FAIRPORT ASSET MANAGEMENT
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The Compass

Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

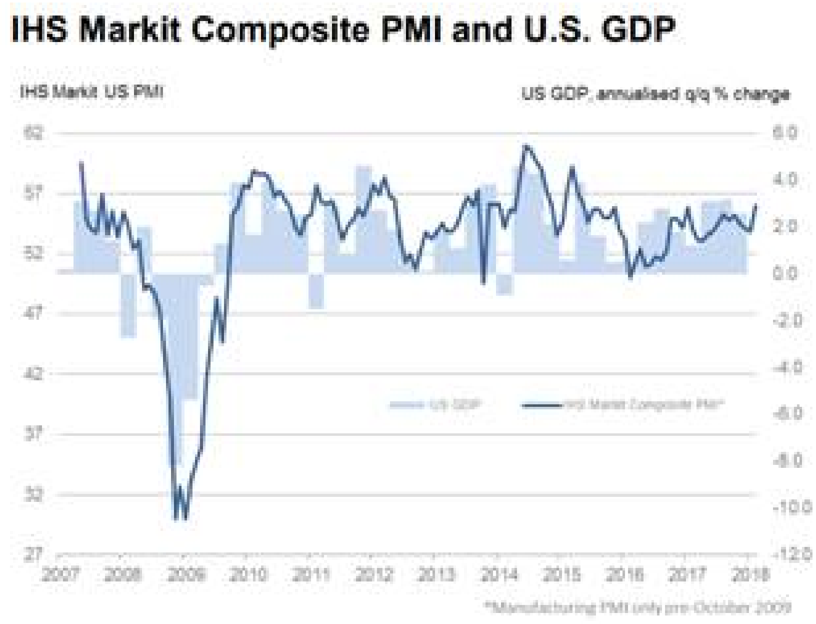
March 2018
Thank you for your continued trust, loyalty and generous referrals. As always, we encourage you to share this newsletter with friends, family members and colleagues.

Mid-Quarter Commentary as of February 27, 2018
John M. Silvis, CFA
Chief Investment Officer

The equity markets around the globe started 2018 building off the momentum experienced last year with the S&P 500 Index registering a total return of 5.7% in the month of January. Based on the first fifteen trading days, it was the fourth best start to a year since 1950. This would bode well for the rest of the year as historical returns have always been positive with the average annual gain coming in at 24%. Internationally, the MSCI All Country World Index (ACWI) did equally well in the first month matching the return of 5.7% led by emerging markets (which was the best performing asset class last year) capturing 8.3%.

However, January would turn out to be the quiet before the storm as volatility returned to the equity markets as we entered the month of February. After going the whole year in 2017 without a correction of even 3%, the S&P 500 Index experienced a drawdown of -11.8% in the first few days of February. The equity markets were well overdue for some type of correction. Keep in mind, from an historical context, a correction of 10% or more is likely to happen once a year. Moving forward, we would expect more volatility as we head into 2018, more in line with the historical norms of a secular bull market.

The economy remains on firm ground with the fourth quarter Gross Domestic Product (GDP) growth coming in at 2.6%. The rate was lower than the previous two quarters which saw GDP growth of over 3%. However, the past quarter was slowed as inventories, which built up during the year, were drawn down during the last few months of 2017. Economists are increasingly looking for GDP growth to rise in 2018 with the average forecast coming in at 3.0% for the year. Unemployment claims continue to fall, recording 154 straight weeks under 300,000 which is a level that historically has pointed to an expanding economy. Business confidence continues to trend higher with company surveys, measured by EvercoreISI, hitting its highest levels since 2014. Flash PMI for February, released earlier this month by IHS Markit, shows Manufacturing PMI at a 40 month high with the overall Composite PMI at a 27 month high. Current readings would correspond to GDP growth above 3% (see chart).



Sources: IHS Markit, U.S. Bureau of Economic Analysis.

On the consumer side, the effects of the tax cuts passing last year will start to show in lower payroll withholdings for most Americans. Over 3 million employees either saw a bonus check or a wage increase due to the new tax laws. Consumer net worth continues to climb with home prices, measured by the CoreLogic Case-Shiller Home Price Index, rising 6.3% in December versus the previous year.

Yields on the 10-year Treasury have broken out since the end of last year and are approaching long term support. The movement in rates has coincided with the transition to Jerome Powell as the new Federal Reserve Chairman earlier this month. Powell has reaffirmed his predecessor's view that Fed will likely raise rates three times in 2018, in line with earlier projections. Higher economic growth and rising wages will likely shift the focus in the coming months towards inflation and the Fed's long term target of 2%. After several years below the target, a meaningful shift above 2% could spark inflationary concerns.

The current economic expansion is not limited to just the U.S. as growth continues to accelerate around the globe with virtually all regions showing signs of economic improvement. Economies overseas have been the primary beneficiaries of rising consumer demand in the United States. Emerging markets have benefited the most from the global pick up and should see solid growth in the next few quarters. China, the second biggest market behind the U.S., is expected to maintain its current path of 6.5% to 7% growth in 2018, in line with the government's official target. Globally, monetary policy should remain accommodative for most of the year as Japan is expected to maintain its easing program and Europe will likely taper their bond buying later in the year.

As global growth improves, it's likely that commodity prices will continue to climb as demand starts to outstrip supply. Oil prices have remained above $60 per barrel and should see some support for higher prices, aided by the decline in the dollar. The greenback dropped -10% last year and looks to continue the decline this year.

International equities will likely outpace their domestic counterparts again this year, building off the trend from 2017. Emerging markets were the best performing asset class so far this year returning 8.3% in the month of January. Developed international markets slightly trailed the S&P 500, returning 5.0% during the month of January. Like here at home, we would expect more volatility in overseas equity markets as rates drift higher and geopolitics remain in the spotlight.

We still favor Large Caps stocks over Small Caps, carrying over a theme from last year. However, Small Caps could see a bump from the new tax code as they tend to have less exposure overseas and benefit more directly from the pickup in consumer demand here at home. On a sector level, the leaders at the end of last year continued that role in the New Year with Technology, Healthcare, Financials and Consumer Discretionary all out ahead of the benchmark. Defensive sectors remain the laggards with Utilities, Staples and Real Estate falling behind. We remain confident the cyclical sectors led by Technology and Financials will drive the equity markets forward in the coming months. Corporate earnings growth, fueled by an expanding economy, will continue to press higher with the most recently reported quarter gaining 15% versus last year. We would expect to see earnings growth of over 10% in the New Year with lower corporate taxes being a tailwind in an already positive backdrop.

Overall we remain constructive on the equity markets in 2018 and should see further gains as we move into the New Year. However, volatility will likely increase and we would expect to experience pullbacks along the way in the continuation of the equity expansion.

Fixed Income Commentary as of February 27, 2018
Rick D'Amico, CFA
Manager of Investments

In late January, 10-year U.S. Treasury yields broke decisively through a key resistance level of 2.62%, and have since moved sharply higher to their current rate of 2.90%. The recent move higher in rates can be primarily attributed to higher inflation expectations and an increase in the term premium. As far as inflation is concerned, there is evidence to suggest that wage pressures are starting to build, as the year-to-year changes in the Employment Cost Index and Average Hourly Earnings are now at their highest levels since 2008, and 2009, respectively.

The next key resistance level to watch on the 10-year Treasury is 3.05%, which represents the top of a downtrend line dating back 32 years! Given the strength of this next resistance level, 10-year Treasury yields could be due for a short pause before resuming their march higher. In addition, bond sentiment is the most bearish since the start of the financial crisis. Historically, when bond sentiment has been this extreme, we've seen a recovery in bond prices.

Going forward, investors will continue to look for clues on the path of interest rates from newly installed Federal Reserve Chairman Jerome Powell. According to Roberto Perli's (Cornerstone Macro) analysis of Powell's recent testimony "nothing of what Powell said suggested that the Fed is about to drastically depart from its very gradual pace of rate hikes." Our base case scenario calls for 3 interest rate increases in 2018, with an outside chance of 4. As Chairman Powell stated in his recent testimony "the FOMC will continue to strike a balance between avoiding an overheated economy and bringing PCE price inflation to 2 percent on a sustained basis." The next key Fed event to watch is the March 21st FOMC meeting, where Chairman Powell will give his first press conference. According to the Fed Funds futures market, there is also a 100% probability that the FED increases interest rates .25% at this meeting.

As of February 27, 2018, the Barclays U.S. Aggregate Bond Index has posted a negative 2.28% year-to-date return. Fairport remains cautious on fixed income going forward, favoring strategies that have tended to perform better in rising a rate environment such as high yield bonds and floating rate debt.

Announcing our 2018 Community Beacon – YWCA Greater Cleveland

Fairport is pleased to announce the YWCA Greater Cleveland as our 8th annual Community Beacon recipient. Desiring to unify our efforts as a firm to provide meaningful support to the Northeast Ohio community, Fairport selects one charitable organization per year that reflects our firm's values. 2018 marks 150 years of service for YWCA Greater Cleveland. Their past is rich with impact, change and achievement and their mission is undeniably aligned with our core purpose of inspiring families and our women-focused Luma Wealth division.

YWCA Greater Cleveland is dedicated to eliminating racism, empowering women and promoting peace, justice, freedom and dignity for all. Their programs are designed to create a future where homelessness is prevented, racial disparities are dismantled and women's leadership is accelerated.

As part of our commitment, we will raise awareness and goodwill as sponsors for the Anniversary Campaign, Women of Achievement awards luncheon and Circle 2018. Our employees and clients will have the opportunity to volunteer at several events with families and children. And our experienced advisors will share their expertise as brand ambassadors.

"We are just thrilled to be named the 2018 Community Beacon Recipient," stated YWCA Greater Cleveland President & CEO Margaret Mitchell. "We're so elated because the Fairport family commits their heart, hands and head fully to a Beacon recipient for a year and there is no greater gift than that. Past recipients of this award are amazing and we are so proud to be recognized for the important work we do."

We join our clients and friends who are YWCA board and advisory council members, donors and staff in celebration and support. And we forward to sharing our experiences with YOU throughout the year. Visit www.ywcaofcleveland.org to learn more about their life-changing initiatives, sign up for their eNews and get involved!

CELEBRATING 150 1868 – 2018 YEARS

eliminating racism
empowering women
ywca
Greater Cleveland

5 Important Financial Dates for 2018

No one wants to miss an important financial deadline, especially when there may be costly repercussions. Mark your calendar with these financial to dos to avoid paying unnecessary penalty fees or missing out on savings opportunities - and stay on track to your wealth goals.

1 PAY YOUR INCOME TAX

This year the tax filing deadline is Tuesday, April 17th since the 15th falls on a Sunday and the 16th is Emancipation Day (the day President Lincoln freed the slaves and a recognized holiday in Washington, D.C.). If you cannot have your taxes completed by the deadline, you must file for an extension by April 17th. Then you have until October 15th to submit your return.

What happens if you miss the deadline? The IRS is not as concerned if your return is late *if they owe you money*, but you don't get your refund until you file. *If you owe* the IRS money and miss the deadline without filing for an extension, you will be assessed penalty fees.

2 PAY YOUR INCOME TAX (QUARTERLY) IF YOU HAVE NON-WITHHELD INCOME

Individuals who do not have estimated taxes withheld from a regular pay check need to make quarterly estimated tax payments to the IRS. This applies to people who are self-employed or business owners, and those who earn interest, dividend or rent income of greater than $1,000 for the year. In 2018, quarterly payments are due, as follows:

- 1st quarter – April 17, 2018
- 2nd quarter – June 15, 2018
- 3rd quarter – September 17, 2018
- 4th quarter – January 15, 2019

3 MAXIMIZING HEALTHCARE BENEFITS

Nearly 7% of the average high-net-worth household's expenditures goes toward healthcare,* so it's important to maximize the benefits your health plan provides.

During your firm's open enrollment period (generally held for a few weeks in the fall, with plan changes effective January 1st) take the time to re-evaluate your options based on your recent plan usage and potential changes to the offerings. Company's deadlines differ, so check your firm's cut off for plan enrollment, contributions and expense submissions. Also, don't leave healthcare money on the table. If you have a Flexible Spending Account (FSA), you may need to 'use it or lose it' by year end. The IRS allows employers to give FSA owners a grace period of 2 ½ months past the end of the year to use up the funds. If you have money remaining in your FSA for 2017, check to see if your employer provides an extension through March 15th. If so, and you do not have any medical appointment scheduled, you can make eligible medical purchases, including prescriptions, over the counter medicines and other products such as bandages, thermometers and first aid kits. And, keep in mind that FSAs generally require active renewal during your employer's open enrollment period.

However, if you have a Health Savings Account (HSA) the funds roll over every year and can also earn interest – and there is no usage deadline. An HSA is a high deductible plan you contribute to with pre-tax dollars (up to the allowable limit). Interest earned, investment gains and allowable withdrawals are also tax-free. The deadline for contributing to an HSA is the same as the tax deadline. This means that you can make 2017 contributions through April 17, 2018.

4 PREPARE FOR RETIREMENT

To maximize your retirement savings, take advantage of opportunities to fund your account with pre-tax savings. Know the deadlines for contributing to (and withdrawing from) the plans that are relevant to you.

- **For Traditional and Roth IRAs**, the most common retirement savings vehicles, you can contribute up to the allowable maximum by the tax deadline, April 17, 2018.
- **SEP IRAs**, generally for small business owners and their employees, must be established and funded by the tax filing deadline; if you file an extension, you have until the extension deadline, October 15th.
- Contributions to employer sponsored qualified retirement plans, such as a **401(k)**, are typically due on the last business day of the calendar year. Keep in mind that only funds withheld from your paycheck are tax deductible.
- **Individual 401(k)s** must be set up by business fiscal year end, typically December 31st; contributions can be made through tax filing deadline, including an extension.

If you are older than 70 ½, remember to take your required minimum distribution (RMD) from your IRAs by December 31st. Failure to take RMDs on time can result in a penalty.

5 TAKE ADVANTAGE OF YEAR-END TAX STRATEGIES
Effective tax planning strategies can help you minimize your income and estate taxes, provide for your family or favorite charity, and grow your retirement account. Making a gift to a loved one can be done without tax consequence if you keep it within the annual exclusion limit which is currently $15,000 per donee. Making a charitable donation is a way to reduce your income taxes and do good at the same time – but donations must be made by December 31st. Donating highly appreciated stock instead of cash will provide further benefit by allowing you to avoid capital gains tax on the appreciation.

You can also reduce your tax burden through tax-loss harvesting, selling a security that has gone down in value to offset investment gains. While you have until year-end to do so, it often makes more sense to take advantage of this strategy earlier in the year, such as when your investment portfolio is rebalanced. Your advisor can work with you to determine if this strategy makes sense for your situation and recommend the appropriate timing. As always, please reach out to a member of your Fairport team if you have any questions or to discuss further.

**Household healthcare spending in 2014, Bureau of Labor Statistics, August 2016, Vol. 5/No. 13*

Fairport News
We're life-long learners! Read about our most recent continuing education and leadership training experiences.

Andrew Connors completed the Schwab Executive Leadership program. The elite training program focuses on developing leadership, innovation, talent management, strategic marketing and entrepreneurship skills to help leaders manage and grow their firms.

Rick D'Amico attended the 2017 NABE (National Association for Business Economics) Annual Meeting featuring Federal Reserve Chair Janet Yellen in September, CFA Society of Cleveland Wealth Management Conference in October and the Best of BlackRock Symposium with **Katie Sheehan** and **Mike Kalinoski** in February.

Chris Isabella participated in the 2017 MEGA Tax Conference in December via webinar.

John Silvis attended the world's largest exchange traded funds event - InsideETFs - in January.

Newsletter Disclosures
This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable.