ALBITZ/MILOE & ASSOCIATES, INC.

REGISTERED INVESTMENT ADVISER

FINANCIAL NEWSLETTER

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SPRING 2019

THE CRYSTAL BALL

It is very clear that one of the critical questions investors now have is this: “Is the economy going into a recession?” That’s an easy one because the answer is surely “Yes.” The real question though is “When?” Of course, no one knows that answer for certain. There is a strong likelihood of a slowdown in the next year, but again that will depend upon many factors that are still playing out.

When the yield curve inverted recently (interest rates on the 3-month treasury were higher than on the 10-year treasury), the pundits all said it was a sign of an imminent recession. When Fed chairman Jerome Powell said that it was unlikely the Fed will raise interest rates in 2019, the clamor was that he was nervous about a slowdown in the economy. When the transportation index rolled over, the outcry was that it was signaling that the economy wasn’t growing. These are all viable concerns. The biggest precipitant for a recession in our eyes would be a serious drop in the stock market, not a three month “correction.” This could get people nervous about spending money and this type of hunkering down can cause a real economic retreat. Yet, in spite of all the angst we feel, the stock market is within whispering distance of its all-time high level. Go figure.

We are aware of the old joke that says, “When your neighbor is out of a job, that's a recession; when you are out of a job, that’s a depression.” The reality is that recessions are not all bad and disastrous. They tend to clear the system of misallocations of capital, we see unprofitable investments get written off, asset prices adjust to more realistic levels, and government mismanagement is exposed and ideally corrected. Ultimately the economic slate is wiped clean (at least cleaner) and a renewed upswing in the economy can begin. The bottom line is this: do not fear recessions…they will happen and if one embraces this reality, you’ll find that they will typically give investors the gift of being able to buy assets at good prices.

When the stock market sold off in the last quarter of 2018, the expectation was that we might be entering a long term bear market (measured as a 20% decline from the peak). On page three of this newsletter, we discuss five major bear markets, their causes and their length. It is a reminder that there is nothing new under the sun. Many of the things we are seeing now and are dealing with in the present have occurred in the past with the only difference being the names of the people involved and a twist in the circumstances. That is part and parcel of why we remain optimistic. In times of trouble, we remember the sage dictum “This too will pass.” And it will.

Back to the market: In the ensuing three months of 2019, much of the above mentioned losses have been erased. But are we out of the woods? That’s a tough question to answer definitively because many, many companies’ stock prices are still well below their peaks, and many are still in bear markets. We think it is going to be a selective market for the rest of the year; opportunities will come and go very quickly. We saw an interesting comment from a commentator on TV recently. He said that from January 2018 to March 2019, the Dow Average traversed over 58,000 points, but from those same dates the actual average was up a total of 40 points. If that doesn’t tell you not to worry about the day to day “noise” in the market, nothing will. We figure that this year will be a good year but not necessarily a great one. Next year will be the interesting one.

Overheard

“I dream of a world where a chicken can cross a road without anyone questioning its motives.”

WHEN THE BABY ARRIVES

Clete and his wife recently welcomed their second child into the family. He shares some thoughts:

Having a child is a good time to reflect about family, the future, and think about the financial items to address as a result. The U.S. Department of Agriculture reports that the cost of raising a child is $233,610, which does not include the cost of college. Financial planning for this will be useful. Here are the most important things to do when you have a baby.

The first item to review is your health insurance plan. In most cases, new babies are covered without being listed under their mother's plan for a 30-day window following birth. After that, you will need to add them to your plan and ideally ensure the pediatrician you choose is in-network and conveniently located. There are a handful of trips you will be making to the doctor's office the first year.

Next, review your life/disability insurance coverage. A child is a financial responsibility that is your own and it is important to protect your family by having the proper insurance coverage in place in the event of an untimely death or disability. Fortunately, these events are unlikely and as a result insurance coverage is generally affordable. We have found that term policies typically provide the most cost-effective coverage for young families.

It is also a good idea to update your account beneficiaries and establish or review your estate planning documents (will and/or living trust). You will likely want your new child listed in some capacity as a beneficiary or contingent beneficiary on your accounts; which is not always automatic. Establishing a will and/or living trust to name guardians and determine who will take care of your children if you are unable to do so allows you, rather than the state, to decide what is best for your children.

A 529 college savings plan is a tax efficient way to save for your child's college education. Funds are deposited after-tax but any growth can be withdrawn tax-free for college expenses. The cost of college continues to rise with some schools costing significantly more than others. Getting an early start saving for this future expense will help. Fund the plan consistently irrespective of market movements.

Lastly, with all your efforts focused on the new baby, do not forget to take care of yourself and ensure you continue funding your own personal savings and retirement accounts. When prioritizing where to allocate your savings, remember that there are loans for college, but not for retirement.

Now back to changing diapers. Enjoy your little one!

529 Plan Updates- College Savings

In 2017, Congress passed the Tax Cuts and Jobs Act (H.R.1), and it was signed into law in December of that year. As part of this package, changes were made regarding qualified distributions from 529 College Savings Plans. Under the new law, up to $10K in tuition for K-12 education was added as a qualified expense. However, it's important to note that this change was a federal change and the ability to take the K-12 distributions from a 529 Plan tax-free only applies to taxes filed with the IRS.

Many states had their tax codes set to sync with federal changes and automatically allowed the K-12 expenses to be withdrawn tax-free. In 2018, a handful of states not synced with federal law, passed corresponding legislation to have their state tax laws updated (AR, IA, KE, ME, NC, OH). Unfortunately, the following states continue not to follow federal law: CA, CO, IL, MN, MT, NE, NM, NY, OR, VT.

Using CA as an example, if funds were withdrawn from a 529 Plan reported to a resident of CA, then CA would treat the distribution as a non-qualified expense and assess a 2.5% penalty tax on any earnings withdrawn (principal distributions are not taxed).

Our suggestion: Prior to taking a withdrawal from a 529 plan for K-12 expenses, be sure to consult your tax advisor!

Before investing, the investor should consider whether the investor's or beneficiary's home state offers any state tax or other benefits available only from that state's 529 Plan.

PERSONAL NOTES

Tracy B. - 14 years flew by in a blink of an eye! Good to hear about the upcoming adventures!

Bob and Alice Y. - Welcome! We look forward to working with you.

Roland C. - Isn't the Social Security Administration fun to deal with?!

Ellen D. - Hang in there.

WHAT MAKES A BEAR MARKET?

At the end of 2008, the U.S. stock market (measured by the S&P 500*) entered into bear market territory for the first time since the 2008-2009 global financial crisis. A bear market is classified as a 20% drop from its peak. The S&P 500 saw this peak on September 21, 2018, as it skyrocketed to an intraday high of $2,940.91. On December 26, 2018, it hit $2,346.58, a drop of 20.20%, before closing the year at $2,506.85. No one knows what the future holds, but looking back on some past bear markets can give us a clue as to what we can anticipate. Here's a look at five notable bear markets since the Great Depression.

The Stock Market Crash of 1929
Period: September 1929 – June 1932
Length: 34 months
S&P 500 loss: 86.1%

The stock market crash on October 29, 1929 (known as Black Tuesday) started the Great Depression, the worst economic crisis of modern times. This to date is America's most famous bear market and lasted nearly three years. The crash followed the Roaring Twenties; a time marked by a golden age of technological advances. Innovations such as the radio, automobile, aviation, telephone, and the power grid were adopted and companies that created these pieces saw their stocks soar in the 20's. Investors were infatuated with the returns available in the stock market, especially by the use of borrowing money on margin. It didn't end well.

Nixon's Civil Unrest of 1969
Period: November 1968 – May 1970
Length: 18 months
S&P 500 loss: 36.1%

Shortly after Richard Nixon was elected president, a bad year of civil unrest and high inflation led to a bear market. Riots, assassinations, and tensions over Vietnam only extended the decline in the stock market.

Stagflation, Dismissal of the Gold Standard, and the Oil Crisis of 1973

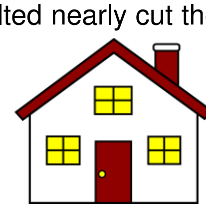
Period: January 1973 – October 1974
Length: 21 months
S&P 500 loss: 48%

This bear market started with the end of the Bretton Woods monetary system and was later elevated by the 1973 oil crisis. To add to these events, there was the unfavorable combination of high inflation and high unemployment (an economic situation known as stagflation).

The Dot-com Bubble of 2000
Period: March 2000 – October 2002
Length: 31 months
S&P 500 loss: 49%

The dot-com bubble was a historic economic bubble and period of excessive speculation. It occurred due to the extreme growth in the usage and adaptation of the Internet. As a result of the success of the Internet, many investors were eager to invest, at any valuation, in any dot-com company, especially if it had one of the Internet-related prefixes or a ".com" suffix in its name. During the crash, several online shopping companies, as well as communication companies, failed and shut down. The failure of these companies and the fear that resulted nearly cut the S&P500 in half.

The Housing Bubble and Global Financial Crisis of 2008
Period: October 2007 – March 2009
Length: 17 months
S&P 500 loss: 57%



The collapse in the U.S. housing market triggered a financial collapse felt around the world and led to the Great Recession. The years leading up to the crisis were characterized by an excessive rise in asset prices and associated boom in economic demand. U.S. mortgage-backed securities, which had risks that were hard to assess, were marketed around the world, as they offered higher yields than U.S. government bonds. Many of these securities were backed by subprime mortgages, which collapsed in value when the U.S. housing bubble burst during 2006, and homeowners began to default on their mortgage payments in large numbers starting in 2007. This led to a financial crisis that cut the S&P 500 by 57% and resulted in massive public financial assistance, known as government bailouts.

Of course, there are many other examples of bear markets. The key to remember is that they happen and it is best to be proactive when protecting your portfolio. No one rings the proverbial bell when it is time to sell but if you don't take more risk than you need to accomplish your goals, you will be ahead of the game.

***The S&P 500 Index** is a capitalization-weighted index made up of 500 widely held large-cap stocks in the Industrials, Transportation, Utilities, and Financial sectors.

A STORY

Every day for six months, George would go into the local watering hole, sit at the far end of the bar and order three shots of whisky. He would drink them one at a time and then leave. For six months the bartender set up the shot glasses, poured the drinks and left George alone. Finally, one day he said, “Hey George, you’ve been coming in the past half year and ordering three shots. Is there any significance to this?” George said, “Well, I have two brothers and they both moved out of the state. When we were young we all worked together and after work we would go to the bar and each have a shot. So since they moved, I just like to think of them and I have a shot for each of us.” The bartender said, “That’s nice. Now I get it.” A couple of weeks later, George comes into the bar and orders only two shots. Of course, this disturbs the bartender who figures something is wrong. He looks at George and says, “I’m sorry to ask but did something happen to one of your brothers? George looks up and says, “No, they’re fine, it just that I’ve decided to quit drinking.”

THINGS TO REMEMBER

- If someone has to say “trust me,” don’t trust them.
- Buy quality and pay the price. It’s more expensive for a reason.
- To be rich is to be content.
- You can’t make good times last long enough.
- When you want something, always talk with the person who has the authority to say “Yes.”
- Money is only good for what it will buy you.
- The future has room for only one truth.
- It’s always easy for the person who doesn’t have to do it.
- The only time you draw one card for an inside straight is when you are playing for jellybeans.
- Sometimes it’s the principle and sometimes it’s the money… and sometimes it’s both.
- When in doubt, there is no doubt.

Phil’s Opinions and Judgments…

On Basketball…

I love most sports and basketball is high on the list. I have to say, though, that when it comes to the playoffs, I’d take college March Madness over the NBA Finals any day of the week.

On the Inverted Yield Curve…

Many pundits jumped up and down when the 3-month treasury interest rate moved higher than the 10-year treasury interest rate. There were a few anomalies that caused that move. The one to watch though is the 2-year compared to the 10-year. They are close now but not inverted. So recession fears can take a rest for the time being. Realize that the junk bond sector will signal a recession expectation by the market (watch the price action in the ETFs in that sector for clues.)

On Music…

I found a real down to the soul interpretation of one of the prettiest songs ever, the Lennon and McCartney composition “And I Love Her” as performed by the Brad Mehldau trio. Check out this jazzy piano rendition of a classic. It’s great.

On Friendship…

It’s important to know who your friends are. It’s more important to know who your friends aren’t.

On the Cold SoCal Winter…

I know we need the rain and the snowpack. And to be sure, we got plenty of it this past winter. Personally though, I can do without the cold weather. The other day when the weekend weather provided a beautiful clear 78 degree sunny day, it just seemed like everyone was in a better mood. Springtime can certainly bring happiness along with it. I, for one, am ready.

Until next time,

Phil Chris Paul Clete Sylvia Vance

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