Investor Insights & Outlook

January 2017 4th Quarter Concorde Investment Management

International Economic Overview

A Message from Concorde Investment Management

We are pleased to provide the following overview of the domestic and international economic backdrop and the financial markets that impacted our investment policy and strategy during the Fourth Quarter of 2016, as well as other articles of interest.

So far, it seems the main effect of Brexit is the weakness of the Pound. Immediately post Brexit the Pound weakened relative to the U.S. Dollar to the range of 1.30 to 1.35. Once we got into October it dropped to the low 1.20's which is where it has stayed through January. This did help British exporters during Q4 as they reported a substantial boost to their competitiveness. The weak Pound also helped tourists visiting the UK as output in the distribution, hotels and restaurants sector rose by 1.7%. Inflation, as we wrote about at the end of Q3, has moved higher, hitting 1% in October which is its highest level in 2 years.

One thing we will be watching as it relates to international economic activity is what trade deals the new administrations puts together. During Trump's first week in office he signed an executive order killing the TPP and the administration has signaled it will be working on signing bilateral trade agreements rather than multilateral. Each one of those trade agreements will be unique and heavily impact trade and trade deficits. Every trade minister in any country that the U.S. imports goods and services from better become highly aware of any relative trade imbalance with the U.S. One way the new administration may try to goose the GDP of the United States is through adjusting trade imbalances towards the U.S. GDP= private consumption spending + investments + government spending + (exports – imports). In the calculation, if we have a trade deficit (aka more imports versus exports), then it subtracts from GDP. Nominal dollar growth of U.S. GDP in 2016 was $530.3 Billion. That includes an overall trade deficit of $500 Billion (2015 number). If the new administration can figure out a way to squeeze that trade deficit down by $150 Billion or so then the GDP number will move into the mid 3 to 4% range. The countries that the Trump administration will look to accomplish that with, which should be no surprise, are countries the U.S. has the biggest trade deficits with: China ($343B), Germany ($74B), Japan ($67B), Mexico ($53B), and Canada ($35B).

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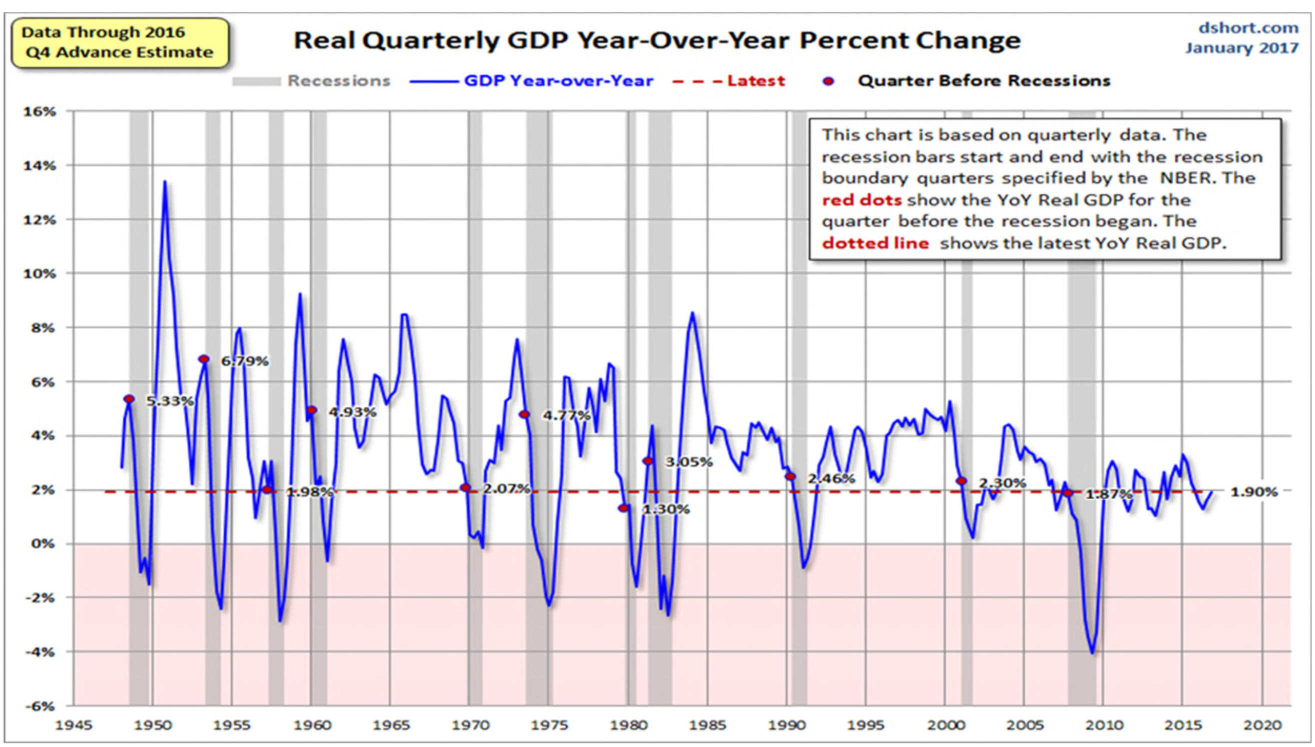
Domestic Economic Overview

Q4 Real GDP increased at an annual rate of 1.9%, below estimates of 2.2%. Given the behavior of the equity markets during Q4 we might have expected a better than estimate number rather than worse. This was much lower than Q3 Real GDP of 3.5% although a big portion of that number was Soybean exports after South America had a poor harvest (really!). Actual Real GDP for the full year 2016 was 1.6% which was the weakest since 2011. Not much of this is surprising given there wasn't going to be a material increase in GDP growth until the U.S. had some real structural changes to commerce, trade, regulatory, and tax policy. The drivers in Q4 that contributed to the 1.9% were consumption expenditures (holiday shopping), inventory investment which we expect is related to a surge in oil drilling given the price recovery, and the housing market.

One of the new items that is constantly reported on is how slow this recovery is compared to historical recoveries after recessions. The below graph crystalizes that comment. The lightly shaded grey bars are recessions. Looking back, we can see that post recession growth is usually much higher than our current run and 9 of 11 recessions have begun at a higher level of Real YoY GDP.

We assign that to regulatory burden, capital allocation decisions of companies, and lack of wage growth. Those may be coming to an end with the new administration however we've seen nothing concrete proposed as of yet, just headlines of increased infrastructure spending, tax cuts, and regulatory reduction. Those changes will be difficult to get through Congress, all in one fail swoop. This has two possible meanings: First, net job adds looks robust because there weren't as many hires during the holiday season that get laid off, or Second, small business enthusiasm for new possible tax and regulatory reform has already trickled to additional hires. The day we sent our mailings out ADP announced payroll increase of 246k vs estimates around 175k for January. While ADP has a poor track record (average error by ADP is 42k over the past year), this is a robust number to start 2017. The estimates have goods-producing companies adding 46k, construction jobs of 25k, and manufacturing and mining 21k.



Equity Markets

The domestic equity markets surged in the last half of the fourth quarter adding to what had been a good year up to that point. The sectors that outperformed included financials, industrials, energy and materials, which all are typically considered value groups. Financials, particularly commercial banks, responded to higher short and long term rates and the cyclical sectors gained strength from improving industrial and energy trends and some increasing optimism for accelerating growth. Generally speaking, smaller capitalization stocks of all types outperformed larger caps for the year and quarter and there continue to be wide divergences in sector performance. Broader large and multi-cap benchmarks rose between the high single digits and low double digits for the year after the end of year rally. Overall, although the year over year profits recession appears to have ended, the recent gains may be reflecting a rosier outlook than is warranted with the uncertainty of possible changes in fiscal and regulatory policy.

Internationally, many emerging markets continued to rebound at year end from what have been weak performances in recent years. Some larger emerging markets however, such as India, Mexico and China faltered in Q4 and ended the year flat to down. Geographic selection continues to be very critical. The developed international markets, primarily Western Europe and Japan, were very subdued both in the quarter and for the full year. Historical valuations for both emerging and developed international markets are at a discount to domestic markets and that is probably justified with their higher risk factor for U.S. investors. However, gradual increasing stability in most of Western Europe and improving commodity prices in many emerging markets suggest some investment exposure for investors is warranted.

As always, we are evaluating individual situations for good value and there continue to be a select number of attractive opportunities in the market. We believe in staying close to fully invested with some reserves in cash or policy flexibility to take advantage of weakness.

WEB PRESENCE AND CLIENT LOGIN

Last year we launched our website www.concordeco.com. If you have not already done so, please take a few minutes to explore the website. On the site you will find information about our firm, services, certain literature, and access to client portals. Notice that our "Client Access" tab has a pathway to a "Concorde Login". To obtain your personal login information, please contact Greg Wood at gregwood@concordeco.com or 972-701-5412 and he will work with you to get your account set up.

Fixed Income

The fixed income markets and Fed policy continued to capture a considerable amount of the investment discussion in the fourth quarter. The Federal Reserve raised their target Fed Funds rate as expected and also implied that the likelihood of multiple increases in 2017 is increasing. Additionally, Treasury bond and note yields continued their upward trend as improving economic statistics, increasing labor and core inflation and optimism with regard to a potentially more favorable business environment created a strong surge in yields the last 6 weeks of the year. The investment and economic implications if this trend continues could be significant. Clearly, rising yields will damage the value of fixed income investments, particularly longer maturities. In the short term this could drive some investment dollars into equities. Historically, rising 10-year Treasury yields while below 5.00% are positive for equity market returns. Another positive is that this move towards normalized levels could drive more rational capital allocation decisions, adding to growth momentum. A significant move is still required before 10-year Treasury yields (currently 2.50%) reach normal historical levels of 4.00-5.00% based on relationships to nominal GDP, Fed Funds rates and core inflation. This highlights an environment that is still attractive for business and consumers.

With the conviction that we may be breaking the artificially low rate environment of the recent past, investment strategy in fixed income is critical. We will continue to utilize a mix of core short to medium term Treasuries and Agencies, select investment grade and below investment grade corporates, short term, primarily revenue based municipals and a mix of institutional flexible strategy funds to generate significant income with limited duration and credit risk. This diversified approach produced superior results in the second half of 2016 as Treasury yields rose persistently and performed particularly well in the 3 months ending November 30 at the height of the surge. If rates continue to rise into a 2.50-3.50% range on 10-year Treasuries during this year we would begin to extend maturities gradually on core positions to capture the higher yields.

A Guide to College-Savings Options

by Timothy Strauts

Is setting up a college-savings account for a child or grandchild an item on your to-do list? You know you should get it done; that matriculation date just keeps creeping closer. But finding the right vehicle to save for college can be daunting. There are many choices, and it can be difficult to discern the differences between each type of account.

Below, we've outlined a few salient features of a few of the most common college-savings vehicles, including the tax treatment for each, how much you can contribute, who can contribute, the rules governing distributions, and a summary of the types of individuals who will tend to benefit most from each investment vehicle.

529 College-Savings Plan

Tax Treatment: Contributions not deductible on federal income tax. Contributions may receive a state tax break (either a deduction or a credit). Money compounds on a tax-free basis and withdrawals to pay for qualified college expenses are tax-free, too.

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Tax Benefit: Possible state tax break; tax-free compounding; tax-free withdrawals. Contributions treated as completed gifts; apply $14,000 annual gift-tax exclusion (per person, so $28,000 per married couple) or up to $70,000 ($140,000 per married couple) with five-year election (click here to read the IRS rules on this).

Contribution Limit: Per IRS guidelines, lifetime contributions cannot exceed the amount necessary to provide education for beneficiary. What this actually means varies widely by state and by plan--anywhere from $235,000 to $425,000 for non-prepaid tuition plans. Deduction amounts vary by state, and gift tax may apply to very high contribution amounts.

Income Limit: None.

Withdrawal Flexibility: Medium. Investors can withdraw contributions at any time without taxes or penalty. Withdrawals of investment earnings must be used for qualified college expenditures or will incur taxes and a 10% penalty. Those withdrawing funds for noncollege expenses may also be required to pay back any state tax deduction they've received on contributions. They can, however, change the beneficiary of a plan, as long as the new beneficiary is a family member of the former beneficiary.

Investment Flexibility: Low. Investors in 529 plans must choose their investments from a preset menu offered by the plan.

Required Distributions: None.

Pros: High allowable contribution amounts, state tax breaks on contributions, and tax-free compounding and withdrawals. The plans reduce the financial-aid impact compared with money held in the student's name.

Cons: States may impose an extra layer of administrative costs, and investment choices may be costly and/or subpar.

Best for: Individuals who are aiming to stash a significant sum for college while also enjoying tax benefits.

Coverdell Education Savings Account

Tax Treatment: Contributions not deductible on federal or state income tax. Money compounds on a tax-free basis, and withdrawals to pay for qualified educational expenses are tax-free, too. Contributions don't have to be made with earned income, meaning grandparents can contribute even if parents are ineligible due to income limits.

Tax Benefit: Tax-free compounding; tax-free withdrawals for qualified educational expenses.

Contribution Limit and Time Frame: $2,000 per beneficiary, per year; must make contributions by the time beneficiary is age 18. (Any amount exceeding $2,000 per year per beneficiary is subject to a 6% excise tax penalty.)

Income Limit: For 2016, single income tax filers with modified adjusted gross incomes of more than $110,000 and married couples filing jointly with incomes greater than $220,000 cannot make contributions to a Coverdell.

Withdrawal Flexibility: Medium. Withdrawals of contributions are tax- and penalty-free. And in contrast with 529 assets, in which withdrawals will incur taxes and a penalty unless used for qualified college expenses, Coverdell assets may be used for elementary and high school expenses, too. You can also change the beneficiary of a plan, as long as the new beneficiary is a family member of the former beneficiary.

Investment Flexibility: Medium. Coverdell ESA investors can, in theory, invest in a broad swath of assets, but fewer and fewer investment providers offer the accounts.

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Required Distributions: Funds must generally be distributed from an account by the time the student reaches age 30, though they may be rolled over into a Coverdell ESA for another eligible family member.

Pros: Ability to use funds for elementary and high school expenses; flexibility to invest in a broad variety of securities, including mutual funds and individual stocks.

Cons: Limited contribution amounts and lower MAGI thresholds; investment providers may not offer this account type.

Best for: Individuals aiming to invest relatively smaller sums for education--including elementary, high school, and college--who are seeking more investment flexibility than 529s afford.

UGMA/UTMA
Tax Treatment: Aftertax contributions. Earnings and gains taxed to minor; for children under age 19 and full-time students under age 24 (whose unearned income does not provide half their support), first $1,050 of unearned income is tax-exempt, the next $1,050 is taxed at the child's rate, and over $2,100 is taxed at parents' rate.

Tax Benefit: First $2,100 of earnings and gains subject to lower tax rates. Transfers treated as completed gifts; apply $14,000 annual gift tax exclusion.

Contribution Limit: None. Gift tax may apply to contribution amounts above $14,000 per child for single filers; $28,000 for married couples.

Income Limit: None.

Withdrawal Flexibility: Greater. There is no penalty for using assets to pay for non-educational expenses, regardless of the child's age. However, even though custodian retains control of assets until beneficiary reaches 18 or 21 (depending on the state and type of account), the assets may be used only for the child's benefit (that is, not to cover basic parental obligations such as food and shelter). When the minor in whose name the UGMA/UTMA account is established reaches age of termination, he or she assumes control of all the assets.

Investment Flexibility: Greater. UGMA/UTMA investors can invest in a broad swath of assets.

Required Distributions: Minor takes custodial ownership of assets at age of termination (18-21)--varies by state and account type.

Pros: No penalty for not using earnings for educational expenses; can be used for any purpose that benefits beneficiary.

Cons: Counted as student's assets, heavier impact on financial aid eligibility. Cannot transfer beneficiary. Contributions are irrevocable. At age of majority, beneficiary is entitled to account assets.

Best for: Individuals who may not attend college.

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Roth IRA

Tax Treatment: Aftertax contributions; tax-free compounding and withdrawals after five years, at age 59 1/2.

Tax Benefit: Tax-free compounding and withdrawals.

Contribution Limit: $5,500 (under 50); $6,500 (over 50).

Income Limit: Single filers with modified adjusted gross incomes below $132,000 can make at least a partial contribution for 2016. Married couples filing jointly can make at least a partial contribution if their modified adjusted gross incomes are less than $194,000. Investors of all income level can contribute to a Roth with the 'backdoor' maneuver.

Withdrawal Flexibility: Medium. Roth IRA contributions can be withdrawn tax-free for any purpose. And while you'll typically face taxes and a 10% early withdrawal penalty if you take out investment earnings from your Roth before age 59 1/2, the 10% penalty usually assessed for early withdrawals from an IRA is waived if funds are used to pay for college tuition, books, fees, and other qualified expenses.

Investment Flexibility: High. Most investment types can be held inside an IRA, with a few exceptions.

Required Distributions: None.

Pros: Investors can choose low-cost and best-of-breed investments with limited administrative costs. For financial aid: not counted as asset in need-based calculations. Money not spent on college can be used for retirement instead.

Cons: Limited contribution amounts. If you are depending on the Roth IRA to help fund your retirement you may be depriving yourself of years of tax-free growth and distributions by removing funds from the account to pay for college. For financial aid: Distributions taken from Roth IRA (even if contributions only) are counted as income the year after they are taken.

Best for: Savers aiming to invest relatively smaller sums and who desire more flexibility in terms of investment options and use of assets (can be used to pay for college and to fund retirement).

Disclosure: 529 plans are tax-deferred college-savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax.

This is for informational purposes only and should not be considered tax or financial planning advice. Please consult with a financial or tax professional for advice specific to your situation.

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