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

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Don't Let Renewed Market Turbulence Rattle Your Summer

What a difference a month makes in today's markets! As you may recall, in last month's newsletter we reported that the S&P 500 had hit a new record high in April, and that the Dow Jones Industrial Average had spent an entire month over 26,000 for the first time all year. Well, that all changed in May. The Dow fell below 25,000 for the first time since January, and the S&P finished the month down about 6.5%. Overall, it was Wall Street's worst May since 2010.[1]

As was the case throughout most of 2018, the fear among investors was driven mainly by trade. President Donald Trump once again ramped up his trade war with China, and near the end of the month he announced new tariffs on Mexican imports, which took many investors by surprise. Who knows how much the picture might have changed again by the time you're reading this newsletter? Unfortunately, that's the reality of today's markets: they're in such a rapid state of flux again that it's hard to keep up.

We say "again" because we did go through this for most of 2018. Uncertainty around the impact of the trade war was offset by strong economic data, including GDP growth surpassing 4% in the second quarter. Big investors seemed optimistic one day and terrified the next, resulting in record levels of market volatility for most of the year. Things were much calmer this year until May, despite no real progress in resolving the trade war and the emergence of new warning signs for the economy—most

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Using Portfolio Losses

Capital gains on investments held for one year or less are short-term capital gains taxed at ordinary income tax rates. For investments held over one year, the maximum long-term capital gains tax rate in 2019 is 20%. While the 20% rate is below the maximum ordinary income tax rate of 37%, it still takes a significant chunk out of your investment portfolio.

To help minimize your capital gains tax bill, you should actively harvest any losses in your portfolio. Some strategies to consider include:

Recognize losses to at least offset $3,000 of ordinary income. Keep in mind the tax rules regarding gains and losses — capital losses offset capital gains and an excess of $3,000 of capital losses can be offset against ordinary income. If you are holding stocks with losses in your portfolio, you should probably take advantage of this tax rule.

If you still want to own the stock with the loss, you can sell the stock, recognize the tax loss, and then repurchase the stock. You just have to make sure to avoid the wash-sale rules. These rules state that you must repurchase the shares at least 31 days before or after you sell your original shares to recognize the loss for tax purposes. That timing can be troublesome. If the stock's price rises substantially before you repurchase it, your tax savings from the loss deduction may not be worth as much as the investment gains during that time period. You can avoid that concern by purchasing the additional shares first and then selling your original shares 31 days later. Another strategy is to

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Market Turbulence

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notably the flattening of the yield curve, which we discussed in last month's newsletter.

Most Inverted Since 2007

In May, that warning sign continued, with the yield curve becoming the most inverted it's been since 2007.[2] As of this writing, the yield on the 10-Year Treasury rate is down to 2.1%, with 2-Year yields at 1.85% and the Fed Funds rate remaining at 2.5%.[3] The bottom line is that when long-term rates are lower than short-term rates, it's an obstacle for lending. This is exactly the situation we forecast two months ago when the Federal Reserve announced it was planning to discontinue the unwinding of quantitative easing by September. We believe the situation will continue, and we also stand by our forecast that this classic symptom of a recession (the inverted yield curve) could become the major cause of a recession by sometime in 2020, if not sooner. Other economics experts agree.

According to a new report by the National Association of Business Economics, a majority of economists surveyed say they believe that a recession will hit by the end of 2020, with about half of them saying they believe it will begin halfway through next year.[4] Among the reasons they cite for the turning economic tide are diminishing returns from the Trump Administration's corporate tax cuts, and the growing impact of his trade policies on US businesses and consumers. Again, all of this explains the renewed spike in volatility on Wall Street, as big investors once again have "one finger on the trigger", ready to pull out as soon as next sustained drop takes hold.

As mentioned, though, that volatility could quickly settle down again and the markets could start trending upward—as we've seen time and again throughout the Trump presidency. In fact, last month we noted that the inverted yield curve could actually be good for the stock market in the short term. The stalled low-interest rate environment may force many everyday investors back up the risk curve and into the market, and prompt corporations to continue increasing their use of stock buybacks. Those drivers could expand the equity bubble further in 2019, but we believe the odds of the market regaining its previous peak and climbing higher from there are increasingly slim, given all the factors at play.

Don't Take Worry on Vacation

So, what does it all mean for everyday investors? Well, if you've already made the shift to actively-managed financial strategies focused on protection and income, it doesn't mean much. In fact, you barely have to think about it. That's exactly the point of investing-for-income: it reduces your risk even in highly uncertain, rapidly changing times like now. That's the core of active management: it ensures that Income Specialists will work to maximize your income return even in a challenging interest rate environment like the current one.

If, on the other hand, you're not sure that you've sufficiently reduced your risk, or made changes recently that can help maximize your return even further, now is a great time to do so, not only because market volatility and recession fears have spiked again, but also because it's now summer. If you're like most people, you're looking forward to a nice relaxing summer, as free from worry and uncertainty as possible. A single meeting with your advisor before your vacation could dramatically increase your odds of achieving that goal. If you have friends or loved ones you think might benefit from that message, by all means share this newsletter with them! This may well be a year when the old Wall Street adage "Sell in May and Go Away" turns out to be great advice.

Have a great summer!

[1] "Trade War, Tariffs Send Wall Street to Worst Month of May Since 2010," Money and Markets, May 31, 2019

[2] "Inverted Yield Curve Becomes Most Inverted Since 2007," Yahoo Finance, May 29, 2007

[3] YCharts.com

[4] "Economists' Fears of a 2020 Recession in the US Surge," CNN Business, June 3, 2019

Using Portfolio Losses

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purchase a similar stock, perhaps of a competitor, to replace the stock you sold. Since it isn't the same stock, you don't have to wait 31 days to purchase it.

Consider recognizing all, or a substantial portion, of any losses in your portfolio. Realize that no one likes to sell investments at a loss. And since you can only offset an excess of $3,000 of capital losses against ordinary income, you might wonder why you should incur excess losses that can't be used currently, even though you can carry them forward to future years. There are a couple of advantages to this strategy.

First, it gives you an opportunity to totally reevaluate your portfolio. If you are convinced all your investments are good ones, you can sell them, recognize the tax loss, and then repurchase the stocks, being sure to avoid the wash-sale rules. But it's probably more likely that you own some investments you wish you didn't or you don't think will recover as quickly as other investments. This is your opportunity to reinvest in stocks you believe have better long-term potential.

Second, it gives you more flexibility when recognizing gains in the future. You may be a little more skittish about letting capital gains ride with the market. Until you use all your capital losses, you can recognize capital gains without worrying about paying taxes. Even if your losses are long term, you can use them to offset short-term capital gains that would be subject to ordinary income taxes.

Use stock losses to offset other capital gains. You don't have to match stock losses with stock gains. If you have capital gains from the sale of another type of asset, such as a business or real estate, stock losses can be used to offset those gains.

Don't gift stocks with losses. If you are planning a large charitable contribution, it makes sense to donate appreciated stock held for over a year. You deduct the fair market value as a charitable contribution, subject to limitations based on a percentage of your adjusted gross income, and avoid paying capital gains taxes on the gain. If the stock has a loss, however, you should first sell it and then send the cash to the charity. That way, you get the charitable deduction and recognize a tax loss on the sale.

If you have losses in your portfolio, you may be able to use them to help reduce your income tax bill. Please call if you'd like to discuss these strategies in more detail.

Taxes and Retirement Withdrawals

As you prepare for retirement, develop a retirement withdrawal strategy that provides you with the income you need, minimizes the impact of taxes, and keeps your investment mix focused on your goals and personal situation. Here are some strategies to consider:

Withdrawal Order Matters

The order in which you take assets can have an impact on what you pay in taxes. The sequence strategy follows this order:

- Required minimum distributions (RMDs) from retirement accounts
- Taxable accounts
- Tax-deferred retirement accounts, such as a traditional IRAs, 401(k), 403(b), or 457
- Tax-exempt retirement accounts, such as a Roth IRA or Roth 401(k)

RMDs should be taken first if you're older than 70½ because if you don't, in most cases, you will pay a penalty that is half the amount of what was not withdrawn.

After the RMDs or if you are not 70½, you should take income from your taxable accounts until you've used all of the funds. The reason for this is that tax-advantaged accounts still have the potential to grow on a tax-deferred basis.

On your taxable accounts, you will most likely have to sell investments on which you will pay capital gains on any appreciation, which is from 0% to 20% depending on your tax bracket. The majority of taxpayers pay no more than 15%, since long-term capital gain rates are much lower than income tax rates.

Finally, you should use the assets in your tax-deferred accounts on which you will pay ordinary income tax. If you have Roth accounts, these funds will not be taxed.

Avoid Paying Taxes on Social Security

Up to 85% of your Social Security benefits are taxable if you make more than the income thresholds. If your adjusted gross income, nontaxable interest, and half of your Social Security reaches $25,000 for individuals and $32,000 for couples, you will pay income taxes on up to 50% of your Social Security benefits. Additionally, if your retirement income reaches $34,000 for individuals and $44,000 for couples, you will pay income taxes on up to 85% of your Social Security payments.

You want to manage your income to reduce the percentage of your Social Security benefits that are taxed. With this strategy, you'll want to make the income threshold the target instead of the income associated with a specific tax bracket.

Take Advantage of Lower Capital Gain Rates

If your taxable income falls into one of the two lowest tax brackets, you can sell stocks that were held longer than a year as a tax-efficient means to generating cash flow. In 2019, taxpayers in the 10% and 12% income brackets will realize long-term capital gains or receive qualified dividends without being taxed. This is a great strategy if you have a high proportion of assets in taxable accounts and a lower amount of recurring income.

Business Data

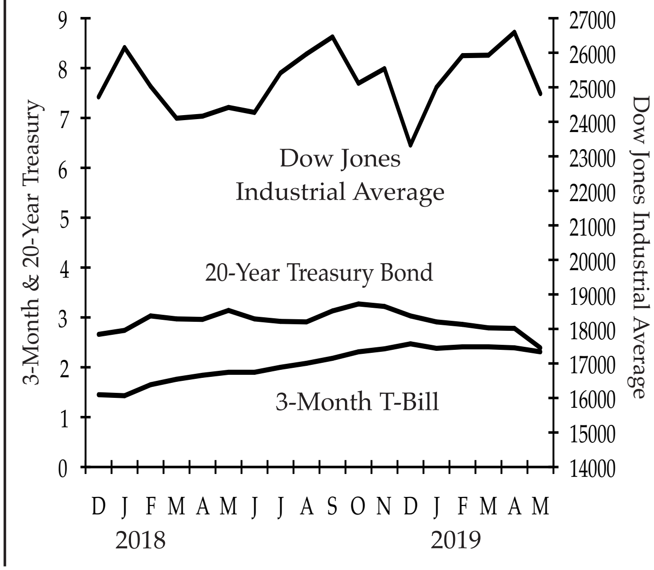
Indicator	Month-end Mar-19	Apr-19	May-19	Dec-18	May-18
Prime rate	5.50	5.50	5.50	5.50	4.75
3-month T-bill yield	2.41	2.39	2.31	2.47	1.90
10-year T-note yield	2.55	2.55	2.14	2.89	3.07
20-year T-bond yield	2.79	2.78	2.39	3.03	3.14
Dow Jones Corp.	3.74	3.74	3.63	4.40	3.89
GDP (adj. annual rate)#	+3.40	+2.20	+3.10	+2.20	+2.20

Indicator	Month-end Mar-19	Apr-19	May-19	% Change YTD	12-Mon.
Dow Jones Industrials	25928.68	26592.91	24815.04	6.4%	1.6%
Standard & Poor's 500	2834.40	2945.83	2752.06	9.8%	1.7%
Nasdaq Composite	7729.32	8095.39	7453.15	12.3%	0.1%
Gold	1295.15	1282.30	1295.55	1.1%	-0.8%
Unemployment rate@	3.80	3.80	3.60	-2.7%	-7.7%
Consumer price index@	252.78	254.20	255.55	1.4%	2.0%

— 3rd, 4th, 1st quarter @ — Feb, Mar, Apr 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

December 2017 to May 2019



Calculating Your After-Tax Rate of Return

To help make investment decisions, you should calculate your overall and after-tax rate of return on your investments.

Conceptually, an investment's total return equals the change in market value plus any dividends, interest, or capital gains, divided by the beginning market value. Practically speaking, however, total return can be difficult to calculate, especially if you invested additional money or took distributions during the year. If so, you may need the help of a computer to calculate your total return precisely.

Once you know your total return, calculate your after-tax return. From your dividend, interest, and short-term capital gain income, deduct the amount paid in taxes at your marginal tax rate. From your long-term capital gains, deduct capital gains taxes paid. You can then calculate your after-tax return.

If there's a significant difference between your total return and after-tax return, reevaluate your investment strategy to make it more tax efficient. Emphasizing investments that generate capital gains or placing income-generating investments in a tax-deferred account are just two strategies you may want to consider. If you'd like help evaluating the tax efficiency of your portfolio or would like to review your investment strategy, please call.

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