SEIA PRIVATE CLIENT GROUP NEWSLETTER
SIGNATURE ESTATE & INVESTMENT ADVISORS, LLC®
Established 1997

SEIA Report

JULY
2019
VOLUME 12
ISSUE 2

HAPPY BIRTHDAY AMERICA! HAPPY BIRTHDAY CYCLE!

FEATURE

BY **Deron McCoy**
CFA®, CFP®, CAIA, AIF®
Chief Investment Officer

One decade.

On July 1st, the current business cycle turned 10 years old. That's a long time and in fact breaks the record for the longest economic expansion ever by eclipsing the previous record set during the 1990s[1]. No doubt a litany of articles will be written about this milestone, but while most publications will likely focus on the negatives in the aftermath of the Great Recession, we would like to focus on the positives and the true underlying reason why this expansion has endured so long—you!

The "Big Government Stimulus" Fallacy

Hopefully the history books won't try to credit big government for the expansion. If they do, however, they may praise the early efforts of the Troubled Asset Relief Program (TARP bailout) or Fed Chair Ben Bernanke and his use of exotic zero interest rate (ZIRP) and Quantitative Easing (QE) monetary policies. But pay close attention to how the writers artfully avoid drawing any overseas comparisons. Think about it: if big government action and their acronyms saved the day and provided the groundwork for our expansion, shouldn't we be seeing epic growth everywhere around the developed world?

Let's first look more closely at monetary policy. While the U.S. flirted with ZIRP, interest rate policy overseas went even further – actually moving rates into negative territory! Now 10 years later, overseas debt floods the marketplace with over $11 trillion worth of bonds sporting a negative yield to maturity[2] (yes, you must in fact PAY Switzerland, Germany, and Japan for the privilege of loaning them your money for 10 years!). And QE? Again, countries overseas took the idea and went one step further. Like the U.S., the Bank of Japan (BOJ) bought government bonds in their QE program but the BOJ also purchased Exchange-Traded Funds (ETFs) and now owns 80% of all outstanding ETFs in their country and is the top-10 shareholder in 40% of Japanese public companies[3].

The cumulative results of these big government initiatives? Europe stands on the cusp of their third recession in the last 10 years, and Japan has had 11 quarters of negative growth this decade—an average of more than one per year[4]!

Different Scoreboard – Same Results

So, if big government deserves praise for this prolonged expansion but we can't keep score via GDP, perhaps we can more accurately keep score via stock prices. From the market bottom in March 2009, French equities have roughly doubled, Japan is up around 170% and Germany is up a little over 200% leading all large overseas developed countries. Certainly, these are reasonable returns; but they are nowhere near the American market. Over the same period, U.S. Large Cap stocks (S&P 500®) gained more than 300% (plus dividends) before slightly pulling back here in Q2[5].

And what if we don't confine ourselves to monetary policy or to just developed nations? If you want to analyze Emerging Markets and centrally planned economies, you have to look to China—the world's second largest economy. Yet once again, the U.S. comes out miles ahead as the Shanghai stock index is up just 40% since the depths of the Great Recession[6].

1 Bureau of Economic Analysis
2 Financial Times (https://www.ft.com/content/cf39a9a4-8ea2-11e9-a24d-b42f641eca37)
3 Reuters (https://www.reuters.com/article/us-japan-economy-boj/kuroda-defends-japan-central-banks-etf-buying-sees-no-near-term-exit-idUSKBN10602Q)
4 World Bank (https://data.worldbank.org)
5 Bloomberg
6 Bloomberg

continued on page 2...

> I believe successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

Brian D. Holmes,
MS, CFP®, CMFC, AIF®, *President & CEO*

ABOUT SEIA

Signature Estate & Investment Advisors, LLC® (SEIA) is a Registered Investment Advisor firm offering Investment Supervision and Financial Planning Services tailored to align the unique needs of affluent individuals and corporations. Fundamental experience and professionalism enable the financial advisors, with SEIA's research and support staff, to design a financial plan or investment portfolio to align the client's goals.

ABCD'S OF LATE CYCLE INVESTMENT MANAGEMENT

A — Account management
- Rebalance and take profits
- Reposition portfolio

B — Behavior management
- Fix roof now. Don't be a forced seller in a downturn. Get off margin
- Raise dry powder now that can be redeployed later

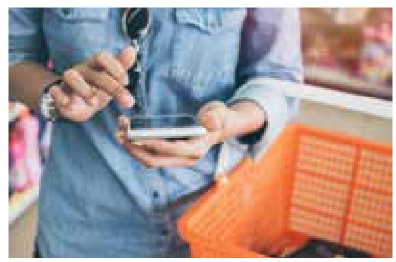
C — Capital protection
- Introduce portfolio hedges if appropriate

D — Diversify concentrated positions
- Reduce single stock risk and diversify

Rethinking The Narrative

As financial analysts we value facts. If the overseas experiments don't corroborate the original thesis, then we must revisit the underlying premise. Maybe our record expansion wasn't because of big government initiatives. Maybe, in fact, it was despite them. Perhaps it was American ingenuity, grit and perseverance that saved us…the spirit of U.S. citizens and corporations to unearth problems and quickly solve them. Maybe, dare we say it, it's our capitalistic profit motive that has spawned a work ethic and a dynamic economy that can morph and shift with the times. Did stock prices go up in this expansion because of QE? No. Stock prices went up because corporate profits went up—plain and simple.

Consider the technology innovation and dynamism of U.S. corporations over the last decade—you can find great examples in every sector of the economy.



Consumer Goods and Services: This one is easy and it's not just about sharing pictures. Over this expansion, we have witnessed the launch of the iPad and maturity of the smartphone, as mobile technology has evolved from limited 3G to the cusp of life changing 5G. Ten years ago, the App Store was barely a year old. Today, it has changed and enriched our lives in too many ways to list. Just grab your phone and think about all the apps you've come to rely on. When planning a vacation, we now browse beach resorts on Instagram, book flights on Kayak, rent a house on Airbnb, Venmo friends to split costs and make dinner reservations on OpenTable. We post pictures on Facebook for grandparents, Facetime kids to congratulate them on their baseball that we watched on Game Changer, use Ring to answer the doorbell from half a world away, and rely on Uber to get around or deliver food to us. And now, most activities can be accomplished simply by speaking into a hockey puck-like personal assistant!

Energy: In case you missed it, the United States is now energy independent. U.S. scientists and entrepreneurs not only developed the method to frack an oil well, but then spent the next 10 years perfecting it. Originally, it took nearly two and a half months to frack a well; now it takes just

10 days. As a result, we've gone from the world's biggest oil importer to its largest exporter – with Texas now pumping more oil than Iraq or Iran[7]. In 10 years, the Bakken and Eagle Ford went from pumping 1.1 mil to 5.2 mil barrels a day, and future estimates continue to climb[8].

Manufacturing: The current rhetoric is that emerging markets have stolen all our manufacturing jobs as greedy corporate CEOs have outsourced everything overseas. Yet the undeniable data shows that U.S. manufacturing output is at an all-time high! And a recent study by Deutsche Bank finds that the U.S. is more immune than most other countries to the risk of automation[9]. Why? We provide manufacturing jobs that are higher up the food chain. Need a tool? We can now print one using 3D printing technology. The jobs that we have outsourced are the lower skilled tasks that will eventually be automated away.

Healthcare: The breakthroughs in this sector have been nothing short of amazing. Robots can now perform surgery (but that's already old news). To cite just a few breakthroughs on an exceedingly long list; we can now modify someone's DNA to treat a disease, send signals to a patient's retina or brain, and create human body parts using 3D printers!

Climate: Well, maybe this is the one area where big government can do good. While there's certainly a great deal more work to do, it's good to know that forty-nine years after the birth of the EPA in 1970, Aggregate Emissions (of the six common pollutants) are down 73% since the birth of the EPA in 1970. Although CO2 emissions are up 25% over the same time period—they are down a couple of percentage points in the last 10-years, even as GDP, population, and vehicle-miles traveled are all up considerably[10]. How? Again, perhaps we can point to capitalism's helping hand, as clean transportation has evolved from the dreaded EV1 to the much sought-after clean rides from Tesla, Bird, and Lime.

But I do believe we will likely have a recession—maybe two. And when it occurs, it won't be big government that saves us. It will be you. It will be the dynamism of capitalism and the next generation of scientists, doctors, engineers, and entrepreneurs that will seek out problems and fix them.

The Next 10 Years?

How we live and how we work will inevitably evolve – from resource efficiency solutions to smart homes and the continued extension of Internet connectivity into physical devices and everyday objects (IoT). How we travel (e.g., self-driving cars) and where we travel (e.g., space) are likely to change. Biotech, nanotech and fintech all will change. And this list likely doesn't even touch on your specialty! But that's the ultimate point of this article—the litany of American capitalistic ideas in the next decade is bound solely by the limits of your collective imaginations.

This article will seem very dated by the time 2029 comes around and there is no way I'm going to go on record to opine on what exactly the future will hold. But I do believe we will likely have a recession—maybe two. And when it occurs, it won't be big government that saves us. It will be you. It will be the dynamism of capitalism and the next generation of scientists, doctors, engineers, and entrepreneurs that will seek out problems and fix them. And as we lap into summer and will soon celebrate our nation's birthday, we'll conclude by saying 'congratulations' to the recent graduates. We look forward to your ingenuity, energy, and profit-seeking endeavors over the next 10 years! Happy Independence Day everyone!!

7 AEI (https://www.aei.org/publication/map-chart-of-the-day-the-texas-miracle/)
8 EIA (https://www.eia.gov/petroleum/drilling/pdf/dpr-full.pdf)
9 Deutsche Bank: https://www.dbresearch.com/PROD/RPS_EN-PROD/PROD0000000000469843/Automation_%E2%80%93_not_a_job_killer.pdf
10 EPA: www.epa.gov

LIFECARE AFFORDABILITY PLANNING

SEIA's Tom West is Leading the Way

Thomas C. West
CLU, ChFC, AIF®
Partner

It's potentially the single largest retirement expense Americans will need to plan for, yet few of us choose to even contemplate the possibility of a healthcare crisis let alone plan for one. Undoubtedly, you've seen or heard at least some discussion around the skyrocketing costs of healthcare in retirement. The Employee Benefits Research Institute (EBRI) estimates that in order to have a 90% probability of covering just their out-of-pocket retirement healthcare costs (i.e., Medicare premiums and copays, along with dental, vision and hearing) a healthy 65-year-old couple needs to put aside $296,000.[1] And that doesn't even include the costs of long-term care (LTC). Seven out of every ten of us will require long-term care at some point in our lives – costs that aren't covered by Medicare and which can quickly and easily exceed $500,000.[2]

Wading through all the various available choices and putting a lifecare affordability plan in place requires very specialized knowledge

Not too long ago, healthcare was a relatively simple planning endeavor. Your only long-term care coverage decision was to either purchase traditional LTC insurance or fund those costs (if they occurred) out-of-pocket. Your care options were also fairly limited: either move into a nursing home or pay for in-home care. Today, in addition to traditional LTC insurance there are hybrid life/LTC policies, along with an array of different LTC riders that can be added to permanent life insurance policies as well as certain annuities. The number of care options has also expanded with the emergence of continuing care retirement communities (CCRCs), long-term care specialty facilities, and new home health solutions.

Creating Your Plan Of Care

Wading through all the various available choices and putting a lifecare affordability plan in place requires very specialized knowledge – expertise we at SEIA are lucky enough to have in-house in the person of Tom West, CLU, ChFC, AIF® and his team (working out of our Tysons Corner office).

Tom has served the caregiving industry for more than 20 years in a variety of capacities, and has been sought out by the Wall Street Journal, the Washington Post, the New York Times and most recently Barron's (*A New Way to Pay for the Single Biggest Retirement Expense* and *How to Pick Your Retirement Home When There are More Choices Than Ever*) for his insights on strategies to help families preserve their wealth from a healthcare or housing crisis.

In fact, just this month Tom and his team launched a new program called the Lifecare Affordability Plan™ – designed to provide clients with a holistic approach to financial planning for a plan of care... "At SEIA, we believe wealth management goes well beyond your investment portfolio," notes Brian Holmes, President and CEO. "We're committed to providing actionable strategies like lifecare planning to help ensure that our clients have a comprehensive roadmap for all their financial needs – including housing and healthcare."

We encourage you to check out the program website to learn more about this important new SEIA offering.

www.affordlifecare.com

1 Employee Benefits Research Institute, Issue Brief, October 2018
2 Genworth Cost of Care Survey, 2018

OPPORTUNITY KNOCKS

Qualified Opportunity Funds offer a new way to defer and potentially reduce your capital gains

BY **Eric C. Pritz**
CFP®, CMFC
Senior Partner

While most of the discussion surrounding the 2017 Tax Cuts and Jobs Act has focused on changes to corporate and personal tax rates, deductions and exclusions, there's one potentially beneficial provision that has received relatively little media coverage but a lot of cocktail party buzz among affluent investors – a new program designed to encourage investments in economically distressed communities certified by the Treasury Department as "Opportunity Zones."

Unlike previous efforts to create similar Empowerment Zones, this initiative is unique in both its expansiveness as well as its generous tax advantages. Not only are there a total of 8,700 certified Opportunity Zones (compared to just 40 Congressionally approved Empowerment Zones),[1] the variety of qualified underlying investments has been broadened.

It presents a unique opportunity for socially conscious investors to do good while also doing well – directing much needed capital to help revitalize disadvantaged communities and getting a potentially beneficial tax break in return.

How Opportunity Funds Work

Let's suppose that in the wake of this current 10-year bull market, you have one or more highly appreciated assets with large embedded long-term capital gains that you want to sell. Perhaps it's an investment property, a large concentrated company stock holding, or simply a decade's worth of portfolio growth. Rather than forking over either 15% or 20% in capital gains taxes (depending on your income bracket), you may want to consider re-investing those gains in a Qualified Opportunity Fund (QOF) which can offer a three-fold benefit:

1. A deferral/postponement of any unrealized gains for as long as you maintain the QOF investment or until your 2026 taxes (whichever comes first);

2. A reduction (i.e., step-up in basis) in taxes owed on the deferred gains depending on how long you maintain your QOF holding. If you hold you shares for five years, your deferred gain will be reduced by 10%. And after seven years, it will be reduced by another 5%;

3. A permanent exclusion from tax on any gains that arise from investing in the QOF, if you maintain your investment for 10 years or longer.

Additionally, unlike other strategies for deferring unrealized capital gains (e.g., 1031 property exchanges), with QOFs you need only reinvest the capital gains portion received from the sale of an asset rather than the entire sale proceeds. And because QOFs are real estate investments, there are also depreciation tax benefits to be gained.[2]

Investor Considerations

While the goal of Opportunity Zones is both noble (funneling capital into struggling, economically distressed communities) and a tremendous opportunity for certain qualified investors with substantial unrealized capital gains, it's an investment that also carries unique potential risks.

The rules governing opportunity zone investing are complex – QOFs must invest 90% of their capital in physical assets, such as real estate or equipment, that are located in approved opportunity zones and/or ownership interests, such as stock, of businesses that operate at least partially in opportunity zones.[2] As a result, investors need to be diligent in selecting an experienced specialty fund manager with a proven track record in identifying the most promising investment opportunities and structures while ensuring compliance with established IRS and Treasury rules.

Investors need to be very thoughtful about how much they're willing to allocate to a QOF given the potential 10-year lock-up required to achieve a tax-free return on their investment. You want to make sure you set aside enough liquid cash to pay any deferred taxes. Consideration also needs to be given to potential money flows into and out of these funds (particularly around the 2026 tax deferral deadline) and the impact those flows may have on the fund's ability to maintain its investment portfolio.

Considering investing in a QOF? We suggest you ask yourself one simple question: does it stand on its merits purely as an investment? Rather than focusing on the potential capital gains deferral, think of that benefit merely as a bonus. Make your decision instead based on the fundamental underlying investment thesis.

Given the unknowns as to what these new investments will ultimately look like, the number of unproven investment managers rapidly moving into the space to meet the growing interest and anticipated demand, as well as the unique intricacies of your personal tax situation, it's vital that you work closely with your SEIA advisor to first determine whether a QOF makes sense given your circumstances, and then to conduct appropriate due diligence to identify an optimal fund for your needs.

1 Forbes, "Opportunity Zones May Help Investors and Syndicators More Than Distressed Communities," August 2018
2 H.R.828 – "Investing in Opportunity Act," February 2017 (https://www.congress.gov/bill/115th-congress/house-bill/828/text)

The Signature Fund for Giving's ongoing mission is to build meaningful relationships with our partners and foster their continuing efforts of empowering local youth.

We look to focus our giving efforts to specific causes to meet the needs of our partners. We are proud to announce our ongoing commitment to A Place Called Home's annual Back to School event where the Fund will buy the needed materials to support the Center's members as they embark on the upcoming school year. Our SEIA Partners, Advisors, and Staff will present the school supplies on Saturday, August 3rd to more than 250 families.

If you have any questions regarding our Fund or how to participate, we invite you to contact Hayley Wood at 310-712-2323 or hwood@seia.com.

SEIA

SIGNATURE ESTATE & INVESTMENT ADVISORS, LLC®

HEADQUARTERS

Century City, CA
2121 Avenue of the Stars
Suite 1600
Los Angeles, CA 90067
T 310 712 2323
F 310 712 2345

SEIA.COM

Newport Beach, CA
610 Newport Center Dr.
Suite 300
Newport Beach, CA 92660
T 949 705 5188
F 949 705 5199

Pasadena, CA
155 N. Lake Ave Suite 780
Pasadena, CA 91101
T 626 795 2944
F 626 795 2994

Redondo Beach, CA
1848 S. Elena Ave.
Suite 100
Redondo Beach, CA 90277
T 310 712 2322
F 310 712 2377

San Mateo, CA
3 East Third Avenue
San Mateo, CA 94401
T 800 723 5115
F 310 712 2345

Tysons Corner, VA
1650 Tysons Blvd.
Suite 1575
Tysons Corner, VA 22102
T 703 940 3000
F 703 738 2259

Houston, TX
1700 Post Oak Blvd
2 Blvd Place, Suite 600
Houston, TX 77056
T 713 963 4699
F 310 300 0512