CAPSTONE PACIFIC
INVESTMENT STRATEGIES INC

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The Capstone Quarterly

Happy New Year! We hope you had a wonderful 2017 and we wish you an even better 2018. In this newsletter Bryce reviews some of our stock market observations we made over the course of 2017 and offers some stock market perspective as we begin 2018. Casey highlights five important questions she thinks most employees should be asking about their benefits at work. Jon reminds us that it's never too late to start budgeting. We wrap up this newsletter with some updates on TD Ameritrade's expanded list of exchange traded funds that trade for free, as well as some updates on what is happening around the office.

Bryce's Point of View

-By Bryce Pease, CFP®, Chief Investment Officer

The Year in Review, the Year Ahead

We spend a lot of time thinking about what is going on in the world and how best to position client's investment assets through our investment decisions and recommendations. Two major asset classes we focus on are equities (stocks) and fixed income (bonds). We also factor into our analysis asset classes such as real estate, precious metals, commodities (oil, for example), currencies, and alternative investments like inverse funds (funds that are designed to "short" a particular sector and move in the opposite direction of that sector). In all our analysis, our objective is to try and put together a mix of investments that helps clients' accounts participate in the rising trends of the global financial markets while attempting to protect clients' accounts on the downside with no guarantees against losses.

In most cases we feel it's best that clients own baskets of securities in the form of mutual funds or exchange traded funds, rather than taking on what we consider to be excessive risk of owning individual securities. In our commentary, this is why we tend to talk in terms of asset classes or sectors rather than indiviual names of companies or indiviual investments. Our feeling is that when it comes to retirement accounts, college savings accounts or family accounts, one of the most important parts of long-term investing is getting the sector right. We believe that if we focus our analysis on a certain sector, then the rest will follow. And in particular, we feel that focusing our analysis on the US stock market can help serve as a guiding factor and indicator for other asset classes and sectors.

So how did we do in our analysis of the US stock market in 2017?

As we entered 2017, both the stock and bond markets had gone through a period of serious volatility following the 2016 presidential election. The stock market, after appearing as though it was going to tank the night of the election, rebounded sharply coming out of the election through the end of the year. The fixed income bond markets had experienced a sharp sell off after the election. Here is what we said in our January 2017 newsletter:

> *"…we think the stock markets may have finally entered a sustainable trend while the bond markets may be stabilizing after a sharp sell-off. In addition, we think there are some sectors with some potential to grow in the new economic and political environment."*

As of the end of 2017, The S&P 500 was up a little over 18%. The bond market were also up in 2017, for example the exchange traded fund AGG (a U.S. aggregate bond fund) was up for the year approximately 3.5% (plus dividends). (1)

As the year moved along, we didn't waiver in our opinion on the strong trend of the stock market. The stock market had a good first quarter in 2017 and in case anyone was wondering if a strong first quarter meant the stock market was going to correct, we said in our April 2017 newsletter that we thought things still looked good for the US equity markets:

> *"History suggests though this market may have some tailwinds this year. Since 1945, the US stock market, as measured by the S&P 500, has rose in value during the months of January and February 27 times. In other words, over the last 72 years, 27 of those years the market has been up the first two months of the year. In those years that the S&P 500 rose in value during the months of January and February, each one of those years recorded positive returns for the stock market."*

And the U.S. stock markets, as mentioned above, continued up after the first quarter of 2017.

I'm not trying to toot our own horn here, I'm driving at a point about an important factor in stock market analysis, which I'll mention more about below. In the meantime, there is one more comment we made in our analysis in 2017 I'd like to highlight.

At the end of the first half of the year, the U.S. stock market as measured by the S&P 500, was up over 7% for the year. We made the point that just because the market went up in the first half of the year, didn't mean it had to go down the second half of the year. In our July 2017 newsletter, we said:

> *"While it might be easy to assume that the stock market has gotten a little ahead of itself and is due for a pullback, history suggests otherwise. In looking at market returns since 1946, we see that when the market has had a strong performance the first half of the year, there is historically a strong likelihood it will have a strong second half of the year. There is of course no guarantee the marekts will continue up, but historically we think the case can at least be made that a strong first half of the year could serve as tail winds for a strong second half."*

And we certainly have had a strong second half of the year with the S&P 500 more than doubling it's first half of the year performance.

The point I would like to make in this newsletter about stock and bond market analysis is that we think proper analysis of any sector of the financial markets needs to include the concept of "momentum." The idea behind momentum in price movement is that when something is going up, the upward movement in prices tends to attract more buyers and turns a developing trends into a sustainable trend. This works on the downside too, with negative trends driven by selling pressure. In 2017 the U.S. stock market seemed to be driven up in part by momentum, despite all the global uncertainty and political changes.

So what is our outlook for 2018? Will this bull market turn into the longest running bull market in U.S. history?

We don't know.

What we do know is the momentum trend for the U.S. stock market still appears to to be strong for the time being. What we feel will ultimately take the U.S. stock market into a sustained sell-off and bear maket is a recession. However, our sense is that we will probably see a recession coming with increased volatility in the U.S. stock market. We believe there is a chance we may see a recession and down market coming when this upward momentum in the stock market is finally interrupted by increased volatility.

Consider history.

Over the last 40 years, the S&P 500 has tended to move 1% or more 67 times in a year before it heads down into a 10% or more drop. What that says to us is that the markets tend to start bouncing around before heading down. While not a guarantee of the future, history suggests that a period of calm markets like we have been experiencing is not necessarily a harbinger of a crash. As of October 2017, the S&P 500 had only moved 1% or more 11 times. (2) Since October 2017, the markets have been trading in a similar range with very few 1% or more daily moves in prices. While there is always the risk of a sudden crash in the markets, if history has anything to say about it, we could see a market drop coming preceeded by market strong daily moves one way or the other in the markets.

To reiterate: we don't think a lack of volatility is an indication that the upward momentum of this market is due for a correction, or worse. It's actually quite the opposite, we think increased volatility along the lines of historical tendencies will be a sign of an impending downtrend in the markets that could lead to negative momentum and selling pressure.

If and when a downtrend in market returns happens, we have a plan in place to try and help and avoid large losses in the market. Avoiding large losses along the way is, in our opinion, the key to long-term investment success.

Casey's Corner

-By Casey Morris, CFP®

Five Questions to Ask Your Benefits Department at Work

Are you still working and trying to make the most of your benefits at work? Consider asking these five questions of your benefits department at work.

1. "*Does my pension have cost of living adjustments*?" If your employer offers a pension in retirement, it's important to know if that pension offers any type of cost of living adjustments (sometimes referred to as a "COLA"). Some pensions we see remain flat and never increase over time. Getting clarity on whether or not your pension has any COLA is one of the most important aspects to long-term retirement planning and helping you keep pace with the rising cost of living over time.

2. "*Does my retirement plan offer matching contributions*?" Make sure you are taking advantage of any matching contributions to your retirement plan at work. We often meet people who don't know if there are matching contributions to their retirement plans (401k, 457, TSP, etc.) at work. Don't over look this important boost to your retirement savings.

3. "*Who are my beneficiaries on file?*" If it's been awhile since you reviewed your beneficiaries, you may want to do this. Things change over time, and the person you named as a beneficiary to your accounts when you first went to work (like an ex-boyfriend or girlfriend for example), may no longer be the person you want to receive your money if something happens to you.

4. *“Does my retirement account have a self-directed brokerage account?”* Some employees find the investment options in their retirement account are too limited for them and want more options. Some employer sponsored plans also have a self-directed brokerage account where you can invest in a wider range of securities. There are obviously risks associated with investing and you may want to get professional advice if you go this route.

5. *“How much will my life insurance costs increase over time*?” We find that employees often rely on their work life insurance as their primary life insurance coverage. Employer based life insurance plans can be easy to qualify for with no medical underwriting, and can be relatively inexpensive. However, sometimes these plans get more expensive over time and can be very expensive if you plan to carry these plans into retirement. For some, applying for a private life insurance policy can make sense. Having a clear understanding about the costs of your employer based life insurance can help you make better decisions today about what might work best for your personal life insurance needs over time.

The Planning Perspective

-By Jon Teran, CFP®

It’s Never Too Late to Start Budgeting

In 2017, Casey and I had the opportunity to travel to Sacamento several times to teach financial education classes for the U.S. Forest Service. Each class was around two hours long and was full of mostly younger firefighters in the beginning stages of their careers. In these classes we covered a range of topics from saving, investing, budgeting, Social Secuity, pensions, paying down debt, etc.

One of things we focus on in our classes is creating a budget. Creating and sticking to a budget is something that is very important to do as you are launching out in your career. But it got me thinking, if a person or couple has never really budgeted and are in the middle stages of their career, entering or in retirement, is it too late to start budgeting?

I know it might seem to go without saying, but of course it’s never too late to start budgeting! In fact, learning to budget in the middle or later stages of your career can in some ways be an even more productive process because you not only have more to work with, typically, in terms of resources and income, but for those who are on down the road in their lives and careers, learning to budget at that point can be meaningful in a whole different way.

When you are young and trying to plan out your budget and financial priorities, a lot of times, you are doing this in the abstract—you may not have kids yet, you might not have the house, you might not yet have a sense of where you are headed in your career or when you want to retire. But as you move along in life and even heading towards retirement, things can be much more concrete. Your priorities are clearer and you are dealing with financial matters in concrete reality rather than an imagined future.

I would never suggest a person starting off in their career should not budget or set savings goals, far from it. But one of the challenges when you are younger is that because you don’t know exactly where you will end up down the road in your financial, family and career situation, you sometimes have to resort to rules of thumb financial strategies that may or may not be the best for you in the long run. Learning to budget, save and work towards financial goals later in life, can be very productive as you hopefully have a more realistic sense of where your life is headed and what are your true financial priorities.

So if you never got off on the right foot and developed a good budgeting habit when you are younger, don't fret. Learning to budget later in life, even in retirement, can be a very productive process because you are doing so with a very tangible sense of your priorities, resources, goals and how the overall realities of your life are shaping out.

There are plenty of budgeting resources online, but if you would like a copy of our budgeting and debt management worksheets, feel free to give our office a call, we'd be happy to provide you a copy.

Did You Know?

TD Ameritrade recently increased the number of exchange traded funds that trade for free on their platform. They removed most of the previous 100 funds from the lineup and added almost 300 funds for us to choose from. While we don't always stick to using solely the funds that trade for free, we try to incorporate them into our portfolios as often as possible to save our clients on trading charges paid to TD Ameritrade. You might have already seen, or might see in the near future, a few trades being placed on your account(s) to take advantage of this expanded program.

Finally…

How about some updates about what's happening around the office?

Jon recently joined the board of the San Gabriel Valley Financial Planning Association as their membership committee chair. Also, we are very proud that Jon was once again named coach of the year for the AYSO Region 2 Girls 12U Division. He was named as one of the coordinators of the year in his work "coordinating" coaches for the Boys 10U division in AYSO Region 2.

Casey and her husband have recently purchased a travel trailer and have been experiencing the joys and learning curve of the camping lifestyle. They are both avid outdoors type people so look forward to many years of enjoying the freedom and convenience, especially with their two dogs, that comes with camping in a travel trailer.

Bryce and his wife recently took a driving trip to visit his mother and her husband in the Black Hills of South Dakota. It was especially significant because they took their 5 year old granddaughter along to help his mother and her husband celebrate their 90th birthdays. What an amazing memory for all!

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) *Morningstar*
(2) "The market usually gives this 'advance warning' before plunging," Fred Imbert, *CNBC* October 24, 2017