Condor Capital Reviews 2nd Quarter 2018

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

Domestic equities bounced back into positive territory after a slow start to 2018, with technology, energy, and small-caps posting particularly impressive results.

Trade disputes between the U.S. and several trading partners escalated significantly in the quarter, adding a new layer of uncertainty to global markets. Emerging markets equities posted their worst quarter in over a year.

Within fixed income, short-term yields moved higher as the Federal Reserve raised interest rates once again at its June meeting. While the 10-year Treasury briefly surpassed 3% before ticking lower, the yield curve once again finished the quarter flatter than it began.

June 2018

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Domestic equity markets returned to positive territory in the second quarter, bouncing back from a slow start to 2018 that marked the first negative quarter for the S&P 500 Index in two years. While growth-oriented sectors, such as technology and healthcare, continued to march higher, some relatively surprising sectors, such as energy and real estate, contributed to the positive domestic performance as well. Despite ups and downs in previous quarters, energy finished as the top performing sector amid a significant increase in oil prices. The industrial and financial services sectors, on the other hand, finished the period as two of the worst-performing sectors. Small-cap stocks had a tremendous quarter, with the Russell 2000 Index hitting multiple all-time highs and significantly outperforming its larger peers across both growth and value.

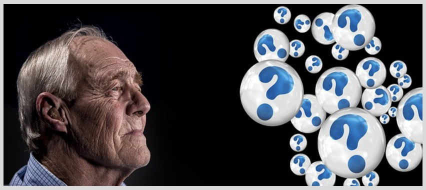
The volatility that returned to equity markets in early 2018 persisted in the second quarter. In addition to concerns over rising yields and high stock price valuations, a significant escalation of international trade disputes added a new layer of uncertainty. The Trump administration escalated its protectionist rhetoric and began to make specific tariff threats against major U.S. trading partners in the second quarter, leading foreign nations to respond in kind. Small-cap stocks, which tend to be more domestically focused due to their smaller size, were largely able to sidestep many of these concerns, helping to contribute to their significant outperformance in the period. Beyond trade disputes, international equity markets in the second quarter were also impacted by a strengthening U.S. dollar and pockets of slowing economic growth following a period of robust expansion across the vast majority of global economies in the latter half of 2017. Amid these trends, emerging markets equities had their worst quarter in over a year, with Latin America experiencing particularly noteworthy losses.

Fixed income markets continued to be guided by many of the same forces from previous quarters, including gradual quantitative tightening, another interest rate increase by the Federal Reserve, and the resulting shifts in the yield curve. In keeping with its long-term plan to pull back from post-crisis easy money policies, the Fed maintained course with its balance sheet reduction program and raised interest rates once again at its June meeting. The increase sent the Fed's discount rate up to a range of 1.75% to 2% and pushed yields higher on the short end of the curve higher. Despite the 10-year Treasury Yield briefly touching 3% in April and May, yields on the longer end of the curve failed to keep pace with the short-term increases over the course of the quarter, resulting in another flattening of the yield curve. Within this backdrop, shorter term bonds once again outperformed longer term issues and high-yield bonds outpaced their investment-grade counterparts amid persistently low default rates. Municipal debt outpaced taxable bond issues in the second quarter, with higher-yielding munis performing especially well thanks to an increased willingness by investors to buy back into distressed issuers. International fixed income markets were generally lower in the period, with emerging markets having a particularly rough quarter.

Outlook – While the U.S. stock market through the first half of 2018 has been more volatile and experienced less appreciation relative to the strong move higher in 2017, we feel that the developments of the first half of the year are actually healthy. This is because the slight pause in upward movement of stocks in tandem with strong increases in corporate earnings has given companies time to live up to expectations that were priced into stock prices last year and has made many domestic equities a bit less expensive relative to their underlying earnings. Considering the fundamental strength of the U.S. economy and private sector, we continue to maintain our cautiously positive view that U.S. equities remain on solid footing moving forward.

Despite many reasons for optimism, there are factors that investors will continue to monitor as the year progresses. Tariffs and trade disputes have moved to the forefront in light of the events of the second quarter, and the threat of a trade war is a legitimate concern that could impact global economic growth if tensions boil over. That being said, it is likely that cooler, more free-trade-oriented heads will prevail, and the fact that the Trump administration has placed significant emphasis on the stock market provides hope that the administration will show sensitivity to any tariff-related damage. Rising interest rates and the flattening of the yield curve will continue to be a focal point as well, though the Fed's clear signaling of its strategy and the market's relatively muted reaction to the June rate hike indicate that markets may be becoming more acclimated to this monetary policy backdrop.

Most importantly, the strong corporate and economic state of the U.S. economy remains intact. Corporate earnings growth expectations remain well in the double digits for the coming quarters, deregulatory action continues to unlock opportunity in various sectors, and the positive effects of the Tax Cuts and Jobs Act on corporate balance sheets appear to be hitting their peak. Macroeconomic data remain a significant tailwind as well, with unemployment below its long-term average and recent GDP growth surpassing the expectations of many economists. Still, as the prior two quarters have shown, equity markets rarely post smooth, linear gains in the short term and investors should continue to be prepared for some inherent short-term volatility. Over the longer-term, however, we remain cautiously optimistic and continue to feel that investors with diversified portfolios suiting their long-term goals and needs remain well poised to navigate the current market.



It has been well-publicized that persistent underfunding and America's aging population are straining Medicare and Social Security. Exactly how bad is the problem and what does it mean for future benefits?

Deficit Funding

Many were alarmed when, on June 5, the good people who run Medicare and Social Security released a report that said that the Medicare program will become insolvent in 2026 and Social Security will face a similar fate in 2034. The Medicare projection is three years earlier than the previous report, while the Social Security projection is unchanged from previous estimates.

These problems are not new, of course. People are living far longer than anticipated when Social Security was created in 1935; in fact, the average life expectancy for a person who managed to reach age 30 at that time was age 68 for men and 70 for women. Today it's 79 for men and 82 for women. Meanwhile, Medicare has been hit with higher-than-inflation medical expenses—along with, of course, those longer lifespans.

Alarmists point out that the Social Security and Medicare Trust Fund reserves are "invested" in government securities, which is essentially the government writing itself an IOU—currently to the tune of $2.8 trillion, which is the total "asset reserves" in our largest social programs. Individuals are advised not to run their own finances this way, accumulating deficits but meticulously keeping slips of paper around which represent a promise to pay back every single nickel and dime eventually. But in fact, today nearly all of the money paid out to Social Security recipients, and on behalf of Medicare enrollees, are simply transfers of money paid into the program by workers. The money comes in in the form of FICA payments and taxes on Social Security benefits, and goes back out the door to beneficiaries.

So where's this alleged deficit? That can be found on page 9 of the report, in a section labeled "Assumptions About the Future." There, the report makes economic projections about the next 75 years, including the future fertility rate (children per woman), mortality, the annual percentage change in worker productivity, average annual wage increases, inflation, unemployment and the interest rate earned by those IOUs the government is writing to itself. Page 18 shows a graph that illustrates the projected outcomes of three different sets of assumptions for all these (basically unknowable) variables, and one can see that two of them are, shall we say, not optimal, while the third projects not just solvency, but actual prosperity for the combined trust funds going forward well past the year 2090.

Even if the worst case comes to pass, and the programs goes "bust," they won't actually stop paying benefits. There will still be workers who pay FICA taxes, and even if there is no trust fund, these collected payroll taxes can be transferred, as they are now, to Social Security and Medicare recipients. The Social Security trustees report, on page 58, how much of the projected payments would be covered by workers going out to 2090 under the three future scenarios. The worst case scenario says that there will be roughly an 18% shortfall in 2040, rising to roughly 22% by 2090. Basically, that means that Social Security recipients, worst case scenario, would have to get by on 82% of the benefits they were expecting in 2040, and 78% if they manage to live all the way out to 2090.

And, of course, that's if nothing is done to shore up the program between now and then. One of the simplest options on the table is to raise the age people can collect full retirement benefits as the average lifespan goes up, basically "indexing" retirement benefits to changes in longevity. Congress could marginally raise FICA taxes or impose more taxes on Social Security income.

The best advice here is not to panic about the fate of our country's social programs. There is no question we need to address their solvency, and with gridlock in Washington, that seems like a bit of a long shot. But even if Congress can't agree on tweaks and fixes, the world won't come to an end. Social Security and Medicare recipients will have to tighten their belts a bit—and maybe start voting for candidates who offer real solutions to the budget issues in Washington.

Cryptocurrencies such as Bit-coin skyrocketed higher in 2017 but many investors who rushed in have lost large chunks of their investment in the subsequent sell-off. Where do these "Cryptos" stand now and what could the future look like for the space?

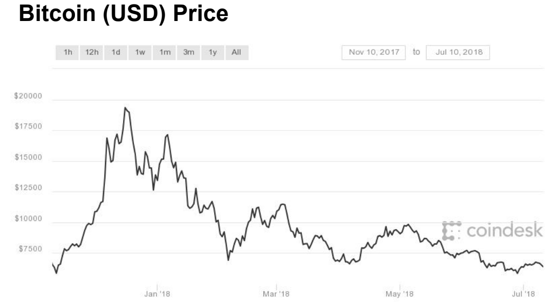
Crypto-Crash

Chances are, if you remember the dot-com crash, it is not fondly. The Nasdaq Composite Index fell a total of 78% peak-to-trough, as companies like Pets.com cratered into oblivion.

Today's cryptocurrency investors are experiencing similar pain, and there's no clear end in sight. Bitcoin is down 55% this year, and the decline is now over 70% from top to, well, today. The total value of all tokens has fallen from $830 billion to around $236 billion. Meanwhile, the damage has spread to other tokens. A website called Dead Coins lists 800 other cryptocurrencies that are worth either zero or close to zero.

At its height, Bitcoin was clearly a bubble. Now it's hard to tell what the future holds. Regulators around the world have stepped up their scrutiny of cryptocurrencies, concerned that they have become a breeding ground for illicit transactions involving drugs and weaponry, along with money laundering, market manipulation and fraud. But bulls point out that the Nasdaq stocks eventually recovered dramatically from their dismal lows—and say that at these prices, or the potentially lower prices to come, these coins manufactured out of thin air might be a bargain.

Bitcoin (USD) Price



The Tax Cuts & Jobs Act doubled the standard deduction, reducing the incentive for some taxpayers to itemize charitable deductions. Here's how to make sure your charitable gifting remains tax-efficient under the new law.

Reclaiming Charitable Deductions

You may remember that when the new tax law was debated, there was a lot of chatter around the possibility that Congress would totally eliminate the deduction for charitable contributions. That Republican-backed proposal never made it into the final Tax Cuts + Jobs Act, but in other ways the tax changes may wind up having a similar effect on many taxpayers.

How? By doubling the standard deduction, the Tax Code will greatly reduce the number of tax filers who itemize. Another part of the new law adds to the reduction in itemizing by capping the value of the deduction for state and local taxes at $10,000—far below what many taxpayers living in high-tax areas of the country will actually pay.

The result? In the past, roughly 30% of us were itemizers. That number is expected to drop to 10% by the time we start filing this year's taxes. Of course, if you don't itemize your deductions, you don't get to deduct your charitable contributions.

Some quick math shows how this works. Let's suppose a married couple plans to make $14,000 worth of charitable gifts this year. Their state and local tax deduction is capped at $10,000. Together, the two equal $24,000—which happens to be the same as the new standard deduction. They get no incremental deduction for their $14,000 of charitable gifts.

What to do? One way to overcome the impact of the new tax provisions is to bundle several years worth of charitable contributions into a single tax year, contributing the higher amount to a donor-advised fund rather than to the charities directly. If the same couple were to give two years worth of donations to a donor-advised fund, that would come to $28,000. Add in the $10,000 maximum deduction for state and local taxes, and suddenly it makes sense to itemize. The additional $14,000 results in a tax savings of about $5,180 for people in the 37% tax bracket.

Of course, if the couple were to bundle five or ten years worth of charitable contributions into the same tax year, that would further increase the value of the deduction, and they can happily take the standard deduction in the other years. Going forward, the money in the donor-advised fund can be contributed each year to charitable causes just as it had been before, in $14,000 annual increments. Meanwhile, the assets that remain in the fund are growing tax-free, creating additional charitable assets for future donations.

Professionals have built entire careers on helping people be more productive and motivated, but much less attention is paid to helping Type A individuals to de-stress. Read on for some simple tips and tricks to slow down and unwind.

The Secret Recipe for Laziness

For many people, laziness is not a virtue; it is something that has to be overcome with daily habits and willpower. But what about the driven Type A personality who has been told by his/her doctor that the current lifestyle will almost certainly lead to a premature death? How can those people cultivate a more balanced existence, by letting a little laziness into their lives?

Psychologist Sandi Mann, author of The Upside of Downtime, and Jaye Derrick, assistant professor of psychology at the University of Houston, offer some tips to the more driven among us in a recent blog post. Their first insight is that many anxious perfectionists and overachievers don't do well with downtime because they can't manage to think of it as time well-spent. The solution? Put downtime on your schedule, and recognize that relaxing can improve productivity and performance. Basically, that means reframing your lazy time as work.

After that, consider the distinction between "important" and "urgent." Some activities are very important, but do you actually have to do them as soon as you finish the previous project? Derrick recommends that you re-sort your "to-do" list (all Type As have one) into tasks that are unimportant (delete them from the "to-do" list, or at least delegate them), Non-Urgent Important (don't feel like you need to plunge into them right away) and Important Urgent (these actually do require your immediate attention).

Finally, you can spend your downtime on hobbies or activities that recharge you physically and emotionally. Is binge-watching a TV show really energizing you? Are you recharged by scrolling through your Instagram account? "Work hard, play hard" is a perfect motto for the Type As among us. But it's also okay to do nothing without triggering your personal guilt-o-meter. Remember, the longer you live, the more you can accomplish.

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I received a large refund on my tax return. Should I adjust my withholding?

You must have been pleasantly surprised to find out you'd be getting a refund from the IRS — especially if it was a large sum. And while you may have considered this type of windfall a stroke of good fortune, is it really?

The IRS issued over 112 million federal income tax refunds, averaging $2,895, for tax year 2016.1 You probably wouldn't pay someone $240 each month in order to receive $2,900 back, without interest, at the end of a year. But that's essentially what a tax refund is — a short-term loan to the government.

Because you received a large refund on your tax return this year, you may want to reevaluate your federal income tax withholding. That way you could end up taking home more of your pay and putting it to good use.

When determining the correct withholding amount, your objective is to have just enough withheld to prevent you from having to owe a large amount of money or scramble for cash at tax time next year, or from owing a penalty for having too little withheld.

It's generally a good idea to check your withholding periodically. This is particularly important when something changes in your life; for example, if you get married, divorced, or have a child; you or your spouse change jobs; or your financial situation changes significantly.

Furthermore, the implementation of the new tax law at the beginning of 2018 means your withholding could be off more than it might be in a typical year. Employers withhold taxes from paychecks based on W-4 information and IRS withholding tables. The IRS released 2018 calculation tables reflecting the new rates and rules earlier this year. Even so, the old W-4 and worksheet you previously gave to your employer reflect deductions and credits that have changed or been eliminated under the new tax law.

The IRS has revised a useful online withholding calculator that can help you determine the appropriate amount of withholding. You still need to complete and submit a new W-4 to your employer to make any adjustments. Visit irs.gov for more information.

What is the difference between a tax deduction and a tax credit?

Tax deductions and credits are terms often used together when talking about taxes. While you probably know that they can lower your tax liability, you might wonder about the difference between the two.

A tax deduction reduces your taxable income, so when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by an amount equal to your deductions multiplied by your marginal tax rate. For example, if you're in the 22% tax bracket and have $1,000 in tax deductions, your tax liability will be reduced by $220 ($1,000 x 0.22 = $220). The reduction would be even greater if you are in a higher tax bracket.

A tax credit, on the other hand, is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and determined how much tax you owe, you subtract the amount of any tax credit for which you are eligible from your tax obligation. For example, a $500 tax credit will reduce your tax liability by $500, regardless of your tax bracket.

The Tax Cuts and Jobs Act, signed into law late last year, made significant changes to the individual tax landscape, including changes to several tax deductions and credits.

The legislation roughly doubled existing standard deduction amounts and repealed the deduction for personal exemptions. The higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

The law also made changes to a number of other deductions, such as those for state and local property taxes, home mortgage interest, medical expenses, and charitable contributions.

As for tax credits, the law doubled the child tax credit from $1,000 to $2,000 for each qualifying child under the age of 17. In addition, it created a new $500 nonrefundable credit available for qualifying dependents who are not qualifying children under age 17. The tax law provisions expire after 2025.