PEAK CAPITAL
MANAGEMENT

D. MICHAEL BURLEIGH
Registered Investment Advisor

953 NE Jensen Beach Blvd.
Jensen Beach, FL 34957

772-334-9592 • 772-334-3856 fax
Mike@peakcapitalmanagement.net
www.peakcapitalmanagement.net

THE ADVISOR

APRIL 2019

Whether Intentional or Not, Fed's Flattening of the Yield Curve is Bad News

We've been warning about the potential dangers of a flat yield curve ever since late 2016. That's when the Federal Reserve first started raising short-term interest rates again after holding them to near-zero for seven years in conjunction with quantitative easing (QE). So, when the yield curve finally did completely flatten in March, we weren't surprised it happened. However, we were surprised by how it happened—and are deeply concerned about what it could mean for investors still carrying too much stock market risk in their portfolios.

First, a little review. There are only two ways the Fed could create a flat yield curve: by raising short-term interest rates too high or by manipulating long-term rates downward until they are even with, or lower than, short-term rates. Now, there would seem to be no logical reason for the Fed to intentionally create a flat yield curve; not only is it a well-known symptom of a coming recession, but it can also be the cause of a recession, which we'll discuss more later.

So, throughout 2018, it was a relief that each time the Fed announced it was planning another short-term rate hike, the bond market seemed to accommodate the move. Bond yields would increase slightly with each announcement, giving the Fed just enough room to implement its marginal increases without flattening the yield curve. That all changed in December when the bond market (which is often said to be smarter than the stock market when it comes to economic forecasting) seemed to say, "Enough is enough." This time, long-term rates didn't rise ahead of the Fed's short-term hike, essentially forcing the Fed to put the brakes on its planned rate increases for 2019—which it did.

Strange Move

That's what makes what happened on March 20 so strange. On that day, the Fed reiterated its commitment to keeping additional short-term rate hikes on hold.[1] This was good news since, with the current Fed funds rate at 2.5% and the yield on the 10-Year Treasury rate only at 2.54% on that day, the yield curve was already nearly flat. However, in that same announcement, the Fed also mentioned it was planning to discontinue its "unwinding" of quantitative easing this year. Although few market analysts seemed to take note, we were stunned by the announcement!

Continued on page 2

Having the Talk

Take a moment and pretend your older sister and her husband pass away unexpectedly, leaving their three young children behind. You are called into their lawyer's office immediately. You learn that you and your husband were named guardians of your three nieces and the family dog. While you love your nieces, your life just changed in the blink of an eye. You went from being a professional, childless, young couple in a condo to a five-person family with a dog and a two-story home. Situations like this don't just happen in movies — they happen to people in real life, and not as infrequently as you might think.

Now imagine you are the parents of those three children. What if your younger sister and her husband weren't able (or willing) to care for your children? What if they decided to pass guardianship on to the next person; or worse, what if the children had to go live in foster care? Or what if your sister and her husband accept guardianship of your children, but move them into that condo in the city? These conversations are absolutely critical if you have dependents.

In many families, finances and estate talk are taboo. Talking about what will happen after a person dies can be painful and scary, but neces-

Continued on page 3

Fed's Flattening

Continued from page 1

Why? Because it was almost as if the Fed was saying: "Since we're no longer able to raise short-term rates, we're going to flatten the yield curve by driving down long-term rates!" Remember, the whole QE unwinding effort was meant to manipulate long-term rates upward by selling back all the trillions of dollars in bonds the Fed purchased during three rounds of QE. The strategy was to increase the supply of bonds, thereby decreasing the price and increasing long-term yields. By stopping this process, the Fed is saying it will cease increasing the supply of bonds, which means if demand remains the same, prices will rise, and yields will come down.

Sure enough, soon after the announcement, the yield on the 10-Year Treasury rate dropped by 30 basis points. Long-term rates across Europe also fell, some into negative territory. Currently, the yield on the 10-Year Treasury is at 2.4%, while short-term rates remain at 2.5%.

So, why did the Fed make what seems like a blatant move to flatten the yield curve? Well, one can only speculate, of course, but the contentious relationship between Fed Chairman Jerome Powell and President Trump is certainly no secret. Trump has been openly critical of Powell and the Fed overall, blaming them for much of the historic stock market volatility that occurred last year. Could the creation of a flat yield curve be payback; a way to dramatically increase the risk of a recession and major stock market crash ahead of the 2020 elections?

Well, that explanation sounds far-fetched. We believe it's more likely that these incredibly smart people at the Fed have become so focused on reading data that they've lost sight of the Big Picture—which is not uncommon.

In 1972, a famous accident occurred in the Florida Everglades. Eastern Airlines Flight 401 went down because its entire crew had become so focused on a burnt-out bulb on their landing gear indicator that they didn't realize their autopilot had put the plane into a gradual descent. By the time they did notice, it was too late. Despite all their training and intelligence, they were too focused on reading one gauge to notice the bigger problem.

Symptom or Cause

That may be a fitting analogy for what's happening with the Fed. They've become so focused on data and details (and so comfortable with the idea that they can artificially manipulate anything) that they've lost sight of the bigger picture. They're so caught up reading their charts, graphs, and dot-plots that they've forgotten to simply look out the window and, metaphorically speaking, fly the plane.

This is concerning, because with the yield curve now flat, "the plane" may already be in a descent. Yes, there may be some aspects of the flat yield curve that actually create a temporary spike for the stock market, but long-term the situation is perilous. Banks need a spread in interest rates in order to make money on loans. Without it, odds are they'll have to tighten up their underwriting standards and lend less money. When that happens, a domino effect toward recession usually isn't far behind. Fewer homes and cars are purchased, people start spending less, companies start laying off, and on it goes. That's how this flat yield curve could quickly change from a symptom of a possible recession to a major cause.

Naturally, a recession would be the worst possible news for the stock market, and with the third major sustained drop of our current secular bear market cycle still to come, it could be very bad news for investors over 50 who haven't yet reduced their stock market risk!

[1]"Fed Holds Line on Rates, Says No More Hikes Ahead This Year," CNBC, March 20, 2019.

Emotional Issues That Prevent Estate Planning

Many people have a difficult time planning their estate. There are many issues that must be faced to prepare a will or a trust; and for some, these issues can become emotional hurdles. You need to acknowledge these emotions and accept that this is just part of the process.

Facing mortality — Death is not something anyone wants to talk about, but it is inevitable. Some are so superstitious they feel that even saying the word death might cause it to happen. There really isn't a solution to your fears, but you can at least be reassured that by developing a plan, you will be taking care of your loved ones.

Not being in control — Many think of estate planning as relinquishing control of their assets, when it is actually quite the opposite. Developing a will or a trust will ensure that your assets will be handled exactly the way you want. There are approaches to developing an estate plan in which you can maintain control while protecting your assets.

Family decisions — Depending on your family's situation, there are many decisions to be made that can cause family friction. Who should be the executor? What should you leave each family member? Who is best suited to take over the family business? Does one child need more financial help than others? Should all your children be treated equally?

These are difficult issues, but keep in mind if you don't make them, you could leave your family with a mess to deal with and the potential that your family could be torn apart by arguing over your estate.

Costs — Costs to develop an estate plan will vary depending on your family's situation. Think of your estate plan as a gift to your family and peace of mind for you that your final wishes will be carried out. Make sure you have a full understanding of the costs before proceeding with the development of the plan.

Having the Talk

Continued from page 1

sary. It's important to talk with your loved ones about what you want, what they want, and what is laid out in your will.

4 Tips to Help You Have the Talk

- **Keep it light —** Having this discussion can bring up a lot of emotions for your loved ones; thinking about losing someone you love so dearly is painful. So keeping the conversation light but to the point can help keep it on track and productive. There may also be tensions that arise through the process — maybe multiple people want the same thing, or someone gets offended by how you've decided to split your money. You might consider conversing with people individually to avoid upset.
- **Talk openly and honestly —** A decision you have made may hurt someone's feelings, or there may be things you don't want to tell people about, but it is crucial to be open and honest with your beneficiaries.
- **Discuss values, not just valuables —** When you die, how do you want people to remember you? What parts of you do you want to live on? This may include traditions, values, family names, rituals, religious beliefs, and so on. This is an important matter to bring up during discussion with your family. Think back on times that meant a great deal to your family or traditions that have brought joy. Maybe it's important to you to have your grandmother's name passed on from generation to generation. Talk about these things with your family to share how you feel and see how they feel.
- **Have a professional present —** Having your estate planner present can be helpful, and in some cases, necessary. Many times, a professional has a better understanding of how estate planning works and can assist by answering any questions your loved ones may have. You might have a family-only conversation first and then a second conversation with your family and the estate-planning professional.

Like any important discussion, this talk may be difficult. The best thing you can do is take into account who you are speaking with and how you want to present the topic. Every family is different and every talk will be different, but make sure you have it. Please call if you'd like to discuss this in more detail.

Distributing Your Estate to Grown Children

When your children were young, your primary concern was probably how to provide for them in the event you and your spouse died. Even though they may now be grown, your children are probably still the center of your estate plan. Just because they are adults doesn't mean you have to leave their entire inheritance to them outright. Consider these factors first:

- **Do you want to distribute your estate gradually?** If substantial assets are involved, you may want to set up trusts to distribute your assets gradually, such as in thirds when each child reaches age 25, 30, and 35. You can always give the trustee power to make early distributions for specific circumstances.
- **Have you selected a trustee carefully?** If trusts are involved, you want a trustee who is impartial and will deal fairly with all your children. Think twice before naming one of your children as trustee. One sibling in a position to decide what happens to another sibling's inheritance can cause disagreements.
- **Have you thought about the consequences of a child divorcing?** You probably don't want a portion of your assets distributed to an ex-daughter-in-law or ex-son-in-law, so special provisions may need to be added.
- **Have you considered how assets will be distributed among children?** Perhaps one child is better off financially than your other children. Do you divide your estate equally or give less to the financially well-off child? Children often feel a right to an equal share of their parents' estate, even if they have a substantial estate of their own. If you decide to make unequal distributions, be sure to explain why personally or in a letter left with your estate-planning documents. Hopefully, this will prevent hurt feelings or disagreements among siblings.
- **Do you need to make special distributions to even out inheritances?** Perhaps you have paid all college costs for some children, while other children have not attended college yet. You may want to ensure that all children receive a college education, and then distribute the rest of your estate equally.
- **Should you coordinate your estate plan with your children's estate plans?** If your children have substantial estates of their own, it may not make sense to leave additional assets to them. They may prefer those assets go directly to their children, helping to minimize family estate taxes.
- **Have you explained the need for estate planning to your children?** Especially if you are leaving a substantial estate to your children, they may need to plan their own estates. You don't need to dictate what they should do with their estates, but gently remind them why they need an estate plan. After major life events, such as marriage, divorce, or a child's birth, remind your children to revise their plans.

Business Data

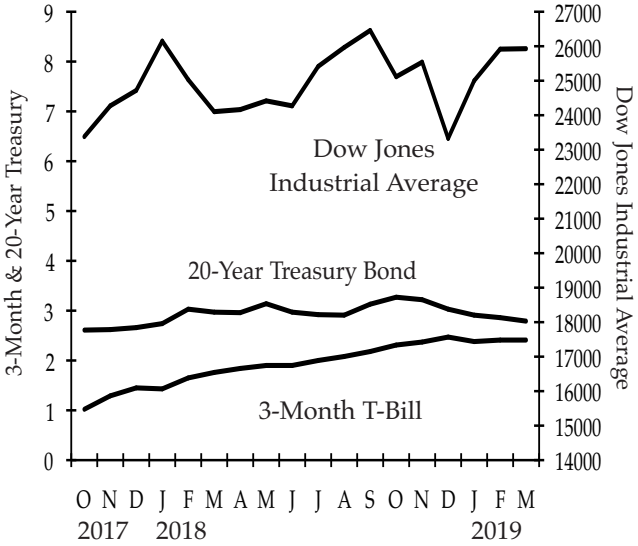
Indicator	Month-end Jan-19	Feb-19	Mar-19	Dec-18	Mar-18
Prime rate	5.50	5.50	5.50	5.50	4.75
3-month T-bill yield	2.38	2.41	2.41	2.47	1.76
10-year T-note yield	2.75	2.66	2.55	2.89	2.86
20-year T-bond yield	2.91	2.86	2.79	3.03	2.97
Dow Jones Corp.	4.16	4.08	3.74	4.40	3.70
GDP (adj. annual rate)#	+4.20	+3.40	+2.20	+4.20	+3.20

Indicator	Month-end Jan-19	Feb-19	Mar-19	% Change YTD	12-Mon.
Dow Jones Industrials	24999.67	25916.00	25928.68	11.2%	7.6%
Standard & Poor's 500	2704.10	2784.49	2834.40	13.1%	7.3%
Nasdaq Composite	7281.74	7532.53	7729.32	16.5%	9.4%
Gold	1323.25	1319.15	1295.15	1.1%	-2.2%
Unemployment rate@	3.90	4.00	3.80	2.7%	-7.3%
Consumer price index@	251.23	251.71	252.78	0.3%	1.5%

— 2nd, 3rd, 4th quarter @ — Dec, Jan, Feb Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

October 2017 to March 2019



What Happens to a Beneficiary's Share If He/She Dies before You?

If one of your beneficiaries dies prior to you and you have not updated your will or trust, there are several scenarios that could play out depending on what is, or isn't, stated in your will.

Bequest lapses — Let's say your will states that John is to receive half your estate if he survives you. If he predeceases you, his share of the estate will lapse and become what is known as the estate's residuary, or what is remaining after all of the specific bequests are made. Typically, the residuary of the estate will be given to the other surviving beneficiaries.

Per stirpes designation — Per stirpes means by roots. If your will states that Bob is to receive 20% of the estate if he survives you, but he doesn't survive you, per stirpes, his portion will be given to his heirs.

Sometimes it can be a little more complicated. Let's say Bob and his wife had two children and both his wife and one child are deceased. The deceased child also had one living child. In this case, half of Bob's 20% will be given to his surviving child and the other half will be given to the deceased child's living child, who would be Bob's grandchild.

State intestacy laws — If your will states that John is to receive 100% of your estate, but John predeceases you, and there are no other beneficiaries or directions, each state has an intestate succession as to who will inherit the estate. The estate will pass to your closest kin based on that state's law. John's death made the will void, so your next closet relative will inherit your estate.

Update your will or trust — These scenarios point out the importance of keeping your will or trust updated, especially after a beneficiary has died. It is also important to provide specific directions of succession for your estate, so that your wishes are clear.

FR2018-1217-0216

PEAK CAPITAL
MANAGEMENT
953 NE Jensen Beach Blvd.
Jensen Beach, FL 34957