PALLADIUM
REGISTERED INVESTMENT ADVISORS
The value of trust. The wealth of experience.

PERSPECTIVES

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"The future ain't what it used to be."
Yogi Berra, professional baseball player and manager, 1925-2015

"If the world were perfect, it wouldn't be."
Mark Twain, writer, 1835-1910

- **Contradiction…** We are awestruck by the contradiction between the steady improvement in the financial markets and global economic activity versus what we see and hear on the nightly news.

- **Headlines…** which don't seem to make it to the nightly news…

"US Job Openings Hit New High" Dow Jones, 6/7/17

"World Bank Sees Global Economic Growth at 7-Year High in '17" Dow Jones, 6/5/17

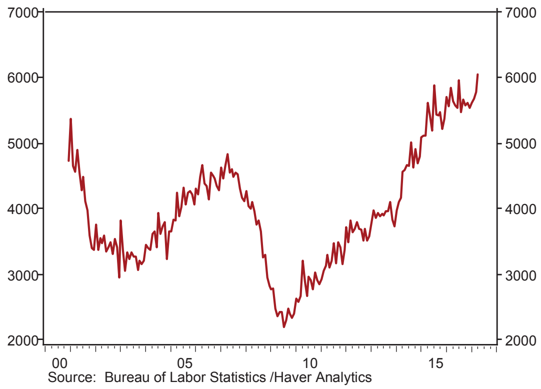
"Buyers Fuel Market for New Homes" The Wall Street Journal, 6/24-25/17

"Earnings Growth in the First Quarter the Best In Nearly Six Years." Bloomberg News, 5/16/17

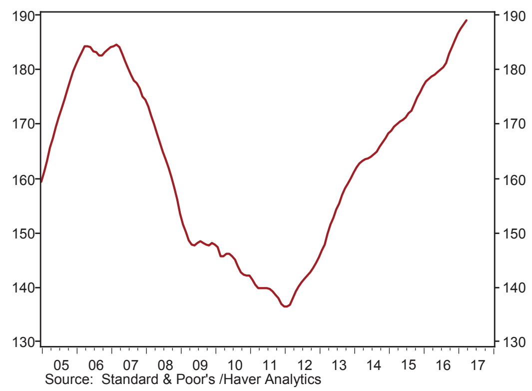
- **Like the tortoise…** While the recovery is one of the longest on record, it is the slowest on record (MarketWatch). As we've noted over the last seven years, the emotional and financial imprint left by 2008-09, as well as the regulations issued in the aftermath, have made this recovery quite slow, but also sustainable and free of cyclical excess. Having lost nearly 8 million jobs in the Great Recession, over 16 million have been added since its end.

- **Employment and housing continue to improve…**

JOLTS: Job Openings: Total Thousands

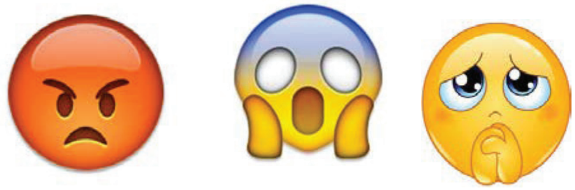


S&P Core Logic Case-Shiller Home Price Index: US National



- **Question…** when does an "economic recovery" become an "economic expansion"?

- **And yet…** when we click on the news, we get…



- **The anger, fear and worry are palpable.**

- **The list is long… (in no particular order)**
  - North Korea
  - Russia
  - China
  - The Middle East
  - Political dysfunction
  - Random acts of terrorism
  - Populism/Isolationism
  - Rapidly expanding cyber threats
  - India versus Pakistan

- **Lest you think we're being narrow-minded…** about the contradiction between what we see going on economically/financially and the geo-political issues that dominate the headlines, we certainly appreciate the gravity of those dangers, but we also believe ***fear sells***.

- **We would offer…** two additional sources of angst that we believe are prevalent:
  1. **Technology-led digital disruption and globalization**
  2. **Longevity plus low interest rates**

- **That's right…** ***technology*****…** is the source of considerable angst. While many cite trade agreements and corporate tax rates as the cause of globalization, technology has transformed how business is done all over the world --- how things are made, how services are provided, and how products are delivered --- and there is no stopping it.

- **Global competition has increased…** putting pressure on wages here in the U.S.

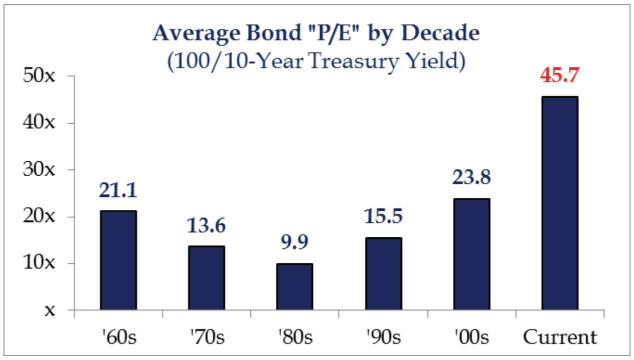
- **Entire industries have been disrupted…** shattering what many assumed would be safe and secure employment.

- **Disruption:**
  - The world's largest taxi company owns no taxis (Uber)
  - The largest accommodation provider owns no real estate (Airbnb)
  - The world's most valuable retailer owns no inventory (Alibaba)
  - The most popular media provider creates no content (Facebook)
  - The world's largest movie theater owns no cinemas (Netflix)
  - The production of oil and gas via fracking has altered supply forever

- **It's not just those in the workforce feeling technology's effect…** Technological advances in health care have increased longevity.

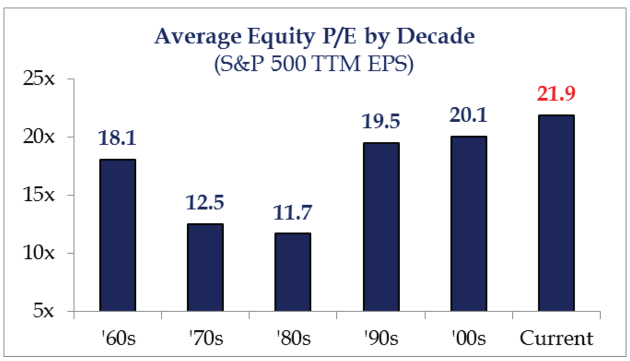
- **And, while improved health is certainly a good thing…** low interest rates and longevity have combined to create considerable anxiety amongst the record number of individuals entering retirement.

- **It's a challenge…** to earn even a 3% rate of interest without taking a measure of risk. In turn, many are left to worry whether their retirement savings will exhaust before they do.



The chart at left quantifies the high cost of a bond. Today, the 10-year US Treasury offers an investor 2.19% interest income. Said differently, it costs the investor $45.70 of their principal to generate $1.00 of interest income a year. Rarely has the price been so high or the yield so low.

- ***"What about stocks?"***



Common stocks offer higher long-term returns, but at their present value ($21.90 for $1.00 of earnings), the future return is likely to be below historical averages. Further, stocks come with lots of volatility. The potential for negative returns, in combination with ongoing withdrawals, can quickly undermine one's retirement savings.

- **"Expected returns"…** Given the current level of interest rates, one should assume an expected return from bonds of somewhere between 1% and 3% in the years ahead. For stocks, with valuations higher than average, the next five to ten years could bring returns of 6% to 8% … along with the constant potential for downturns along the way.

- **Asset allocation…** That is, the marriage of bonds and stocks and the management of their proportions are ***critical***. While conceptually simple, it is far-and-away the most difficult decision. Especially so, when neither stocks nor bonds are at bargain prices.

- **Expense control…** Faced with the prospect of lower than average, yet volatile returns, ***expense awareness is as critical as asset allocation***. Fixed expenses and volatile returns present a real threat to successful outcomes.

- **Fiduciaries.** On June 9th, landmark legislation went into effect regarding professional advice as pertains to retirement plans. The effect was to require that any such advice serves only the best interest of those receiving the advice. If you thought that was a given, please read on.

- **Registered Investment Advisors,** like Palladium, have always been held to a ***fiduciary standard***.

This requires that we always put our client's best interest first. By contrast, the broker-dealer community has been held to a ***suitability standard***, requiring recommendations that are suitable based upon the investor's personal level of income and/or assets. Once the suitability is satisfied, the advice need not be premised upon the client's best interest.

- **We welcome this change.** While there will be more i's to dot and t's to cross in order to provide the regulatory authorities the evidence they require, we hold the fiduciary standard like the Holy Grail. Our best interest has always been the result of serving our clients' best interest.

- **Using that as a segue…** we are delighted to note that Palladium was recently named to the Financial Times' "FT 300", as one of the top 300 RIAs in the country. Using a variety of criteria, the publication assesses this 300 -- from amongst over 2,000 -- as having desirable traits for investors. We would be pleased to share the report with you.

- **A final thought…** We noted that the economy has grown slowly -- but in a sustained fashion -- despite increased regulation on lenders and increased caution by investors and borrowers. So just how has it been that over 16 million new jobs have been added?

- **Americans did it.** For all of its warts, democracy, capitalism, and the work ethic of the American population has no rival. Americans are the most entrepreneurial and innovative people on the planet. Improving "things" is an American pastime.

- **Imagine then…** that some eight years after the Great Recession --- with the finances of individuals and businesses having now healed --- it may only take modest tweaks to the existing tax and regulatory policies to unleash the economy's greater potential.

- **A 2007 Treasury Department review…** offered that "labor may bear a substantial burden from the corporate tax rate." Similarly, the Congressional Budget Office found that labor bears 70% of the burden of corporate income tax, while domestic savers bear the balance through a reduced return on their investment.

- **Just a tweak…** to the corporate tax rate might then increase business investment in capital and labor… and wages in the process.

- **As ever…** we remain optimistic (albeit cautiously so).

- **Enjoy your summer!**

Summer 2017

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