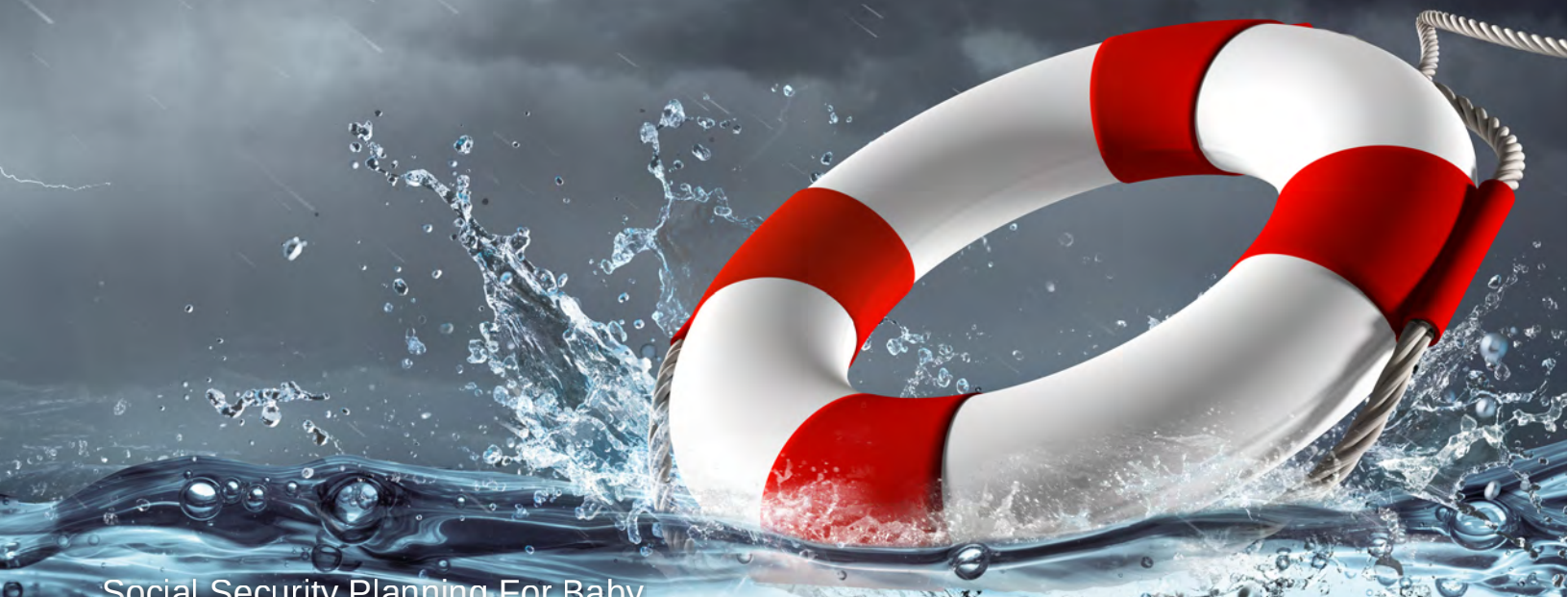
October 2019

PINNACLE QUARTERLY

Will The Fed's Rescue Come Too Late?

The Pinnacle Investment Team



MOUNTAIN PEAK
WEALTH ADVISORS, LLC
PLANNING, EDUCATION, ADVICE & KNOWLEDGE

October 2019

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Social Security Planning For Baby Boomers

Deb Kriebel, MBA, CFP®
Partner, Wealth Manager

Born in the period between 1946 and 1964, a new wave of baby boomers retires every day. And for those boomers turning 62 this year, this will be the first opportunity to claim Social Security benefits. Unfortunately, they'll suffer penalties if they do so before full retirement age. That's why it's so important to know all your claiming options—and the consequences of those options—before you start receiving your benefits.

When Should You Apply For Social Security Benefits?

So, when should you apply for benefits? The answer is… it depends. It depends upon the unique characteristics of your personal situation. These include your health status, your life expectancy, your need for income, whether or not you plan to work, survivor needs, and (if you are married) coordination with your spouse's benefits.

The decision as to when you should claim your Social Security benefits is very important. Your Wealth Manager has specialized training in Social Security planning and enjoys access to software tools that will help analyze your unique circumstance to help you maximize your benefits.

Let's take a quick look at the rules that will impact what you receive.

A Lifetime Annuity

Social Security is one of the few sources of income that you can't outlive; it's a lifetime annuity. And of course, the longer you live, the more you will extract from the system. If your benefit starts out at $2,000 per month, and you live 10 more years, you will receive over $300,000 in lifetime benefits. If you live 20 more years, you'll receive over $600,000 in lifetime benefits. And if you live 30 more years, you'll receive more than $1 million over your lifetime. (This example assumes an annual cost of living increase of 2.8%.)

Social Security also offers annual inflation adjustments. So if your benefit starts out at $2,000 per month, and if annual increases are 2.8%, in 10 years you will be receiving $2,636 per month. In 20 years your monthly benefit will be $3,474, and in 30 years your check will be $4,580.

How Are Social Security Benefits Calculated?

In order to calculate your benefits, Social Security looks at your annual earnings over your lifetime, indexes them for inflation, and picks the 35 highest years' earnings to include in the formula. The indexed earnings are totaled and divided by 35 to come up with an average. If you don't have 35 years of earnings, the missing years will be filled with zeroes. This has the effect of lowering benefits for men or women who have taken time out of the workforce to raise children or take care of elderly parents.

Next, a formula is applied to your average indexed monthly earnings to determine your primary insurance amount (PIA). This is the amount you will receive at full retirement age.

Benefits At Full Retirement Age

Full retirement age (FRA) is the age at which you can claim full, unreduced benefits. For everyone born between 1943 and 1954, full retirement age is 66. For everyone born in 1960 and later, full retirement age is 67. For those born in 1955 through 1959, full retirement age is 66 plus some number of months. If you apply for Social Security after full retirement age, your benefit will increase by 8% for every year that you delay. After age 70, you do not earn delayed credits, so everyone should claim their benefits by age 70.

Social Security offers spousal benefits for men and women. The spousal benefit is 50% of the primary worker's PIA at full retirement age (the primary worker must have filed for benefits). The low earning spouse must be at least 62 for a reduced benefit or full retirement age for a full spousal benefit. Spousal benefits do not earn delayed credits after FRA.

Benefits For A Divorced Spouse

A spouse can receive Social Security based on the ex's work record, providing the marriage lasted at least 10 years, they are currently unmarried, and the ex-spouse is at least 62 years old. The ex-spouse will not be notified that a claim has been made on their work record, and you do not need to know the location of your ex. However, you will have to provide proof showing the dates of your marriage and divorce. If you are receiv-

ing divorced-spouse benefits and you remarry, your benefits will stop. Of course, you may then qualify for spousal benefits based on your new spouse's work record.

Widow And Widower Benefits

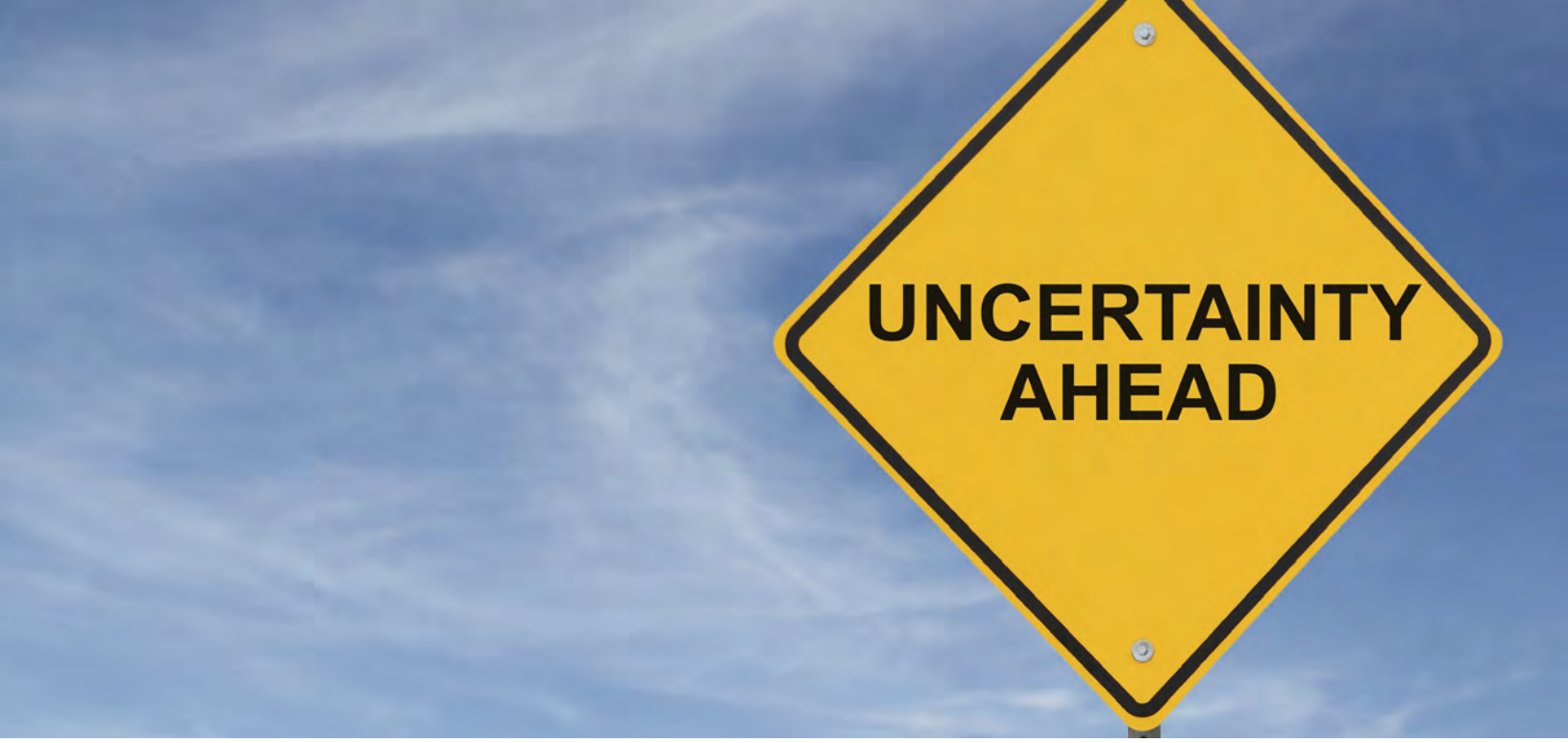
Survivor benefits are available for those who have been married for at least 9 months (except in case of an accident). To start benefits, the survivor must be at least 60 years old, or 50 if disabled. However, if the widow or widower applies before full retirement age, the benefit will be reduced, just as it is for regular benefits.

If you remarry before age 60, you will not be able to receive a survivor benefit based on your previous spouse's record, unless your remarriage ends. If you are a divorced spouse, you are entitled to divorced spouse survivor benefits as long as your marriage lasted 10 years.

Discuss This With Your Pinnacle Wealth Manager

Making good decisions about when to take your benefits can be complicated. Be sure to discuss Social Security planning with your financial advisor to ensure that your benefits are properly coordinated with the rest of your financial plan.

Deb Kriebel, MBA, CFP®, is a partner and wealth manager at Pinnacle Advisory Group.



Two Ways To Ease The Retirement Transition

Mindy Gasthalter, CFP®, MBA
Wealth Manager

I've had two clients in the recent past who struggled with whether or not they should retire. Neither client cared for their jobs, but didn't think they were ready for retirement, and so decided to stay put until they figured out 'what was next.'

Shift From Full-Time To Part-Time Work

In the first case, the client ultimately decided to retire from her job, realizing that she could just as easily figure out what came next in the non-work world. However, not wanting to make the leap entirely, she spent two years trying a variety of different part-time options. She didn't ultimately find anything that piqued her interest long term, so she decided to stop trying. After two years of transitional part-time work, she was ready for full retirement. She soon shifted into a routine of the gym a few mornings a week… tennis or golf on the other days… and more time with a relatively new spouse and grandkids.

Could working part-time in your current job before retiring help? I think this is a great solution, if your employer allows it. Who wouldn't love to work three or four days per week, and then have three or four days off? Easing into retirement is a great option if it's available.

My client was lucky, and initially filled her time with part-time work, which enabled her to gradually acclimate to the idea of full retirement. She also had outside interests and a supportive family, which contributed to her smooth transition.

Unfortunately, my second client is in a different situation, and part-time work is off the table. His job is demanding and the environment is dysfunctional and draining; every day is a struggle. He knows he should go—largely because it would dramatically improve his mental health—but he doesn't have many outside interests. Not only that, but he's also single with no children or grandchildren, and so is at a loss for what he would do in those 40 hours a week that he now spends at work. Recently, the client decided to engage a therapist who specializes in transitions to see if that will help.

Take A Pre-Retirement Gap Year

He might also benefit from taking a gap year before leaping into retirement. You probably know about the gap year between high school and college. (Most recently, we heard that Malia Obama was taking a gap year.) My client is an animal lover; maybe there's an opportunity to volunteer for a non-profit that rescues animals.

Gap years are no longer just for the young. There are structured programs and opportunities for those over 50, as well. Maybe that's the answer my client needs: Scour the programs and opportunities, see what grabs his interest, and make a plan to go.

Should you be interested in service, the Peace Corps offers three month in-country training with a two year commitment. Two additional resources to explore for those looking to take a pre-retirement gap year are www.goabroad.com and www.volunteerforever.com. I must admit that while looking at Volunteer Forever, I found at least six opportunities I would love to sign up for. I'll start crafting my auto-responder now…

Mindy Gasthalter, CFP®, MBA is a Wealth Manager at Pinnacle Advisory Group.

How Long Will $500,000 Last In Retirement?

Ken Solow, CFP®
Founding Partner,
Chief Investment Officer

How long will $500,000 last in retirement? The answer is… it depends. You'll need to start with some basic retirement questions. To a large degree, your ability to retire on $500,000 will depend on your answers:

- How old are you and how long do you want to plan on funding your retirement?
- How much will you spend in retirement?
What are your other sources of income?
- Will you receive an inheritance or other sources of assets?
Do you own your $500,000 in pre-tax or after-tax accounts?

And finally, what is your investment risk tolerance?

This last question is a particularly interesting one, because the (surprising) answer is it doesn't matter as much as you might think. Let me explain: There is a large body of research centered on how much you can withdraw from a portfolio without running out of money. Prior to the 1990s, researchers used the average returns and volatility of stocks and bonds at the time to conclude that the safe withdrawal rate was 6%-7% each year. Using the 7% withdrawal rate, your $500,000 could reliably pay you $35,000 annually, or a little over $2,900 per month. This approach came to the intuitive answer that the higher returns you get from your portfolio, the more money you could withdraw to fund your retirement.

The Change In Safe Withdrawal Rates

That changed in the 1990s when withdrawal rate studies used a slightly different methodology. Instead of just looking at the impact of portfolio returns, researchers wanted to know the impact of portfolio volatility on safe withdrawal rates. Where prior studies used the average returns and volatility of stocks and bonds, they used actual historical sequences of returns of stocks and bonds over different time periods. As a result, retirement 'common sense' changed in a flash, because the earlier assumption that taking more risk and earning higher returns would reward you with higher safe withdrawal rates was disproved. It turned out that constructing riskier portfolios resulted in lower withdrawal rates, because portfolios ran out of money during market crashes or long-term bear markets. Constructing lower risk portfolios with lower allocations to stocks and higher allocations to bonds resulted in similar results when inflation was raging in the 1970's and bond returns were sharply lower.

The 'sweet spot' in the early studies was a portfolio constructed of 60% stocks and 40% bonds—the well-known 60/40 portfolio. If you are not especially risk tolerant (meaning you lose sleep when the stock market goes into one of its periodic meltdowns), then the bad news is that the average decline of a 60/40 portfolio in a bear market using data from 1970 to the present is about 25%. In an average bear market, your $500,000 portfolio would suffer paper losses of $125,000, reducing the value at the market bottom to only $375,000.

That's the good news.

The bad news is that these declines in portfolio value are made worse by the withdrawals you would be taking to fund your retirement.

The Real Risk To A $500,000 Retirement

Even if you can tolerate what most investors identify as the moderate risk of a 60/40 allocation, the peril to your retirement is all about taking withdrawals from the portfolio in a bear market in either stocks or bonds. If you are not withdrawing from your portfolio, you can patiently wait for the stock market to recover from bear market declines. The problem is that although bear markets are typically followed by above average bull market returns, when you consider portfolio withdrawals in addition to market declines, you simply don't have enough capital left to benefit from the higher returns that follow the bear market. It may be counterintuitive, but you don't have to take more risk to maximize your ability to retire on $500,000. The research tells us that anything more than a 60% allocation to a well-diversified stock portfolio just doesn't help.

The average safe withdrawal rate (safe meaning there was no historical scenario when you run of money) from the portfolio based on original studies was 4%. Later research showed that if you properly diversified your portfolio by owning more than just U.S. stocks and U.S. bonds, the safe withdrawal rate increases to the 4.5% to 5% range. Put differently, your $500,000 can safely pay you up to $25,000 annually (or $2,083 per month), adjusted for inflation, for the rest of your life.

Invest With Less Volatility

But what if you could invest your portfolio so that you received returns similar to historical market returns, but you did so with less risk or volatility? To get the answer, I asked our Director of Planning Research and acknowledged expert on safe withdrawal rates, Michael Kitces. He writes, "If you can do 60/40 returns with lower risk, you would be able to sustain higher withdrawal rates (you'd close the gap between the 6.5% average withdrawal rate and the 4% "safe" withdrawal rate that defends against bad return sequences.)"

So how can you gather market returns in a diversified portfolio with less risk than market history suggests? Unfortunately the planning industry tells us we can't. They say you are doomed to gather the average returns and volatility of financial markets in the future. However, at Pinnacle Advisory Group, we utilize active management techniques that allow us to change portfolio asset allocation in dangerous markets. As a result, we offer clients the possibility of earning market returns with less than market volatility… and consequently offer the possibility of driving higher withdrawal rates from client portfolios.

Of course, we have a full-time team of portfolio analysts to implement our risk management techniques. If you are a "do-it-yourselfer," I typically recommend that you stick to a properly diversified 60/40 portfolio and take your 4.5%-5% withdrawals. All you have to do is rebalance your account annually and make sure you don't overspend in any particular year.

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MARKET OUTLOOK

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After an impressive move higher during the first half of 2019, risk assets saw little movement to the upside in the third quarter. The S&P 500 did reach a record high of 3,025 on July 26th, only to slide back six percent over the following six trading days as, once again, investors had to digest trade war concerns. The trade war has become a familiar distraction for the market over the last two years, and we do not anticipate an imminent resolution.

The uncertainty surrounding global trade tensions did induce investors to continue investing in lower-risk assets. The ten-year treasury bond price rose as yields fell from a peak slightly above 2% to a low of 1.45%, and then climbed slightly at quarter-end to yield 1.70%. Rate sensitive equity sectors, like Utilities and Real Estate, produced solid returns of 7-8%. Meanwhile gold continued to move higher, finishing the quarter around $1500 per ounce, for a gain of 8-9%.

As the quarter ended, the S&P 500 was able to regain some ground, and finished very close to where it started at 2,971. International stocks in developed nations were also unchanged, while emerging markets, led by China, finished a few percentage points lower.

Clearly, high levels of uncertainty have driven much of the price volatility domestic markets experienced for the last few months.

Trade War Offsets Rate Cuts

The strong upward move for equity markets in June and July was largely due to investors anticipating the start of a new easing cycle by the U.S. Central Bank. The Federal Reserve was barely able to meet those expectations, cutting the Federal Funds rate by 0.25%. The committee referenced "global developments for the economic outlook as well as muted inflation pressures" as the basis for their decision, but acknowledged there was both sustained expansion in economic activity and strong labor market growth. Further, Chairman Powell described the action as a mid-cycle adjustment, which was interpreted by investors as the Fed only doing one rate cut. Many investors were hoping for the start of a major easing cycle, which would imply many more cuts in 2019 and into next year. Investor disappointment in the Fed statement was reflected in market behavior.

On August 1st the president tweeted that the tariffs already placed on $300 billion worth of Chinese goods would be raised by 10%. An already disappointed market dropped 4.5% over the next three days, and remained there through August. September, historically the worst performing month for the S&P 500, bucked its historical tendencies and moved higher, as Fed Chairman Powell recognized the policy mistake and signaled that more easing was probably appropriate.

In a bit of 3rd quarter deja-vu, the Federal Reserve met on September 18th and cut interest rates by another 0.25%, citing concerns regarding the global economy and muted inflation. Unfortunately, the rate cut was promptly followed by disappointing trade news. Chinese officials cancelled a planned visit to the U.S. to meet with farmers in Montana, while the president told reporters he was under no pressure to complete a deal.

In September a significant and highly anticipated central bank stimulus program was initiated by the European Central Bank, including the announcement of a significant rate easing package. ECB president Mario Draghi announced that the bank would: 1) cut interest rates; 2) restart a continuous quantitative easing program beginning in November that includes 20 billion euros of bond purchases per month, and 3) make eurozone refinancing operations more favorable. The bond market responded with cautious optimism following the announcement. Clearly global regulatory and monetary policy, along with trade policy uncertainty, was another major driver of volatility during the quarter.

The cavalry, in the form of global policy makers, has certainly showed up to support slowing global growth. In the third quarter, 13 major central banks cut rates while only one raised them. It is our opinion that a major, globally-coordinated easing cycle should be seen by investors as supportive of risk assets, even if some economists are questioning whether lower interest rates can solve the problems faced by the global economy. A sustained move above 3000 in the S&P 500 would be a good first step toward making that a reality.

What Exactly Are The Global Developments?

While our own recessionary model does indicate that risks have risen, we don't immediately foresee a U.S. recession. The domestic consumer market is healthy, and for a service-based economy like that in the United States, the strength of consumer spending is vitally important. Additionally, consumer confidence is high, wages continue to tick upward as measured by year-over-year changes in average hourly earnings, and household debt service and financial obligation ratios continue to appear very low. Housing, a trailing indicator to economic growth, is improving, according to the National Association of Home Builders. These factors, in concert, continue to bolster domestic economic optimism.

On the downside, international markets are experiencing a protracted manufacturing recession that has started to effect business confidence. Investors are questioning whether a service-based economy like ours can avoid the global manufacturing slowdown, or if the U.S. is next on the list and could fall into recession. Two recent broad-based U.S. manufacturing reports illustrate this point: The September ISM Manufacturing index reported contraction (a reading below 50) in the U.S., driven by trade war uncertainty and strength in

the U.S Dollar, while the Markit Manufacturing Index (MMI), which is more domestically focused, continues to point to expansionary activity. If the trade war and the subsequent global economic slowdown escalates further, there is a risk that business confidence in the U.S. could erode to the extent that the domestically-focused MMI will contract as well.

Maybe the Rest of the Globe Needs The Cavalry...

Globally, economies are more oriented towards manufacturing, and recent economic data reflect this orientation. Fleeting signs of stabilization earlier in the year have evaporated, leaving serious recession concerns among global powers. In Germany, industrial manufacturing has been in contraction since the beginning of this year. In the second quarter, the German GDP went negative at -0.1% and there are fears that the 3rd quarter could provide another negative reading. Similarly, South Korean exports are especially sensitive to trade and they have fallen by 22% year over year. Japan exports are down 10%, Swedish PMIs have been falling, Taiwan exports are falling… we could go on.

Finally, political noise is certainly heating up around the world:

- Brexit is an ongoing saga with the October 31 deadline approaching.
- Middle East tensions are up after the latest attack on two major oil processing facilities inside Saudi Arabia.
- The U.S.-China trade war continues, with little hope for a quick resolution.
- A separate trade war between South Korea and Japan has the potential to escalate into something much more dangerous.
- An impeachment inquiry into President Trump has been opened.

Is The Cavalry Too Late?

As we enter the 4th quarter, we believe central banks will continue to support stocks with easing measures. The banking system started to show signs that more liquidity is needed from the Fed, with rates on overnight repurchase agreements (short-term money market lending rates) soaring to almost 10%. In reaction, the Fed stepped in and provided liquidity to relieve the pressure. Some market participants are suggesting that permanent operations, like Quantitative Easing (QE) programs, are needed. If the Fed did restart QE programs, it would be another policy decision that would be supportive of risk assets. Whether or not this comes to pass, it is safe to say that the market is actively telling the Federal Reserve that more attention is needed. Investors are pricing in a 93% chance of another rate cut by December.

The question then becomes: Will it be too late and/or will it be enough? During the manufacturing recession of 2015/16, central bank actions in coordination with fiscal stimulus provided the spark to reignite global growth. We believe a similar coordinated response could be the key to avoiding recession this time. Will Germany pass a fiscal stimulus plan in response to recessionary conditions? Will Chinese data start to improve after a massive stimulus push throughout the year? Or have they done enough already, and it will just take time to filter through to spur real growth?

Our Positioning: A Small Step Below Benchmark Risk

We believe that the prudent stance is to be slightly below benchmark risk. Last quarter, our stated goal was to move to neutral. In light of heightened risks due to the factors we've outlined here, our portfolios remain at 95% of benchmark risk. Our U.S. equity positioning is overweight in defensive sectors, like consumer staples,

and also overweight in early cyclical sectors, like technology. Alternatively, we are positioned underweight in late cycle sectors (industrials and energy) and international equities.

In fixed income, we also remain slightly defensive. Treasury holdings are above benchmark weight, while corporate bond exposure is below benchmark weight. Additionally gold is overweight in portfolios, although that position has been cut in recognition of the large increase in gold prices.

The battle between a slowing economy and global central banks will continue into the 4th quarter. If global economic data starts to improve, we will not hesitate to move back to benchmark levels of risk (or slightly higher). At the same time, if the situation continues to deteriorate, we will position more defensively.

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Risk associated with equity investing include stock values which may fluctuate in response to the activities of individual companies and general market and economic conditions.

Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Although bonds generally present less short-term risk and volatility risk than stocks, bonds contain interest rate risks; the risk of issuer default; issuer credit risk; liquidity risk; and inflation risk.

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