# YOUR FINANCIAL FUTURE

Your Guide to Life Planning

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We thought of you when we reviewed this article and hope you find it interesting. Please call if you have any questions and we hope all is well!


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## In This Issue

## Key Takeaways

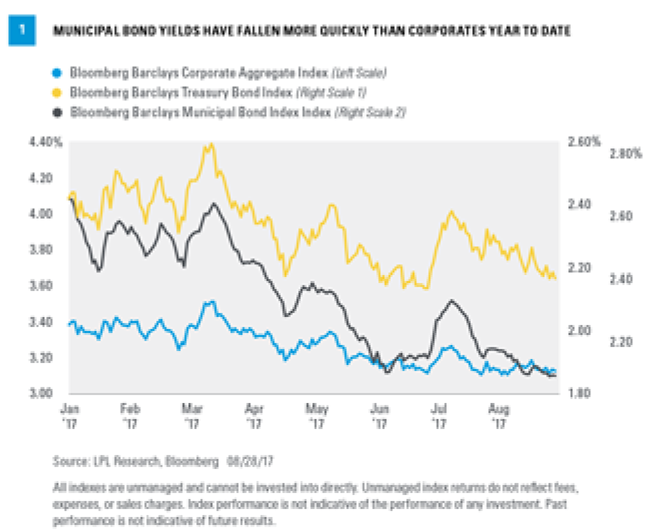
- Municipal bonds have performed well in 2017, but increased seasonal supply this fall may be an impending headwind.
- Valuations are stretched--evident by taxable equivalent yields and ratio analysis.
- Despite higher prices, investment-grade municipal bonds can offer a tax-advantaged way to potentially increase credit quality and diversify portfolios.

## Will Munis Fall With the Leaves?

With autumn around the corner, many municipal bond participants are wondering if the high prices are poised to drop, much like the fall leaves. Thus far in 2017, municipal bonds have performed well, and as such, valuations are beginning to look stretched with higher prices and new issue supply expected to increase. Additionally, the threat of a budget impasse in September looms if Congress doesn't extend the debt ceiling and reach a 2018 budget agreement, which could weigh heavily on fixed income markets. Despite all of these factors, we continue to view municipals favorably, but there may be a better entry point after the new issue supply and the leaves have fallen.

### YIELDS HAVE DECLINED, PRICES HAVE RISEN

Cheaper prices enticed buyers back into municipals at the beginning of the year, following a substantial sell-off in late 2016. The rally in prices can be seen by comparing the yield for the Bloomberg Barclays Municipal Bond Index against the Bloomberg Barclays Corporate Aggregate and Bloomberg Barclays Treasury Bond indexes [Figure 1]. Starting the year at 2.65%, the municipal index yield is now lower by 65 basis points (0.65%) at 2.09%, while the corporate index fell 26 basis points (3.37% to 3.11%), and the Treasury index lost 27 basis points (2.44% to 2.17%). When yields fall, prices rise (and vice versa), so the larger drop in municipal yields indicates stronger year-to-date performance.




### RECENT PERFORMANCE HAS BEEN SOLID

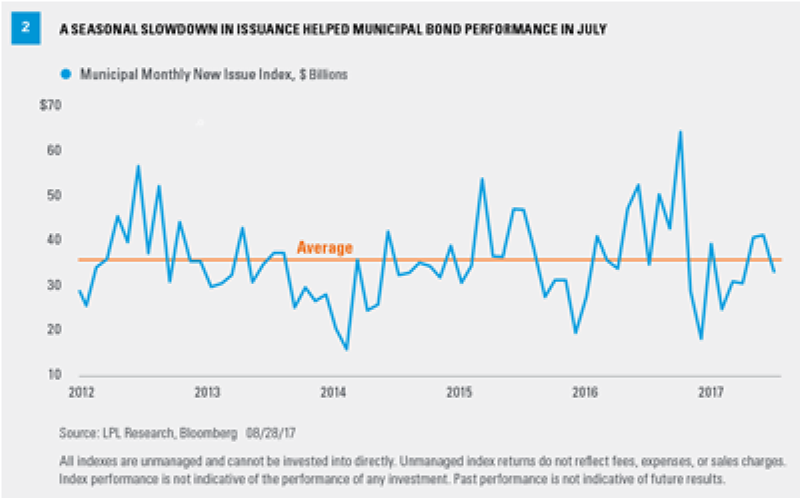
The Bloomberg Barclays Municipal Bond Index has posted a total return of 0.66% this month (as of August 29, 2017) and 5.09% thus far this year. This is a slight rebound from return levels earlier in the summer. June is typically a heavy coupon reinvestment period when many interest rate payments are received and reinvested back into the bond market, thus driving the demand higher later in the season. Generally, when demand outpaces supply, prices rise and performance improves. Year to date, municipals are beating the Bloomberg Barclays U.S. Aggregate Bond Index, an index comprised of high-quality mortgage-backed bonds, U.S. Treasuries, and investment-grade corporates, by 1.65% (5.09% versus 3.44%).

### …BUT RELATIVE VALUATIONS ARE STRETCHED

Municipal bond investors often pay a higher price (and receive less yield) for the added potential benefit of the tax-free income they receive. Generally, when municipal prices are below comparable taxable bond prices, municipal bonds are said to be cheap. Another way to compare relative value is to look at the ratio of municipal bond yields to similarly dated Treasury bond yields, where higher ratios represent cheaper relative valuations. Historically, using Bloomberg pricing data, a 5-year ratio above 75%, a 10-year ratio above 85%, and a 30-year ratio above 95%, are thought to represent value. Currently, the 5-year ratio is 65%, which is well below the historic average of 90% (2001-2017), pointing to rich valuations in this part of the yield curve. The 10-year ratio is 86%, above the historic average, but more expensive than the 5-year average of 97.2%. The 30-year ratio is now at 100%, also above its historic level, but expensive compared to the 5-year average of 103%. Together, these indicate that relative valuations have become somewhat stretched. (Note that the ratio figures may differ depending on the data source used.)

**BOND SUPPLY**

In addition to ratios showing that municipals are slightly expensive, new issue supply may be growing. The supply of new bonds priced in the market also affects the relative value of municipals. July's issuance of $33 billion was below the 10-year monthly average of $36 billion according to the Municipal Monthly New Issue Index, which caused price strength in the market. Historically, demand increases and supply tends to shrink between July and August [Figure 2]. However, issuers can take advantage of bonds' higher prices and issue after the summer months, which could lead to price weakness.




**CONCLUSION**

Investment-grade and high-yield municipals have performed well so far this year. We do not expect a second half sell-off like last year, but supply is historically heavier after the summer months and inflows are expected to decrease based on seasonal trends. These factors could contribute to some market weakness in the near term. Tax-free yields relative to taxable U.S. Treasuries are lower than in early 2017, which may cause investors to look to other fixed income sectors for additional yield. While a better entry point may be ahead, we continue to favor investment-grade municipal bonds in a portfolio context for appropriate investors, as they offer very little correlation to stocks and can be used to potentially increase credit quality and diversify portfolios.

*IMPORTANT DISCLOSURES*

*The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.*

*The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.*

*This information is not intended to be a substitute for specific individualized tax advice. We suggest that you discuss your specific tax issues with a qualified tax advisor.*

*There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.*

*Diversification does not ensure against market risk.*

*Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.*

*Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.*

*High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.*

*Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.*

*Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.*

*Yield spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings, and risk.*

*INDEX DEFINITIONS*

*The Bloomberg Barclays Municipal Bond Index is a market capitalization-weighted index of investment-grade municipal bonds with maturities of at least one year.*

*The Bloomberg Barclays US Aggregate Bond Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.*

*The Bloomberg Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. Bloomberg Barclay's U.S. Treasury Index includes public debt of the U.S. Treasury with a remaining maturity of one year or more.*

*The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.*

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Weekly Market Commentary | Week of August 28, 2017

## HIGHLIGHTS

- Based on the Corporate Beige Book Barometer, companies remained generally upbeat during the second quarter earnings season.
- The number of mentions of the Trump administration in earnings conference calls has dropped substantially over the past two quarters.
- The positive tone from management teams appears to support a positive outlook for continued earnings gains.

## CORPORATE BEIGE BOOK: UPBEAT AS EXPECTED

The LPL Research Corporate Beige Book Barometer--our measure of corporate sentiment that reflects an analysis of earnings conference call transcripts--shows that companies remained generally upbeat during the second quarter earnings season. This is hardly a surprising outcome, given actual earnings results were very good and estimates of future earnings held up relatively well as companies provided forward-looking guidance.

*Earnings call transcripts analyzed took place starting in mid-July extending through the third week of August.*

### SECOND QUARTER 2017 EARNINGS SEASON

Corporate America delivered another outstanding earnings season in the second quarter of 2017, with the second consecutive quarter of double-digit year-over-year earnings growth; a solid 4% upside to forecasts and relatively upbeat guidance from management teams translated into resilient forward estimates. We were particularly impressed with the breadth of earnings gains and atypical upside to revenue forecasts. For more details, click here for our overview of earnings season.

### WHAT IS THE CORPORATE BEIGE BOOK?

We use earnings conference call transcripts to gauge overall sentiment of corporate management teams, much like we have done with the Federal Reserve's (Fed) Beige Book to create our Beige Book Barometer (the Fed's Beige Book is a qualitative assessment of the U.S. economy and each of the 12 Fed districts). To create our Corporate Beige Book, we count the number of strong words (or variations of "strong") and the number of weak words (or variations of "weak") and calculate the difference between the two. Examples of strong words include "robust," "solid," and "optimistic"; examples of weak words include "soft," "fragile," and "pessimistic." We can then compare that differential with prior quarters to make comparisons over time. Although not every single call transcript is analyzed, we believe the trends observed provide valuable insights.

**POSITIVE SENTIMENT CONFIRMS EARNINGS STRENGTH**

Corporate sentiment remained very optimistic during the second quarter based on our tally of positive and negative words in earnings conference call transcripts. Although we observed a drop in overall directional language (the total of strong and weak words), the differential remains positive **[Figure 1]**, while the ratio of positive-to-negative words has been on a steady climb since the end of the Chinese currency crisis in spring 2016 **[Figure 2]**. Specifically, from the third quarter of 2016 to the second quarter of 2017, the ratio of strong-to-weak words rose steadily from 2.6 to 6.8. The drop in directional language may simply reflect stability in the macro environment.

The improvement in management sentiment is encouraging and consistent with the strong earnings season. Corporate profits are growing at a solid, double-digit pace, and we believe the positive tone from management teams supports our outlook for further earnings gains.

Here are some excerpts from call transcripts supporting the improved economic and business sentiment:

- "We see moderate growth in the global economy. We expect U.S. gross domestic product (GDP) growth of 2.2% in calendar year 2017 and 2.5% in calendar year 2018. Consumer spending is solid, investment and trade are rebounding, and measures of business confidence remain high.--*Transportation*
- "The U.S. economic outlook remains solid, with job and wage growth sustaining consumer confidence and supporting continued economic expansion."--*Building materials*

**FOCUS ON THE WHITE HOUSE HAS FADED**

The amount of time since the election combined with the lack of fiscal policy initiatives that have been implemented led to a sizable drop in the number of mentions of the Trump administration over the past two quarters **[Figure 3]**.

We can also look at policy-related words such as "tax" or its variants and see the same story. The word "tax" was mentioned over 400 times during fourth quarter 2016 earnings conference calls, compared to less than 100 during the second quarter 2017 reporting season. Over this period, mentions of "infrastructure" (34 to 18), "trade" (91 to 45), and "regulations" (39 to 3) have also fallen substantially.

This analysis suggests that the market's expectations for tax reform and other policy initiatives that the Trump administration and Republican leaders have proposed are low, presenting a potential opportunity for an upside surprise. That thesis is supported by recent underperformance of the so-called "Trump" trades such as small cap stocks (tax reform beneficiaries). A weaker U.S. dollar and gains in Treasuries are also inconsistent with policies promoted by the administration that are expected to tighten up trade rules, stimulate inflation, and push up Treasury yields.

Here are some executives' comments on Washington, D.C. policy initiatives:

- "While I still believe that monetary policy is keeping rates artificially low, I also believe that elected officials need to do more on the fiscal policy front, especially through tax reform, to spur faster economic growth." *--Insurer*
- "Certainly, if we can find our way towards putting together an infrastructure bill, that would be very positive." *-Industrial equipment*
- "We continue to be cautiously optimistic that the stage is set for economic expansion. Offsetting that is a general uncertainty with respect to government policy, and economic initiatives, which may be putting a slight damper on corporate outlooks."--*Hotel*

**NONEXISTENT TALK OF RECESSION**

Corporate executives generally try to stay away from the "R" word (recession) when talking with investors, confirmed by the small number of mentions of the word over the past several years. But the second quarter took that to a new, low level with just three mentions **[Figure 4]** versus the quarterly average of nine since the first quarter of 2015. This data point, combined with our assessment of leading economic indicators, continues to point to low recession odds over the next year, as discussed in this week's *Weekly Economic Commentary*.

**WEAKER DOLLAR LED TO FEWER MENTIONS**

The amount of attention on currencies has fallen dramatically over the past two years, reflecting the stability and then weakness in the U.S. dollar. Currency mentions fell more than 20% for the second straight quarter and are at the lowest level since the first quarter of 2015 **[Figure 5]**. The drop makes sense given the U.S. Dollar Index has been down year over year since July 20, 2017, after approaching 20% year-over-year increases in early 2015. Currency had a marginal negative impact on overall S&P 500 earnings in the second quarter, and based on current exchange rates, could have a positive impact in the third quarter.

Here are several management comments on currency:

- "As a U.S. headquartered global company, currency translation has been a headwind on sales and earnings for more than a year. However, given the U.S. dollar weakening during the second quarter, and assuming those current exchange rates hold, we expect only a modest currency translation affecting our sales and earnings in the third quarter."--*Materials*
- "FX was mostly in line with our expectations, with one point of negative impact on total revenue growth, even with the slightly weaker than expected U.S. dollar."--*Software*

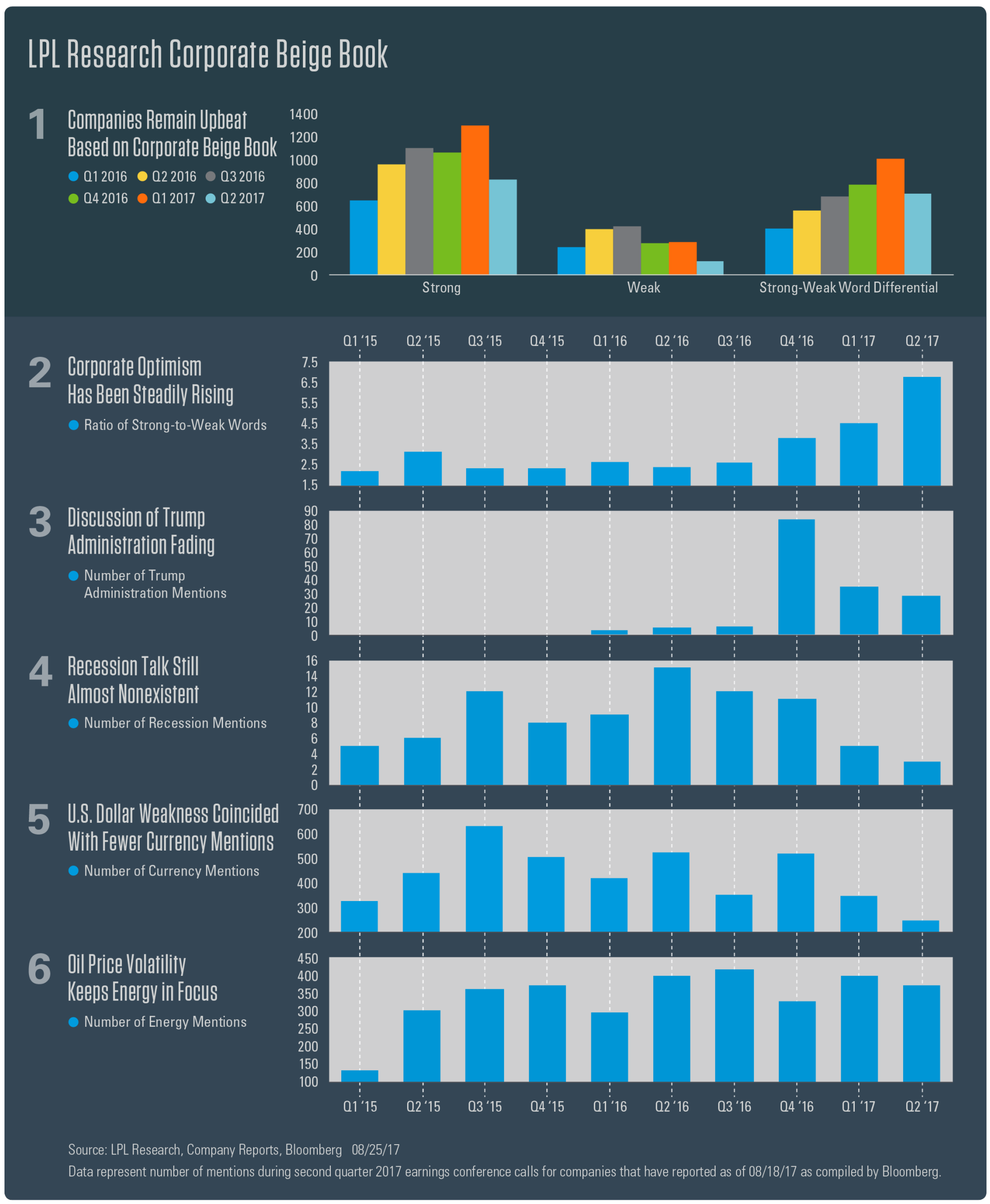
We see the potential for modest gains in the U.S. dollar over the balance of the year depending on the policy path in Washington, D.C., actions of global central banks, and movement in interest rates.

**ENERGY STILL GETTING ATTENTION**

Oil's rise from the mid-$20s per barrel in February 2016 to the low $50s late last year eased concerns about the negative impact on energy and energy-sensitive companies. Since then, oil prices have pulled back into the upper $40s; and while this is well above levels that had oil producers suffering, the topic continued to get a lot of attention from management teams this earnings season. In fact, oil and its variants (energy, gas, fuel, etc.) surprisingly got more mentions during this quarter than in the first quarter of 2016 **[Figure 6]**, when oil bottomed. Hurricane Harvey's impact is likely to keep energy relevant during the third quarter, though we would expect attention on the topic to fade later this year should oil prices remain range bound.

**CONCLUSION**

Management sentiment during second quarter earnings season was quite positive which is hardly surprising given actual earnings results were so good and estimates of future earnings held up well. We believe the positive tone from management teams supports our outlook for further solid earnings gains, but will continue to report back as time progresses.

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*Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.*

*Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.*

*The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.*

*All investing involves risk including loss of principal.*

*INDEX DESCRIPTIONS*

*The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*

*The USD Index measures the performance of the U.S. dollar against a basket of foreign currencies: EUR, JPY, GBP, CAD, CHF and SEK. The U.S. Dollar Index goes up when the dollar gains "strength" compared to other currencies.*

*This research material has been prepared by LPL Financial LLC.*

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# Auto-Escalation Programs -- A Boon to Retirement Savings

**Much of the advance in retirement savings can be attributed to strong investment performance, but auto-escalation -- a plan feature that automatically raises contribution rates until the savings rate reaches a predefined limit -- apparently played a significant role.**

Retirement plan participants broke savings records in the first quarter of 2017, thanks in part to the auto-escalation feature adopted by a number of plan sponsors.

According to data compiled by Fidelity Investments, the total savings rate (employee and employer contributions combined) reached 12.9%, up from the previous high of 12.8% in first quarter of 2006, while the average account balance rose to $95,500, up from $87,600 the previous year.[1] Overall, more than one in four (27%) of workers increased their plan contributions in the past 12 months.

## It's Automatic

Much of the advance in retirement savings can be attributed to strong investment performance, but auto-escalation -- a plan feature that automatically raises contribution rates until the savings rate reaches a predefined limit -- apparently played a significant role. According to Fidelity, the auto-escalation feature, which typically takes effect in the first quarter of each year, was responsible for half of the savings increases made by the 27% of workers who -- in the plans Fidelity administers -- recently upped their contributions.[2]

Often coupled with auto-enrollment, auto-escalation is not as widely used. A recent study by the Defined Contribution Institutional Investment Association (DCIIA) found that 62% of employers with large plans -- defined as plans with more than $200 million in assets -- used auto-enrollment, while just 48% have adopted auto-escalation.[3]

## Do-It-Yourself

If your employer has not yet adopted auto-escalation, don't despair. There are countless ways you can take it upon yourself to boost your retirement savings. Here are just a few suggestions:

- Apply a raise or bonus to retirement savings. Consider boosting your contribution rate with each increase in pay you receive. Making voluntary increases a habit year in and year out could bring you that much closer to the maximum contribution allowed by your employer. For 2017, plans may allow up to $18,000 in elective contributions plus an additional $6,000 in catch-up contributions for those employees age 50 and older.

- Cut back household expenses. You may be surprised by how quickly small savings can add up. Things as simple as brown-bagging lunch, switching from brand name to store brand items, and doing away with premium cable channels can make a noticeable difference in your monthly cash flow. Setting up a monthly budget of income and expenses may help you find ways to cut back more.

- Forgo a tax refund. The IRS reported that as of March 31, 2017, the average income tax refund check for individual tax returns filed during the 2017 season was $2,878.[4] If you typically get a tax refund, consider revising your W-4 form to reduce your withholding. Your paycheck will grow, allowing you to consider increasing the amount you save in your employer's retirement plan.

You can probably think of other ways to save, such as paying off credit card debt. It really doesn't matter how you achieve your goal, the important thing is to build your retirement account in ways that work for you.

[1]*benefitnews.com, "Retirement savings rates climb to record levels," May 14, 2017.*

[2]Bloomberg, "You're Killing It With Your 401(k)-on Autopilot," May 12, 2017.

[3]Defined Contribution Institutional Investment Association, "DCIIA Plan Sponsor Survey 2014: Focus on Automatic Plan Features," June 2015.

[4]The Internal Revenue Service, "Filing Season Statistics for Week Ending March 31, 2017," April 6, 2017.



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