ST. JOHN & ASSOCIATES
INTEGRATED FINANCIAL SERVICES

2018 4th Quarter Financial & Investment General Commentary

This General Commentary covers information of general interest on the Firm, Financial Planning, Financial Services, Market Results, Economic & Market Conditions, Economic & Market Outlooks and Portfolio Investment Management. The last page provides a list of index returns for each of the market's major categories.

Our sources of information are diverse and vary from period to period. For this period, sources referred to include Greenrock Research, the Wall Street Journal, Investment News, Morningstar, Fidelity Investments, Kitces.com and others.

INFORMATION OF GENERAL INTEREST

We continue to work on the process of converting clients' portfolios to our new portfolio design and asset allocation. We had to temporarily stop finalizing the transitions as the market volatility dramatically rose during the 4th quarter. The market direction was not the key to this delay, but the volatility related to the huge daily and sometimes violent swings was the issue. The transition to the new portfolio structure involves temporarily holding cash and with the volatility we decided it was too risky to make the change under these conditions. Selling or buying at the wrong time could have dramatically hurt the portfolio during those swings. Looking at the VIX, an index of volatility, showed the highest level of volatility since 2012. We continue to collect paperwork and client approval, but will be holding the paperwork until the volatility moves within a more normalized range.

Much has happened since our 3rd quarter reporting and even since the end of the 4th quarter reporting. In our Market Reporting we have drilled down into more depth than usual because we believe we are at or near a tipping point in the market. For those of you who are not inclined to read this Market Report in depth or even if you are, it would be helpful for your understanding to read the Conclusion first for a brief overview.

With the change in regulations, beginning in 2019 we will be revising the way we manage client 401(k), 403(b), annuities and any other investments not held at Fidelity Investments. Instead of trading these accounts on our internal schedule, we will be rebalancing these accounts only with the client during each client's meeting with us. In turn, our quarterly fees will be annualized based on their values as of the date of each client's meeting and changed once a year.

Fidelity recently sent to each client a notice advising them that they could add a trusted contact person to their accounts if they were not reachable or if they detected an issue of diminished capacity. While they are required to provide this option to you by regulation, we concur that this is worth considering. If you would like us to assist you in implementing this through Fidelity, please advise us.

In addition to the tax code changes effective for your 2018 return, a number of changes have taken place with the beginning of the 2019 tax year. These include increases in the contribution limits for your employer-based contribution plans, IRA and Roth accounts and other increases in other tax provisions. There has also been a 2.8% increase in the monthly Social Security payments as well as an increase in the Part B Medicare Premiums.

For those clients reaching age 65 during 2019, if you are not notified by the Social Security Administration some 6 months before your birthday, you should contact them about enrolling in Medicare Part A if still working and Medicare Part A & B if you are retiring. You will also need to decide about taking Social Security at your retirement or delaying beyond age 65 up to age 70.

While the average annual rate on money market funds is only 0.32% annualized, some lenders are paying as much as 2.25% interest. Fidelity Investment is one of the sources paying more that 2.0% per year. If you have cash that is not invested in your portfolio and being held in a low rate account and would like to have a personal non-investment account at Fidelity to hold your funds, please let us know and we will help to set-up and deposit your funds. From this account you will be able to write checks, withdraw funds and make deposits electronically.

Many of our clients living in metro Atlanta interested in appealing their property tax were referred to Rob Vinson by our firm. We are pleased to report that many of these clients have reported that they were pleased with the service he has provided. If you are still waiting for the completion of your appeal, please know that the Fulton County appeal process has been backed up by the large volume of appeals, that they have prioritized commercial property first and are just now beginning to address residential appeals.

FINANCIAL PLANNING & SERVICES

Tax Planning

A Few Points of Clarification

As we file our 2018 tax returns, we will see firsthand the effects of the "Tax Cuts and Jobs Act," which is the legislation that created the changes.

One of the most widely discussed changes in the 2018 tax reform bill involves income tax brackets and marginal tax rates. Tax brackets refer to specific ranges of income and their corresponding tax rates. Marginal tax rates apply to different levels of income - the higher the income, the higher the tax rate. What this means to you is that your income is not taxed at one rate but at several different rates, depending on your income.

Tax brackets for married taxpayers filing jointly

2017		2018	
10%	$0–$18,650	10%	$0–$19,050
15%	$18,651–$75,900	12%	$19,051–$77,400
25%	$75,901–$153,100	22%	$77,401–$165,000
28%	$153,101–$233,350	24%	$165,001–$315,000
33%	$233,351–$416,700	32%	$315,001–$400,000
35%	$416,701–$470,700	35%	$400,001–$600,000
39.6%	$470,701 or more	37%	$600,000 or more
Standard deduction:	$12,700	Standard deduction:	$24,000
Personal Exemption:	$8,100	Personal Exemption:	Eliminated

BUSINESS INSIDER

For example, if your taxable income is $120,000, your tax rate isn't a flat 22% that is your **marginal tax rate**. You're actually taxed 10% on the first $19,050, 12% on the next $77,400 and 22% on the the remainder up to the $120,000. So instead of paying $26,400 in taxes ($120,000 x 22%), a couple making $120,000 would pay around $20,565 in income taxes. This works out to around 17% and is your **effective tax rate**. This concept is often misunderstood by taxpayers.

For 2018, the tax brackets have shifted, and almost all of the marginal tax rates have been cut. That means nearly everyone will have lower income tax rates (on the same income) in 2018 and beyond. However, a little-remarked-upon provision changing the way inflation is calculated is among the big changes contained in the tax overhaul. The new method, using the so-called "chained" consumer price index to determine when to adjust tax brackets and eligibility for deductions, is expected to push more Americans into higher tax brackets more quickly. In the past, the tax code used the traditional CPI measure issued by the Labor Department each month.

By switching to this new method, the government will bring an additional $134 billion into federal coffers over the next decade, according to the Joint Committee on Taxation.

How will that happen?
It comes down to this: The chained CPI makes inflation appear lower, and that means tax brackets will be adjusted upward more slowly - but lots of workers will continue to get raises based upon the faster-rising traditional CPI. In other words, your income may rise faster than the inflation adjustments, forcing you to pay taxes at a higher rate - even though you may not feel any richer.

"Compared to where taxpayers would be under present law, by 2027 most individuals will actually pay more taxes," said Steve Rosenthal, senior fellow at the Urban-Brookings Tax Policy Center. The difference will be slight, perhaps just a few tenths of a percentage point a year, he says, "but over time, these fractions of a percentage point add up and can amount to a fair amount of money."

And unlike other parts of the bill that expire over time (sunset currently in 2025), such as the tax cuts for individuals, this new inflation measure will last indefinitely.

We detailed other key features of the tax law changes in our 2018 2nd quarter general commentary.

Consider revising your **withholding allowances** as we get into the new year. This is especially necessary if you've had a salary increase, received a large refund or paid a significant amount of taxes when you filed in the past. A withholding allowance is like an exemption from paying a certain amount of income tax. So, when you claim an allowance, you're telling your employer (and the government) that you qualify not to pay a certain amount of tax. The *more* allowances you claim, the less tax your employer withholds from your paychecks. If you were to claim zero allowances, your employer would withhold the maximum amount possible. The value of a single allowance is based on factors like your tax bracket, the frequency of your paychecks and your filing status.

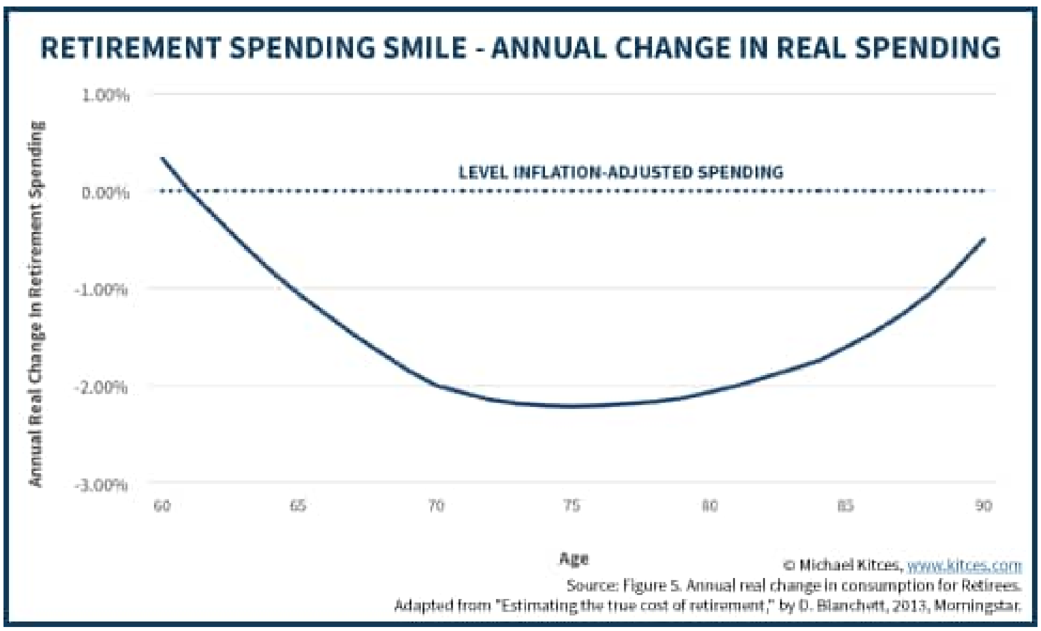
To help you calculate the right number of allowances, the IRS has a Personal Allowances Worksheet. Let us know is you have any questions on this topic.

Retirement Planning
We'd like to introduce you to the Retirement Spending Smile…see illustration below.

Here's what we mean. A number of retirement spending studies have attempted to analyze the question of retiree spending behavior throughout retirement. Results of these studies suggests that retiree household expenditures do decline slowly but steadily throughout retirement. Indeed, results indicated that consumer expenditures experience a real (inflation-adjusted) decline of approximately1% per year, but with a notable upturn at the end that makes retirement spending look somewhat like a smile. This retirement spending smile varies slightly for retirees with different household spending levels. After reaching the spending trough in their late 70s – early 80's, average real expenditures increase, though they do not necessarily exceed their initial retirement levels until retirees reach their mid-nineties.

This research is important since most financial plans are designed with constant inflation-adjusted spending as one of the assumptions – albeit a conservative one, when future spending is not always clearly knowable. That assumptions *could* leave individuals to over-save for retirement.

We will continue to study this as part of our ongoing commitment to deliver highly effective comprehensive financial plans to our clients.



College Planning

The first and primary first step in late-stage college planning – when a student is 5 years or less away from the traditional age for beginning college, is to create your college list. The college list is the single most important factor in helping families save on the cost of a college education. Building the right list of candidate schools is the essential first step for families that are in this stage of the timeline (junior and early senior year of high school). Using the list of candidate schools from your college list, you can then accurately apply college planning scenarios to help identify ways to reduce your out-of-pocket college costs at schools on your candidate list. We have a relationship with a third party that provides a service which includes a clear, step-by-step process for building your college list including interviews with parents and student, several student assessments and reviews of the results and more.

They also have a service called FAFSA Assist, which will guide you through the financial aid process, review financial aid awards for fairness, appeal awards where prudent, and more. We have negotiated very favorable rates for their service and have a relationship with them that goes back several years. Contact Bryan if you're interested and he will provide you more details. We're glad to be able to offer this to our clients for this most difficult and large financial expenditure – paying for college.

MARKET RESULTS

Trade wars, the U.S. Federal Reserve Action (the Fed), China and the strong U.S. dollar dominated the past year and remain key issues going forward. It appears that the idea of a U.S. recession risks appears low, but volatility is high, earnings growth has slowed and the market was due for a correction.

In the short-term, the sell-off feels overdone. For 2019 in general, our outlook is mixed. As usual, it isn't a good time for letting fear or greed dictate approach. If anything, declines make stocks more attractive than they were a few months ago. Valuations are now mixed. The forward PE of the S&P 500 is at 15, which is compelling relative to still low interest rates. Other metrics such as price to sales or the value of the US market compared to GDP show stocks remaining expensive.

International stocks are trading at lower valuations and are compelling on this basis. After years of US dominance, we believe a global approach is highly likely to be rewarded over the coming years. We believe that European growth can improve over the next couple of quarters. We view emerging markets as oversold, but see a bounce as dependent on the next move in the ongoing trade wars between the U.S. and other countries.

The Equity Market Looking Backwards

There were very few places to hide in the 4th quarter and in 2018 in general. The domestic equity segments were very different depending on what time periods you look at. Larger value-oriented companies, although negative for the quarter, outperformed the larger growth-oriented segment of the market. The growth-oriented stock which have led the market over the past few years were the hardest hit in the 4th quarter, yet didn't look too bad as we look at the annual returns. This was because the growth stocks had a run up during the first half of the year and then fell towards the end of the year. International equity has remained in a slump and it was weak for the quarter as well as the year. Fixed income was marginally positive, but still well below historic returns.

During the year, there was a clear rollover of those 5 stocks that have been driving the market over the past few years which have picked up the Acronym "FAANG". Facebook, Apple, Amazon, Netflix and Google (Alphabet). While these stocks do not necessarily have a huge influence on the portfolios, we mention them only because they drive the indexes being reported constantly in the news and it is what you are being told about the market. These are the top weighted stocks in the S&P 500 and the NASDAQ. The Dow has other stocks with their own issues. The key stock in each of these indexes is Apple. Apple is one of the largest positions in each of the indexes. For the quarter, Apple lost 29.8%, but in contrast was only down 5.1% for the year. The S&P 500 and Nasdaq are also significantly affected by their largest holdings which in addition to Apple are Facebook, Amazon, Netflix and Google. The Dow is affected by its largest positions which are Boeing and United Healthcare. For the quarter, Facebook, Amazon and Netflix were all down over 20% with Google coming in at a loss of 13%. This may be the beginning of a rollover of these heavy tech names even though most of these stock returns were still positive for the year, but it is too early to tell.

The Bond Market

Interest rates rose which typically would drive fixed income returns negative, but fear from the stock market drop led investors to Treasuries and a need for yield has driven investors to lower quality yet higher yielding bonds. A bond rally in the final weeks narrowly saved 2018 from becoming just the third year since 1926 that U.S. stocks and bonds both had a negative return. The fight over Treasuries and lower quality/higher yield bonds cannot last and will at some point implode on themselves. While we have always considered bonds lower risk, we are concerned that this level of risk has significantly increased without the awareness of most conservative investors and this may come to everyone's attention quickly should we head towards a recession.

ECONOMIC & MARKET OUTLOOK

The Domestic Marketplace

Let's start with 2017. To understand 2018, at least the first part, a review of 2017 will help. The S&P 500 was up 21.8% in 2017 and every month experienced positive returns. Volatility was at historic lows as the biggest intramonth decline was less than 3%. There was anticipation of corporate and individual tax cuts as well as the loosening of regulations. Investors were excited about the Trump Agenda especially with Republicans controlling both Houses of Congress. The FAANG stocks led the way and consumer confidence was high. There was talk of 4% GDP growth after the tax cuts were passed and that growth was expected to continue for a very long time. The message was our economy was strong, and the new president was ushering in a growth era.

2018 continued that mantra as the tax cuts were passed and Q2 2018 saw 4% GDP growth. Q3 came in over 3% and there was more talk of 3%-4% GDP growth continuing for a very long period. Both the stock market and the bond market reflected higher GDP growth, as stock prices and bond yields both rose. The 10 Year U.S. Treasury peaked at a 3.24% yield on November 8th and the S&P 500 peaked up 9.2% for the year on September 20th. Talk of continued 3%-4% GDP growth was abundant, and there were suggestions that we were just getting started.

WHAT A DIFFERENCE A QUARTER MAKES!

By the end of the year the 10 Year yield dropped to a 2.69% yield as talk of an economic slowdown replaced the euphoria of high growth. The Fed set a target GDP growth of 2.3% for 2019. The S&P 500 went from a high of 2,930 on September 20th to a low of 2,351 on December 24th. December, in particular, was dramatic as the S&P 500 ended down 9.03% in spite of a huge rally the last 5 trading days of the year on very low volume. 2018 left us with a taste of two markets, the one we hoped for and the one that was built on reality.

SO, WHAT HAPPENS IN A 2% GDP GROWTH ENVIRONMENT?

We wrote about this last January, so it is interesting that the topic comes back up 12 months later. GDP growth in this country from 1947-1999 was 3.5%, while GDP from 2000-2018 was 2%. The first period of 3.5% GDP growth was driven by two distinct economic phenomena, the rebuilding of America after World War II and the combination of the coming of age of the baby boomers, emergence of China and the advances of technology in the 1980s and 1990s. This country had huge economic catalysts during these two periods. The U.S. government started the rebuilding of America after World War II with policies like the Highway Act and the GI Bill which was followed by corporate spending and expansion. The baby boomers as well as China needed everything from toasters to cars, banking services to healthcare as we saw the expansion in the 1980s and the 1990s. In addition, the advances of technology helped push growth to levels never imagined.

Today the catalysts are hard to find. Demographics in our country, Europe, China and Japan point to a slowdown in growth, not a boom time. The S&P 500 started in 1958 and a look at the returns from 1958-1999, the boom time, as compared to 2000-2018, the low growth period, may give us some insights into what we can expect over the next decade. From 1958-1999 the S&P 500 compounded at 12.9% while from 2000-2018 it compounded at 4.9%.

The returns of the last 19 years are almost assuredly our future. Without big catalysts that drive growth and with our demographic make-up, it seems nearly impossible to believe we will return to the grand old days of double-digit returns. When we study what large firms are projecting for equity returns over the next decade, we find some proof of our theory. Vanguard is suggesting less than 2% while Black Rock and Goldman Sachs are suggesting 5%, just what the market has produced over the last 19 years. Bob Schiller, an American economist and Nobel Laureate, is projecting 2% while Jeremy Siegel, an economics and Finance professor at the Wharton School, suggests 5%.

This, however, may not be dire. Inflation is very low as well, and if the indices give us 5% in a 2% inflationary period, it is still possible to help achieve investment goals. The world and the markets changed after the 2000 and 2008 equity and bond market collapses. Markets cycles became for volatile and if this continues to be our environment, we feel confident our growing dividend strategies will outperform the overall market just as it has done since the year 2000.

We would love to see higher GDP growth, but prudence and our fiduciary responsibility requires we deal with our observation of reality, not our hope for the most optimistic outcome.

WHAT ARE OUR OBSERVATIONS FOR 2019 AND BEYOND?

1. The volatility of 2018 is here to stay. We likely will not see the low volatility of 2017 for a very long time, perhaps not for decades. Markets hate uncertainty, and we live in a very uncertain world. So, expect markets to react to perceived good news or bad news in a dramatic fashion. One month you will see a rising market because of a jobs report or growth report, and the next month you will see a falling market because of the shape of the yield curve or a report on China's slowdown. Expect this, it will be the reality of our markets. We will need to keep you focused on the long-term.

2. The Fed target of 2.3% GDP growth for 2019 is likely very accurate. Expect our country to be in the 2% GDP growth environment for years. But, also expect volatility in GDP growth over the period. Over the last 19 years we have experienced 2% GDP growth, but we have seen annual numbers of 4% and negative numbers. It is normal for GDP growth to have some volatility, so expect to see that volatility in the future.

3. Non-U.S. stocks will outperform U.S. stocks for a long time. The dollar has been very strong, but there are cycles to the of dollar strength followed by dollar weakness. Investors have been lulled into thinking that you only need the domestic market. The S&P 500 has outperformed EAFE, an index of major non-US stocks, in 5 out of the last 6 years, yet historically there is cyclicality to the over and under performance of both indices. History shows that there are periods of over and under performance of domestic vs. and international stocks and vis-a-versa. Currently domestic is outperforming international. Will this trend continue in 2019? Well no one can answer that, but you do not want to be on the wrong side of that argument if and when it reverses.

4. The cash flow from our growing dividend strategy will be higher over the next decade than the appreciation of the underlying stocks. Our new equity portfolio has a 3.7% current dividend yield. Our underlying managers believe dividend growth will continue to be in the 8% area. We did some analysis that assumes dividend growth of just 6% over the next decade. If that were the case, and it should be noted that it could be lower than 6%, the compounded cash flow over that decade would be 5.17% with the dividend yield in the 10th year of 6.63%. That 5.17% compounded cash flow is higher than any estimate we can find of total return for the general domestic stock market. This should not seem optimistic to you. Over the last 19 years the S&P 500 has compounded at 4.9% while our dividend portfolios have compounded at 7.6%.

5. The traditional bond market is still a broken asset class. The yield on the 10-Year U.S. Treasury on 12/31/2018 was 2.69%. Until that gets to 5%, you will need to be less dependent on fixed income that you have been traditionally. Our expectation is bond returns will be lower if not negative as yields rise. This is why we are suggesting all clients need a Liquid Alternatives focus.

6. Non-liquid investments can perform very well when compared to traditional, liquid investments. There are non-liquid investments available with high cash-flows (5%-6%, and very favorable terms) in need of infrastructure funding with minimums and very reasonable fees. These need to be reviewed for clients as part of our overall investment strategy.

Looking Forward

As we discussed last quarter, we feel following the mid-term elections and the democrats taking majority control of the House, it is likely to capture an increasing share of the spotlight. A divided Congress would likely mean more noise and investigations, but less action. This tends to be a positive for stocks, which tend to enjoy a softer legislative agenda, but the shutdown may in the end have an effect of hindering growth in the economy and that would have a negative effect on the market. The calendar year following midterm elections has historically been very strong, posting an average annual return of approximately 17.9% since 1927, but we have never had a shutdown last this long and do not know what effect it will have in the end.

CONCLUSION

Our new portfolio is designed to address both the issues of the equity and bond portions of your portfolio. In lieu of holding various classes of bonds funds and a mixture of growth and value oriented domestic and international mutual funds, we are refocusing the portfolio to invest in individual equities and bond alternatives to improve portfolio income generation, avoiding some of the market's risk and to help produce cash needed for withdrawals or help to build cash to rebalance without having to affect sales during possible downturns. Income generation will reduce some of the risk of the equity part of the portfolio by investing in dividend paying stocks only and supplementing bonds with a range of selective and timely alternative ETF investments. While adding a small amount of additional risk to the bond side, and less risk on the equity side, we set up the opportunity to outperform the traditional stock and bond market returns.

We believe a move from a growth-based portfolio to a growing dividend equity portfolio is the prudent move over the next 10 years, but periods like the last 12 and 18 months make it difficult to make that case. We get that. It may not be intuitive to all clients that avoiding overpriced stocks even when they are achieving great returns is an integral part of a thoughtful long-term investment strategy, but we feel that time will prove us right.

Additionally, we feel that history is also on our side with regards to the bond side of the portfolio as we must look for alternative solutions to gain opportunities to outperform historical bond returns in times of rising rates.

St John & Associates

Below are the returns for mutual fund categories making up our clients' portfolios and the major stock market averages. Morningstar sourced these mutual fund returns. Returns beyond one year are annualized.

	4th Qtr. 2018	1 Year Average	5 Year Average	10 Year Average
Large-Cap Growth	-15.43	-2.09	8.16	13.74
Large-Cap Value	-12.49	-8.53	5.37	10.91
Mid-Cap Growth	-17.57	-6.65	5.61	13.16
Mid-Cap Value	-15.72	-12.86	3.88	11.66
Small-Cap Growth	-20.82	-5.76	5.12	13.36
Small-Cap Value	-19.16	-15.46	1.86	11.00
DJIA	-11.31	-3.48	9.70	13.16
S&P 500	-13.52	-4.38	8.49	13.12
S&P Mid-Cap 400	-17.28	-11.08	6.03	13.68
Russell 2000	-20.20	-11.01	4.41	11.97
Russell 3000	-14.30	-5.24	7.91	13.18
Health	-16.28	-0.40	8.90	15.10
Commodities	-9.41	-11.25	-8.80	-3.78
Real Estate	-7.19	-5.97	6.92	11.50
Technology	-17.64	-3.21	11.71	17.03
Emerging Markets	-7.47	-16.07	0.53	7.61
Intl Large Growth	-13.87	-14.08	1.38	7.43
Intl Large Value	-12.30	-15.44	-0.82	5.52
Intl Small/Mid Growth	-17.67	-18.34	2.11	10.87
Intl Small/Mid Value	-14.39	-19.13	0.54	7.77
MSCI EAFE	-12.54	-13.79	0.53	6.32
MSCI Emerging Mkt	-7.47	-14.58	1.65	8.02
MSCI World	-13.42	-8.71	4.56	9.67
Inflation Protected	-0.95	-1.64	1.14	3.11
Intermediate Term	2.24	1.41	1.47	1.79
Short Term Bonds	0.45	0.92	1.25	2.65
Multi Sector Bonds	-1.51	-1.52	2.51	6.19
Barclays Agg Bond	1.64	0.01	2.52	3.48
High Yield Bonds	-4.33	-2.59	2.71	9.25
High Yield Muni	0.19	2.11	5.69	7.79
World Bonds	0.29	-1.48	1.01	3.63
Fidelity Cash Reserve	0.46	1.47	0.41	0.24