Stark Financial Advisers, Inc.

A Registered Investment Adviser

2nd Quarter 2018 Commentary

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Special points of interest:

- It's Time to Be Sensible and Not Panic
- Give Credit to Uncle Sam for Higher Stock Prices
- Economy in Best Shape in 10 years
- How Will the New Tax Law Affect You?
- High Dividends Equal Low Stock Prices
- Wage Inflation, the Biggest Risk to Stocks
- Taxes and Investment Performance

Inside this issue:

A Correction is Not a Crash

For nearly a decade stocks have been the go-to investment. Supported by easy monetary policy, volatility has been historically low as prices have continued to march higher. Now volatility is increasing, and we have been experiencing a very overdo correction. It's time to be sensible and not panic. A correction is not a crash. Corrections occur when valuations become to rich. Market corrections are normal and are defined as market pullbacks of 20% or less. Market timing is hardly ever successful but that doesn't stop some investors from shifting investments into cash in hopes of addressing market downturns. Often this strategy results in missing some of the market's biggest gains while they sit on the sidelines. Peer pressure also influences some investors. Don't sell just because others may be. Perhaps unfortunately, there is a custom of reporting returns quarterly. Short-term changes in the market can give the appearance of volatility. However, over a longer time the market is comparatively tranquil. This is an insight that is often lost when markets are correcting. Proper asset-allocation and a long-term buy-and-hold strategy may not be exciting, but it has historically been an effective strategy. In an asset-allocation strategy such as we employ, asset class allocations are determined by an investor's risk tolerance and time horizon. Changes in asset class valuations trigger portfolio rebalancing. When one asset class becomes overvalued (or undervalued) compared to another, the allocation to that asset class is increased or reduced to maintain an efficient, risk appropriate portfolio. Investment decisions are not driven by an attempt to time the market, emotion, or the herd instinct. Be greedy when others are fearful. As Warren Buffet said, "the more (the market) goes down, the more I like to buy."

Thank you Uncle Sam

Since mid-2016, the S&P 500 has rallied 37% (42% including dividends), the result of an ongoing global synchronized recovery. On December 22, 2017 the new tax code was signed, providing $1,500-$2,000 of relief to the average American family, and incentivizing capital spending. On February 8, Congress avoided a government shutdown by passing a spending bill, appropriating funds for the military, non-defense programs and disaster relief. According to Credit Suisse economists, this largess should add 60 bps to 2018 GDP (20-30 bps from tax plan, 30-40 bps from spending bill). Robust growth has multiplier effect on profits. Credit Suisse's work indicates that a 1% rise in GDP translates into a 2½% increase in S&P 500 revenues. Operating leverage further amplifies this upside. Company guidance indicates that the effective tax rate will fall from 27% to 22%, a 7% increase in profitability for the median S&P 500 company. A combination of tax benefits and faster GDP has resulted in a substantial increase in analyst estimates, with 2018 EPS expected to grow 18%.

The State of the US Economy

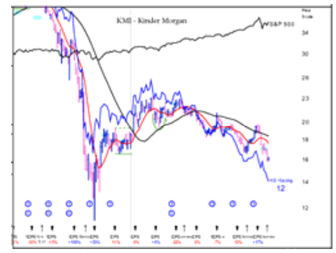
10 years after the global financial crisis, the state of the economy is good. In fact, it is in the best shape that it has been in since the crisis and by many metrics, since well before the crisis. An important place to see the improvement is in the labor market. After peaking at 10 percent in October 2009, the unemployment rate fell rather steadily to 4.1 percent in January--the lowest level since the 1960s (except for one short period). The post-crisis performance of gross domestic product (GDP) growth has been more disappointing, averaging just 2 percent per year over the past seven years. However, beginning with the second quarter of last year, growth has shown some momentum. Over the past three quarters of 2017, real GDP increased at an average rate of almost 3 percent. Consumer confidence has returned to pre-crisis levels and business optimism has also improved. The tax and fiscal packages passed in recent months could help sustain the economy's momentum. An area that continues to lag is productivity growth. Much attention has been made of the apparent low level of inflation despite the tightness in labor markets. The 12-month increase in headline PCE prices was 1.7 percent in December, below the Fed's 2 percent objective. Most likely, the current shortfall in inflation from target is due to transitory factors that will fade through 2018. Suffice to say, a deviation from the Fed's target of a few tenths of 1 percentage point, are not likely to cause concern. Against this economic backdrop, it is appropriate that monetary policy should continue to be gradually normalized. Initiated in October, the US Federal Reserve bank started to gradually scale back the reinvestment of proceeds from maturing Treasury securities and principal payments from agency securities. With the balance sheet normalization plan now on autopilot, the federal funds rate remains the Fed's primary tool for adjusting the stance of monetary policy. At the January meeting, the Federal Open Market Committee decided to maintain its target range for the federal funds rate between 1-1/4 percent and 1-1/2 percent. Further gradual increases in the policy rate are appropriate to both sustain a healthy labor market and stabilize inflation around the Fed's 2 percent objective.

Changes in the 2018 Tax Law

The new Tax Law brings many changes. The current seven-bracket structure remains, but the income thresholds and current rates of 10, 15, 25, 28, 33, 35 and 39.6 percent change, with rates under the Act set at 10, 12, 22, 24, 32, 35 and 37 percent, effective Jan. 1, 2018. The top individual tax rate of 37 percent applies for couples with taxable income of $600,000 or more and individuals with taxable income of $500,000 or more. The individual AMT has been retained, but with higher exemption amounts ($109,400 for joint filers) and increased phaseout thresholds ($1 million for joint filers). Most itemized deductions have been eliminated other than charitable deductions, home mortgage interest deductions (with the cap lowered from $1 million to $750,000 for new mortgages by joint filers on first or second homes), and state and local income, sales, and property tax deductions (combined cap of $10,000). The standard deduction has nearly doubled to $12,000 for individuals and $24,000 for joint filers. Also doubling, the child credit to $2,000 ($1,400 of that being refundable), and permission to use Section 529 accounts to save for certain elementary and secondary education expenses as well as for higher education. Graduate students also may continue to exempt the value of reduced tuition from their income. The interest deduction on home equity loans has been eliminated. The Law allows for the deduction of medical expense in excess of 7.5 percent of Adjusted Gross Income ("AGI") for 2017 and 2018 (then returning to those in excess of 10 percent). The estate tax has been retained, with a doubling of the estate tax exemption thresholds to approximately $11 million and $22 million, with continued inflation indexing after Dec. 1, 2019 (but reverting to pre-Act law after 2025). Current laws regarding the recognition rules for the sales of securities have been retained allowing investors to identify which securities are being sold.

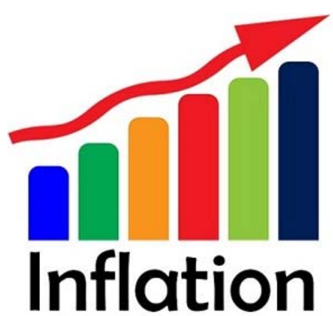
High Dividend Yields Can Equal Low Stock Prices

At a point in history where interest rates are still near historic lows, investors often seek out companies that have high dividend yields. But, there is a downside. Dividends are a proxy for interest rates. When bonds suffer, so do stocks that are dividend plays. Since rates bottomed after June 2016, the more of a company's earnings that it pays as dividends, the worse its stock has done. In any market, the highest dividend payout ratios often appear at businesses with lackluster profits or debt-burdened balance sheets. Since rates have steepened, investors have preferred companies with ample reserves of cash. Many of the top-performing stocks lately have been those with high levels of cash as a percentage of their assets. An example is Kinder Morgan that had the highest dividend payout ratio among Standard & Poor's 500 stocks in 2017. The gas pipeline operator paid 50 cents of dividends despite earning only a penny a share. Kinder's stock has fallen some 25% in the past 12 months. Other examples are Apache, down 35% and CenturyLink off 28%. (We are excluding real estate investment trusts, which measure earnings differently and must pay out most earnings, by law.) There is a flip side. Companies with low payout ratios such as Cigna and Cooper Cos., (each paid out around 1% of earnings as dividends), have seen their shares rise around 27% and 13% respectively. Many companies that have retained most of their earnings such as Global Payments, PVH, and Texton have all beaten the market. The strategy that has historically provided excellent returns is one that focuses on companies that are increasing their cash dividends consistently.



Inflation—The Biggest Risk to Stocks

Are we headed for a trade war? It's unlikely. Most likely President Trump is assuming an extreme position from which he plans to negotiate. While tariffs have rattled the market, there are other risks such as higher interest rates. Interest rates coming off of historic lows are normalizing. Look for the 10-year yield to stabilize around 3% - 3.5%. Not high enough to trigger an exodus from stocks. An upside surprise in inflation however, could trigger higher interest rates and encourage the sale of equities. As uncertainties have developed the market has had panic attacks and volatility has increased. These scary panics are likely to continue but not develop into a bear market. Overall positive market fundamentals should provide a floor against a cyclical decline. But, stocks aren't cheap and you need to have a long-term horizon to buy now. On the positive side, what drives stocks are earnings and the earnings story is phenomenal. Earnings of $155 for the S&P 500 this year and $166 for 2019 supports the possibility of the S&P trading at 3100, up about 15% from current levels, within next year. What you need to watch is wage inflation. A surprise pickup in employee costs would reduce



profit margins and bring down earnings estimates. Lower earnings expectations would reduce the target valuations for stocks and likely cause investors to sell as they adjust to the lower expectations. Despite our favorable view of domestic stocks, we have pared back our domestic exposure increasing allocations to Developed Market and Emerging Market equities. This is simply a valuation play which recognizes that on a relative basis, foreign securities are cheaper. One driving feature of emerging markets is that countries are becoming wealthier. The middle classes are growing and there is more spending on items other that food and fuel. A weaking US dollar is a risk when investing overseas. Traditionally, the dollar does poorly when the rest of the world is doing well. A weak dollar drags down non-US returns. This year the dollar has fallen about 2.5%. From current levels further downside is possible but unlikely to be severe enough to offset the valuation advantage of many foreign markets. In summary, we expect stocks both domestically and foreign to move higher. Our strategy and allocations would change if a surprise pick-up in the rate of inflation and level of interest rates develops.

About Stark Financial Advisers

Stark Financial Advisers is a registered investment adviser affiliated with R.M. Stark & Co., Inc., an SEC registered broker dealer. SFA seeks to achieve positive returns over a long-term investment horizon by creating and maintaining the optimum portfolio for each investor. We view the optimum portfolio as one having the highest potential return consistent with the risk tolerance and investment horizon of the owner.

We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

Taxes and Investment Returns

The United States income tax system was enacted in 1913. The highest marginal rate exceeded 90% during both World War II and the Korean War, while the lowest marginal rate rarely exceeded 20%. A 91-year examination between 1926 and 2016 of past capital market returns of four traditional asset classes shows that stocks have provided the highest returns and largest increase in wealth over the period. Fixed-income investments provided only a fraction of the growth provided by stocks. In all asset classes, taxes have had a dramatic effect on returns. Stocks are the only asset class that provided significant long-term growth. Considering taxes, government bonds barely outperformed inflation. Municipal bonds outperformed government bonds but significantly underperformed stocks. The adverse effects of inflation and taxes become pronounced over the long-term. From 1926 to 2016 stocks averaged an 8% return after taxes compared with 10% before taxes. Bonds averaged 3.5% after taxes. Cash equivalents earned 2.1%. Treasury bills fared the worst. Assuming $1 invested in 1926 the current purchasing power has been reduced to $0.49 after accounting for both inflation and taxes. While it is impossible to avoid taxes, it is often possible to defer taxes. By deferring taxation, the impact of taxes can be reduced maximizing contributions to tax-deferred vehicles such as IRAs and 401 (k) plans. The longer the deferral period, the greater the advantage. Finally, in a world with taxes if you desire substantial growth, you may want to consider a larger allocation to stocks assuming your time horizon and risk appetite allows.

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"Helping Clients Balance Risk and Return"

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