Cambridge ADVISORS inc. INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE MARCH 2018

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MARKET COMMENTARY

US stocks started the year strong but then tumbled and ended the quarter with a small loss. Large cap stocks in the S&P 500 fell –0.76% in the first quarter of 2018 while small cap stocks in the Russell 2000 fell -0.08%. International stocks of developed markets in the MSCI EAFE were down -1.53% but emerging market stocks were able to record a gain of 1.07%. Meanwhile, bonds were unable to provide protection as their yields rose during the period resulting in a –1.46% return for the Barclays US Aggregate Bond Index.

Volatility was largely dormant in 2017 but re-emerged in 2018. In 2017, the S&P 500 had only 8 days where the index moved up or down 1% or more. In first quarter of 2018 alone, the S&P 500 has had 23 such moves (2016 had 48). The S&P 500 had a 10% correction from its high in January while last year the index never had more than a 3% pullback. Although volatility has picked up in 2018, it is still near long-term averages and not cause for concern at this time as economic fundamentals are still sound according to Strategas Research.

Not all stocks suffered; technology and consumer discretionary stocks both had positive returns of 3.5% and 3.1% respectively. Usually consumer staples stocks and telecom stocks are considered lower risk because of their non-cyclicality and higher dividend rates and so they can be a safe haven when volatility is present. However, this time they are the bottom performers with losses of –7.1% and –7.5% in the quarter. Many analysts have also been pointing to financial stocks as likely outperformers for the full year believing they will benefit from higher yields, lower taxes and financial deregulation. They also believe that energy stocks are valued attractively and will benefit from tax reform.

Stocks are not down due to recession fears. Fourth quarter GDP growth was revised higher to 2.9%. Full year GDP growth for 2017 was 2.6% - the best full year since the recovery began. Looking forward, analysts are projecting 3% or higher GDP growth in 2018. JPMorgan estimates that the soonest we could possibly see recession pressures would be the second half of 2019 but they also believe it would be a shallow recession at that and it may not even occur in 2019. Both JPMorgan and Strategas Research are projecting GDP growth to slow in 2019 to near 2% and JPMorgan expects long-term GDP growth to remain at those levels.

Corporate profits are also not the problem. Earnings for the S&P 500 grew 13.5% in the fourth quarter. Revenues were up 8.5% First quarter earnings are expected to be up more than 15% according to Zacks Investment Research and the full year estimates are for 21% earnings growth.

Most analysts believe that tax reform will be good for economic growth and corporate earnings. The lower corporate tax rate and cash that will be repatriated from overseas will result in more money available for reinvestment in business expansion and capital expenditures, as well as money that can be returned to shareholders through dividends and stock repurchases. Estimates are that total fiscal policy from tax cuts, spending and repatriation will amount to $200 billion in 2018.

Investors seem to be forgetting the benefits of tax reform and instead focusing on renewed inflation fears, concerns regarding a trade war with China and more recently Facebook's data-harvesting activities. Inflation is expected to rise to the Fed's target 2% or possibly up to 2.2% but it is not expected to be out of control. The tariffs are estimated to total $36.5 billion in 2018 which is much less than the $200 billion fiscal stimulus from tax reform so Strategas Research believes their impact is being overexaggerated in stock price movement. Their biggest concern regarding the tariffs would be their negative impact on business confidence. JPMorgan also believes the threat of a trade war is overblown and it would likely be more of a "trade squirmish". Facebook's woes have caused investors to pause and reconsider the lofty valuations they were placing on the FANG stocks (Facebook, Amazon, Netflix and Google) and other technology stocks. Technology has been a growth driver and many analysts expect that to continue especially with capital investment from Tax Reform.

The Federal Reserve raised rates again in the first quarter. The move was expected. Two or three additional increases are anticipated in the rest of 2018. Treasury yields continued to climb higher. The 10-year Treasury bond was yielding 2.41% at the end of 2017 and reached 2.94% in mid-March before retreating. It ended the quarter at 2.74%. The rapid rise resulted in negative bond returns for the quarter noted earlier as the depreciation in bond prices outweighed the interest earned for the period. JPMorgan estimates that the 10-year Treasury yield could reach 3.5% by year-end.

2018 BENCHMARK RATES of RETURN

INDEX	FIRST QUARTER	YTD
S&P 500	-0.76%	-0.76%
DJIA	-1.96%	-1.96%
NASDAQ	2.33%	2.33%
Russell 2000	-0.08%	-0.08%
International	-1.53%	-1.53%
Fixed Income	-1.46%	-1.46%

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have.

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Most analysts continue to favor stocks over bonds this year but they also note that they expect volatility to continue. International economies are also growing and their stocks are at lower valuations so they still have room to grow as well. Fixed income faces a difficult year as yields are expected to rise. Gradual increases in yields would be helpful for most investors in the long run but rapid increases can be disruptive in the shorter-term. A large decline in bond prices is not expected, though, and the volatility of stocks means there is still room for bonds in many portfolios to reduce risk. We may continue to trim exposure in high-yield and long duration bonds for some clients to reduce risk. If you have questions about your account, please do not hesitate to contact your advisor.

FINANCIAL PLANNING

Charitable Gifts

Tax Reform has many facets to it and it may impact how you make charitable gifts or donations to your church. We encourage our clients to talk with their accountants to see if any changes would be beneficial.

With the standard deduction being raised to $24,000 and the state and local tax deduction being capped at $10,000, it may be advantageous for some couples to take the standard deduction some years and itemize their deductions in other years. In the years where the standard deduction is taken, you would try to minimize your itemized deductions. It may mean that you don't make charitable deductions that year to get the maximum benefit from taking the standard deduction. Then, in the years that you do itemize deductions, you maximize your deductions. For instance, in those years you may double up on your charitable donations.

For those who want their donations to charities to be constant each year, it may be possible to set up a charitable account at Schwab or with a community foundation where the gifts are made in specified years (and the tax deduction taken) but then the funds can be distributed over multiple years to the recipients so that they receive a more even income stream. Gifts of appreciated stock or cash can be made to the charitable account.

Gifts of appreciated stock are still advantageous over cash because you can avoid paying tax on the gain regardless of whether or not you are using a charitable account.

For those who are over 70 1/2 and have an IRA, it can be even more advantageous to make gifts directly from your IRA. Rather than receiving a tax deduction, the income is not included in taxable income or AGI (adjusted gross income). So, in years that the standard deduction is taken, gifts from the IRA can also be made without reducing the benefit of taking the standard deduction. Regardless of income, you can contribute up to $100,000 per year from your IRA. The amount given will count towards your required minimum distribution for the year. Keeping AGI low also provides advantages when calculating the cost of Medicare premiums, Medicare part B premiums and prescription drug premiums.

Your advisor is happy to work with you and your accountant to develop and implement a gifting strategy.

CAMBRIDGE ADVISORS NEWS

We are happy to report that once again Cambridge Advisors was recognized as one of the ***"Top 9 Best Financial Advisors in Omaha"*** by AdvisoryHQ, a financial review and ranking news media platform. To generate a more reflective award ranking of the top advisors and investment managers, AdvisoryHQ went beyond just analyzing the size of an advisory firm. AdvisoryHQ developed a "Top-Down Advisor Selection Methodology" that is based on a wide range of filters including fiduciary duty, independence, transparency, level of customized service, history of innovation, fee structure, quality of services provided, team excellence, and wealth of experience.

AdvisoryHQ uses a 4-step selection methodology to identify, research, and generate its list of top ranking firms:

- **Step 1:** Using publicly available sources, AdvisoryHQ identifies a wide range of financial advisors, RIAs, financial planners, and wealth management firms providing services in a designated area.
- **Step 2:** The firm's review and selection team then applies initial methodology filters to narrow down the list of identified firms. These filters include each firm's fee structure, fiduciary duty classification, and level of independence.
- **Step 3:** After trimming down the initial list, AdvisoryHQ conducts a deep-dive assessment of the remaining advisors. The award criteria takes into account a range of factors, including experience level (broad level of expertise and extensive years of experience), transparency, level of customized services, and website quality. Open door policy, resource availability (number of "available" advisory professionals and supporting staff), and range of provided services are also assessed to build up a broad picture of what each firm has to offer, before the final selection process occurs.
- **Step 4:** Based on the results of AdvisoryHQ's assessment, the firm's research and selection team then finalizes the entities that make it into the respective top ranking lists, which are then published to the general public.

AdvisoryHQ listed the features below as key factors in their decision. We are pleased that these things they like about Cambridge are not new to the firm—they are core values that have been important to us since our inception in 1990.

- Registered Investment Advisor
- Process and Customized Plans
- Long-Term Relationships
- Personalized Approach
- Team Approach

We are honored to be included on their list for the third consecutive year. The full report can be seen at http://www.advisoryhq.com/articles/best-financial-advisors-in-omaha-nebraska.