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QtrNotes

Qtr 2 April 2016

FIRESTONE CAPITAL MANAGEMENT

Volume 24 No. 2

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Form ADV Offer

Each year, the SEC requires that we notify clients when we have updated our disclosure brochure, known as the Form ADV Part II. You can download the updated document from our website by entering the following URL into a browser:

firestonecapital.com/docs/FCM Form ADV Part II.pdf

If you would like a copy sent to you directly, please call our office. We will be happy to mail or email you one.

Quotes:

I'm not saying the market is never right when prices go down (or up). I'm saying the market has no special insight and conveys no consistently helpful message. It's not that it's always wrong; it's that there's no reason to presume it's right.

Howard Marks,
Oaktree Capital

The stock market has predicted nine of the last five recessions.

Paul Samuelson (1966)
MIT professor & Nobel laureate

Luck is where opportunity meets preparation.

Denzel Washington

Market Perception vs. Economic Realities

In the middle of a heated political season, if we listen to the candidates, the economy couldn't be much worse and each of them can tell us who is to blame. Is it really as bad as they want to insist? By allowing our understanding to be colored by the constant doom-and-gloom rhetoric, our perception of the economic condition may be very different from reality.

Index	3/31/2016	YTD
Dow Industrials	17,669.72	1.5%
S&P 500 Index	2,059.74	0.8%
Russell 2000	1,114.03	-1.9%
MSCI EAFE	1,652.03	-3.7%
Global Bond Index	468.21	5.9%
10-Year Treasury yld	1.77%	

The start to 2016 has already been full of ups and downs: within the span of three months, we have seen a miniature version of the "emotional cycle of investing." The Dow Jones index fell 6% in first 5 days of January and continued to fall, reaching a 10% correction by February. Oil prices had fallen without pause since 2014 and by February dipped to $26 per barrel. Investors were clearly on edge, fearing more pain would follow, as oil experts predicted prices could fall even farther, to $10 per barrel.

Yet since early February, oil has rallied 50% and stock markets have rebounded. A month ago investors feared a recession; today investor behavior suggests the coast is clear.

Predictions for the rest of the year remain muted: the same theme since the end of the recession in 2009. While growth has been slow, it has not been steady. Last year alone we saw economic growth swing from under 1% to almost 4%. In the global economy, factors that can affect growth include the price of oil, global currency fluctuations, central bank forecasts, and even the weather.

Stock indices have been flat to down for the year overall, but not evenly across the board. Value stocks have done well, while growth-oriented stocks have pulled back. Health care stocks, the darling of the market last year, are down almost 30% this year. Commodity stocks, which struggled mightily last year, are up 8% this year. Diversified portfolios have benefitted.

One question that has yet to be resolved is when the Federal Reserve will meaningfully raise interest rates. We are still early in the normalization of interest rates, as the Fed has enacted just one quarter-percent increase in seven years. By the Federal Reserve's own estimates, we should expect two more rate hikes in 2016, which combined could bring the benchmark rate close to 1.0%. Should the planned hikes come to pass, they will be a welcome sign that inflation is approaching the targeted level, employment numbers are strong, and the economy is growing at a good pace.

Inflation is at the heart of the debate over interest rates. Monetary leaders worldwide believe that inflation is a necessary component of a healthy economy, and that 2% inflation is the "Goldilocks" number, the balance between price stability and maximum economic productivity. When inflation is lower, there is less incentive to consume now versus later; higher inflation pushes current demand up too quickly, which fuels cycles of ever-increasing prices.

US inflation has averaged less than 1% over the last year, the missing piece of the puzzle explaining why the Federal Reserve hasn't acted more aggressively. Low oil prices and a strong US dollar have kept down the cost of consumer goods; global consumer demand has been below average, causing a supply/demand imbalance. Now that oil prices may have bottomed and currency markets seem to be stabilizing, we believe it is wise to anticipate increased inflation.

Even at a 2% inflation rate, goods and services become 50% more expensive in just 20 years. Inflation is an invisible tax, which slowly erodes

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Safety in Numbers:

Better Mousetraps, Same Rats

From the dawn of the computer age, every innovation – computing power, memory, connection speed and efficiency – has been met and leapfrogged by usage. We often comment on how the phones in our pockets have more computing power than the entire Apollo space program; we rarely note that a single game on that phone requires more raw processing, in less time, than a rocket launch did.

The ugly underbelly of the computer world also innovates at the same furious pace. As solutions are found for one strain of malware, cyber-criminals change their business models, upgrade their technology and refine their approach to keep their profits flowing.

The newest threat, which is not really new, is ransomware, which locks down a system or an entire network until the victim pays for a decryption key. Municipal governments and entire hospitals have been held hostage, but the most common victim is an ordinary person's home computer.

Fortunately, the means of delivery is still the same: emails with toxic links or booby-trapped attachments, with social engineering baiting the hook. The newest threats are fought with the oldest means: don't be a sucker. Scepticism still works.

Perception vs. Reality

(cont'd from page 1)

purchasing power. A good sign for consumers is that over the past year, wages for American families grew by a healthy 2.5%, faster than the cost of living.

Because the unemployment rate remains low, we anticipate additional pressure on wages. As the global economy heals, we expect inflationary pressures to rise. We recognize that inflation is inevitable, but we cannot predict the pace or timing. To cushion the effects of inflation, we continue to maintain investments in assets with growth power greater than inflation.

The 4% Rule in Today's Environment

With the first wave of baby boomers reaching 70 in 2016, planning for retirement is front and center for both clients and planners, and the assumptions of past decades are facing challenges and tests.

Planning for retirement used to be easy. Planners described retirement income as a three-legged stool: many retirees still had traditional pensions, Social Security was the second leg, and the final leg was personal savings. In years gone by, you could simply buy a portfolio of high-quality bonds with your savings, live off the 5% interest and reinvest the maturing bonds at current rates. Even if interest rates fell, social security and pensions gave retirees a cost-of-living adjustment.

Back in 1994, to answer clients' questions of how much they could draw down from their portfolios without depleting their funds, California financial planner Bill Begen first formulated the "4% Rule". Since that time, the same rule of thumb has been used: a 4% draw from a portfolio is sustainable. The assumption stood unchallenged for two decades, during times of good markets and bad – until these last two years, when we have been hit with the double-whammy of low interest rates and difficult stock markets. Clients, and even some advisors, have begun to question whether the 4% rule still works.

Retirement planning is more complicated now. In addition to the scarcity of traditional pensions (fewer than 15% of private-sector employees still have them), a portfolio of high-quality bonds is unlikely to yield much. The misperception that income investments are a retiree's only choice has led investors to keep searching for higher-yielding – and higher-risk – investments for their portfolios. Two bear markets in a decade have burned investors and made too many abandon stocks entirely.

What retirees need to live on is really *cash flow*: a check every month, which can come from a total return strategy, a combination of interest on bonds, dividends on stocks, and capital gains harvested from selling appreciated securities.

Do we believe that the 4% withdrawal rate still works? Yes, with a few caveats. The portfolio must be diversified, with at least 40% in growth investments: equities, both domestic and international (or mutual funds that hold stocks), real estate and other alternative assets, even a bit of commodities to hedge against inflation rising in the future. Further, this is not a "set-it-and-forget-it" game plan. The portfolio needs to be monitored and rebalanced regularly.

Using common sense helps. In years when portfolios are not performing well, withdraw less. In years when returns blow out the lights, reserve some for leaner years. Retirement is a dynamic process. Assumptions should be tested on a regular basis, and spending plans should be tailored to the results. We have the tools to help you navigate this process. Let us develop your base case and help you manage your retirement.

Estate Taxes

We normally talk about estate taxes in terms of the potential Federal tax burden on a large estate. With an exclusion of \$5.4 million per person for 2016 (\$10.9 million per couple), only the estates of the 1.2% wealthiest Americans are currently subject to Federal tax. But Federal estate taxes are not the only death taxes that may come into play.

Many states have decoupled their estate taxes from the Federal exclusion amounts. Here in Florida, we have no state estate tax, but 15 other states, including New York, Pennsylvania, Washington, and Massachusetts, as well as the District of Columbia, do have state inheritance or estate taxes, with rates up to 18% and relatively modest exemption levels.

Even if you live in a state with no separate death tax rules, if you expect to inherit assets or act as an executor for someone in one of these states, check out the rules regarding that state's estate taxes.