

### Market Comments January 2018

#### **The ever-increasing stock market – proceed with caution**

Most of us enter the new year with anticipation and excitement for what's in store for the coming year – maybe this year with a little more nervousness about equity exposure.

The stock market ended 2017 strongly with the rally continuing into the first few weeks of the January. We maintain our cautious optimism. A growing US economy supports higher stock prices but we are on a historically long streak without having a 10% price correction. The stock market will reward us over the longer run with “some bumps in the road” along the way.

- The US economy has been growing since mid-2009 and could become the longest expansion on record according to the Wall Street Journal (1)
- The employment situation is strong with job growth showing good month-to-month gains, and the unemployment rate of 4.1% at a 17-year low (2)
- The new tax code will provide stimulus to the economy. We are already seeing signs of businesses planning to repatriate overseas cash, pay one-time bonuses to employees and invest in US facilities
- Consumer confidence reached a 17 year high in November based on The Conference Board (3)
- The FED believes in the strength of the economy as they continue to push interest rates higher. The rate increases are measured and predictable.

There is good reason to be optimistic about the future of the stock market, but also cautious because we know that over time markets never move in only one direction. It's been over 2 years since we have seen a correction where the stock market drops 10%. Vanguard's chief economist says that we have a 70% chance of a market correction this year (4).

We believe the best strategy for current conditions is to stay close to our target asset allocation so that we have equity to participate in the market's continued advances while having enough safety in our bond and cash allocations to buffer us from any corrections we may encounter. We do not expect any eminent crash in markets and will remain nimble if conditions change. If the economy and interest rates play out as we anticipate, we should be in for a smooth ride. Markets don't like surprises. There are any number of geopolitical events that could rattle the equity

market for which we have no insight. We would love to hear your thoughts. Please give us a call if you would like to revisit your target allocations or discuss your current portfolio.

### **Tax Law Changes – Basic Principals stay the same**

The newly enacted tax law which will be in effect for 2018 has winners and losers. Limiting the deduction for state and local taxes is a cost for many of us that live in high tax states like NJ, NY, CT, MA or California. The near elimination of the Alternative Minimum Tax (AMT) will be a help to many of our clients. From a broader perspective, the tax code changes for individuals are small compared to the significant reduction of corporate taxes. From a financial planning perspective, the principal rules remain the same:

- When saving, use all the tools available to you to save for retirement on a tax-advantaged basis.
- When drawing on assets in retirement, spend taxed assets first and defer drawing IRAs until you are required.

Adding to and keeping your savings in tax deferred accounts allows for faster growth because you do not need to pay taxes on the gains until the funds are withdrawn from the accounts. An additional benefit is that your tax rates are likely to be lower after you stop working and are enjoying retirement.

For individuals, the Individual Retirement Account, IRAs and Roth IRAs, are the “best tools for the job”. You can make an IRA contribution of \$5,500 per year (\$6,500 if you are over 50 years old) as long as your taxable compensation was at least that much. Disciplined investing year-after-year produces historically good results over the longer term. Many people make their annual IRA contributions at the beginning of the year so that they can gain an additional year of tax deferral.

Businesses have a broader array of choices for reducing current income taxes and putting away larger contributions to retirement plans for owners and employees. SEP IRAs, Simple IRAs, 401(k) plans and Profit Sharing Plans are some of the choices available to small and medium sized businesses. We are experienced with the various options and happy to help you set up and manage a pension plan for your business. If you already have a pension plan in place, we could offer a second opinion to evaluate additional opportunities for savings or investments.

## **Bitcoin and Cryptocurrencies –**

### **The technology has value but Bitcoin is a speculative gamble**

One of the hottest new trends that we see is the emergence of cryptocurrencies, for which Bitcoin is the largest. We do not consider Bitcoin, or any of the cryptocurrencies, to be a reasonable investment but instead a highly speculative gamble. Bitcoin routinely changes in value by 10% a day with values swinging from \$4,000/bitcoin last July, to \$19,000 in December and back to \$10,000 this week. Bitcoin is the largest of the cryptocurrencies with a total value of \$180 billion (5), meaning that all bitcoin in circulation is worth about half the value of Exxon (6). It gets significant media attention but is not that material from an overall financial system standpoint.

A traditional currency, backed by the full faith and credit of a country, serves two purposes:

1. A store of value – we expect a dollar to retain its purchasing power for a reasonable time period
2. Means of transacting – the grocery store accepts my dollars to buy food

Bitcoin has some advantages over current payment technologies so it may find a place as a means of transacting but we struggle with understanding its use as a store of value.

The Blockchain is a computer network that tracks every Bitcoin from when that particular bitcoin was initiated, or mined. It would be like if every dollar bill had a tracking device that reported where it has been since it was printed by the US Treasury. Owning a bitcoin, or a fraction of one means that you have a unique identifier on the blockchain. When you spend your bitcoin the fact that you owned it at one time is permanently recorded on the block chain. From our experience, receiving and paying with bitcoin is possibly the easiest way to transfer value. It's certainly easier than using a credit card and far easier than cash. We suspect that the transactional value of Bitcoin or utilizing the blockchain will have a material impact on how we exchange value in the future.

When we talk to the people who are deeply engaged in cryptocurrencies, they say that the “trust of the network” is what secures its value. “If everyone who buys and sells Bitcoin believes that it is worth \$10,000, it will hold that value”. We don't believe the argument. There are also limited avenues to buy and sell Bitcoin and even fewer places to spend it. Bitcoin may become an accepted world currency one day...or it may explode into a cloud of dust. We are happy to discuss what we know about bitcoin and cryptocurrencies.

As always we are here to discuss your current or changing situations, help make sense of the evolving times and figure out which investments are right for you. If you have friends or relatives who you would benefit from talking to us, we would be happy for the referral.

With warm regards,

**Ralf, Rob, Brett, and Bruce**

Sources:

1. <https://www.wsj.com/articles/u-s-economic-expansion-could-become-longest-on-record-1513179000>
2. Bureau of Labor Statistics <https://data.bls.gov/timeseries/LNS14000000>
3. <https://www.conference-board.org/data/consumerconfidence.cfm>
4. <https://www.cnbc.com/2017/11/27/chance-of-us-stock-market-correction-now-at-70-percent-vanguard.html>
5. <https://coinmarketcap.com/>
6. Reuters – XOM market cap \$370 billion on 1/22/18

*Be sure to let us know if your family circumstances have changed in a way that could alter your investment profile and objectives. We welcome your questions or comments, or would be happy to review your financial situation or portfolio at your convenience.*

*A copy of Lucas Capital Management, LLC's ADV is always available upon request.*

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