old, life is full of changes and financial decisions. Kendall Capital has the experience to help guide clients through tough times.

# Why Now Could Be a Good Time for a Roth IRA

*By Brian Mattox*

Roth IRAs are one of the best gifts that Congress has ever given Americans when it comes to saving money for retirement. Contributions grow tax deferred like with traditional IRAs, but withdrawals are usually tax-free if they're made after you turn 59½ years old.

Also, there are no Required Minimum Distributions (RMDs) with Roth IRAs at age 70½ like with traditional IRAs. And you can continue making contributions to a Roth IRA throughout your lifetime, regardless of your age, so long as you have earned income.

However, Congress placed eligibility restrictions based on one's income that prohibit many affluent Americans from using them. In 2019, if your modified adjusted gross income (MAGI) is $122,000 - $137,000 (if you're single) or $193,000 - $203,000 (if you're a married couple filing jointly) in 2019, your contributions are limited.

## A Workaround: Roth IRA Conversions

There is one way to enjoy the benefits of a Roth IRA even if you make too much money to contribute to one. You can convert a traditional, SEP or SIMPLE IRA to a Roth IRA.

But there's one big drawback to Roth IRA conversions that keeps many people from doing them: You must pay income taxes on the value of your IRA at the time of the conversion. If your IRA is large, this could result in a big lump sum payment that's due to the IRS when the conversion is made.

## Down Market = Conversion Opportunity

If you've been considering a Roth IRA conversion but hesitated because of the big tax bill, now might be a good time to think about pulling the trigger. Why? Because the recent stock market pullback could lessen the severity of the tax bite.

Remember, the amount of income tax due will be based on the value of your IRA when the conversion is made. So if your IRA has lost value due to the drop in stocks over the past few months, your tax bill will drop along with it.

Here's an example that illustrates the potential tax savings of converting to a Roth IRA during a down market:

Suppose you're 55 years old and you have a traditional IRA that was worth $1 million at the market's peak last year. You plan to retire in 10 years at 65, at which time you project that the IRA will be worth $2 million.

Due to the stock market retreat, your IRA has lost 20% of its value and is now worth $800,000. If you had converted when the market was at its peak, your tax bill would have been $250,000. But if you convert now, your tax bill would be just $200,000 — a tax savings of $50,000.

Now let's look out 10 years to retirement. You still expect your IRA to be worth $2 million based on long-term stock market trends. By converting to a Roth IRA now, you'd not only save $50,000 in current taxes, but you'll have $2 million in tax-free retirement income 10 years from now.

## Other Factors to Consider

There are a few other factors that could make now a good time for a Roth IRA conversion. One of these is your current tax bracket. If the 2018 Tax Act put you in a lower tax bracket than before, or maybe you're between jobs and thus have less income than usual, you could take advantage of the opportunity by converting now.

Now might also be a good time for a Roth IRA conversion if you plan to leave IRA assets to your kids and grandkids. Doing so would allow you to prepay income taxes for your heirs and not have to take any RMDs if you have other sources of income to meet your retirement living expenses. Plus, your family inherits the best gift of all, tax free investments.

## Not Necessarily All or Nothing

Keep in mind that you don't have to convert your entire IRA to a Roth IRA. You can make a partial Roth IRA conversion, which would help reduce current taxes while also further diversifying your retirement savings.

Due to the big tax hit, Roth IRA conversions aren't for everybody. Please consult your fee only fiduciary independent advisor for additional personal advice. But if you are planning one, the stock market swoon could make now a good time to do so.

# Ways to Ease the Cost of College

*By Jason Tkach*

## How much could a college education cost in the 2030s?

You may want to take a deep breath and sit down before reading the next paragraph.

A MassMutual analysis projects that four years of tuition, room, and board at a private college will cost nearly $369,000 in 2031. CNBC offers a slightly cheaper estimate, putting the total expense at $303,000 for a freshman setting foot on campus in 2036. (Today, the cost of four years at a private university is less than half that.) How about the price tag for four years of tuition, room, and board at a public university in that year? The same CNBC article says that it may reach $184,000.

Finding money to pay for college can be a huge challenge. There are ways to counter the cost: a student can work full time or assume student loans. But, there are other ways that you may want to explore if you do not want your child to take on a more challenging path through school or get soaked with debt.

## Grants and Scholarships

Grants and scholarships are more abundant than many people realize. Grants are based on need; scholarships on merit. Grants can be issued incrementally or in lump sums to a student; most are awarded on a first-come, first-serve basis, which is why it is so crucial to fill out the Free Application for Federal Student Aid (FAFSA) early. A school accepting your student will evaluate your student's FAFSA, then send a letter detailing his or her eligibility for federal and state grants. As for scholarships, there are literally millions of them. Sallie Mae provides an online search tool (www.salliemae.com/college-planning/tools/scholarship-search/) to explore more than 5 million such awards, and you can use it to drill down to prospects that are strong possibilities for your student.

## 529s and IRAs

Through a 529 plan, you can invest to meet future college costs. 529 plans come in two varieties, and both varieties have common tax advantages. 529 plan earnings are exempt from federal income tax, and 529 plan assets may be withdrawn, tax free, so long as the money pays for qualified education expenses. While there are no federal tax breaks linked to 529 plan contributions, more than 30 states offer state income tax deductions or credits for them, including Maryland.

Some 529 plans are prepaid tuition plans, giving you the option to prepay up to 100% of your student's future tuition at a public university within your state (most of these plans do not pay for housing costs). You may be able to convert a prepaid tuition plan so that the assets can be used to pay tuition at an out-of-state university or private college.

The great majority of 529 plans are college savings plans, similar to Roth IRAs. In a college savings plan, you can direct your contributions into equity investments, which offer you the possibility of tax-advantaged growth and compounding. However, if the investments perform badly, your college fund may shrink.

You may choose to fund a 529 plan account incrementally or with a lump sum. States put different limits on the amount of money that a 529 account can hold, but six-figure balances are often allowed. You can invest in any state's 529 plan and pay for higher education expenses with 529 plan assets at any qualified U.S. college or university.

Some families use Roth IRA assets to pay for college. A Roth IRA gives you a degree of flexibility that a 529 plan does not. Suppose your child does not go to college. While this may seem unlikely, some young adults do start careers without a college education. In that event, you still have a Roth IRA: a tax-favored retirement savings account with the potential for tax-free withdrawals.

A Roth IRA is not a perfect college savings vehicle. The annual contribution limit is low compared to a 529 plan and while you may withdraw an amount equal to your contributions without penalty at any time of life, a Roth IRA's earnings represent taxable income when withdrawn early. And although Roth IRA assets are not countable assets on the FAFSA, tax-free Roth IRA contributions, once withdrawn, still amount to untaxed income for your student (i.e., the Roth IRA beneficiary), and they lower a student's eligibility for need-based aid.

## Going to college should not mean going into debt.

Would you like to plan, save, and invest to reduce or avoid that consequence? We encourage you to reach out to us at Kendall Capital to evaluate your options.

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