Condor Capital Reviews 2nd Quarter 2017

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In the second quarter of 2017, domestic stocks generally continued to perform well, with the technology sector leading the way and the energy sector struggling.

Internationally, Europe had a strong quarter amid easing political uncertainty, while emerging markets again generally performed strongly.

In the U.S., the Federal Reserve decided to raise interest rates for the third consecutive quarter and outlined its plans for an eventual reduction to its $4.5 trillion balance sheet.

Markets continued their positive trend in the second quarter of 2017, with domestic, international, and fixed income markets all generally posting gains. Despite growing caution by investors over relatively high equity valuations in domestic markets, major indexes continued to tick higher. An outsized portion of this move was driven by the technology and healthcare sectors, which emerged as the leading market movers in the period. Energy stocks, on the other hand, faced sizeable losses as oil prices fell amid persistent oversupply. Amid these trends, growth outperformed value and large-caps slightly led their mid- and small-cap counterparts. Overall, the S&P 500 index gained 3.09% in the second quarter.

International equities again outpaced domestic stocks in the second quarter of 2017. One key catalyst that pushed developed markets higher was a resurgence in European equities. The easing of political risks was a key factor as Britain held a parliamentary vote that may result in a slightly 'softer' Brexit stance and pro-Europe Emmanuel Macron beat out a more populist competitor in France. Within emerging markets, China led the way in large part due to the outperformance of its giant tech firms, while plunging oil prices weighed on more oil-dependent nations. Latin America was a particular weak spot amid the fall in oil prices, chaos in Venezuela, and a growing corruption scandal in Brazil.

One of the driving forces for domestic fixed income in the second quarter of 2017 was the Federal Reserve, which continued to follow through on its more hawkish outlook with another 0.25% rate increase in its June meeting. A flattening of the yield curve was a key factor as well, with short-term yields rising but longer-term yields actually dropping. Because price and yield have an inverse relationship, the fall in long-term yields propelled these securities higher, leading long-duration holdings to outperform. While rising short-term rates weighed on shorter-duration holdings, they generally finished slightly positive. Municipal bonds slightly trailed their taxable counterparts, while government fixed income holdings generally managed to keep pace with corporate bond returns.

Outlook – Looking ahead to the second half of the year, equity valuations are likely to be a key focal point for markets. Stocks such as those in the technology sector, for example, have seen significant inflows because their seemingly ironclad long-term growth prospects have led some investors to view them as a safe haven. As a result, their price tags have increased. Amid improving economic data, some investors may now be rethinking this positioning and rotating their holdings into sectors such as financials, which offer lower multiples and broader exposure to the larger economy. Earnings growth, another closely watched point of interest for markets, will be a key to determining the validity of these concerns moving forward as well. The strong growth in company earnings that many market observers expected for 2017 has so far materialized nicely, with FactSet estimating S&P 500 earnings growth of 8.7% and 6.6% for the first and second quarters, respectively. Earnings growth data for the second half of the year will be a key piece of evidence in determining whether overvaluation concerns are warranted.

Political policy will continue to be a factor as well. While the administration's deregulatory actions have generally been viewed as a positive for businesses, a lack of certainty on healthcare policy and tax reform has added uncertainty to markets. Any clarification on these issues could add a level of stability domestically. Perhaps even more important than fiscal policy will be monetary policy. Following consecutive rate increases in the first two quarters of 2017, the Federal Reserve has shown no sign of backing away from its plan for a third increase before year-end. Perhaps more importantly, the Fed has now put forth an outline for beginning to reduce its balance sheet and could begin to take action on that front before year-end as well. Internationally, central banks such as the ECB have begun to project a rosier economic outlook in public statements, leading many observers to believe that they may be signaling future plans to begin rate increases of their own.

The second quarter of 2017, and the first half of the year as a whole, has been broadly positive across the majority of markets worldwide. While this run-up has made many investors money, it has also spawned concerns that a pullback is approaching. It remains our belief, however, that market fundamentals remain stable and economies do not lose ground simply because 'it has been a while.' As always, attempts to predict and time the short-term direction of the market remain ill-advised for the vast majority of individuals. Rather, investors are best suited by maintaining a diversified portfolio that takes into account their specific goals and risk tolerance with a long-term perspective.

See disclaimer on final page

- **The ability to deduct mortgage interest is a key tax benefit of home ownership.**
- **Know when you can and can't deduct closing costs and other expenses.**
- **When selling your home, understand the implications of capital gains and losses on your federal income taxes.**

Tax Benefits of Homeownership

Buying a home can be a major expenditure. Fortunately, federal tax benefits are available to make homeownership more affordable and less expensive. There may also be tax benefits under state law.

Mortgage Interest Deduction

One of the most important tax benefits of owning a home is that you may be able to deduct any mortgage interest you pay. If you itemize deductions on your federal income tax return, you can deduct the interest you pay on a loan used to buy, build, or improve your home, provided that the loan is secured by your home. Up to $1 million of such "home acquisition debt" ($500,000 if you're married and file separately) qualifies for the interest deduction.

You may also be able to deduct interest you pay on certain home equity loans or lines of credit secured by your home. Up to $100,000 of such "home equity debt" (or $50,000 if your filing status is married filing separately) qualifies for the interest deduction. The interest you pay on home equity debt is generally deductible regardless of how you use the loan proceeds. For alternative minimum tax purposes, however, interest on home equity debt is deductible only for debt used to buy, build, or improve your home.

Deduction for Real Estate Property Taxes

If you itemize deductions on your federal income tax return, you can generally deduct real estate taxes you pay on property that you own. For alternative minimum tax purposes, however, no deduction is allowed for state and local taxes, including real estate property taxes.

Points and Closing Costs

When you take out a loan to buy a home, or when you refinance an existing loan on your home, you'll probably be charged closing costs. These may include points, as well as attorney's fees, recording fees, title search fees, appraisal fees, and loan or document preparation and processing fees. Points are typically charged to reduce the interest rate for the loan.

When you buy your main home, you may be able to deduct points in full in the year you pay them if you itemize deductions and meet certain requirements. You may even be able to deduct points that the seller pays for you.

Refinanced loans are treated differently. Generally, points that you pay on a refinanced loan are not deductible in full in the year you pay them. Instead, they're deducted ratably over the life of the loan. In other words, you can deduct a certain portion of the points each year. If the loan is used to make improvements to your principal residence, however, you may be able to deduct the points in full in the year paid.

Otherwise, closing costs are nondeductible. They can, however, increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Home Improvements

Home improvements (unless medically required) are nondeductible. Improvements, though, can increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Capital Gain Exclusion

If you sell your principal residence at a loss, you can't deduct the loss on your tax return. If you sell your principal residence at a gain, you may be able to exclude some or all of the gain from federal income tax.

Capital gain (or loss) on the sale of your principal residence equals the sale price of your home minus your adjusted basis in the property. Your adjusted basis is typically the cost of the property (i.e., what you paid for it initially) plus amounts paid for capital improvements.

If you meet all requirements, you can exclude from federal income tax up to $250,000 ($500,000 if you're married and file a joint return) of any capital gain that results from the sale of your principal residence. Anything over those limits may be subject to tax (at favorable long-term capital gains tax rates). In general, this exclusion can be used only once every two years. To qualify for the exclusion, you must have owned and used the home as your principal residence for a total of two out of the five years before the sale.

What if you fail to meet the two-out-of-five-year rule? Or you used the capital gain exclusion within the past two years with respect to a different principal residence? You may still be able to exclude part of your gain if your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances. In such a case, exclusion of the gain may be prorated.

Other Considerations

It's important to note that special rules apply in a number of circumstances, including situations in which you maintain a home office for tax purposes or otherwise use your home for business or rental purposes.

Ballooning student loan debt: it isn't just for the young anymore. Here's why older Americans are increasingly feeling the pain and some simple rules on how to avoid getting in over your head.

Student Loan Debt: It Isn't Just for Millennials

It's no secret that today's college graduates face record amounts of debt. Approximately 68% of the graduating class of 2015 had student loan debt, with an average debt of $30,100 per borrower — a 4% increase from 2014 graduates.[1]

A student loan debt clock at finaid.org estimates current outstanding student loan debt — including both federal and private student loans — at over $1.4 trillion. But it's not just millennials who are racking up this debt. According to the Consumer Financial Protection Bureau (CFPB), although most student loan borrowers are young adults between the ages of 18 and 39, consumers age 60 and older are the fastest-growing segment of the student loan market.[2]

Rise of Student Debt Among Older Americans

Between 2005 and 2015, the number of individuals age 60 and older with student loan debt quadrupled from about 700,000 to 2.8 million. The average amount of student loan debt owed by these older borrowers also increased from $12,100 to $23,500 over this period.[3]

The reason for this trend is twofold: Borrowers are carrying their own student loan debt later in life (27% of cases), and they are taking out loans to finance their children's and grandchildren's college education (73% of cases), either directly or by co-signing a loan with the student as the primary borrower.[4] Under the federal government's Direct Stafford Loan program, the maximum amount that undergraduate students can borrow over four years is $27,000 — an amount that is often inadequate to meet the full cost of college. This limit causes many parents to turn to private student loans, which generally require a co-signer or co-borrower, who is then held responsible for repaying the loan along with the student, who is the primary borrower. The CFPB estimates that 57% of all individuals who are co-signers are age 55 and older.[5]

What's at Stake

The increasing student loan debt burden of older Americans has serious implications for their financial security. In 2015, 37% of federal student loan borrowers age 65 and older were in default on their loans.[6] Unfortunately for these individuals, federal student loans generally cannot be discharged in bankruptcy, and Uncle Sam can and will get its money — the government is authorized to withhold a portion of a borrower's tax refund or Social Security benefits to collect on the debt.

(By contrast, private student loan lenders cannot intercept tax refunds or Social Security benefits to collect any amounts owed to them.)

The CFPB also found that older Americans with student loans (federal or private) have saved less for retirement and often forgo necessary medical care at a higher rate than individuals without student loans.[7] It all adds up to a tough situation for older Americans, whose income stream is typically ramping down, not up, unlike their younger counterparts.

Think Before You Borrow

Since the majority of older Americans are incurring student loan debt to finance a child's or grandchild's college education, how much is too much to borrow? It's different for every family, but one general guideline is that a student's overall debt shouldn't be more than his or her projected annual starting salary, which in turn often depends on the student's major and job prospects. But this is just a guideline. Many variables can impact a borrower's ability to pay back loans, and many families have been burned by borrowing amounts that may have seemed reasonable at first glance but now, in reality, are not.

A recent survey found that 57% of millennials regret how much they borrowed for college.[8] This doesn't mean they regretted going to college or borrowing at all, but it suggests that it would be wise to carefully consider the amount of any loans you or your child take out for college. Establish a conservative borrowing amount, and then try to borrow even less.

If the numbers don't add up, students can reduce the cost of college by choosing a less expensive school, living at home or becoming a resident assistant (RA) to save on room costs, or graduating in three years instead of four.

[1] The Institute for College Access & Success, Student Debt and the Class of 2015, October 2016

[2-7] Consumer Financial Protection Bureau, Snapshot of Older Consumers and Student Loan Debt, January 2017

[8] *Journal of Financial Planning,* September 2016

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Please remember to contact Condor Capital Management if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing, evaluating, or revising our previous recommendations and/or services. Please also advise us if you would like to impose, add, or modify any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement as set forth on Form ADV Part II A/B continues to remain available for your review upon request.

What Are Bond Ratings?

Bond ratings are an essential tool when considering fixed-income investments. Ratings provide a professional assessment of credit risk, or the risk of default, which can be measured to some degree by analyzing the bond issuer's financial condition and creditworthiness.

Credit rating agencies perform this type of analysis and issue ratings that reflect the agency's assessment of the bond issuer's ability to meet the promised interest payments and return the principal upon maturity. The best-known independent rating agencies — Standard & Poor's, Moody's Investors Service, and Fitch Ratings — use similar scales in descending alphabetical order, ranging from AAA/Aaa for the most creditworthy bonds to C/D for the least creditworthy.

Bonds rated BBB/Baa or higher are considered "investment grade." Lower-rated bonds, commonly called "junk bonds," are non-investment grade; they generally offer higher yields and are considered speculative with higher credit risks. Bond insurance can add a layer of protection, but it is only as good as the insurer's credit quality and ability to pay.

A credit rating is not a recommendation to purchase a bond. Even so, higher-rated bonds in general may be more appealing to investors, and — due to supply and demand — typically have a lower yield than similar bonds with a lower rating. Investors must balance risk and reward when choosing bonds that present a comfortable risk while providing a yield that is appropriate to help meet investment goals.

Ratings are very important to a bond issuer when the bond is first offered for sale, because a higher rating may reduce interest costs. After the initial sale, significant shifts in the issuer's financial condition could result in rating changes that may affect the bond's yield and market value. However, as long as the issuer does not default, a change in a bond's rating would not affect the coupon rate or the principal due upon maturity.

Bonds carry other risks as well, such as market risk, interest rate risk, and inflation risk. However, these depend on factors that are difficult to measure or predict.

The principal value of bonds fluctuates with changes in market conditions. A bond sold prior to maturity may be worth more or less than its original value.

What is an ERISA Fiduciary?

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to protect employees who participate in retirement plans and certain other employee benefit plans. At the time, there were concerns that pension plan funds were being mismanaged, causing participants to lose benefits they had worked so hard to earn. ERISA protects the interests of plan participants and their beneficiaries by:

- Requiring the disclosure of financial and other plan information
- Establishing standards of conduct for plan fiduciaries
- Providing for appropriate remedies, sanctions, and access to the federal courts

It's the fiduciary provisions of ERISA that help protect participants from the mismanagement and abuse of plan assets. The law requires that fiduciaries act prudently, solely in the interests of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and paying reasonable expenses of administering the plan.

Fiduciaries must diversify plan investments to minimize the risk of large losses, unless it's clearly prudent not to do so. Fiduciaries must also avoid conflicts of interest. They cannot allow the plan to engage in certain transactions with the employer, service providers, or other fiduciaries ("parties in interest"). There are also specific rules against self-dealing.

Who is a plan fiduciary? Anyone who:

- Exercises any discretionary control over the plan or its assets
- Has any discretionary responsibility for administration of the plan
- Provides investment advice for a fee or other compensation (direct or indirect)

Plan fiduciaries may include, for example, discretionary plan trustees, plan administrators, investment managers and advisors, and members of a plan's investment committee.

Fiduciaries must take their responsibilities seriously. If they fail to comply with ERISA's requirements, they may be personally liable for any losses incurred by the plan. Criminal liability may also be possible.