Financial Advisory Service, Inc.

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FAS Monthly Economic and Market Update

August 2018

As of July 31, 2018

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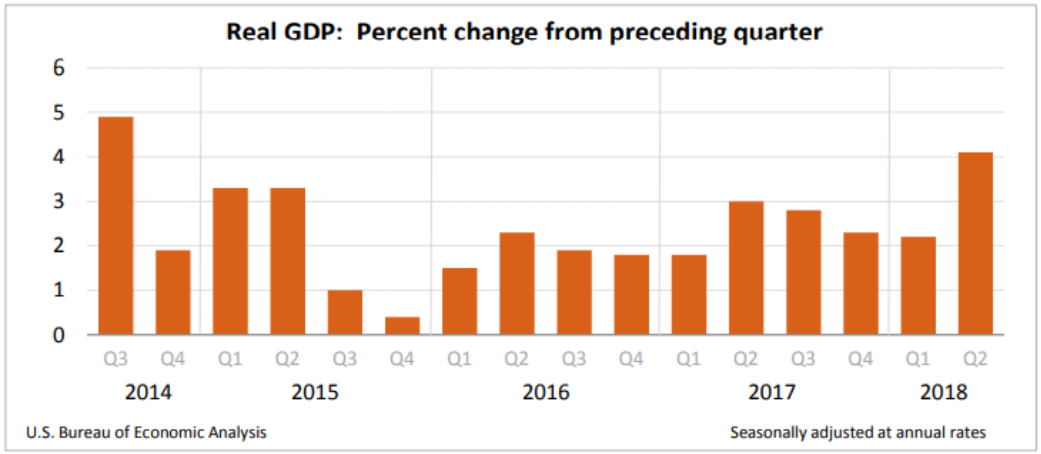
Economic Conditions

Gross domestic product grew at an annual rate of 4.1% in the second quarter of 2018 according to the advance estimate released by the US Department of Commerce; the US's best pace since the third quarter of 2014. Second quarter growth was also the third-best growth rate since the Great Recession. Personal consumption, exports and federal government spending were some of the biggest positive contributors offsetting detractors like falling fixed residential investment and declining inventories. With the double whammy of rising interest rates and housing growing more expensive it shouldn't be a surprise that residential investment has been a detractor to GDP growth. Existing home prices recently hit a record high and the homebuyer affordability composite index is at a 10-year low. Couple that with rising mortgage rates and you can see why existing home inventories are beginning to creep up and have risen above the levels they were at this time in 2017. US housing inventory rose in the last year through June for the first time since 2015 according to the National Association of Realtors.



Market Conditions

Index Returns	Jul '17	YTD
S&P 500	3.60%	5.34%
DJIA	4.71%	2.81%
NASDAQ	2.15%	11.13%
MSCI EAFE	2.42%	(2.18%)
Barclays Aggregate	0.02%	(1.59%)

July was a positive month for most major indexes across the board. US stocks were off to a strong start last month following the release of optimistic Fed minutes and a solid jobs report. Tech continued to lead the rise as usual until late July with the release of missed earnings reports, most notably Facebook and Netflix. Stocks pulled back before slightly recovering before month's end. The S&P 500 returned 3.60% in July – about 2% from its January 2018 record high. The NASDAQ returned a more modest 2.15% last month but is up 11.13% for the year. The Dow rose 4.71% in July with help from big names like Apple and JP Morgan but trails the other two major US indexes as high-priced names like Goldman Sachs, Caterpillar and 3M have weighed down the year-to-date performance. The latter two names get 20% and 31%, respectively, of their revenues from Asia, so it should be no surprise tariffs have had a negative effect on the index comprised mostly of multinational and industrial companies. The impending trade war has caused many investors to seek haven in US small cap companies whose revenues are predominantly driven by domestic sales. The Russell 2000 was up 1.69% in July and is up 8.8% for the year.

529 College Savings Plans

In the first quarter newsletter we discussed briefly the slight changes in the tax law with 529 College Savings Plans that expanded the plan benefits to allow qualified distributions for private, public or religious elementary, middle and high school tuition. With many of our clients using 529 plans to pay for their children and grandchildren's education, we thought it would be important to highlight the key benefits that come with investing in these savings vehicles.

For those unfamiliar with 529 College Savings Plans let us first describe the structure and tax treatment of these accounts. A 529 plan allows investors to save money for education expenses in a tax-efficient account that allows for tax-free growth and distributions. Contributions in 529 accounts grow tax-free and qualified distributions from these accounts used for education costs are exempt from federal income tax. Qualified distributions include costs for tuition, fees, books, supplies, computers, and some room and board. The tax law changes that took effect January 1, 2018 that expanded qualified distributions to include education expenses for K-12 now allow tax-free distributions up to $10,000 per student per year. Any distributions that don't qualify as education expenses are subject to ordinary income tax on the earnings portion of the distribution plus a 10% penalty.

Every state has at least one sponsored 529 plan and some allow contributions to be deducted

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529 College Savings Plans

from state income tax including Kansas and Missouri. The recent tax law changes make the 529 plan even more beneficial when paying tuition for K-12 schools since it essentially allows parents to pay for education fees with money that is tax-free at the state level. For example, Kansas allows all contributions up to $6,000 per student, per year to be deducted from state income taxes, which means that parents can use a 529 plan as a conduit for paying tuition for private schools by contributing $6,000 to a 529 plan and subsequently withdrawing those assets to pay for tuition, allowing them to take the $6,000 deduction and save $342 (assuming a 5.7% state income tax rate) per child each year.

Considering the uncertainty of the future, there is always a chance a beneficiary may not need the money due to receiving a scholarship or deciding not to attend college. In these situations owners of the accounts have the option to change the beneficiary of the account to another qualifying family member with no tax consequences. The same would be true for parents who didn't exhaust all 529 assets for the beneficiary's education costs throughout their college career and those assets could be transferred to the next child to attend school. If the beneficiary receives a scholarship or attends a US Military Academy, distributions can be taken without being assessed the 10% penalty – although the earnings would still be subject to ordinary income tax.

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529 College Savings Plans

When contributing to a 529 plan it is also important to consider that contributions are viewed as gifts for tax purposes. This means for 2018 *each* parent can gift up to the annual exclusion amount of $15,000 to each of their children without triggering a gift tax ($30,000 per child). Additionally, if the children have rather generous grandparents, each of them could also contribute up to $30,000 ($15k from each grandparent) to each grandchild without having to worry about gift taxes as well. Keep in mind only one household can claim the state tax deduction. One caveat to the gift tax exclusion is the option which allows an individual to give as much as 5 years' worth of annual gifts in one year which in 2018 would be $75,000. Any amounts above the annual gift exclusion amount or the 5-year amount will either be assessed a gift tax or taken from your lifetime estate and gift tax exemption – currently at $11.2M per person.

The average annual tuition for a public four-year university has increased from $3,190 30 years ago to about $9,970 today – a 213% increase according to a report from The College Board. With education costs continuing to rise and $1.4 trillion in student loan debt, saving for college is more important today than ever and it would be wise to consider taking advantage of tax-efficient accounts like 529 plans. Your advisor at FAS would be happy to discuss these topics in more detail with you.

Disclosures & Index Definitions

Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

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Investments in bonds will be subject to credit risk, market risk and interest rate risk. Interest rates will have an inverse effect on prices of bonds. Bonds of lower credit ratings, also known as High Yield bonds which hold a rating of less than investment grade (BB+ and below), will have greater risks attached than will those of investment grade bonds and will experience greater volatility.

All dates are as of July 31, 2018 unless stated otherwise.

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Index Definitions

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.