Lassus Wherley ...a View from the Top

Building Better Futures

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Happy New Year!

Here are our thoughts on the recent happenings in the financial markets and answers to some great questions from clients.

Happy New Year and welcome to another year full of surprises and interesting times. Based on the first week of 2018, it will not be boring. When we were looking at the topics for discussion in this issue of the VFT, it was really difficult to narrow it down to a few. Of course, the changes to the tax code are front and center, the Bitcoin craze, and then we have the federal budget and all the moving parts involved in it, and last but certainly not least we have the impact of all these things on the financial markets. And we can't forget all the political gyrations happening right now in the US and other parts of the world.

We are still waiting to see whether there will be a government shutdown since the Democrats are holding out for a DACA deal before signing off on a budget. Someone will have to blink if a budget deal is to be agreed to before the deadline of January 19, 2018. It isn't looking very positive right now.

Let's start with a review of 2017 and we will answer some of the great client questions we received.

2017 In Review

In the last week of December, 2017, the S&P 500 closed above 2500 for the first time, while the other major US averages also notched new highs. Last year's momentum has definitely carried over into the new year with yet another round of investor exuberance bringing the S&P 500, the Dow Jones 30 and the Nasdaq to new highs in the first trading sessions of the new year.

Gains were seen in most international markets as well as they

opened in the new year. European markets were particularly strong as investors voiced their confidence that recent strength seen in European economies will continue by bidding up shares.

In 2017, both emerging markets and international developed markets indexes bested the 21.8% total return (price appreciation plus divi-

dends) posted by the S&P 500. The US market rose on the expectation of a boost to economic growth and earnings from the tax plan and continued relatively easy monetary policy on the part of the Fed.

The MSCI Emerging Markets Index returned 37.8% on the year, the highest of the three major international indexes. This index received a boost from Chinese internet and technology stocks, such as Tencent and Alibaba, which nearly doubled in price on the year. China's total return of 54.3% led the rest of the world.

International developed markets, as measured by the MSCI EAFE Index, returned 25.6% as investors were encouraged by healthier European economies and balance sheets and higher earnings growth rates. Returns on selected developed markets country indexes include France at 29.9%, Germany at 28.5%, Japan at 24.4% and the UK at 22.4%.

At this point, US equities are more expensive than international equities in terms of price earnings ratios and dividend yield. US equities are also up 295% from their bottom in March, 2009, while international equities, as measured by the ACWI (All Country World) ex-US Index, are up 127% over the same time frame.

The S&P 500 sells at a price earnings ratio of 18.2 times 2018 estimated earnings and yields 2.0%, while the ACWI ex-US Index sells at 14.3 times and it yields 3.0%. That being said, the standard deviation of returns of international developed market indexes and emerging market indexes is also higher at 18.4 for the EAFE and 23.0 for the Emerging Markets vs. 14.5 for the S&P 500, so a bit of a discount is to be expected.

We should also note that returns on international investments get a boost from a weakening dollar, and the US dollar declined over 9% in 2017. At this point, the consensus view is for the rout in the dollar to continue, in spite of the fact that the Fed will be raising rates and dollars will be filtering into the US economy from the tax plan. If the consensus view is wrong and the dollar rebounds from here, this would be negative for returns this year on several asset classes, including commodities and international developed and emerging market stocks.

2017 was an amazing year in the markets in many ways. One of the biggest surprises in the stock market last year was the extremely low volatility in global markets we saw throughout most of the year. This is certainly not what had been expected as the year began.

This low volatility in global markets occurred throughout the year in spite of plenty of headlines that would normally have caused markets to jump wildly. Investors focused on the fact that the major central banks were still providing support for eq-

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uities through quantitative easing and low interest rates. This, and the first synchronous global growth seen in a very long time, encouraged investors to continue to invest in equities, both domestic and international. While earlier in the year markets had seen some bouts of volatility surrounding hurricanes Harvey and Irma, the missile launches by North Korea, and terrorist attacks in Europe, by the fourth quarter volatility was much more subdued. The Cboe Volatility Index (VIX) closed out the year at 11.04, near its historical low, and it closed on January 4, 2018, at 9.22. Just as a point of reference, this index briefly spiked above 40 in late 2008 and again in 2011.

When we look at possible surprises in 2018, one of them could be an unexpected return of inflation.

For the time being, investors continue to believe that given a synchronous global economic expansion, rising earnings and accommodative financial conditions in the capital markets, there remains value in stocks, and they are buying without worrying too much about what could go wrong. At the head of the list of what could go wrong is some kind of geopolitical event involving North Korea or perhaps Iran. We cannot plan for this type of event. These fall under the heading of wild cards.

Another surprise in 2017 was the strength seen in bonds. As we entered the year, many investors predicted that bonds would decline in value as the Fed raised interest rates, as tax cut plans were hashed out, and as the economy strengthened. However, two groups of buyers continued to buy bonds in spite of these concerns. These were foreign investors, whose home country yields are much lower than those available on US Treasuries, and aging baby boomers, who like the returns and perceived safety of bonds in general, and US Treasuries in particular. The 10-year US Treasury, the Barclays Capital Aggregate Bond Index, and the JP Morgan Emerging Markets Bond Index returned 2.14%, 3.54%, and 9.32%, respectively on the year.

When we look at possible surprises in 2018, one of them could be an unexpected return of inflation. We noted in our last View from the Top that inflation has been running lower than it should be at this point in the economic cycle. That was before the tax plan was passed which will be providing a fair amount of fiscal stimulus to the economy. The risk now is that the prospect for a return of inflation is being underestimated.

Stocks can still do well with moderate inflation since corporations can raise prices which allows earnings to rise. Bonds, however, do not do so well as they are a "fixed income" investment. So, while some inflation might be a good thing, signaling that the economy has sufficiently strengthened so that prices can, at long last, go up, it tends to benefit

stocks much more than bonds.

The tax plan itself is a wild card. This plan was put together quickly and without a lot of vetting or consultation. With a cut in the corporate tax rate to 21%, earnings per share for the S&P 500 have already been marked up to $145 for 2018, and stocks have continued to rise given this bump. What is concerning is the unintended consequences that will become clearer once the plan is actually in place. This will take some time since we are just beginning to review the impact on corporations and on individuals in 2018 and beyond.

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Finally, we noted in the last View from the Top that individual investors were not yet overly bullish. Well, that has now changed. The American Association of Individual Investors (AAII) Survey for the week ended January 4, 2018, indicated that the percent of respondents who expected stock prices to climb over the next six months was at 59.8% (historical average is 38.5%). AAII members who were neutral on stocks stood at 24.7% (historical average is 31%), and those who were bearish stood at 15.6% (historical average is 30.5%). That certainly sounds bullish!

We continue to monitor the economy and the financial markets based on the increases in value. We do expect a pullback driven by profit-taking and/or some macro event sometime in the near term. But the bottom line is our crystal ball continues to be a little foggy right now. We credit the crazy snow cyclone or whatever we called that insane weather last week.

So stay tuned because things can change very quickly in this world that seems to be driven more and more by the constant barrage of social media.

Here are a couple of great questions from some of our clients. Let us know if you have one you would like included.

Question: ***Should I be investing in Bitcoins? Everyone seems to be making money on them.***

Answer: The quick answer to this question is no, but there is a lot of information and misinformation out there on Bitcoin and the many other new cryptocurrencies. I have read many different articles, including the original White Paper, to make sure we have a solid understanding to answer questions like this one. In my research I ran across a blog post that does a much better job of explaining Bitcoin than I could do. Here is the blog post written by a young man who goes by the name **The Unassuming Banker** and provides an excellent discussion around the value or lack of value within this cryptocurrency universe. We thank

him for giving us permission to share it with you.

What is Bitcoin actually worth?

UnassumingBanker.com
Facebook: UnassumingBanker
Twitter: @UnassumingBnkr

Lately it's hard to go a day without someone asking me a question about Bitcoin. What is it? Why is it so valuable? Should I buy some? How do I buy some? The guy down on the corner in the pawn/gold exchange shop said he can buy me one (yes, this is actually happening!).

It seems Bitcoin and the crypto-currency craze has truly reached the mainstream and the implication of that are as of yet unknown. What we do know is that it's attracting every shady crook and scam artist in the world. And why not? There really is tons of money to be made. I hope the following sheds some light on what Bitcoin is and isn't.

Blockchain

Let's start our discussion with the technology which made Bitcoin possible called "blockchain". In very simple terms the blockchain technology is a record of all transactions ever done in Bitcoin. Imagine a gigantic piece of paper that lists every transaction ever completed. Then imagine that there are thousands of copies of this paper, and all of them are automatically updated when any two people agree to exchange Bitcoins. Every time a transaction takes place all these copies are checked for consistency to make sure you actually have the Bitcoins you claim to have. If everything checks out the new transaction is added to all the pieces of paper at once.

This is the heart of the truly genius idea that is blockchain, and it is what it makes it possible to have certainty over a Bitcoin balance someone owns, without needing any central party (like a bank) to verify it. If all the pieces of paper agree then the balance is correct, and trying to doctor or fake all the pieces of paper at once is impossible. The best (and worst) thing about this technology is that it has been made available for absolutely FREE to anyone who wants to use it.

Bitcoin is simply the oldest known use of the blockchain technology. Someone, a long time ago (in technology terms), decided to create a coin called a "Bitcoin" using blockchain and started trading it with other people. This was quickly picked up by all types of criminal and illegal activity providers as a way to exchange money without having to go through a bank. Fast forward a few years and everyone and their mother wants to own one because they saw it on TV.

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Cryptocurrencies or e-coins

The best (and worst) thing about blockchain technology is that its FREE, which means anyone can create a coin out of thin air, name it whatever they like, and start using it to trade with other people. It quite literally takes less than 24 hrs to do so for someone with mediocre tech skills. The only difficult part is convincing suckers, err sorry, I mean lovely people, that the coin you created is worth something. This simple fact has led thousands of scam artists throughout the world to create their own coins and sell them to unsuspecting retirees and "I wanna get rich quick" targets.

You may have heard there is a limit to the number of Bitcoins that can be created and therefore the supply is limited, which is in turn used as a justification for its price. For a number of technical reasons this is true, however, there is absolutely no limit to the number of cryptocurrencies that can be created. Have you heard of Bitcoin Cash? How about Bitcoin Gold? Bitcoin Silver? Ethereum? Litecoin? There is an even a Dogecoin, as in Doge-coin. Yes I am NOT kidding. Google it. It was created as a joke and it now has a 700 million dollar market cap.

Yup, they all exist, 1,365 different coins as of last count, and thousands more will be created as long as people are willing to throw real money at them. So much for the "you can't make more of it!" argument.

Intrinsic Value vs. Market Value

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Market value is simply determined by the difference between supply and demand. If the demand exceeds supply at any point in time then the price will go up and vice versa. You can easily observe this in the "wild" each Christmas. A few years ago it was the PlayStation 4 (PS4) that was bought up by "investors" and re-sold at ridiculous premiums to desperate guilt-riddled parents wanting to make up for not being around all that much. The PS4's sticker price was $500 but on eBay they were selling for well over $2,000. The demand for PS4s far exceeded supply during that Christmas season time period.

Fast forward to 2017 and PS4s are on sale for $299.

Has the PS4 changed since that $2,000 Christmas? Does it provide 10 times less value to its owners

now than it did back then? Is it no longer able to play games or access Netflix? Does it have fewer games and less accessories? The answer is of course a big fat NO. So why is it so much cheaper? It's because fewer people are competing to buy a far larger supply of PS4s on the market. The PS4's market value has changed drastically but it's intrinsic value has moved very little.

Gasoline has intrinsic value because you can burn it to move your car. In turn your car has intrinsic value because it can move you from place to place. Your stock holdings have intrinsic value because they are expected to eventually pay you dividends. Your home has intrinsic value because you can sleep in it and it can keep you warm and dry. Your dollars have intrinsic value because the government guarantees you can pay taxes and buy government services with them.

The intrinsic value of anything is simply the tangible value it provides and may or may not equal the market value at any one time. A good way to think about intrinsic value is as a floor to the value of any object. If the market value falls below that floor, enough people will simply choose to use the object rather than sell it, since they get more value out of keeping it. This in turns reduces supply and increases price back up to intrinsic value.

If there is a sudden interest in a product, market value often goes far above the intrinsic value, and then settles back down once the hype dies down. Thus financial bubbles of all kinds are born.

In some cases calculating intrinsic value is fairly easy (bonds, loans, mortgages, investment real estate) and in other cases it's much harder (new technologies, your own home, time spent with family).

The good news is that calculating the intrinsic value of Bitcoin is extremely easy!

Let me get my calculator out…. Drum roll please…… It's exactly….. $0!

It's essentially the same thing as printing your own fraud-proof monopoly money. Should people stop wanting to buy your monopoly money, the only intrinsic value it will have is a certain bathroom function, which is still more than you can do with an e-coin.

Coins vs tech

Normally investors disagree on the intrinsic value of something and bring up arguments such future potential of a technology to justify

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various valuation. However, remember, Bitcoin is NOT a technology, it is an electronic piece of paper with transactions listed on it. Just a bunch of 1's and 0's in a bunch of computers backed by absolutely nothing. Blockchain itself is a very valuable technology freely available to anyone, however, you are NOT buying blockchain when you buy Bitcoin, you own none of the tech behind it.

To illustrate imagine that someone had found a cure for cancer and posted the step-by-step instructions on how to make it on-line, freely available for anyone to use. Now imagine that the same person also created a product called Cancer-Pill using their own instructions, trade marked it, and started selling it to the highest bidders. I think we can all agree a cure for cancer is immensely valuable to society (blockchain may or may not be, we still have to see), however, how much is a Cancer-Pill worth?

Initially, with no one else making cancer curing pills, and people hearing about the trade-marked name, it's very likely the profits would be quite large and the price of the pill ridiculously high. However, as the money flows in, another person would without a doubt create a pill using the same freely available instructions and call it Cancer-Away. Cancer-Away may not initially be as recognizable as Cancer-Pill, so it might fetch a smaller price, but eventually both prices would converge as they are essentially the same thing. Over time, with more and more cancer curing pills with different names arriving on the market, the price of all of them would converge to something very close to the cost of production (ie. materials + time to make it). I think we can all agree this is a good thing, as it means the maximum number of people will be able to cure their cancer at the lowest possible price.

How does this apply to Bitcoin? Well, Bitcoin is simply the initial Cancer-Pill, but as mentioned above there are now 1,365 different "pills" in production and counting. While creating a cancer pill, even with step-by-step instructions, would require some materials, equipment and incur some costs, the production of a random generic e-coin costs pretty damn close to $0. All you need is a website and some hype.

The bottom line is that while a cancer pill is very valuable, it would not be a good investment to buy up the pills for far above the cost of making them, if the formula for making them is freely available to

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anyone. Similarly buying Bitcoin, or any other e-coin, is a bad investment even if you truly believe block-chain technology will change the world.

It's amazing to see all these coins get created and their "inventors" claiming theirs is for some reason a slightly better version of blockchain, and then selling you the damned coin instead of the supposedly superior tech! Next time you see one of these guys on TV notice how deftly they switch between the term "coin" and "blockchain" creating an illusion that it's all the same thing. Believe me these people know exactly what they are doing.

<u>So is it all just a giant pile of poop?</u>

No, not at all, the technology used in creating Bitcoin is great. However, at this time, I'm not aware of anyone offering a good practical use for it. The problem with the current crop of e-coins and blockchain applications is easy to illustrate.

Imagine for a second a world where only Bitcoin exists and you are going to buy some milk. What would be the price printed on that milk carton?

1 BTC? Or 1.5 BTC Or 2 BTC?

Aside from the fact that, at current prices, this would be some seriously expensive milk, the answer is that no price could be printed. That's because if a price was printed, a poor grocery employee would have to sit there with an eraser and pencil, and every minute or so change the price. And then by the time you got to the cash register, the price would have changed again.

The point is that a real currency's primary "intrinsic" value is as a medium of exchange or a measuring stick for value. If a centimeter or inch on a measuring tape was constantly changing in physical size, it would not be particularly useful to ask for a 6 inch sub. It might end up being the size of an airplane.

The thing that makes cryptocurrencies such a speculative craze right now, their stratospheric increases in value, is also the reason the current crop will likely fail in their intended use as currencies. However, out of the ashes of that, it's likely that a new use of blockchain will emerge. The decentralized fraud proof ledger might be used to keep track of balances in another exotic currency called the Canadian or US dollar or Euro.

On that note, if you still want to invest in e-coins, I would like to invite you to buy my brand new UB coin for only $1 per coin. I

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don't have blockchain up yet, but I'll keep track of all your purchases in my Excel, and the second I hit 2K I'll spend the 2 days to get the blockchain up and running. It's your opportunity to get in on the ground floor before it's worth $10,000 per coin!

Ahhh, sometimes I wish I had looser morals….

This allows you to take advantage of itemized deductions during certain periods of time but can create challenges in terms of having the dollars available to make the larger than normal contributions.

Question: ***I have heard discussion about bunching or bundling your itemized deductions to get more benefit under the new tax law. What does bunching your deductions really mean and why would it make sense for me?***

Answer: Excellent question and one we have been discussing a lot since the new Tax Bill was passed and signed. The first part of the answer is in terms of how some folks that were able to itemize deductions prior to 2018 may now be better served by taking the standard deduction. This is due to several changes that have taken place including the increased standard deduction and the $10,000 limit on the deduction for SALT or State and Local Taxes.

The standard deduction under the Tax Cuts and Jobs Act nearly doubles to $12,000 for singles and $24,000 for married couples who file jointly while eliminating personal exemptions. If your average itemized deductions are less than the new standard deduction, bunching may be helpful in certain years. An example would be doubling your charitable deductions in one year so that your itemized deductions are higher than normal. The next year you would take the standard deduction. There has been much discussion about charitable funds to help individuals accomplish this bundling. With a fund you can make several years' contributions and then distribute the funds to charities of your choice over time.

This allows you to take advantage of itemized deductions during certain periods of time but can create challenges in terms of having the dollars available to make the larger than normal contributions.

Lassus Wherley News

It is with mixed emotions that we announce that Robin Rabin retired at the end of last year. Robin joined Lassus Wherley in February of 1995 as Executive Assistant to the firm's President. She was promoted to Office Manager six months later. In 2003, Robin was promoted to Director of Sales, a position she held when she retired in addition to her role as Executive

Assistant. Before joining Lassus Wherley, Robin was Manager of Administrative Services in the Customer Service Department of an environmental firm.

In addition to her official responsibilities, Robin on numerous occasions arranged for luncheons during company meetings and holiday celebrations. She was also known for bringing in impromptu goodies, including her pistachio cake, that she made for her coworkers for St. Patrick's Day. We will definitely miss the pistachio cake but more importantly we will miss Robin and wish her many years of health and happiness.

Keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term.

We recognize the uncertainty surrounding us today, and we know that the world is changing very quickly.

So please let us know if you have questions we can answer for you or concerns we can help you address.

And remember to practice that deep breathing when the world starts to get to you. And for the golfers it can be a really good time to go out and hit golf balls, which is my favorite way of reducing stress.

Stay warm and try to enjoy this crazy winter!

Diahann

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