First Quarter 2018

GALECKI FINANCIAL MANAGEMENT FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	2017
S & P 500 Index	1.11%	6.64%	21.83%
Russell Midcap Index	0.93%	6.07%	18.52%
Russell 2000 Index	-0.40%	3.34%	14.65%
Dow Jones Industrial Average	1.92%	10.96%	28.11%
Morgan Stanley EAFE Index	1.61%	4.23%	25.03%
MSCI US REIT Index	-0.21%	1.41%	5.07%
Bloomberg Commodity Index	2.99%	4.71%	1.70%
Barclays Aggregate Bond Index	0.46%	0.39%	3.54%

INDEX RETURNS

Calendar year 2017 produced strong gains across most asset classes. U.S Large cap stocks as measured by the S&P 500 surged 21.83% on the year and returned 6.64% in the final three months. Growth continued a strong run with the S&P 500 growth index gaining 27.44% while the S&P 500 Value index rose 15.36%.

Mid cap stocks finished the year up 18.52% after a 6.07% gain in the fourth quarter according to the Russell Mid Cap Index. Small cap stocks climbed 14.65% on the year and were up 3.34% in the final three months.

Returns outside of the U.S. were very strong with the MSCI EAFE index gaining 25.03% on the year and 4.23% in the final quarter. Emerging Markets gained 7.44% in the final quarter to finish the year up 37.28%.

The bond market was positive in the fourth quarter with the Barclays Aggregate Bond index gaining 0.46%. On the year, the Barclays Aggregate Bond index rose 3.54%. Meanwhile, the JP Morgan Emerging Markets Bond Index rose another 1.17% in Q4 and finished the year with a gain of 10.46%

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy grew at a 3.2% annualized rate in the third quarter following the 3.1% rate in the 2nd quarter. Early estimates for the fourth quarter are in the range of 2.5-3.0%. Although the first quarter of each year tends to be soft, most economists believe that we will have a nice pickup in GDP in quarters 2-4 for 2018.

The Leading Economic Index increased in October by 1.2% to 130.4 following a 0.1% increase in September and a 0.4% increase in August. The economy is expected to continue to pick up steam in 2018 as we begin to rebuild

GALECKI FINANCIAL MANAGEMENT 1990-2015 25 YEARS from two major hurricanes and the worst fire in California's history. Industrial Production rose 0.2 percent in November following a big revision in October of +1.2%. The Capacity Utilization rate was at 77.1 percent in November which is still 2.8 percentage points below the historical average. Although this means that we will probably not have pricing pressure in manufacturing, we believe that 2018 will be the year for wage inflation.

Non-farm payrolls increased by 148,000 in December and the unemployment rate remained at 4.1%. Many economists believe that we could get a reading of 3.5% for an unemployment rate in 2018. Initial weekly unemployment claims were 261,000 for the week ending January 6. According to the JOLTS survey, there were 5.9 million job openings in November.

Manufacturing increased in December to 59.7% from 58.2% in November on the ISM PMI index. This marks the 103rd consecutive month of expansion. The ISM Non-Manufacturing index was at 55.9% in December which marks the 96th consecutive month of expansion. The Business Activity Index was at 57.3% and the New Orders Index was also at 54.3%. All data continues to suggest good manufacturing growth in 2018.

Global economies have been on fire without much media attention. The JP Morgan Global PMI was at 54.5 in December up from 52.7 a year ago. The Euro area is at 60.6 lead by Germany and France who are at 63.3 and 58.8 respectively. Emerging markets continue to surge with a December reading of 52.2 lead by Taiwan at 56.6 and India at 54.7. Growth outside of the U.S. will continue to be a major story in 2018 as the U.S. economic cycle may begin to slow while international economies continue to flourish.

EQUITY AND BOND MARKETS

The S&P 500 is now over 2,700, the Dow Jones Industrial Average is above 25,500 and the Nasdaq has surpassed 7,200. It has been a remarkable run for U.S. stocks since March of 2009. In fact, the S&P 500 is now up 295% from those levels.

The chart above shows the performance of the S&P 500 and the MSCI ACWI ex-US index (All World index not including U.S.) from 1997 through 2017. You can see significant outperformance by the S&P 500 since 2009 with a 295% gain vs. a gain of 127% in the ACWI ex-US index. More importantly, the P/E ratio for the S&P 500 is now at 18.2 times earnings with a 20 year average of 16.0. However the ACWI ex-U.S. index is only carrying a P/E ratio of 14.3 times earnings with a 20 year average of 14.5.

Earnings in the U.S. are at all-time highs, while Europe and most Emerging Market markets still have a long way to go before they return to their 2011 peaks. With relatively low valuations and improving fundamentals, we believe that international stocks will outperform U.S. equities in 2018.

The bond market was difficult in 2017, but might be even tougher in 2018. The Federal Open Market Committee (FOMC) announced another 0.25% increase in the federal funds overnight lending rate. This was their fifth increase and it brings the rate into the 1.25% to 1.5% range. Most economists expect the Fed to hike rates three times in 2018 which will continue to bring the short end of the yield curve higher. With the 10 year Treasury yield around 2.5%, three hikes would make the yield curve flat unless long term rates increase.

In addition to the rate hikes, the Federal Reserve has indicated that it will be reducing its balance sheet over the next few years. The current balance sheet contains $4.46 Trillion of Treasuries and Mortgage Backed Securities. They would like to reduce this to around $2.6 Trillion by 2022. This extra inventory could put pressure on prices and drive up yields over this time frame. Existing bonds may face a stiff headwind during this next phase.

PORTFOLIO MANAGEMENT

The Investment Committee recently increased the international allocation of the preferred portfolio. This change was funded by taking profits off of the table from U.S. Large Cap growth funds that were up significantly and U.S. Large Cap Value funds that also had gains. As mentioned earlier, valuations in the U.S. have become extended and the Committee wanted to reduce this risk in the portfolio. Money was added to both the international developed funds and international emerging funds.

The Investment Committee also recently made some changes to the bond side of the portfolio. Our Market Neutral fund was reduced and money was used to purchase a low duration bond fund which should increase our diversification and hold up well if the equity markets contract.

This is the longest rally in the history of the U.S. without a 3% correction in the S&P 500. It began on November 4, 2016 and is still strong early into 2018 at over 420 days. At some point, we will see a pullback in domestic stocks. However, as long as the economy continues to show strength, we will ride out the short-term corrections as they are impossible to time.

FINANCIAL PLANNING

The Tax Cuts and Jobs Act of 2017 was signed into law in late December and is effective for 2018. There are many new items to consider and discuss with your planner and tax preparer. Here are a few key items:

- The top corporate income tax rate drops to 21% from 35%. AMT was also repealed for businesses.
- Households will still have a 7 tier tax bracket system. However, most brackets were trimmed back and the highest rate declined to 37% from 39.6%.
- Estates and Trusts will move to just 4 tax brackets: 10%, 24%, 35% and 37%.
- Capital Gains and Qualified Dividends retain their old thresholds.
- The Pease Limitation which was a phase-out of certain deductions for households earning more than $261,500 for individuals or $313,800 for married couples has been repealed. This will provide a reduction in marginal tax rates for those previously impacted.
- The new standard deduction will be $12,000 for individuals and $24,000 for married couples. Personal Exemptions have been removed, but the child tax credit increased to $2,000 per child.
- The higher standard deduction also brought changes to many itemized deductions including a reduction of the AGI threshold for deducting medical expenses to 7.5% from 10%.
- The equivalent exemption amount for individual estates has increased from $5.6 million per person to $11.2 million and will be portable. Therefore, a married couple will have the first $22.4 million of their estate pass to their heirs free of federal estate tax.

Here are some smart phone apps that we think you might enjoy. Please let us know if you have any new apps that you would like to share with everyone.

- **Economy**: The Economy application by Cascade Software allows you to review financial data for the U.S. economy as well as individual states. It also includes economic indicators for many other countries. The application may cost $2.99 on some platforms.
- **Run Social**: Run Social makes your treadmill do so much more. Run through the real-world with videos of beautiful locations and see, inside your video, avatars of yourself and others doing the same thing around the world. The app can track your running speed and distance. This is a free app.
- **Tiny Scanner:** This application is the little app that scans everything. Scan documents, photos, receipts, or almost anything with your iPad or smart phone. Scans are saved as images or PDFs. Email or share the PDF as needed. Never be without a scanner again. It is a free application.

Company News

2017 Gold Level Winner for the YMCA Workplace Wellness Awards

Galecki Financial Management was proud to receive a Gold Level Award from the YMCA for Workplace Wellness in 2017. The awards recognize employers who create a healthier workplace for employees based on an assessment of a workplace’s physical environment, physical activity opportunities, health promotional efforts, healthy eating options and company policies.

GFM provides a free health club membership to each employee and their family. Employees are given flexibility with their lunch so they can go to the gym, run the trails, or take a walk. Shower facilities are available in the office after a workout.

GFM has a new wellness challenge for all employees. A monthly drawing for a gift card will be given to any employee who accumulates more than 360 minutes of exercise for the month. All employees that meet the required minimum amount of activity for six straight months will also receive a Gift card. GFM is very proud of our healthy culture and thankful for the employees that make it so special.

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com.