# Condor Capital Reviews 4th Quarter 2017

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The fourth quarter of 2017 capped off a year of economic strength, low volatility, and numerous all-time highs for domestic equity markets.

Continued global synchronized growth propelled international markets higher, with E.M. equities among the year's top performing assets and developed markets generating significantly positive returns as well.

The Federal Reserve raised interest rates for the third and final time in 2017 and perhaps for the final time in Janet Yellen's tenure as Fed Chair.

**December 2017**



Equity markets both domestically and internationally closed out a tremendous 2017 with another set of positive returns in the fourth quarter, with fixed income markets returning more muted but still generally positive results as well. Broad and consistent corporate earnings growth and positive economic data throughout most of the world were some of the main driving forces, with deregulatory action and a late-year tax reform package providing some additional stimulus. The S&P 500 Index hit numerous all-time highs in 2017, finishing the fourth quarter up 6.64% and 21.82% on the year. Every sector posted positive returns in the quarter, with consumer cyclical stocks leading the way. For the year, technology was the top performer by a significant margin, followed by healthcare and industrials.

International markets were characterized by a second consecutive quarter of robust economic data across a vast majority of geographic regions. This phenomenon, referred to by some as global synchronized growth, buoyed both developed and emerging markets in the second half of the year. While emerging markets outperformed almost all other asset classes significantly in 2017, developed markets averaged greater than 20% returns as well. Both Japanese and European equities slightly outperformed the U.S., as a relatively slow post-crisis recovery began to fully hit its stride and some post-Brexit uncertainty began to abate.

The Federal Reserve decided to raise interest rates yet again at its December meeting, marking the third and final increase of 2017. In keeping with its larger tightening strategy, the move was very clearly signaled by the Fed and left very few investors surprised. While the Fed's 2017 rate hikes pushed the short end of the yield curve higher, the effects largely failed to materialize on the longer end of the curve, resulting in a notably flatter yield curve. As a result, short-term fixed income securities lagged their longer-term counterparts in both the fourth quarter and year overall (the relationship between price and yield is inverse so rising short-term yields lead to falling price). Risk-on sentiment was an important factor for the bond market as well, with corporate debt, high-yield securities, and emerging markets issues outperforming government-issued, investment-grade, and domestic debt, respectively.

Outlook – After a broadly bullish year, there are numerous reasons for optimism heading into 2018. The structural underpinnings that supported market gains in 2017, including corporate earnings growth, consistently high business and consumer sentiment, and positive economic data worldwide, appear intact and poised to continue. While questions regarding the length of the rally and whether equity markets are overvalued are likely to reemerge in 2018, we continue to believe that these concerns are overblown. Note that markets do not fall because they hit an imaginary ceiling or because 'it has been a while.' Perhaps most importantly, equity markets in 2018 should benefit from an entirely new catalyst in the form of tax reform.

The GOP tax reform bill, passed into law in December, will make its full impact felt in 2018. The most significant tax overhaul since the 1980s, the bill will bring the corporate tax rate down to 21% across the board. While it is likely that some positive anticipation has already been priced into the market, the majority of the bill's benefits to economic growth and corporate earnings are likely yet to be realized. Industries that currently pay the highest effective tax rates, including financials, retail, and telecom, are among the best-positioned sectors to profit from the changes, though the bill appears to be stimulative across the board. Domestically focused companies are likely to see larger benefits as well, as a greater percentage of their income will benefit from the lower domestic rate. Small-cap stocks look set to be a particular winner here, as these firms often do not have the global reach and diversification of their large-cap peers. Additionally, the bill will allow companies to repatriate profits from overseas at a significantly discounted rate. This will benefit large tech companies like Apple, Microsoft, and Cisco with large offshore reserves and could catalyze a large-scale event, such as a large acquisition or special dividend.

After breaking away from a prolonged period of accommodative global monetary policy in 2017, the Federal Reserve is likely to continue this path next year. The central bank estimates it will increase rates three more times in 2018 and continue to wind down its balance sheet in a very structured manner, keeping with the clear signaling it has emphasized. Three more rate increases would result in a 2% Federal Funds rate for the first time since 2008, indicating further confidence over the future of U.S. inflation and economic growth. Turnover will be a key storyline for the Fed in 2018 as well. In addition to multiple vacancies on its board, Fed Chair Janet Yellen will be replaced by Jerome Powell when her term ends in February. While markets will be closely monitoring the new Chair for any divergence from Yellen's approach, most observers expect Powell's outlook to align closely with his predecessor's, minimizing any disruption to the path of U.S. monetary policy moving forward. Outside the U.S., robust global growth and further tightening by the Fed will likely increase the pressure on central banks in places like Japan and Europe to begin backing away from highly accommodative policies of their own.

Overall, we maintain a moderately optimistic outlook for 2018. While we caution investors that corrections are a regular, even healthy, part of financial markets that occur roughly once per year on average, they are generally short-term in nature and more often than not do not portend a recession. Moreover, the underlying fundamentals of the market appear to still be intact and should see even greater benefits in the wake of tax reform. As a result, we continue to view any attempts to time the market as ill-advised and, as always, advocate for maintaining a comprehensive, diversified portfolio based on investors' long-term goals and needs.

**As the massive baby boomer generation begins to reach retirement age, the makeup of the U.S. labor force, consumer spending habits, and the country's economic potential could all begin to change.**

# Demographic Dilemma: Is America's Aging Population Slowing Down the Economy?

It's no secret that the demographic profile of the United States is growing older at a rapid pace. While the U.S. population is projected to grow just 8% between 2015 and 2025, the number of older Americans ages 70 to 84 will skyrocket 50%.[1]

With roughly 75 million members, baby boomers (born between 1946 and 1964) make up the largest generation in U.S. history. As a group, boomers have longer life expectancies and had fewer children than previous generations.[2]

Now, after dominating the workforce for nearly 40 years, boomers are retiring at a rate of around 1.2 million a year, about three times more than a decade ago.[3]

Though the economy has continued to improve since the Great Recession, gross domestic product (GDP) growth has been weak compared with past recoveries. A number of economists believe that demographic changes may be the primary reason.[4]

## Spending Shifts

The lower birth rates in recent decades generally mean that fewer young people are joining the workforce, so the consumer spending that fuels economic expansion and job creation could take a hit. When young people earn enough money to strike out on their own, marry, and start families, it typically spurs additional spending — on places to live, furniture and appliances, vehicles, and other products and services that are needed to set up a new household.

On the other hand, when people retire, they typically reduce their spending and focus more on preserving their savings. Moreover, retirees' spending habits are often different from when they were working. As a group, retirees tend to avoid taking on debt, have more equity built up in their homes, and may be able to downsize or move to places with lower living costs. More spending is devoted to covering health-care costs as people age.

If a larger, older population is spending less and the younger population is too small to drive up consumer spending, weaker overall demand for products and services could restrain GDP growth and inflation over the long term. Less borrowing by consumers and businesses could also put downward pressure on interest rates.

## A New Normal?

The onslaught of retiring baby boomers has long been expected to threaten the viability of Social Security and Medicare, mainly because both are funded by payroll taxes on current workers. But this may not be the only challenge.

A 2016 working paper by Federal Reserve economists concluded that declining fertility and labor force participation rates, along with increases in life expectancies, accounted for a 1.25 percentage point decline in the natural rate of real interest and real GDP growth since 1980. Furthermore, the same demographic trends are expected to remain a structural impediment to economic growth for years to come.[5]

Put simply, a nation's potential GDP is a product of the number of workers times the productivity (output) per worker, and the U.S. workforce is shrinking in relation to the total population.

The labor force participation rate — the percentage of the civilian labor force age 16 and older who are working or actively looking for work — peaked at 67.3% in early 2000, not coincidentally the last time GDP grew by more than 4%. The participation rate has dropped steadily since then; in August 2017, it was 62.9%. This reflects lower birth rates, increased college enrollment, some men in their prime working years dropping out of the labor force, and large numbers of retiring baby boomers.[6]

Many economists acknowledge that U.S. population trends are a force to be reckoned with, but the potential impact is still up for debate. Some argue that labor shortages could drive up wages and spending relatively soon, followed by higher growth, inflation, and interest rates — until automated technologies start replacing larger numbers of costly human workers.[7]

Even if demographic forces continue to restrain growth, it might not spell doom for workforce productivity and the economy. Another baby boom would likely be a catalyst for consumer spending. Family-friendly policies such as paid maternity leave and day-care assistance could provide incentives for women with children to remain in the workforce. It's also possible that a larger percentage of healthy older workers may delay retirement — a trend that is already developing — and continue to add their experience and expertise to the economy.

1, 3) The Conference Board, February 24, 2017

2) *The Wall Street Journal,* January 16, 2017

4-5) Federal Reserve, 2016

6, 8) *The Financial Times,* October 25, 2016

7) U.S. Bureau of Labor Statistics, 2016-2017, Bureau of Economic Analysis 2017

***Saving for retirement while paying off existing debt obligations can seem like an impossible conundrum. Here are some helpful tips and strategies to conquer your debt without mortgaging your future.***

## Managing Debt While Saving for Retirement

It's a catch-22: You feel that you should focus on paying down debt, but you also want to save for retirement. It may be comforting to know you're not alone.

According to an Employee Benefit Research Institute survey, 18% of today's workers describe their debt level as a major problem, while 41% say it's a minor problem. And workers who say that debt is a problem are also more likely to feel stressed about their retirement savings prospects. Perhaps it's no surprise, then, that the largest proportion (21%) of those who have taken a loan from their employer-sponsored retirement plans have done so to pay off debt. Borrowing from your plan can have negative consequences on your retirement preparedness down the road. Loan limits and other restrictions generally apply as well.

The key in managing both debt repayment and retirement savings is to understand a few basic financial concepts that will help you develop a strategy to tackle both.

### Compare potential rate of return with interest rate on debt

Probably the most common way to decide whether to pay off debt or to make investments is to consider whether you could earn a higher rate of return (after accounting for taxes) on your investments than the interest rate you pay on the debt. For example, say you have a credit card with a $10,000 balance that carries an interest rate of 18%. By paying off that balance, you're effectively getting an 18% return on your money. That means your investments would generally need to earn a consistent, after-tax return greater than 18% to make saving for retirement preferable to paying off that debt. That's a tall order for even the most savvy professional investors.

And bear in mind that all investing involves risk; investment returns are anything but guaranteed. In general, the higher the rate of return, the greater the risk. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but you won't have had the benefit of any gains. By contrast, the return that comes from eliminating high-interest-rate debt is a sure thing.

### Are you eligible for an employer match?

If you have the opportunity to save for retirement via an employer-sponsored plan that matches a portion of your contributions, the debt-versus-savings decision can become even more complicated.

Let's say your company matches 50% of your contributions up to 6% of your salary. This means you're essentially earning a 50% return on that portion of your retirement account contributions. That's why it may make sense to save at least enough to get any employer match before focusing on debt.

And don't forget the potential tax benefits of retirement plan contributions. If you contribute pre-tax dollars to your plan account, you're immediately deferring anywhere from 10% to 39.6% in taxes, depending on your federal tax rate. If you're making after-tax Roth contributions, you're creating a source of tax-free retirement income.

### Consider the types of debt

Your decision can also be influenced by the type of debt you have. For example, if you itemize deductions on your federal tax return, the interest you pay on a mortgage is generally deductible — so even if you could pay off your mortgage, you may not want to. Let's say you're paying 6% on your mortgage and 18% on your credit card debt, and your employer matches 50% of your retirement account contributions. You might consider directing some of your available resources to paying off the credit card debt and some toward your retirement account in order to get the full company match, while continuing to pay the mortgage to receive the tax deduction for the interest.

### Other considerations

There's another good reason to explore ways to address both debt repayment and retirement savings at once. Time is your best ally when saving for retirement. If you say to yourself, "I'll wait to start saving until my debts are completely paid off," you run the risk that you'll never get to that point, because your good intentions about paying off your debt may falter. Postponing saving also reduces the number of years you have left to save for retirement.

It might also be easier to address both goals if you can cut your interest payments by refinancing debt. For example, you might be able to consolidate multiple credit card payments by rolling them over to a new credit card or a debt consolidation loan that has a lower interest rate.

Bear in mind that even if you decide to focus on retirement savings, you should make sure that you're able to make at least the minimum monthly payments on your debt. Failure to do so can result in penalties and increased interest rates, which would defeat the overall purpose of your debt repayment/retirement savings strategy.

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## What Financial Resolutions Should I Consider Making as I Look Ahead to 2018?

If you donate your car to charity, you can claim an income tax deduction for the donation if you itemize your deductions on your federal income tax return.

A new year is right around the corner, bringing with it a fresh start for you and your finances. What will you do this year to help improve your financial situation?

**Evaluate your savings goals.** The beginning of the year is a great time to examine your overall financial plan. Maybe you want to buy a new vehicle this year or save money toward a Caribbean cruise next year. Perhaps you want to focus less on material items and more on long-term goals, such as your retirement savings. Regardless of what you are setting money aside for, make sure you come up with a realistic savings plan that will help you achieve your goals and avoid the risk of significant loss.

**Pay down debt.** Whether you owe money on your credit cards or have student loan payments to make, the start of a new year is a good time to develop a strategy to reduce your overall level of debt. Reducing your debt can help create opportunities to contribute toward other goals throughout the year. But unless you can definitely afford it, don't plan to pay off all your debts in one fell swoop. Set a smaller goal that you'll be more likely to achieve over the course of the year.

**Automate as much as you can.** Your plan to pay down debt can be accomplished more easily if you automate your bill paying, saving, and investing. Most banks, credit card issuers, retirement plan providers, and investment companies offer services that make payments automatic — allowing you to worry less about payment dates. The best part is that it might only take a few taps on your smartphone to make these processes automatic.

**Think about organizing your financial documents.** If your overall financial situation is already in good shape for the new year, consider taking time now to clear out and organize your financial records. Do you have important documents, such as your tax returns or passport, in a safe place? Are you holding on to records that you no longer need? Organizing your financial records now can save you time and frustration later if you need to locate a particular document.

## What Education Benefits Are Available to Servicemembers?

The documentation needed to obtain a federal income tax deduction for donating used property to a charity typically depends on the value of the property. In general, do not attach the documentation to your income tax return. Keep the records so that you can provide them to the IRS if requested to do so.

Military education benefits are available to help servicemembers cover the cost of education. Consider taking advantage of these programs if you're eligible.

Active-duty servicemembers and veterans who served on active duty on or after September 11, 2001, may be entitled to Post-9/11 GI Bill benefits. This program can pay up to the full cost of in-state tuition and fees at public colleges for up to four years, or up to a certain maximum if you attend a private college or foreign school. Vocational and correspondence school programs may also be covered. Tuition is paid directly to the school, with eligible students receiving a monthly housing stipend and up to $1,000 per academic year for books and supplies that is paid at the beginning of each semester.

The Yellow Ribbon Program is a provision of the Post-9/11 GI Bill that allows veterans to attend participating schools and graduate programs that cost more than the state tuition cap. Another benefit is the Transfer of Entitlement option, which enables servicemembers and veterans to transfer some or all of their unused GI Bill benefits to a spouse or dependent children. However, certain requirements must be met before the transfer is approved.

The Montgomery GI Bill offers two main programs: one for active-duty members and another for actively drilling reservists. The duration of benefits varies for the programs, but both make payments directly to the student. If you're eligible for both the Post-9/11 GI Bill and the Montgomery GI Bill, you must decide which benefit you want to receive. This decision is final and cannot be changed, so you'll want to think carefully about which education benefit will be most advantageous to you.

Supplemental benefits may be available to servicemembers and veterans, including tuition assistance, scholarships, licensing and certification programs, work-study programs, and tutorial assistance. Learn more about your options by visiting benefits.va.org.