July – August 2019

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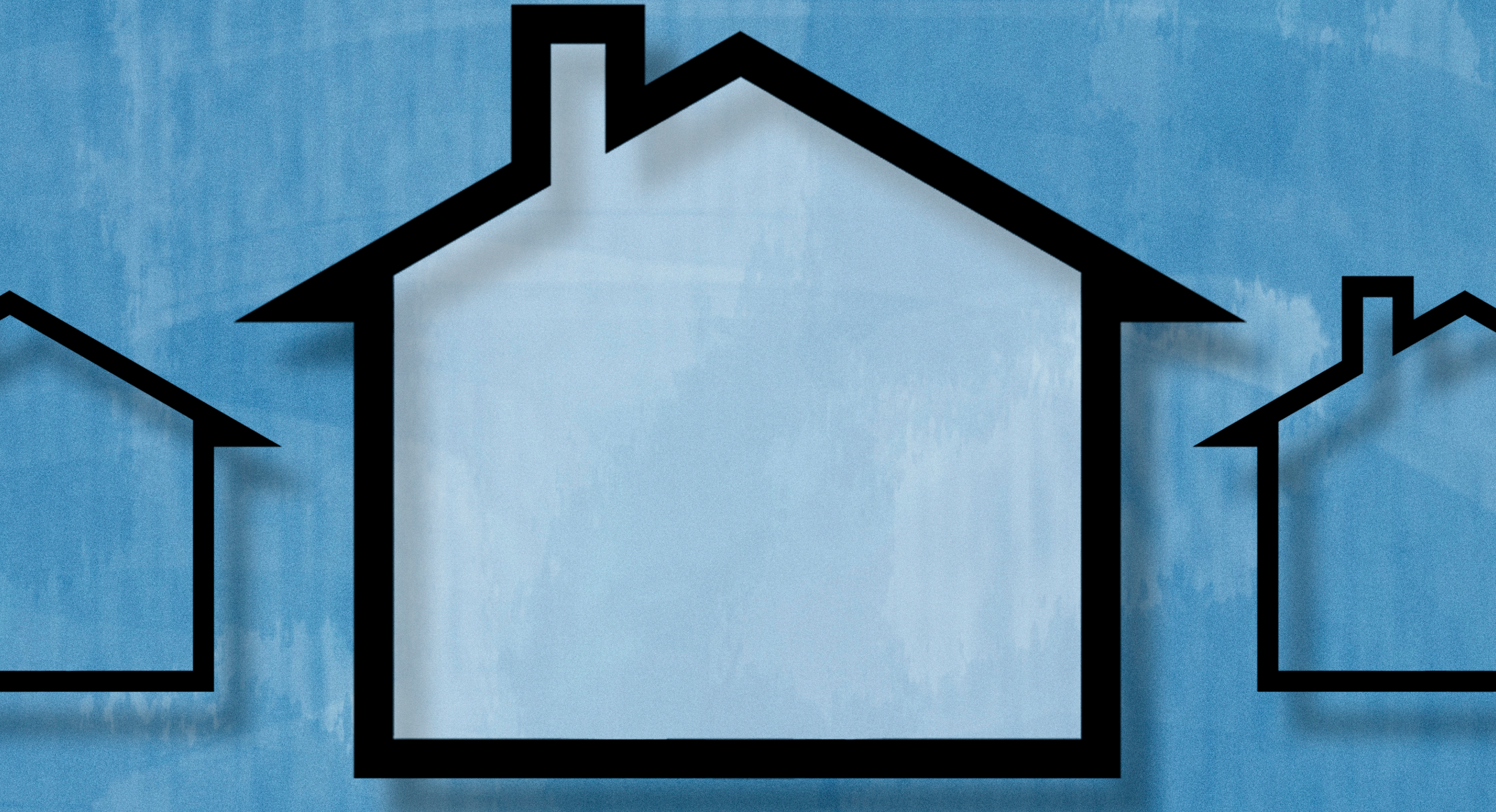

YOUR HOME

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Federal Reserve Is Expecting Winter In July

Dear valued clients and friends,

Last February, St. George, Utah had its biggest snowstorm in 20 years. Nearby, Zions National Park closed. Local schools did a late start. Motorists on the freeway were asked to use snow chains. The storm total? 3.8 inches! So, not that much . . . if one is prepared.

Without a doubt, the greatest risk in such a situation is overconfidence. The same could be said about investing. And even though it is summer, the Federal Reserve is going to start spreading salt on the roads for wintery conditions.

As I write, the Fed is preparing for its 5th meeting of 2019, which will be held July 30th–31st. The overwhelming majority of experts believes the Fed will lower interest rates for the first time in a decade. It would do this to encourage greater borrowing and give the economy a boost.

Celebrating a rate decrease this July is like increasing your speed on a sunny day while the snowplow drivers are starting their engines. Why are the plows heading out?

The U.S. economy has been growing at just over 2 percent for a decade. Tax cuts provided a short-term bump, but it looks like the growth is headed right back to the 10-year trend. That's not so bad, but it has the Fed nervous.

If the Fed lowers rates at the end of this month, it is sending a signal to the rest of us that the experts believe there may be some rougher weather ahead. They will be dropping the salt on the roads in anticipation. Only time will tell how the forecast and driving conditions will change.

Are you driving too fast for the conditions with your investments? Stocks and bonds have been wildly positive this year, which has some investors too excited. Most of these gains just brought market prices back to where they were before a negative overreaction last December. That drop has had a lasting impact on how most investors feel. In other words, the market data is neither hot nor cold right now, but investors are too focused on one or the other. So, when it comes to your investments, I recommend going the speed you and your advisor decided on in your last review.

James

James R. Derrick Jr., CFA®
Chief Investment Strategist

Be Cyber Aware - Impersonators

Impersonation is the latest trend with cybercriminals. They are primarily imitating well-known brands such as Microsoft, Amazon, Apple, etc. The days of terrible-looking spam messages are mostly gone and have been replaced with carefully crafted emails to fool you into believing they're legitimate. You click and enter your credentials, and it's all downhill from there.

Make sure an email is valid before clicking links or opening attachments. If you're using an easy password or the same password on more than one site, you need to change them. If necessary, use a password manager.

Spiking the Punch Bowl

Why Federal Reserve Shouldn't Lower Rates, But Will Anyway

By James R. Derrick Jr., CFA®

I don't remember a time when people have been more worried about a recession than they are now. Even the Federal Reserve has been so cautious that it has painted itself into a corner. It plans to lower interest rates on July 31st even though there is little need to do so.

The Fed cuts rates in order to stimulate greater borrowing and spending. It believes that the economy may have peaked in 2018 and may only be growing by 1.6 percent right now (Federal Reserve Bank of Atlanta). That slowdown has the economists at the Fed worried. They have repeatedly implied they are looking to lower rates. Such action is likely to boost the economy by causing a domino effect in the interest-rate world–affecting everything from savings to mortgage rates.

U.S. Unemployment Rate

However, lowering rates now does not seem like the Fed's "style." Justin Lahart, a writer for *The Wall Street Journal,* summed up the current situation with the Fed nicely:

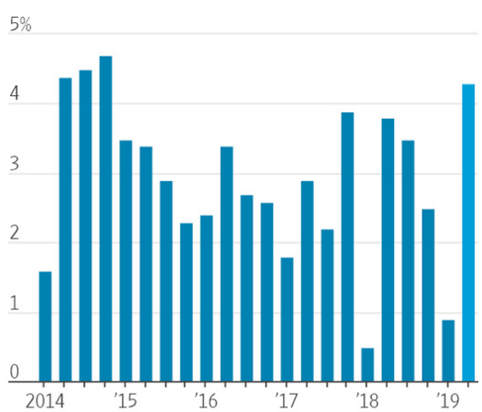
"William McChesney Martin, the Fed chairman in the 1950s and 1960s, quipped that the Fed's job is 'to take away the punch bowl just as the party gets going.' Today's Fed plans to spike the punch instead."

However, ignoring expectations of a rate cut after the Fed members have been so vocal in favor of such action could be shocking. So, it is possible that the Fed will make a change in July while emphasizing all the positive things going on. That would communicate to investors that more rate cuts are unlikely unless the data changes.

The Fed was created in 1913 in order to make this nation's financial system more stable and more flexible. It seeks steady prices (inflation) and high employment. Right now, we have both. Inflation is currently at 2 percent–a goldilocks number that is neither too hot nor too cold. Unemployment is at 3.7 percent, which is the lowest level since December 1969.

So, what is the Fed so worried about? U.S. manufacturing is going through a slump. According to Morgan Stanley, new orders for U.S. goods are at their worst levels in 5 years, and they are trending down. It should be mentioned that manufacturing represented just 11 percent of the U.S. economy in 2018.

Change in consumer spending, at an annual rate



Note: 2Q 2019 is estimated
Source: Commerce Department (historical data); Macroeconomic Advisers (estimate)

American consumers, we drive nearly 70 percent of the U.S. economy. According to the Commerce Department, our spending jumped by 4.3 percent in the second quarter of 2019. That is being helped by a rise in wages, which just bounced higher. The Federal Reserve Bank of Atlanta estimates that over the last year, wages have risen by 3.9 percent.

There may be some extra gyrations in the stock market as investors try to forecast the Fed. Hang in there. The good news, according to Ned Davis Research, is that if the Fed does lower rates and the economy turns out not to need it, the stock market has historically done well. SfS

Don't Burn Down The House!

By Mikal B. Aune, CFP®

A home is the largest asset for American households, surpassing retirement accounts, vehicles, and other assets.[1] For 30 percent of households, their home is their only source of wealth.[2]

Unfortunately, many people don't have a plan to protect their homes after they pass away. This can leave their home open to probate expenses, creditors, and other issues that may burn down the value of their home. To protect your home and most effectively pass it on to your heirs, consider the following issues and options.

Many people mistakenly think that having a will can protect their home. It helps control who benefits from the house and in what manner. However, even if a person has a will in place, his or her home must still go through probate after they pass away.

For a couple, that process would take place after the second spouse passes away. As the home goes through probate, there can be significant expenses, and the value of the house will be on the public records.

In an attempt to avoid probate, some people will mistakenly add on a child as a third joint tenant. However, this can have devastating tax implications, as the child will be deemed to have been "gifted" the home and inherit the existing cost basis.

For example, if the parent(s) bought the home for $50,000 and it is worth $250,000 at the time of the parents' passing, the child will have to pay tax (when selling the home) on the gain of $200,000. That would be roughly $40,000 in taxes at a 20 percent long-term capital gains rate. The couple would have been better off to leave the home in their name; then it would at least get a step-up in basis, where the heirs would only pay taxes on any gains above the $250,000 upon selling.

There are two better options to address these issues and still get a step-up in basis.

Transfer On Death Deed (TODD)

The first option is to create a TODD and file it with the county recorder.[3] The TODD has only been an option since May 8, 2018, when Utah enacted the "Utah Uniform Real Property Transfer of Death Act." Previously, Utahans didn't have a cost-effective method to transfer a home to their heirs.

Now an individual or couple can list beneficiaries that will inherit the home, thus avoiding probate and keeping the value private. It will allow the inheritors to get a step-up in basis, and to file a deed with the county recorder's office only costs $40.

However, a TODD has some potential issues:
(1) A home inherited through a TODD cannot be sold for one year unless the personal representative files probate, which negates the original purpose – avoiding probate.
(2) The TODD may violate transfers to minors' laws, and creditors of the beneficiary can take away the inherited property. Both Salt Lake and Utah County recorders' offices recommended speaking with an attorney before creating a TODD (reducing the cost-effectiveness).

Trust

A trust may bring you the most control while keeping the value private. Like the TODD, a trust allows the property to get a step-up in tax basis. Plus, the trust can hold a property for a minor, protect it from creditors, and provide flexibility to sell immediately. It should be created through an estate-planning attorney, and the home must be re-titled in the name of the trust. This is more expensive than a TODD, but usually costs less than probate. It may also save a lot of headache and heartache.

SFS and its employees do not provide legal services; therefore it is important to coordinate with your attorney regarding your specific situation.

Sources: (1) https://www.nahbclassic.org/fileUpload_details.aspx?contentTypeID=3&contentID=215073&subContentID=533787&channelID=311
(2) https://www.financialsamurai.com/percentage-wealth-outside-primary-residence/
(3) https://accesssaltlake.com/p468/transfer-on-death-deeds-now-provided-under-utah-law/

A New Housing Paradigm

By Sharla J. Jessop, CFP®

Since the housing crisis and recession of 2008, the American dream of homeownership has changed. Younger generations are weighing the benefits of owning their own home with the freedom that renting provides–flexibility to move for work and to avoid responsibilities and expenses that come with ownership. Plus, they are weighing the additional amenities that can be enjoyed from some rental communities: pool, fitness center, dog park, common use areas, etc.

Aging boomers are also considering changes. They are also interested in reducing responsibility, as well as downsizing their homes. Having someone care for the lawn and shovel the snow is enticing. Not to mention the fun of living among neighbors near their own ages.

5 things to consider before purchasing a home:

(1) Your monthly mortgage payment should not equal more than 28% of your gross monthly income. This includes principal, interest, taxes, and insurance.

(2) Avoid mortgage insurance. It does not benefit you. You can do this by making a down payment of 20 percent or more. If you can't put down at least 20 percent, then once you have 20 percent equity, check on removing the mortgage insurance.

(3) Plan for extra expenses! If your home is new, this will include window coverings, appliances, and landscaping. If buying an existing home, plan on costs for updating and fixing known and unknown problems.

4) Keep the loan term as short as possible without financially boxing yourself in. A 15-year mortgage should have a lower rate than a 30-year mortgage. Always try paying extra principal each month.

(5) Keep money available for emergencies in a dedicated savings account. Using a credit card or a loan for emergencies will compound your problems.

5 things to know before downsizing:

(1) Ask yourself if your current home can be modified or updated to accommodate your needs as you age. You can always pay for someone to care for the yard.

(2) Increased demand for patio-style homes and planned living communities has driven up the prices. You may find that selling your large home to downsize may not be worth the price.

(3) Determine what you want. Some retirees want to be close to family or need a place to host family. Others are looking to get away or want an adult community.

(4) Understand the additional costs of Home Owners Association (HOA) fees that cover the services, upkeep, and common areas. Get a copy of the HOA contract and consider asking about its current financial condition.

(5) Protect your retirement. Avoid debt. Remember, using savings to purchase a retirement home may create future liquidity problems.

Don't Bite off More than You Can Chew

How Much Home Debt is Too Much?

By Leah Nelson

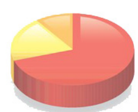
You've decided to buy a house. Congratulations! Now, what? How do you know how much home you can afford? The last thing you want to do is take out more debt than you can handle. Remember, lenders will approve you for a loan with payments much higher than you should ever pay on a monthly basis! It's up to you to know how much you can really afford.

Flexibility

Consider your budget. Are vacations a priority? What about other interests and goals? You need to keep your monthly debt payments under 36 percent of income, so you have the financial flexibility. (Sharla's recommendation of 28 percent on page 5 was for housing debt only, while the 36 percent is for total debt.)

Interest Rate

Something else that will affect your budget is the interest rate on your mortgage. Even a small change in interest rates can significantly impact how much you can afford. If interest rates go up, or your credit history is a little rough, you won't be able to afford as much home since you will have to pay more in interest.



Total Debt

Your monthly mortgage expenses and all other debt payments should not exceed 36 percent of your gross monthly income. Add your potential mortgage payment and other debt payments (car loans, credit card debt, student loans, etc.) together, then divide by your before-tax monthly income.

For example, if John is considering a housing payment of $1,800 (including mortgage, insurance, property taxes), a car payment of $300, and a student loan payment of $150, that would equal $2,250. Divide by his $6,500 monthly, and we have the percentage. These fixed expenses would be 34 percent of John's gross income (under 36 percent, so he should be in the clear).

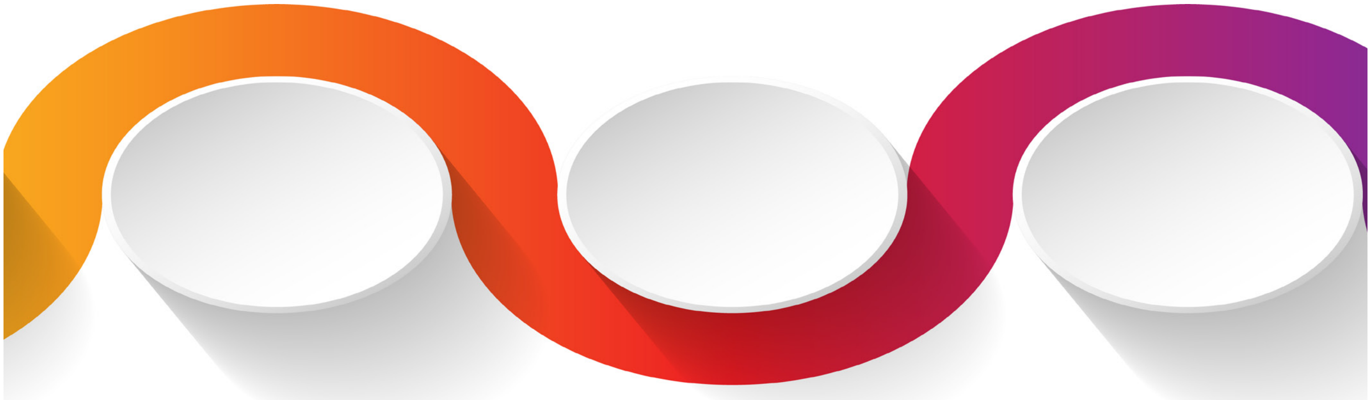
Monthly Payment

To get the price of a house you can afford, search for a mortgage calculator online and plug in the numbers. Going back to my previous example, we determined that John could afford a mortgage payment of $1,800 per month. If he gets a 4 percent interest rate and has $20,000 for a down payment and closing costs, with a loan of 30 years, he could afford a home that is around $285,000.

Down Payment

The amount of your down payment will also factor into how much you can spend on a home. The more expensive the house, the bigger down payment you will need. The bigger your down payment, the less your mortgage and payment will be.

If you have a 20 percent down payment, your monthly payment will be much less since you won't be required to have mortgage insurance.



The Recession Obsession

By Jordan R. Hadfield

Over the last 18 months, I have heard more, read more, and been asked more about recession than any other financial topic. Many people were scarred by the great recession of 2008, and fear similar suffering may be coming. I understand the concern, but is this recession obsession helping investors reach their financial goals, or is it inadvertently hurting portfolio returns?

Misbehavior motivated by fear of downturn is far more costly than the downturns themselves, and that includes the great recession of 2008. When it comes to investing, we are truly our own worst enemy.

The economy cycles through phases of growth, peak, recession, and trough. Then it repeats. On average, a recession comes every 5.6 years and lasts 11 months.

Too much of a good thing?
Economic positives often turn into financial imbalances that are so excessive they need to be corrected (tech stocks in 2000, housing in 2008). When balance is restored, business and people should get back to normal and economic growth will turn positive again. This makes recessions, in hindsight, like relatively small speed bumps on the economic highway.

When is our fear of recession damaging?
The recession obsession can cause investors to try to avoid losses by sitting on the sidelines. Nobody knows when the market will drop or how far it will fall. Likewise, the upward bounces catch those sitting out by surprise. That's why the best days in the market typically follow large pullbacks.

Since 1980, investors that stayed in the market 99.9 percent of the time and missed only the best five days would have missed out on a massive 35 percent! Increase the best days missed to just ten, and returns are cut in half!

What about the best days? Since 1998, six of the ten best days occurred within two weeks of the ten worst days. Thinking you can get one while avoiding the other is not reasonable.

As we enter the 11th year of the current economic expansion, it is helpful to know that some of the strongest market increases have occurred during the late stages of the cycle.

Those who avoid the market under the pretense of protection inadvertently keep themselves from receiving that potential growth. Investors who stay fully invested through entire cycles, including recessions, experience greater growth.

The best advice I can give, for your portfolio and your sanity, is to create a financial plan that works for you. Stick to that plan and don't worry too much about economic cycles. The financial plans we create for clients account for pullbacks, downturns, and recessions. Although every year in the market won't be positive, your long-term outlook will be.

(Secret recession tip: After the stock market has dropped significantly, it's usually better to buy than to sell; think of it as a long-term buying opportunity.)

Your SFS Team

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