



# YOUR FINANCIAL FUTURE

Your Guide to Life Planning

December 2017



Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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Corporate America delivered another outstanding earnings season.

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The yield curve continues to flatten, but remains far from inverting or signaling an impending recession.

### A Year of Spending (and Saving) Wisely

A step-by-step approach can make a long list of tasks more manageable. This checklist can help you address your financial tasks bit by bit.

## Weekly Market Commentary | Week of November 20, 2017

## KEY TAKEAWAYS

- Excluding the hurricane-riddled insurance sector, Corporate America produced its third straight quarter of double-digit earnings growth.
- Strong revenue upside, outstanding technology sector performance, and rising estimates were among the highlights.
- Positive earnings growth continues to provide support for the stock market, even at elevated valuations.

## HIGHLIGHTS FROM ANOTHER STRONG EARNINGS SEASON

Corporate America delivered another outstanding earnings season. S&P 500 Index earnings are tracking to an 8.2% year-over-year increase for the third quarter with just a handful of companies left to report. Excluding the impact of hurricanes within the insurance group, corporate America produced its third straight quarter of double-digit earnings growth. The amount of upside to earnings estimates was slightly below average in the quarter, but we consider the season a success given the strong upside to revenue forecasts, along with generally upbeat outlooks from corporate management teams.

The consistency with which companies have beaten estimates is particularly impressive, even when considering the historical pattern of consensus estimate reductions that give companies a lower bar. Earnings have beaten consensus estimates for 34 consecutive quarters, covering much of the current economic expansion (based on Thomson data).

## CONSIDER THE SOURCE

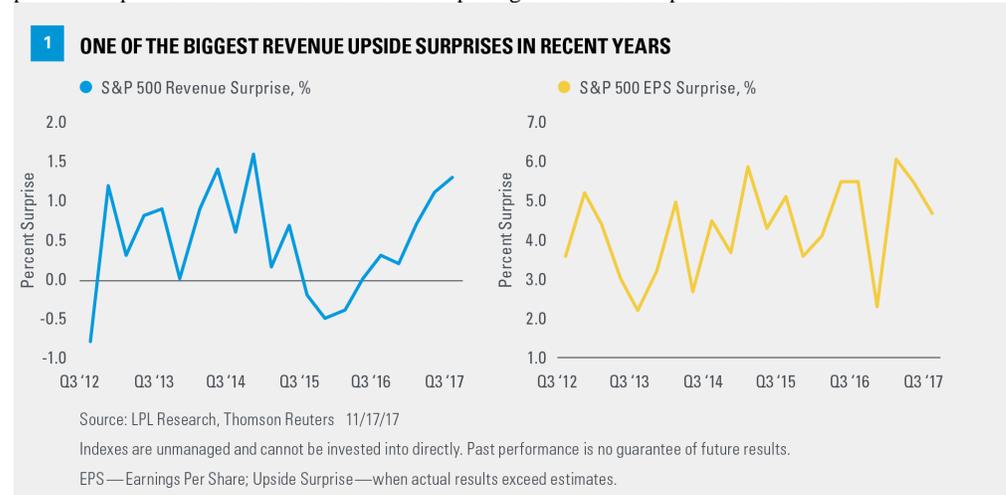
Different sources such as FactSet, Bloomberg, Standard & Poor's, and others have different calculations than Thomson Reuters for S&P 500 earnings, based on various methodologies and different interpretations of what constitutes operating earnings. We favor Thomson Reuters and FactSet for their long track records and wide followings.

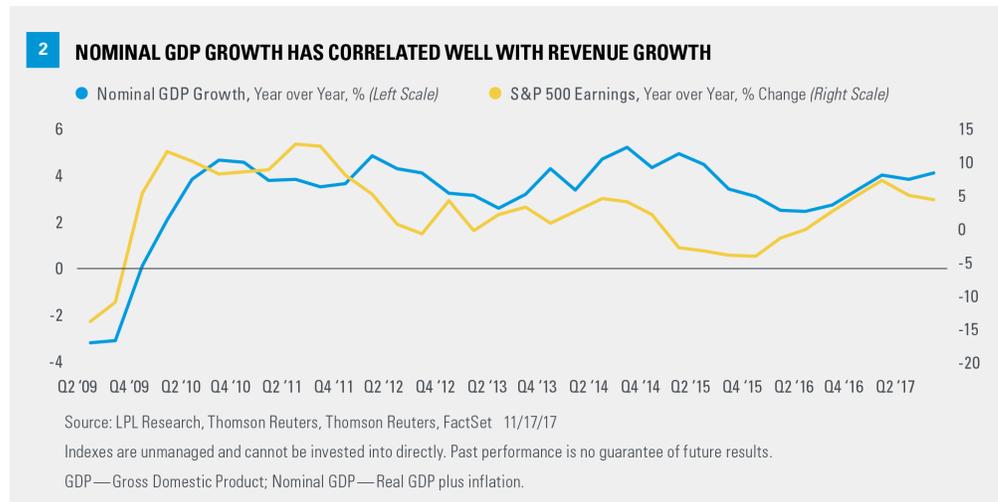
## SEASON HIGHLIGHTS

Here we share three highlights from the third quarter earnings season.

1. **Revenue upside.** S&P 500 revenue rose a solid 5.4% year-over-year in the third quarter. Perhaps more impressively, the index produced a revenue upside surprise of 1.3% compared with estimates as of September 30, 2017, one of the best performances of recent years [\[Figure 1\]](#). The revenue beat rate of 67% has only been topped once since 2011 and that was last quarter (Q2 2017) at 69%. The correlation between revenue and nominal gross domestic product (GDP)—or GDP including inflation—clearly helped during the quarter as the pace of nominal economic growth has picked up from under 3% in 2016 to about 4% over the past three quarters [\[Figure 2\]](#). (Note that GDP is commonly reported in real, or inflation-adjusted terms.)

The earnings upside for the S&P 500 has been fairly typical this earnings season. The average company has produced upside of 4.7% while on a market cap weighted basis the upside is a more moderate 2.3%.



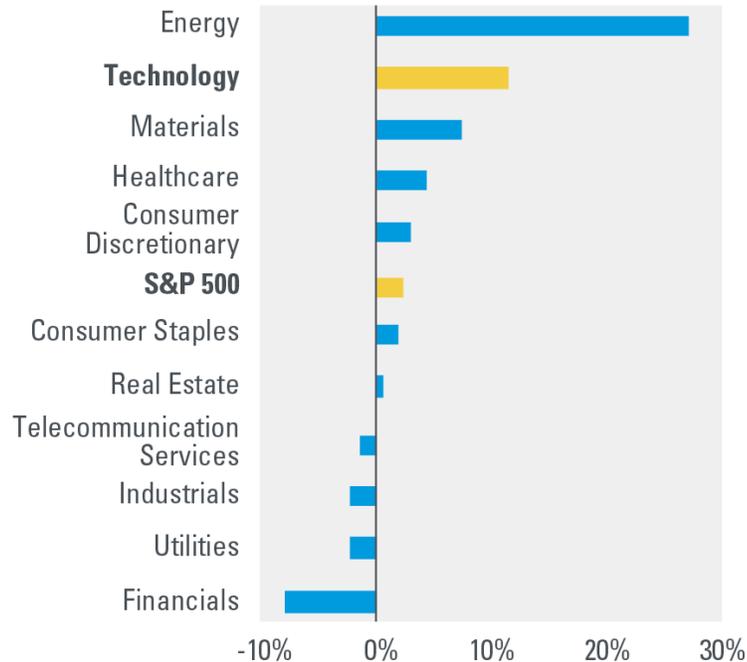


2. **Technology strength.** Although the energy sector produced the most upside to estimates among the 11 sectors, energy's gains came off of a very low base with easy comparisons. As a result, we are more impressed with the upside that the technology sector produced—more than 11% above estimates [\[Figure 3\]](#). At 24%, the earnings growth rate the sector produced in the quarter isn't too shabby. Semiconductor strength was the biggest driver, while internet and cloud computing themes were evident. The quarter has not been only about technology, though the sector has contributed roughly two-thirds of the overall S&P 500 increase; energy has contributed about 30% of the increase while healthcare has contributed

about 15%.

### 3 STRONG UPSIDE FROM TECHNOLOGY AND ENERGY

● Upside to 10/01/17 Estimates



Source: LPL Research, Thomson Reuters 11/17/17

As of 10/17/17.

All indexes are unmanaged and cannot be invested into directly.

Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. All performance referenced is historical and is no guarantee of future results. Estimates may not develop as predicted.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

3. **Rising estimates.** It is rare to see S&P 500 estimates for the next four quarters rise during earnings season but that is indeed what has happened. Since October 1, estimates for the next four quarters--the fourth quarter of 2017 through the third quarter of 2018--have risen by 0.3%. That doesn't sound like much but compared to the average 2-3% decline, and last quarter's 0.6% drop, it is very impressive and suggests optimism among corporate management teams.

We believe this dynamic reflects a favorable macroeconomic environment for corporate America, more so than analysts lifting their estimates to factor in the impact of tax reform. Better growth, improving capital equipment spending, strong consumer and business confidence, a weaker U.S. dollar, and limited wage pressures are among the factors supporting management outlooks for corporate profits. Meanwhile, market-based measures of tax policy optimism suggest still low expectations for a corporate tax cut, even after the House passed its tax package on November 16. Next month we will update our Corporate Beige Book barometer: an analysis of the topics covered in companies' earnings conference calls.

#### CONCLUSION

Third quarter earnings season has come to a close and it was another good one. Despite significant hurricane drags, companies produced solid earnings and revenue, led by the technology sector's stellar performance, while forward

estimates uncharacteristically rose. The macroeconomic environment is supportive of further earnings gains, even in the absence of tax reform. Strong earnings continue to support stocks even at elevated valuations. Much more on earnings coming in our Outlook 2018 publication due out next week where we discuss the potential for a tax boost to 2018 S&P 500 earnings and whether next year's consensus estimates around \$146 per share are in play (hint: we think that they are if the corporate rate is lowered).

*Due to the upcoming release of Outlook 2018: Return of the Business Cycle, the next weekly commentaries will be published on December 4. We hope the Thanksgiving holiday is enjoyable for all.*

#### **IMPORTANT DISCLOSURES**

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*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.*

*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.*

*Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.*

*Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, 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.*

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

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*Tracking #1-669556 (Exp. 11/18)*

## Bond Market Perspectives | Week of November 13, 2017

**Key Takeaways**

- The yield curve continues to flatten, but remains far from inverting or signaling an impending recession.
- The most recent decline in steepness has been driven by higher expectations for future rate hikes, due to continued economic improvement and a pickup in inflation expectations.

**Further Flattening**

Recent Treasury yield curve flattening may be a warning sign from fixed income markets, but there are also arguments to suggest otherwise. Historically, an inverting yield curve has been a solid leading indicator of recessions. However, the yield curve's recent behavior is seemingly incongruous with that of equity markets, which have continued to hit record highs throughout the year. Although the yield curve may be implying a slower growth environment than equity markets are signaling, the curve is still a long way from inverting.

**CONTINUED FLATTENING...**

Year to date, the Treasury yield curve has flattened considerably. The steepness of the yield curve, the difference between longer- and shorter-term Treasury yields, can be seen as a proxy for future growth and inflation expectations. If a high rate of growth and inflation are expected, fixed income investors will demand more of a premium to lock in their money at prevailing interest rates for a longer period of time. After locally peaking at a steepness of 1.36% on December 22, 2016, the 2-year/10-year curve has flattened considerably to a cycle low of 0.68% on November 7, 2017, below its pre-election level one year ago [Figure 1]. The 5-year/30-year curve has flattened to a similar extent. Despite this seemingly pessimistic indicator from fixed income markets, equity markets have continued to move higher, with the S&P 500 Index up 17.3% on a total return basis year to date through November 10, 2017.

**...BUT FAR FROM INVERTING**

Investors must remember that despite the trend of flattening throughout the year, the yield curve is still far from inverting. An inverted yield curve has historically been a good indicator of recessions, and has preceded each of the last nine recessions going back to 1955. On average, an inversion has led the subsequent recession by about five quarters; in the most recent recession in 2008, it was eight quarters. We don't believe that there will be a yield curve inversion during 2018, so despite relative flatness, the yield curve is not signaling an impending recession.

**WHY THE STALL?**

The most recent leg down in steepness started in the beginning of September. Since then, the yield curve has flattened modestly again, by 10 basis points (0.10%) based on the 2-year/10-year steepness and by 23 basis points (0.23%) based on the 5-year/30-year (as of November 10, 2017). Although a flattening yield curve usually brings to mind rising

short-term yields and declining long-term yields, this most recent flattening event has occurred as yields have risen across the entire yield curve, with short-term outpacing long [Figure 2].

## 2 SHORT-TERM YIELDS' INCREASE HAS OUTPACED THAT OF LONGER-TERM YIELDS



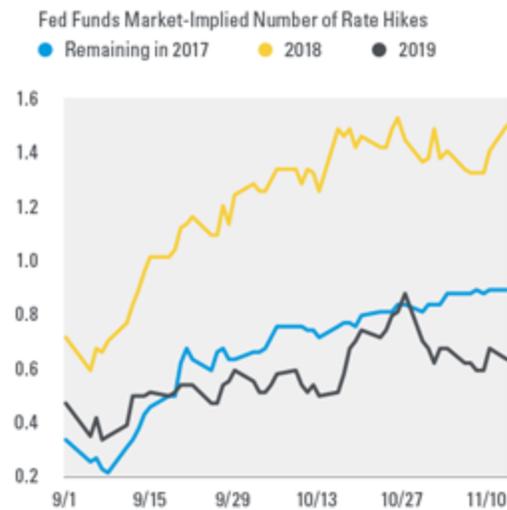
Source: LPL Research, Bloomberg 11/13/17

Performance is historical and no guarantee of future results.

Several factors are contributing to this current environment:

- **Inflation expectations.** Longer-term yields have moved higher since early September, pressured by increasing inflation expectations (the difference between Treasury yields and Treasury Inflation-Protected Securities yields) as the price of oil has continued to rally. Breakeven 10-year inflation expectations moved from 1.78% to start September, to 1.91% as of November 10, 2017.
- **Policy progress.** Further development on potential tax reform has also pushed long-term rates higher, as has ongoing support from economic data.
- **Rate hike expectations.** Rate hike expectations for the next two years have waned as a result of Jerome Powell's nomination to lead the Federal Reserve (Fed), as he is considered less hawkish relative to other candidates who were being considered. However, those expectations have nonetheless climbed considerably since early September [Figure 3].

### 3 RATE HIKE EXPECTATIONS HAVE NOTCHED HIGHER SINCE EARLY SEPTEMBER



Source: LPL Research, Bloomberg 11/13/17

Market-implied rate hike expectations are calculated based on the pricing of various fed funds futures contracts. Rate hike expectations may not develop as predicted.

Although Powell signals continuity of current (relatively dovish) monetary policy from the Fed, rising inflation expectations may force the Fed's hand, potentially leading to a more aggressive pace of rate hikes in coming years. For years, the Fed has found itself in a "goldilocks zone" with decent growth, an improving labor market, and yet tepid inflation, allowing them to pursue a very gradual, measured approach to interest rate hikes. But should labor market tightness lead to a surprise pickup in inflation to the Fed's 2% target (or higher), the Fed could be forced into quick successive hikes. Neither the Fed nor financial markets would like this scenario.

## GLOBAL FACTORS

The global nature of the investment landscape may also be partially to blame for our flattening yield curve. Demand for high-quality developed market sovereign debt remains strong, and the U.S. boasts longer-term yields far above those of Germany, Japan, and almost all other developed nations. As we have seen throughout 2017, a material rise in Treasury yields has inexorably been met with a pickup in foreign demand, limiting further upward moves in long-term rates, and thus leading to a flatter curve.

Global central bank action over the last decade could also be changing the efficacy of yield curve inversion as a recession predictor. Through programs like the Fed's quantitative easing, in which bonds were purchased to drive down interest rates (the European Central Bank and Bank of Japan are still employing similar programs), investors have been reaching for yield in a progressively lower-yielding environment. Ten years ago, an investor could get 3.25% yield on a 3-month Treasury bill, whereas today, that investor can only receive 2.88% yield on a 30-year Treasury bond. Investors in search of meaningful yields have been pushed to longer-maturity bonds, keeping the yield curve flat and potentially limiting the importance of the yield curve inversion signal, should we get one.

## CONCLUSION

Although the bond market is sending more sobering signals than equity markets, other indicators corroborate the equity market's view of the economy, including: improving economic data, solid gross domestic product growth, positive earnings, and high consumer confidence, among others. Factors like foreign demand and still benign inflation are helping to restrain the long end of the yield curve, while interest rate hikes (and expectations for future hikes) have picked up steam, leading to a gradually flattening curve. The curve remains far from inverted, however, and is not yet sending a warning signal from the fixed income markets.

## IMPORTANT DISCLOSURES

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*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.*

*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.*

*Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.*

*Yield curve inversion is a situation where longer-term interest rates fall below shorter-term interest rates.*

*The presidents of regional Federal Reserve Banks are commonly classified as hawks or doves. Hawks generally favor tighter monetary policy, with less monetary support from the Federal Reserve. Doves are the opposite, generally favoring easing of monetary policy.*

*International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets.*

*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.*

#### **INDEX DEFINITION**

*The Bloomberg Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).*

*RES 9801 1117 | Tracking #1-667343 (Exp. 11/18)*

## A Year of Spending (and Saving) Wisely

Do you wait until the last minute to pack for your vacation or shop for back-to-school clothes for the kids? Do you find it difficult to start projects -- and then to finish them? Are you chronically late for appointments? If so, then chances are you are a procrastinator.

When it comes to managing your finances, procrastination can keep you from reaching your goals. But by breaking your spending and saving priorities down into monthly increments, you may find it easier to stay on track.

### Try some of these tips all year long.

**January** -- Start an emergency savings fund with the goal of accumulating three to six months of living expenses. By setting aside just \$25 a week, you could save \$1,300 after just one year. It's important to have a backup plan -- and financial cushion -- when the unexpected happens.

**February** -- Make sure you are making the most of your tax-deferred retirement savings opportunities. If you have access to an employer-sponsored retirement plan, such as a 401(k), are you contributing the maximum allowed? Generally, you may contribute up to \$18,000 to qualified retirement plans in 2017, and those 50 and older may contribute an additional \$6,000. (Additional plan limits may apply.) What about an IRA? The good news is you have until April 17, 2018, to contribute up to \$5,500 (or \$6,500 for those 50 and older) to an IRA for tax year 2017.

**March** -- Start organizing your tax documents -- Form W-2s from your employer(s), property tax receipts, mortgage interest, charitable donation receipts, etc. -- so you're ready to meet with your tax advisor and get the biggest refund you are entitled to.

**April** -- If you are one of the roughly 75% of Americans who do get a refund, consider directing it toward your emergency fund or credit card debt, or put the extra money toward your retirement. Every little bit can add up.

**May** -- Spring is in the air -- and for many Americans -- the weather is warming up. Lowering the temperature on your hot water heater during summer months may help to cut costs. The U.S. Department of Energy (DOE) estimates that water heating accounts for about 18% of energy consumed in the average home. The agency recommends turning the heater setting on your water heater to warm (120F degrees) to save on energy costs. Visit the DOE [website](#) for more energy saving tips.

**June** -- Have a green thumb? Vegetables fresh from the garden are less expensive than canned or frozen foods -- and they taste better, too! If you are not an experienced gardener, start small -- try a few tomato plants. And don't forget to water and fertilize regularly.

**July** -- Are you signing the kids up for sports teams? If so, consider buying the needed equipment at used sporting goods stores. From catcher's mitts to hockey skates, these stores sell their wares at a fraction of the original cost.

**August** -- Look for everyday learning experiences to teach your children about money. Have young children write down the price of similar items at the grocery store. Assist older kids in learning about managing money by allowing them to buy school supplies with a planned budget. Help children of all ages to set up a savings account at the local bank and decide how much they will plan to save each month for wish-list purchases.

**September** -- In August and September many auto dealers try to clear their lots to make room for next year's new models. If you don't mind haggling, you may be able to shave money off a car's sticker price.

**October** -- Plan for year-end tax saving moves. For instance, holding on to investments in taxable accounts for more than one year will generally qualify you for a lower tax rate on any capital gains -- 15% for most taxpayers and 20% for taxpayers in the top income tax bracket (39.6%). Also, keep in mind that realized capital losses can be used to offset realized capital gains for federal tax purposes. Any excess losses up to \$3,000 (\$1,500 for married individuals filing separate returns) can be deducted against ordinary income. A loss greater than that amount can be carried over to future tax years, subject to the same limits.

**November** -- Many charities begin active fundraising at this time of year. Generally, charitable contributions to qualified charitable organizations are deductible. Also, before sending a donation to your favorite charity, you may want to obtain more information about the organization by checking various online resources, such as BBB Wise Giving Alliance or Charity Navigator, to find out if the charity meets your giving criteria.

**December** -- Consider giving yourself an early holiday gift -- the gift of travel. Did you know that the first two weeks of December (after the Thanksgiving rush) is one of the slowest travel periods -- offering some of the best travel deals to destinations in the United States and other locales? If you want to take advantage of the December travel "dead zone," start shopping for flights a month or more in advance.

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