**2018: The Year of the Dog**

A picture containing person, indoor, man, wall

Description generated with very high confidence2018 marks the year of the dog in the Chinese Zodiac. This highlights the universal values of dialogue and solidarity. Selfishness, greed and ignorance are major sources of inequality on earth. The Year of the Dog implies expressing ideas and, importantly, listening to others. Let’s hope this year is a turning point in our national dialogue.

**401(k) Salary Deferral Limit Increases**

The annual limit on 401(k) salary deferrals under IRC Section 402(g) increases by $500 this year. The basic limit is $18,500 while the limit for those over age 50 is $24,500. For semi-monthly payroll periods, the max. salary deferral would be $770.83 or (above 50) $1,020.83 per payday.

**The Tax Cuts and Jobs Act of 2017**

Congress recently passed legislation lowering the top corporate income tax rate to 21% and providing a 20% deduction for businesses structured as pass-through entities. The estate tax exemption is doubled effectively eliminating estate taxes on estates under $20 million. Retirement plan rules were not changed. I’m doing a six-hour course on the tax bill next week and will be writing a special edition of Capstone Perspective reviewing details of the items in the tax bill I consider most important to my clients, their businesses and their families.

**Roth IRA Accounts for All Americans**

A Roth IRA is the swiss army knife of financial planning. These accounts: 1) allow a person to completely avoid income taxes on earnings and capital gains, 2) avoid required minimum distributions, 3) provide an alternative, tax-free source of retirement income and, 4) are a great vehicle to leave tax-free assets to offspring. I think nearly every American should have one!

Unfortunately, single Americans who earn more than $135,000 ($199,000 for couples) are banned from directly contributing to a Roth IRA. However, anyone can convert a traditional IRA to a Roth. So, for those with higher income, it’s just a two-step process: 1) contribute to a traditional IRA and 2) convert the traditional IRA to a Roth IRA. This is a taxable transaction but there would only be tax on any gains while the money is in the traditional plan.

A close up of a sign

Description generated with very high confidenceMany people mistakenly believe they cannot contribute to an IRA if they have a 401(k). The truth is ALL AMERICANS with earned income can make IRA contributions, regardless of participation in an employer plan and regardless of how much they make. It is just that the income tax deduction for contributions to IRA accounts is not available for higher income Americans who also participate in a company plan. Building Roth balances does not involve up-front deductions anyway. You can make 2017 IRA contributions until April 15, 2018. We handle direct and “conversion” setups for many clients. Please call or e-mail me if you are interested in, or have questions about how All Americans can join the ROTH IRA party.

**401(k) Balances are up Significantly**

Fidelity reports annually on the average account balances for 401(k) plan participants nationally. As you would expect, balances are up across the board for 2017. It was surprising to me the size of the increases in all categories. This reflects positive investment results, higher employer commitment contributions and, of course, participant optimism. For example, the average 401(k) account for millennials aged 25 to 34 with 1 to 4 years of participation increased a whopping 43%!

A picture containing table, indoor, sitting

Description generated with high confidence**The Markets and the Economy, Fourth Quarter and Full Year 2017**

The S&P 500 index of large domestic stocks gained 6.6% in the fourth quarter and 21.8% for 2017. The index has gained 113% since the market high in 2007 and 376% since market low of early 2009. The consumer discretionary sector beat out technology for the quarter, gaining 9.9% and was up 23% for the full year. Technology was close behind, increasing 9% for the quarter but was the runaway leader for the year, gaining 38.8%. Energy rebounded with a 6% gain in the quarter bringing the sector’s year to date number to a loss of 1%. Telecom gained 3.6% for the quarter but was still in the red by 1.3% for the year. Finally, healthcare stocks were up only 1.5% for the quarter but did turn in a 22.1% performance for the year.

For several years, I’ve been talking about foreign markets being more reasonably valued and providing important opportunities. This was born out in 2017 as the developed foreign index (EAFE) was up 22.4% and the emerging markets turned in a sweet 37.8% gain. A key contributor to the emerging markets performance was China, up 54.5% for the year. Even after this great year in 2017, foreign stocks are still undervalued relative to historical averages and the domestic market.

Gross Domestic Product is expected to have increased to 3% for 2017. Headline inflation remained docile at 2.2%, up somewhat but still well below the 50-year average of 4.1%. Core inflation was just 1.7% while food was just up 1.4%. Energy was up 9.5%. While some short-term interest rates have increased somewhat, most interest rates in the U.S. remain near long term lows.

**Short term economic bump**. The Tax Cuts and Jobs Act (TCJA) should have positive effects on GDP. On the negative side, it will lead to an increase in the deficit in the short term. I believe it will be positive for the economy, jobs and the deficit in the long run but I seem to be in the minority on this. I believe the Reagan tax cuts of the early 1980s and the peace dividend from the end of the cold war led to the strong economy and markets of the 1990s. Of course, the administration in power at the time took credit for the good conditions.

**Shortage of workers in the U.S.** With projections for GDP growth for next year running in the 3% range, there is a possibility this could be a one-year wonder because of a shortage of workers. Unemployment is running at historically low rates, currently 4.4%, and the rate is projected to decrease to 3.4% this year. This would be the lowest rate since 1953. Basically, unemployment can’t realistically go lower. Barring big gains in productivity, economic growth may not be able to maintain momentum in 2019.

**A yellow sign on a pole

Description generated with very high confidence**

**Inflation still benign but long interest rates should rise.** Though the FED has raised short term rates and has told us they plan to continue, inflation is still benign at 2.2%, even with the boost to inflation from the energy sector. If the economy does slow in 2019, prospects for higher inflation seem small. However, the FED has told us they will continue to raise short term rates. Most prognosticators expect 3 to 4 hikes this year. If this happens, longer rates should also increase somewhat. It’s important to be positioned to benefit from this rather than be hurt by it. Don’t own long and intermediate term high quality bonds without understanding these bonds will decline in value. You may have to hold them to maturity. It is critical to understand the bond funds you own. They should not be the type that would be hurt in a rising rate environment.

**Corporate profits growth.** Corporate earnings should increase along with the economy and the effect of lower tax rates. Earnings for the S&P 500 companies are expected to rise nearly 17% this year. So, stocks could gain 17% this year with no increase in the price/earnings level of the market.

**Cannabis and Cryptos**. The runup in Cannabis companies and A close up of a sign

Description generated with high confidenceCryptocurrencies remind me of other manias I’ve witnessed or read about. Investors seem to not care about valuations. They just expect to be able to sell these assets to someone else at a higher price at some point. Cryptos will eventually earn legitimacy and some Cannabis companies will make money in a legal manner. Both are radically overvalued currently and will probably be one of the things talking heads point to when they are discussing the next bear cycle.

**Melt-up**. “If current macro trends continue, I wouldn’t be surprised if the equity market gained substantially from current levels in the months ahead in an almost parabolic fashion.” [wrote](http://www.wealthmanagement.com/resources/wealth-management-yearend-outlook?elqTrackId=79034d4580a94323b7f76ec4ee26731f&elq=428bfdc1f64f47dab793231a2246afd4&elqaid=12073&elqat=1&elqCampaignId=10537&utm_rid=CPG09000005743225&utm_campaign=12073&utm_medium=email&elq2=428bfdc1f64f47dab793231a2246afd4) Ryan Beach, the CEO of CLS Investments. But he worries investors are too deep in love with the current bull market and might abandon reason. “How many years in a row can we inaccurately warn that ‘winter’ is coming before investors lose confidence in our warnings and abandon carefully crafted, diversified portfolios?”

I agree with him. The end of bull and bear markets are often characterized by capitulation. During the 2008-2009 market downturn, even patient, experienced investors capitulated by giving up on stocks. We may eventually see just the opposite. Many investors who were previously wary of stocks because of the 2018 bear may decide they have to get invested. FOMO (fear of missing out) strikes again. Doing some selling into a melt up would probably be a good strategy.

**Mutual Funds 2018: Low Diversification**

I regularly review all mutual funds clients own including 401(k) plan fund options we don’t manage when I help them with their plan allocation. I’ve noticed a recent trend toward less and less diversification. The list of top holdings from fund to fund is strikingly similar. This is because much of the returns of the market have occurred in the same relatively small list of stocks. For managers to keep up with their benchmarks or the competition, they must own the same stocks. Also, investors think investing in index funds will provide them with broad diversification. 90% of indexing is in the S&P 500 index. The same list of best performing stocks makes up a disproportionate percentage of the index. When the next bear hits, these same stocks may be hit the hardest. It is more important than ever to be diversified into smaller stocks, foreign stocks and domestic stocks in the sectors that have underperformed in current market conditions. Resist the temptation to put more money into the funds that have done the best recently.

**Electric Vehicles, A Way to Profit**

A red car

Description generated with very high confidenceLevi Strauss accumulated great wealth by selling denim jeans to California gold rush miners. Few of those miners came close to striking it rich like the inventor of the iconic Levi brand jeans. Tesla has successfully changed the image of the electric vehicle from glorified golf cart to fast, sexy vehicles. Tesla, however, is always in need of new capital and no profits are in sight. Like Levi Strauss did the during Gold Rush, selling things the miners need to do their job, a way to profit from the EV “Gold Rush” is to invest in companies selling the manufacturers the things they need to do their jobs.

We’ve compiled a portfolio of companies that appear to be positioned to benefit from the rise in EV manufacturing. For the most part, these companies are high priced relative to traditional valuation measures. Obviously, I’m not the only person in the world interested in this idea. So, I am buying a fraction of the size of position I would like to eventually own of these names. Inevitably, there will be bumps in the road to EV dominance and the stock market itself will eventually dip. This then will provide the opportunity to add to these positions at more reasonable valuations. Call or e-mail me if you are interested in more information on my EV supplier portfolio.

Thank you for your business!

Michael Dunham CFP®, CPC, QPFC

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\*Market Returns: All data is indicative of total return which includes capital gain/loss and reinvested dividends for noted period. Index data sources; MSCI, DJ-UBSCI, WTI, IDC, S&P. The information provided is believed to be reliable, but its accuracy or completeness is not warranted. This material is not intended as an offer or solicitation for the purchase or sale of any stock, bond, mutual fund, or any other financial instrument. The views and strategies discussed herein may not be appropriate and/or suitable for all investors. This material is meant solely for informational purposes, and is not intended to suffice as any type of accounting, legal, tax, or estate planning advice. Any and all forecasts mentioned

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