HBK Wealth Management
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WEEKLY ECONOMIC COMMENTARY

This Week's Economic Review and Outlook

May 2015

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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Weekly Economic Commentary | Week of May 4, 2015

KEY TAKEAWAYS

- Since the peak in oil prices in June 2014, consumers saved some, spent some on nonessential items, and paid down some debt, even as measures of consumer sentiment soared.
- The big drop in gasoline prices has not provided a big lift to the consumer sector, which continues to struggle in this recovery, nor did it change the overall tepid trajectory of consumer spending.
- Stubbornly weak wage and income growth, which has a significant impact on consumer spending, remain key constraints on spending.

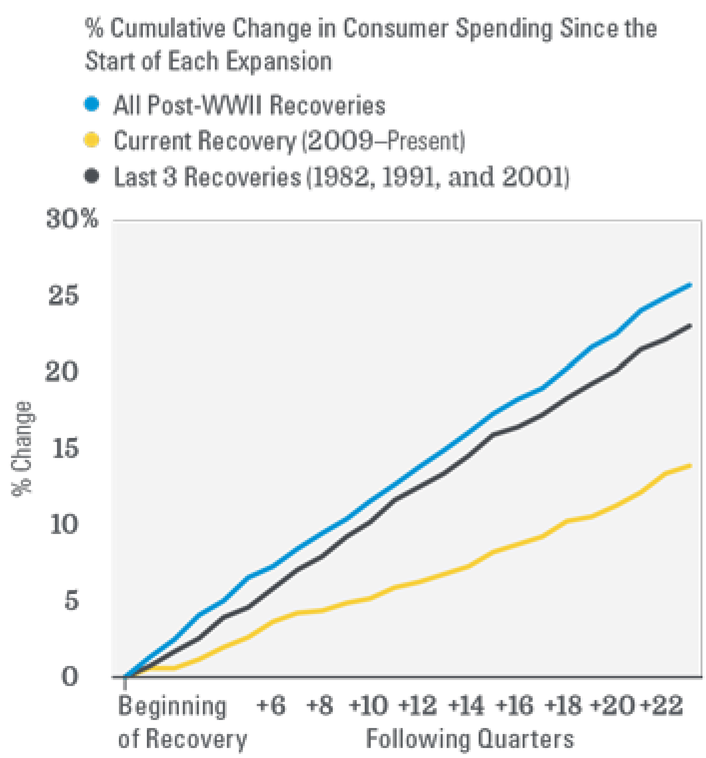
CONSUMER CONSISTENCY

U.S. consumers spent an annualized $302 billion on gasoline and other consumer energy products (home heating oil, natural gas, etc.) in March 2015--aided by the 33% drop in gasoline prices between June 2014 and March 2015--$116 billion (or 28%) less than they spent in June 2014 [Figure 1]. What did consumers do with all the money they saved? With many households still reeling from the 2007-09 Great Recession and its aftermath, and perhaps believing that the drop in energy prices was temporary, consumers saved some, spent some on nonessential items, and paid down some debt, even as measures of consumer sentiment soared. Sound familiar?

Click here for Figure 1, The Drop in Oil Prices Has Saved Consumers $116 Billion.

The big drop is gasoline prices has not, as some expected, provided a big lift to the consumer sector, which continues to struggle in this recovery, nor did it change the overall tepid trajectory of consumer spending. Since the end of the Great Recession--23 quarters ago in Q2 2009--consumer spending has increased by a cumulative 14%, well under the 25% gain seen at this point, on average, in all post-WWII economic recoveries, and the 23% average gain seen in the first 23 quarters of the last three economic recoveries, which are the most comparable to today's recovery [Figure 2].

2 CONSUMER SPENDING IN THIS ECONOMIC EXPANSION HAS BEEN RUNNING WELL BELOW THE NORMAL PACE



Source: LPL Research, Bureau of Economic Analysis 05/01/15

SUPPORTS AND CONSTRAINTS

When we last wrote in-depth about the consumer in the November 10, 2014, edition of the *Weekly Economic Commentary*, "Consumer Conditions," we noted that while the drop in gasoline prices would be a plus for spending, other factors would likely have a much bigger impact on the consumer, given that gasoline accounts for only 3% of personal spending.

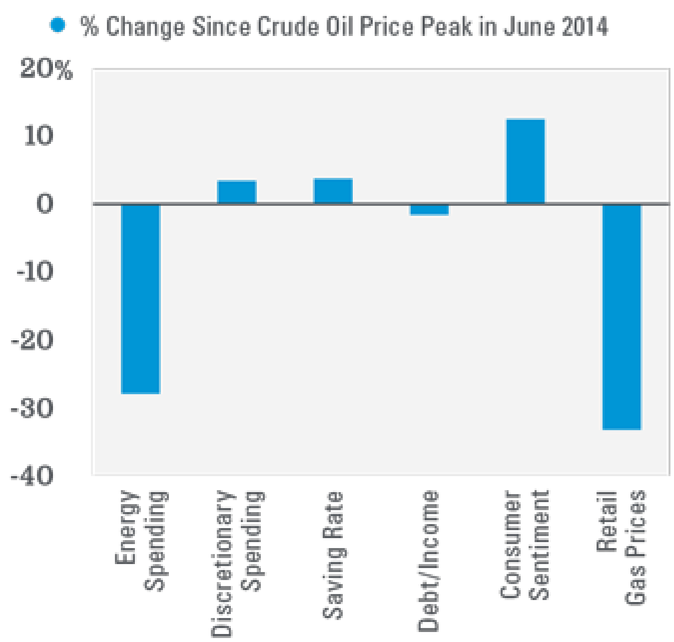
The good news is that the better tone to the labor market, the sharp rise in household net worth (which is the result of the recovery in housing prices, near all-time high equity market levels, and consumers' paying down debt), and prerecession levels of confidence all act as supports for the consumer. In addition, the precipitous drop in consumer energy prices over the past 9-12 months has left the share of consumer incomes dedicated to purchases of energy (3.5%) near the lowest level in nearly 15 years, providing some breathing room for consumers.

However, stubbornly weak but improving wage and income growth--which have a far bigger impact on consumer spending than any of the positives listed above--remain key constraints on spending. In short, while the big drop in consumer energy prices is a plus, at just over 4% of overall consumer spending (around $300 billion), the category just isn't large enough to move the needle on overall consumer spending, which is running at over $12.2 trillion.

Figure 3 details the percent change in several key consumer categories since oil prices peaked in June 2014:

- Consumer spending on energy
- Consumer spending on discretionary items
- Consumer savings rate
- Consumers' debt to income ratio
- Consumer sentiment
- Retail gasoline prices

3 CONSUMERS HAVE SPENT MORE, SAVED MORE, AND PAID DOWN DEBT SINCE ENERGY PRICE PEAK IN JUNE 2014



Source: LPL Research, Haver Analytics 05/01/15

LARGELY CONSISTENT BEHAVIOR

The big drop in energy spending (28%) and gasoline prices (more than a 30% drop) stands out, although, as noted above, overall energy spending accounts for just over 4% of all consumer spending. The other consumer category that has moved up dramatically since oil prices peaked in June 2014 is consumer sentiment, which moved to an 11-year high in November 2014, before moving lower in early 2015. Consumer spending on discretionary items like cars, movies, televisions, and vacations increased by nearly 4% from June 2014 through March 2015. Consumers also increased their saving rate, perhaps sensing that the drop in energy prices was only temporary. And while spending less on gasoline, more on discretionary items, and saving more, they also managed to pay down some debt.

In many respects, consumers really did nothing different in the past 9-12 months than they did in the early stages of the recovery from the Great Recession, when they also, in aggregate, spent some, saved some, and paid down some debt as the $787 billion economic stimulus package worked its way through the economy. Looking ahead, we continue to see consumer spending running at around two-thirds of normal, supporting gross domestic product (GDP) growth above 3.0% for the remainder of 2015.

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Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

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Tracking #1-379108 (Exp. 05/16)

Weekly Market Commentary | Week of May 4, 2015

KEY TAKEAWAYS

- We believe emerging markets (EM) score well when evaluated along some of the same criteria that NFL football teams use to assess potential draft picks:speed, strength, value, upside potential, and character.
- According to our evaluation, EM scores very well on the first four metrics, and the fifth--character--is sufficiently discounted in terms of policy and corporate governance risks.
- EM may make a good draft pick to add to your portfolios.

EMERGING MARKETS MAY MAKE A GOOD DRAFT PICK TO ADD TO PORTFOLIOS

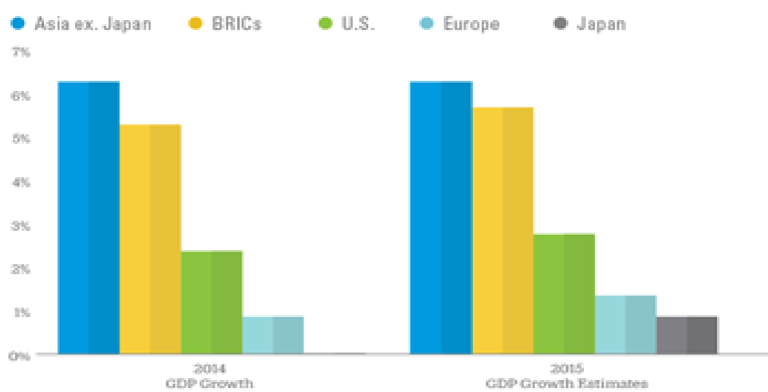
The evaluation process NFL football teams go through to prepare for the NFL draft, which took place this past weekend, is not unlike the investment decision-making process. We in LPL Research get in our "war room" every day to scour global markets for investment opportunities. Like NFL teams looking for talented football players to add to their teams, when looking for investment talent we are also looking for some of the same qualities: speed, strength, value, upside potential, and character. Emerging markets (EM) score well on these criteria overall and, we believe, may represent a good draft pick for your portfolios.

FINDING INVESTMENT TALENT

We believe emerging markets score well when evaluated along some of the same criteria that NFL football teams use to assess potential draft picks:

Speed. Football teams look for fast players; we look for fast-growing or accelerating economies. Some of the fastest-growing economies in the world are emerging market economies, particularly in Asia, supported by favorable demographics, monetary stimulus, and policy reforms. China's economy grew at a reported 7% pace during its most recently reported quarter (Q1 2015) and is expected to grow at that pace for the full year, based on Bloomberg consensus forecasts [Figure 1]. We do, however, acknowledge China's true growth rate may be slightly lower than its reported growth rate. More broadly, Asia ex. Japan is growing at a more than 6% pace, while the so-called "BRICs" (Brazil, Russia, India, and China), despite the drag from a contracting Russian economy, are expected to grow at a more than 5% pace in 2015, faster than their developed country counterparts. Despite stalled growth in Brazil, EM offers the best speed, while developed markets--mainly Europe and Japan--are just plodding along. (For more details on global growth, see our *Weekly Economic Commentary*, "Gauging Global Growth: An Update for 2015 & 2016," April 13, 2015.)

1 EM ECONOMIES ARE GROWING FASTER THAN DEVELOPED COUNTERPARTS



Source: LPL Research, Bloomberg 05/01/15

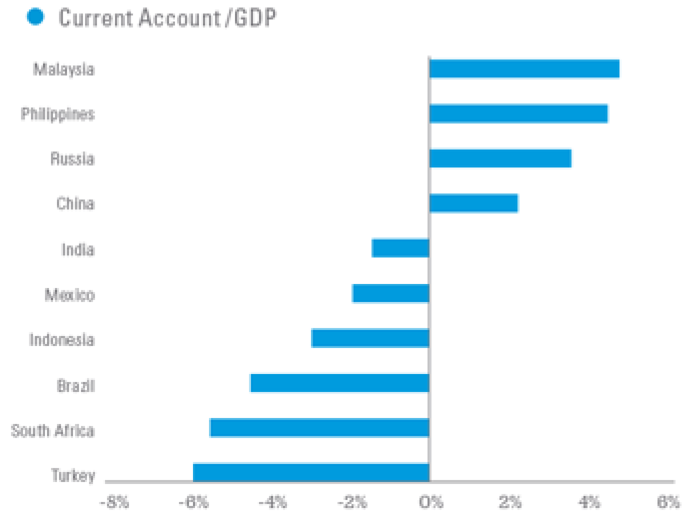
BRIC countries includes Brazil, Russia, India, and China.

While EM is delivering economic growth, that growth is not translating into earnings growth yet. This is a concern, although earnings may pick up in the second half of 2015 and in 2016 if early signs of a recovery in commodity prices are sustained, policy reforms take further hold in such countries as China and India, and growth in developed markets improves (our base case), helped by weaker currencies.

Strength. Strength is another characteristic important in both football and investing. More specifically, for EM, financial strength matters. EM stock market losses during the so-called "taper tantrum" in May through September 2013 highlighted the importance of financial strength and favorable trade balances, while Greece's struggles in recent years are an extreme example of the importance of a country's financial position. Asian countries are generally financially stronger than the rest of the EM universe, one of the reasons we suggest investors focus there. Figure 2 shows current account balances as a percentage of gross domestic product

(GDP), a measure of a country's global trade position. A higher percentage reflects more going out (exports) than coming in (imports), which can provide important support for a country's currency and can help attract capital from abroad.

2 ASIAN EM COUNTRIES ENJOY STRONGER TRADE POSITIONS



Source: LPL Research, Haver Analytics 05/01/15

Most EM Asian countries also have manageable government budget deficits and debt loads. Many EM countries showed economic resilience during the recession in 2008-09. Having lived through a major crisis in 1998, many EM countries did not have the degree of leverage in their financial systems and property markets as the U.S.

Value. In the NFL draft, teams are looking for players that offer good value for the draft slot where they were selected, i.e., players who turn out to be better than the rest of the league expects. Similarly, as investors, we try to uncover investment opportunities that the market has mispriced, providing appreciation potential (think Moneyball by Michael Lewis). A search for value in the global equity market leads us to EM. Despite the solid outperformance by the MSCI EM Index year to date (10% gain compared with 3% for the S&P 500), EM is still trading at a 25% discount to the S&P 500 Index, as measured by the forward price-to-earnings (PE) ratio [Figure 3]. By this measure, valuations are still attractive relative to history and have room to potentially rise further.

Click here for Figure 3, EM Remains Attractively Valued Compared with the U.S.

Upside potential. In the NFL draft, particularly in the later rounds where the odds may be stacked against a player's success in the league, teams are looking for players with big upside. From a technical analysis perspective, we believe EM offers attractive upside potential. Relative strength of the MSCI EM Index has improved substantially this year, reversing a multiyear downtrend (relative strength is simply the EM Index divided by the S&P 500 Index). While we cannot be sure the strong performance will continue, we believe recent improvement in relative strength is a good sign that, when coupled with the magnitude of underperformance versus the S&P 500 Index over the past five years [Figure 4], suggests a potential opportunity to recapture some of those relative losses. On an absolute basis, we also believe EM technicals are bullish, based on the price of the MSCI EM Index being above its 50-, 100-, and 200-day moving averages. Since mid-March 2015, gains in oil and the pause in the U.S. dollar's ascent have provided additional support.

Click here for Figure 4, EM Has More Ground to Potentially Make Up.

Character. NFL teams want to draft players with good character who will represent their franchises well. Many high draft picks have failed in this respect, due to poor behavior off the field. The investment comparison we would make here is around policy and corporate governance. For example, during Russia's military conflict in Ukraine, Russian companies were harmed by the more pronounced recession brought on by economic sanctions (in addition to the energy downturn). Chinese stocks typically trade at discounts to similar businesses in more mature markets because local state-owned enterprises do not always act in the best interests of shareholders.

The pace and depth of reform is another way we can look at character. Many emerging markets have been hampered historically by heavy government interference and corruption. Brazil is currently going through a scandal involving Petrobras, its partially state-owned oil company. But other emerging markets are making meaningful economic reforms. India in particular appears to be throwing off vestiges of its very state-controlled economy. China has been cracking down on corrupt government officials. Mexico is now allowing foreign investors in its energy business after decades of a complete monopoly by its state oil company. These are positive signs that the character of these markets is improving.

These "character issues" are important considerations for EM investors and are not always reflected in economic and market statistics, a reason we believe active managers can add value in these markets relative to the EM benchmark.

CONCLUSION

In some ways, identifying investment opportunities is like the NFL draft. When selecting investments, like professional football teams, we are looking for speed, strength, value, upside potential, and character. We believe EM scores very well on the first four metrics, and that the fifth--character--is sufficiently discounted in terms of policy and corporate governance risks. EM may make a good draft pick to add to your portfolios.

IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

All investing involves risk including loss of principal.

Investing in foreign and emerging markets securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical risk, and risk associated with varying accounting standards. Investing in emerging markets may accentuate these risks.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The MSCI Emerging Markets Index captures large and mid cap representation across 23 emerging markets (EM) countries. With 822 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

DEFINITION

Forward price-to-earnings is a measure of the price-to-earnings ratio (PE) using forecasted earnings for the PE calculation. While the earnings used are just an estimate and are not as reliable as current earnings data, there is still benefit in estimated PE analysis. The forecasted earnings used in the formula can either be for the next 12 months or for the next full-year fiscal period.

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Art and Collectibles: Planning for the Transfer of Your Treasured Property

Passing along property during your lifetime may be one way to minimize estate taxes.

For many individuals collecting artwork, jewelry, antiques, and other vintage treasures is a lifelong passion. Deciding what is to become of your valuable personal assets when you are no longer around to care for them is not something to take lightly, particularly when it comes to planning for the distribution of your estate.

Let's say over the years you have accumulated several valuable oil paintings. Ask yourself: Do I want to pass my collection on to family members? Do they have the expertise to manage valuable or fragile assets? Would a museum be a better home? Is it economically feasible to keep my collection intact, or will I need to sell some pieces to cover various expenses?

If you don't address these questions while you are here and able to do so, it is likely that your estate executor or attorney -- who may not have your passion for art -- will do so for you when you're gone. Deciding what to do with a treasured collection generally involves three tasks: assessing value, naming beneficiaries, and communicating your intentions.

Assessing Value

Putting a price tag on your collectibles is, pardon the pun, more art than science. Viewers of the "Antiques Road Show" on PBS know that the appraised value of unique property sometimes surprises even the owner. You'll want to consult a professional appraiser who specializes in your type of collectible. Location, too, may be a consideration. If you own a prized statue from a local sculptor, you may want to speak to a nearby appraiser who is familiar with the regional market.

A paper trail -- receipts, newspaper articles, old photos, and letters -- that can help trace the history of, for example, an antique Smith & Wesson revolver collection could enhance your appraisal. After all, if sold at auction, a gun proved to be fired by Teddy Roosevelt would most certainly bring in a higher bid than one owned by an anonymous cowboy. Needless to say keeping good records that include the tax basis and appraised value of collectibles will come in handy when assessing capital gains, identifying gift and donation deduction amounts, and submitting insurance claims should such property become lost or damaged.

Naming Beneficiaries

When drafting a will, be specific in bequeathing your tangible and personal property. Doing so will help you avoid the potential for family discord by noting item-by-item who gets what and under what circumstances. For added clarity, it may be wise to identify primary and alternative beneficiaries for such items.

Gifts to Charity; Weighing the Tax Implications

You may want to consider making a charitable gift to a museum or other reputable institution. Passing along property during your lifetime may be one way to minimize estate taxes. By consulting with your tax advisor, you might decide to make a gift during your lifetime that offers an immediate tax deduction. In contrast, bequeathing a gift postmortem may mean missing out on any income tax benefits while you are alive.

A formal gift agreement will spell out the terms of the transfer. For instance, would you want a particular item to be on a permanent or restricted exhibit? Should your gift be made anonymously or should the piece include your family's name engraved on a plaque?

Preserving Your Valuables for Posterity

It is important to leave sufficient liquidity at your death to avoid the unintended sale of a treasured collection to raise fast cash. Creative life insurance strategies may be employed to match the value of the donation. A trust professional working with your attorney can explain other strategies that may help execute your charitable wishes and extend your legacy for future generations.

Communicate Your Intentions

No matter what approach you choose, it is important to communicate clearly with family members and other third-party beneficiaries. Write your wishes down to mitigate chances for misunderstanding. With proper planning, you can enjoy your passion and take advantage of potential tax benefits at the same time.

This communication is not intended to be legal and/or tax advice and should not be treated as such. Each individual's situation is different. You should contact your legal and/or tax professional to discuss your personal situation.

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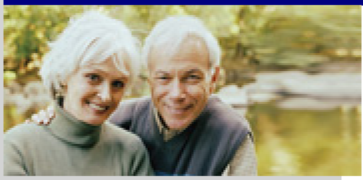

Planning for Known -- and Unknown -- Health Care Costs in Retirement

Financial advisors often recommend taking a holistic approach to calculating income needs in retirement, factoring in such costs as taxes and debt payments along with other typical expenses including health care.

The issue of health care costs in retirement -- and planning for them well in advance of retirement -- is becoming a centerpiece of any retirement planning discussion.

A recent study by Employee Benefit Research Institute (EBRI) projected that in 2014, men and women who wanted a 90% chance of having enough money to cover out-of-pocket health care expenses in retirement would need to have saved $116,000 and $131,000 respectively by age 65.[1] This is a sobering goal when you consider that just 42% of workers in their 50s and 60s report total savings and investments in excess of $100,000.[2]

Part of the problem with putting a price tag on retiree health care expenses is that every situation will vary depending on an individual's health, the type of health care coverage they carry, and when they hope to retire. That said, EBRI has identified some "recurring expenses," or standard elements of cost that can be estimated and planned for in advance as well as "non-recurring" expenses that are less predictable but tend to increase with age.

Recurring vs. Non-Recurring Expenses

Using data gleaned from the Health and Retirement Study (HRS) -- a longstanding, highly respected study of representative U.S. households with individuals over age 50 -- EBRI was able to categorize utilization patterns and expenses for two separate types of health care services:

- Recurring services -- include doctor visits, prescription drug usage, and dentist services. Since these services tend to remain stable throughout retirement, it is possible to calculate an average out-of-pocket expense among individuals age 65 and older of $1,885 annually.[3] Projecting forward, and factoring in the following assumptions: a 2% inflation rate, a 3% rate of return on investments, and a life expectancy of 90 years, EBRI estimates that one would need $40,798 at age 65 to cover the average out-of-pocket expenses for recurring health care needs throughout retirement. It should be noted that this calculation does not include expenses for any insurance premiums or over-the-counter medications.
- Non-recurring expenses -- include overnight hospital stays, overnight nursing home stays, home health care, outpatient surgery, and special facilities. Unlike recurring expenses, the cost of most non-recurring services increases with age. For example, average annual out-of-pocket expenses for nursing home stays are estimated at $8,902 for those in the 65 to 74 age group, $16,948 for those aged 75 to 84, and $24,185 for individuals aged 85 and up.[3]

Yet because the likelihood of utilizing these services and the degree to which they will be needed is largely unknown, projecting the savings needed to cover these costs throughout retirement is an elusive exercise. However, by thinking about the total out-of-pocket savings goals of $116,000 for men and $131,000 for women cited earlier in terms of recurring and non-recurring costs may help retirees and those nearing retirement in their planning efforts.

Bigger Picture Planning

Financial advisors often recommend taking a holistic approach to calculating income needs in retirement, factoring in such costs as taxes and debt payments along with other typical expenses including health care. In addition to the out-of-pocket health care calculations discussed above, consider what you think you might have to pay in annual premiums if you were to apply for health insurance today. Lastly, and perhaps most important, add in an allowance for inflation -- both general and health care inflation.

Your financial planner can help get the retirement income planning discussion started and -- as part of that exercise -- can work with you to put some numbers around your health care planning needs.

This article offers only an outline; it is not a definitive guide to all possible consequences and implications of any specific saving or investment strategy. For this reason, be sure to seek advice from knowledgeable professionals.

[1]*Employee Benefit Research Institute, news release, "Needed Savings for Health Care in Retirement Continue to Fall," October 28, 2014.*

[2]*Employee Benefit Research Institute, 2014 Retirement Confidence Survey, March 2014. (Not including the value of a primary residence or defined benefit plans.)*

[3] Employee Benefit Research Institute, "Utilization Patterns and Out-of-Pocket Expenses for Different Health Care Services Among American Retirees," February 2015.

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