

# QUARTERLY INSIGHT

## MARKET UPDATE



### STOCKS VOLATILE BUT STRONG AMID SLOWING ECONOMY, TRADE DISPUTE

An up-and-down second quarter resulted in further stock-market gains, capping off the best first half for the S&P 500 Index since 1997. The market volatility that began last October continued in the first half of 2019. Stocks plunged nearly 20% in late 2018 on fears of rising interest rates, trade uncertainty, and Chinese economic worries. The S&P 500 bounced back in a big way in the first quarter, gaining 13% as the Fed tempered expectations for rate increases and trade tensions seemed to ease.

In April, the S&P 500 reclaimed the October 2018 highs as earnings surpassed lowered expectations and it appeared the U.S. and China were making progress on trade talks. Then in May, leaders from both sides turned up the heat on each other. President Trump simultaneously threatened tariffs on Mexico and threatened to dramatically increase tariffs on China, sending markets down sharply. In June, the Fed signaled its willingness not only to abandon plans for interest rate hikes, but to cut rates if economic conditions deteriorate. This boosted stocks, and the S&P gained 7% in June alone. Tech stocks were the most volatile in the first half but ultimately finished first among the sectors, followed by consumer discretionary, industrials, and real estate. Health care, telecom, energy, and utilities lagged significantly but still gained nicely.

### INTEREST RATES FALL, BOND PRICES RISE, SENDING DIFFERENT SIGNALS THAN STOCKS

The bond market seemed to be signaling rising economic risk even as stocks flirted with record highs. Bond yields fell around the world and in the U.S. as the global economy showed signs of slowing, and as central banks telegraphed the prospect of further interest-rate cuts. The yield on the 10-year U.S. Treasury note fell a half percent from 2.5% in March to 2.0% in June. Bond yields in most developed economies are even lower, with some in or approaching negative territory. This led to solid gains for bond investors in the first half. The Barclays Aggregate Bond Index gained more than 6%.

Meanwhile, the yield curve has remained flattish or even inverted at some points, which is historically an indicator of further economic weakness to come. Typically, the bond market has been a more reliable indicator of future economic performance than stocks.

### ECONOMY SOFTENING, RECESSION RISK RISING BUT STILL RELATIVELY LOW

The Fed and the bond market have reacted to risks from the trade dispute. In addition, each has reacted to signs of slowing growth abroad and early signals of slowing in the U.S. Economic data that typically provide early signals of future activity have been slowing since last September, suggesting a possible (but not

2019:  
SECOND  
QUARTER

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## TOTAL RETURNS

	2Q2019	2019
S&P 500	4.3%	18.5%
Dow Jones Industrial Average	3.2%	15.4%
NASDAQ	3.9%	21.3%
Russell 2000	2.1%	17.0%
MSCI EAFE (International)	4.0%	14.5%
Barclays Aggregate Bond Index	3.1%	6.1%

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## MARKET UPDATE



certain) growth slowdown ahead. The U.S. expansion is now in its 121st month, the longest on record and more than twice as long as the average since World War II. However, this expansion has been weaker than most.

This isn't the first time the economy has seemed to be cooling off during the current expansion. Similar slowdowns occurred in 2012 and 2016. There are still many indications the economy is healthy and growing. For example, small business optimism is strong and consumer confidence is high. And while the yield curve has been flattening, there are numerous recession indicators that are not flashing red (or yellow).

The future of this expansion is likely to hinge mostly on the impact from the trade negotiations with China. So far, the tariffs imposed have damaged sentiment as much or more than actual trade activity. The next round being threatened would be a more direct hit to consumer goods, which could lead to a more painful outcome than those imposed thus far. This points to the significance of the negotiations ahead. The long-term impact of trade policy is hotly debated, but it seems clear that the short-term impact of additional tariffs could be a major roadblock to a continuation of the current expansion.



### EARNINGS GROWTH DOWN AFTER STRONG 2018

Corporate earnings received a boost from the tax reform that took effect in 2018, and this is a headwind to further earnings growth in 2019. Earnings grew by more than 20% in 2018, but this year are forecasted to be negative in the second and third quarters, with a slight bump in the fourth quarter. However, any forecasts should be taken with a healthy amount of skepticism given the enormous uncertainty of the outlook for trade policy. If the trade war intensifies, it is likely to further hinder earnings growth, increasing the risk of an earnings recession.

### FED LIKELY TO CUT INTEREST RATES

The Fed has pivoted quickly from a hawkish stance in late 2018 to a more dovish posture today. As recently as last fall, the Fed was telegraphing rate hikes in order to fight rising inflation.

Then the stock market sold off and economic growth and inflation seemed to be cooling as the trade dispute heated up. By January, the Fed had shifted its language to a more "patient" approach, and by June it was signaling potential rate cuts.

We are currently in the longest stretch without a rate cut in the last 50 years. The Fed will meet in July and expectations are high for a rate cut, and possibly for more in the latter part of the year. Fed Chairman Powell has directly acknowledged the impact of the trade negotiations on the Fed's outlook, and indicated the Fed is ready to respond accordingly if trade disputes lead to further economic weakness.

Such a rate cut in July is being termed an "insurance" cut, because it would be done in an effort to cushion the impact of increased tariffs as opposed to overwhelming tangible evidence of economic slowdown. Low inflation is another reason the Fed is likely to cut rates, because it provides more flexibility to cut without risking overheating the economy.

### WHEN UNCERTAINTY ABOUNDS, DISCIPLINE IS KEY

By definition, the future is always full of uncertainty. Investing is a constant exercise in decision-making in the midst of it. There are times when it seems there are more questions than ever, and during such periods it is crucial to stick to a disciplined, consistent strategy. We focus on providing counsel while managing portfolios for any environment, implementing the appropriate level of diversification to provide peace of mind and confidence for the future. ●

## UNCLE SAM MAY CHANGE THE RULES OF RETIREMENT PLANNING, AGAIN



Navigating the shifting terrain of retirement, tax, and estate planning can be a complicated and arduous journey. With so many variables and moving pieces the landscape is constantly evolving. It requires clear and consistent communication between clients and their team of advisors. Like it or not, a third "person" must also be included at the meeting table - Uncle Sam.

We're discussing Uncle Sam again because the House recently passed H.R. 1994 by an overwhelming majority (417-3). This bill is known as the SECURE Act, or Setting Every Community Up for Retirement Enhancement Act of 2019. The bill would make profound changes to the existing rules regarding IRAs, including eliminating the "Stretch IRA." The bill is not yet law, and now awaits passage in the Senate and presidential approval. Based on our assessment, it appears some form of this bill could become law in late 2019 or 2020.

## UNCLE SAM MAY CHANGE THE RULES OF RETIREMENT PLANNING, AGAIN



### CONGRESS' BALANCING ACT

The bill includes changes intended to make retirement and education savings accounts simpler and more cost effective, especially for less-affluent savers. As a result, certain changes would likely lower tax revenue for Uncle Sam. Under current law, this revenue reduction must be offset by additional changes that would generate more tax revenue. This generated the idea of elimination of the Stretch IRA.

On the positive side for taxpayers, the main changes include:

- Allowing small employers to consolidate their interests to sponsor a retirement plan;
- Eliminating the maximum age of 70 ½ for contributing to a traditional IRA;
- Increasing the RMD (required minimum distribution) age from 70 ½ to 72;
- Allowing employers to offer annuities within a 401(k) plan;
- Allowing withdrawals of up to \$10,000 from 529 plans to pay student loans.

On the “negative” side for taxpayers would be the aforementioned elimination of the Stretch IRA.

### DEFINING THE STRETCH IRA

Under current law, non-spousal beneficiaries of an IRA can “stretch” withdrawals from an IRA over their (presumably) longer life spans, a valuable tax-planning and estate-planning strategy. Every year, non-spousal beneficiaries are required to take a distribution from the inherited IRA. The amount is calculated based on the IRS factor for their life expectancy and the balance of the account on the last day of the prior year. Their annual required distributions are often smaller than the original IRA owner’s would have been given the ability to use their longer expected life span. These smaller distributions allow the beneficiary to stretch the IRA over a longer time period and sometimes pay less in taxes than the original IRA owner would have.

### PLANNING IMPLICATIONS: FEDERAL INCOME TAX LAW

As noted, the bill proposes that most non-spousal inheritors would now be required to take these distributions over 10 years, emptying the account sooner and potentially resulting in a much higher distribution rate. It isn’t clear yet whether the new bill requires annual distributions over the new 10-year period. But it is clear that Uncle Sam is doing the math and has no plans to take in less revenue with this proposal.

If the bill becomes law, some potential ways to soften this impact before the IRA owner passes away include:

- Re-evaluating a conversion to a Roth IRA, and who should inherit traditional versus Roth IRAs;
- Specifically targeting beneficiaries by age and income to minimize tax impact;

- More aggressive use of charitable gifting strategies, such as charitable remainder trusts benefiting children, funded at the IRA owner’s death.

### PLANNING IMPLICATIONS: ESTATE PLANNING

It appears the owners of large IRAs are in the crosshairs of the federal government given the impact of the elimination of the stretch provision. Many owners of larger IRAs often name an IRA trust as the beneficiary so as to control the distributions and maintain the IRA after death. These strategies will need to be re-evaluated if the SECURE Act becomes law as the existing strategies could fail or become unnecessary.



### BOTTOM LINE: WHAT WE'RE WATCHING

This bill will likely undergo changes as it goes through the Senate (which already has its own version) and goes through the negotiation process before landing on the President’s desk. But given the overwhelming majority of passage in the House and the need for offsetting tax revenue, it appears some version of this bill is likely to become law sometime in the next 12-18 months. Knowing this, it’s critical to have a wealth manager in place who can not only keep up to date on these changes, but can also coordinate with professionals from the tax and legal perspective. As this latest shift in the landscape demonstrates, the need for integrated wealth management has never been greater. We will continue to monitor this issue and other developments in the coming months as events unfold.🌐

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*If you are a client of Johnson Investment Counsel, you should receive account statements on at least a quarterly basis directly from the qualified custodian that holds and maintains your assets. You are urged to carefully review all custodial statements for accuracy. If you are not receiving custodial statements, please contact our Chief Compliance Officer, Scott Bischoff at (513) 661-3100.*

## NEW SHAREHOLDERS

We are pleased to announce and congratulate three new shareholders of the firm: Tara Adams, Ryan Easter, and Dan Gusty. Since 2001 JIC has been a privately-held, employee-owned firm, which has allowed us to truly focus on the long-term needs of our clients.



**Tara N. Adams, CTFA**  
Johnson Trust Company  
Vice President of Trust Services  
Senior Trust Officer,  
Family Office Services,  
Principal



**Ryan W. Easter, PMP®**  
Johnson Investment Counsel  
Director of Information  
Technology, Principal



**Daniel P. Gusty, CPA, CFP®**  
Johnson Investment Counsel  
Director of Central Ohio Market,  
Senior Portfolio Manager,  
Principal

## PROMOTION

We are pleased to announce the promotion of Jason Farler, CFA, to Director of Johnson Family Office Services. Jason has been with the firm since 2001. Jason is a CFA Charterholder and is a member of the CFA Society of Cincinnati. He has been recognized by the CFA Institute for his commitment to continuing education through their voluntary personal development program.



Farler

## JIC OPENS SOUTHEASTERN MICHIGAN OFFICE



Henderson

Johnson Investment Counsel has expanded into the Southeastern Michigan market. Joe Henderson, CLU, CFP® has been hired to lead the expansion and will be based in Novi, serving clients from Metro Detroit, Ann Arbor, and the entire Southeastern Michigan region. Joe comes to Johnson from Vintage Financial Services, where he served more than 120 clients, managing \$150 million in assets.

## NEW DESIGNATION

Johnson Investment Counsel is committed to continuing education to provide personal development for our employees and better service to our clients. Tony Miliano, an Associate Portfolio Manager in our Kenwood office, has earned his Chartered Financial Analyst Designation.



Miliano

## NEW ADDITIONS TO THE TEAM

- > **Kristen S. Curtiss**  
Portfolio Manager Assistant
- > **David M. Ostmann**  
Operations Associate
- > **Amanda A. Wallace**  
Client Support Assistant
- > **Arien C. Wright**  
Client Support Assistant



Curtiss



Ostmann



Wallace



Wright



## ABOUT US

Johnson Investment Counsel, Inc. is one of Ohio's largest independent wealth management firms, managing over \$10 billion in assets. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-based, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs, and more. Johnson Investment Counsel has built strong, long-term relationships with individuals, families, charitable organizations, foundations, and corporations through four integrated divisions.

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