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*Frank*ly Speaking©

Welcome to the Q2-2018 issue of *Frank***lySpeaking**©, now in its 26th year. The purpose of this newsletter is to keep you informed of current issues and global events that could impact your finances. Please feel free to share your thoughts with us, as we welcome your comments.

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In This Issue

Economic and Market Commentary

The U.S. economy is continuing to perform well and the near-term outlook remains positive.

Momentum is solid, especially in the labor market, even though spending indicators have slowed lately, suggesting a slower pace of Q1 gross domestic product (GDP) growth.

This softness may reflect a typical seasonal pattern of weaker gross (GDP) in the first quarter of the year.

Growth is likely to be stronger over the balance of 2018, reinforced by solid domestic fundamentals, strong global activity, fiscal stimulus and still accommodative financial conditions.

Labor markets will likely tighten modestly under this scenario which would also help to raise inflation up to the Federal Reserve's (Fed's) target. We are not concerned that inflation will spike sharply higher.

There are some risks to this optimistic outlook, the first of which is trade imbalance issues. I don't mean the isolated tariffs that have been enacted so far, but the possibility of an escalating and broadening trade war that could adversely affect financial conditions and economic activity.

Economist anticipate only modest further trade restrictions and a gradual shift in financial conditions to providing less impetus to growth as the Fed continues to reduce policy accommodation.

Other risks that could cause abrupt, severe disruptions cannot be ruled out. While we don't see the economy in imminent danger of overheating, these risks can increase in the medium-term as the Fed often finds it difficult to tighten financial conditions just enough to bring the economy in for a soft landing.

The forecast looks reasonably clear for now with households continuing to enjoy solid income growth, a rising net worth, manageable debt and especially debt service, elevated confidence and firm labor markets.

Business borrowing is up but does not appear overly stretched. The gap between capital expenditures and internally generated funds has picked up from the lows reached after the recession.

Leverage remains well below levels that preceded past downturns, suggesting there is room for investment to accelerate. That acceleration seems to have begun, on the back of improved confidence and still favorable financial conditions.

The global economy has also picked up momentum, supporting US exports, especially given the effects of a weaker dollar over the past year.

And then there's the fiscal stimulus of the tax package and the spending agreement which should lift growth by .50% to .75% in 2018 and 2019.

The effects would be larger, however, effective tax rates are not much lower, given the many offsets and base-broadening provisions, and the economy is near full employment. These fiscal stimulators will have less of an impact because there are few pent-up demands to be vented and less room to accommodate them without pressuring capacity constraints and pushing up interest rates.

In fact, demand-side stimulus could be counterproductive at this point in the cycle, boosting near-term growth but increasing the risk of overheating and financial excess.

These are the kinds of imbalances that can eventually make recession more likely, in part by tempting the Fed to tighten more aggressively.

To counter these risks, the economy needs to address supply side stimulus with policies to boost potential growth and afford the expansion extra space.

There are elements in the tax plan that might help on this front, along with recent regulatory changes, but the value of these kinds of supply-side benefits are hard to determine and are likely to take time to come to fruition.

The earmarked spending increases are more apt to provide an immediate lift to demand, but little long-term benefit as they are short on things like infrastructure that might help lift potential output.

Even under optimistic assumptions about the growth effects of the tax package, the fiscal changes are almost sure to worsen the federal government's long-term fiscal challenges by possibly requiring more federal borrowing that could eventually crowd out private, productive investment.

Forecasts project some improvement in potential growth as productivity rebounds, supported by a strengthening of business investment and as tight labor markets being able to persuade more people into the labor force and prompt firms to search even harder for efficiencies.

These improvements will be incremental but possibly sufficient enough to mitigate other structural drags, including demographics. Productivity can sometimes be surprising to the upside. Few anticipated the surge in the late 1990s, for example, but we would caution against building that into a base case.

There is still the looming threat of protectionism that could undermine potential growth. So far, the announced tariffs are too small to have much adverse impact, either on financial markets or the macro economy.

But if they are the beginning of a broader trade war, it could seriously undermine the rules-based global order and weigh heavily on financial markets, economic efficiency and potential global growth.

We really don't see that happening, but it is a risk that can't be dismissed. With China's trade practices coming under increased scrutiny and North American Free Trade Agreement (NAFTA) negotiations ongoing, we may have not heard the last of protectionism.

If there is no improvement in the economy's potential, it will be hard to sustain recent rates of growth, let alone acceleration, especially now that much of the economy's spare capacity has been absorbed.

Labor markets are already close to full employment and wages continue to accelerate only modestly and somewhat unpredictably. Labor markets have tightened, but not so much that they are overheating and should help push inflation back up to target.

Recent inflation readings have been firmer, reinforcing our assessment that some of the slippage early last year reflected transitory factors. We feel that inflation will rise back to target as the temporary restraints fade and inflation expectations remain generally well anchored.

We also believe that fears of an inflation surge are overblown given the general inactivity in the inflation process, the stickiness of inflation expectations and the reduced responsiveness of inflation to diminished slack.

Fed policymakers are likely feeling more confident in their outlook and more convinced that continuing on a gradual path of reducing policy accommodation is the proper course.

The Fed hiked rates 25 basis points at the March FOMC meeting, as expected, as labor markets continued to tighten and inflation looked likely to return to target.

They will remain inclined to scale back accommodation for fear that failing to do so would risk fueling the kinds of excesses and imbalances that might necessitate a more abrupt and potentially destabilizing policy tightening later on.

Additionally, it's not as if the steps taken so far have weighed too heavily on the economy or financial markets. In fact, overall financial conditions had continued to ease until early this year and their recent tightening has been relatively modest.

Furthermore, the economy has solid momentum and the fiscal stimulus is apt to add to that. Recent readings on inflation have been more upbeat and given that inflation often lags, and still seems to respond to changes in slack, the case for continued removal of monetary policy stimulus remains.

However, there are reasons for the Fed to be cautious in removing accommodation. First, even though interest rates are low by historical standards, the neutral rate seems likely to remain lower, suggesting that it might not take much more in the way of rate hikes to restore a more neutral stance.

Also, there may still become residual slack in labor markets and finally, though inflation has looked better of late, it has been running below target for years. It is important that it return to 2%, or above, to ensure that expectations remain firmly anchored near the Fed's objective.

How policymakers balance these competing arguments is dependent on how the economic outlook evolves. Our view remains that further improvement in labor markets and progress on inflation will keep policymakers inclined to remove policy accommodation, though not aggressively by historical standards.

That's likely to include not only continued balance sheet reduction, but also further rate hikes. The next 25 basis points could be in July, but more likely, coming at the September Federal Open Market Committee (FOMC) meeting, followed by perhaps three additional moves over the following 12 months and a bit more beyond that, ultimately taking the funds rate back towards 3% or so.

After a brief period of correction in February, financial markets have calmed in recent weeks, reassured by signs of solid fundamentals, strong global growth, declining fears of overheating and rising interest rates.

Do not confuse geopolitical event-triggered volatility with fundamental breakdown. The market jitters we are experiencing are primarily fueled by concerns about trade frictions.

The economic base-case remains broadly supportive of risk assets with a slight weight on Treasury prices, but only a slight one, especially at the longer end of the yield curve, which should be supported by still relatively dormant inflation.

However, a lot of good news has been priced in to risk assets and from here rates of return are unlikely to match what's been seen in recent years, especially if troubles on the trade front intensify.

Mortgage Rates Down Again

MCLEAN, VA, Apr 5, 2018) - Freddie Mac (OTCQB: FMCC) today released the results of its Primary Mortgage Market Survey® (PMMS®), showing average mortgage rates dropping for the second consecutive week.

The 30-year fixed-rate mortgage (FRM) averaged 4.40% with an average 0.5 point for the week ending April 5, 2018, down from the previous week when it averaged 4.44%. A year ago, at this time, the 30-year FRM averaged 4.10%.

The 15-year FRM averaged 3.87% with an average 0.4 point, down from the previous week when it averaged 3.90%. A year ago, the 15-year FRM averaged 3.36%.

The 5-year Treasury-indexed hybrid adjustable-rate mortgage (ARM) averaged 3.62% with an average 0.4 point, down from the previous week when it averaged 3.66%. A year ago, the 5-year ARM averaged 3.19%.

As of January 1, 2016, the PMMS no longer provides results for the 1-year ARM.

(Average commitment rates should be reported along with average fees and points to reflect the total cost of obtaining the mortgage. Borrowers may still pay closing costs which are not included in the survey.)

Len Kiefer, Deputy Chief Economist, Freddie Mac stated that rates had been dropping on trade-related anxiety in financial markets, but benchmark 10-year Treasury stabilized on Wednesday, April 4th at a level slightly lower than from the start of the previous week.

Mortgage rates followed by dropping for the second consecutive week where the average 30-year fixed mortgage was 4.40%.

Although rates on the 30-year fixed mortgage are up 0.3% from the same week a year ago, a robust labor marking is helping home purchase demand offset modestly higher rates.

The Mortgage Bankers Association reported in their latest Weekly Mortgage Applications Survey that the Purchase Index was up 5% from a year ago indicating that this spring is on track for a modest expansion in purchase mortgage activity.

Exciting News!

Frank and David are excited to share with all our PFP clients and friends that we have successfully completed our transition in ownership which began 5 years ago!

David has taken over as President/CEO of Personal Financial Profiles and Frank has taken on his new role as Chairman Emeritus.

While David continues taking on more of the daily operations, Frank will remain dedicated to work diligently with all the clients, co-manage their portfolios and continue to contribute to the success of PFP and the financial future of our clients.

Surprisingly, a high percentage of Investment Management firms have no succession plan and often leave their clients unprepared for the future.

Our firm's commitment to a viable succession plan was put into place almost 6 years ago and ensures that the management of our client's finances are well cared for and will go on without interruption.

If you haven't had the opportunity to speak with David recently, please give him a call 239-598-9141. David will be splitting his time between the Naples, FL office and the Coral Springs, FL office and would love to meet with you at either location.

As always, Frank will still be available in the Coral Springs office at 954-755-8647.

International Insight

After eight years of steady but modest growth in the U.S., some investors may be concerned that the American economy is nearing the end of the cycle.

For much of the rest of the world, it is still early in the cycle. Europe appears to have entered a prolonged period of strength and the euro-zone economy is expected to grow nearly 2% in 2018, according to the International Monetary Fund (IMF).

Overall, the IMF expects global gross domestic product (GDP) to increase 3.7% in 2018, from 3.6% in 2017, with each of the world's major economies firmly in the growth column.

Most of the world's major equity market indexes achieved or neared multiyear highs in 2017, as investors set aside concerns about politics and focused on the broadening expansion.

European stocks went on a tear in 2017, rising 26% in U.S. dollar terms and outpacing U.S. shares on that basis for the first time since 2012. Emerging markets equities also outpaced the U.S., soaring 37%.

Market levels suggest that these better investment opportunities may continue in non-U.S. markets. Consider that the U.S. accounts for 52% of global market capitalization, near a historic high.

Granted, a number of factors justify a relatively higher share of market cap for U.S. companies, as it is the home market for many of the world's dominant companies, and roughly 40% of Standard & Poor's 500 Composite Index company earnings come from overseas.

Also consider that the forward P/E ratio for the U.S. market, at 18.5 times earnings, is much higher than other major markets.

On the other hand, emerging markets share of global market cap appears relatively modest compared with its contribution to GDP and, emerging economies are expected to contribute half of global GDP by 2021.

Subdued volatility will not continue indefinitely. The possibility of trade skirmishes between the U.S. and China, an unexpected spike in inflation or the remote chance of conflict with North Korea could all trigger higher volatility.

Despite relatively low current levels, U.S. interest rates remain higher than many other developed markets, partly because the U.S. economy has sustained a significantly higher growth rate.

The higher yields in the U.S., relative to other developed markets, should continue to support demand for U.S. Treasuries.

Demand for higher yielding emerging markets debt has risen substantially and is expected to continue. Many emerging markets economies are growing at a steady clip and do not have any significant economic imbalances.

Investment managers found numerous ways to generate solid returns in 2017 as the equity bull market spread across the globe and nearly all of the 47 stock markets that comprise the MSCI ACWI posted gains.

As a result, valuations are elevated across regions and asset classes, but careful stock picking will be essential going forward.

Stock prices can be vulnerable to the likelihood of rising volatility. Furthermore, following years of lengthy risk-on, risk-off periods of investing, equity market correlations recently have fallen to multiyear lows.

Such an environment can be favorable for investment managers with a careful, research-driven approach to stock selection.

The synchronized global expansion appears to be entering a period of sustainabil-

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ity, but with volatility at multiyear lows, complacency has spread across markets and valuations are higher across a range of asset classes.

International equities still represent an attractive return potential, but we will continue to diversify our portfolios to mitigate risk during periods of volatility.

Where is Market Volatility Heading?

There are various scenarios as to where market volatility is heading, all of which can be endlessly debated. There are many subjective elements to the debate about which factors might suggest more nervousness in markets.

Higher volatility can be attributed to the U.S. economy being in a late-cycle phase and showing signs of overheating, the departures of top White House advisers, Central Banks cutting back on quantitative easing or Brexit.

Lower volatility can be attributed to synchronous global growth, economic forecasts of 3.9% growth for both 2018 and 2019, low inflation and believing that central banks will lend support in the event of major upsets.

We agree that no central bank would want to stake claim to sacking the economy by pursuing an interest-rate policy considered too aggressive.

As you can see, there are good arguments for both cases. We conclude from observations made over the past years and at the beginning of this year that the political arena has presented several unexpected surprises in recent years and the impact on markets was significantly smaller than expected.

This means, that from a market and volatility point of view, we don't want to overstate the importance of political events, unless they have tangible economic consequences.

The market correction at the beginning of February demonstrated the concerns that dominate the market most, the risk of a sudden inflation flareup triggering interest-rate hikes.

Market nervousness increases especially in times of disruptions. For example, when concerns about deflation turn into concerns about inflation or when the response pattern of new central-bank decision makers is not yet known.

Frankly Funny

Walter took his wife Ethel to the state fair every year, and every time he would say to her, "Ethel, you know that I'd love to go for a ride in that helicopter." But Ethel would always reply, "I know that Walter, but that helicopter ride is $50 and living on a fixed income, $50 is a lot of money."

Finally, they went to the fair, and Walter said to Ethel, "Ethel, you know I'm 87 years old now. If I don't ride that helicopter this year, I may never get another chance." Once again Ethel replied, "Walter, you know that helicopter is $50 and living on a fixed income, $50 is a lot of money."

This time the helicopter pilot overheard the couple's conversation and said, "Listen folks, I'll make a deal with you. I'll take both of you for a ride; if you can both stay quiet for the entire ride and not say a word I won't charge you! But if you say just one word, it's $50."

Walter and Ethel agreed and up they went in the helicopter. The pilot performed all kinds of fancy moves and tricks, but not a word was said by either Walter or Ethel.

The pilot did his death-defying tricks over and over again, but still there wasn't so much as one word said.

When they finally landed, the pilot turned to Walter and said, "Wow! I've got to hand it to you. I did everything I could to get you to scream or shout out, but you didn't. I'm really impressed!"

Walter replied, "Well to be honest, I almost said something when Ethel fell out but, you know, when you are on a fixed income, $50 is $50 and that's a lot of money."