FLOWER CITY CAPITAL

March 2019 Newletter

Dear Members of Flower City Capital,

We hope you're looking forward to the start of spring. As always, we begin with an executive summary:

Executive Summary

- The late-cycle US stock market rally from last year's lows has continued, bringing markets closer to all-time highs
- US economic data has been mixed, while growth remains strong overall
- Global economic growth has been slowing, though it may accelerate later this year
- The Fed has paused its rate hike campaign waiting for more robust inflation
- Our portfolio shift last year towards more risk has done well, last week we moved to pare back risk exposure as the markets have readjusted
- Lastly, we look at Credit Shelter Trusts in our Planning Spotlight, an effective tool to limit potential estate tax liabilities

Market Overview

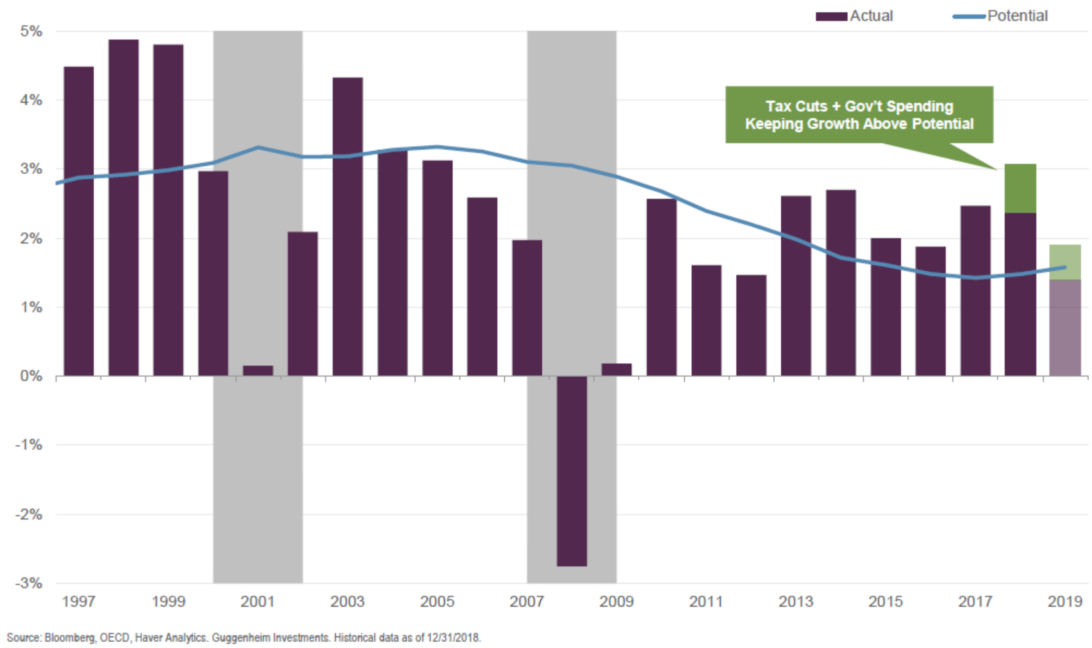
While looking at the current market picture, it is helpful to remember where we were only a few short months ago. The end of 2018 saw extreme fear and market selloffs across asset classes as the Fed was raising interest rates and global growth diverged.

So far this year markets have readjusted upward as underlying fundamentals remain strong. Stocks have increased across the board with the US in the lead, up as much as 13% YTD. International stocks have also increased with the potential for good news throughout the remainder of this year (low inflation and easy monetary policy, trade deals, Chinese stimulus, etc.)

	Price Return (As of March 25, 2019)			
	1 Mo	**3 Mo**	**YTD**	**Yield**
Equities				
US Large Cap	(0.2%)	19.2%	11.9%	1.9%
US Mid Cap	(2.8%)	20.6%	13.3%	1.4%
US Small Cap	(5.0%)	19.9%	12.8%	1.4%
Intl. Developed USD	(0.4%)	13.3%	9.7%	2.8%
Emerging Markets USD	(2.0%)	11.5%	8.8%	2.5%
Fixed Income				
US Bond	1.2%	2.7%	2.2%	3.1%
International Bond USD	1.3%	2.9%	2.7%	0.9%
High Yield	0.3%	8.4%	6.3%	6.0%
Emerging Market Bond USD)	0.8%	6.3%	5.3%	5.2%

While US economic growth has slowed, overall fundamentals remain positive and strong. Consumer based and housing market data are in good shape as are corporate margins and balance sheets.

US GDP Growth is expected to be lower in 2019, but still above it's potential



With the continued strength of the US economy, stocks have rallied sharply upward. Sentiment has swung in the opposite direction away from the extreme levels of fear we saw towards the end of 2018.

The S&P 500 has dramatically rebounded…

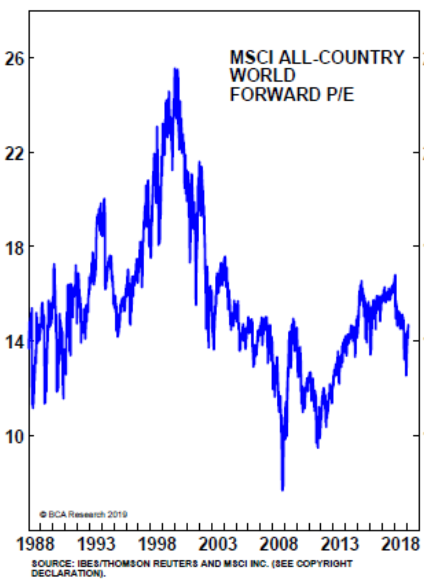
…the CNN Fear and Greed Index shows a shift in sentiment

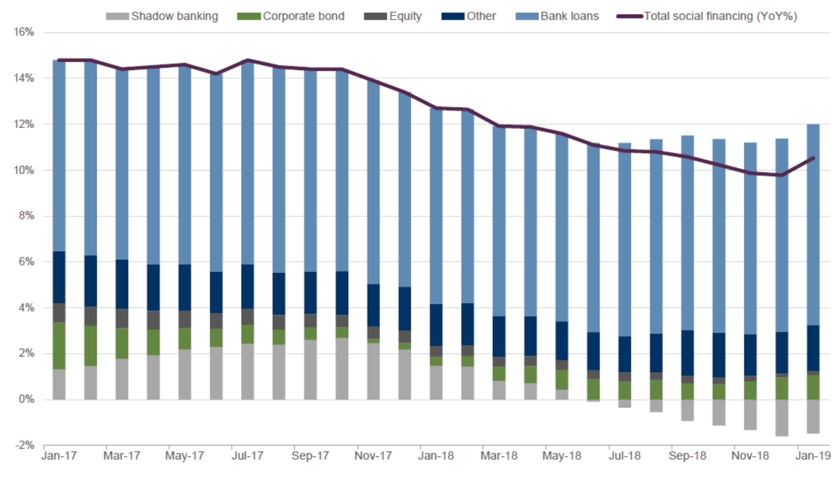
International markets appear to be reflecting much of the bad news in 2018, waiting for a sign that things have changed. However, we may be at an inflection point where global growth could reaccelerate later this year.

Continued favorable financial conditions in the form of low inflation and accommodative monetary policy, success on the trade deal front and the return of Chinese government stimulus among other things would provide support for international markets and risky assets in general.

Global Stocks appear to be reflecting the bad news of 2018…

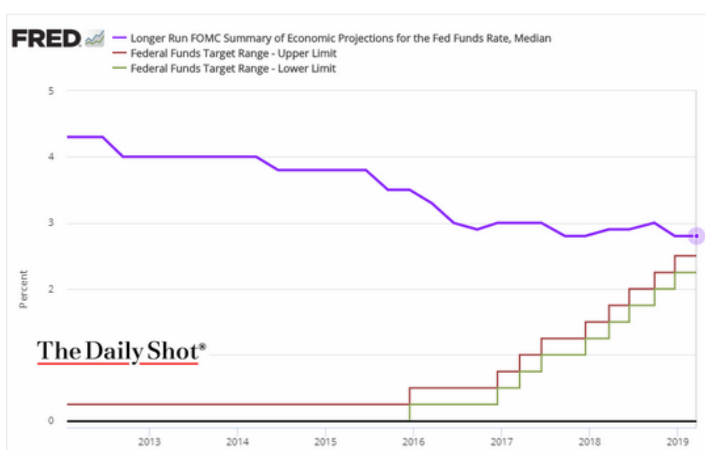
…though potential tailwinds exist for global growth in 2019, including Chinese stimulus





One of the driving factors in the market rally has been the dovish turn of the Fed, which has repeatedly communicated its intention to pause further rate hikes given inflation has yet to reveal itself, despite the late cycle economic period and tight labor market. In fact, the market is pricing in an interest rate cut.

This means the Fed is not intentionally slowing the economy in an effort to prevent it from overheating. This is constructive to equity prices in that it signals economic strength and easy money will continue for now.



Though the Fed is pausing now, rates remain below what is considered "neutral," which suggests further hikes may not be over. As a result, there is still interest rate risk in Fixed Income, where bond prices fall as interest rates rise.

Our Portfolios

The fact remains we are in the late-cycle phase of the economic and business cycles, and as a result expect volatility to continue. At the end of last year, we increased risk in our portfolios and bought equities when everyone else was selling. This worked nicely as the markets have rebounded. Given the market readjustment without a strong conviction for the future, last week we reduced risk by bringing portfolios back to our neutral targets.

Regarding Fixed Income, we continue to favor shorter duration as there is still a headwind from potential inflation and rising rates, though less so than before with fewer rate hikes ahead. Our risky bond position is neutral, preferring to be paid adequately in the form of higher spreads to assume default risk

Planning Spotlight: Credit Shelter Trusts

The 2017 Tax Cuts and Jobs Act included a provision which as increased the federal estate and lifetime gift exemption from $5,490,000 to $11,180,000 per individual or $22,360,000 for a married couple. This change effectively raised the threshold under which no estate taxes are applied at the federal level. However, residing in one of a handful of states may trigger estate or inheritance taxes at the state level. The good news is, there are different strategies that we can implement now to help eliminate or greatly reduce the impact of potential future liabilities. Every situation is different as is every state that enforces an estate or inheritance tax, therefore, it is important to understand the entire financial picture in order to implement the best strategy.

One strategy to help reduce or eliminate the impact of a state estate tax is to implement a Credit Shelter Trust. This approach creates an irrevocable trust for the benefit of a surviving spouse (and heirs) at the first spouse's death and funds it with assets up to the state estate tax exemption limit. By doing this, these assets are moved outside of the couple's taxable estate and therefore not subject to further estate tax calculations, thus saving clients' heirs potentially hundreds of thousands of dollars or more. These trusts are specifically designed to provide support to the surviving spouse for the remainder of their life and then pass on to the designated beneficiaries. This can all be accomplished by adding provisions to wills or living trusts.

Please do not hesitate to contact us with any questions, investment or otherwise.

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