Quarterly Review July 2018

Market Comments

Markets have been fairly flat for the first half of 2018 with the S&P 500 up 2.6%. The result is not reflective of the daily turbulence as markets are driven either up or down by headlines and presidential tweets. Concerns over new tariffs or an all-out trade war one day are mitigated by comments the next day, frequently causing market swings of 1-2% on a daily basis. Overall the past 6 months, we have seen big moves but at the end of this first half, there is no meaningful change to the value or direction of stocks. We continue to believe in the long- term growth of the economy, which will drive company values and stock prices higher. The stock market is inherently volatile and to achieve the gains associated with stock market investing, we will continue to experience some bumps in the road.

Economic statistics continue to point to a stable, growing economy. The labor markets remain strong with unemployment at 4% and fairly consistent job growth each month with over 200,000 jobs being added again in June (1). More people are moving back into the job market and we are finally getting some wage growth. Inflation has started to pick up as we saw the Producer Price Index was up 3.7% year on year (2) and Consumer prices are rising the most since 2012(3). By many measures, we are in a late stage of economic recovery but with GDP growth in the 2% range it sure doesn't feel like the economic overheating we normally see in the last innings before a recession. It is very difficult to predict the timing of the peak and recession. In our opinion, we are closer to the end than the beginning of this growth period.

In terms of interest rates, short term rates continue to move higher as the FED keeps pressure on what they see as a healthy economy. The FED raised short term rates again in June for the 7th increase in this tightening cycle. We expect with the continuing labor market strength and emerging inflation that the FED will continue raising rates to moderate the economy. The longer end of the yield curve has not moved up in tandem with the short end resulting in a flat yield curve. Today the 30-year Treasury is yielding 2.93% while the 2-year Treasury at 2.58% (4). We find the best opportunity for investing in bonds in the 3-6 year range where we can capture a reasonable yield without taking significant risk.

Will Social Security be there for us?

Aging of the US population will put a strain on the government's ability to support us in retirement. The Social Security program's costs will exceed income this year for the first time since

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1982 according to the latest annual report of the trustees of Social Security and Medicare (5). In the same report, it is expected that the $3 trillion trust fund will be depleted in 2034 unless congress takes some action to shore up its finances. Medicare's hospital insurance fund is expected to run out in 2026 .

When the Social Security program was enacted during the FDR administration in 1935, life expectancies were lower and the number of workers paying into Social Security far outnumbered the number of Social Security recipients. In 1960, there were 5.1 Social Security covered workers per beneficiary and in 2013 there are only 2.8 payers per beneficiary (6). As the baby boomers retire, there will be even fewer workers per retiree. Medicare was enacted in 1965 as a result of an advisory council recommendation that Social Security was not sufficient for the elderly to meet the high and unpredictable costs of health care. Several modifications have been made to Social Security and Medicare over the past 50 years but the basic programs remain the same as when they were enacted.

As a country, we should be proud of our social welfare systems, like Social Security and Medicare, that support our vulnerable elderly population. At the current rate of spending growth, the status quo cannot continue without a reduction in benefits, increases in funding, or both. For our clients who are receiving or counting on Social Security and Medicare to support their retirement, these potential changes can be worrisome. An AARP report outlined different proposals for "fixing" the system, which include reduced benefits for higher income retirees (7). Since its inception, Social Security benefits have been available to all retirees who have paid into the system regardless of other income from pensions, investments, or savings. One proposal is to reduce benefits for people who have significant sources of income. Medicare already has a high-income premium surcharge in place called the Income-Related Monthly Adjustment Amount, "IRMAA". Sadly, this punishes those of us who have put away a healthy nest-egg for retirement. There is no eminent legislation on Social Security but we all saw how fast Tax Reform went from a campaign promise to law. We can help you evaluate and prepare.

Some steps to consider in preparing for any changes to Social Security:

1. Know your current situation – Go to SSA.gov and create a "My Social Security Account"

which will allow you to understand your future benefits based on the current law.

2. Make a Financial Plan which shows the role your Social Security will play in your retirement picture. We are happy to help work with you through the process, using our financial planning tools.

3. Increase your savings – the best preparation is having a portfolio large enough to be self-sufficient without Social Security.

4. If you are already receiving Social Security, please discuss this topic with your children. The benefits that you receive may be diminished for the next generation requiring them to rely more on their own investments for retirement.

5. Structure your investments to reduce your taxable income. This will help with Medicare's IRMAA current costs and with Social Security if it is modified to reflect other income. Reducing your taxable income doesn't mean you earn less money, it's being thoughtful about how you earn income, time distributions, and select the type of account where you hold assets. Tax advantaged investments like Municipal Bonds and MLPs can be helpful. Also, tax deferral through IRA, 401(k) or other pension plans will minimize your taxable income.

We are here to help you navigate your financial future – call us to discuss.

The Fiduciary Rule is Dead

Sadly, we see that the large broker-dealers and insurance industry have effectively convinced Washington that their agents and brokers do not need to act in the best interest of clients. We are disappointed by this reversal because it hurts investors.

Lucas Capital is a Fiduciary and we always act in our client's best interest. Our only revenue is from fees paid directly by you to us – we do not earn any commissions, fees, or rebates on any product we recommend.

It's hard for us to imagine how some people who call themselves financial advisors so firmly believe that they need to put their own interests before those of their clients that they will lobby politicians to prevent the Fiduciary Rule from becoming law.

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Capital Management, L.L.C.

If you like our service, please tell a friend
We care for our clients as if they were our own family, offering sound practical advice. We would be pleased to serve your friends or family members with the same care that we give to you. If you know someone who may be interested in working with us, please have them give us a call or send an email

With warm regards,

Ralf, Rob, Brett, Bruce, and Kathleen

Sources:
1. https://www.bls.gov/news.release/empsit.nr0.htm
2. https://www.bls.gov/news.release/ppi.nr0.htm
3. https://www.bls.gov/news.release/cpi.htm
4. Reuters Treasury yields 7/13/18
5. https://www.ssa.gov/oact/trsum/
6. https://www.ssa.gov/history/ratios.html
7. AARP,"The future of Social Security", https://www.aarp.org/content/dam/aarp/work-and-retirement/social-security/2012-06/The-Future-Of-Social-Security.pdf

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.
