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Market Update

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BEAR CLAWS and BULL HORNS

Fed tightens, markets have a hissy fit as any child does, financial conditions cramp up, the Fed then backs off. Market then rallies, financial conditions ease, and the Fed is back in the game.[1]

–Peter Boockvar, CIO, Bleakely Financial Group

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After a bearish decimation of markets last fall, Christmas rang in with enough good cheer to spark a Santa Claus rally that has yet to look back. Notwithstanding special qualities endowed in Santa's sleigh or perhaps Frosty the Snowman's hat, the market hit bottom on Christmas Eve and the rally since has been fast and furious:

EQUITIES 2/28/2019	4 Weeks	Year-to-Date	1 Year	3 Years*	5 Years*
S&P 500 TR	3.21%	11.48%	4.68%	15.28%	10.67%
Dow Industrials TR	4.03%	11.62%	5.95%	19.04%	12.38%
Nasdaq Composite PR	3.44%	13.52%	3.57%	18.23%	11.82%
Russell 2000 TR	5.20%	17.03%	5.58%	16.67%	7.36%
MSCI EAFE NR USD	2.55%	9.29%	-6.04%	9.32%	2.07%

Source: Morningstar.com. TR = Total Return (includes dividends). PR = Price Return. NR = Nominal Return. EAFE = Europe, Australasia, & the Far East. MSCI = Morgan Stanley Capital International.

**Annualized figures.*

January alone saw the S&P 500 rise 7.83%; collectively, the market is up almost 19% since Christmas. What changed, exactly?

Interest rates are always a focal point for markets, and we've seen what amounts to a tectonic shift in the stance of the world's biggest influencer of not only rates but of global markets: the Federal Reserve. Only four months ago, the Fed was signaling an end to "accommodation" (supporting markets with low rates), priming investors with the expectation of a rate hike in December and at least three more in 2019.

By their meeting on December 18, 2018, markets had swooned 13% from their highs, consumer confidence had taken a hit, and housing looked far too much like 2006. The following day, Fed Chairman Jerome Powell and the Federal Open Market Committee delivered their promised quarter-point hike, but softened their future guidance to two hikes rather than three in 2019. In the crosshairs of President Trump's critical commentary ("I think the Fed is a much bigger problem than China"), Powell and the Fed justified their unanimous rate hike (to a range of 2.25% to 2.5% for the Fed Funds rate) in citing a strengthening job market and rising economic activity, but acknowledged slowdowns in both private and business fixed investment.

Alone in the White House on Christmas Eve, President Trump gave his opinion of the Fed on Twitter:

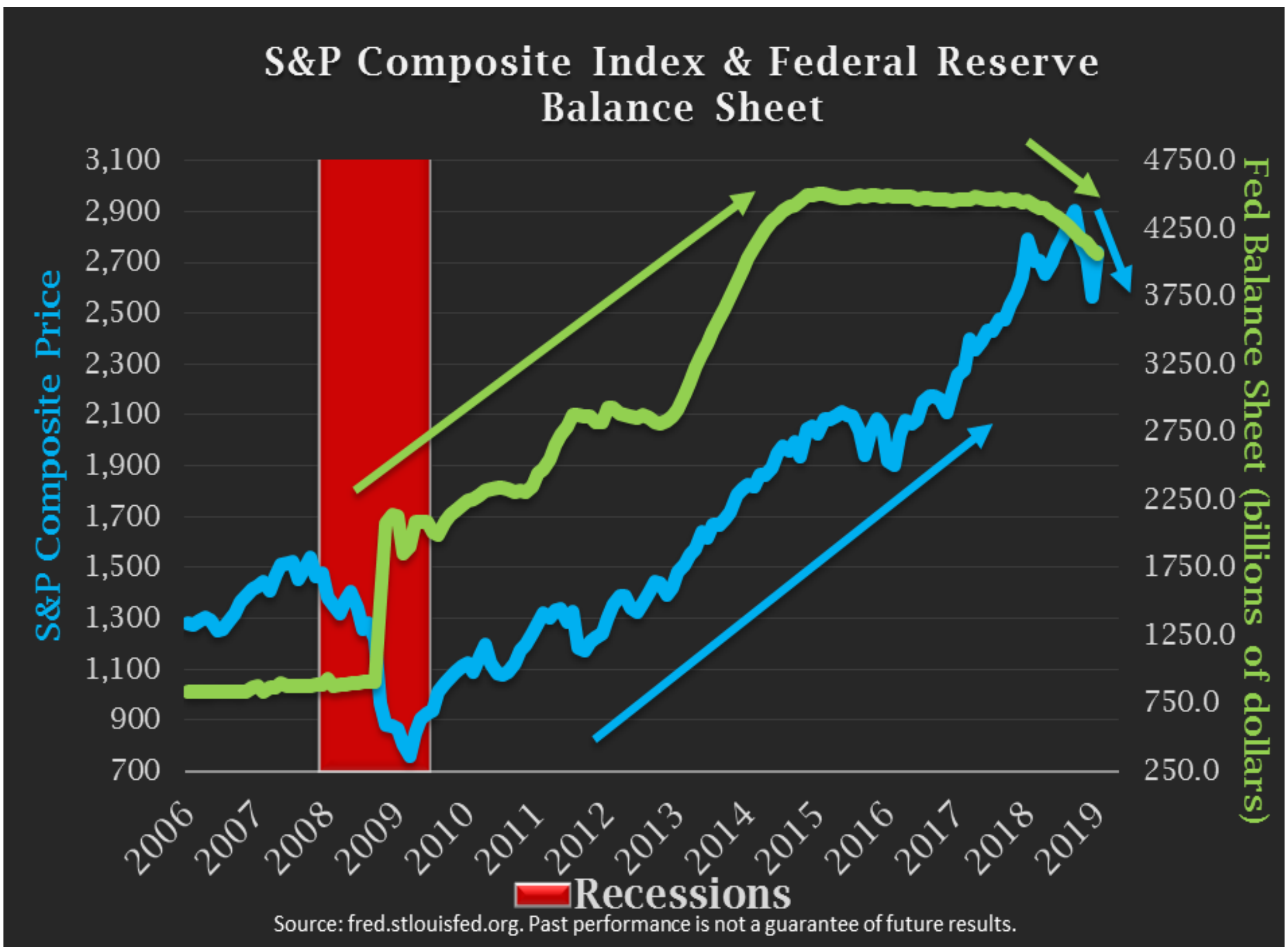
> *"The only problem our economy has is the Fed. They don't have a feel for the Market, they don't understand necessary Trade Wars or Strong Dollars or even Democrat Shutdowns over Borders. The Fed is like a powerful golfer who can't score because he has no touch - he can't putt!"*

Nervous traders sold the market down, lopping 653 points off the Dow and establishing the worst Christmas Eve for markets in history. Sentiment could hardly have been more negative, but out of that bottom came a Santa Claus rally to remember. Within a week, the Dow had reclaimed 1,500 points, and emotions began to shift in a major way.

As the New Year began, Chairman Powell and Fed governors began spreading an increasingly dovish message regarding monetary policy, emphasizing "patience" and stating there is "no preset path" for raising interest rates or reducing the balance sheet.[2] Various Fed Presidents began calling for a pause in rate hikes, and Powell followed the FOMC meeting at the end of January stating, "The case for raising rates has weakened somewhat," and the Fed would adopt a "wait-and-see approach regarding future policy changes."[3] A number of notable market watchers, including Mohamed El-Erian of Allianz and former Fed Chair Janet Yellen, have opined since that the next Fed move may be a rate cut.[4]

One policy change that was addressed in the January meeting was what to do with the Fed's balance sheet. As the Fed's primary weapon in the aftermath of the financial crisis (2007–2008), the balance sheet became bloated through three rounds of Quantitative Easing (QE), growing from around $800 billion in 2007 to $4.5 trillion by 2015. Beginning in December of 2013, the Fed "tapered" (i.e., systematically cut the amount of new bond purchases) the growth of the balance sheet, and in October 2014 they officially ended QE while maintaining the balance sheet size by replacing securities as they matured.[5] This ended in October of 2017 with "Quantitative Tightening" (QT), a strategy to "wind-down" the balance sheet quietly, "in the background." [6]

There is what current bond king Jeff Gundlach calls "an eerie correlation" between the Fed's balance sheet and the stock market. Gundlach, who is founder of investment firm DoubleLine Capital, stated, "Once the Fed started quantitative tightening, the global stock market tipped over right on schedule."[7] The following chart shows the graphic correlation between the S&P 500 and the Federal Reserve balance sheet:



When the Fed was expanding its balance sheet by buying trillions of dollars of government bonds and mortgage-backed securities (adding liquidity to the system, not unlike lowering interest rates), the stock market loved it and behaved accordingly. But it should come as no surprise that when the Fed began doing the opposite, the market wasn't so thrilled. And now, after reducing the balance sheet by $500 billion, Powell has gone from reduction "autopilot" (December 19), to "we wouldn't hesitate to make a change" in policy (January 4), to announcing the framework of a plan to bring the "end of balance sheet normalization" (January 30).[8] Gundlach commented, "Jay Powell did a full capitulation. The markets have been throwing a party ever since."[9]

Whether the Fed Chair capitulated is subject to opinion, but the Fed certainly pivoted toward a pause in rate hikes. According to the CME Group, the probability that the Fed will sit tight through their next three meetings (through June) is above 95%, and from there through the end of the year it decreases only to 93.5%. And strikingly, in the small chance they do change rates, the probability leans toward a rate <u>cut</u>.[10]

Keep in mind that probabilities guarantee nothing, and the economy is fluid and dynamic. The Fed has two mandates: to maintain price stability (inflation control) and maximum employment. Inflation has been muted since the Great Recession (not quite reaching the Fed's target of 2% per annum) and unemployment, while ticking up recently from 3.7% to 4.0%, has been at its lowest levels since 1969. Inflation usually rises when employment is strong and the economy is growing, but its absence may point to structural economic weaknesses, and the Fed doesn't want to exacerbate the problems (real or perceived) by raising rates too high. [11]

The Federal Reserve has a powerful responsibility to keep the U.S. economy on track, but it is largely a thankless job due to the global scrutiny and armchair quarterbacking it endures while endeavoring to maintain independence and objectivity. We think the shift in the Fed's policy stance was a positive one and reflects the current economic state of affairs. We watch the credit markets very closely, and they will have a lot to say about the direction of interest rates in the months ahead.

Stay tuned!

Recent issues of *Market Update* can be found online at the Stockman Wealth Management page of www.stockmanbank.com. To be included on the email distribution list (four issues per year, plus special updates as necessary), please contact us at: Eric.George@stockmanbank.com - thank you!

BENEFICIARY DESIGNATIONS AND TRUSTED CONTACTS

When we bring our new clients on board at Stockman Wealth Management, we ask a lot of questions, and personal ones at that. We ask for familiar but private information, such as dates of birth and Social Security numbers, and the U.S. Patriot Act dictates we collect state Driver's License or U.S. passport information. While we are required to collect and maintain all of this information (and routinely distribute our Privacy Policy, which outlines how we use this information), there are two areas for which we are required to ask for information, but as the client you are not required to supply it: beneficiary designations and trusted contacts.

Naming beneficiaries and trusted contacts is one of the simplest and most important things anyone can do to protect themselves and their heirs. The first step is to understand what the terms mean and how they can work for you.

First, let's discuss **beneficiary designations**. Many people have gone through the process of designating a beneficiary, whether for a retirement account, life insurance policy, or bank account. A beneficiary is someone you would like to receive the proceeds of your account in the case of your passing. Such assets will go directly to the named beneficiary (or beneficiaries) without regard to last wills and testaments, superseding separate estate plans and bypassing probate. A beneficiary designation is a powerful estate-planning tool for everyone's use, but there are some important guidelines to follow:

- You must choose a primary beneficiary (or several), but naming contingent beneficiaries is optional. A primary beneficiary is first in line to receive benefits in the case of your passing; a contingent beneficiary will only inherit benefits if the primary can't — generally meaning they can't be found, they refuse the benefits, they can't legally accept them, or they die before you do.
- You can name any number of primary beneficiaries and contingent beneficiaries, but you have to allocate the percentage of your account you would like to go to each beneficiary, and for both primaries and contingents the total allocation must equal 100%.
- Beneficiaries can be named on IRA accounts (traditional, Roth, SIMPLE, SEP), 401(k) and 403(b) plans, deferred-compensation employer plans, life insurance plans, investment accounts, bank accounts, and any financial account designated as "Transfer on Death" (TOD).
- In community property states, designating someone other than a spouse as a primary beneficiary requires the notarized signature of that spouse.[12] Montana is not a community property state.

- Be aware that your beneficiary may not be directly eligible for your gift or may not actually want it. A minor child or incapacitated person (without the means to manage the assets) receiving assets as a beneficiary may require legal counsel to address questions of guardianship, conservatorship, and investment management. A beneficiary recipient in a high tax bracket may find themselves pushed into an even higher one. These are two examples of simple mistakes made by well-meaning account owners that ultimately reduce the value of their gift. Takeaway: Ask your financial advisor/planner about your beneficiary choices, and be sure to tell your beneficiaries you have them in mind.
- Perhaps most importantly, update your beneficiaries every three-to-five years, and any time you have a life-changing event, including:
    - Change in residence
    - Death of a spouse or close family member
    - Marriage, Divorce, Remarriage, etc.
    - Adoption
    - Birth of a child or grandchild

  This would also be the time to update your will, living will, any trusts, powers of attorney, and health care proxies. We will cover these in future articles. Additionally, reviewing the names on all jointly-held accounts would be recommended at this time.

If you are looking to designate beneficiaries on a 401(k), 403(b), or deferred-compensation employer plan, know that the responsibility of designating beneficiaries lies with you (the account owner), NOT with plan custodians or administrators. Sometimes, beneficiary information may be pre-populated on plan documents, but mistakes are not uncommon – always check the information for yourself before authorizing it with your signature.

Also, if your financial institution goes through a merger or consolidation, or simply changes to a new organizational/operating system, your named beneficiary may not transfer. It is wise to always keep digital or hard copies of beneficiary designations, and check with each institution to ensure their information matches yours. Again, keep in mind that beneficiary designations are powerful things, as they take precedence over wills and last testaments and avoid the costs of probate. Beneficiary designations are a simple and effective tool to plan your estate, and we can help you do it right.

What would you like to learn about in the next edition of *Market Update*?

Please email us your feedback and questions to: Eric.George@stockmanbank.com

Trusted Contacts are sometimes confused with beneficiary designations, and it is not unusual to see the same person(s) listed as both. However, they serve distinct purposes. A designated beneficiary is technically an heir of the account owner, and is contacted only upon the owner's death; a trusted contact person is actually a resource for the advisor while the account owner (client) is still alive.

Beneficiary designations have been around for decades, whereas trusted contacts are relatively new. The Securities and Exchange Commission (SEC) instituted new rules regarding trusted contacts that went into effect in February of 2018 aimed at preventing elder fraud. But these rules apply to account holders of all ages, and protect against circumstances that can affect anyone. The two principal rules dictate the following:

1. Advisors are permitted to place temporary holds on disbursements of funds or securities from the accounts of specified customers where there is a reasonable belief of financial exploitation of these customers (FINRA Rule 2165); and
2. Advisors are required to make reasonable efforts to obtain the name of and contact information for a trusted contact person ("trusted contact") for a customer's account (FINRA Rule 4512).[13]

The rules are mutually reinforcing: an advisor can put a hold (stop all activity) on your account if s/he detects what may be fraudulent activity, and if the advisor has requested trusted contact information and the client has provided it, the advisor has someone with whom to discuss the matter.

A client gives the advisor contact information of someone they trust in order to help the advisor (1) administer the client's account; (2) protect the client's assets; and (3) respond to possible financial fraud. That means we may get in touch with your trusted contact if:

- We've tried to get a hold of you without any luck over a period of time, and we're concerned about your safety;
- We need to confirm your health status, particularly in the case of mental decline or diminished capacity;
- We need to confirm the identity of any legal guardian, executor, trustee or holder of a power of attorney;
- We have reason to believe there is financial exploitation occurring.

When you give us a trusted contact, you authorize us to disclose your account information to that person. And to this end, a trusted contact must be a natural person (not a corporation or a law firm) age 18 or older.[14] Otherwise, there are no stipulations as to who you choose. Your trusted contact need not be a family member, and s/he could be your attorney, accountant, or another third-party professional, whose accountability and perhaps even fiduciary responsibility would be beneficial.

Ultimately, you want to choose someone with good judgment who will take the responsibility seriously. That includes respecting your privacy and acting with discretion. Whomever you choose, let that person know you have chosen them and be sure they are willing to fulfill the role. And then share the name of your contact with your family, letting them know you have taken this important step in safeguarding your financial health and future.

If you have a question about either beneficiaries or trusted contacts, or want to double-check who you have chosen, don't hesitate to give us a call. And if you would like to add a beneficiary or trusted contact, we can help you as well. Our advisors and financial planners are always ready to assist you with any financial questions.

Call or email us any time.

[1] https://www.cnn.com/2019/01/10/investing/fed-markets-balance-sheet/index.html.
[2] https://www.cnbc.com/2019/01/04/powell-says-fed-will-be-patient-with-monetary-policy-as-they-watch-how-economy-does.html.
[3] https://www.cnbc.com/2019/01/30/fed-chair-jerome-powell-says-the-case-for-raising-interest-rates-has-weakened.html.
[4] https://www.cnn.com/2019/02/06/economy/janet-yellen-fed-rate-cuts/index.html.
[5] Then-Fed Chair Ben Bernanke introduced the "tapering" concept during his testimony before Congress on May 22, 2013, bringing turmoil to stock and bond markets later dubbed "taper tantrum." See https://in.reuters.com/article/usa-fed-2013-timeline/timeline-key-events-for-the-fed-in-2013-the-year-of-the-taper-tantrum-idINKCN1P6034.
[6] "Although the process of normalizing the size of the balance sheet will be in the background, that process will interact with the Committee's decisions regarding the federal funds rate." Jerome Powell, "Thoughts on the normalization of monetary policy," June 1, 2017 speech at the Economic Club of New York, https://www.federalreserve.gov/newsevents/speech/powell20170601a.htm.
[7] https://www.cnn.com/2019/01/10/investing/fed-markets-balance-sheet/index.html.
[8] https://www.cnbc.com/2019/01/04/fed-chief-powell-just-walked-back-his-autopilot-remark-and-the-financial-markets-love-it.html, https://www.morningstar.com/news/dow-jones/TDJNDN_201901045124/fed-chairman-powell-sees-flexibility-on-rates-this-year-update.html.
[9] https://www.cnn.com/2019/01/10/investing/fed-markets-balance-sheet/index.html.
[10] The Chicago Mercantile Exchange (CME) has an excellent website offering free access to information and data, particularly covering commodities. Their Fed Watch tool can be seen at https://www.cmegroup.com/trading/interest-rates/countdown-to-fomc.html.
[11] With interest rates pushed down to zero and the massive Quantitative Easing instituted after the Financial Crisis (both unprecedented), we are for all practical purposes in unchartered territory. The unfortunate case study is Japan, which began its experiments with QE in the early 1990s in response to the bubble in the Nikkei Stock Exchange bursting; the Bank of Japan (the "Japanese Fed") has fought a deflationary spiral every since, and Japan witnessed recessions in 2011 and 2015, and barely avoided another last year.
[12] The community property states in the U.S. are Washington, Idaho, Nevada, California, Arizona, New Mexico, Texas, Louisiana, and Wisconsin.
[13] See Securities Exchange Act Release No. 79964 (Feb. 3, 2017), 82 FR 10059 (Feb. 9, 2017), available at www.sec.org.
[14] For beneficiaries, this is not the case – for example, you could name a charitable non-profit organization as a beneficiary, but not as a trusted contact.

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