KENDALL CAPITAL

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# SECURING TOMORROW

## INSIDE



## *The Trump Effect and Wall Street's Rally*

*by Clark Kendall*

### THE QUARTER IN BRIEF

Two events strongly influenced U.S. and foreign financial markets in the fourth quarter. Donald Trump's win in the presidential election led to a rally on Wall Street, and the Federal Reserve's December interest rate hike was taken in stride. The S&P 500 ended up gaining 3.25% in three months. The United Kingdom scheduled its Brexit, and OPEC elected to trim oil output for the first time in eight years. Oil rallied, and so did the dollar; precious metals retreated. The housing sector showed strength even as mortgage rates ascended. On the whole, the most-watched U.S. economic indicators were encouraging.

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### DOMESTIC ECONOMIC HEALTH

On December 14, the Federal Reserve announced its second quarter-point rate hike in two years. The federal funds rate was reset at the 0.50-0.75% range, and the central bank's latest dot-plot forecast showed three planned rate moves in 2017 instead of the previously projected two. Fed officials emphasized that oncoming tightening will be "gradual."

By November, monthly payroll gains were averaging 180,000 for the year. The main U-3 jobless rate was at 4.9% in October and at 4.6% in November. The U-6 rate that included the underemployed fell from 9.5% in October to 9.3% a month later. In November, the U-3 rate was at its lowest level since August 2007, and the U-6 rate had not been so low since April 2008.

As the fourth quarter ended, consumer confidence indices looked very impressive. The Conference Board's monthly index was well over the 100 mark at 109.4 in November, and it pushed further north to 113.0 in December. The University of Michigan's household sentiment gauge sat at 87.2 in October then rose to 93.8 in November and 98.2 for December.

Both the service and factory sectors expanded during fall 2016. The Institute for Supply Management's non-manufacturing index rose to 57.2 in November from 54.8 in October. November marked the 82nd straight month of service sector growth in America. The Institute for Supply Management purchasing manager index for the factory sector advanced to 53.2 in November from the prior mark of 51.9, indicating an improved pace of growth. In related news, factory orders rose 0.6% in October and 2.7% in November.

Consumer spending accelerated 0.4% in October, but only half that in November. Consumer incomes rose 0.5% in October, and then flattened a month after that. Core retail sales (minus car and gasoline purchases) followed a similar pattern: up 0.5% in October and 0.2% in November.

As energy costs rose, the annualized gain in the

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headline Producer Price Index (PPI) went from 0.8% in October to 1.3% in November. (By November, the core PPI showed a 1.6% yearly gain.) Consumer inflation remained beneath the Federal Reserve's 2% target. As of November, the Consumer Price Index (CPI) was up but 1.7% in 12 months, with the core CPI up 2.1%. The Federal Reserve's core Personal Consumption Expenditures (PCE) price index was 1.8% higher year-over-year in October, but that number declined to 1.6% in November.

## GLOBAL ECONOMIC HEALTH

The Eurozone economy had expanded only 0.3% in the third quarter, and by November, euro area yearly inflation was still at 0.6% with six member nations experiencing year-over-year consumer price deflation. Populist movements in France, Germany, and Italy gained traction, most notably Italy's Five Star Movement. Italian Prime Minister Matteo Renzi resigned in November after his party's attempt at constitutional reform was voted down by the electorate; the Five Star Movement has vowed to hold a national vote on whether or not Italy should stay in the European Union if it assumes power in 2018.

"The long-awaited OPEC accord to reduce oil production finally came to pass in late November. A 1.2-million-barrel-per-day cut was eventually agreed to by OPEC and non-OPEC oil producers."

Teresa May, the United Kingdom's prime minister, announced her country would make its Brexit from the E.U. as early as the summer of 2019, by invoking Article 50 of the Lisbon Treaty no later than the end of March 2017. May expected the U.K. to have a full role in E.U. policy-making through 2019. The European Central Bank made a policy decision to keep easing. In December, it announced an extension of its asset-purchase program through the end of 2017; though, the amount of monthly bond buying would be trimmed from €80 billion to €60 billion beginning in April.

The long-awaited OPEC accord to reduce oil production finally came to pass in late November. A 1.2-millon-barrel-per-day cut (effective in January) was eventually agreed to by OPEC and non-OPEC oil producers; though, some analysts felt not all parties to the agreement would comply with its terms. In the Asia-Pacific region, Japan continued its weak economic growth, while the latest statistics showed China's GDP holding steady at 6.7% in the third quarter.

## WORLD MARKETS

Looking at foreign benchmarks, the best price returns of the fourth quarter were largely in Europe. The DAX rose 9.23% during the quarter, and the CAC 40 advanced 9.31%. The 13-week gain for the FTSE 100 was not quite so large: 3.53%.

All that said, those big gains paled next to that of the Nikkei 225. Japan's major equity index added 16.20% in the fourth quarter. Other indices in the Asia-Pacific region and the Americas fell far short of that kind of quarterly performance, but there were other fourth quarter advances. The TSX Composite rose 3.81%; the All Ordinaries, 3.51%. The Shanghai Composite improved 3.29%; the MSCI World, 1.48%. MSCI's Emerging Markets index and the Sensex both fell 4.56%, while the Hang Seng retreated 5.57%.

## COMMODITIES MARKETS

Lean hogs led the pack in commodity futures in the fourth quarter, with prices rising 35.28%. Oats gained 22.19% during the quarter. Among the major commodities, unleaded gasoline led the way with a 15.83% advance; natural gas and copper were close behind, respectively adding 13.71% and 12.75%.

West Texas Intermediate crude had a fine quarter, gaining 7.59%; oil settled at $53.89 a barrel on the NYMEX on December 30, capping off an advance of 46.12% for the year.

The dollar rally was one factor that turned quarter four into a subpar quarter for precious metals. Palladium sank 5.49% in the final three months of 2016; gold, 12.81%; platinum, 12.85%; and silver, 17.28%. Gold and silver did have a nice year – gold prices rose 7.18% on the COMEX in 2016; silver prices, 15.04%. In crops, the leading fourth quarter loser was sugar, which fell 15.17%; coffee futures slumped 11.52%.

## REAL ESTATE

Mortgages grew more expensive in the fourth quarter. As the quarter ended, Freddie Mac said that the average interest rate on a 30-year conventional home loan was 4.32%. Mean interest on the 15-year fixed rate mortgage (FRM) was 3.55%; mean interest on the 5/1-year ARM, 3.30%. Look at how those December 29 numbers compare with the ones from Freddie's September 29 Primary Mortgage Market Survey: 30-year FRM, 3.42%; 15-year FRM, 2.72%; 5/1-year ARM, 2.81%.

**Quarter in Review,** *continued on page 4*

## *The Fiduciary Standard*

**By Carol Petrov**

The Department of Labor's new rule regarding the fiduciary standard and retirement plan accounts will be phased in during 2017 and fully implemented by 2018. Under the new rule, financial professionals who consult retirement savers will be held to an ethical and legal obligation to always act in a client's best interest. This is the definition of the Fiduciary Standard.

**Kendall Capital has abided by a fiduciary standard since 2005.** Roughly 8% of financial advisors abide by the fiduciary standard, but thanks to the new rule, even more will. In fact, the fiduciary standard may soon become the "new normal" in the financial services industry, and we believe this is long overdue.

> "Roughly 8% of financial advisors abide by the fiduciary standard, but thanks to the new Department of Labor rule, even more will."

Historically, investment professionals have been asked to uphold a suitability standard when making recommendations to their clients. Under the suitability standard, financial products are recommended based a client's age, income, net worth, and savings goals. Many in the brokerage industry believe this standard has been adequate.

The Department of Labor disagrees. In its view, the suitability standard is merely the broker's interpretation of the client's needs and goals but they are under no obligation to discuss alternatives. Hence a conflict of interest ensues simply because a financial professional who is compensated by commissions, will find a way to make the one with the largest commission, a suitable investment. So, which financial services professionals uphold a fiduciary standard and emphasize fee-based or fee-only planning? If you're not a Kendall Capital client, this is a good question to ask yourself.

**Too many terms muddies the water.** The financial services industry is criticized for being too confusing for average people. And rightly so! We call ourselves Independent, Financial Planner, Financial Advisor, Registered Representative and have an alphabet of designations to boot. However, the one question that hits to the heart of the matter is how are you compensated?

Many financial professionals call themselves Independent simply because they are not affiliated with one major firm. However, their recommendations are skewed by the commissions they receive from the companies they represent. Whether they're with a large broker-dealer or not, if the advisor is compensated by commissions, you should question their intention. At Kendall Capital, we not only adhere to the fiduciary standard, but we choose to be fee-only meaning our only form of compensation is the fees paid to us by our clients. We receive no compensation or commission for the investments we recommend to our clients. So, our advice and recommendations are truly unbiased.

In short, the financial services industry is not perfect. The new Department of Labor rule demanding a fiduciary standard from the professionals advising people with retirement accounts takes a big step toward remedying some of its imperfections. What matters most is that clients receive quality advice and excellent service while their advisors are paid fairly for their time and incentivized to keep clients in good financial health over the long run.

At Kendall Capital, we understand that one size does not fit all, and that is why we provide tailored solutions to each Middle Class Millionaire.

-Kendall Capital Value Statement #5

**Quarter in Review,** *continued from page 2*

As home loans became costlier, more buyers stepped forth: existing home sales rose 1.5% during October and another 0.7% in November. That data comes from the National Association of Realtors, whose pending home sales index rose just 0.1% in October and slipped 2.5% the next month. The national S&P/Case-Shiller home price index measures year-over-year price gains for existing homes; its annualized increase reached 5.6% in October, up from 5.4% in September. New home buying rose 5.2% in November after a 1.4% October fall, the Census Bureau reported.

Real estate construction surged in October, but waned with colder weather in November. The Census Bureau said that groundbreaking increased 27.4% in the tenth month of 2016, with a 2.9% boost for building permits. A month later, starts were down by 18.7%, with permits reduced by 4.7%.

**LOOKING BACK…LOOKING FORWARD**

The fourth-quarter performances, noted in the accompanying table, left the big three U.S. equity indices at the following year-end settlements: Dow Jones Industrial Average, 19,762.60; NASDAQ Composite, 5,383.12; S&P 500, 2,238.83. While the big three all posted fourth quarter gains, their advances were matched or surpassed by some other benchmarks. The U.S. Dollar Index rose 7.06% for the quarter, and the Russell 2000 gained 8.43%. Unsurprisingly, given some of the quarter's major commodity gains, the PHLX Oil Service index added 12.33%, and the S&P GSCI index improved 9.25%. Amid all this, the CBOE VIX rose 5.64% to end the trading year at 14.04.

Treasury yields moved north, especially after the election. The 10-year note's real yield rose ¾ of a percentage point from 1.75% to 2.5% during the fourth quarter. While this may not seem like much it is actually a 42% rise which is significant.

Investors are entering the first quarter with a good deal of optimism but also with an awareness that anything could happen. Wall Street has been bullish on the incoming Trump administration and that confidence will likely continue as it begins to shape policy in Washington. At the same time, market participants are keeping a cautious eye on the Fed, the strong dollar, and the possibility of a stock bubble inflated by euphoria. Economic signals have looked much better of late than they did a year ago, and the stock market appears to be on much sturdier legs than it was at the beginning of 2016, when it fell precipitously. With the earnings recession having faded away, perhaps the market will get a boost this next earnings season that will lift the Dow above 20,000. For this best-case scenario to emerge, domestic and global belief in the new president and his administration needs to be strong and sustained, and geopolitical events from overseas need to be tolerable for the bulls. It will be an interesting first quarter.

| % CHANGE | 2016 | Q4 CHG | Q3 CHG | 10-YR AVG |
|---|---|---|---|---|
| DJIA | +13.42 | +7.94 | +2.11 | +5.86 |
| NASDAQ | +7.50 | +1.34 | +9.69 | +12.29 |
| S&P 500 | +9.54 | +3.25 | +3.31 | +5.79 |

Sources: barchart.com, cnbc.com, bigcharts.com, treasury.gov – 12/30/16
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.
These returns do not include dividends.

## Should You Care What the Market Does Each Day?

By Paola Bruening

Investors are people, and our high tech society often causes people to become impatient. No one likes to wait in line or wait longer than they have to for something, especially when so much is just a click or two away.

This impatience also manifests itself in the equities markets. When the S&P 500, Dow, or NASDAQ take a tumble, some investors grow uneasy. Their impulse is to sell, get out, and get back in later. If they give into that impulse, they may effectively pay a price.

Across twenty years ending in 2015, the annual return of the S&P 500 averaged 9.85%. During this same period, the average retail investor realized a yearly return of just 5.19%. Why the difference? It could partly stem from impatience.

Some investors may be worrying too much and acting on those worries to their detriment. An investor who glances at a portfolio once per quarter may end up making more progress toward his or her goals than one who anxiously pores over financial websites every day.

Too many investors make quick, emotional moves when the market dips. Logic often goes out the window when this happens, along with long-term perspective.

Some long-term investors focus on buying shares of respected companies. Warren Buffett does. He has famously said that an investor should buy shares of a firm to own a piece of it, not merely in hopes that its share price will rise.

Certain companies are so strong, their brands so renowned, that their investments weather downturns better than shares of other firms. In a raging bull market, “all boats rise” and many types of shares may perform well. Buffett often tries to invest in companies whose investments may perform well in both up and down markets. In especially bullish times, his returns have sometimes lagged the market, but chasing the return is not his objective.

In contrast with Buffett’s patient long-term approach, investors who care too much about day-to-day market behavior may practice market timing, which is as much hope as strategy.

“Too many investors make quick, emotional moves when the market dips. Logic often goes out the window when this happens, along with long-term perspective.”

To make market timing work, an investor has to be right twice. Ideally, he or she sells high, takes profit, and buys back in at some point of capitulation. This is hard even for Wall Street professionals. More often, “do-it-yourself” investors buy high and sell low.

Investors who alter their strategy in response to the headlines may end up changing it again after further headlines. While they may feel on top of things by doing this, their returns may suffer from their emotional and impatient responses.

## 2017 Retirement Plan Contribution Limits

Each October, the Internal Revenue Service announces changes to annual contribution limits for IRAs and workplace retirement plans.

**Are any of these limits rising for 2017?**

Unfortunately, no. Annual contributions for Roth and traditional IRAs remain capped at $5,500 for 2017, with an additional $1,000 catch-up contribution permitted for those 50 and older. This is the fifth consecutive year those limits have gone unchanged. The SIMPLE IRA contribution limit is the same in 2017 as well: $12,500 with a $3,000 catch-up permitted.

There is a slight increase though when it pertains to the employer contribution to a SEP-IRA which rises $1,000 in 2017 to $54,000; this adjustment also applies for individual 401(k)s.

**Am I eligible to contribute?**

When determining if you’re eligible to make contributions to a deductible Traditional IRA or a Roth IRA, you must see where your modified adjusted gross income (MAGI) falls for the given year. For 2017 we get a very slight bump up in the amount of income we can earn and still contribute to these types of accounts.

For Roth IRA contributions the phase out ranges are:

**2017 Plan Contributions,** *continued on page 7*

# Investing in a Concentrated Stock Market

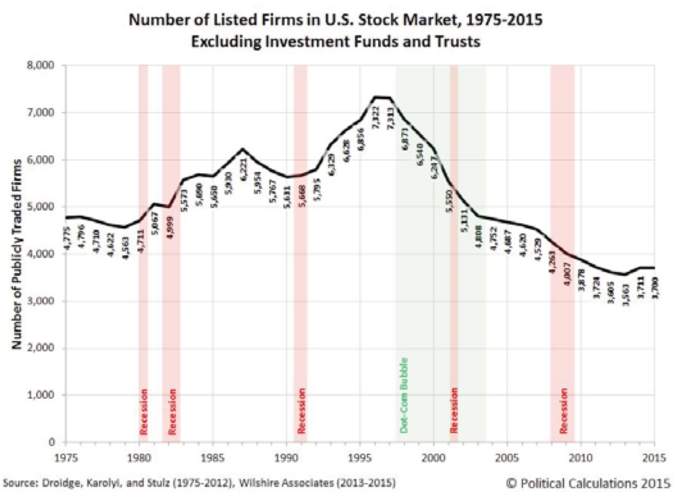
**By Jason Tkach**

Investing is a daunting task for many Middle Class Millionaires and knowing where not to invest occasionally makes the entire investment process much easier. Here's a brief rundown of where we are now, where we think the markets are going in 2017, and what it all means for our various investment strategies.

**The market has become highly concentrated.**

One of the biggest underlying issues facing the investment market is that fewer companies are going public, or they're waiting longer to do so. In 2000, there were 7,800 publicly traded companies in the U.S.; in 2016, that number had shrunk to 3,600.

There's also a huge push in our industry toward the "buy the index" strategy. As a result, the top 54 companies of the S&P 500 represent half of the S&P's market value. Relative to the broad market, the other 450 companies in the S&P,



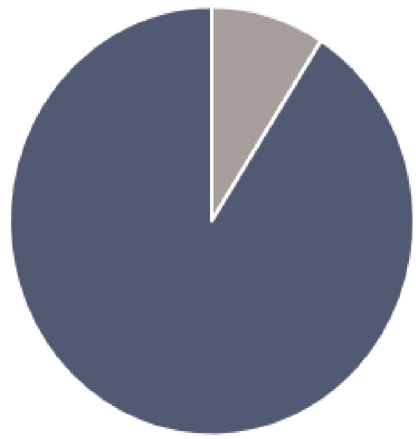

and the rest of the 3,700 publicly traded companies based in the U.S., these "nifty fifty" companies' stocks are becoming quite expensive (as measured by price per earnings, price-to-sales ratio, and relatively higher international sales).

**The economic climate is shifting.**

Since the November election, the 10-year U.S. Treasury yield has increased from 1.6% to 2.6%. This is a dramatic move, and it will have a sweeping effect. As the investment rate rises, so does the discount factor for investments while the value of future cash flows declines.

Meanwhile, trade issues could weigh even more heavily this year. Since 2014, the U.S. dollar has appreciated more than 20% against the Euro. Boeing, for example, is struggling to sell its airplanes in world markets because Airbus offers a 20% less expensive product. Couple the strong U.S. dollar with President-Elect Trump's pledge to pursue trade barriers, and large US-based companies (now trading at a premium) may have even more difficulty selling their products and services in the world market.

**S&P 500 Market Capitalization**



***Gray*** *= Top 50 stocks representing 50% of the S&P Market Capitalization*
***Blue*** *= Remaining 450 stocks representing the remaining 50% of the S&P500 Market Capitalization*

**Investors should weigh opportunity and risk accordingly.**

Our best advice is to avoid the top 54 stocks in the S&P 500. Kendall Capital's Growth at a Reasonable Price (GARP) portfolio is doing its best to steer clear of those top stocks in the S&P 500. Instead, we look for opportunities in small- and mid-cap securities with high percentages of domestic sales.

Our second piece of advice is to consider investing in the fixed income market. Kendall Capital's Income and Growth portfolio is actively searching the fixed income market for opportunities. We've essentially been out of the fixed income market for years, but as interest rates continue to rise, bonds will start to look very attractive.

One final note. There is no simple, universal formula for determining how assets should be allocated. Much depends on the factors we use in developing client's investment policy statements. These are customized to take into account their unique personal criteria, goals and the right mix of our investment portfolios to help them reach those goals.

**2017 Plan Contributions,** *continued from page 5*

*Single/head of household $118,000-133,000 ($1,000 higher than 2016).

*Married couples $186,000-196,000 ($2,000 higher than 2016).

For those who wish to make some deductible contributions to a Traditional IRA, the rules are complex and depend on whether or not your spouse also contributes to a retirement plan. Please call us to discuss these options.

**Will you be able to put a little more into your 401(k), 403(b), or 457 plan next year?**

No. As an employee your contributions stay the same - $18,000 for 2017. (That limit also applies to the Thrift Savings Plan for federal workers.) The additional catch-up contribution limit for plan participants 50 and older remains at $6,000. If 2017 brings you an opportunity to make 1099 or self-employed income or you're considering starting a business, please consult with us to determine your retirement plan options no later than October 1st.

**Are you self-employed, with a defined benefits plan?**

The limit on the yearly benefit for those pension plans increases by $5,000 next year. The 2017 limit is set at $215,000.

**What about Health Savings Accounts (HSA)?**

HSAs are sometimes called "backdoor IRAs" because they can essentially function as retirement accounts for people 65 and older; at which point withdrawals can be used for any purpose – not just medical expenses. They're designed for those who have a high-deductible health insurance plan (HDHP) for themselves or through their employer. If you have a plan like this and don't have an HSA, you're missing out. You could make a deductible contribution up to $3,400 for individuals ($6,550 for family coverage) regardless of your income, to an account which you could invest in mutual funds and watch grow just like your other IRAs. There is a lot of confusion about this type of account so feel free to call us for more information.

***Reminder: Federal taxes are due Tuesday, April 18, 2017.***

## *A Small Change to Social Security in 2017 with a Possible Medicare Premium Hike*

The average Social Security recipient will receive a whopping $5 per month raise in 2017. Social Security's mean monthly benefit is projected to rise, from the current $1,355, by this scant amount because of low yearly inflation measured by the federal government.

Social Security cost-of-living adjustments (COLAs) are tied to changes in the CPI-W. The CPI-W is the Consumer Price Index (CPI) that measures inflation for urban wage earners and clerical workers. If that seems a bit incongruous to you, it also does to senior advocacy groups. They would prefer that these COLAs be based on the CPI-E, a version of the CPI that tracks consumer costs for the elderly.

The CPI-E gives more weight to increases in medical and housing costs than the CPI-W. If Social Security COLAs were linked to the CPI-E, as many experts believe, they might be greater. Data from the Bureau of Labor Statistics backs up this assertion, as healthcare costs alone advanced 5.1% in the 12 months ending in August 2016.

Medicare premiums have increased slightly from $121.80 to $134.00 per month for newly enrolled recipients or those on Medicare who do not collect Social Security. However, 70% of Social Security recipients who have Medicare will simply see their "raise" go toward covering Medicare Part B premiums which increased from $105.00 to $109.00 per month. Federal law tries to keep premiums down for this 70% of the elderly and disabled based on their income. Just who makes up the other 30% of Medicare recipients? Quite possibly many of you reading this newsletter.

If your Adjusted Gross Income (AGI) is greater than $85,000 (single filer) or $170,000 (joint filer), you'll be asked to pay an additional $187.50 per month. If your income is even higher, the premiums continue to increase. It's important to understand that this premium is based on income from 2 years prior (in other words 2017 premiums are based on 2015's tax return). So, if your income spiked due to a special circumstance, you can appeal the decision. Additionally, if you anticipate being close to these threshold's you should let Kendall Capital know so we can help reduce your AGI before the end of the year.

The tiny 2017 Social Security COLA at least beats expectations. Social Security's Board of Trustees had forecasted the mean monthly benefit to rise 0.2% in 2017, not even $3 a month for the average recipient. Monthly Social Security benefits have risen an average of 2.3% per year since 2000, even with no COLAs occurring in 2009, 2010, and 2016.

## *The Price of a Pill in the United States*

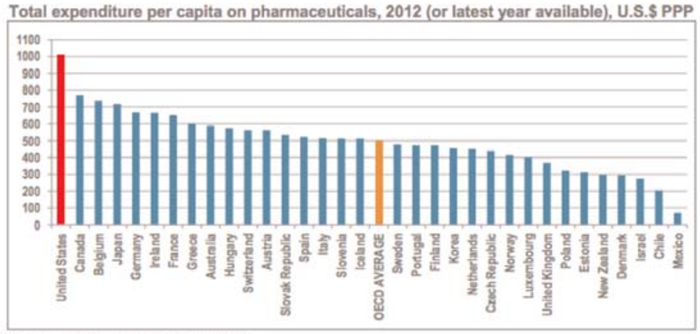
We often hear that medical costs are too high in the U.S., and Medicare will go bankrupt in the future. So how high are drug prices, and are those prices contributing at all to the high medical costs in the U.S.?

A Public Citizen research report looked at the prices older citizens pay for their medications under the Medicare Part D plan, the largest federal drug program, which now covers more than 39 million people. You might be surprised to know that when the plan was passed by Congress under the Bush Administration, Medicare was not allowed to "interfere" with the negotiations between drug manufacturers and pharmacies. The program was prohibited from leveraging its purchasing power to create economies of scale.

The researchers compared the total expenditure per capita on pharmaceuticals across 33 large nations around the world, and found that not only did the U.S. spend the most—just over $1,000 a year per U.S. consumer, but the U.S. was a huge outlier over the rest of the world. Canada, whose socialized medical system is widely derided in political debates, came in second, at $750 per capita, and Belgium, Japan, Germany, Ireland, France and Greece are all near or above $600. At the other end of the scale, countries like Chile ($200), Israel ($300) and Denmark ($300) have managed to control drug costs without sabotaging the quality of their citizens' health care.

A separate analysis in the same report found that Americans pay much higher prices for patented drugs than any country in the world—by a nearly 2:1 ratio. In fact, Medicare Part D pays nearly twice as much for the same medications as the Veterans Health Administration (VHA), due to the VHA's ability to negotiate prices with its own purchasing power.

**Total expenditure per capita on pharmaceuticals, 2012 (or latest year available), U.S.$ PPP**




Source: OECD Health Statistics (2014).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