Blue Bell

PRIVATE WEALTH MANAGEMENT

FALL NEWSLETTER 2017

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"What, me worry?"

"What, me worry?" is a quote made famous by Alfred E. Newman, the fictitious comic book character from Mad Magazine. The quote epitomizes the recent equity markets. We are all aware that there is a lot to be concerned about including North Korea, natural disasters, a toxic environment in Washington, terrorism, and the Federal Reserve's plan to unwind it's $4.5 trillion balance sheet that it built up after the Great Recession. Despite all of the aforementioned worries, the markets continue to march higher.

Investor optimism remains at elevated levels despite the almost daily calls from market gurus predicting 50-70% declines in stock prices, predictions that they have been making for years in the face of rising markets. With investor optimism at its highest level since September 2000, it is important to note that investor optimism was at its lowest level in February 2009 right before the March 2009 lows and subsequent market turn around. The point is whether it is investor optimism or market gurus, both regularly get it wrong when predicting short-term market movements. This is why it is critical to have an investing plan that, in our opinion, includes diversification and hedging with long-term profits as the ultimate goal.

In our summer Newsletter, we emphasized tax reform and deregulation as important market issues. The markets are cheering the recent tax proposal, which, if passed by Congress, may see corporate tax rates drop from a high of 35% to 20%. For investors, lower corporate tax rates should translate to higher corporate earnings and thus higher stock prices. This was exhibited in the S&P 600 small-cap index which has rallied tremendously since the announcement of the tax reform proposal.

With just three weeks left in the third quarter, the S&P 600 small-cap index was up a measly 0.11% versus the S&P 500's positive return of 9.95%. As the quarter ended, the small-cap index had an incredible return of 7.77%, to close the quarter up 7.88% year-to-date.

The most important reason for the continuation of the 2017 rally, is earnings. Earnings growth has been at spectacular levels this year with analyst estimates for the fourth quarter of 2017 growth to be as high as 11.70%. U.S. GDP, which just a few quarters back was stuck at 1.10%, is now expected to grow by 3.10%. This also has had a major impact on stock prices.

There are areas of concern that we must be mindful of. These include, but are not limited to, a lack of progress on the tax plan, the rate of earnings growth reversing in the future, and finally, large interest rate movements. Personally, I am most concerned about the effect rising interest rates will have on the bond market in the US and world economy. The domestic bond market is considerably larger than the domestic equity market. With interest rates at such low levels, small movements in rates could have a devastating effect on long-term bond buyers, especially those in bond mutual funds and leveraged closed-end funds. This is the precise reason that in many cases we prefer to achieve downside protection through hedging with Structured Investments and options as opposed to relegating a portion of portfolios to bonds and other fixed income.

Finally, with the year coming to an end, it is important to review all of your investments, whether at Blue Bell PWM or elsewhere, and determine their cost basis. While we take great effort to be tax-efficient investors and attempt only to pay taxes on long-term capital gains, these gains may be greater this year than in past years. Please check with us so that you will be certain to have paid a sufficient amount of estimated taxes on these long-term capital gains.

As always, we thank you for the confidence you place in us and are here to answer any questions or concerns you may have. Please also keep in mind to be certain to inform us of any significant changes to your financial situation.

How Much Are Fund Fees Costing You?

Imagine you are driving down the road and notice the much-dreaded gas light is blinking on your dashboard. You pull up to an intersection and spot a gas station on the left, advertising a price of $2.75/gallon, and another gas station on the right, with an advertised price of $2.45/gallon. Which way do you turn? The answer is obvious: turn right. Any rational decision maker would not have to think twice about choosing the station that will cost them less to fill up their tank. Unfortunately, many investors make the mistake of turning left in their investment decisions and end up paying a substantially higher price for a fund that has a much cheaper alternative.

Bloomberg analyst, Eric Balchunas, recently shed light on this issue in the current market for mutual funds by tweeting a screenshot of a Bloomberg terminal displaying market data corresponding to fifteen mutual funds. Balchunas' tweet shows that people are investing their money in funds that are charging them expense ratios from 0.25%, all the way to an outrageous ratio of 1.34%. An expense ratio is the annual fee that funds charge their shareholders and is the percentage of assets deducted per year for fund expenses, including 12b-1 fees, management fees, administrative fees, and other operating expenses. This essentially means that the higher the expense ratio, the more money is taken from the pockets of investors and delivered to the pockets of those firms and fund managers.

Eric Balchunas
@EricBalchunas
Following

Deep diving in index mfs am surprised by how many S&P 500 index funds have over $1b while charging over .25%, it's around $50b worth..

	Ticker	Name	Fund Bmk Primary	Expense Ratio	Tot Asset (M)
1)	SPIBX US	INVESCO S&P 500 INDEX-B	SPX	1.340	1,082.607
2)	SFAAX US	WF INDX ASST ALLOC-A	SPX	1.100	1,295.826
3)	GASFX US	HENNESSY GAS UTILITY-INV	SPX	1.010	1,452.040
4)	SNPAX US	STATE FARM S&P 500 INDEX-A	SPX	0.730	1,464.424
5)	PLFMX US	PRINCIPAL L/C S&P 500-R3	SPX	0.720	5,379.454
6)	MXVIX US	GRT-WST S&P 500 INDX-INV	SPX	0.600	2,797.800
7)	GRMSX US	NATIONWD S&P 500 INX-SRV	SPX	0.570	2,634.529
8)	WFILX US	WF INDEX FUND-A	SPX	0.560	1,882.315
9)	VADAX US	INVESCO EQ-WGT S&P 500-A	SPX	0.540	7,652.529
10)	PSIAX US	PRUDENTIAL QMA STOCK INDX-A	SPX	0.530	1,112.545
11)	PEOPX US	DREYFUS S&P 500 INDEX FUND	SPX	0.510	2,654.679
12)	MMIEX US	MM S&P 500 INDEX FUND-SV	SPX	0.370	3,392.705
13)	MSPIX US	MAINSTAY S&P 500 INDEX FD-I	SPX	0.350	1,297.089
14)	PREIX US	T ROWE PRICE EQTY IDX 500	SPX	0.290	29,263.930
15)	USSPX US	USAA S&P 500 INDEX FD-MEMBER	SPX	0.250	6,453.036

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While no one would argue that the 0.25% expense ratio corresponding to the USSPX is a much better ratio than the 1.34% ratio that is offered from SPIBX, these numbers are still incomparable to the incredibly low ratios offered by exchange-traded funds; securities that track an index, but are traded on the exchange. The chart below shows up-to-date data on the above mutual funds and compares them to the Schwab US Large-Cap ETF with an expense ratio of only 0.03%.

Mutual funds and ETFs have similarities that, for the most part, allow the two fund types to be considered alternative investments; both offer low risk via diversification and professional management to ensure each fund's basket of securities are skillfully handled. This means that the decision of which to pursue should then come down to the cost associated with each, and while there are various differences between ETFs and mutual funds that investors should be aware of, ETFs are generally less costly than mutual funds.

Mutual funds are structured to charge transparent fees (load fees) on top of the high non-transparent fees (expense ratio). A load fee is a sales charge that investors pay when buying or redeeming shares in a mutual fund. The chart below

Ticker	Name	Fund Bmk	Load (not included in expense calculation)	Expense Ratio	Total Assets ($B)	Expenses (actual)	Expenses (using SCHX's 0.03% rate)	Savings Using Schwab ETF
SPIBX	Invesco S&P 500 Index B	SPX	5.00%	1.34%	$1.10	$14,740,000	$330,000	$14,410,000
SFAAX	Wells Fargo Index Asset Allocation	SPX	5.75%	1.10%	$1.30	$14,300,000	$390,000	$13,910,000
PLFMX	Principal Large Cap S&P 500 Index R3	SPX	None	0.73%	$5.40	$39,420,000	$1,620,000	$37,800,000
SNPAX	State Farm S&P 500 Index A	SPX	5.00%	0.66%	$1.50	$9,900,000	$450,000	$9,450,000
GRMSX	Nationwide S&P 500 Index SVC	SPX	None	0.57%	$2.60	$14,820,000	$780,000	$14,040,000
MXVIX	Great-west S&P 500 Index Investor	SPX	None	0.54%	$3.10	$16,740,000	$930,000	$15,810,000
VADAX	Invesco Equally-weighted S&P 500 A	SPX	5.50%	0.54%	$7.60	$41,040,000	$2,280,000	$38,760,000
PSIAX	Prudential QMA Stock Index A	SPX	3.25%	0.53%	$1.10	$5,830,000	$330,000	$5,500,000
PEOPX	Dreyfus S&P 500 Index	SPX	None	0.50%	$2.70	$13,500,000	$810,000	$12,690,000
WFILX	Wells Fargo Index A	SPX	5.75%	0.45%	$1.90	$8,550,000	$570,000	$7,980,000
MMIEX	MM S&P 500 Index Svc	SPX	None	0.37%	$3.40	$12,580,000	$1,020,000	$11,560,000
MSPIX	Mainstay S&P 500 Index I	SPX	None	0.34%	$1.30	$4,420,000	$390,000	$4,030,000
USSPX	USAA S&P 500 Index Member	SPX	None	0.25%	$6.50	$16,250,000	$1,950,000	$14,300,000
PREIX	T. Rowe Price Equity Index 500	SPX	None	0.21%	$29.30	$61,530,000	$8,790,000	$52,740,000
SCHX	**Schwab US Large-Cap ETF**	**SPY**	**None**	**0.03%**				

displays a column containing the load fee for each fund, these of which have not been included in the expenses and savings calculations. Therefore, you can expect to pay an even larger amount in expenses than shown for those funds carrying a load. ETFs do not pay a load fee, but are subject to commission fees (which vary by firm and are typically negotiable), as well as their relatively low expense ratio. In fact, the aforementioned Schwab ETF has a 0% commission fee, leaving the .03% expense ratio as its sole expense. These structural differences between the two vehicles give ETFs a rather consistent cost advantage over mutual funds, and thus benefit investors by not taking away from performance.

For example, in the first row of the chart below, a total of $1.1 billion assets are invested in the Invesco S&P 500 Index B Fund with a 1.34% expense ratio, costing shareholders $14.74 million in fees alone. If those same assets were instead invested in the Schwab ETF with the 0.03% ratio, shareholders would only pay out $330,000 in fees, saving them a whopping $14.41 million per year! This simple calculation, which is shown for the other remaining funds in the last column, makes it evident that investors would be far better off investing in the Schwab ETF than any of the mutual funds listed below.

So, should one always invest in ETFs over mutual funds? Not necessarily. Both products provide diversification and can enhance the returns of a portfolio when utilized correctly. However, understanding the structure of each fund type, and more importantly, researching all of your options and not simply falling subject to the pitch of a great salesman, ensures that you will not turn left and pay $2.75/gallon to fill up, when there is a much cheaper alternative right around the corner.

Self Employed Retirement Plans: You Have Options!

We know that self-employed Americans already have a lot on their plate however we wanted to take the time to discuss retirement plan options that could provide increased benefits over traditional retirement accounts. Certainly, a majority of people are familiar with the traditional 401(k) plan, but when considering small-business retirement plans, there are typically three additional plans small business owners should consider before making a decision:

1. Self-Employed 401(k) Plan
2. Simplified Employee Pension Plan (SEP IRA)
3. Savings Income Match Plan for Employees (SIMPLE IRA)

While all of these retirement plans are catered for small-business, it is very important to understand the different characteristics (contribution limits, administration costs/responsibilities, tax benefits) in order to find the plan that fits your business needs. Much of the decision can be made after considering a few questions: How many employees do you employ? How much do you want to allow for contributions and from whom (you or your employees)? Do you want payment flexibility?

The Self-Employed 401(k) plan, also known as the individual or one-participant 401(k) plan, is the same as a traditional 401(k) but is designed for companies with no employees other than a spouse. This plan allows for annual salary deferrals of up to $18,000 (and an additional $6,000 if above the age of 50) for 2017. As your own employer, you may make additional contributions up to 25% of your income with a cap of $54,000 on total contributions. For example, if you contribute $18,000 as an employee, you may contribute up to as much as additional $36,000 as the employer. The Self-Employed 401(k) can be a great tool for self-employed small business owners operating a business as it allows for significant contributions.

The Simplified Employee Pension IRA (SEP) has many similar rules to a traditional individual IRA but allows for larger contributions than a traditional individual IRA much like the Self-Employed 401(k).Where these two small business plans differ is that the SEP IRA is available to all small business owners with any number of employees, including those outside of their immediate family. Contributions are made on a pre-tax basis by the employer only and they may contribute the lesser of 25% of employee compensation or $54,000 for 2017. One more benefit to this plan is that you are not required to contribute every year, which might be a very important factor if your company has a significant amount of variable income from year to year.

Other important rules to remember with SEP IRAs are that all contributions rates must be the same for all eligible employees and employees are always 100% vested in the accounts so any contributions immediately belong to them.
The Savings Incentive Match Plan for Employees (SIMPLE IRA) offers a very different structure for the self-employed and can be implemented in a company with up to 100 employees.

This plan caps annual employee contributions at $12,500, but does not require a minimum, which provides employees with a bit more flexibility between years. On top of the employee contribution, the employer can choose one of two different contribution options: a.) up to a 3% match of an employee's annual compensation (can be cut to 1% for two out of five years) not exceeding $12,500 or b.) a fixed contribution of 2% of each employee's compensation. SIMPLE IRAs also are maintained on a

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calendar-year basis, not a company's fiscal year, and have strict deadlines regarding when they can be established and funded.

We know that as a small business owner, you have a significant amount of time tied up in your business, but understanding your options can lead to significant financial benefits to you and your employees. Having the right retirement plan can be a very important incentive to offer employees and could help attract the best talent to your company.

	Self-Employed 401(k)	**SEP IRA**	**Simple IRA**
Intended for use by	- Self-employed or small business owners with no employees besides a spouse	- Self-employed or small business owners with any number of employees	- Companies with up to 100 employees
Who makes contributions?	- Employer and employee (in most cases this will be the same individual)	- Employers only	- Employer and employee
Contribution limits and requirements	- Maximum contributions into a participant's account are capped at $54,000 in 2017 - Employed can contribute up to 25% of annual compensation up to $54,000 cap - Employers may make salary deferrals up to $18,000	- Employers can contribute the lesser of 25% of employees' annual compensation or $54,000 for 2017 - Contributions not required every year - Employer's contribution rate must be equal for all employees' accounts - Participant must be over 21 and worked 3 of the last 5 years for the employer	Employer may choose to make either: **a.)** 100% match on first 3% of employee contribution employer may choose to reduce this match to 1% in two out of five years or **b.)** a non-elective 2% contribution for all employees - Employee may contribute up to 100% of annual compensation up to a cap of $12,500

Reminders

- If you plan on donating to charity, appreciated stock or a direct transfer of your required-minimum distribution (RMD) may be a better alternative than cash. Please contact our office to discuss further.
- Please check with your accountant and inform us of any tax-loss carryforward you may have.
- If you mail a check, please make the check payable to "Charles Schwab & Co, Inc." with your account number written on the check.