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The Financial Solutions Advisor

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Economic & Market Perspectives

Market volatility was a 2018 theme that is persisting in 2019. After a decade of unprecedented liquidity provision courtesy of the Federal Reserve (Fed), liquidity is draining out of the system as the Fed and other central banks move toward tighter monetary policy. Earnings growth likely will decelerate in 2019, as year-over-year comparisons become more challenging in light of the tax-cut-related boost to earnings in 2018. Continued U.S. dollar strength and the impact of trade tariffs could be additional headwinds for earnings, even though stock valuations have become more reasonable. Investor sentiment is likely to swing in a wider range in 2019 assuming volatility persists, although the bouts of excessive optimism seen in 2018 likely will fade.

Global growth may slow in 2019 as the economic cycle nears a peak, with increasing drag from worsening financial conditions combining with full employment and rising prices. Global stock markets may peak in 2019 if leading indicators signal the gathering clouds of a global recession. If we borrow the severe weather scale for storms and apply it to the global economy and markets, we aren't forecasting "Recession Warning," meaning a recession is here or imminent. A better term is "Recession Watch," in which conditions are favorable to a recession if a number of risk factors (e.g., trade, interest rates, inflation) deteriorate. While trade tensions have the potential to inflict substantial damage on the world economy, it would require a significant escalation from the measures implemented so far to trigger the next global recession.

For all the concerns about trade policy, Brexit and other issues, 2018's big stock market declines generally were driven by inflation and interest rate concerns. These are the indicators investors should watch most closely in 2019. Historically, when unemployment and inflation rates have converged to become the same number—signaling an overheating economy—it has marked the beginning of a prolonged downturn for the stock market, followed about a year later by a recession. The gap between the unemployment rate and the inflation rate is close to one percentage point in major countries like Germany, Japan, the United Kingdom, and the United States. Another leading indicator, the yield curve, also has shown a narrowing gap between short- and longer-term Treasury yields. These gaps may close in 2019 and signal a peak for international stocks ahead of a global recession.

The worst may be over for the bond bear market. After more than two years of steadily rising bond yields (and falling bond prices, which move inversely to yields), our research suggests that 10-year Treasury bond yields may have peaked for this tightening cycle at the 3.25% level. The Fed likely will continue to raise short-term interest rates to about 3% in 2019, but we don't see longer-term yields moving much above the recent highs. Tighter global monetary policy, a strong U.S. dollar and sluggish global growth exacerbated by trade conflicts are likely to weigh on economic growth and inflation, limiting the rise in bond yields. However, the path forward isn't likely to be smooth. As markets adjust to tightening financial conditions, volatility is likely to increase.

We expect the Fed to raise rates two to three more times, bringing the federal funds target rate to the 2.75% to 3% area in early 2019, short of the Federal Open Market Committee's (FOMC) 3.4% median estimate for 2020. Because short- and long-term interest rates tend to converge at cycle peaks, the yield curve likely will flatten toward zero. We suggest investors gradually add to average portfolio duration when yields rise.

As the Fed normalizes rates and reduces its balance sheet, volatility may increase in riskier parts of the fixed income market—such as bank loans, high-yield and emerging-market bonds—due to issuers' high leverage. We suggest investors move up in credit quality and/or limit exposure to these asset classes. Municipal bonds may post solid performance in 2019, as demand appears strong for tax-exempt income.

Source: Schwab Center for Financial Research

2018 Returns

S&P 500	*-4.38%*
NASDAQ	*0.04%*
Russell Small Cap	*-11.01%*
Russell Mid Cap	*-9.06%*
MSCI EAFE	*-13.79%*
MSCI World	*-8.71%*
Barclay US Agg. Bond	*0.01%*
Barclay Municipal Bond	*1.28%*

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Key Retirement and Tax Numbers for 2019

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans and various tax deduction, exclusion, exemption, and threshold amounts. Here are a few of the key adjustments for 2019.

Employer retirement plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $19,000 in compensation in 2019 (up from $18,500 in 2018); employees age 50 and older can defer up to an additional $6,000 in 2019 (the same as in 2018).

- Employees participating in a SIMPLE retirement plan can defer up to $13,000 in 2019 (up from $12,500 in 2018), and employees age 50 and older can defer up to an additional $3,000 in 2019 (the same as in 2018).

IRAs

The combined annual limit on contributions to traditional and Roth IRAs increased to $6,000 in 2019 (up from $5,500 in 2018), with individuals age 50 and older able to contribute an additional $1,000. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA is phased out for the following modified adjusted gross income (AGI) ranges:

	2018	2019
Single/head of household (HOH)	$63,000 - $73,000	$64,000 - $74,000
Married filing jointly (MFJ)	$101,000 - $121,000	$103,000 - $123,000
Married filing separately (MFS)	$0 - $10,000	$0 - $10,000

The 2019 phaseout range is $193,000 - $203,000 (up from $189,000 - $199,000 in 2018) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered.

The modified AGI phaseout ranges for individuals to make contributions to a Roth IRA are:

	2018	2019
Single/HOH	$120,000 - $135,000	$122,000 - $137,000
MFJ	$189,000 - $199,000	$193,000 - $203,000
MFS	$0 - $10,000	$0 - $10,000

Estate and gift tax

- The annual gift tax exclusion for 2019 is $15,000, up from $14,000 in 2018.

- The gift and estate tax basic exclusion amount for 2019 is $11,400,000, up from $11,180,000 in 2018.

Kiddie tax

Under the kiddie tax rules, unearned income above $2,200 in 2019 (up from $2,100 in 2018) is taxed using the trust and estate income tax brackets. The kiddie tax rules apply to: (1) those under age 18, (2) those age 18 whose earned income doesn't exceed one-half of their support, and (3) those ages 19 to 23 who are full-time students and whose earned income doesn't exceed one-half of their support.

Standard deduction

	2018	2019
Single	$12,000	$12,200
HOH	$18,000	$18,350
MFJ	$24,000	$24,400
MFS	$12,000	$12,200

The additional standard deduction amount for the blind or aged (age 65 or older) in 2019 is $1,650 (up from $1,600 in 2018) for single/HOH or $1,300 (the same as in 2018) for all other filing statuses. Special rules apply if you can be claimed as a dependent by another taxpayer.

Alternative minimum tax (AMT)

	2018	2019
Maximum AMT exemption amount		
Single/HOH	$70,300	$71,700
MFJ	$109,400	$111,700
MFS	$54,700	$55,850
Exemption phaseout threshold		
Single/HOH	$500,000	$510,300
MFJ	$1,000,000	$1,020,600
MFS	$500,000	$510,300
26% rate on AMTI* up to this amount, 28% rate on AMTI above this amount		
MFS	$95,750	$97,400
All others	$191,500	$194,800
*Alternative minimum taxable income		

Reviewing your Estate Plan

An estate plan is a map that explains how you want your personal and financial affairs to be handled in the event of your incapacity or death. Due to its importance and because circumstances change over time, you should periodically review your estate plan and update it as needed.

When should you review your estate plan?

Reviewing your estate plan will alert you to any changes that need to be addressed. For example, you may need to make changes to your plan to ensure it meets all of your goals, or when an executor, trustee, or guardian can no longer serve in that capacity. Although there's no hard-and-fast rule about when you should review your estate plan, you'll probably want to do a quick review each year, because changes in the economy and in the tax code often occur on a yearly basis. Every five years, do a more thorough review.

You should also review your estate plan immediately after a major life event or change in your circumstances. Events that should trigger a review include:

- There has been a change in your marital status (many states have laws that revoke part or all of your will if you marry or get divorced) or that of your children or grandchildren.
- There has been an addition to your family through birth, adoption, or marriage (stepchildren).
- Your spouse or a family member has died, has become ill, or is incapacitated.
- Your spouse, your parents, or another family member has become dependent on you.
- There has been a substantial change in the value of your assets or in your plans for their use.
- You have received a sizable inheritance or gift.
- Your income level or requirements have changed.
- You are retiring.
- You have made (or are considering making) a change to any part of your estate plan.

Some things to review

Here are some things to consider while doing a periodic review of your estate plan:

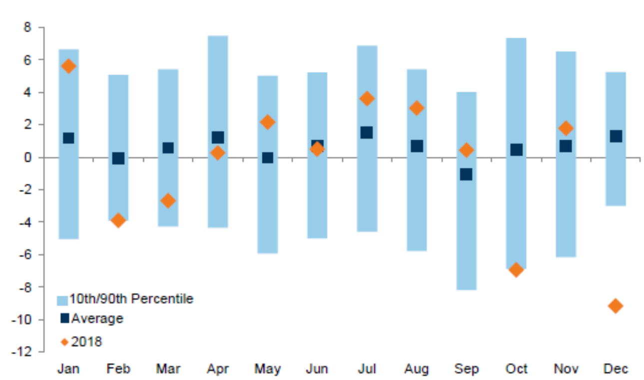
- Who are your family members and friends? What is your relationship with them? What are their circumstances in life? Do any have special needs?
- Do you have a valid will? Does it reflect your current goals and objectives about who receives what after you die? Is your choice of an executor or a guardian for your minor children still appropriate?
- In the event you become incapacitated, do you have a living will, durable power of attorney for health care, or Do Not Resuscitate order to manage medical decisions?
- In the event you become incapacitated, do you have a living trust or durable power of attorney to manage your property?
- What property do you own and how is it titled (e.g., outright or jointly with right of survivorship)? Property owned jointly with right of survivorship passes automatically to the surviving owner(s) at your death.
- Have you reviewed your beneficiary designations for your retirement plans and life insurance policies? These types of property pass automatically to the designated beneficiaries at your death.
- Do you have any trusts, living or testamentary? Property held in trust passes to beneficiaries according to the terms of the trust. There are up-front costs and often ongoing expenses associated with the creation and maintenance of trusts.
- Do you plan to make any lifetime gifts to family members or friends?
- Do you have any plans for charitable gifts or bequests?
- If you own or co-own a business, have provisions been made to transfer your business interest? Is there a buy-sell agreement with adequate funding? Would lifetime gifts be appropriate?
- Do you own sufficient life insurance to meet your needs at death? Have those needs been evaluated?
- Have you considered the impact of gift, estate, generation-skipping, and income taxes, both federal and state?

This is just a brief overview of some ideas for a periodic review of your estate plan. Each person's situation is unique. An estate planning attorney may be able to assist you with this process.

A December to Remember

December was an abnormally bad month last year, against historical seasonality trends

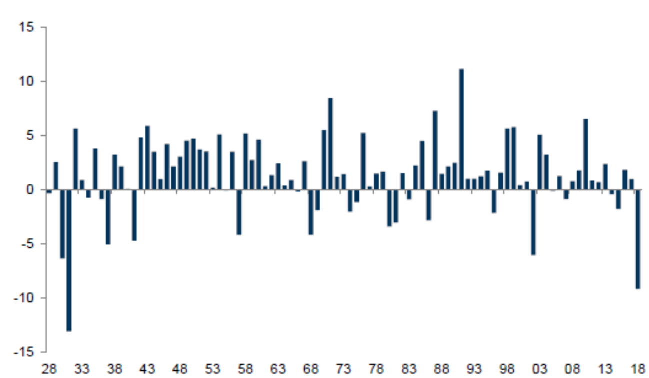
Distribution of monthly S&P 500 returns since 1928



Source: Bloomberg, Goldman Sachs Global Investment Research

December last year saw the poorest performance for US Equities since the Great Depression

Historical S&P 500 December returns



Source: Bloomberg, Goldman Sachs Global Investment Research

Infographic: Financial Lessons from Football

Review your game plan

You haven't saved enough for retirement...or for college. Your credit card debt is spiraling. You've been blindsided by unexpected expenses. When your finances hit a rough patch, call a time out and review your game plan. Rethink your strategy to account for changes in your personal life, the economy, or market conditions.

Focus on fundamentals

Big plays are important, but so is steady execution. Even seasoned players need to focus on game fundamentals. One important financial fundamental is your budget. Once you know exactly how much money is coming in and how much is going out, you can identify what plays to call to get your finances back in shape.

Make adjustments

Football teams make adjustments throughout the game. As you begin to make forward progress, keep the momentum going by regularly reviewing and fine-tuning your own game plan to balance competing priorities. Soon you'll be better prepared to tackle the challenges that stand between you and your financial goals.

"It's not whether you get knocked down, it's whether you get up."
-Vince Lombardi

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