SWM INVESTMENT REPORT JAN 2018

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WEALTH MANAGEMENT

The Positive Impact of Tax Reform

If we had to point to one particular reason for the red hot stock market, look no further than corporate tax reform. Last month, Congress passed a major tax bill that will be a tremendous stimulant for large US companies. Since these intentions were announced last year, the anticipation and eventual execution of the bill has put the S&P 500 on the longest stretch ever without a 3% pullback. The stock market enjoyed uncharacteristic consistency with a positive return in all 12 months. The S&P 500 finished the year with a 19% gain, which is also 10% higher than its historical average. The tax law, which went into effect on January 1, lowered the corporate rate for large US companies from 35% to 21%, which in turn increases cash flow for all shareholders. The impact for individuals, families, and small businesses is minimal and probably more negative than positive.

Furthermore, as part of the tax bill, corporations will enjoy a repatriation tax rate of 15.5% for returning money to the U.S. from their overseas cash piles. Apple is by far the biggest US Company in the S&P 500, and at the end of the most recent quarter, Apple had $268.9 billion in cash and marketable securities, more than $250 billion of which was held outside the United States. Apple plans to bring the majority of it back to the U.S.

So what will US companies do with all of this cash and tax savings? It is very possible they will make capital expenditures and invest in their business for long-term growth. Could we see unemployment as low as 3.5% if companies choose to hire more employees? Maybe so.

Some economists see this stimulus hiking GDP to a 2.8% growth rate in 2018, which is up from 2.5% in 2017. Other possibilities could be a kick off in mergers and acquisitions, which is bullish for the stock market. Many companies have already announced bonuses, wage increases, and increased benefits, such as 401k matching for employees. But in reality, the most likely benefactors will be investors and shareholders. I would expect two big tail winds in the form of stock buybacks and increased dividends for many companies.

Stock Dividend Increases

Investors love passive cash flow and corporate stock dividends are one of the most tax efficient ways to receive money on a monthly or quarterly basis. Stock Dividends, at its core, is your share in the profits of a company or basket of companies you own. For ETF investors, we have index funds that build portfolios using various dividend focused algorithms. These algorithms might seek companies paying consistent and sustainable dividends, where any company who has cut their dividend will be disqualified out for an extended period of time. Some will have a multi-step screening process that invest in companies paying the highest dividend rates or companies that are increasing their dividends. With rates still so low on corporate bonds, these types of ETFs will most likely see dividend increases over the next 12-24 months and become more attractive. The possibility of rates inching higher, the speculative thirst for growth stocks, and hint of inflation has made dividend stocks underperform in the short-term. This is the most attractive place for new investment in 2018, as it is good time to buy “defense” when everyone is focused on “offense”.

Stock Buybacks

Another possibility, although less likely, with the stock market trading at all-time highs and premium valuations, would be companies participating in stock buyback programs. Buybacks can often create a level of support for the stock, and short-sellers often shy away from companies that may be acquiring their own stock because it is possible a large buyback will increase share prices. Stocks trade in part based upon supply and demand, and a reduction in the number of outstanding shares can precipitate a price increase. Therefore, a company can bring about an increase in its stock valuation by creating a supply shock via a share repurchase.

No Sign of a Recession

One of the leading Wall St. strategists, who is least likely to be optimistic, is Scott Minard of Guggenheim. Market timing is almost impossible, but I always read his material because it is important to have a well-informed view on his thoughts with the current business cycle. In summary, he believes the next recession will not begin until late 2019 to mid-2020. For a guy who is always concerned, this is very comforting. Valuations in the market may be valid, but there are so many catalysts from the tax package, investors keep buying. Regardless of this momentum and stimulus, we are well overdue for a pullback of 5% and small pullbacks are part of the growth process. We will circle back in 90 days to do some analysis of current Price-to-Sales and Price-to-Earnings ratios on the S&P 500 compared to historical averages.

We are not Buying Crypto Currencies!

In my opinion, there is a bubble in crypto currencies. I understand that Bitcoin was born in 2009 because some creative technology geeks saw the balance of power shifting to Bernanke and other international bankers during the financial meltdown. And yes, it's a nice idea to diversify out of a fiat currency if you don't trust the US dollar or you live in a communist country with a corrupt government. Maybe you understand the block chain technology it uses, and think it will change the world.

We at SWM, have had many inquiries about Bitcoin, and our stance is simple. We invest in stocks, bonds, and real estate. We will not be setting up relationships with Bitcoin dealers. If you want to speculate in this area, you are free to do so on your own. We are not advocating any investment in anything related to Bitcoin.

SWM- 5 Priorities for our Clients in 2018

1. We are committed to account growth and client service. We are excited to hire another financial planner next quarter so we can continue to grow client accounts and execute at a high level. We will be in the same office building but moving upstairs to suite 333. We will be increasing our square footage from 550-1300 square feet.

2. We continue to seek ways to reduce taxes and fees for our clients. This includes setting up retirement plans, utilizing low cost ETFs, tax loss harvesting in taxable accounts, and seeking out tax efficient real estate investments.

3. We are always looking for ways to increase growth & passive income as well as reducing portfolio volatility. We seek to maximize this effort without adjusting the assigned risk budget for each client.

4. We will work with each client to create an "exit strategy" looking at the big picture and assisting in developing a financial plan.

5. We will continue to structure portfolios using a combination of our strategies which will be unique for each client. Our Growth Model, Dividend Model, Tactical Model, Preferred Real Estate holdings, and Income/Capital Preservation strategies are all monitored and reviewed weekly.

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