Condor Capital Reviews 1st Quarter 2018

Condor Capital
1973 Washington Valley Rd
Martinsville, NJ 08836
(p) 732-356-7323
(f) 732-356-5875
info@condorcapital.com

The first quarter of 2018 was marked by a significant increase in volatility in equity markets despite continued strength in the underlying economy.

There was some dispersion of returns within international equities, with developed markets finishing the quarter marginally lower and emerging markets split but generally positive.

The Federal Reserve completed a much-anticipated leadership transition in the first quarter, with Jerome Powell taking over for former Chairwoman Janet Yellen. As evidenced by a March rate hike, the central bank's outlook under Powell seems largely in-line with his predecessor's.

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After a prolonged period of low volatility, volatility returned to domestic equity markets in the first quarter of 2018. As represented by the S&P 500 Index, the U.S. stock market had six days of moves either higher or lower by 2% or more in the quarter after no such moves in the entirety of 2017. Catalysts for this volatility included investors' fears that equity valuations had become too high, that inflation and yields would begin to spike as the Federal Reserve pulls back from quantitative easing, that wage growth would shift companies' income from profits to wages, and that heated tariff talk could lead to a trade war. After all of the ups and downs, the S&P 500 Index finished the first quarter down 0.76%. While the technology sector was once again the top-performing sector, it was not immune from the market's newfound volatility, with the mega-cap internet giants and semiconductor manufacturers both experiencing significant down days at various points throughout the quarter. Most other sectors posted negative returns, with energy, consumer staples, and telecom among the biggest laggards. Growth stocks tended to fare better than their value counterparts amid these trends, and small-caps slightly edged out their mid- and large-cap peers.

International markets showed mixed results in the first quarter of 2018. Developed markets finished the quarter marginally negative, as European and Japanese equity markets stagnated after a strong fourth quarter run-up. Emerging markets, on the other hand, posted slightly positive returns in the period, with Latin America finishing as the top performing emerging region amid a stabilizing political and economic environment, and India regressing a bit in the quarter to finish as the worst performer. Despite heightened volatility due to escalating trade tensions with the U.S., Chinese equities finished the first quarter slightly positive.

The Federal Reserve was a major focal point for fixed income markets once again. In addition to its continued unwinding of post-crisis quantitative easing programs, the central bank completed its much-anticipated leadership transition in the first quarter. Janet Yellen was succeeded by Jerome Powell, an existing Fed Governor with a similar view on monetary policy as Yellen. While there was some talk of bond markets "testing" the new Chairman early on, the Fed has stayed the course with its unwinding program early in Powell's tenure, and the continuity of the outgoing and incoming Chairs' outlooks appears to have allowed for a smooth transition. In a twist from prior quarters, however, inflation fears returned to bond markets a bit in the first quarter. Because rising inflation eats into an investment's real return, increasing so-called purchasing power risk, it is of particular concern to relatively safer, slower growing fixed income markets. All told, the 10-year Treasury yield moved as much as 48 basis points higher in the first quarter before coming back a bit towards the quarter's end to finish at 2.74%.

Outlook – In light of the long run-up and the historically depressed volatility levels in recent years, we view the market movements of the first quarter as an inevitability and even, in some ways, a healthy development. Markets cannot continue to run higher forever, and the fact that markets appear to have found support is an encouraging sign. As we have noted before, corrections of 10% or more happen once per year on average and are generally short-lived, so the past three correction-free years were more of an anomaly than the developments in the first quarter. That being said, it is completely understandable for investors to feel nervous and uncomfortable when their life savings fluctuate significantly. As such, we continue to recommend asset allocations that best reflect investors' needs and risk tolerance and that balances these interests in both bull and bear markets.

Moving forward, we continue to have a cautiously optimistic outlook for domestic equities. The U.S. economy is still exceptionally strong, with consistently positive GDP growth and unemployment near an 18-year low. Moreover, corporate earnings are expected to continue to rise significantly, with FactSet estimating an impressive 17.1% earnings growth across the S&P 500. The benefits of corporate tax reform are likely not yet fully realized and should help contribute to the positive trend in earnings as well. While concerns like relatively high valuations and fears of a trade war do remain, we feel that some of the worry here may be overblown. Remember that the current premium on domestic equities is just as much a vote of confidence by the market as it is a cause for concern, and the earnings growth expected in the second quarter should help support current valuation levels. Additionally, any serious trade action still has months of review and public commentary to go through before being enacted, meaning the current rhetoric surrounding the issue is more likely a brash negotiating tactic than a harbinger of a trade war. Finally, it is important to note the difference between a market pullback and a larger economic crisis. Even the most pessimistic market watchers are generally not calling for a recession or economic crisis in the near term, meaning any market pullback is unlikely to be compounded with any large, systematic issue for the economy.

At the end of the day, volatility like we saw this quarter is why we've consistently recommended a long-term approach that takes into account both the hope of capital appreciation and the need for downside protection. The recent market movements are an unfortunate reminder that equities can be volatile in the shorter term, but their long-term value in a diversified portfolio cannot be forgotten. While recent downturns have been uncomfortable, they must be viewed in the context of the strong multi-year run-up that preceded them. Any knee-jerk decisions to try and time the market are likely to backfire when equities move higher once again. As a result, we continue to advise against basing asset allocation decisions on short-term moves and trends, but rather advocate for staying the course with a comprehensive, diversified portfolio based on your long-term goals and needs.

See disclaimer on final page

Escalating trade tensions have roiled the stock market recently, but what exactly is at stake for business and investment communities across the globe?

The Trade War that Isn't — Yet

When most of us hear talk about something described as a "war," we intuitively recognize that there could be very unpleasant outcomes on all sides. Wars have one thing in common: there is seldom a clear-cut "winner" amid the damage and destruction.

So when President Trump declares a "trade war" against the world's second-largest economy, it's natural that many people—including, apparently, a large number of investors—would feel spooked about what's to come in our collective future. This explains why every escalation of words, and new lists of things that will be taxed at U.S. and Chinese borders, has provoked sharp downturns in the markets.

But what, exactly, is a "trade war?" Beyond that, what is a "trade deficit" and why are we trying to "cure" America's trade deficit with China?

To take the latter issue first, every bilateral trade deficit is simply a calculation, made monthly by government economists, that adds up the value of products manufactured in, say, China that are purchased in, say, the U.S. (Chinese exports or U.S. imports), and subtracts the value of products manufactured in the U.S. that are purchased by Chinese consumers (U.S. exports or Chinese imports). The first thing to understand is that this is not a very precise figure. To take a simple example, Apple manufactures its iPhones in southern China, ship them to the U.S. for sale, and the value of each of the millions of smart phones is counted as a Chinese export to the U.S. market. Apple reaps extraordinary profits, but this is considered a net negative in terms of U.S. trade.

Moreover, the full value of each iPhone is considered on the import ledger, without subtracting out the value of the "services" that Apple provides. The software and design were, after all, created in the U.S., and are a large part of the value of the phones that people become so addicted to. But these financially valuable aspects of the phone, made in America, are not reflected in the trade numbers.

Beyond that, many economists question whether a trade deficit is a bad thing in the first place. Chances are, you run a significant trade deficit with your local grocery store; that is, it brings to your neighborhood the food you put on the table, and you exchange money for it. You import food, but the grocery story doesn't import a comparable amount of things you make in your garage. Are you materially harmed by this economic opportunity that takes dollars out of your pocket and puts them in the hands of the grocery store? If you were, you might take your business to the grocery store further up the road, and run a trade deficit with a different establishment.

How does this relate to the U.S./China trade relations? Simple mathematics indicates that Chinese manufacturers are taking dollars from U.S. consumers, but they have to do something with those dollars to balance the ledger. That money finds its way into purchases of U.S. debt (Treasury bonds) or reinvestment in the U.S. economy, buying real estate or investing in domestic companies.

You fight trade wars with tariffs, which are simply a government tax on specific items when they cross the border. So when the Trump Administration announces the list of 1,300 different products that will become the targets of its tariff plan, that means that anyone buying those products will see their taxes go up—invisibly, in a higher cost of living.

The bigger potential damage comes when China retaliates in kind, and certain sectors of the U.S. economy have to pay the Chinese government a tariff for the privilege of selling their products to the Chinese market. China represents 15-20 percent of Boeing's commercial airline sales, so a proposed 25% tariff could sting. More directly impacted are U.S. farmers. Soybeans represent the largest agricultural export from the U.S. to China ($14.2 billion worth of shipments in 2016, about one-third of the U.S. crop), and the Chinese consume a lot of U.S.-raised pork. When the tariffs were announced, pork futures dropped to a 16-month low, and soybean futures fell 5% overnight.

The larger concern is that China is preparing to shift its sourcing of agricultural products from the U.S. to Brazil and Argentina, and the retaliatory tariff makes this economically attractive for Chinese consumers. Will that business ever come back again?

If this has you worried, or searching China's latest list to see which stock might be impacted as the rhetorical trade war escalates, it might be helpful to take a step back. So far, none of these tariffs have been levied; no actual shots have been fired in the trade war, which means it is not yet a "war" at all. The U.S. and China are trading retaliatory lists of potential targets, and there is some escalation in the value and extent of those lists. But when it comes time to actually fire those shots, the most likely scenario is a generous compromise that leaves us with the status quo.

Remember how worried the markets were when the Trump Administration abruptly announced new levies against global steel and aluminum imports? It turned out to be mostly bluster. A full 50% of all U.S. steel imports, from Brazil, South Korea, Mexico, Canada and others, were exempted from those tariffs. Larry Kudlow, the White House's new economic advisor, said several times last week that there would be, in fact, no new tariffs, and no trade war with China. It will be months before any of the proposed tariffs could be put into place, which is plenty of time for Kudlow's prediction to come true—and make all the panic sellers who drove down stock prices look a little bit silly.

While discussing sensitive and emotional topics surrounding aging parents' estate planning can be uncomfortable at times, it is a highly important part of an individual's wealth management preparations. Here are some of the most important questions to ask to help facilitate some of aging relatives' most crucial planning decisions.

Don't Wait to Ask Aging Parents These Important Questions

It's human nature to put off complicated or emotionally heavy tasks. Talking with aging parents about their finances, health, and overall well-being might fall in this category. Many adult children would rather avoid this task, as it can create feelings of fear and loss on both sides. But this conversation — what could be the first of many — is too important to put off for long. The best time to start is when your parents are relatively healthy. Otherwise, you may find yourself making critical decisions on their behalf in the midst of a crisis without a roadmap.

Here are some questions to ask them that might help you get started.

Finances

- What institutions hold your financial assets? Ask your parents to create a list of their bank, brokerage, and retirement accounts, including account numbers, name(s) on accounts, and online user names and passwords, if any. You should also know where to find their insurance policies (life, home, auto, disability, long-term care), Social Security cards, titles to their house and vehicles, outstanding loan documents, and past tax returns. If your parents have a safe-deposit box or home safe, make sure you can access the key or combination.

- Do you need help paying monthly bills or reviewing items like credit card statements, medical receipts, or property tax bills? Do you use online bill pay for any accounts?

- Do you currently work with any financial, legal, or tax professionals? If so, ask your parents if they want to share contact information and whether they would find it helpful if you attended meetings with them.

- Do you have a durable power of attorney? A durable power of attorney is a legal document that allows a named individual (such as an adult child) to manage all aspects of a parent's financial life if the parent becomes disabled or incompetent.

- Do you have a will? If so, find out where it is and who is named as executor. If the will is more than five years old, your parents may want to review it to make sure their current wishes are represented. Ask if they have any specific personal property disposition requests that they want to discuss now.

- Are your beneficiary designations up-to-date? Beneficiary designations on your parents' insurance policies, pensions, IRAs, and investment accounts will trump any instructions in their will.

- Do you have an overall estate plan? A trust? A living trust can be used to help manage an estate while your parents are still living. If you'd like to learn more, consult an estate planning attorney.

Health

- What doctors do you currently see? Are you happy with the care you're getting? If your parents begin to need multiple medical specialists and/or home health services, you might consider hiring a geriatric care manager, especially if you don't live close by.

- What medications are you currently taking? Are you able to manage various dosage instructions? Do you have any notable side effects? At what pharmacy do you get your prescriptions filled?

- What health insurance do you have? In addition to Medicare, which starts at age 65, find out if your parents have or should consider Medigap insurance — a private policy that covers many costs not covered by Medicare. You may also want to discuss the need for long-term care insurance, which helps pay for extended custodial or nursing home care.

- Do you have an advance medical directive? This document expresses your parents' wishes regarding life-support measures, if needed, and designates someone who will communicate with health-care professionals on their behalf. If your parents do not want heroic life-saving measures to be undertaken for them, this document is a must.

Living Situation

- Do you plan to stay in your current home for the foreseeable future, or are you considering downsizing?

- Is there anything I can do now to make your home more comfortable and safe? This might include smaller projects such as installing hand rails and night lights in the bathroom, to larger projects such as moving the washing machine out of the basement, installing a stair lift, or moving a bedroom to the first floor.

- Could you benefit from a weekly or monthly cleaning service?

- Do you employ certain people or companies for home maintenance projects (e.g., heating contractor, plumber, electrician, fall cleanup)?

Memorial Wishes

- Do you want to be buried or cremated? Do you have a burial plot picked out?

- Do you have any specific requests or wishes for your memorial service?

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1973 Washington Valley Rd
Martinsville, NJ 08836
(p) 732-356-7323
(f) 732-356-5875
info@condorcapital.com

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Crypto-Crash

Last year, it was hard to turn on your computer without reading about the dramatic rise in cryptocurrency values, or see advertisements for ways that you, too, could participate in this get-rich-quick opportunity to buy virtual money that is backed by no government on Earth.

It's almost always the case that when an investment becomes wildly popular and experiences a dramatic runup in price, that is exactly the wrong time to invest. And it turns out that cryptocurrencies were no exception.

While the stock markets were dropping moderately in value, cryptocurrencies lost their owners an estimated $60 billion in the last week of March, including a $20 billion drop over one dramatic six-hour period. Bitcoins are trading below $7,000, and the trend is taking them toward their February 6 low—and, perhaps, further. In case you're not up on other cryptocurrencies, there's something called Ether (now $381 per coin); Bitcoin cash ($691.48); Litecoin ($116.27) and Ripple (49 cents).

The problem, as always, is figuring out whether these alternative currencies are actual investments. For now, there are very few stores which accept them as actual money. Bitcoin's primary purpose in the marketplace has famously been to enable drug and weapons traffickers to buy and sell without leaving a paper trail for international police agencies to follow. Chances are, those markets are not of much interest to you or your portfolio, so it might be wise to watch this crytpo-mania play itself out from the sidelines.

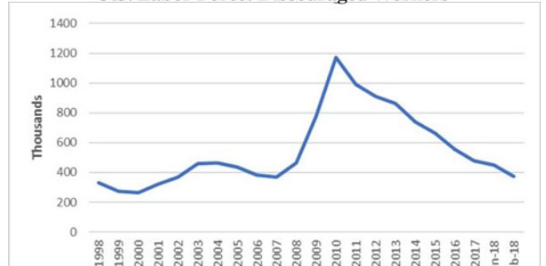
The Slack in the Labor Market

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.

The U.S. unemployment rate has been dropping steadily ever since it reached 10% during the awful depth of the Great Recession; the Bureau of Labor Statistics says that today only 4.1% of Americans are out of work, the lowest rate in nearly two decades.

But most of us know that this cannot be the whole story. Companies are showing no sign of being desperate to find workers, and the very low increases in worker salaries suggests that there is no bidding war for their services.

So where do we find the hidden slack in the job numbers? For that, you have to look at another statistic that is compiled by the Bureau of Labor Statistics: the number of "discouraged" workers in the U.S. economy. The Bureau defines "discouraged" as "those persons not in the labor force who want and are available for work, and who have looked for a job sometime in the prior 12 months, but were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey." These individuals, misleadingly, are dropped from the Bureau's pool of available workers, and as they stop looking for work, they paradoxically help lower the statistical calculations of the unemployment rate.



So what has been going on with the discouraged worker statistics lately? Here, we find some very good news. The number has declined from 522,000 this time last year to 373,000 today—reaching a level not seen since before the Great Recession. The chart shows the trend, indicating that we still have a ways to go before there are fewer discouraged workers than there were in the late 1990s, but that we are on a fairly steady path to getting there.

What happens when the number of discouraged workers approaches zero? THAT'S when you'll start to see wage growth start to accompany the low unemployment rate. As the slack is taken out of the labor market, as we start to run out of discouraged workers, we will see that long-awaited bidding war for people in the workplace. The consequences from there are uncertain. It could lead to moderately higher inflation, or we could see technological advances which reverse the recent trends and put a lot more people out of work—like, for example, self-driving trucks replacing truck drivers.

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