



# Q1 2018 NEWSLETTER

## New Hire

About halfway through the first quarter of 2018, Ashley hired Kellen Enright as his new paraplanner. The position was originally posted as virtual, but Kellen lives in the Twin Cities area so they are fortunate to be able to work together in downtown Minneapolis. Kellen recently completed his bachelor's degree in Financial Planning at Minnesota State University - Mankato and is excited to begin his career in the industry.

## TD LINC Conference

In early February, Ashley attended the annual TD National LINC conference in Orlando, FL. He had the opportunity to learn, share and collaborate with top professionals in the advisor community. The 3-day experience included workshops, conference sessions and conversations about the latest industry trends, innovative technology technology and better business solutions.



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## 2018 First Quarter in Review

Is the bull market finally over? For the first time in nine calendar quarters, the U.S. investment markets delivered a negative overall return. It was only a slight decline, but the decline reminds us that markets can and do go down from time to time.



## Tax Cuts and Jobs Act of 2017

Shortly before the end of last year, the TCJA was signed into law. Some key changes are: increased child tax credit and standard deduction, elimination of personal and dependent exemptions, and slightly broader tax brackets. Also, 529 plan funds may now be used for K-12 tuition expenses.

Below, you'll see that Arete Wealth Strategists is partnering with My529 to help clients take advantage of the new 529 tax rules!

### Upcoming Bay Area trip:

June: 10th - 13th

## Key West and Cozumel Cruise

In the middle of March, Ashley and the rest of his family boarded a cruise for Key West and Cozumel. The cruise was designed to be educational, with many members of the Society of Financial Services Professionals (FSP) organization delivering presentations. Ashley presented a slideshow about the Principles of Global Financial Planning. Ashley, his wife, and his two girls had a wonderful week in the Caribbean!

After starting the year strong, the Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—finished the quarter down 0.76%. The comparable Russell 3000 index was down 0.64% for the first three months of the year.

Large cap stocks posted identical small losses. The Wilshire U.S. Large Cap index dropped 0.76% in value, while the Russell 1000 large-cap index fell 0.69%. The widely-quoted S&P 500 index of large company stocks dropped 1.22% in value during the year's first quarter.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies posted a 0.73% loss over the first three months of the year. The comparable Russell 2000 Small-Cap Index lost a bit of ground as well, falling 0.08% for the quarter. The technology-heavy Nasdaq Composite Index finished the quarter with a gain of 2.33%, making technology the standout performer of the year so far.

International stocks are fully participating in the downturn. The broad-based MSCI EAFE index of companies in developed foreign economies lost 2.37% in the recent quarter. In aggregate, European stocks were down 2.57% over the last three months, while MSCI's EAFE's Far East Index lost 0.67%. Emerging market stocks of less developed countries, as represented by the MSCI EAFE EM index, gained a meager 0.93% in dollar terms in the first quarter.



Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, fell 7.42% during the year's first quarter. The S&P GSCI index, which measures commodities returns, gained 2.37% in the first quarter.

In the bond markets, coupon rates on 10-year Treasury bonds have continued a slow but steady rise to 2.75%, while 30-year government bond yields have fallen slightly to 2.97%. Five-year municipal bonds are yielding, on average, 2.06% a year, while 30-year munis are yielding 3.01% on average.

What's going on? The first quarter saw the first correction—that is, a decline of more than 10%—in three years, which dragged returns down from a roaring start to the year.

Industry pundits have many triggering effects to point to, from chaos in the White House to the possibility of a global trade war, to fears of inflation or higher interest rates, to the simple fact that U.S. stocks have been priced much higher than their historical averages. They aren't getting much explanatory data from the economic statistics; the unemployment rate is testing record lows and new jobs are being created at record levels. More importantly, annual earnings estimates for S&P 500 companies rose 7.1% during the first three months of the year—the fastest rise since FactSet began keeping track in 1996.

Ironically, the small downturn plus the jump in earnings may have forestalled a bigger corrective bear market later. The S&P 500, by some measures, is now trading at 16.1 times projected earnings for the next year, compared with 18.6 in late January when the markets were extraordinarily bullish. Stocks are not as overpriced as they once were, and the corporate tax cut could lead to higher reported earnings throughout the year.

Some are questioning whether the large cap indices fully reflect the overall U.S. economy these days. As mentioned earlier, the technology sector is generating positive returns. If you were to take Amazon.com, Microsoft, NetFlix, NVIDIA Corp., Cisco Systems and Apple, Inc. out of the S&P 500, the downturn would have been much worse, as companies like Procter & Gamble, Exxon Mobil and General Electric all lost value. As tech roars and more



traditional companies see their shares losing value, technology makes up a greater portion of the capitalization-weighted indices, and its returns will have a higher impact in the future.

In any case, it appears that investors have become increasingly nervous about their stock investments. Over the past three months, the CBOE Volatility Index--the VIX index--widely known as Wall Street's "fear gauge," posted its biggest quarterly rise since the third quarter of 2011, jumping 81%. The VIX reflects option traders' collective expectations for the S&P 500 index's volatility over the coming 30-day period, and by this measure, traders had been very calm for the 18 months before early February. Now the VIX is at or near its historical average, which suggests that the equities markets are going to experience a totally normal bumpy ride going forward. This is a good time to fasten seat belts, and also consider whether you'd have the patience to ride out a bear market. We can't predict when that will happen, of course, but I think everybody realizes that the bull market cannot last forever.

Sources:

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### **Time to Look at Facebook**

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The revelation of Facebook's FB data breach involving Cambridge Analytica was followed by a March 26 announcement that the Federal Trade Commission is investigating Facebook's ability and willingness to protect user information. While this development may raise further doubts regarding Facebook and its user growth and engagement, along with more demand for EU-type regulation in the United States, we remain confident that the company can endure the short-term impact of the data breach. At this point, we do not expect a significant long-term negative effect on Facebook's platform and operations.

The Cambridge Analytica scandal reignited the discussion about the safety of private user data, and now the FTC is examining the procedures and technology through which Facebook attempts to protect such data every day. This is not the first time the FTC has looked into Facebook and its handling of data. In 2011, the FTC filed a complaint against the company, stating that data in the social graph that the Facebook platform and its users help create had become accessible to third-party app developers. This is similar to what may have taken place when University of Cambridge professor Aleksandr Kogan used an app to conduct a survey, indirectly allowing the professor and Cambridge Analytica to get their hands on



around 50 million Facebook users' information. The FTC and Facebook reached a settlement in 2011 that basically ordered the company to not only take further steps to protect user data from third parties, but also make it easier for users to refuse to allow access to their private data.

Such data breach issues can affect Facebook's top- and bottom-line growth and valuation in a couple of ways. First, the doubts that this news has created could lead to a gradual long-term defection of Facebook users. We think the main effect would be on users in the U.S. and Europe, markets for which we have modeled mere 3% and 6% average monthly user growth per year through 2022, respectively. The user count in those markets has been growing at around 6% per year during the past five years. If we assume no growth and a net 1% decline in the monthly users in those regions during our explicit forecast period of five years and hold average revenue per user constant, this could lower Facebook's five-year revenue compound annual growth rate to 18.5% from our current assumption of 22%.

We note that Facebook also has another attractive and fast-growing property, Instagram. While Facebook doesn't break out Instagram revenue, based on our research and some data from eMarketer, we estimate that Instagram generated around 11% of Facebook's total revenue last year. Also, Instagram has been successful in bringing more users, as its user count has increased at a 41% CAGR the past three years, according to eMarketer data. Snap and Twitter remain as alternatives for Facebook users. However, given that Instagram has a different brand name and completely separate app from Facebook, we think its popularity will remain intact, making it a more likely destination for former Facebook users. With this in mind, we think the impact of the Facebook platform's user defection can be discounted only slightly by assuming that some Facebook-only users will jump on Instagram.



Second, if the U.S. government takes more regulatory actions, which the announced FTC investigation may indicate, Facebook's ability to collect and share necessary data with advertisers could be affected. If that were to happen, the return on investment for what were previously pretty accurate user-targeted ads would decline, which would also reduce advertisers' demand for Facebook's ad inventory. We don't think advertisers would instantly abandon Facebook and the world's largest user platform. However, in such a case, they may begin to slowly allocate their Facebook ad dollars to other digital platforms or more-traditional marketing channels such as television.

### **Another Tariff, Another Downturn**

Last week, stocks went on sale again, but there didn't seem to be a lot of bargain hunters stepping in to take advantage. The S&P 500 dropped 5.9% over five days, its worst week since January 2016.

This follows a by-now-familiar pattern: the Trump Administration announces tariffs—this time on Chinese imports with an estimated value of \$60 billion a year—but is not specific on the details. Traders fear that there will be retaliation against American products sold abroad, and put a lower value on the large multinational companies that account for most exports and make up most of the major indexes.

The last time this happened, the tariffs involved steel and aluminum, and the panicked sellers later discovered that the impact on global trade was actually quite small, due to negotiated exemptions for major steel producing nations like Canada and South Korea—plus the Eurozone and Mexico. This time around, the U.S. trade representative has 15 days to develop a list of specific Chinese products to slap the additional taxes onto, and there will be a public comment period before the threatened tariffs go into effect. China has announced that it is developing its own list, and as companies (and farmers) become aware of what is included in



its reported \$3 billion tariff package, they will lobby for exemptions which may turn this announcement into another tempest in a teapot.

Meanwhile, in the wake of the Cambridge Analytica scandal, admissions that private information on 50 million people had been pilfered, and up to 126 million Americans had seen posts by a Russian troll farm on its site, Facebook shares fell almost 10%, from 176.83 down to 159.39. This took the social media giant down from the 5th largest-capitalization company in the S&P 500 index to the 6th (behind Berkshire Hathaway)—dragging the index down even further.

What's remarkable about the selloff over things that might or might not happen is that it came amid some very good news about the U.S. economy. Durable-goods orders jumped 3.1% in February, sales of newly-constructed homes were solid, and Atlanta Fed president Raphael Bostic announced that there were “upside risks” in GDP and employment. Translated, that means that the economy is looking too good to keep interest rates as lows they have been—which means this is a curious time to be selling out and heading for the investment sidelines.

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### **The Value of Diversification**

It's not always easy to grasp the value of diversification—why, in other words, it's better to own many stocks inside a mutual fund than one or two stocks on their own. But recent research conducted by Arizona State University finance professor Hendrik Bessembinder offers some insight.



Bessembinder is not afraid of numbers. He calculated every one month return of every U.S. common stock traded on the New York and American Stock exchanges, and the Nasdaq exchange, since 1926. Even though nearly half of the 25,782 stocks that have been in existence over this time period lasted 7 or fewer years, this still accounted for 2,524,849 individual monthly returns from July 1926 through December 2015.

What did Bessembinder find? Among other things, only 4% of the listed stocks accounted for the entire lifetime dollar wealth creation of the U.S. stock market since 1926. In other words, all the market returns came from only 86 top-performing stocks out of nearly 26,000. If you owned some of those stocks, mixed with the vast majority of stocks whose companies underperformed or went out of business, you got decent returns. If you decided you could pick your own handful of stocks, there is an almost overwhelming chance that you would have missed out on the small number of winners.

Source:

[https://www.marketwatch.com/story/why-picking-stocks-is-only-slightly-better-than-playing-the-lottery-2017-06-28?link=sfmw\\_tw](https://www.marketwatch.com/story/why-picking-stocks-is-only-slightly-better-than-playing-the-lottery-2017-06-28?link=sfmw_tw)

### **Employment Slack**

The U.S. unemployment rate has been dropping steadily ever since it reached 10% during the awful depth of the Great Recession; the Bureau of Labor Statistics says that today only 4.1% of Americans are out of work, the lowest rate in nearly two decades. But most of us know that this cannot be the whole story. Companies are showing no sign of being desperate to find workers, and the very low increases in worker salaries suggests that there is no bidding war for their services.

So where do we find the hidden slack in the job numbers? For that, you have to look at another statistic that is compiled by the Bureau of Labor Statistics: the number of “discouraged” workers in the U.S. economy. The Bureau defines “discouraged” as “those



persons not in the labor force who want and are available for work, and who have looked for a job sometime in the prior 12 months, but were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey.” These individuals, misleadingly, are dropped from the Bureau’s pool of available workers, and as they stop looking for work, they paradoxically help lower the statistical calculations of the unemployment rate.

So what has been going on with the discouraged worker statistics lately? Here, we find some very good news. The number has declined from 522,000 this time last year to 373,000 today—reaching a level not seen since before the Great Recession. The chart shows the trend, indicating that we still have a ways to go before there are fewer discouraged workers than there were in the late 1990s, but that we are on a fairly steady path to getting there.

What happens when the number of discouraged workers approaches zero? THAT’S when you’ll start to see wage growth start to accompany the low unemployment rate. As the slack is taken out of the labor market, as we start to run out of discouraged workers, we will see that long-awaited bidding war for people in the workplace. The consequences from there are uncertain. It could lead to moderately higher inflation, or we could see technological advances which reverse the recent trends and put a lot more people out of work—like, for example, self-driving trucks replacing truck drivers.

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<https://www.bls.gov/cps/lfcharacteristics.htm#discouraged>



## **Aging without Support**

Probably the most forgotten minority in America is the “elder orphans”—aging retirees who no longer have a spouse (if they ever had one), no kids and no caregiver.

According to The Gerontologist magazine, about one-third of 45 to 63-year-olds are single, and most of them never married or are divorced. Meanwhile, about 15% of 40-44-year-old women have no children. These statistics don't tell the full story of a small but significant aging population who are growing older without a support network—the American Geriatric Society thinks that nearly one-quarter of Americans over age 65 lack someone to care for them if they become physically incapacitated or experience cognitive decline. And many will; statistics show that 69% of Americans will need long-term care at some point in their lives—usually later in life.

How are these people coping? An article in a recent issue of U.S. News & World Report says that the best advice is to plan for long-term care needs with an LTC policy and/or a home that is retrofitted for an elderly occupant. It's also important to make social connections and avoid being lonely. A 2012 study found that the loneliest older adults were nearly twice as likely to die within six years as the least lonely, regardless of health behaviors or social status. The most powerful finding was that human connection helps ward off depression.

One way to raise the connection level is to retire in a college town, where the elder orphan is surrounded by young people and can stay engaged with activities like mentoring. At the same time, it is recommended that these people find like-minded retirees who can look out for each other. Some have actually gone so far as to create communities that act like surrogate families.

The elder orphans need someone to speak up for them if they're incapacitated, which means finding a friend who knows their Social Security number, keeps their insurance card, knows which medications they take, and can be designated as the durable power of attorney for health care against the day when they start losing cognitive capacity. As a last resort, this person could be hired; an attorney who specializes in elder care law might either serve in that capacity or find a professional who is willing to do so.



Source: [http://health.usnews.com/health-news/health-wellness/articles/2015/10/26/no-spouse-no-kids-no-caregiver-how-to-prepare-to-age-alone?src=usn\\_tw](http://health.usnews.com/health-news/health-wellness/articles/2015/10/26/no-spouse-no-kids-no-caregiver-how-to-prepare-to-age-alone?src=usn_tw)







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