October 2017

The Capstone Quarterly

Fall is upon us and we hope you all are enjoying a nice change of pace as we head toward the holiday season. While there was certainly no shortage of exciting news this summer, the financial markets seemed to take things in stride. Most noticeably, in our opinion, was the Dow Jones Industrial Average and S&P 500 hitting all-time highs. How much longer can the run up last? In this newsletter Bryce discusses President Trump's potential windfall and how the financial markets could be impacted. Casey writes about the Equifax data breach and steps you can take to try and protect yourself. Jon reviews some ideas on how to teach kids about money. And we wrap with a reminder about required minimum distributions (RMDs) for retirement accounts, end of year retirement plan contributions, and who to contact about your money managed by Capstone Pacific in case we are hit by a natural disaster here locally.

Bryce's Point of View

-By Bryce Pease, CFP®, Chief Investment Officer

"Trump's Potential Windfall"

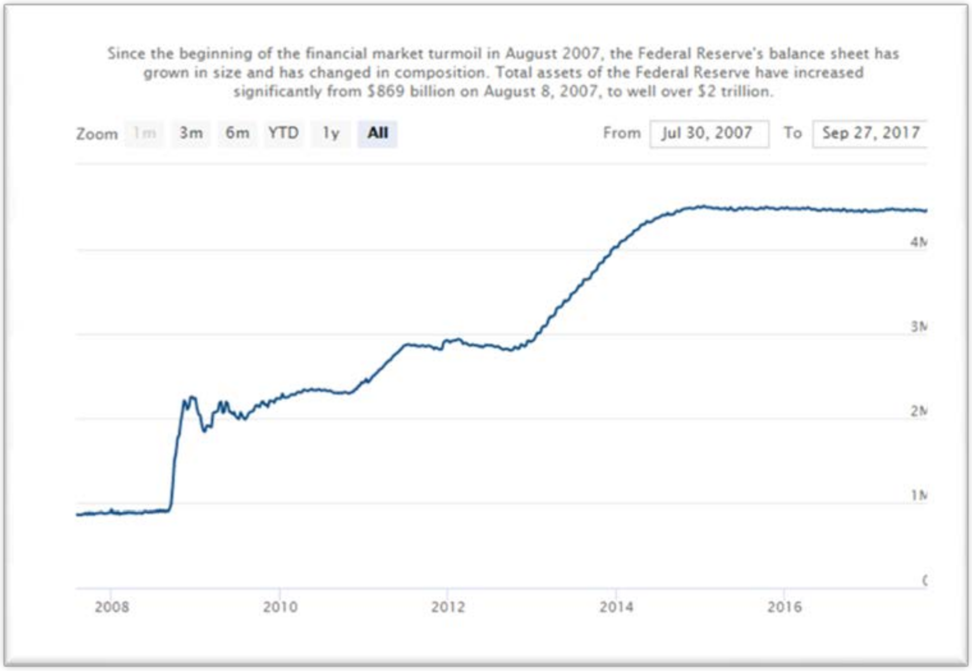
Politicians make big promises. President Trump is certainly no different. Of all the things he has promised to do, one of the things that actually might be more financially within reach than might be expected is his plan to spend 1 trillion dollars on infrastructure.

This isn't a political commentary. Nor are we saying we agree or disagree with President Trump's infrastructure plan. What we think is worth pointing out in this article are the potential investment implications if President Trump follows through with his big promise to spend 1 trillion dollars "rebuilding America's infrastructure." (1)

But where is he going to get the money? President Trump intends to lower taxes, so the additional money can't come from new taxes.(2) What's more, our national debt continues to pile up. The national debt just went past $20 trillion dollars for the first time ever—that's $125,000 per household. When you add in Social Security and Medicare, the total is more like $103 trillion dollars, or $800,000 per household. Some economists estimate the total debt to be even more. And politicians don't seem to have any intention of bringing spending under control. For the first 11 months of the fiscal year ending on August 31, 2017, the federal government took in just under $3 trillion and spent more than $3.6 trillion. That's a $600 billion dollar (approximately) deficit. These numbers are staggering and mind numbing. (3) But even with lowering taxes in light of the national debt and out of control government spending, we think President Trump just might find himself in a position to receive a financial windfall that could allow him to follow through on his promise of infrastructure spending. And he had nothing to do with why he is in this position. It all goes back to the financial crisis.

In March 2009, in the depths of the financial crisis, the Federal Reserve started taking measures to try to stimulate the economy. The Federal Reserve created money out of thin air with the stroke of a computer key, and began buying up mortgage backed bonds and Treasury bonds. Part of the Fed's theory is that by injecting newly created money into the economy, this is supposed to jump start economic activity. Whether or not this helped or hurt the situation is a topic for another article.

Total Assets of the Federal Reserve



Prior to the financial crisis, the Federal Reserve owned $800 billion worth of bonds. Now, thanks to money printing to purchase bonds, the Federal Reserve owns over $4.5 trillion of bonds.

Just to reiterate, the Federal Reserve has printed money and purchased bonds that now sit on their balance sheet.

Source: www.federalreserve.gov

The way the Federal Reserve does this is one sided accounting. This is critcal to understand. When the Federal Reserve prints money and buys the bonds, there is no offsetting entry anywhere. The money the Federal Reserve uses to buy these bonds are not dollars created by business enterprise or labor, it is money the Federal Reserve creates through a stroke of a computer key to buy these bonds.

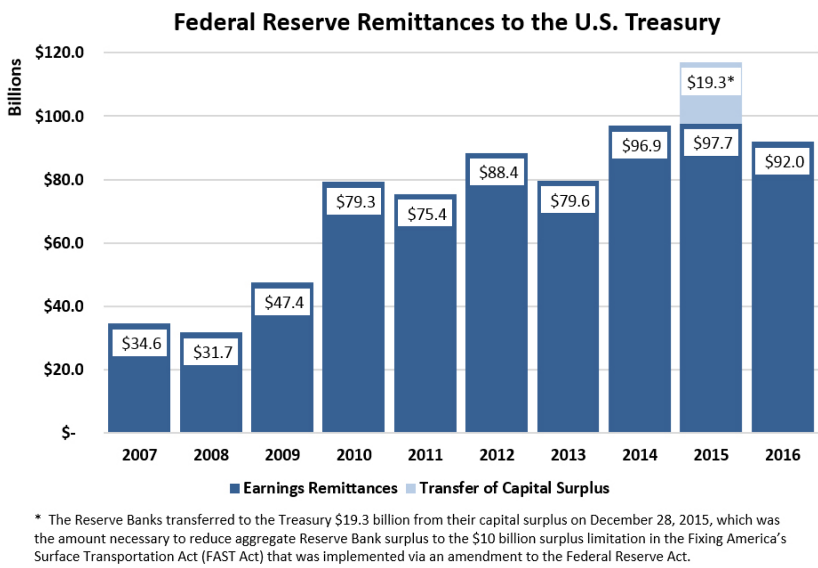
If this is hard to grasp, it should be. This is not the way most of us think about things. When we buy things, there is a corresponding activity in our bank account that removes the money from our bank account and transfers the money to the entity from which we made our purchase while we take possession of the item we purchased. Not so with the Fed, they just create money when they want to buy the bonds.

So here's what this all comes down to. The Federal Reserve is sitting on top of a mountainheap of US Treasury and mortgage backed bonds. The way bonds work is that they eventually are sold or mature, meaning they get redeemed for cash. Well, by law, the Federal Reserve is not able to hold cash, instead the Federal Reserve must send the funds directly to the US Treasury.

See how that works? The Federal Reserves creates money out of thin air to buy bonds. And when those bonds mature and are converted to cash, that cash goes straight to the US Treasury.

Now we could take a stab at paying off our debts with the proceeds from these bonds, but if history is any guide, getting spending under control doesn't seem to be in the cards any time soon. The funds coming due from these bonds is, in our opinion, going to get spent. And we think these funds could easily be used for President Trump's infrastructure spending plan. He's got a pretty penny to work with.

Consider the numbers.



Since 2009, the Federal Reserve has more than trippled the amount of funds being remitted every year to the US Treasury. Last year the Fed sent the US Treasury $92 billion and that was just the interest on the Fed's $4.5 trillion portfolio.

Just think what's going to happen when those $4.5 trillion dollars start to mature. That's right, you guessed it, those funds are going right to the US Treasury, which means these funds are going to end up right on the desk of the president.

Source: www.federalreserve.gov

In fact, over the next 5 years, by 2022, a little over $1.5 trillion of the $4.5 trillion dollar bond portfolio will mature, be cashed in and the proceeds remitted to the US Treasury.(5) The remaining $3 trillion of the $4.5 trillion dollar bond portfolio matures 5-10 years out, and beyond. If President Trump needs $1 trillion for infrastructure spending in the next 5 years, he's got it in the form of Treasury and mortgage backed bonds that the Fed purchased during the financial crisis that are maturing over the next 5 years.

So if President Trump does in fact use these proceeds for infrastructure spending, there are some potential investing implications we think are worth considering. There could be some sectors of the market, such as industrials, basic materials and transportation, that could benefit from infrastructure spending. Spending on infrastructure could have an impact on the financial markets overall as infrastructure spending could lead to more job growth, for the time being, which could be good for the stock market as that could mean more money going towards saving, spending and investing.

As we like to consistently remind clients, all financial markets cycle back down at some point, and this market will prove to be no different. We still have a down market strategy in place. But the course of economic, political and central bank events that have unfolded over the last decade across multiple political administrations, various economic situations and financial market conditions, appear to be coming together in a very interesting way that could add some more fuel to the fire to keep these financial markets going up, at least just a little longer, with certain sectors potentially leading the way. We'll see.

Casey's Corner

-By Casey Morris, CFP®

You've probably seen headlines like this over the past few weeks: ***Equifax Says Cyberattack May Have Hit 143 Million Customers*** *(6)*

Every year, it seems more and more companies are falling victim to hackers. Even large organizations like Verizon, Wal-Mart, and Target aren't immune. But the recent cyber-attack on Equifax is especially noteworthy. As one of the three largest credit-reporting companies in the United States, Equifax stores a lot of private information. In this case, names, addresses, birthdates, Social Security numbers and even driver's license numbers were stolen. Credit card numbers for about 209,000 people were also stolen.(7)

You may be asking yourself, "How do I know if I have personally been affected by Equifax's data breach?" Equifax has created a website, www.equifaxsecurity2017.com, where you can check if your personal information was involved. You can also enroll in a free credit-monitoring service provided by Equifax, which many experts recommend using. (8) If you decide to use the Equifax website, here is what the Federal Trade Commission recommends you do.

- Find out if your information was exposed. Click on the "Potential Impact" tab and enter your last name and the last six digits of your Social Security number. Your Social Security number is sensitive information, so make sure you're on a secure computer and an encrypted network connection any time you enter it. The site will tell you if you've been affected by this breach.
- Whether or not your information was exposed, U.S. consumers can get a year of free credit monitoring and other services. The site will give you a date when you can come back to enroll. Write down the date and come back to the site and click "Enroll" on that date. You have until November 21, 2017 to enroll.

But whether you choose to use Equifax's checker website or not, there are additional steps the government suggests you take:

1. Get a free credit report from www.annualcreditreport.com. Check for any accounts or charges you don't recognize.
2. Consider contacting your financial institution and placing a "credit freeze." This makes it harder for someone to open a new account in your name.
3. File your taxes as early as possible—before a scammer can. Tax identity theft happens when someone uses your Social Security number to get a tax refund or a job.
4. Don't believe anyone who calls and says you'll be arrested unless you pay for taxes or debt—even if they have part, or all, of your Social Security number, or say they're from the IRS.
5. Watch for signs of identity theft. Warning signs include withdrawals from your bank account you can't explain, failure to receive expected bills, and merchants refusing your checks.

Changing your online passwords and signing up for a third-party credit-monitoring service are also prudent steps. For more information, I recommend visiting www.identitytheft.gov.

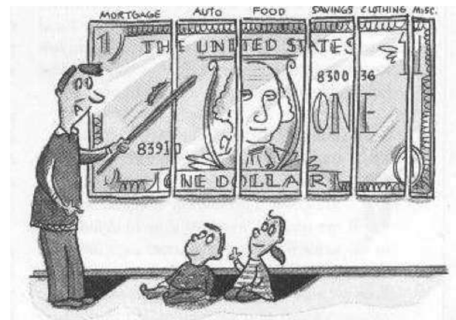
None of these steps are foolproof but by taking concrete steps to protect yourself, your identity, and your money, you make it much, much harder for hackers and scammers.

The Planning Perspective

-By Jon Teran, CFP®

"Teaching Kids About Money"

Maybe our country wouldn't be in its current debt predicament if politicians and central bankers learned better lessons about money as children. So for the sake of the future of our country, and for the well being of our families, I thought I would mention a few points to keep in mind when it comes to teaching kids, and grandkids, about money.



When we think about teaching, it's easy to think about the classroom setting, lectures or one way conversations from student to teacher.   Afterall, that's how we grew up learning in our school systems. But there are lots of teaching moments surrounding money that can happen in the real world.(9)

When it comes to teaching kids and grandkids about money, think about ways to teach money lessons in the course of everday life.

For example, help your kids and grandkids weigh the cost and benefit of every day small purchases. While it's always fun to spoil the kids, maybe next time they ask for a soda or ice cream, perhaps you can ask them if instead of buying them the treat if they would rather you put the money in their savings account (hopefully they have a savings account).

It's also important to set limits and restrictions. If your child or grandchild breaks something, don't just offer to replace it. Help them to understand the cost of the item and come up with a plan to replace the item—a realistic plan that helps them save and earn money.

Or maybe the next time your child or grandchild wants to buy a new digital device or video game system, go over with them how this purchase fits into the family's entertainment budget. Trying to help your kids understand the entire family budget (like the picture above) can be overewhelming. Instead it might help for them to understand just a portion of the budget, especially if there is a real life need or want they have that fits into that budget. Then come up with a plan of action and timetable to help them put together the funds. You could include birthday money, earnings from extra chores, and how much the parent or grandparent might be willing to chip in for the item.

These are just a few ideas to get the wheels turning on teaching kids and grandkids about money. The truth is, teaching kids about money has more to do with the parents than it does the kids. We love our kids and grandkids, and are suckers to make life easy for them. But sometimes, it is better for our kids and grandkids to use everyday opportunities to help them be better stewards of their money.

Did You Know?

Our hearts go out to those suffering from the recent hurricanes, tropical storms and earthquakes. We hope, too, that you don't have any friends or relatives who were in harm's way. If you do, both you and they will be in our thoughts and prayers. In the wake of these natural disasters, we find it important to remind you of Capstone Pacific's disaster preparedness. We have procedures in place to ensure we can reopen as soon as possible in the event of a catastrophe. We've also taken steps to safeguard all vital data, including data connected to your own finances. That way, we can continue helping you work toward your goals without having to start over. In the event of a natural disaster and we are unable to be reached by phone, TD Ameritrade can be contacted directly at 800-431-3500. We will also make every effort to update our website (www.capstonepacificinc.com) and Facebook page (search "@capstonepacific") with important information. We hope we never have to deal with a situation that calls for such action, but we believe it is best to be prepared.

Finally…

Please remember you are required to take required minimum distributions (RMDs) from your retirement plans if you are age 70.5 or older. You must factor in all your IRAs and retirement accounts when calculating your RMD amount for the year. You are also required to take minimum distributions if you have inherited an IRA—this applies to both inherited Roth and Traditional IRA. There are stiff penalties for not taking your RMD for the year so please let us know if you have any questions. We always recommend IRA owners consult with their accountant as they are in the best position to help calculate RMDs.

Another deadline coming up is for those still in the phase of making contributions to their retirement plans. While you have till the tax filing deadline in 2018 to contribute to Traditional and Roth IRAs for 2017, that is not the case for work based retirement plans like 401ks, 403bs, etc. You must make contributions by the end of the calendar year to have the contributions count for the current year. This would be something you discuss with your employer. Again, we recommend you also discuss this with you tax professional.

Thank you again for your business, we look forward to our next meeting or conversation with you.

Sincerely,

The Team at Capstone Pacific

P.S. If you ever run across anyone who could use our services, we always appreciate it when you pass on our name.

(1) "Trump's Plan to Rebuild America's Infrastructure." www.whitehouse.gov, June 8, 2017
(2) Julie Hirschfield David, Alan Rappeport, "Trump Proposes the Most Sweeping Tax Overhaul in Decades," *New York Times*, Sept. 27, 2017.
(3) Editorial "Will Congress ever tackle the national debt?" *San Gabriel Valley Tribune*, Sept. 24, 2017
(4) Press Release: Federal Reserve Board announces Reserve Bank income and expense date and transfers to the Treasury for 2016. www.federalreserve.gov, January 10, 2017.
(5) Rodney Johnson, "The Modern-Day Allied Mark: How the Fed Could Gift Trump His Infrastructure Dreams," *Boom and Bust*, April 2017.
(6) Brian Womack, "Equifax Says Cyberattack May Have Hit 143 Million Customers," *Bloomberg*, September 7, 2017.
(7) Seena Gressin, "The Equifax Data Breach: What to Do," Federal Trade Commission, September 8, 2017.
(8) "When Information Is Lost or Exposed," Federal Trade Commission, accessed September 8, 2017.
(9) Picture source, www.moneyning.com