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The Weiss Report

Smart and Steady

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What's The Deal With Interest Rates?

In this edition of The Weiss Report we will tell you things you need to know about interest rates but have been too afraid to ask.

We will begin with how interest rates change. Common belief is that all interest rate changes begin with the federal government agency called the Federal Reserve Board (The Fed). Yes, it is true that the Fed controls the amount of money available in the banking system and does set a specific interest rate, called the Fed Funds Rate. This rate is the strongest tool to control circulation, as it is the rate members banks are charged by the Fed when they borrow money. Member banks often need to borrow money to maintain cash to debt ratios, which are federally mandated.

But, in general, it is the worldwide trading markets that set interest rates. This occurs most in the financial trading markets in the U.S. treasury bonds and the U.S. Dollar. Interest rates are a large component in world trade and it is their decisions that influence interest rates much more than the Fed.

For example, let's look at what has happened in 2017 with one commonly discussed instrument, the 10 year U.S. Treasury bond. The year started with this key benchmark trading near 1.50%. This was one of the lowest rates for this instrument in history. As news spread that inflation seemed to be rising, and the Fed was likely to raise their benchmark rate, traders began to become aggressive sellers of the 10 year Tbond. Having more sellers than buyers generally leads to a fall in prices. The price decline reflects that the interest rate on the 10 year Tbond was rising. By the time the Fed actually raised rates in mid-March, the Tbond rate was already trading at 2.50%. Rates moved up one full percentage point before the Fed raised their rate. It is this type of action that convinces us that it is the worldwide trading in our debt and currency is the real driver of interest rates, not the Fed.

But, why do interest rates need to fluctuate at all? Interest rates are the primary weapon to control inflation. Commonly misunderstood, inflation is an insidious cycle of rising prices which reduces the buying power of money. Raising interest rates above a known inflation rate generally reduces speculative borrowing. In the 1970s, interest rates stayed too low for too long. By 1974, inflation was higher than the borrowing rates. This condition was so out of hand that rates were pushed to stifling levels in the early 1980s to combat inflation, which had exceeded 10% per year.

This action broke the back of inflation and we have seen falling inflation and interest rates for most of the past 35 years. We believe that this has been a significant contribution to the greatest economic expansion in history.

Inflation has now been very low for over 15 years, but has begun to creep higher. The markets sense this and have preemptively raised interest rates. We have a more detailed explanation of the relationship of interest rates and inflation in Enclosure #3.

So the next question is: why are interest rates rising now? The answer depends on who is asked. We believe that the Great Recession of 2008 saw the world economy contract. This drove interest rates to historic lows to resuscitate the failing economies. It took a very long time, but it appears that the global economy is finally set for rebound of true growth. At the same time, inflation is starting to rise. Rising rates are occurring today to keep inflation in check. For example, higher interest rates on mortgages, makes it more expensive to borrow. This should reduce speculative real estate purchases and counteract the effects of inflation. When the general rate of interest is too low relative to inflation, people have an incentive to accelerate purchases with borrowed money. This action is how inflation can rise further. When money is relatively cheap to borrow, it is commonly said that we have "too much money chasing too few goods."

How does the change in the trend of interest rates impact you? In the short-term, not very much. If you are a homebuyer, the recent rise in mortgage rates from approximately 3.7% in December 2016 has risen to approximately 4.3% today. This increases the payment on a $200,000 mortgage about $30 per month. The cost of buying or leasing a car should rise about $9 per month. While increased costs are rarely positive, this type of increase isn't enough to bite consumers very hard.

If you're an investor in fixed income securities, the price that you can sell your holdings has dropped a bit. How much bond prices fall is a function of the new higher interest rates and the amount of time one loans their money. Rising interest rates on a 25 year bond is more profound than it is on a five year bond.

Yes, interest rates seem poised to rise more in the next few years. But, if the ascent is gradual, then higher payments on borrowed money will follow. So far, the effects of higher interest are minimal. If rising interest rates keep inflation at 2% or less than the economy can grow without a major hit to the buying power of our savings.

Portfolios

Portfolios we manage by discretion have seen very few changes in the first quarter of 2017. We implemented a strategic shift to a broadly diversified allocation shortly after the November 2016 election. In the four months since the change, portfolios are growing at rates that are competitive with popular indices. Perhaps more importantly, the growth rates for most clients are matching their needs discovered in our retirement planning process.

We mentioned earlier that a trend of slowing rising interest rates could also create potentially positive opportunities for investors. We view rising interest rates as a signal that economic growth might be accelerating. We think data about the rise in consumer and business confidence confirms that rising interest rates at this time is concurrent with our economy getting stronger.

If stock prices are somewhat predicated on the expectation of corporate earnings accelerating, then markets in general should do well. The rising tide floats all boats is a common saying. It is also true that 2014-5 saw earnings growth decline. Some in the media referred to the event as an earnings recession. With our wider sail strategy, we would expect to benefit from any acceleration of earnings over the next few years.

In fixed income securities our opinion is changing. While the rising interest rate trend had a few false starts, we have tried to maintain allocations to bonds with intermediate maturities (5-10 years) to proactively minimize the effects of interest rates rising putting pressure on the prices of the bonds held.

We believe that it is time to review the level of commitment to bonds. For portfolios we maintain with dedicated commitments to individual bonds, we will suggest lowering the allocation in future meetings.

Enclosures

The first enclosure is a quick strategy update from Raymond James. It provides snapshops of capital markets, sector weighting within the S&P 500, and economic indicators. It also discusses themes within global markets as well as tactical outlooks for the next 6-12 months. We have found this to be helpful and believe you will as well.

The second enclosure is an article about common passwords in 2016. We believe that cyber security is a vital topic to discuss with all clients and will have much more to say about it in future editions. To start the conversation, we wanted to bring up the importance of a quality password. If you find that any of your passwords are on this list, we recommend changing them ASAP.

Lastly, the third enclosure is a commentary we've written to discuss interest rates further. We tried to go a little deeper into the different types of inflation and provide a little discussion on how/why they happen. We welcome any questions readers may have.

Important Disclosures

This report is not intended as a complete description of the securities, markets or developments referred to herein. It should not be viewed as an offer to buy or sell any of the securities mentioned. Information has been obtained from sources considered reliable, but we do not guarantee that the foregoing report is accurate and complete. Additional information and sources are available upon request.

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Past performance does not guarantee future results. There is no assurance the trends mentioned will continue. No investment strategy, including diversification and asset allocation, can guarantee a profit or protect against loss in a declining market. Dividends are not guaranteed and will fluctuate. This analysis does not include transaction costs and tax considerations. If included these costs would reduce an investor's return.

The authors' opinions are subject to change without notice.

There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices rise.

Gross Domestic Product (GDP) is the annual market value of all goods and services produced domestically by the US.

U.S. Treasury Securities are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and guaranteed principal value.

Companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification. Investments in the energy sector are not suitable for all investors. Further information regarding these investments is available from your financial advisor.

It is not possible to invest directly in an index. The S&P 500 is an unmanaged index of 500 widely held stocks. The Russell 2000 index is an unmanaged index of small cap securities which generally involve greater risks. The Russell 3000 index is an unmanaged index that measures the performance of the 3000 largest US companies based on total market capitalization. Past performance may not be indicative of future results.

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INVESTMENT STRATEGY QUARTERLY QUICKVIEW

APRIL 2017

THEMES

Global Uncertainty: A Balanced Perspective for Worldwide Concerns

This year, opportunity appears to be greater than threat in the world outside of the United States and a slightly weaker dollar would likely deepen such trends, absent other risks surfacing. If the Brexit vote indicated an alternative path for European nations, the election of an overtly anti-euro French president would threaten to blow apart the coordination of the last couple of generations. Meanwhile, the Chinese system is in the midst of an unprecedented change evolving from an agricultural and manufacturing focus to one which fully encompasses the service sector.

U.S. Equities: The Trump Effect?

The market has had every chance to show its concern and not only does it seem unfazed by President Trump, it has actually embraced him and, by extension, the uncertainty that comes along with him. While the market is obviously optimistic that the policies are going to get implemented, the risk is that it either takes too long to happen or that Congress will only be willing to pass sanitized versions of the policies, something to which the market may not respond well.

Q&A: Confidence, Policy Normalization and the Importance of Free Trade

Despite ongoing concerns about Brexit and China's economic transition, the global economic outlook has improved, which is also helpful for the U.S. capital investment outlook. Following an extended period of unusual accommodation, the Fed's key near-term objective is policy normalization – getting the federal funds rate closer to a long-term equilibrium level (provided conditions are supportive).

For more information, refer to the full *Investment Strategy Quarterly.*

ECONOMIC SNAPSHOT

ECONOMIC INDICATOR

FAVORABLE	GROWTH
	EMPLOYMENT
	BUSINESS INVESTMENT
	HOUSING AND CONSTRUCTION
	MONETARY POLICY
	FISCAL POLICY
	REST OF THE WORLD
NEUTRAL	CONSUMER SPENDING
	MANUFACTURING
	INFLATION
	LONG-TERM INTEREST RATES
	THE DOLLAR

From Scott Brown, Ph.D., Chief Economist, Equity Research

TACTICAL OUTLOOK (6-12 months)

FAVORABLE	U.S. SMALL CAP EQUITY
	NON-U.S. EMERGING MARKET EQUITY
	INVESTMENT GRADE INTERMEDIATE MATURITY FIXED INCOME
	ALTERNATIVE INVESTMENTS
NEUTRAL	OVERALL EQUITY
	U.S. LARGE CAP EQUITY
	NON-U.S. DEVELOPED MARKET EQUITY
	REAL ESTATE
	OVERALL FIXED INCOME
	INVESTMENT GRADE SHORT MATURITY FIXED INCOME
	NON-INVESTMENT GRADE FIXED INCOME (HIGH YIELD)
	GLOBAL (NON-U.S.) FIXED INCOME
	MULTI-SECTOR BOND STRATEGIES
	CASH AND CASH ALTERNATIVES
UNFAVORABLE	U.S. MID CAP EQUITY
	INVESTMENT GRADE LONG MATURITY FIXED INCOME

The tactical asset allocation outlook above reflects the Raymond James Investment Strategy Committee's recommendations for current positioning. Your financial advisor can help you interpret each recommendation within this material relative to your individual asset allocation policy, risk tolerance and investment objectives.

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INVESTMENT STRATEGY QUARTERLY QUICKVIEW

APRIL 2017

CAPITAL MARKETS SNAPSHOT

EQUITY	AS OF 3/31/2017*	1Q 2017 RETURN**	12-MONTH RETURN
Dow Jones Industrial Average	20,663.22	5.19%	19.91%
S&P 500 Index	2,362.72	6.07%	17.17%
NASDAQ Composite Index	5,911.74	10.13%	22.88%
MSCI EAFE Index	1,792.98	7.25%	11.67%
RATES	**AS OF 3/31/2017***	**AS OF 12/30/2016****	**AS OF 3/31/2016**
Fed Funds Target Range	0.75-1.00	0.50-0.75	0.25-0.50
3-Month LIBOR	1.15	1.00	0.63
2-Year Treasury	1.28	1.22	0.76
10-Year Treasury	2.42	2.49	1.83
30-Year Mortgage	4.30	4.32	3.83
Prime Rate	4.00	3.75	3.50
COMMODITIES	**AS OF 3/31/2017***	**1Q 2017 RETURN****	**12-MONTH RETURN**
Gold	$1,244.85	8.64%	0.63%
Crude Oil	$50.60	-5.81%	31.98%

*Price Level
**Total Return

SECTOR SNAPSHOT

	SECTOR	S&P WEIGHT
OVERWEIGHT	INFORMATION TECHNOLOGY	21.9%
	FINANCIALS	14.7%
	INDUSTRIALS	10.1%
	ENERGY	6.5%
EQUAL WEIGHT	HEALTH CARE	14.0%
	CONSUMER DISCRETIONARY	12.2%
	MATERIALS	2.8%
	TELECOM	2.4%
UNDERWEIGHT	CONSUMER STAPLES	9.4%
	UTILITIES	3.1%
	REAL ESTATE	2.8%

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The Most Common Passwords In 2016 Are Truly Terrible

The most popular one of all? "123456."

By: Nina Golgowski – The Huffinton Post – 1/18/2017

Cybersecurity is on many people's minds these days, and yet using "password" as a password is apparently still a thing.

On Friday, password management company Keeper Security released a list of the most common passwords of 2016 — and it's, well, shameful.

The most popular password, making up nearly 17 percent of the 10 million passwords the company analyzed, was "123456." "Password" was also among the top 10 passwords, coming in as the eighth most common.

Keeper Security assembled the list using a collection of passwords that were leaked through data breaches in 2016. The company didn't include leaked passwords if the breaches were announced that year but occurred prior to 2016, co-founder and CEO Darren Guccione noted in a blog post that revealed the findings.

Keeper Security advised users to select a password that's more than six characters long and contains a variety of characters — including numbers, uppercase and lowercase letters, and even special characters. The company also suggests avoiding full words, which it refers to as "dictionary terms."

Two of the most common password-cracking techniques are dictionary cracks and brute force cracks, Keeper Security says.

Dictionary cracks try combinations of known passwords and personal information. This may include a user's favorite sports team, children's names, phone numbers or birthdays. Brute force cracks often use machines to compile potential passwords that wouldn't be found in a dictionary. "Machines that can be purchased for less than $1,000 are capable of testing billions of passwords per second," Keeper Security warns on its website.

Though Guccione admonished internet users for not selecting more secure codes, he also said websites are responsible for protecting their users.

"What really perplexed us is that so many website operators are not enforcing password security best practices," he wrote. "While it's important for users to be aware of risks, a sizable minority are never going to take the time or effort to protect themselves. IT administrators and website operators must do the job for them."

<u>THE TOP 25 MOST COMMON PASSWORDS OF 2016:</u>

1. 123456
2. 123456789
3. qwerty
4. 12345678
5. 111111
6. 1234567890
7. 1234567
8. password
9. 123123
10. 987654321
11. qwertyuiop
12. mynoob
13. 123321
14. 666666
15. 18atcskd2w
16. 7777777
17. 987654321
18. qwertyuiop
19. mynoob
20. 123321
21. 666666
22. 18atcskd2w
23. 7777777
24. 1q2w3e4r
25. 654321
26. 555555
27. 3rjs1la7qe
28. google
29. 1q2w3e4r5t
30. 123qwe
31. zxcvbnm
32. 1q2w3e

Did your password make the list of shame? If so, it may be time to do some serious updating, or risk kissing your internet security goodbye.

The Weiss Report
Volume 20 Number 2
Enclosure #3

Inflation: A Primer

Inflation is not very familiar to most people. The last great cycle of inflation peaked in 1981. But, like all cycles, we seem to be headed for rising inflation in the future, so we thought it was worthy of a TWR enclosure to try to explain inflation and its effect on the economy.

As we discuss in the TWR, inflation is a condition of rising prices over a long period of time. As best as we can determine, inflation is not caused by any one thing, but a series of economic conditions which pushes prices of goods and services higher. While the causes of inflation have been debated for decades and centuries, the effects of inflation are easier to explain.

Rising inflation erodes the purchasing power of dollars earned and saved. Currently, we are seeing rising prices. If inflation were 3% per year, a pack of gum that today sells for $1 will cost $1.03 next year. If inflation remains at a 3% level, then that pack of gum would sell for just over $1.06 two years from now. Inflation can be said to erode the value of the currency (also known as a decline in purchasing power). So when the U.S. dollar declines in value, it takes more currency to buy the same item. Currency devaluation is the concurrent other side of the inflation coin. Many academics view currency devaluation as the real economic consequence of inflation, but we consumers can only see the nominal price of goods and services rise.

Academics tend to put inflation into context in three different ways.

First is what is called Cost Push inflation. When a company is faced with increased production costs like raw goods, materials, and wages, they will preserve their profit margins by passing the increased costs to the consumer in the form of higher prices.

A simple example would be an increase in the price of milk. Such a rise would surely drive up the cost of a cappuccino at your favorite coffee shop since each cup would then be more expensive to produce than before the price of milk increased.

The second academic concept about inflation is called Demand Pull inflation. When wages begin to rise, workers have more disposable income. Their accelerating consumption force prices to rise faster than if wages were stagnant. This increase in liquidity and demand can pull prices of goods higher.

An example of Demand Pull inflation can be seen when consumers with more money to spend see something to purchase they deem cheap. When wages rise, many people decide to undertake home improvement projects. This increased demand will not only increase the prices of materials at Home Depot or Lowes etc, but should also pull the wages up for contractors, plumbers, carpenters, and related skilled trade workers.

The third academic concept of inflation is the most dangerous to the long term health of the economy. This type is referred to as Monetary Inflation. Any economy has a finite amount of capital in the system. It is often referred to as the Money Supply. One of the purposes of the Fed is to monitor the size of the money supply. If the Fed were to put more money into the general money supply that exceeds the growth of the economy, the value of each dollar is diminished. This action, mentioned above, is how purchasing power gets diminished. To avoid this condition, the Fed adjusts the amount of money in the Money Supply in an attempt to keep prices stable, as has been the case for the last decade or so.

While we have presented three different forms of inflation, it is Monetary Inflation that can do the most harm. In the 1970s, the Fed did not takes steps soon enough to control the amount of money in circulation. This set off an almost 10 year run of higher inflation. By the end of the decade, inflation was being measured over 10% per year. Add this example to the millions of consumption decisions made every day and the result was and can be again an unsustainable price spiral making spending and saving much more difficult.

Today, inflation is rising above approximately the 2% as measured by the Consumer Price Index (CPI). We hope that with the tools of technology, the Fed can more easily monitor the money supply, and with pro growth economic policies from Washington D.C. that another spiral of inflation like the 1970s can be avoided.