LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Despite the continued turmoil in Washington, the financial markets and economy appear to be on a stable course for the moment. Accordingly, in this issue we give a little thought to the newly evolving risk – cyber security, and also the implications of the new Fiduciary Rule, in addition to our snapshot of the economy and markets.

The Economy

The trends described last quarter continue. Consumer confidence continues to improve. Stock market values continue to rise. Employment continues to grow at a stable pace, nearing the limits of previous expansions. Home values continue to grow as the inventory of unsold homes continues to shrink. The Fed continues to raise short-term interest rates, but longer-term rates have dropped off, providing a bit of mortgage relief. Inflation remains tame, registering 1.9%, and first quarter GDP measured 1.4%. The Atlanta Fed's real-time GDP estimate for the second quarter is 2.9%. Economists who scan the horizon for signs of recession are still coming up empty, although there are plenty of people describing where the clouds may develop.

There is no question that the expansion will end at some point. Business cycles are not forever. The tricky question is when. Despite the political reaction, the election seemed to lift the spirits of ordinary people out of the depressed, low-growth state of mind that prevailed through 2015 and 2016, perhaps just because there was a change – any change. The improved confidence has extended the growth, despite the fact that the outlook is not really any different. High levels of government debt and the hangover from the Fed's money printing, not to mention the demographics of a retiring population, are very likely to restrain any return to the "glory days" of the 1980's and 1990s for quite some time to come.

The Markets

Most areas of the stock market continue to make new highs, although the larger company averages have been more robust than the small. Technology companies were leaders in the quarter until about a month ago. This is currently a very different market than the stealth bear market we witnessed from 2015-16, when many areas were down 20% or more, while the indexes quoted on the nightly news looked like all was well. Bonds, too, have regained some or all of the losses they took in the debacle after the election, which made properly diversified portfolios under-perform.

It is important to keep in mind though that all is still not well in Mudville, even if you like Casey's batting style. As we have often mentioned, valuations are still high and getting higher. As stock prices increase faster than underlying economic growth, and bond prices increase without any fiscal or monetary discipline, risk continues to increase. Current market gains may turn out to be imaginary, just like the feelings of wealth in 2007 that were based on extended real estate prices. The problem at that time was that many people monetized their imagination by over-extending mortgage debt. There is a lesson to be learned from that – to not take undue risk in today's environment, and manage your risk carefully.

Cybersecurity

As financial planners and advisors, we feel it is important to consider what can go wrong, as well as what can go right. These days, computer security risks have become widespread enough to pose a real threat to a person's well being. At this point it may be only a major inconvenience if a person's credit card number, their identity, tax returns, or medical information is stolen. The recent ransomware episodes of WannaCry and Petya rise to a new level as we become more and more dependent on our computers and data to operate our everyday lives. You buy insurance to protect against risks to your home and life and to mitigate liability. It makes sense to organize your computer habits to protect against cyber risks. You can control the biggest cyber risks, because they come from things you do or don't do. Here are several ideas to consider.

Cyber folks say that virus malware contamination and entry into computer systems primarily comes from clicking on links in "phishing" e-mails, following the horsey strategy employed by the Greeks against Troy centuries ago. Other than using virus detection software, and not clicking on these links (go straight to the company's website, if the letter looks legitimate), the primary recommendations are to keep your operating system software up-to-date and patched. If you must still use Windows XP, don't keep any important data there. Make frequent backups of your data, and remove them from your machine. Put them on a USB thumb drive or USB attached hard drive, then disconnect it and put it on the shelf until the next back up. Use different strong, randomly generated passwords (not "Password" or "QWERTY") and password manager software to keep track of them all. Take advantage of "two factor authentication", the mechanism that calls your phone to provide another code in addition to your password. It is a definitely a hassle, but consider using it for important accounts like banks, brokers and doctors.

The DOL Fiduciary Rule

Do you think that your financial advisor keeps your best interest in mind? The government thinks not. As you might surmise, the new rule from the Department of Labor says that financial advisors (including stock brokers and insurance agents) must put their clients' interest before theirs. Despite much resistance from the financial industry (suggesting that maybe your broker wasn't fully looking out for you after all), the rule became effective in June.

Sounds great, right? There are several things to be aware of: 1) It only applies to retirement accounts – IRA's, 401k's, 403b's and the like. Regular brokerage relationships are not affected. 2) The rule was amended to allow a "Best Interest Contract Exemption", which basically says that a broker / advisor can do things which are not normally in keeping with the actions of a fiduciary, like charge commissions, if they acknowledge their fiduciary status, promise to provide advice that is in the best interest of the client, and disclose fees, compensation, and conflicts of interest. So if you come across a "BICE" within the papers you sign to open an account - read it. Note that this change primarily affects commissioned salespeople. Registered Investment Advisors have always been required to act as fiduciaries for all types of accounts. This has also been a requirement of CFP®s for several years.

The emphasis of the rule is to reduce conflicts of interest by making sales commissions level, so there is no incentive for a broker or agent to recommend one product over another. A result of this has been the introduction of mutual fund "T-Shares". This new class will generally reduce the load commission for all shares to 2.5% plus a 1/4% annual charge. Currently fund distributors charge different amounts for different funds, e.g. charging less for bond funds than stock funds. Although the T-share commission is lower than the typical 5% commission of current A-shares, after paying for the A-shares once, you can generally switch between funds of the same family. With T-shares, the 2.5% charge will be incurred with each change, potentially making portfolio re-balancing more costly.

A reason for all the complexity and alphabet soup of share classes is because the financial industry has been very creative over the years in figuring out different ways to imbed hidden commissions and rebates inside the fund loads and expenses. Another alternative to both the current share types and the T-shares may be "clean" shares that strip away all the hidden commissions, rebates, etc. contained in typical mutual fund loads. With these shares, the broker would simply set its own commission schedule. Gee, that sounds awfully straightforward and transparent.

LFM&P has been a fiduciary for our entire fifteen-year history, long before it became fashionable, because it was the right thing to do. If you would like help looking into your financial future, evaluating your risks, managing your investments, or planning to manage your income effectively, please call or e-mail.

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