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# Money Matters

A monthly publication to keep our clients informed about current financial issues and trends

Quarterly Newsletter

*First Quarter 2017*

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## 2017 First Quarter

Are we in the late stages of a bull market—that time when the market suddenly takes off like a rocket for no apparent reason?

Over the last eight years, the S&P 500 index has returned more than 250%. But the tail end of this run seems to have accelerated the trend. The first quarter of 2017 provided the highest returns for U.S. large-cap stocks since the last three months of 2013. The Nasdaq index has booked its 21st record close of the year so far, and the indices have recorded a 30% rise over the past six quarters, marking the fastest advance since 2006.

The first quarter of 2017 has seen the broad measure of U.S. stocks, Russell 3000 index, gain 5.74% in the first quarter.

Looking at large cap stocks, the Russell 1000 large-cap index finished the first quarter with a 6.03% performance, while the widely-quoted S&P 500 index of large company stocks was up 6.07% in the first three months of 2017.

Meanwhile, the Russell Midcap Index gained 5.15% in the first quarter.

Investors in smaller companies marked by the Russell 2000 Small-Cap Index finished the quarter up 2.47%, while the technology-heavy Nasdaq Composite Index rose 10.13% in the first quarter, continuing its record-breaking climb.

Even the international investments were soaring through the start of the year. The broad-based EAFE index of companies in developed foreign economies gained 7.25% in the first three months of calendar 2017. In aggregate, European stocks gained 7.44% for the quarter. Emerging market stocks of less developed countries, as represented by the EAFE EM index, rose 11.45%.

Looking over the other investment categories, real estate investments, as measured by the S&P Global REIT index, eked out a 1.72% gain during the year's first quarter. The S&P GSCI index, which measures commodities returns, lost 4.42%, in part due to a 5.81% drop in the S&P crude oil index. Gold prices shot up 8.64% for the quarter and silver gained 14.18%.

In the bond markets rates are incrementally rising. Coupon rates on 10-year Treasury bonds stood at 2.40% at quarter end, while 30-year government bond yields rose to 3.02%.

The pundits on Wall Street have been telling us that the market's sudden meteoric rise—which really accelerated starting in December of last year—is the result of the so-called "Trump Trade," shorthand for an expectation that companies and individuals will soon be paying fewer taxes and be burdened by fewer regulations, leading to higher profits and greater overall prosperity. Adding a trillion dollars of promised infrastructure spending will create the expectation of an economic boom across virtually all sectors.

However, there is, as yet, no sign of that boom; just a continuation of the slow, steady recovery that the U.S. has experienced since 2009. The latest reports show that the U.S. gross domestic product—a broad measure of economic activity—grew just 1.6% last year, the most sluggish performance since 2011. The U.S. trade deficit widened in January, and both consumer spending and construction activities are weakening from slower-than-average growth rates.

The good news is that corporate profits increased at an annual rate of 2.3% in the fourth quarter, which shows at least incremental improvement. However, the previous three months saw a 6.7% rise in profits, suggesting that the trend may be downward going forward.

It's possible to read too much into the recent failure of health care legislation, and imagine that we're in for four years of ineffective leadership. There will almost certainly be a tax reform debate in Congress in the coming months, but the surprising aspect—as with the healthcare legislation—is that there seems to have been no pre-prepared plan for Congress to vote on. We know that the Republican President and Congress want to lower corporate tax rates and simplify the tax code—which, in the past, has meant adding thousands of new pages to it. We know that there is general opposition to any form of estate taxes, but nobody is proposing which deductions would be eliminated in order to make this package revenue-neutral.

Similarly, there have been no details about the infrastructure package, which means we don't know yet whether it would be a budget-busting package of pork barrel projects or a real contribution to America's global competitiveness.

We can, however, be certain of one thing: as the bull market ages, we are moving ever closer to a period when stock prices will decline. This is all part of the natural business cycle. This is a good time to ask yourself if your asset allocation is appropriate. How much of a downturn would I be able to stomach either before panic sets in or my lifestyle is endangered? We review the range of returns during our meetings, but it's always a good time to confirm your stock and bond allocations. John F. Kennedy remarked "the time to repair the roof is when the sun is shining."

If you're not concerned of a downturn, then you should look at the next bear market the way the most successful investors do, and envision a terrific buying opportunity, a time when stocks go on sale for the first time in the better part of a decade. For some reason, people go to the shopping mall to buy when items go on sale, yet they do the opposite when the investment markets go down. Knowing this can be an unfair advantage to your future wealth, and even make you look forward to the end of this long, unusually steady, increasingly frantic bull run in stocks. After all, if history is any indication, the next downturn will be followed by another bull run.

## Quarterly Benchmarks

| | 1Q | YTD | 1 Year | 3 Year | 5 Year |
|---|---|---|---|---|---|
| **Fixed Income** | | | | | |
| 3-Month T-Bill | 0.15% | 0.15% | 0.39% | 0.18% | 0.13% |
| Citigroup World Government Bond Index | 1.55% | 1.55% | -3.65% | -1.20 | -0.58% |
| Barclays 7 Yr. Muni Bond Index | 1.95% | 1.95% | -0.06% | 2.89% | 2.72% |
| Vanguard Total Bond Market Index Fund | 0.91% | 0.91% | 0.43% | 2.60% | 2.27% |
| **Large Cap** | | | | | |
| Vanguard 500 Index Fund | 6.05% | 6.05% | 17.13% | 10.34% | 13.26% |
| **Mid Cap** | | | | | |
| Russell Mid Cap Index | 5.15% | 5.15% | 17.03% | 8.48% | 13.09% |
| **Small Cap** | | | | | |
| Russell 2000 Index | 2.47% | 2.47% | 26.22% | 7.22% | 12.35% |
| **International Equity** | | | | | |
| Vanguard Developed Markets Index | 7.82% | 7.82% | 12.74% | 1.16% | 6.19% |
| Vanguard Emerging Market Stock Index Fund | 10.84% | 10.84% | 17.57% | 1.91% | 0.87% |

# Creative Giving

Giving to a charity is easy, right? You write a check and send it off to your favorite 501(c)(3) organization, and get a full deduction for the amount on your tax return, up to 50% of your adjusted gross income.

Most professionals like us would recommend that you put a bit more thought into how you give. For instance, instead of giving cash (which is basically what you're doing when you write that check) you could try a more tax-friendly approach: give stock or mutual funds that have gone up in value during your time of ownership. You get a deduction equal to the full value of the securities at the time of donation (rather than how much you originally paid for them), and never have to pay capital gains taxes on the appreciation.

If you want your donation to provide income during your retirement, consider a charitable remainder annuity trust or charitable remainder unitrust, where you put money in a trust set aside for your favorite charity. Over the rest of your life (actually up to a maximum of 20 years) you receive income of at least 5% of the original trust value (annuity trust) or the annually-recalculated actual value (unitrust) each year. When you die, or the term of the trust runs out, whatever assets remain in the trust are forwarded on to the designated charity. In each case, there is a tax calculation, based on the assets and the income you receive, which determines how much of a deduction you will get when you make the donation to the trust. And you avoid paying capital gains and depreciation tax recapture (if the assets happen to be real estate) on the property you contribute.

As an example, suppose you happened to have $1 million worth of real estate that you originally purchased for $200,000. When you sold these properties, you would owe capital gains taxes on the $800,000 of appreciation, plus recapture of the annual depreciation deductions.

Now let's suppose you donated this property to a charitable remainder unitrust. The unitrust would sell the properties for $1 million and reinvest that money in stocks or mutual funds. Under this arrangement, you might get income in the first year of $60,000 (6% of the trust amount), avoid $120,000 in capital gains taxes, and receive an immediate tax deduction of somewhere in the neighborhood of $400,000.

If the stocks and funds in the trust were to earn 7% a year (no guarantee, obviously), then the value of the trust would increase, over the next 20 years, to just under $1.5 million, at which time the full amount would be donated to the charity. Overall, you might receive roughly $1.2 million in income over that same 20-year time period—a figure which, again, depends on the earnings inside the trust.

Another alternative is the charitable lead trust, which works essentially the same way, except that this time the income is paid to the charity for that 20 year term, and then the assets in the trust pass to your heirs estate-tax-free. The lead trust is only appropriate if your assets at death would exceed the current estate tax threshold ($5.49 million per individual, $10.98 million for couples). Of course, the current Presidential administration has vowed to eliminate estate taxes altogether, so not many are rushing to implement lead trusts at the present time.

Finally, some families are creating a charitable inheritance, where the parents donate to a donor-advised fund, receive their tax deduction, and the donor-advised fund invests the assets to grow until the fund is told where they should be distributed. The children are designated as the advisor to those assets, giving them the right to instruct the donor-advised fund where to make donations. It's a simple, creative way to provide the adult children with an opportunity to determine their own charitable inclinations.

The bottom line here is that giving can be more rewarding, and more interesting, than simply writing a check.

# Drone Transport

The advent of driverless cars has made the future look awfully confusing. Will you even OWN a car ten years in the future, when all you'll have to do is pull out your phone and request an automated ride to wherever you want to go? Will there be automated drones that fly above the streets?

Perhaps the clearest picture of the next transportation era has been unveiled by the Airbus organization—the European consortium that makes commercial airplanes. Airbus has recently demonstrated how you will be picked up at your home in a vehicle that looks like a futuristic car. Then, at a transit site, a three-fanned drone will latch onto the car, lifting it from its wheels to take you dozens or even hundreds of miles away. The drone will deposit the cab you're riding in onto another set of wheels, which will take you on the streets to your final destination.

The technology will go on trial sometime within the next ten years, with battery technology cited as the biggest hurdle to full implementation.


# Where to Find Happy People

The World Happiness Report is out, and a group of independent experts have now compiled surveys of people in 156 countries, asking them to evaluate their lives on a scale of 1-10. They then looked at some of the factors that seem to contribute to happiness, and identified five: real GDP per capita (a measure of average wealth); healthy life expectancy at birth; freedom to make life choices; generosity; and whether or not they perceived their society to have elements of corruption.

Number One on the list is Norway, and you might see a certain pattern when you see the runners-up: 2) Denmark, 3) Iceland, 4) Switzerland, 5) Finland, 6) The Netherlands and 7) Canada. Sweden comes in at number 10, rounding out the socialistic Nordic societies. In between are 8) New Zealand and 9) Australia.

Where does the U.S. rank? Number 14, behind Israel (11), Costa Rica (12) and Austria (13). The U.S. ranked poorly in social support and, interestingly, mental illness. America's ranking was as high as third in 2007, when people were less likely to cite corruption as a part of their lives.

Where are people least happy? Most African countries reported low levels of happiness. And, interestingly, the people in China report being no happier today than they were 25 years ago, despite rapidly-growing per capita income. Chinese respondents to the survey attribute their lagging happiness to rising unemployment and a poor social safety net for the less fortunate.

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