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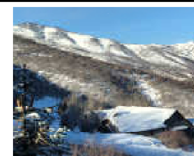

Welcome to the Q1-2019 issue of *Frank*lySpeaking©, now in its 27th year. The purpose of this newsletter is to keep you informed of current issues and global events that could impact your finances. Please feel free to share your thoughts with us, as we welcome your comments.

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Economic and Market Commentary

The US economy is continuing to perform well overall, though there are some concerns that momentum may be peaking and there are growing concerns about global growth weakening, trade tensions and tightening financial conditions.

In the end, most of the evidence suggests that US activity will continue to advance, supported by solid fundamentals.

Our labor markets are near full employment and still tightening, while inflation is back near the Federal Reserve's target, but not exceeding. In short, the economic news continues to be quite favorable.

Economic forecasts have been emphasizing the US economy cannot continue indefinitely on its recent trajectory. The persistence of above-trend growth and ever-tightening labor markets would not only increase the chances of an overheating but might also suggest that the kinds of broader financial and economic excesses that have often spelled trouble in the past could yet develop.

We agree that a moderation in activity is necessary and likely to occur.

We feel that a combination of tighter financial conditions and a gradual weakening of fiscal stimulus, coupled with some slowing abroad and a mild drag from trade frictions, would guide the US economy onto a more moderate trajectory.

This would moderate growth in 2019 into 2020 to a pace more in line with its longer-term potential, helping prolong the expansion by limiting potentially destabilizing excesses.

That seems a reasonable outlook, although risks have been rising lately. One reason is that financial conditions have tightened more sharply than anticipated.

If this scenario continues or intensifies, it could raise meaningful downside risks to the outlook curtailing the amount of further Fed tightening likely to be needed to guide the economy onto a more sustainable path.

Additionally, global growth momentum has been weakening, with uncertainties about China, raising the risk that these drags could have a negative impact and trade uncertainties would remain largely unresolved.

Currently, these developments do not have enough impact to change the central forecast because they have already been anticipated, but they are raising downside risks.

On the domestic political front, the recent election resulting of a divided government is unlikely to alter the fiscal trajectory and will have no material shift in what is already in place.

We do see the increase to demand from fiscal stimulus gradually fading over the next year or two.

Regulatory and trade policies are unlikely to change much either, though the latter remains a wild card. The agreement between the US, Canada and Mexico removes the risk of what could have been a highly disruptive repeal of NAFTA, but risks of other trade restrictions remain.

The fact that the US and China have resumed negotiations, thus delaying another round of tariffs, is a positive step toward resolution.

Although the direct macroeconomic effect on the US of another round of tariffs and subsequent retaliation are apt to be modest, a temporary lift to inflation and drag on growth, cannot be dismissed and, over time, protectionism can weigh on the economy's potential growth by limiting the efficiency gains that trade can deliver.

Housing activity has been sluggish lately but should not cause undue alarms. The tighter financial conditions that will likely be needed to guide overall economic activity onto a more moderate, sustainable path are bound to have a lopsided impact on the interest-sensitive housing sector, which is also contending with the reduced subsidy

featured in the new tax bill.

Whatever weakness we experience in housing, which hasn't been that noticeable so far, may not get much worse given the still-favorable fundamentals such as strong income gains and job markets and the recent dip in mortgage rates.

Trade is another area that may contribute to the moderation in cumulative activity. A stronger dollar resulting from tighter financial conditions, some cooling in global growth and increasing trade restrictions could all weigh on exports.

Business capital expenditures may be impacted by tighter financial conditions, worries about global trade and stretched finances in certain sectors.

Overall, financial conditions remain favorable, supported by high confidence, tax reform, strong profits and still-supportive financial conditions.

Similarly, households continue to benefit from sound finances, elevated confidence, and firm labor markets.

Although growth is expected to moderate over the next year or two, we don't see a recession in the cards. On the contrary, we expect this expansion to persist, becoming the longest ever by next summer and continuing even beyond that.

Even more encouraging is the private sector remains largely void of the kinds of large-scale excesses and imbalances that precipitated recessions in the past.

Humbled by the effects of the 2008 crisis, households and businesses, borrowers and lenders, savers and spenders and regulators have been much more cautious this time. The private sector learned from the past.

The economy also seems less vulnerable to the inflationary overheating that brought on recessions in past cycles, in part by provoking aggressive Fed tightening.

Labor markets are tight and wage pressures have been building, but only modestly.

Moreover, well-anchored inflation expectations, a decreased responsiveness of inflation to slack, a stronger dollar and some hints of at least modest improvement in the economy's supply potential should all work to prevent a material inflation overshoot enabling the Fed to tread carefully, avoiding the over-tightening that often-doomed past expansions.

We believe the US has a reasonable chance of pulling off a soft landing by moderating onto a more sustainable trajectory and curtailing potentially destabilizing excesses without jeopardizing the expansion.

It's also the key challenge facing Fed policymakers. They are trying to balance the risk of doing too little in combating potential overheating and broader economic and financial imbalances against that of doing too much and prematurely short-circuiting the expansion.

That task has been complicated by recent developments, especially the turbulence in financial markets and attendant tightening of financial conditions, increased uncertainties about the global outlook and unresolved trade tensions, which further cloud the outlook.

The case for the additional 25 basis point hike in the funds rate in December seemed compelling.

Labor markets were still tightening, domestic fundamentals were sound, inflation was near target and the funds rate was still slightly below FOMC members range of estimates of neutral. Failing to hike would risk stoking the kinds of excesses and imbalances that might necessitate a more abrupt and potentially destabilizing tightening later on.

Policymakers are apt to adopt a more cautious and explicitly data-dependent attitude about the policy path going forward.

Inflation is continuing display little sign of overshooting and the neutral rate of interest, though admitting of wide bands of uncertainty, is likely to remain lower than in past cycles, suggesting that policy may no longer be that accommodative, especially now that financial conditions have begun to tighten. That tightening has become sharper of late, raising downside risks to the outlook.

With this in mind, we expect Fed policymakers to accept that while additional rate hikes will likely still be appropriate, they are apt to be more gradual and modest than they have been and that there is no predetermined path, thus emphasizing the Fed's flexibility to respond to incoming information and how it shapes the outlook.

Future rates are conditional on how the outlook evolves. We believe that it will evolve in a way that requires further modest increases in the funds rate, though the recent tightening of financial conditions, if sustained, might limit those increases to a maximum of two in 2019 instead of three. But we still see greater risks that the Fed must tighten a bit further and longer to bring about the desired soft landing. Also, the Fed's balance sheet will likely continue to reduce as planned at least into early 2020, with a cumulative reduction of about $1 trillion.

Financial markets have become more volatile lately, reacting to slowing global growth concerns, trade war tensions, Fed moves, Brexit woes, political bantering and how difficult it could be for the US to sustain its current cyclical sweet spot. These are event driven, not fundamental breakdowns.

Granted, there's no shortage of things to worry about on the global front and there is concern that domestic markets might question the sustainability of the good news for the US economic cycle.

The longer growth stays above potential, the tighter labor markets become and the more the Fed hikes, the greater the risk that investors might turn persistently more cautious, increasingly aware that the most favorable phase of the economic cycle for financial assets may be behind us.

But the worries have gotten overdone. We still see overall fundamentals as solid, there is no recession on the horizon, no material inflation overshoot and a moderation to a more sustainable pace that enables the Fed to slow down, all of which are broadly supportive of risk assets.

New Year Brings Lower Mortgage Rates

MCLEAN, VA, Jan 3, 2019) - Freddie Mac (OTCQB: FMCC) today released the results of its Primary Mortgage Market Survey® (PMMS®), showing that the new year started with lower rates across the board.

The 30-year fixed-rate mortgage (FRM) averaged 4.51% with an average 0.5 point for the week ending Jan 3, 2019, down from the previous week when it averaged 4.55%. A year ago, at this time, the 30-year FRM averaged 3.95%.

The 15-year FRM averaged 3.99% with an average 0.4 point, down from the previous week when it averaged 4.01%. A year ago, at this time, the 15-year FRM averaged 3.38%.

The 5-year Treasury-indexed hybrid adjustable-rate mortgage (ARM) averaged 3.98%

with an average 0.2 point, down from the previous week when it averaged 4.00%. A year ago, the 5-year ARM averaged 3.45%.

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.)

Sam Khater, Freddie Mac's chief economist, reported that mortgage rates declined to start the new year with the 30-year fixed-rate mortgage dipping to 4.51%.

He also noted that low mortgage rates, combined with decelerating home price growth, should get prospective homebuyers excited to buy.

However, it will be interesting to see how the recent turmoil in the stock market will affect homebuying activity in the coming months.

IRS Tax Limits for Retirement Plans in 2019

The Internal Revenue Service recently released some of its annual cost-of-living adjustments that will affect the 2019 tax year, such as contribution limits to qualified retirement plans.

The following are some of the important changes to keep in mind.

Elective deferrals for 401(k) participants will be $19,000. The same limit also applies to defined contribution plans such as 403(b)s, most 457 plans and the federal Thrift Savings Plan.

The limit on annual contributions to an IRA is increased to $6,000 for 2019 and the additional catchup contribution limit for participants age 50 and older remains at $1,000, for a total of $7,000.

The IRS increased income limits on who can contribute to a Roth IRA.

The income phase-out range for single filers is modified adjusted gross income between $122,000 and $137,000 in 2019.

Married couples filing jointly have a phase-out range with MAGI between $193,000 and $203,000.

The income limit for deducting contributions to traditional IRAs will increase in 2019. Single taxpayers covered by a workplace retirement plan have a phase-out range between $64,000 and $74,000.

The phase-out for married couples filing jointly will be $103,000 to $123,000, if the spouse making the contribution is covered by a workplace plan.

The limit on the annual benefit received under a traditional pension plan will increase to $280,000.

The contribution limits regarding SIMPLE retirement accounts increased to $13,000.

2019 Social Security and Medicare Changes

Most Medicare beneficiaries will pay slightly more for their health-care premiums in 2019 and some very high-income beneficiaries will pay a substantial difference.

Retirees will get a 2.8% increase in their Social Security retirement benefits in 2019, the biggest cost-of-living adjustment in seven years.

The maximum monthly Social Security benefit for lifelong high earners who begin collecting benefits at full retirement age in 2019 will rise by $73 per month, to $2,861.

Medicare Part B premiums, which pay for doctor visits and outpatient services, will be $135.50 per month, up $1.50 from 2018.

If you are a high-income retiree, defined as individuals with modified adjusted gross income exceeding $85,000 and married couples with MAGIs topping $170,000, you will pay more for both Medicare Part B and Part D prescription drug plan premiums in 2019. MAGI is AGI plus tax-exempt interest.

Medicare Part B monthly premiums plus surcharges range from $189.60 to $460.50 per person per month. Although the surcharges are only slightly higher than in 2018, a new top tier was added in 2019 for very high-income retirees. It applies to individuals with MAGIs over $500,000 and married couples whose MAGI tops $750,000 and are based on 2017 tax returns.

Income taxes are going down because of the new tax law but payroll taxes are not. The maximum wages subject to payroll or FICA taxes, which fund Social Security benefits, increase by $4,500 in 2019. Employers and employees will each pay 7.65% of the first $132,900 of wages.

All wages, including those above the $132,900 cap, are subject to the 1.45% portion of the tax that funds Medicare, plus, individuals with earned income above $200,000 and married couples with earned income topping $250,000 will pay an additional high-income surcharge of 0.9% in Medicare taxes in 2019.

Individuals who claim Social Security benefits before their full retirement age and who continue to work are subject to earnings restrictions that can temporarily reduce or eliminate their benefits.

In 2019, retirees younger than 66 can earn up to $17,640 before losing any benefits, $600 more than 2018. After that, they would forfeit $1 in benefits for every $2 earned over the limit.

If you turn 66 in 2019, you can earn up to $46,920 in the months preceding your birthday without jeopardizing any benefits, up $1,560 from 2018. You will lose $1 in benefits for every $3 earned over the limit.

The earnings cap disappears when you reach full retirement age and you can earn any amount without forfeiting benefits.

The current full retirement age of 66 is increasing for workers born after 1954 which means the reduction for claiming benefits early is also on the rise. For individuals born in 1957 who become eligible for Social Security when they turn 62 in 2019, their full retirement age is 66 and 6 months.

You can still claim Social Security as early as age 62, but your benefits would be reduced by 27.5%, compared to a 25% reduction for those with a full retirement age of 66 who claim at 62.

The cost of the credits that a worker needs to qualify for Social Security benefits and Medicare coverage is going up.

To be eligible for Social Security and Medicare, you must earn at least 40 Social Security credits with a maximum of four credits per year.

In 2019, each credit represents $1,360 in earnings, up $40 from 2018. An individual must earn at least $5,440 in 2019 to qualify for the maximum four credits, compared to $5,280 in 2018.

Social Security benefits are taxed based on combined income, which includes a taxpayer's adjusted gross income, plus tax-exempt interest and half of their Social

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Security benefits.

Individuals whose combined income is between $25,000 and $34,000 pay income taxes on up to half of their benefits. Once combined income tops $34,000, you pay taxes on up to 85% of your benefits.

Married couples with combined incomes between $32,000 and $44,000 pay taxes on up to 50% of their Social Security benefits. Once income tops $44,000, they pay taxes on up to 85% of their benefits.

The Return of Market Volatility

Prior to early 2018, stocks were enjoying their longest period without a 5% pullback in nearly 90 years. That all changed in early February as the S&P 500 Index fell more than 6% during the first three trading days of the month.

By February 8th, stocks had fallen more than 10% from their January highs, leaving many to wonder how things could change so fast.

A few days later, sentiment shifted again, and stocks trended higher signaling the beginning of what was to come in 2018.

The sudden return of volatility can be attributed to many factors, including inflation fears. January employment reports showed an increase in stagnant wage growth, creating fears of accelerating inflation and higher interest rates.

Additionally, there were fiscal policy concerns. Recent tax cuts had sparked worries that fiscal stimulus may prove inflationary, which would put upward pressure on interest rates.

The 10-year Treasury bond yield spiked, hitting its highest level in four years, tempting some investors to pull money out of stocks to invest in bonds.

Algorithmic trading programs using computers to buy or sell stocks, make large trades very quickly. It is estimated that algorithmic trading is responsible for about half of the daily activity in the S&P 500 Index.

Market watchers say some sell programs were activated when the 10-year Treasury yield approached 3% accelerating the downward move and contributing to the market's subsequent rally.

The drop in stock prices could also have been tied to the end of US monetary policy easing last fall. The US Federal Reserve, along with major global central banks, have pursued a policy of low interest rates through quantitative easing in recent years.

Market corrections are a natural part of the investing cycle. Since the end of World War II, there have been 76 corrections of 5% to 10%, 26 pullbacks of 10% to 20%, eight retreats of 20% to 40% percent and three drawdowns greater than 40%.

Future market movements are impossible to predict and volatility is likely to persist.

Your investment portfolio reflects your goals, time horizon and risk tolerance.

Frankly Funny

The English language is very confusing at times. We say things like "slow down" and "slow up" and they are supposed to mean the same thing.

I've often wondered if anyone could tell me the difference between "Completed" and "Finished"?

Fact is that no dictionary has ever been able to define the difference between Complete and Finished.

However, in a linguistic conference, held in London England, Sun Sherman an Indian American, was the clever winner.

His final explanation was very simple. His response was: "When you marry the right woman, you are Complete."

"If you marry the wrong woman, you are Finished."

"And if the right woman catches you with the wrong woman, you are Completely Finished."

His answer received a five-minute standing ovation.

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