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Q3 Market Update

(values as of 9/30/2017; % changes for Q3, not YTD)

U.S. Stock Indices

S&P 500	2,519 (+3.96%)
Dow Jones	22,405 (+4.94%)
Nasdaq	6,496 (+5.79%)
Russell 2000	1,491 (+5.33%)

Global Stock Indices

FTSE (London)	7,373 (+0.82%)
DAX (Germany)	12,829 (+4.09%)
CAC (France)	5,330 (+4.08%)
Nikkei (Japan)	20,356 (+1.61%)
Emerging Mkts	1,082 (+7.02%)

Bond Indices (Bloomberg)

U.S. Gov't.	2,197.75 (+0.38%)
U.S. Corporate	2,868.16 (+1.34%)
U.S. Hi-Yield	1,940.87 (+1.98%)
Eurozone	251.44 (+0.60%)
Emerging Mkts	1,089.33 (+2.27%)

Commodities

Gold (per oz)	1,280 (+3.08%)
Silver (per oz)	16.63 (+0.27%)
Oil (WTI, barrel)	51.67 (+12.28%)

Fixed Income Yields

U.S. 2-Year Treasury	1.45%
U.S. 10-Year Treasury	2.31%
U.S. 30-Year Treasury	2.87%
U.S. High-Yield Index	5.49%

Currency Exchange Rates

Euro/Dollar	1.18
Pound/Dollar	1.34
Dollar/Yen	112.49

What's your (retirement) number?

For a while, the TV commercials were seemingly ubiquitous: a variety of working professionals and business owners, walking around their offices or homes with giant 6-figure or 7-figure numbers trailing behind them like overly dependent puppies. The numbers, of course, were meant to represent the workers' "retirement numbers", the amount of money that those individuals needed in order to support their (or their families') financial needs during their retirement years. The implication, of course, was that retirement savings had a "finish line" of sorts, and that once that number was met, all was well.

That interpretation is, however, an oversimplification. How much money is needed for retirement can vary based on a number of interrelated factors, some knowable, some unknowable. That's why even though the advertisements were both memorable and somewhat effective, still relatively few prospective retirees have any real concept of what "their number" actually is, or whether they're on target to meet that savings goal.

Financial advisors and other industry experts have since attempted to generate a few easily digestable rule-of-thumb guidelines to assist people with their planning, and those efforts have had mixed success. For people who have "typical" financial pictures (average retirement age, average lifestyle expenses), the rules of thumb can be quite helpful. But with dozens of variables at play in the retirement savings equation, not everyone can so easily be placed into an "average" box. While retirement age and income/expense level are always the major drivers of how large a retirement account balance needs to grow, secondary factors like investment risk tolerance, health-related factors, and tax considerations can have significant impacts as well. We'll summarize a few of the major considerations in play, with the hopes of adding some simplicity and clarity to the retirement savings puzzle.

The expense-multiple approach

One of the most commonly cited industry rules of thumb attempts to place a simple multiplier factor on a retiree's expected annual expenses in retirement, with 10 times annual expenses standing as a common target for an age-65 retiree with average lifestyle expenses. In meetings with clients, we'll often refer to this ratio as the "Capital-to-Expense Ratio (CER)", and we'll track it over time as a basic guidepost on the path toward retirement.

In addition to the "10 times expenses" target, we'll also often show younger workers a "glide path" with intermediate targets at 5-year increments: a CER of 2.1 by age 40, for example, or 6.0 by age 55. As long as a younger worker is in line with—or ahead of—these intermediate targets, he or she can have a reasonable expectation of meeting the age-65 goal, assuming that 10-15% of gross income continues to be saved into retirement accounts in the interim years.

It is important to note that the 10.0 CER target does take into account an assumption of at least some income from Social Security, so that the retirement account savings don't have to do all of the heavy lifting. Without that income, the target ratio at age 65 would certainly be higher.

The major driving factors

While the CER of 10.0 is a reasonable average target for a typical retiree, there are a number of factors that will impact whether an individual's personal CER is higher or lower than that standard rule of thumb. Naturally, the two most significant drivers of the target CER are the factors that actually determine future financial needs: retirement age and annual expenses—the more money you spend per year, or the more years of retirement that you need to save for, the higher your CER will need to be at your desired retirement age.

Age	Expense Multiple Target
25	0.1
30	0.5
35	1.2
40	2.1
45	3.1
50	4.4
55	6.0
60	8.0
65	10.0

For someone who wants to retire at age 55, for example, the target CER will likely be anywhere between 18 and 20, depending on the level of annual expenses. And even for two people planning to retire at the "standard" age of 65, the necessary multiple can be several points higher than the recommended 10, if the overall level of expenses are higher. This is primarily due to the fact that higher retirement account withdrawals will generate higher taxes, so the "tax drag" on retirement withdrawals is higher for those with higher expenses/incomes, and more needs to be saved in order to cover that increased tax burden. For those individuals who don't think they can meet the higher multiples that their projected expenses require, some reconsideration of retirement-year expenses may be necessary: moving to an area with a lower cost of living, for example, or thinking twice about travel and other discretionary expenses.

The minor driving factors

Besides the two primary determinants of retirement age and annual expenses, some other considerations can often come into play, as well. These secondary considerations can include investment risk tolerance, health-related factors, other income sources (pensions, business ownership interests, or part-time work), or even certain tax-related impacts.

Most industry CER targets assume an annual investment return on retirement assets of at least 5 to 6%; for an individual with a particularly risk-averse investment approach, this might be an unrealistic target, and the target CER would be higher as a result. Health factors, meanwhile, can cut both ways: an individual with known health problems might have a lower life expectancy (and therefore, fewer years of expenses, and a lower CER target), but those years might also have above-average medical expenses associated with them, driving the target CER higher.

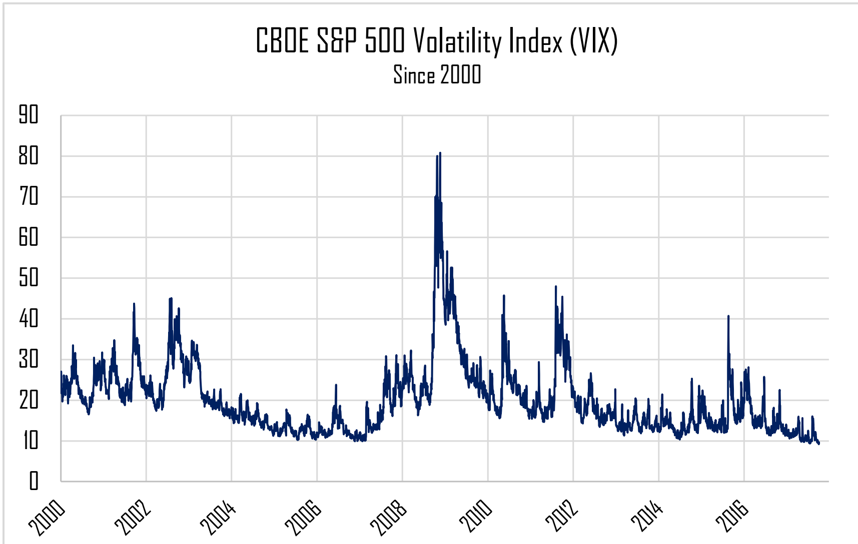
Finally, taxes always need to be considered, since the types of accounts that were used to save for retirement can significantly alter how much needs to be withdrawn annually in order to meet expenses. A saver with a high balance in a Roth IRA, for example, will owe little or nothing in taxes in retirement, and fewer investment dollars will be needed as a result. Understanding how and when to withdraw from a Roth IRA, a Traditional IRA, or a taxable investment account can be complicated, and the expertise of an experienced professional can be vital. And while the CER is a useful tool, it is just a small part of a broader retirement plan, and should be considered only as a guide, not a panacea. Comprehensive retirement planning is a complicated, decades-long process, and we at Cypress are always prepared to help.

Necessary "Nest Egg" by Age and Expenses

Retirement age	$50,000/yr expenses	$75,000/yr expenses	$100,000/yr expenses	$150,000/yr expenses	$250,000/yr expenses
50	$955,000	$1,467,000	$2,018,000	$3,146,000	$5,562,000
55	$900,000	$1,382,000	$1,902,000	$2,964,000	$5,241,000
60	$829,000	$1,274,000	$1,753,000	$2,733,000	$4,832,000
65	$740,000	$1,136,000	$1,564,000	$2,438,000	$4,310,000
70	$626,000	$961,000	$1,322,000	$2,060,000	$3,643,000

Equity Overview – Domestic Equity Markets

The third quarter is typically known as a relatively quiet period for the markets (hence the market aphorism "sell in May and go away"), and this year proved to be no exception. While the S&P 500 index did manage to scratch out a gain of nearly 4%—marking an eighth consecutive quarter of gains and yet another series of all-time highs—the quarter was perhaps most notable for the remarkable lack of any significant volatility, despite a continuing stream of concerning headlines, both in Washington and around the world. Not hurricanes nor a series of Obamacare repeal attempts nor even bubbling North Korean nuclear threats could awake the market from its summer doldrums, as the index simply shrugged it all off and continued grinding steadily higher.



As just one measure of the market's apparent complacency, the CBOE S&P 500 Volatility Index (VIX), often simplistically referred to as the market's "fear gauge", closed below 10.00 for 10 consecutive trading days in July, marking the longest such streak in the history of the index. In fact, since the index was first calculated in 1990, there had been only 9 combined days in 27 years on which the index closed in single digits—just since May, there have now been 29 such days in 2017 alone, making it clear that we are now in uncharted territory from a volatility standpoint.

To be clear, the period of low volatility does not necessarily have to end any time soon, nor is it in any way indicative of an imminent stock market decline. The first time the VIX ever dipped into single digits was in December 1993 (a four-day stretch surrounding the Christmas holiday), and while it did not remain there long, volatility would not return in a meaningful way for several years to follow. The average closing price for the VIX for the subsequent three years was just 14.21 (well below the longer-term average of 19.4), as the market surged higher during the early stages of what would eventually become known as the dot-com bubble (the S&P 500 would rise from 471 to 757 during that same three-year period, an increase of more than 60%).

Unfortunately, the market did not fare quite so well after the next instance of sub-10.00 VIX readings—those occurred in November of 2006, and while the S&P 500 would rally by about 10% in the subsequent year, it peaked soon after and eventually gave way to the financial crisis of 2008-09. As of now, though, there is no immediate indication that today's market is any more like 2006 than it is like 1993. Corporate earnings growth remains strong (having recovered from a brief energy-led dip in 2015 as oil prices swooned), and the bond market has shown remarkable resilience even in the face of steadily tightening Federal Reserve policy.

The discrepancy between the increasingly volatile news flow and the eerie calm of the stock market is noteworthy, but the broader economic fundamentals have not yet shown any meaningful erosion, at least not of the type that typically precedes market declines. Unemployment is low, GDP growth remains positive, and the prospect of significant tax reform could actually mean more earnings growth for the largest corporations, even if more rapid economic growth does not materialize. In other words, while periods of unusually low volatility are typically fleeting, this one may not be ending any time soon.

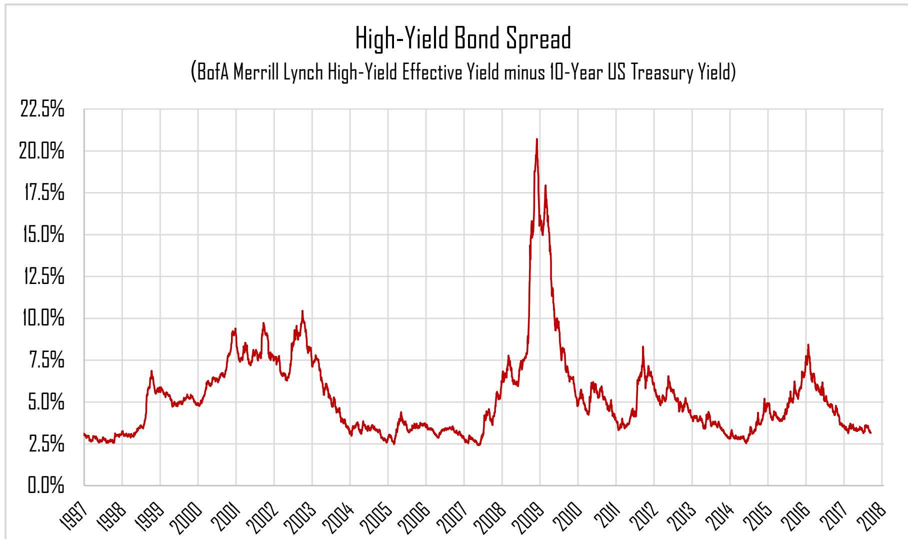
Yields for High-Yield Bonds are at the Lowest Level in Three Years

High-Yield Bonds Continue to Rally – Fixed Income

With the Federal Reserve continuing to gradually withdraw its unprecedented levels of monetary stimulus, it would be reasonable to expect riskier interest-bearing investments to be among the casualties of the tightening cycle. After all, with short-term Treasuries (and some money-market funds) now paying positive yields for the first time in nearly a decade, there is less incentive for investors to "reach" for yield now than in past years, as the risk-reward equation has shifted somewhat in response to Fed policy. Instead, for the most part, riskier interest-bearing assets have completely ignored the movements on the shorter end of the yield curve.

Yes, short-term interest rates have ticked up by about a percentage point, but intermediate-term bonds have remained mostly unchanged so far during the current tightening cycle, while the riskiest of fixed income investments—high-yield or "junk" bonds—have in fact continued to rally, with yields now reaching multi-year lows. That ongoing rally for high-yield bonds marks a stark reversal of fortune from just 18 months ago, when a plunging crude oil price sparked a similar decline in the value of high-yield bonds, with yields nearly doubling by some measures—from under 6% to nearly 10%—in just ten months.

The spread between average yields on high-yield bonds and the 10-year U.S. Treasury yield now stands at just 3.2%, well below the long-run average of 5.3%. At a time when the safest interest rates are on the rise, the riskiest interest rates are paradoxically on the decline, and it certainly seems as though investors are not being adequately paid for the risks (and volatility) that they accept by owning lower-quality corporate debt. It bears mentioning that a return to the average



spread of 5.3% could mean a decline in high-yield bond prices of as much as 25%—notably, an almost identical percentage decline to what was seen between 2014 and 2016, when prices for the SPDR Barclays High-Yield bond ETF (ticker JNK) fell from a peak of 41.80 to a low of 31.49.

Of course, a mean reversion in the high-yield/Treasury spread could also come about via a decrease in the 10-year Treasury yield, which currently stands at 2.35%, well above its international counterparts. That would certainly be the more welcome path for fixed income investors, but the near-term upside for high-yield investors would seem to be limited either way, and the space bears watching over the coming weeks and months.

Could Tax Reform Actually Mean More Taxes For You? – Personal Finance

With Obamacare repeal efforts repeatedly failing, the Republican-led Congress has now shifted its focus to another major goal, tax reform. While details remain scarce, broad guidelines indicate that some taxpayers would face significant changes under the proposed new tax system. Among other things, a major shift in how tax deductions are calculated (and allowed) has been proffered. The standard deduction could be poised to nearly double (to $12,000 per taxpayer), but many itemized deductions could also be eliminated, including that for state and local taxes. For residents of high-tax states (or owners of high-value real estate), that change could mean a difference of thousands of dollars of taxable income per year.