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FINANCIAL FORUM

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Market Commentary

Following the official ending of the Great Recession in 2009, markets have generally traded on a "Risk On" or "Risk Off" basis. Basically, that meant that when central banks were accommodative (i.e. lowering rates or printing money), it was "Risk On" as stocks, bonds, and commodities rallied while the dollar declined in value. Conversely, when there was a macroeconomic scare, such as the Greek default or fears of an economic hard landing in China, markets went "Risk Off" as stocks and commodities fell while bonds and the dollar rallied. Today the "Risk On/Risk Off" theme has been replaced with a "Trump On/Trump Off" refrain. When investors believe that the Republican-controlled government will be effective in cutting taxes and regulations while also enacting a large infrastructure spending program, the dollar, commodities and cyclical stocks (i.e. banks, industrials, and tech) rally while Treasuries and gold falter. This is the "Trump On" trade. However, as doubts arise about the Republicans' ability to get pro-growth reforms through, the "Trump Off" trade happens as gold, bonds, and defensive stocks (i.e. healthcare and consumer staples) outperform and the dollar is down. Up until about two weeks ago, markets had been trading in a "Trump On" fashion. The big question moving forward is whether the policy efforts in Washington and the economic data are going to support a "Trump On" or a "Trump Off" trade? Or as we stated last month, will the U.S. economy reflate (Trump On) or stagnate (Trump Off)?

It finally happened last month…the Dow Jones Industrial Average crossed the 20,000 barrier. Of course, I'm being facetious when I say, "finally" since it only took 42 trading days for the venerable index to go from 19,000 to 20,000. However, before you put on the party hats, here are a few items to keep in mind. First, the Dow is made up of only 30 stocks. Second, the index is price-weighted, meaning that higher-priced companies have more weighting than lower-priced ones. So, therefore, under its current weighting, Goldman Sachs has almost eight times the impact as international conglomerate General Electric. Third, and this may be the most important, the Dow benefits from survivorship bias. Over the years, companies are removed from the index and new companies are added. For example, back in 2013, Visa, Nike, and Goldman Sachs were added to the Dow while struggling Bank of America, Alcoa, and Hewlett-Packard were removed. High-flying Apple was added in 2015. The bottom line is this: Since 2004, if the eight companies that were replaced in the Dow had remained, the blue-chip index would only be at 12,855 today. That's survivorship bias at its best!

It was a big week on the economic front as the Federal Reserve and the January jobs' number headlined the data. As expected, on Wednesday, the Fed left interest rates unchanged amid the uncertainties of where tax cuts, infrastructure spending, and other Trump proposals could take the economy in the near future. While the Fed has long planned to pursue a slow but steady course of normalizing interest rates, it has emphasized that the pace of rate increases will hinge on the progress of the economy. At its December meeting, the Fed stated it planned on hiking rates three times in 2017. However, the futures market is only anticipating two hikes (June and December) this year. In the other big report for the week, the Labor Department reported that the U.S. economy added an impressive 227,000 jobs in January, more than the 175,000 that were expected. However, the unemployment rate rose to 4.8% from last month's 4.7%. The big disappointment in the report was wage growth, which rose just 0.1%. In addition, December's wage growth was revised lower to just 0.2% from a 0.4% increase originally reported. Based on this report, if there is inflation coming, it most likely is not going to be from wages. The report also means that, it is more likely than not, that the first Fed rate hike will not come until June, something the market wanted to hear. Both stocks and bonds rallied Friday on the report.

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Wealth Management – Is a Potential Roth Conversion Opportunity Looming? (Part 2)

As we mentioned last month, with the U.S. federal debt now over $20 trillion, another $100 trillion or so in unfunded liabilities at the local, state, and federal levels, and proposed tax cuts by the Trump administration, we may soon have a situation where rates could be at generational lows, making the conversion of retirement plans and IRAs to Roth accounts beneficial.

Taxes, taxes, taxes…The first aspect of a Roth conversion to consider is the taxes you will have to pay on the funds converted. (Remember, converting to a Roth is a taxable event, but as long as certain requirements are met, all future withdrawals are *tax-free*. There are also no required minimum distributions from Roth accounts at age 70 ½.) Therefore, if you decide that a Roth conversion strategy makes sense for you, it is important to be able to pay the taxes due on the conversion from sources other than from the IRA/401(k) you are converting. Additionally, because you have to pay income taxes at conversion, you have to know what tax bracket you're in today, as well as make assumptions about your tax rate in the future. Obviously, if you're in a higher tax bracket today than you expect at retirement, you may not want to convert. However, if you expect to be in a higher tax bracket down the road (very possible given the country's looming debt obligations), then conversion probably makes sense. Of course, no one has a crystal ball. Congress could also change the rules on taxation of Roth accounts.

Bottom Line: The decision on whether to convert your traditional IRA or 401(k) plan to a Roth account is one filled with uncertainty; uncertainty over future tax rates, life expectancies, and legislative changes. Therefore, you can only make guestimates on these variables. However, it's always good to make informed decisions and, if you have any questions about what's best for your particular situation, we're here to help.

Weekly Thought – A Good Wife is an Educated Wife

According to Swedish researchers, having an educated wife improves a man's chances for a long life. In fact, a woman's education level was found to be a more important factor for a man's longevity than his own education level. The reasoning goes that the wife's education may be more important for a household's food and lifestyle habits than the husband's education. So, let's hear it for beauty and brains.

As always, have a great week.

All the best,

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P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you know of anyone who would like to be added to this list or who might benefit from our services, please pass along our name. We are always looking for opportunities to meet and help great people like you.