Magellan
Planning Group, Inc.

Atlanta — Autumnal Equinox – 2018

Autumn is upon us—my favorite time of the year—and while writing this I find myself in good spirits.

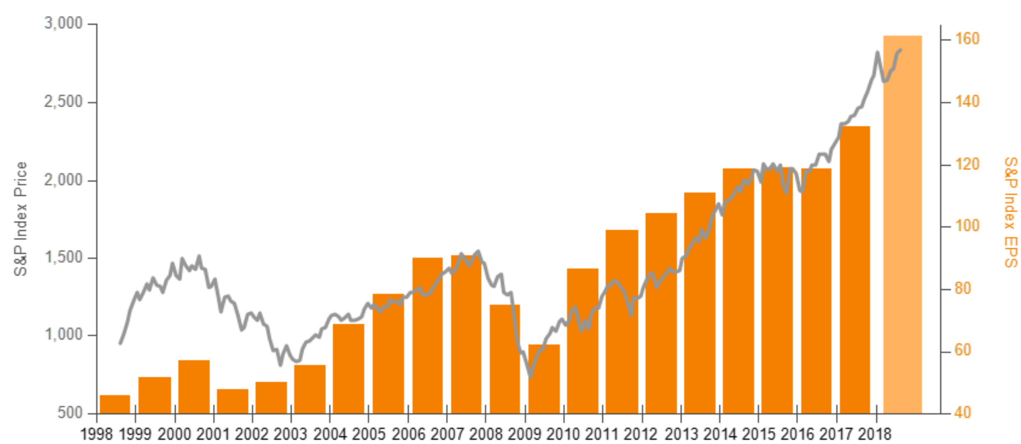
Despite constant news reports over the last two years that the world is coming to an end, I'm happy to report quite the opposite. At this point, everything is proceeding very much in the direction we expected, and indeed, portended.

Obviously geopolitical problems exist, but they always exist, and likely always will. When has there been peace in the Middle East? And when can I expect some?

And yes, there is the "tariff talk" and the so-called "tariff wars" with China. Initially, this caused great consternation in the market, but has since waned as perhaps the fallout will be less than feared. On September 18, the very day China announced another $60 billion in tariffs against the United States, the Dow finished *up* 184 points! [1]

Earnings Per Share vs. S&P 500 Prices

Since 1999, earnings for S&P 500 companies have grown significantly and the index price level is now trending in line with earnings. The earnings per share (EPS) estimate for 2018 is $160.



Source: FactSet as of 08/03/18. Note: Earnings Per Share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock.
Past performance is no guarantee of future results. S&P 500 Index is a gauge of the U.S. stock market, which includes 500 leading companies in major industries of the U.S. economy.

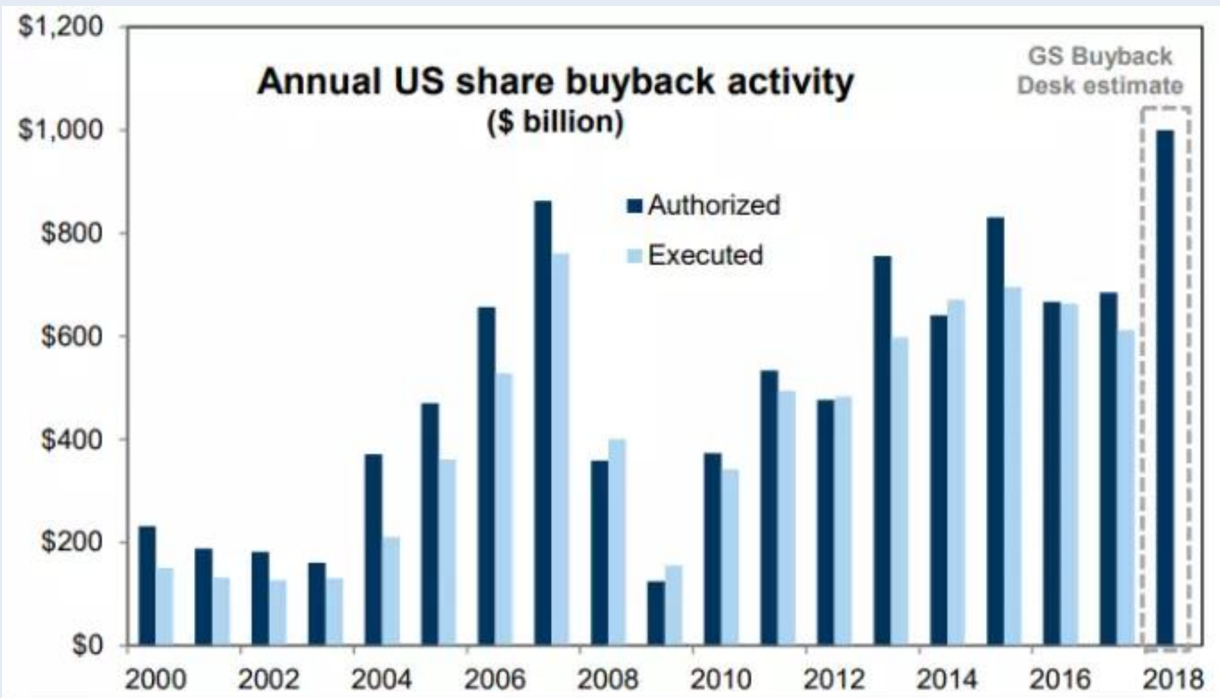
On the other side of the coin, the corporate tax break. Wow! This is a game changer. As my friend Doug Coté, Voya's eminent Chief Economist, likes to point out: "Corporate earnings drive the market." Doug is right. Here you can see the correlation between corporate earnings (bar) and stock prices (line). This is one of those fundamental factors we like to watch.

[1] https://www.bbc.co.uk/news/business-45555749

Corporate earnings were doing well enough before the tax break, but now the U.S. has signaled that it is open for business in a big way, and ready to be competitive again on a global scale. All of a sudden, other countries are at risk of losing business to the U.S., rather than the other way around. After 2018, our corporate tax rate for all companies—foreign or domestic—doing business here is now even lower than Uruguay's. Though Uzbekistan and Vanuatu still have us beat.[2]

As I wrote in a letter back on February 28:

> You will see dividend increases, stock buybacks, and even special dividends as companies seek to allocate all this returning cash. Rest assured, the executives at all these companies will do whatever it takes to get big bonuses, and this can only occur when shareholders are fat and happy. You can always count on the executives doing what's in their best interests.



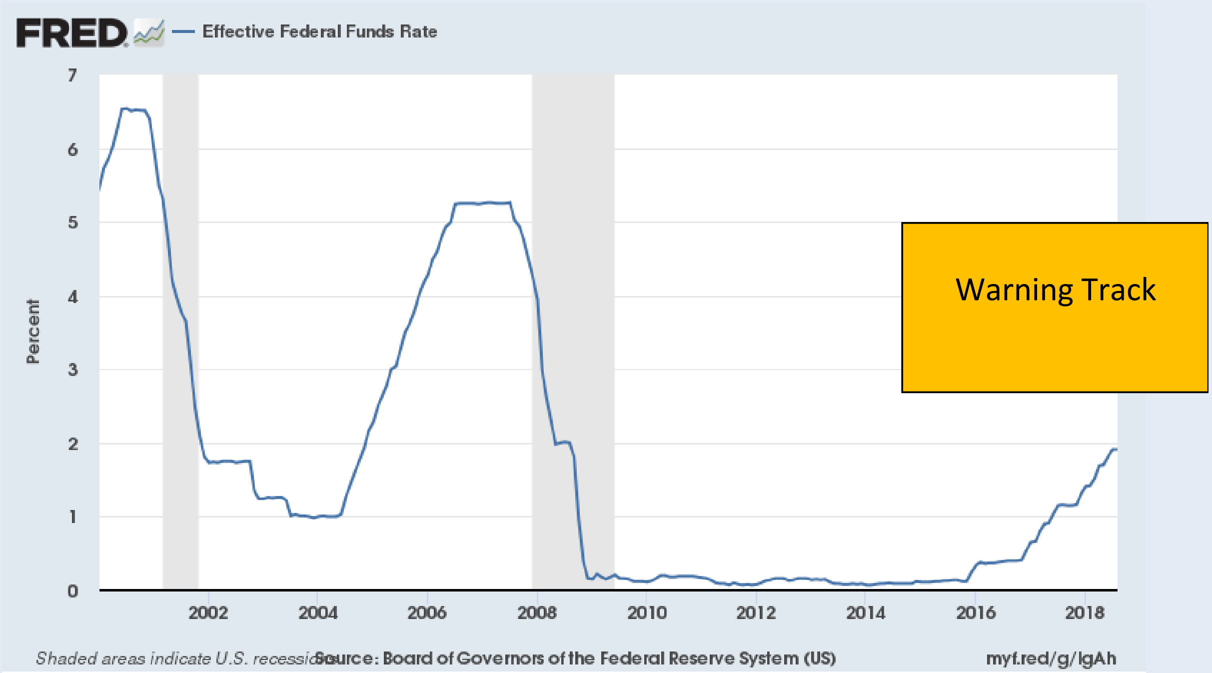
Source: Birinyi Associates, Goldman Sachs Global Investment Research

Well, that is exactly what has happened, and on a record scale. According to the Financial Times, Goldman Sachs reports that US corporate boards are set to authorize $1 trillion in stock buybacks.[3]

Put all of this data together, and things looks pretty rosy. So, what's the problem? The problem is, of course, the Fed.

[1] https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-corporate-tax-rates.pdf
[1] https://www.ft.com/content/00d3d748-9974-11e8-ab77-f854c65a4465

Even though the Fed is tightening, monetary expansion continues (meaning you still see growth; cranes, construction, new buildings, roads, apartments, bridges, stadiums, dog parks, sidewalks, you name it). All of this will give the Fed license to continue.



You can see from the chart above that we have been slowly approaching 2%. Last Wednesday, the Fed announced another 25-basis point rate increase—their normal quarter point move. This puts at about 2.25%, not far from our warning track of 2.75%.

What happens at the warning track? For our clients, we are going to reduce our riskiest exposure beginning with the next rate hike, which would be 3%. And for every rate increase thereafter, we will be taking more profits off the table, and then eventually much of our principal.

With qualified accounts like IRAs and 401k's or other tax deferred accounts, this does not create a problem (usually). But other types of accounts, like non-IRA's, joint accounts, and revocable and irrevocable trust accounts—are mostly taxable (excepting charitable trusts of course).

Thus, making changes, and especially taking profits, creates a taxable event. This is unfortunate, but unavoidable. We therefore must ask ourselves a question: **"Is it better to pay taxes on my gains, or lose my gains?"**

If you fall into this category, you may want to consider tax loss harvesting if you have some unrealized losses (selling positions at a loss and then buying them back 31 days later to realize paper losses for tax purposes).

In addition, it may be prudent to consider taking some profits this year, in order to spread out the tax burden over two, perhaps even three tax years. I would suggest trying to coordinate with your tax professional sometime soon. The last thing you want is an unexpected tax shocker come April 15. I've noticed people really dislike that.

Fed rate increases pretty much go the same way every time as rate hikes are taken two-fold: One, easy money is now a little less easy. And two, the Fed only hikes rates when the economy is booming. So that's great, let's go ahead with all those projects. Subsequent surprise earnings reports, due largely to the tax break, will add fuel to the fire.

And as we expect, the Fed will continue to raise rates… and raise rates… until…

Well, you can fill in the end result.

If you are already a client, then you have nothing really to do but read these letters, stay calm, enjoy your life, and ignore the media. I would suggest a trip to Europe while the dollar is so strong.

If you are not a client, or perhaps you have another "mainstream" advisor—you may want to take heed. The typical "financial advisor" is just pushing the corporate Kool-Aid. And it's not their fault, because they're drinking it too. The ultimate responsibility—and results—belong to you alone.

About J. Kevin Meaders

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Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through Voya Financial Advisors (member SIPC).

About Magellan Planning Group

www.magellanplanning.com

Magellan Planning Group was established in 2000 to provide a service uniquely tailored to the needs of our affluent Atlanta community. We concentrate on *personalized* retirement planning through tri-disciplinary coordination:

- Financial planning with our Certified Financial Planner™ to prepare a retirement plan that takes into account your needs and expectations. We are a fee only asset management firm.

- Estate planning with our in-house Attorney-at-Law to determine and prepare the documents needed to minimize family liability and maximize privacy. (www.magellanlegal.com)

- Tax planning through a relationship with our in-house CPA to manage tax obligations throughout the year and prepare a tax return that takes into account current tax laws. (www.magellantax.com)

Our relationship doesn't begin and end with the preparation of a plan and the appropriate documents. We establish close personal relationships with our clients and their families and maintain those relationships through regular 'check-ups', market commentaries and educational Lunch & Learns.

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