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SECOND QUARTER 2017

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Q1 Market Update

(values as of 3/31/2017)

U.S. Stock Indices

S&P 500	2,363 (+5.53%)
Dow Jones	20,663 (+4.56%)
Nasdaq	5,912 (+9.82%)
Russell 2000	1,386 (+2.12%)

Global Stock Indices

FTSE (London)	7,323 (+2.52%)
DAX (Germany)	12,313 (+7.25%)
CAC (France)	5,123 (+5.35%)
Nikkei (Japan)	18,909 (-1.07%)
Emerging Mkts	958.37 (+11.15%)

Bond Indices (Bloomberg)

U.S. Gov't.	124.99 (+0.68%)
U.S. Corporate	145.48 (+1.26%)
U.S. Hi-Yield	174.78 (+2.94%)
Eurozone	138.32 (-1.43%)
Emerging Mkts	164.22 (+3.50%)

Commodities

Gold (per oz)	1,249 (+8.54%)
Silver (per oz)	18.25 (+14.74%)
Oil (WTI, barrel)	50.54 (-5.97%)

Fixed Income Yields

U.S. 2-Year Treasury	1.27%
U.S. 10-Year Treasury	2.40%
U.S. 30-Year Treasury	3.02%
U.S. High-Yield Index	5.90%

Currency Exchange Rates

Euro/Dollar	1.07
Pound/Dollar	1.26
Dollar/Yen	111.39

Are HSAs the new IRA?

While the Republicans' "repeal and replace" American Health Care Act has been withdrawn for now, apparently left to wither on the vine as Congress attends to other matters, it's likely that it will be revived in some form or fashion in the near future. If and when the bill does return to the front pages of our favorite newspapers and websites, we can expect to hear again about Health Savings Accounts (HSAs), which seem likely to be a cornerstone of any Obamacare replacement plan.

Unfortunately, HSAs alone are probably incapable of solving our nation's healthcare woes, for a variety of reasons. That said, just because the accounts won't be a panacea doesn't mean that we shouldn't be paying attention—after all, if properly utilized, they could be the key to a happy retirement for many of us. That's right, the specific provisions and benefits of HSAs mean that they're not necessarily limited to being a simple healthcare add-on tool, despite what their name might suggest.

On the contrary, HSAs are potentially more powerful than any IRA, 401(k), 403(b), or other deferred compensation plan could ever be when it comes to saving for retirement. If you're eligible to contribute to an HSA (or even if you aren't, but could be), read on to see how you might better utilize HSAs to prepare for multiple financial goals at once.

How do HSAs work?

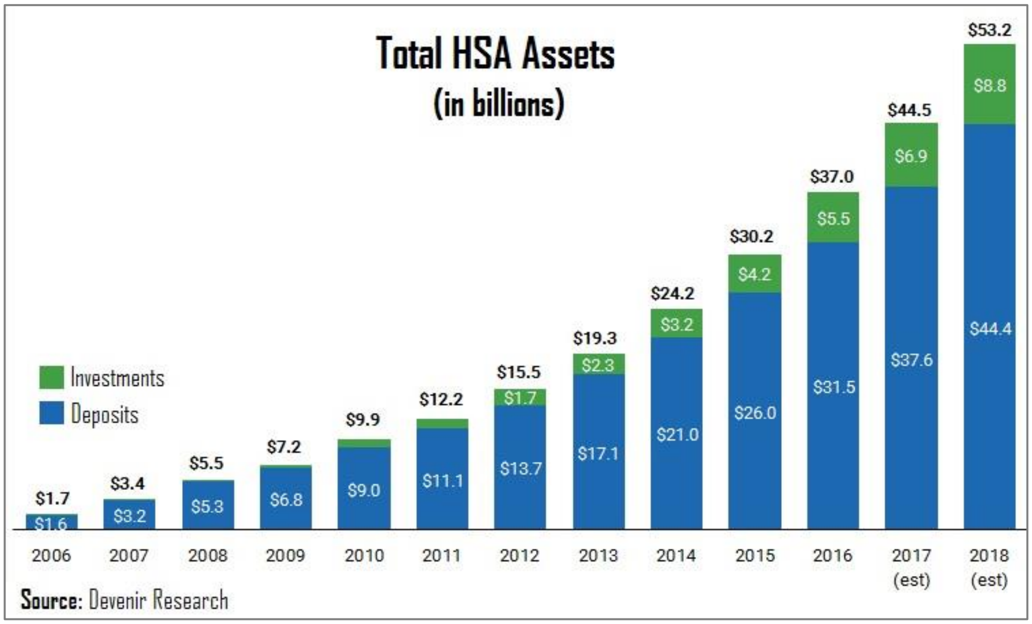
The first thing to understand is that HSAs, much like Roth IRAs, are not actually available to everyone. In order to be eligible to contribute to an HSA in a given year, an individual must first be enrolled in a qualified high-deductible insurance plan (HDHP, per IRS parlance). Medicare recipients are also not eligible, nor are individuals who are claimed as dependents on anyone else's tax return, or certain other excluded individuals.

The high-deductible plan is an attractive approach for many people, since the plans typically come with lower monthly premiums. However, the higher deductible can also mean higher overall out-of-pocket costs, which cannot easily be covered by many lower-income individuals. As a result, the benefits of HSAs do tend to be concentrated among wealthier—and healthier—individuals with greater cash flow flexibility.

For those who *are* eligible, though, an annual contribution of up to $3,400 for an individual (up to a family maximum of $6,750) can be directed to an HSA. Like 401(k) deferrals or traditional IRA contributions, HSA contributions are fully tax-deductible in the year of the contribution (as an above-the-line deduction), allowing for immediate tax relief. Of course, that immediate benefit does carry greater weight for higher-income individuals and families, whose tax rates are highest. It does bear noting, however, that three states (New Jersey, California, and Alabama) do not permit state tax deductions for HSA contributions. In those states, an additional layer of complexity is added, and the decision whether or not to utilize an HSA is less straightforward.

Regardless, the initial tax deduction

benefit is far from the only tax-related benefit of HSAs. In fact, HSAs stand alone in that they are "triple tax advantaged", which is something no other retirement or savings account can claim. In addition to the contribution-year income tax deduction, investment returns earned within HSA accounts are also tax-deferred, again like their retirement plan cousins. However, unlike retirement accounts, withdrawals from HSAs are completely tax-free if used for qualified medical expenses, as defined by the IRS. Therefore, any money directed to an HSA and subsequently used to cover medical expenses will completely avoid taxation, even after investment returns are taken into account.



But what ultimately sets HSAs apart—and what lends them their uniquely flexible nature—is what happens to the funds if they are not needed for medical expenses. For one, HSA funds that are not used in the year of the contribution can be carried forward indefinitely, until they can be used. This sets them apart from their Flexible Spending Account cousins, which are in most cases subject to a "use it or lose it" provision, whereby unspent money disappears and cannot be carried forward.

Furthermore, if funds are held in an HSA until age 65, two additional options become available: remaining HSA funds can be used to cover health insurance (including Medicare) premiums, or they can essentially be treated as IRA funds and used to cover general living expenses. In the latter case, no penalty is owed, and withdrawals incur only ordinary taxes (turning the "triple tax advantage" into a mere "double tax advantage"). In that way, HSAs can be considered something of a hybrid savings vehicle—funds can either be saved for medical expenses or for retirement savings, and only their tax treatment will differ. This contrasts sharply with, for example, 529 plans for college savings, which incur steep penalties if used for any purpose other than college tuition and fees (even secondary school tuition is not a qualifying expense). The hybrid nature of an HSA makes it a particularly attractive savings option for anyone who is eligible to contribute.

To spend or to save?

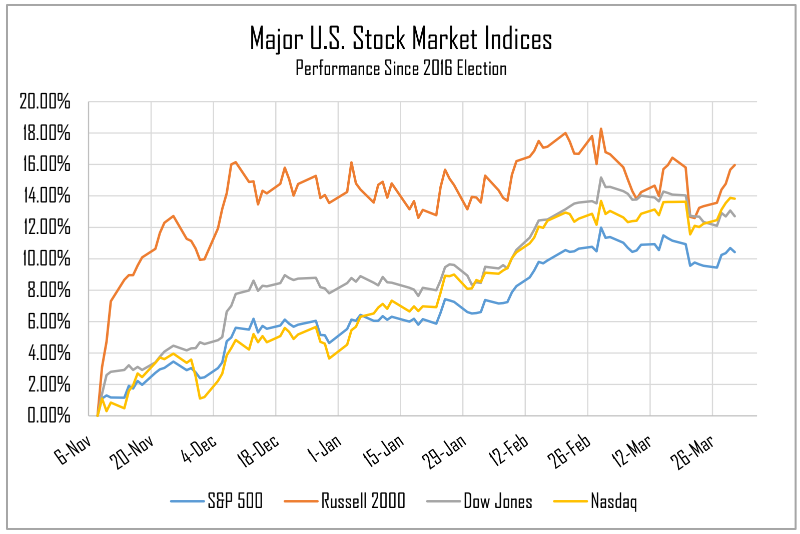
Once a contribution to an HSA has been made for a given year, savers have three basic options: they can use the funds to cover current-year medical expenses, or they can let funds accumulate and begin earning investment returns as a "rainy day" fund (to cover either an unexpected future medical expense or Medicare/Medigap premiums in retirement), or they can bypass the medical use entirely and simply treat their HSA as an additional retirement savings vehicle, to be used alongside any IRAs or 401(k) plans.

The optimal approach to HSAs (and whether to contribute in the first place) can vary from person to person, depending on health status, general financial condition, risk tolerance, and which other resources and retirement plans are available. Decisions about health care and HSAs should not be made in a vacuum, but must be viewed in a broader financial planning context. At Cypress, we're always available to help sort through the options and make sense of an increasingly complex healthcare landscape.

THE DIVERGENCES BETWEEN SECTORS THAT DEVELOPED IN Q4 NARROWED IN Q1

Equity Overview – Domestic Equity Markets

While markets in general continued their strong performance in Q1 (the 5.5% gain for the S&P 500 marked the best first-quarter gain in four years), for the second straight quarter, the divergence between the various indices was perhaps most notable. After the surprise election of Donald Trump in November, stock market gains were concentrated in the small-cap Russell 2000, which gained 8.4% in Q4 (as compared to 3.3% for the broader S&P 500). The tech-heavy Nasdaq, meanwhile, lagged both indices, gaining only 1.3%.



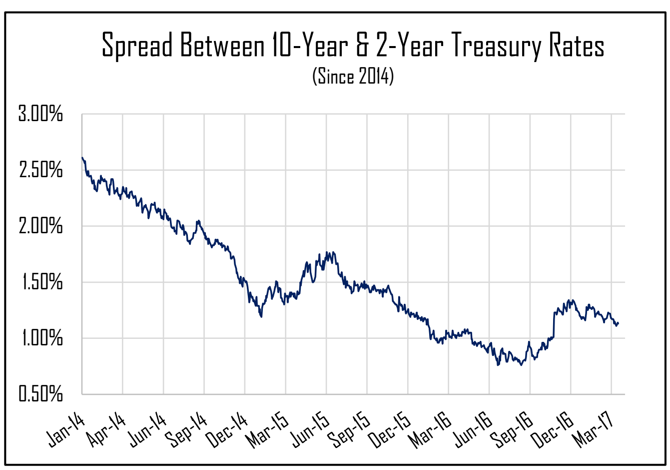
The divergence was mostly explained by an expectation of President Trump's likely policies, including the protectionist "America first" rhetoric that had been so prevalent on the campaign trail. Smaller companies with less global exposure were expected to outperform in a Trump presidency, hence their outsized gains in the immediate aftermath of the election.

But as campaign-trail rhetoric gave way to political reality in Q1, the divergence between the indices began to narrow, and indeed reverse. In Q1, it was the Nasdaq that led the way with a 9.8% surge, while the Russell index digested its Q4 gains, adding just 2.1%. As political wrangling continues and the markets attempt to decipher the ultimate downstream impact of the "Trump effect", stock markets remain generally strong and resilient, even amid tightening monetary policy from the Federal Reserve.

The specific winners and losers of a Trump presidency are still being determined, but holding a well-diversified portfolio with exposure to multiple asset classes remains the prudent decision.

The Fed Hikes Rates, But Not All Rates Rise – Fixed Income

At its March meeting, the Federal Reserve again voted to increase the target range for the short-term Federal Funds Rate by 0.25%, marking the third such increase in the last 15 months. The Fed's moves have increased the target range from the "zero bound" up to 0.75%-1.00%, but not all rates have responded in kind.



For the most part, the longer the maturity of the fixed income security, the less its rate has responded to the recent rate hikes. 30-Year Treasury bond rates, for example, ended the quarter at a level of 3.02%, basically unchanged from the 2.98% level that prevailed at the beginning of 2016 (shortly after the first Fed rate hike).

The relationship between short and long-term rates is generally viewed as providing important information about future economic growth, and a flattening yield curve is rarely consistent with robust economic growth. A recession is not yet imminent, but breakaway growth may not be, either.

European Markets Recovered Strongly From Post-Brexit Volatility

What's Happened In Europe Since Brexit? – Global Markets

Before November's election surprise, the biggest market-moving story of 2016 was the unexpected result of the Brexit vote in late June, in which the U.K. voted in a referendum to withdraw from the European Union. The market reaction—both in stock markets and in currency markets—was swift and severe, marked most notably by a rapid depreciation in the British Pound.

Global Stock Market Returns

(Since Brexit)

Index	Return
Germany (DAX)	20.04%
Japan (Nikkei)	16.45%
England (FTSE)	15.54%
MSCI-Emerging Markets	14.72%
France (CAC)	14.70%
USA (S&P 500)	11.80%

In the nine months since the vote, minimal progress has been made toward determining how and when a withdrawal will occur (though U.K. Prime Minister did formally trigger "Article 50" on March 29th, so as to officially begin the withdrawal process), but the markets have not been nearly as quiet. Despite significant initial jitters, investors have largely shrugged off any uncertainty about the potential reshaping of the European economy, and international markets have in fact outperformed U.S. markets since the vote took place.

London's FTSE 100 Index—which shed nearly 6% in the two days following Brexit—has recovered and then some, ending Q1 at a level more than 15% above its pre-Brexit levels. Germany, which is the largest member of the European Union and theoretically stands to lose the most from a potential breakup of the bloc, saw an even more dramatic turnaround in its markets—after losing nearly 10% after the vote, shares have rebounded to levels more than 20% higher than before the vote. Even Asian markets in Japan and China, which were volatile throughout 2016 as waves of anti-globalism swept across the world, have stabilized and been among the strongest performers over the last 12 months, even despite a period of underperformance in Q4 stemming largely from the "Trump effect".

For investors who have watched their allocations to international stocks trade essentially sideways for the better part of a decade, the recent trend of outperformance likely arrives as something of a pleasant surprise, coming as it does amid almost persistently negative headlines in Europe and elsewhere.

While some developments over the coming weeks and months could certainly derail that trend—the Brexit process, continued weakness in Italian banks, and a number of other upcoming European elections are all likely to garner their fair share of headlines—the lesson for now is somewhat clear. No matter what the day-to-day noise of the markets might suggest, keeping a long-term focus is almost always the best approach.

When nervousness about political uncertainty or central bank policies or even military conflict causes volatility in markets, keeping a cool head and taking advantage of the opportunities that reveal themselves can often be quite profitable in the long run. At Cypress, we continue to believe that exposure to global markets is an integral and valuable part of any diversified portfolio strategy. As always, we will continue to monitor overseas developments that may suggest changes to that approach, but for now, we take comfort from the markets' recent reactions to ongoing current events.