Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

September 2018

As of August 31, 2018

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Economic Conditions

Inflation has been one of the more popular headlines in economic news throughout 2018. Economists at the start of the year warned of rising inflation and the Federal Reserve made it clear that they intended to increase interest rates no less than two times this year. It may seem counter-intuitive, but inflation is necessary for economic growth. The Great Recession actually led to deflation – a decline in prices for goods and services which can lead to higher default rates, higher unemployment, lower incomes and potentially a depression. In 2008, the Fed cut short-term interest rates to basically zero in the hope of stoking inflation to combat deflation. Now, with the economy humming, the Fed is once again more worried about inflation, and thus has steadily raised rates off of zero. However, if the Fed increases interest rates too fast or by too much relative to the rate at which inflation is rising, it could send the economy into a recession. It is a tricky balancing act for the Fed. Steady growth in the economy and easy monetary policy has pushed inflation high enough for the Fed to continue to be more aggressive in raising interest rates. They are expected to raise rates later in September and again in December. The rate of inflation slowed in August causing some to question whether the aggressive posture of the Fed could derail the growth we've experienced throughout the past decade. The yield curve has continued to flatten, meaning that short-term rates are rising faster than long-term rates, and if the curve were to invert it could mean that a recession may be on the horizon. There are several factors the Fed must to take into account when raising interest rates but with full employment and 4% GDP growth inflation should continue to tick higher.

Market Conditions

Two of the three major US indexes hit record highs in the month of August. The S&P 500 and NASDAQ both closed at all-time highs at the end of last month, both hitting significant milestones of 2900 and 8000, respectively. The S&P returned 3.03% in August and is up over 8.5% for the year. The NASDAQ returned 5.71% and is up nearly 17.5% for 2018. The Dow continues to lag the previous two indexes but is still up over 5% for the year. A further strengthening dollar, manufacturing slowdowns in Europe and continued trade tensions led to further declines from international equities. The MSCI EAFE was down 2.19% in August and is now down 4.33% for the year. The 10-year treasury rate rose throughout July before hitting 3% for the third time this year at the start of August before retreating back below 2.9% by the end of the month. The Barclays US Bond Aggregate benefited from the 10-year's pullback from the psychologically significant number and returned 0.64% in August. The index is down just under 1% for the year. With global investors still starved for yield around the world it's unsurprising that we continue to experience a resistance level for the 10-year treasury rate at around 3%.

Index Returns

	Aug '18	YTD
S&P 500	3.03%	8.52%
DJIA	2.16%	5.04%
NASDAQ	5.71%	17.47%
MSCI EAFE	(2.19%)	(4.33%)
Barclays Aggregate	0.64%	(0.96%)

Estate Planning

Several months ago, FAS sent out a letter to all clients encouraging them to review their estate plans with an attorney due to the changes to the estate and gift tax laws included in the Tax Cut and Jobs Act at the start of the year. It is important to ensure the estate plans clients established over the past several years would still be sufficient for achieving the goals they had originally intended when the documents were drafted. In addition to encouraging clients to revisit their estate plans, we wanted to stress just how important having a comprehensive estate plan in place is to ensuring that family members are taken care of in the event of a death, whether expected or unexpected. This is often the least enjoyable piece of financial planning as no one tends to be enthused about planning for their impending death. However, it is often one of the more crucial parts in the planning process as estate taxes, probate, and inheritance issues can often lead to further unpleasantries when dealing with the passing of a family member.

Perhaps the most significant change in the tax law with regards to estate tax is the increase of the lifetime estate tax exemption which was increased from $5.1M to $11.2M per person. This means that individuals can pass away with assets of up to $11.2M and not owe any federal estate taxes ($22.4M for married couples since the exemption is "portable"). While that number is significant and means most

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individuals/couples will not have to worry about paying federal estate taxes, that does not change the fact that all assets not held in trust or without any kind of beneficiary attached to them will be forced to pass through probate. Probate is the process which involves the court getting involved to determine how those assets are to be distributed to your heirs. With probate comes court and attorney fees that can be easily avoided by having an estate plan in place. These issues don't just arrive upon the death of an individual. If someone were to become incapacitated and did not have Durable Powers of Attorney in place that would allow a named individual to make health care and financial decisions for the incapacitated it would be up to the courts to decide who is to be appointed to make those decisions on their behalf.

Putting together an estate plan can ease most, if not all, issues that arise with regard to your estate at death. By creating a revocable trust you are able to not only control how your assets are distributed upon death but also how the beneficiaries are to receive those assets. Trusts are tailored to specifically meet the wants and needs of the grantor when passing assets down to the next generation. For example, passing assets down in trust can shelter those assets from creditors, divorces, or even from the beneficiaries spending all of the trust assets at once, and can be done without being required to go

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through probate. Creating a revocable trust changes nothing with regard to the ownership of your assets today as the grantor(s) of the trust is(are) initially listed as the beneficiary(ies) of the trust. The trust essentially comes into play once one or both of the beneficiaries pass away.

Once a trust is created it is essential that assets are retitled to either make the trust the owner or the beneficiary. Consider the idea that creating a trust is similar to buying a soft drink from a gas station. You go to the counter and pay for the empty cup and once the transaction is done you can either fill the cup with the drink of your choice or you can walk out with an empty cup, essentially rendering the cup useless. Once a trust is drafted and signed, it is the responsibility of the client and their advisor to place assets into the trust in order to have the intentions of the trust carried out. An unfunded trust is as worthless as an empty cup at a gas station.

There are very few, if any, instances where it does not make sense for an individual or couple to draft an estate plan. Regardless of the level of your assets, it is imperative to have a contingency plan in place to prepare for the unexpected. We want to stress that merely having a will is not an estate plan because it does not prevent assets from having to go through probate. A will is just one part of an overall estate plan. FAS has relationships with several attorneys that we regularly consult with to draft estate

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plans for our clients, many of which we have negotiated preferential fees. An estate plan may cost more money on the front end, but can almost certainly save your heirs money on the back end once you are gone. Mortality is an unfortunate certainty that we must all face at some point, and it would behoove all of us to not add the undue stress of dealing with complicated financial affairs to our next of kin when they are already going through a difficult time.

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 August 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.