Q3 2018

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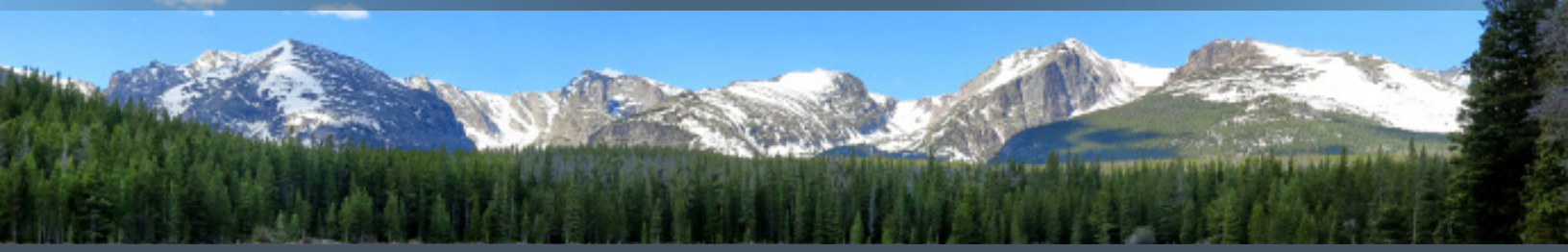
PERSPECTIVES



Economic Update

Our core economic theme for 2018 has been Rounding Third and Heading Home. We've been postulating that the United States and world economies have entered the boom phase of the current economic cycle. Economic growth, inflation pressures and interest rates tend to rise during the boom phase of a cycle. So far this year, these characteristics have come to fruition. Will the economic boom turn into a recession bust soon? Our work today represents our core economic outlook for 2019.

Update on Boom Economic Phase

We sense the boom characteristics mentioned above may have further to play out. We've been forecasting the U.S. economy should grow by 3 percent this year ("real" gross domestic product (GDP) growth). Growth has risen by 2.9 percent over the last 12 months while economic activity surged by more than 4 percent during the second quarter of 2018. Over the last 12 months, prices for consumer goods/services have risen 2.9 percent, up from an annual rate of 1.7 percent a year ago. We've been calling for inflation to rise this year. Our outlook for rising inflation has happened. Along with higher inflation, interest rates have risen as the Federal Reserve has increased interest rates seven times over the last 24+ months.

All major economic segments are participating in this expansion in overall economic growth and the drivers behind this ramp-up in economic activity remain in place. However, it appears to us that the "boom" phase may start softening as we enter 2019.

Signs of Economic Strength – And Maturity?

Our core economic case for 2019 is that the U.S. economy continues to grow through the boom phase, but the pace of overall growth should slow from the strong pace we are currently witnessing. Consider the following evidence suggesting a maturing economic cycle is at hand.

- While economic conditions aren't scheduled, it is interesting to note that the current economic cycle officially started during the second quarter of 2009. Since 1985, we have witnessed three previous business expansions, with the average lasting 95 months. The current expansion is now 111 months in duration. The longest cycle lasted 120 months. By comparison, this cycle is aged (data per NoSpinFORECAST).
- Unemployment typically rises during recessions as economic final demand contracts. The opposite occurs during periods of economic growth. Unemployment typically falls. Currently, the official unemployment rate at 3.9 percent (as of August 2018) is lower than the average low unemployment rate reached over the last three business cycles. The labor market, by past standards, is mature. Many economists agree that the nation has entered a full employment position. Nationally, there are currently as many job openings as people who are officially unemployed, a sure sign of a mature jobs market.
- Following a long period of caution, consumers are feeling more confident. Consumer discretionary spending growth has doubled since the first of the year. Spending growth rates are exceeding income growth rates. Consumers are increasing the use of revolving credit and lowering savings rates. These represent more signs of a mature economic cycle.
- Interest rates are rising as demand for capital matures and becomes stronger. The Federal Reserve has historically raised interest rates when the economy is headed towards recession. The Fed recently continued to normalize monetary policy.
- Short-term interest rates historically rise above long-term rates as the economy matures. This yield-curve inversion has occurred prior to the last several recessions.

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The yield curve (level of long-term interest rates to short-term rates) has flattened quite a bit over the last year or so as it appears the bond market is telling us that the business cycle is maturing.

2019 – Rounding Third and Heading Home Continues

We believe the U.S. economy will show positive, albeit slowing growth rates for the remainder of this year. Along with slowing growth rates, we suggest the current rise in inflation pressures could eventually subside later in 2019.

		Our Estimates	
	2017	2018	2019
Real GDP Growth	2.3%	3.0%	2.0%
Inflation (all-items CPI)	2.1%	2.5%	2.8%
Nominal GDP Growth	4.4%	5.5%	4.8%

Consider the following points which lead us to believe there will be continued overall moderate economic growth occurring over the next 12-18-month period.

- Many of the economic growth benefits accompanying the tax package should lessen as 2019 unfolds, due to calendarization. Comparisons will become tougher throughout 2019 because of the initial benefits which occurred in 2018.
- In general, we think the stage will be set next year for consumption growth to eventually slow from the 2017 – 2018 rates. Rapid growth in consumption patterns tends to go together with strong improvement in the jobs market. With the jobs market having reached maturity, we expect consumption activity to be firm next year, but repeating this year's solid pace may be difficult.
- Interest rates should continue to rise. As an example, we think 30-year mortgage rates could rise to 5 percent sometime in 2019, up from 4.5 percent currently. But the real fireworks regarding interest rate changes in 2019 may occur in short rates. We suggest the Fed will continue raising interest rates until mid-2019. Fed funds interest rates, currently above 2.0 percent, may be in the 3 percent range by mid-2019.
- Overall, uncertainties accompanying both economic and non-economic events may, on balance, create issues moderating overall U.S. economic growth over the next 12 months.
    - There are concerns accompanying trade policy uncertainties.
    - The full impact of BREXIT policies will start to become clearer as the next 12 months unfold. Will BREXIT actions push the United Kingdom into recession? Perhaps. What type of impact may this activity have on the U.S. economy?
    - China's overall growth rate, which has slowed this year, may see another step downward as uncertainties surrounding trade and BREXIT activities weigh on this part of the world.
    - A U.S. mid-term election may usher changed leadership standing from one party to another. For example, some believe the Democrats will retake control of the House of Representatives.

At the End of the Day

So, while we expect slower overall growth and continued increases in interest rates, we are forecasting that the U.S. economy stays out of recession in 2019. Our Rounding Third and Heading Home theme should remain in place for at least the next 12-18 months. Following are points suggesting why we could see a slowing, but still positive economic growth.

- While the Treasury yield curve has flattened, long rates are still slightly higher than short rates. Typically, when inversion occurs, it is sometime between actual inversion and the onset of a recession.
- Another yield spread to watch is the Fed funds rate to the 2-year U.S. Treasury yield. Theory holds that this spread – which somewhat closely matches commercial bank's cost of funds (Fed funds) to rates on loans (2-year U.S. Treasury) gets to the crux of national credit creation. Its recent widening suggests bank credit creation could continue to expand.
- The 6-month rate of change of the Leading Economic Indicators (LEI) is still strong. Currently the LEI is 5 percent higher than was the case six months ago, suggesting economic growth should continue for the short/intermediate term. It is interesting to note that over the last 10 business cycles, the economy has only slipped into recession once when the 6-month rate of change of this index wasn't down by at least 3 percent. The economy hasn't slipped quickly into recession when the rate of change has been this high since the end of World War II (per Ned Davis Research).
- While we believe consumption growth may slow somewhat, we expect investment spending to rise nicely over the next 12 months. Two main factors behind business decisions to invest in productivity-enhancing capital projects are interest rates (which are still very low based on historical norms) and tax policies. The recently-passed tax package ushered in an acceleration in depreciation. Businesses are now allowed to write off 100 percent of investment spending the year the spending occurs. The combination of these two factors makes us believe that business spending growth should be strong in 2019.

In the end, we believe our Rounding Third and Heading Home theme remains intact. Interest rate trends may continue to slowly push to the upside. We suspect overall economic growth should decelerate but remain positive next year. In our view, 2019 will prove to be another year of overall economic growth, extending the current economic growth cycle past its 10-year anniversary. If so, the current cycle would go down in the history books as the longest on record.

Tax Planning Around New Law Saves

The new tax law could save you money if you plan properly. With only a few months left to impact your tax planning for 2018, it is important to act now.

The Tax Cuts & Jobs Act (TCJA) is now in effect for 2018. Tax payers will need to sort through how these changes affect their tax liability. The differences in what you will be able to deduct or itemize have changed substantially. You may want to meet with your tax advisor as early as possible and use the last few months of the year to prepare for these changes.

Here are some money saving opportunities:

Consider funding an IRA account. Most employees who have a 401k plan may have forgotten they might also be eligible for an IRA. If you are Married Filing Jointly and only one spouse has a 401k plan, the other spouse may be eligible for a $5,500 deduction or $6,500 if over the age of 50. Check the IRS limits for Adjusted Gross Incomes that range from $189,000 to $199,000. Those with two qualified employer plans with incomes under $101,000 can both write off the full contribution. This may be enough to reduce other factors, such as eligibility for child care tax credits.

Self-employed individuals may be eligible for an SEP (Simplified Employee Pension). These limits can be substantially higher than an IRA based on business or consulting income. Most plans allow for deductible contributions similar to 401k limits - which for 2018 are $18,500 with an age 50 and over catch-up provision of another $6,000. Higher income earners may also be eligible for a solo 401k or profit-sharing contribution up to 25 percent of your business profit up to $55,000 plus catch-up, depending on your business structure.

Consider maximizing your Health Savings Accounts for the year if they have not already been funded. You may be eligible if you had a high deductible health insurance plan starting no later than December 1st.

An individual can contribute a tax-deductible amount of $3,450 with a $1,000 catch -up provision for anyone over age 55 by December 31st. Households with one spouse on family coverage can contribute $6,850 plus the catch-up for those over age 55.

The penalty for not having health insurance does not expire until 2019. Therefore, those who forgo health insurance for 2018 could still face a penalty. You can apply during open enrollment next month to avoid this penalty.

Consider funding college savings plans, which are eligible for the state income tax deduction for children or grandchildren through www.collegeinvest.org. This will save you the 4.63 percent Colorado income tax on your contribution.

If you pay quarterly estimated tax payments, be aware of the new SALT (state and local tax) deduction limit. It used to be that if you paid your fourth quarter state taxes before year-end, then you would be able to deduct it on your Schedule A the following April. This is now limited to just $10,000 for the entire SALT category including state income taxes and property taxes.

To help reduce unwanted taxable investment income, consider meeting with your financial advisor for tax loss harvesting and to structure your investments to be tax-efficient. The long-term capital gain and the qualified dividend tax was indexed up slightly but in essence remained the same as 2017. Therefore, if you would have been in a 15 percent tax bracket in 2018 (even though there is not a 15 percent bracket this year) then your long-term capital gains and qualified dividend tax is capped at zero, or 15 percent for higher brackets.

It is also important to monitor your tax withholding on your paychecks this year. New withholding tables for employers appear to be shy of the actual tax liability. If you noticed a larger take-home pay starting in February, check with your tax accountant to confirm if you need to increase your withholding for the remainder of the year.

One last major change, the Child Care Credit actually improved for people in higher tax brackets. Parents can now take a credit up to $2,000 if their joint income is under $400,000 or a single parent with income under $200,000.

These tax law changes are important to review as the goal is to keep more of your hard-earned dollars working for you. Plan to take advantage of every deduction you are eligible for and make estimated tax payments on time. Then you won't have to pay any more than necessary.

Five Frequently Asked Life Insurance Questions

September was Life Insurance Awareness Month. Please consider reviewing your policies with your wealth advisor by providing them copies of existing policies, the reasons they were purchased, and who they should call in the event of your death. Finally, consider storing copies of your active policies in a secure location, such as a secure online vault and make sure that your family knows who to contact.

Question #1: How often should I review my existing policies?

Answer: You should review your policy anytime you have a major life event such as marriage, birth of a child, new job (with different salary or change in benefits), starting a new business, death or divorce.

Question #2: If I've experienced one of these life events, what should I review?

Answer: First you should examine the amount of insurance coverage you have and determine if it still meets your needs. Next, you should review your beneficiaries to ensure they are up-to-date. Finally, determine if the purpose of your insurance has changed in any way. For example, maybe you originally purchased a policy to cover college expenses. Now that your child has finished school, this policy may be repurposed for something else.

Question #3: I've always considered life insurance as something that would help my family cover any final expense, paying off debt or replacing income should I die unexpectedly. What other uses should I consider?

Answer:

1. **Providing liquidity:** If you have been a good saver throughout your life, you might believe life insurance

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is an unnecessary expense. While that may be possible, much will depend on how your assets are invested. For example, if you've found a penchant for investing in real estate and have amassed a sizable portfolio of properties, it's important to consider what would happen to these properties in the event of your death. Could you easily convert these assets to cash to cover final expenses, pay-off debt, or pay potential income or estate tax if applicable? Life insurance may provide families with needed liquidity without requiring them to sell assets.

2. **Equalizing your estate:** For business owner's, farmers, or individuals that are assigning specific assets to certain beneficiaries, life insurance could provide you the opportunity to equalize as well as provide liquidity for illiquid estates.
3. **Charitable giving:** For many philanthropic individuals, giving to charity at their death is important. Using life insurance to bequeath specific dollars to charities is as simple as naming the charity as a beneficiary. However, consider this in light of your overall situation…using assets instead of life insurance may actually be more to your advantage.

Question #4: As a business owner, how can life insurance help me?

Answer: Life insurance can help in unique ways. First, it can provide the business with capital to help cover the cost of replacing a key employee. Additionally, it can provide the remaining business owners the liquidity needed to buy-out the share of the business belonging to that key employee after their death.

Question #5: The reasons I originally purchased life insurance have changed, should I cancel my policy?

Answer: Perhaps, but you might also consider repurposing it. For example, let's say you've accumulated a large retirement plan like an IRA or 401k. When these assets pass on to someone other than your spouse, income taxes may become due as that money is distributed. To avoid that ongoing tax burden, if you have an old life insurance policy, you might consider having some or all of those retirement assets go to a charity and passing along the life insurance proceeds to your loved ones. This can allow for more dollars to go to your favorite charity while also allowing for more dollars to be passed on to your loved ones.

Another consideration if this is a term policy is to check the conversion options. You may want to consider converting it to a permanent policy and adding a rider that would provide long-term care benefits. With long term care events impacting many families, these riders provide needed capital at a very crucial time.

What's New at Kummer Financial

We hope everyone is enjoying the Fall leaves! Thank you for all your support as Kummer Financial grows with Mariner Wealth Advisors. We appreciate your referrals and we always welcome the opportunity to help those you know. Please do not hesitate to let us know of any changes in your world so we can keep your plan current.

We are excited to be moving forward with our Mariner partnership. We continue to send announcements of new developments as we adopt new technology systems, add new client services, and continue to provide you with the team support and service you've known at Kummer Financial.

As part of our integration with Mariner, we will be holding several Technology workshops in late October and early November to introduce you to our new client technology portal called MarinerGPS as well as other client service updates. Invitations have been sent out, and details are also available on our website at www.kummerfinancial.com. Contact **clientservice@kummerfinancial.com** or call **303-470-1209** for more information and to RSVP.

We are continuing to grow this year and would like to welcome Michelle Freres, CFP® and Associate Wealth Advisor to the planning team.

Be sure and stay current with our economic updates posted to our website and Facebook. Click the Newsflash button on the KFS website for current events and economic updates.

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