PINNACLE
Wealth Management Group, Inc.

849 Penniman, Suite 201
Plymouth, MI 48170
Phone: (734) 667-5581

FINANCIAL FORUM

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Market Commentary

Wall Street has a history of bringing esoteric financial terms into the mainstream vernacular. For example, ten years ago virtually no one, including myself, had ever heard of the term "quantitative easing" or "QE," in its abbreviated form. As it turns out, it was just a fancy way of saying "money printing" – something our Federal Reserve Bank started and taught to the rest of the central bankers around the globe. Now there's a new term that is just starting to make its way around the trading floors of Wall Street and, I suspect, may be making its way soon to a television or newspaper near you. It's called "Credit Impulse" and it's a byproduct of quantitative easing. Essentially, there are many analysts and investors who believe that the majority of the 2009-2017 stock market rally was nothing more than the result of a massive coordinated credit creation event courtesy of the world's major central banks. In other words, over the past eight or nine years, every major central bank has embarked on a large-scale QE campaign pumping the world full of cash, which in turn has created massive asset inflation in bonds, stocks, real estate, art, you name it, but just mediocre economic growth. In fact, according to Barron's, global central banks have expanded their balance sheets to $19 trillion from about $3 trillion in 2000. The question now is what happens when all these central banks become less accommodative and stop printing money and/or start raising rates? Hence, this is where the term "Credit Impulse" comes from. It is a term that measures the "Rate of Change of Change" of global credit creation/QE. Simply put, while some central banks are still printing money (i.e. ECB, Bank of Japan, etc.), the pace of the increase has not only slowed but has turned negative. This would be akin to taking your foot off the gas while you're still going forward. It's just a matter of time before you stop.

If you need any evidence of slowing global QE, you have to look no further than the headlines from last week. Various central bankers came out to declare that asset prices are inflated and that it was time to normalize interest rates, in part because of those elevated asset prices. At the end of June, the U.S. Federal Reserve raised interest rates for the second time this year, as they promised. The Chinese central bank appears committed to reducing credit in their economy and the ECB stated that their ultra-easy policies won't continue indefinitely. Given the size and duration of this easy money period in our history, it's hard to believe that as central banks try to normalize rates, it's not going to cause some major disruption to the good times in the form of margin calls (remember margin debt is at an all-time high), forced selling of assets bought on leverage, or stress in some other unanticipated area. If this happened on a large enough scale, central banks would have to start buying assets all over again. Bottom line is it is difficult to see how a declining "Credit Impulse" will be good for stocks longer term.

Brilliant insight or hubris? Last week at a conference in London, Fed Chair Janet Yellen said she didn't believe we would see another financial crisis during our lifetimes. Being that I can think of five major crises just off the top of my head in the last 20 years, I don't have a lot of faith in her prediction. (1) In 1997, we had the Asian financial crisis, which culminated in the following year in (2) the plunge in the Russian ruble and (3) the collapse of Long Term Capital Management hedge fund. And let's not forget (4) the popping of the dot-com bubble in 2000 and the (5) housing/credit bubble in 2007 which led us into the Great Recession. In all of the above cases, the crises were preceded by a rise in interest rates and then followed by a cut in rates after the crises became apparent. Let's hope that the rise in rates that we just started doesn't cause us to experience another "crisis."

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Wealth Management – Who Gets the IRA?

Here's a quick quiz to test your IRA beneficiary knowledge. As many of you know, an IRA can be a great wealth transfer vehicle if set up properly. Heirs are able to continue the tax-deferral of the IRA while "stretching-out" the distributions over their much-longer expectancies. The answers are at the end of the quiz.

1. Sara established her IRA 25 years ago at a bank. Today, after numerous bank mergers, she dies. No beneficiary form can be found. Who gets the IRA?
2. John and Samantha are both financially well-off. They decide that John's assets are sufficient to pass to their children and they will leave Samantha's assets to charity. They update Samantha's will to reflect her charitable intentions. At Samantha's death, the beneficiary form on her IRA says the beneficiary is John. Who gets the IRA?
3. Nick has four children. He names his oldest son as both the IRA beneficiary and executor of his will. The will divides the assets equally among his four children. Who gets the IRA?

Answers

1. Unless the beneficiaries have a copy of the beneficiary form acknowledged by the bank, the IRA is going to pass in accordance with the default options in the IRA agreement. Some IRA agreements default to the spouse or, if no spouse, to the children. Many agreements default to the estate. The distribution options for beneficiaries who inherit through the estate are far less favorable than the options for beneficiaries who are named on a beneficiary form.
2. The spouse (John) gets the IRA. IRAs do not go through the will unless the estate is the beneficiary of the IRA.
3. The oldest child gets the IRA. He may be able to disclaim the IRA or gift some of the Required Minimum Distributions to his siblings. A disclaimer generally means that the IRA will go to the estate before going to the siblings which results in less favorable distribution options, as stated above.

Weekly Thought – Life

"Life is 10% what happens to us and 90% how we react to it." Dennis P. Kimbro

I guess that's just a fancier way of saying it's all about ATTITUDE!!! Have a great week.

All the best,

Dan

Daniel A. Cesta, CPA, CFP®, MST
President
Pinnacle Wealth Management Group, Inc.
www.pwmgi.com