Blue Bell
PRIVATE WEALTH MANAGEMENT

Fall NEWSLETTER 2018

We Didn’t Start the Fire!

Interest rates, corporate earnings, fiscal outlook, cyber security, North Korea, China, trade wars. “I can’t take it anymore//We didn't start the fire// It was always burning// Since the world's been turning.” Billy Joel got the idea for “We Didn’t Start the Fire” when he had just turned 40. He was in a recording studio and met Sean Lennon, who had just turned 21, and said "It's a terrible time to be 21!" Joel replied, "Yeah, I remember when I was 21 – I thought it was an awful time and we had Vietnam, and y'know, drug problems, and civil rights problems and everything seemed to be awful." Lennon replied, "Yeah, yeah, yeah, but it's different for you. You were a kid in the Fifties and everybody knows that nothing happened in the Fifties." Joel retorted, "Wait a minute, didn't you hear of the Korean War or the Suez Canal Crisis?" Those headlines formed the basic framework for the song.

Current concerns always feel more significant than any previous worries. Some of the fears in Joel’s famous song still remain today including North Korea and China, yet the S&P 500 closed at 353.40 at the end of 1989 and is priced at 2,913.98 (as of Sept. 28, 2018). Long term investing certainly works.

Perhaps the last line of our market commentary in our summer newsletter, “We expect higher returns for the rest of the year and continue our possible stance,” was one of the most important statements of the entire issue. “Stocks post strongest quarter in years” was one quote I recently came across. With the third quarter ending, we must look to our expectations for the rest of the year. As usual, let’s talk about both the potential positives, as well as the potential negatives we face for the remainder of 2018, after the longest bull market in history.

We continue to be bombarded with negative predictions as writers, research analysts, investment firms and newsletters compete to be “the one” to predict the next bear market. This has been going on since 2009 and quite frankly for as long as I can remember. There will be another recession and there will be a market correction, yet I have found that investors that are consumed with trying to time the next bear market end up significantly behind investors that maintain a long-term view and select investments appropriate for them. This does not mean that you simply ignore risks, rather you try to determine what can go right and what can go wrong and does this investment make sense in the current environment as part of your long-term strategy. In other words, whether it is trying to predict the next bear market or the next bull market, betting all of your eggs on that single prediction may work short-term but rarely works over the long-term. The success of market timing drops as measurement periods lengthen.

Another difficulty with timing the market is that no two corrections are the same. Many of the causes for the next market disruption are not necessarily known risks but rather unknown risks or “black swan” events. Possibly the largest concern we face in terms of potential “black swan” events would be a cyber security attack of the magnitude of 9/11. In most cases, it seems the threats have grown exponentially as the world of online transactions multiplies. The IMF noted recently, “The financial sector is particularly attractive to cyber terrorists,” which should be no surprise to anyone.

I don’t know any financial plans that can address these “black swan” events which would affect all investors in the short run. For this reason, we always recommend a long-term approach to investing. Having some downside protection helps in a correction but is not isolated from a collapse.

The S&P 500 posted its best quarter since 2013. GDP is expected to grow by 3.1% in 2018 which would be the first 3% annual growth in the last 14 years. Stocks react to earnings and earnings growth has been nothing short of spectacular for 2018. Bulls are predicting continued earnings performance in the fourth quarter, setting expectations rather high. Bears are convinced these earnings estimates won’t reach these elevated levels. We must look carefully during the fourth quarter at individual company’s earnings, but more importantly their earnings expectations. Another economic indicator, the Consumer Sentiment Index, recently came in at 100.1 which is up from 96.2 in August. Consumer sentiment continues to be a positive force for U.S. earnings given consumers make up about 70% of the U.S. economy. The Institute for Supply Management’s non-manufacturing gauge was 61.6 last month. That’s up from August’s reading of 58.5 and is the highest reading since the index was created 10 years ago. Employment is as strong as it has ever been in many segments of the population.

Shortages in the workforce (who could have believed this 10 years ago) can cause unexpectedly high wage increases, which is inflationary. The concern about inflation, which may come with a booming economy, is that the Fed will be forced to hike interest rates faster than expected. Interest rate hikes have been shrugged off by investors thus far, but ballooning interest rates will slow the U.S. economy and depending on the pace is likely to have an adverse effect on markets.

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Tariffs continue to be making almost daily headlines and have been a topic of discussion among most economists. Naturally, those immediately effected in a negative way are unhappy. There are others who welcome free trade without tariffs. With the last-minute agreement between the US, Mexico and Canada, some pressure has been removed from the tariff selloff. The U.S. China trade war is the most concerning. It's hard to please all the people, all the time, yet trade tensions must continue to be solved for the long-term health of the world economy.

U.S. economic metrics have been nothing short of spectacular. Most investors prefer a balance in economic terms which is most difficult to predict. Currently, it is our belief that monetary policy is balanced but longer term, if we experience an overheated economy and interest rate increase, this could lead to a stall in the economy and our stock markets will react negatively. Consider the effects higher interest rates have on home buyers. While home prices could remain the same, the cost of owning a home can rise substantially depending upon mortgage rates. The same could be true with many companies balance sheets heavily weighted towards debt.

Elections are only one month away and unfortunately are as nasty as I have ever experienced in my life time. The results will have an impact on short-term as well as long-term investors.

These are only a few of the concerns we have as we move forward in the late stages of an earnings cycle. Let's not forget, the U.S. has been one of the best market in the world to invest in this year. We are still part of a global economy and must watch international earnings growth. China, for example, entered a bear market last quarter as did several other emerging markets. Europe has its own issues with the recent interest rate increases in Italy and a suspect banking system. The South American and Latin American economies are struggling. This typically sets the stage for low valuations in bear markets, which could lead to value investors moving to these areas of future growth potential. We continue to monitor these as well as other issues.

As always, thank you for the confidence you place in us. Please remember to update us on any changes with your personal investment outlook as well as any changes in your personal financial situation. We remain deeply grateful for allowing us to assist in managing your investments. Please call us to schedule an appointment at 610-825-3540.

"Experts" are sometimes wrong about the markets…and everything else

As we approach the end of the year, we would like to highlight some of the differences in projections for the S&P 500 index that Wall Street strategists have made for 2018. These projections are often used by investors to gauge the sentiment among the top strategists for the outlook over the next year; however, these strategists and banks are constantly reassessing their projections. The chart below shows the initial projections for the S&P 500 as of December 19, 2017, their revised projections for the year-end as of July 5, 2018, and the percentage change the S&P 500 would need to undergo by the end of the year to reach current projections.

Firm	Strategist	Initial Projections	Current Projections	Difference From Current Level
Goldman Sachs	David Kostin	2850	2850	1.25%
Citi Group	Tobias Kevkovich	2800	2959	5.12%
Deutsche Bank	Binky Chadha	3000	3000	6.58%
UBS	Keith Parker	3300	3150	11.90%
CFRA	Sam Stovall	2800	2850	1.25%
Credit Suisse	Jonathan Golub	2987	3000	6.58%
Canaccord Genuity	Tony Dwyer	3100	3200	13.68%
Fundstrat Global Advisors	Thomas Lee	3025	3025	7.46%
BMO	Brian Belski	2950	2950	4.80%
JP Morgan	Durbracko Lakos-Bujas	3000	3000	6.58%
Bank of America	Savita Subramanian	3200	3000	6.58%
RBC Capital	Lori Calvasina	3000	2890	2.67%
Oppenheimer	John Stoltzus	3000	3000	6.58%
Total		**3000.92**	**2990.31**	**6.23%**

S&P 500 at 2817 on July 27, 2018 at 1:22PM

Source: **https://www.cnbc.com/market-strategist-survey-cnbc/**

Many of these companies also created models to project their World Cup brackets. You may recall that this summer's World Cup was won by France who defeated Croatia in the Championship. England and Belgium rounded out the final four teams. Goldman Sachs predicted Brazil as their winner; UBS predicted Germany as their winner; ING Group predicted Spain as their winner. Brazil lost in the quarterfinals, Spain lost in the round of 16, and Germany didn't even make it out of the Group stage.

Our point is that making projections about the future is nearly impossible to do accurately. Even the top Wall Street strategists and their advanced models have a high probability of being wrong—even with something as straightforward as soccer. Because no one can perfectly predict what markets will do, we believe it is important to continue investing your money and have some downside protection in your portfolio in case these bullish projections miss the mark.

Charitable Donations: Consider Gifting Your RMD

The Tax Cuts and Jobs Act of 2017 that passed through the Senate and House of Representatives in December of 2017 has had a wide range of effects on taxpayers. The new tax law is nearly doubling the standard deduction to $12,000 for single filers, $18,000 for heads of households and $24,000 for married couples that file jointly. On top of this, taxpayers 65 and older can claim an extra standard deduction of $1,600 if filing single and $2,600 for married couples who are both at least 65 and filing jointly. With the increase in standard deduction and decrease in many itemized deductions, it will often be less beneficial to itemize deductions; however, there are still ways to benefit from charitable contributions, which have historically been itemized. For taxpayers over 70.5 who must take required minimum distributions each year, donating directly from your IRA account to charity will decrease your overall adjusted gross income as well as satisfy a percentage or all of your required minimum distribution. Without the benefits of itemizing deductions, it is important to understand how charitable giving can still benefit you.

For those who currently itemize deductions, this new tax law increases the standard deduction but also places limits on the amount that can be deducted for State and Local Taxes (SALT). There are also limits on interest deductions for homeowners with a mortgage—both of which are itemized. Because of these new laws, the nonpartisan Tax Policy Center estimates that the number of taxpayers that itemize deductions will fall 75% for a total of 5% of all tax returns. Even if you continue to itemize deductions, it is likely that a direct gift of your RMD will prove more beneficial than donating non - appreciated assets, such as cash, to charities.

In the year that you turn 70.5, you must begin taking a Required Minimum Distribution (RMD) from each of your IRA accounts. You can gift your RMD or a portion of your RMD tax-free after you reach this age, which affords you the chance to take advantage of the change in tax code. For those who like to donate a part of their income to charity on an annual basis, you can donate the money tax-free directly through your IRA account and have this count as a portion of your RMD for the year. An individual can transfer up to $100,000 to qualified (501(c)(3)) charities tax-free each year — even if this is more than your RMD — and if you file a joint tax return, each person is able to transfer up to this amount.

As a result of the new tax code, less taxpayers will itemize deductions because it will not make sense to do so. However donating your RMD or a portion of it directly to a qualified charity will continue to benefit tax payers in two significant ways. First, you don't need to itemize your deductions to get a tax benefit from any charitable RMD gifts which in turn saves you time and money. It simplifies the process for you as you can take the standardized deduction instead of following the tedious process of itemizing all contributions you have made throughout the year. Second, the direct contributions to charity serve to keep this money out of your adjusted gross income. If you were to take the money out directly and then gift it to charity, it would be factored into your adjusted gross income which could potentially place you into a higher tax bracket, make more of your social security benefits taxable, and increase your Medicare surcharge.

Taking a qualified charitable distribution is only available through IRAs and to individuals who have reached RMD age, yet these distributions both count toward your RMD requirement and reduce the taxable amount of your IRA distribution — resulting in lower overall tax liability. To see how this may affect you, let's look at an example:

Under pre-2018 tax code, a 72-year old couple filing jointly has an Adjusted Gross Income of $80,000 and pays $2,456 in state income tax, $5,000 in property tax, and $10,000 in charitable gifts would typically itemize deductions. This couple's total itemized deductions equal $17,456 while the standard deduction that they would receive would only be $12,700. Because itemized deductions are more than $4,500 greater than the standard deduction, there would be no reason not to itemize.

Under the new tax code, with taxable income, state income tax, property tax, and the charitable gift amount staying the same, the deduction for state and local taxes (both income and property combined) is capped at $10,000. The itemized deductions that this couple could receive stays at $17,456 while the standard deduction is now at $26,600.

The new tax code makes the standard deduction much more attractive to the couple and they would take this standard deduction.

This example not only demonstrates how the standard deduction is often larger than itemized deductions, but this doesn't even factor in gifting the charitable contributions from your IRA. Gifting from your RMD would not only lower the itemized deductions, but it would serve to lower your adjusted gross income and provide even more benefits. Continuing with this example:

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If this couple gifted the $10,000 donation to charity directly from their IRA, their adjusted gross income will decrease from $80,000 down to $70,000 which pushes them from the 22% federal tax bracket to the 12% federal tax bracket. This will save them $9,200 in federal income taxes and still allow them to take the standard deduction that has increased.

Making a QCD is as easy as contacting the charity of your choice to see who the check should be made payable to and then contacting us. We will guide you through the process to ensure that the QCD is handled properly. We even have the ability to issue a checkbook linked to your IRA account for the sole purpose of making QCD donations. Be sure to obtain the acknowledgement from the charity stating the amount of the donation after you send it and remember, it must be a charity that qualifies for a charitable income tax deduction of an individual.

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Reminders

- If you mail a check, please make the check payable to "Charles Schwab & Co, Inc." with your account number written on the check.
- Talk to your children about the benefits of investing in a Roth IRA account.
- SAVE NOW! Please consider setting up online access to view your accounts online and to receive your statements and trade confirmations electronically.
- Mention to your friends and family about signing up for our weekly blog posts and personal weekly reads about retirement, investing and more on our website!