KENDALL CAPITAL

JUNE 2017
VOL.18 NO.2

SECURING TOMORROW

INSIDE

Quarter in Review 1
Rotherization 3
The Importance of Financial Literacy 5
Will You Really Be Able to Work Longer? 6
Vanishing Stocks 7
The Real Cost of College 8

Decreased Beta in a Rising Market

by Clark Kendall

THE QUARTER IN BRIEF

After a remarkable first quarter, the stock market cooled off slightly in the second quarter – but investors still saw substantial gains. Strong earnings helped take Wall Street's collective mind off a decidedly mixed bag of economic signals. Consumers remained confident as the quarter unfolded; although hiring, inflation, and consumer spending weakened. Home sales declined, then rebounded. Overseas, factory activity in China and the Eurozone showed improvement, and foreign equity benchmarks continued climbing. Many commodities took sizable second quarter losses. When the quarter ended, the bulls were still firmly in charge.

> "Strong earnings helped to take Wall Street's collective mind off a decidedly mixed bag of economic signals."

DOMESTIC ECONOMIC HEALTH

As one quarter ends, the Bureau of Economic Analysis (BEA) commonly makes its final assessment of the prior quarter's economic growth (though, even this "final" estimate may be adjusted in later years). In the last week of June, the BEA announced a "final" first quarter growth number of 1.4%, which was nothing to celebrate. Would second quarter growth come in above 2%?

Second-quarter consumer spending data from the Department of Commerce raised some concerns about reaching that percentage of growth. While April and May brought solid growth for personal incomes (0.3% in the former month and 0.4% in the latter), the gain in personal spending fell from 0.4%, in the fourth month of the year, to 0.1%, in the fifth. Retail sales, too, tailed off: after rising a robust 0.4% in April, they fell 0.3% for May.

Households did feel good about the state of the economy and their financial prospects. At final readings of 97.0 in April, 97.1 in May, and 95.1 in June, the University of Michigan's consumer sentiment index stayed well north of its 86.1 historical average. The Conference Board's index ended the quarter at a very high mark of 118.9.

Hiring figures from the Department of Labor were somewhat weak. Monthly employment reports showed that U.S. firms added 174,000 net new jobs in April and 138,000 net new jobs in May. (In March, the number had been just 50,000.) Was the job market simply at capacity? Only time would tell. Reductions in the labor force participation rate helped send both the headline jobless rate and the U-6 rate, factoring in the underemployed, to notable lows. By June, the headline (U-3) rate had dipped to 4.3%, a level unseen in 16 years; the U-6 rate had fallen to a 10-year low of 8.4%.

On the manufacturing front, the news appeared better. The Institute for Supply Management's (ISM) factory purchasing manager index rose to 57.8 in June, a 34-month peak. This was after readings of 54.8 in April and 54.9 in May. ISM's service sector PMI was also well above the expansion line of 50 in April and May, displaying respective readings of 57.5

Quarter in Review, *continued on page 2*

Quarter in Review, *continued from page 1*

and 56.9 in those months.

Still, federal government reports showed manufacturing and industry production falling off in the second quarter. Industrial output jumped 1.1% in April; then, flattened in May. Manufacturing output went from a 1.1% gain to a 0.4% retreat. Hard goods orders were down 0.9% in April; then, down 1.1% a month later.

Annualized inflation declined during the quarter. The May Consumer Price Index (CPI) showed only a 12-month gain of 1.9% and just 1.7% for core prices. A month earlier, yearly inflation had been at 2.2% with the core CPI rising 1.9%. Did wholesale inflation also lessen? The headline number did, ticking down 0.1% in May to 2.4%. The core Producer Price Index was up 2.1% year-over-year through May, a 0.2% increase from April.

The Federal Reserve lifted the federal funds rate by another quarter point in June to a target range of 1.00-1.25%. It also disclosed it would begin reducing its massive bond portfolio "this year," which could put pressure on long-term interest rates. The central bank intends to let $6 billion of Treasuries and $4 billion per month in agency debt and mortgage-linked securities mature per month to start. In late June, all 34 of the country's largest banks passed the Fed's annual stress tests – a milestone unseen since their adoption seven years ago.

GLOBAL ECONOMIC HEALTH

Emmanuel Macron's decisive victory in France's national election cheered investors concerned about the potential for another crack in the European Union, and it started a rally in the euro, which continued in June after European Central Bank President Mario Draghi commented that "the threat of deflation is gone and reflationary forces are at play." Investors took those words as a strong hint that the ECB would presently end its quantitative easing. As the quarter concluded, Chancellor Angela Merkel's reelection seemed probable in Germany; a fourth Merkel term would be another boost to EU economic confidence and stability.

Manufacturing economies accelerated around the world in the quarter. The Markit Eurozone factory PMI reached 57.0 in May, and then, 57.4 in June (a 4-year peak). Manufacturing PMIs in Vietnam, India, South Korea, Taiwan, and Japan were all above 50 (the level signifying sector expansion) as the second quarter wrapped up. China's official factory PMI was at 51.2 in May; then, 51.7 in June. Its official service sector PMI came in at 54.5 in May and 54.9 in June.

WORLD MARKETS

One factoid conveys how well global equity benchmarks did in 2017's first half: 26 of the world's 30 major indices posted 6-month gains. The last time that happened was in 2009 – and it has only occurred in four other similar intervals within the past two decades.

"Emmanuel Macron's decisive victory in France's national election cheered investors concerned about the potential for another crack in the European Union, and it started a rally in the euro."

Germany's DAX finished the first half up an impressive 7.4% YTD, and France's CAC 40 was up 5.3% on the year as the second quarter ended. The United Kingdom's FTSE 100 was 2.4% higher YTD on June 30. India's Sensex topped the 31,000 level in June, reaching an all-time peak and outdistancing nearly all of its nearby Asia-Pacific benchmarks with an astounding 16.1% first-half advance. The Nikkei Asia300 index did even better, ending the first half of 2017 up more than 21% YTD.

Looking at some regional indexes, the pan-Europe Stoxx 600 index fell 0.5% this past quarter, but still had risen 5.0% YTD through June. The MSCI World Index advanced 3.4% in the quarter, to go up 9.4% for the year; MSCI's Emerging Markets benchmark rose 5.5% in the second quarter, taking its YTD gain to an impressive 17.22%.

COMMODITIES MARKETS

Oil traded under $50 for most of the second quarter, touching a low of $42.05 before rising to finish the second quarter at $46.33 on the NYMEX. Gold ended June at $1,241.40; silver, at $16.57.

Losers outnumbered winners in the commodity sector this past quarter, and some commodities took steep falls. Iron ore slid 21.37% in the quarter; sugar, 17.60%; gasoline, 11.16%; coffee, 10.95%. Other notable losses came for silver, oil, and cocoa, which were all down between 9-10% for the quarter; heating oil and natural gas gave back roughly 5%. Among the big second quarter winners: oats, up 29.32%; CBOT wheat, up 19.81%; feeder cattle, up 10.43%. Palladium picked up 4.78%; soybean oil; 3.62%; corn; 1.72%; copper, 1.66%.

The animal protein and grain sectors were the best-per-

Quarter in Review, *continued on page 4*

'Rotherization': The Federal Government's Plan to Fill Its Coffers

By Clark Kendall

During a recent visit to Capitol Hill to discuss the implementation of the Department of Labor fiduciary rule with Senator Ben Cardin, I learned of a new "rotherization" plan being floated in Congress. Essentially, it eliminates pre-tax retirement savings contributions, thus depriving investors of one of the key benefits of SEPs, 401(k) plans, 403(b) plans, and IRA accounts. Contributions to all these accounts would have to be made after federal taxes are withheld.

What's the purpose of this plan? To fill government coffers now, versus years or decades down the road when millions more Americans retire. Frankly, this proposal is really just a budgeting gimmick. One way or another, the federal government will collect tax revenues from retirement savings. The question is, as this new surge of tax dollars flows into Washington, will "rotherization" end up costing too much? I believe the answer is yes, both for individual investors and for society at large.

Fewer Choices for Investors

The freedom to choose how we save for retirement is a cherished right. It's also important for people who want to maximize their retirement income and pass along as much as they can to their children and grandchildren. Individuals who expect to be in a higher tax bracket when they retire might decide to contribute or convert to a Roth so they can pay taxes as they go. On the other side of the coin, if individuals expect their tax bracket to be lower during retirement, they can choose to make retirement plan contributions using pre-tax dollars and (hopefully) pay lower income taxes once they retire.

In fact, many families—especially those who experience big income fluctuations from year to year or must transition from two household incomes to one—use both pre-tax and after-tax accounts to save as much as they can. If the government limits all individuals to only after-tax retirement plan contributions, I believe it will discourage people from saving for retirement in the first place, and that will harm the people who need incentives the most.

A Wider Gap between the Haves and Have Nots

Right now, the median household income in the U.S. is $53,000, and six in 10 Americans have less than $500 in emergency savings. Millions of working-class families are living paycheck to paycheck. For many of these families, employer-sponsored 401(k)s, IRAs and other pre-tax vehicles have been a godsend, allowing them to save what they can for retirement out using pre-tax dollars.

My greatest concern about "rotherization" is that it will widen the gap between the wealthy (those who stand to benefit the most from after-tax retirement savings accounts) and everyone else. The immediate tax burden will force many lower-income families to limit their contributions to retirement savings accounts; in some cases, it might become too costly to save for retirement at all. Meanwhile, high-income earners who are destined to enter a higher tax bracket upon retirement will continue to take advantage of after-tax savings accounts to maximize and protect their wealth.

There's nothing wrong with taking advantage of retirement planning strategies that minimize one's tax liability in order to ensure a financially secure future and share a lifetime of savings with loved ones. But if the government allows only one option—one that actually discourages saving among certain classes of Americans—it will not only increase the risk of insolvency for millions of future retirees, but also create more of a divergence between the haves and have nots in our society.

I strongly believe government laws and regulations should be written to incentivize individuals to act in the best interest of our community. "Rotherization," in my view, fails to meet that standard.

$200 Million Assets Under Management

Kendall Capital is proud to announce that we have reached the milestone of managing over $200 million assets for our Middle Class Millionaire clients! Thank you to our clients. We appreciate the opportunity to continue to serve you.

Quarter in Review, *continued from page 2*

forming portions of the commodities market in the quarter, respectively gaining 15.13% and 13.34%. The energy sector fell 7.61%; the precious metals sector, 2.09%; the base metals sector, 1.75%.

REAL ESTATE

Home buying slumped in April and then rebounded during May. In the fourth month of the year, the National Association of Realtors calculated a 2.5% decline in resales – but a 1.1% May gain left them 2.7% improved over the past 12 months. That May gain happened with inventory down 8.4% year-over-year and a median existing home price 5.8% higher ($252,800) than a year before. The Census Bureau said that new home sales dropped 7.9% in April but rose 2.9% a month later.

Cheap mortgages were certainly a plus. In Freddie Mac's March 30 Primary Mortgage Market Survey, mortgage types bore the following average interest rates: 30-year fixed, 4.14%; 15-year fixed, 3.39%; 5/1-year adjustable, 3.18%. Freddie's June 29 survey showed the following averages: 30-year fixed, 3.88%; 15-year fixed, 3.17%; 5/1-year adjustable, 3.17%.

Three other closely-watched housing market indicators weakened in the second quarter. The Census Bureau's monthly snapshot of housing starts and building permits showed starts down 2.8% in April and 5.5% in May as well as permits slipping 2.5% for April and 4.9% for May. The year-over-year advance on the 20-city composite S&P/Case-Shiller home price index was 5.9% in the March edition and 5.7% in the April edition (this is a famously lagging indicator). Finally, NAR's pending home sales index took two small steps back, retreating 1.7% in April and 0.8% in May.

LOOKING BACK…LOOKING FORWARD

A sustained rally with only brief, minor setbacks left the notable U.S. equity and volatility indices at the following levels at the end of the second quarter: S&P 500, 2,423.41; Dow Jones Industrial Average, 21,349.63; Russell 2000, 1,415.36; Nasdaq Composite, 6,140.42; CBOE VIX, 11.18. The quarterly gains for the big three are noted below; the Russell advanced 2.39% in three months, while the VIX fell 3.12%. The PHLX Oil Service Sector index brought up the rear among U.S. equity indices, staggering to a 22.54% 3-month loss.

With the three marquee U.S. equity indices up between 15-27% in 12 months, investors are naturally skeptical about how long stocks can maintain such powerful momentum. Bulls still rule Wall Street and see more upside to this market during the rest of 2017. It is true that past performance is no guarantee of future success, but the major Wall Street indices have tended to have a good second half in the past 20 years, regardless of their first-half performance. The Dow and Nasdaq have posted second-half advances during 14 of the past 20 years, and the S&P 500 has followed suit in 13 of the past 20 years. Looking closer at the years featuring these advances, the average second-half rise was 4.31% for the Nasdaq, 3.23% for the Dow, and 2.68% for the S&P. Since 1988, the S&P has never retreated during the second half of a year when it has gained 6% or more in a first half. So, in recent stock market history, when the bulls have been ruling the Street in the first half of a year, they have tended to keep running the rest of the year. Bears might say that the bulls who embrace these statistics are suffering from regency bias, and perhaps, that argument has merit. Then again, bearish analysts have predicted an end to this bull market year after year, and still, it persists.

% CHANGE	Q2 CHG	Q1 CHG	1-YR CHG	10-YR AVG
DJIA	+3.32	+4.56	+19.07	+5.92
NASDAQ	+3.87	+9.82	+26.80	+13.59
S&P 500	+2.57	+5.53	+15.46	+6.12

Sources: seekingalpha.com, barchart.com, bigcharts.com, treasury.gov – 6/30/17
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

The Importance of Financial Literacy

Too few Americans understand personal finance fundamentals.

By Paola Bruening

If only money came with instructions. If it did, the route toward wealth would be clear and direct. Unfortunately, many people have inadequate financial knowledge, and for them, the path is more obscure.

Are most people clueless about financial matters? That depends on what gauge you want to use to measure financial knowledge. The U.S. ranked fourteenth in Standard & Poor's 2015 Global Financial Literacy Study, with just 57% of the country's population estimated as financially literate. Perhaps, this explains why the average household saves less than 6% - considerably less than the European countries and Australia who outranked us.

Obviously, the other 43% of Americans have some degree of financial understanding – but it is mixed with a degree of incomprehension. Witness some examples:

*A recent LendU survey found that nearly half of college students carrying student loans thought those debts would eventually be forgiven if left unpaid.

*This year, Fidelity Investments asked Americans the following question in a multiple-choice quiz: "If you were able to set aside $50 each month for retirement, to how much could that grow in 25 years, including interest, if it grew at the historical stock market average?" The correct answer was $40,000, but just 16% of respondents got it right. Another 27% guessed $15,000 (i.e., 50 x 12 x 25, as if interest was not a factor).

*Only 42% of those quizzed by Fidelity knew that withdrawing 4-5% a year from retirement savings is commonly recommended. Fifteen percent of those older than 55 thought they would be "safe" withdrawing 10-12% per year.

*The S&P 500 has had a positive return in 30 of the last 35 years. Just 8% of those answering Fidelity's quiz guessed this.

Apart from these examples, consider another one at the macro level. According to the latest National Financial Capability Study from FINRA (the Financial Industry Regulatory Authority), only about a third of Americans younger than 40 understand the basic financial concepts of compounding interest, inflation, and risk diversification.

Statistics aside, think about how a lack of financial acumen hurts people's chances to build or protect wealth. How about the employee who skips retirement plan enrollment at work, mistakenly thinking that a tax-advantaged retirement account is the same as a bank account? Or the small business owner puzzled by cash flow and profit-and-loss statements? Or the young borrower who fails to grasp the long-run consequences of only making interest payments on a credit card or loan?

Financial professionals continually educate themselves. They stay on top of economic and market developments and changes to tax law. Average Americans should as well. Ten or twenty years from now, you may find yourself in an entirely different place financially – who knows? The economy, the Wall Street climate, and even the investment opportunities before you could all differ from what you see today. If your financial knowledge is ten or twenty years out of date, you risk being at a disadvantage.

Financial literacy is not about prevention, but instead about empowerment. The more you understand about personal finance, the more likely you will make smart money decisions.

CFA Institute

Kendall Capital Management is proud to meet and comply with the CFA Institute's newly created Asset Manager's Code of Ethics!

Will You Really Be Able to Work Longer?

By Carol Petrov

How long do you think you will work? Are you one of those baby boomers (or Gen Xers) who believes he or she can work past 65? Some pre-retirees are basing their entire retirement transition on that belief, and that could be financially perilous.

In a new survey on retirement age, the gap between perception and reality stands out. The Employee Benefit Research Institute (EBRI) recently published its 2017 Retirement Confidence Survey, and the big takeaway from all the data is that 75% of American workers believe they will be on the job until they reach age 65 or beyond. However, only 23% of retirees polled this year said that they had actually worked until age 65.

So, what are today's pre-retirees to believe? Will they upend all their assumptions about retiring? Will working until 70 become the new normal? Or will their retirement transitions happen as many do today, arriving earlier and more abruptly than anticipated?

Perhaps this generation can work longer. AARP predicts that nearly a quarter of Americans 70-74 years old will be working in 2022, including nearly 40% of women that age by 2024. That would still leave many Americans retiring in their sixties – and more to the point, working until 70 is not a retirement plan.

What if you retire at 62, three years before you can enroll in Medicare? EBRI's statistics indicate that this predicament has been common. You can pay for up to 18 months of COBRA (which is not cheap), tap a Health Savings Account (if you have one), or take advantage of your working spouse's employer-sponsored health coverage. Beyond those options, you could either pay for private health insurance or go uninsured.

"AARP predicts that nearly a quarter of Americans 70-74 years old will be working in 2022, including nearly 40% of women that age by 2024."

What if you end up claiming Social Security earlier than planned? Many folks are claiming their Social Security benefits as early as 62. If you only live to your late 70s, that may not be so bad – you will get a reduced monthly benefit but the total amount of retirement benefits you receive over your lifetime should be mathematically about the same as if you waited until your FRA (66, 67 or somewhere in between). However, if you plan to work part-time or think you may live beyond 80, you should think carefully before locking in the lower benefit for life.

All that being said, working past 65 can take on many meanings. Perhaps you can no longer handle the physical or mental strains of your current career, but would be quite content "downshifting" into another job. This may be in the same company, but in another department or with less hours. By keeping your skills current and staying flexible, employers are more willing to keep you. One should see this stage of their lives as an opportunity to put their heart into work they truly enjoy so they not only preserve their assets longer, but keep their minds sharp and spirits high.

A Friendly Reminder of What to Do with Suspicious Emails

Recently, we have had a number of clients reach out to us with concerns about an email they had received from a sender claiming to be Schwab, TD Ameritrade or another financial institution. We want to remind you that if you receive a suspicious email, please do not click on any links or forward the email directly to us.

If you would like our input, please take a screenshot of the email and send the screenshot to us for our review. Alternatively, a quick way to find out if the email is spam or a phishing attempt is to hit "reply." If the email address is does not appear to be anything close to the financial instiution claiming to have sent the email, it is very likely spam or a phishing attempt.

You may also reach out to the financial institution claiming to have sent the email to find out if they have, in fact, sent you an email. If they have not, the financial institution may ask that you forward the email or send a screenshot to their fraud department for their review.

Vanishing Stocks

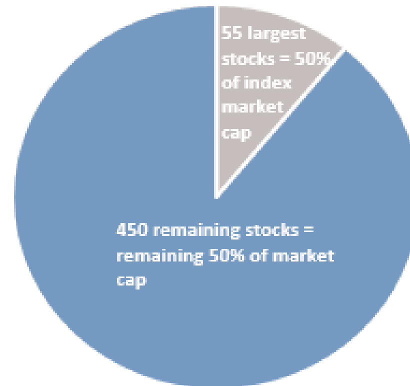
By Jason Tkach

A recent Wall Street Journal article, citing a study by the Center for Research in Security Prices, tells us something remarkable about the climate in which we are investing: the number of stocks on the U.S. market has quietly diminished by more than half over the last 20 years. In November 1997, investors could choose from 7,355 U.S. stocks. Today, there are fewer than 3,600.

Why haven't you noticed this? The majority of the decline has come from vanishing companies ranging from small to microcap—the sort of names with which are you are likely not familiar. Small stocks have diminished from more than 2,500 in 1997 to fewer than 1,200 today. Microcap companies that are even smaller numbered nearly 4,000 in 1997, compared to 1,900 today. Some went out of business, while others were gobbled up by private equity firms.

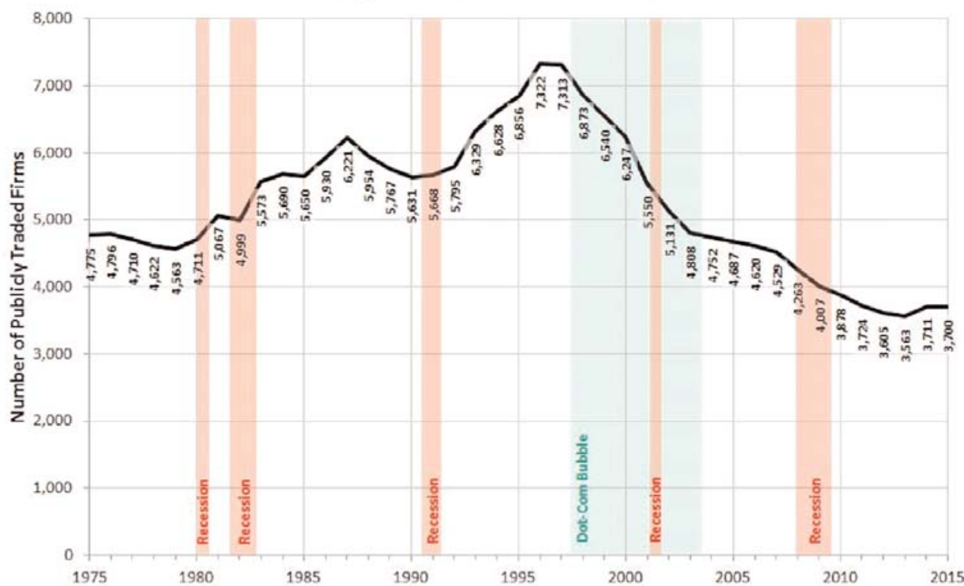
Meanwhile, the environment has changed; instead of new companies going public to replace those that have retired from the market, venture capital firms are allowing younger companies to stay private for longer. Thus creating a situation where the surviving companies tend to be larger and better known.

We see this situation unfolding in the current market capitaliztion of the S&P 500. Today, the top 55 stocks of the S&P 500 represent 50% of the index's market capital. This has also been fueled by the consumer's craving for passive index investing.



Given that the US Dollar has been very strong relative to other world currencies, those 55 stocks have greatly outperformed when compared to other major domestic and world indices. We continue to see value and opportunities in the other 445 small and mid-cap stocks within the S&P 500. The fact that many equities have vanished over the years has created unique opportunities which we utilize within our portfolios.

Source: https://www.wsj.com/articles/stock-picking-is-dying-because-there-are-no-more-stocks-to-pick-1498240513



The Real Cost of College

By Madolynn Morken

How much will your family end up paying for college? Your household's income may have less influence than you think – and some private colleges may be cheaper than you assume.

Private schools sometimes extend the best aid offers. Yes – it is true that the more money you earn and the more assets you have in a tax-advantaged college savings plan, the harder it becomes to qualify for financial aid. Merit aid is another matter, however; most private colleges and universities that boast major endowment funds support healthy, merit-based aid packages.

These scholarships and institutional grants – awarded irrespective of a family's financial need – can reduce the "sticker shock" of a college education. A study from the National Association of College and University Business Officers found that grant-based aid effectively cut tuition and fees by an average of 48.6% in the 2015-16 academic year. If your child can fit into the top quarter of a college's student population in terms of grades or achievement, merit aid may be a possibility. A college that is your child's second or third choice might offer him or her more merit aid than their first choice.

Relatively speaking, some universities demand more from poorer families. An analysis published in 2016 by New America noted 102 U.S. colleges, with endowments of greater than $250 million, charged their poorest students more than $10,000 in tuition for the 2013-14 academic year. Additionally, of over 1,400 colleges and universities New America studied, hundreds of them expected their attendees from families earning $30,000 or less per year to pay the equivalent of at least half of their earnings on college costs.

The state legislature of New York made a striking move this spring. It decided to waive tuition for many full-time undergraduate students at both 2-year and 4-year public colleges and universities within its borders. To qualify, households had to earn less than $100,000 annually – and students had to pledge to work and reside in New York state after they earned their degrees. (The annual earnings threshold will soon rise to $125,000.) Students will still have to pay fees (and if needed, room and board), be a US Citizen, permanent resident or refugee and maintain a GPA sufficient to stay in school and graduate on time.

New York is not the only state making such an offer. Programs like the Tennessee Promise and the Oregon Promise have made community college tuition free in those states. Delaware and Minnesota have adopted similar plans, and Rhode Island and Arkansas also have like policies in the works. Any little tuition break helps, especially in these times. According to the Institute for College Access and Success, about 70% of college graduates in 2015 owed a great deal of money; their average education debt was $30,100.

600 Jefferson Plaza
Suite 410
Rockville, MD 20852

phone: 301.838.9110
fax: 301.838.9113
toll free: 877.260.7935

info@kendallcapital.com

Chief Investment Officer . . . . . Clark Kendall
Relationship Manager & Financial Planner . . . . . Carol Petrov
Portfolio Manager . . . . . Paola Bruening
Portfolio Specialist . . . . . Jason Tkach
Client Service Associate . . . . . Madolynn Morken
Accounting Associate . . . . . Zemin Zhu
Marketing Specialist . . . . . Diane Kendall

This publication is only intended for clients and interested investors residing in states in which Kendall Capital is qualified to provide investment advisory services. Please contact Clark Kendall at 301-838-9110 to find out if the investment adviser is qualified to provide investment advisory services in the state where you reside. Kendall Capital does not attempt to furnish personalized investment advice or services through this publication. Any subsequent, direct communication with a prospective client will be conducted by a Kendall Capital investment advisory representative qualified in the state where the prospective client resides. Some of the information given in this publication has been produced by unaffiliated third parties, and while it is deemed reliable, Kendall Capital does not guarantee its timeliness, sequence, accuracy, adequacy, or completeness and makes no warranties with respect to results to be obtained from its use.