The ACM Journal

Stark Raving Dad

Lately, it seems all we do is drive kids to their various activities. Last Saturday we dropped our oldest off at the high school at 9:00 am so he could catch the bus to his cross-country meet. We then went straight to soccer with my seven-year-old daughter. After an hour of watching soccer that was reminiscent of the Keystone Cops, we stopped home for a few minutes to pick up my middle child so we could get him to baseball on time. We dropped him off a couple towns over, then drove half an hour to get to the cross-country meet. We watched that, went back to the baseball game, and finally arrived back home around 5:00 pm.

This is a fairly typical Saturday for us. It sometimes becomes a logistical nightmare, but if the weather is good, it is a lot of fun watching all the events.

I have particularly gotten into my oldest son Omar's cross-country races. As a former Nordic ski coach at the high school and college levels, I'm a sucker for endurance sports.

People often ask how you can watch a cross-country race; after all, it isn't exactly designed to be a spectator sport. However, I believe that is only true if you congregate around the start and finish the way most folks do.

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Identity Theft

By now, everyone is aware of the massive data breach at Equifax. Something like 143 million Americans had their personal information exposed in the hack. That effectively means that every American adult was impacted. You can check to see if you are on the list here: www.equifaxsecurity2017.com. I'll bet you are.

We have received a lot of phone calls about this. We don't believe there is any serious risk to your investment accounts, as our custodial firms require signature authorization in order to disburse funds. However, if you are concerned, you can request additional security measures for electronic access to your accounts if they are held at Charles Schwab.

The bigger risk is identity theft. It is now conceivable that your information could be used by a third party to open up new lines of credit in your name. This may be credit cards, car loans, bank loans, etc. If you are concerned about this, there are steps you can take.

Primarily, you can put a credit freeze on your account by visiting the web sites of the major credit reporting companies. The websites are below:

Equifax: www.freeze.equifax.com

Transunion: https://freeze.transunion.com

Innovis: https://www.innovis.com/securityFreeze/index

Experian: https://www.experian.com/freeze/center.html

While the data breach was recently announced, it actually occurred several months ago, and likely persisted for some time. It seems the initial hacking episode occurred in March, and continued undetected until July of this year. At which point, Equifax learned of the breach and moved to fix the problem. It was over a month until the public was notified that their personal information was exposed. Interestingly, during the period that Equifax learned of the problem, but before it was released to the public, Equifax management had time to sell personal holdings of their Equifax stock.

That last point might make you angry, and demand some regulatory response. Indeed, the U.S. Securities and Exchange Commission has warned public companies in the past that they could be the target of enforcement actions if they mislead investors about a significant data leak that affects share prices. However, you might consider that the SEC just announced a major data breach of its own.

The SEC's electronic system for public company filings was hacked, resulting in the loss of highly sensitive data that could be used for insider trading purposes. While this information was released to the public on September 20th of this year, the actual incident occurred in 2016. Perhaps the SEC will initiate an enforcement action against itself.

The point here, other than venting my frustration with government incompetence, is to note that data breaches are frequent and widespread. All of us, whether or not we use computers, have sensitive personal information that is available on the internet. There isn't much we can do about it, except take a few common-sense security measures to reduce the risk as much as possible.

Portfolio Review

The third quarter of 2017 was one of continued political strife at home, missile launches and increasing tension in Asia, several devastating natural disasters, and efforts by the Federal Reserve to slow the economy. In the face of that, the stock market rose to record highs.

Stocks Post Strong Gains

The stock market, as measured by the S&P 500, rose 4.5% in the third quarter. Mid-cap, small-cap, and international stocks all rose by a bit more or less, but all major markets experienced solid returns. Year-to-date gains are impressive, led by international stocks.

There is certainly no shortage of negative events to point to as reasons for the stock market to falter, and valuations by some measures are near historic highs. However, stocks continue to trend higher, and I believe there is reason to believe the good times could continue to roll.

Interest rates remain low, inflation is tame, burdensome regulations are being relaxed, and corporate profits are rising. That's the ideal backdrop for stocks. If we hadn't just notched eight years of impressive gains already, most would think this is a golden age for stock market performance.

Instead, negativity and caution reign. Most headlines and many market strategists suggest that another drop could be imminent. Anything is possible, and a breather for the market wouldn't be unexpected, but barring a major exogenous event, the economy and capital markets appear poised for continued strength.

Bonds Anemic

The situation is a bit different for the bond market, where lackluster gains are likely for the foreseeable future. That is not a forecast for losses, just anemic positive returns. Bonds are up over 3.1% year-to-date, but it is unlikely that returns of even that magnitude will persist. The Fed has indicated it will continue raising short-term interest rates. It has also embarked on a new policy of "quantitative tightening". Rather than buying bonds in the open market to create liquidity, as it has done in the wake of the financial crisis, the Fed is now doing the opposite. It will unwind its historically large portfolio of bonds by letting them mature, and not repurchasing a similar amount in the open market. This will take liquidity out of the economy, which

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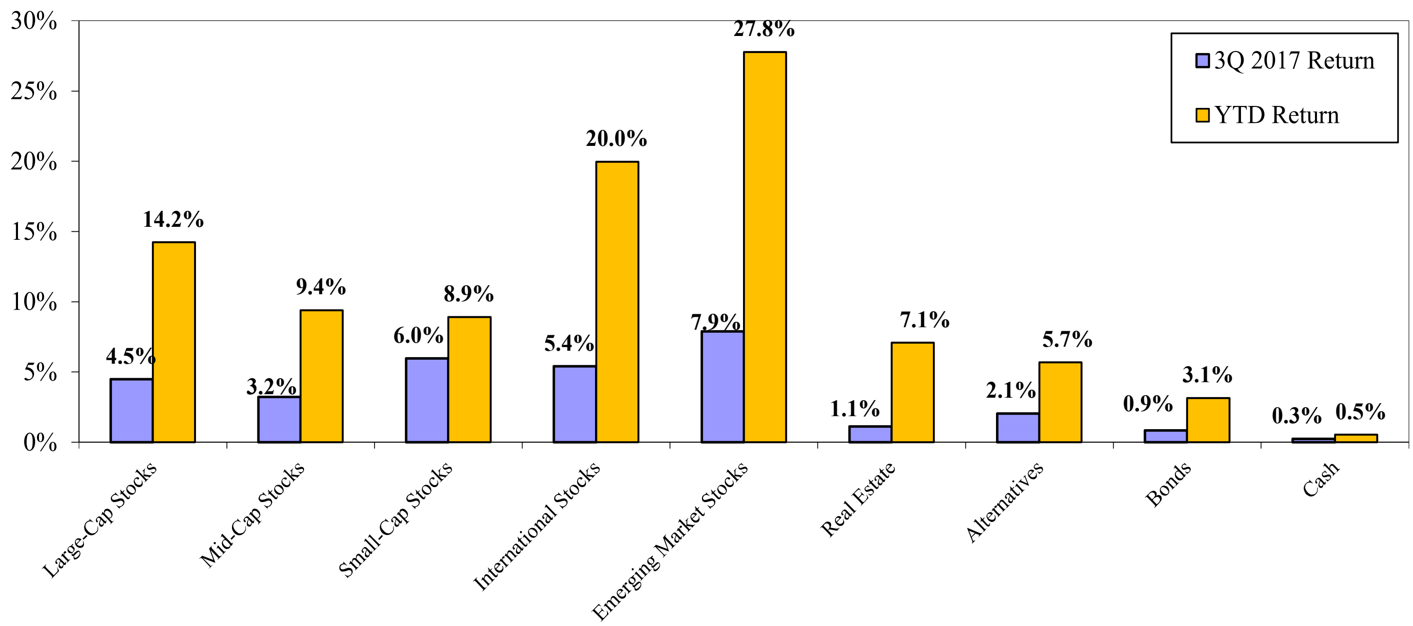
Third Quarter 2017 Asset Class Returns



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indices. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 30-day T-Bill.

Tax Planning Time

By Chris Cebula, CPA

As hard as it may be to believe, yearend is just around the corner, and that means it is time to think about tax planning. This year, it seems that year-end tax planning is facing a perfect storm of unknowns.

The house recently passed a $4.1 trillion budget, which some hope will be the start of a major tax reform package before yearend. The details of what that reform will ultimately look like aren't clear. However, several popular deductions could be eliminated, radically altering the way we think about tax planning.

Historically, true tax reform has been a once-in-a-lifetime event. The last significant change to the tax code was in 1986 when President Reagan signed the Tax Reform Act into law. Prior to that, you have to look back to the 1954 enactment of the Internal Revenue Code. However, that doesn't mean there haven't been changes to the tax law. Since the most recent reform, the U.S. tax code has gone from 30,000 pages to over 70,000 pages. Accordingly, there has been much criticism of how unwieldy tax law has become.

Nevertheless, the question remains of whether tax legislation will pass this year, and if so, whether it will be sweeping and retroactively applied. As a result of these unanswered questions, some of the normal year-end tax strategies are up in the air. While it is not our preferred method, it seems that waiting until the last possible moment may be the best strategy for 2017.

That said, it is prudent to start thinking about some contingency strategies. One of the ideas being kicked around is a dramatic increase in the standard deduction, possibly up to $30,000 for joint filers, which could make this tax year, if not retroactively applied, the last year that some filers could itemize deductions for certain expenses, including charitable deductions. Depending how the law changes, it could make sense to accelerate charitable giving, perhaps through a donor-advised fund.

Also being discussed is the ability to deduct state and local taxes on your federal return. Again, if not retroactively applied, it may make sense to "prepay", if possible, those taxes in 2017 so that they can be included on this year's return.

Other strategies that may make sense include deferring income, including bonuses, and retirement distributions in excess of required distributions into next year, and waiting to delay Roth conversions.

In the meantime, it still probably makes sense to lower your taxable income by making contributions to qualified retirement accounts. For those working, and with access to 401(k) plans, that means maxing-out your contributions up to $18,000, plus a $6,000 "catch up" if you're over age 50. For those with SEP IRA accounts or Solo 401(k)s, the maximum is $54,000. IRA contributions may also make sense depending on your circumstances.

The tax reform debate is just beginning, and with our sharply divided political environment, anything (or nothing) could happen. However, regardless of the ultimate outcome, there will be strategies that can help make your tax burden as efficient as possible. Give us a call if you would like to discuss how these strategies may apply to your personal situation.

Firm News

We may have announced it before, but we recently updated our website. There are a host of resources there, including electronic versions of all our newsletters, articles, and even a few videos. We try to send most of this to you directly, but there are a few items that you likely missed. I know from our recent client satisfaction survey that hardly any of you have been to our new website. I'm sure you have more interesting things to occupy your time than watching videos of me discussing ETFs, but there are some solid educational tools out there if you are interested. You can find it at www.armbrustercapital.com.

Speaking of our client satisfaction survey, I want to thank everyone for taking the time to participate. We had a 50% response rate, which is quite good for these things. Generally the responses were quite favorable, but we did get some good comments and recommendations, which we intend to follow up on. That said, please feel free to contact us anytime with feedback. We're always looking for ways to improve, so don't wait for the next survey to share your thoughts.

We also recently updated our iPhone app. You may recall that we launched an app a few years back to help calculate required minimum distributions on retirement accounts. A new version has been launched, so update your current app, or go to the App Store and search for "IRA RMD" to download it.

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Portfolio Review

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the Fed is betting is now strong enough to stand on its own. This is likely a healthy policy, but it could result in rising interest rates, which is bad for the bond market.

Alternatives Disappoint

Given our dour outlook on bonds, we've been talking about using alternative investments as a replacement for bonds to hedge long-term portfolio risk. The third quarter was not kind to our alternative investments (see related article on reinsurance), making our argument look a little foolish. That said, the nature of investing is that every long-term strategy will sometimes experience short-term periods that look bad. So, we may be wiping a little egg from our faces, but we're not ready to eat crow on this yet.

There is a lot of evidence and theory to support diversifying into investments beyond stocks and bonds. Our timing isn't always impeccable, but we believe our long-term thesis on alternative investments still holds.

Current Thinking

Given valuation disparities between the U.S. and overseas stocks, and the fact that interest rates are likely to rise, we're taking a look at our stock allocation. As you know, we are far from market timers, and do not make many tactical changes to our portfolios. However, it seems there may be some longer-term structural events unfolding in the stock market. Accordingly, we're looking at scaling back or possibly even eliminating our allocation to REITs. REITs are now included in major stock market indices, so we would continue to have exposure, just not as much.

This would reduce our portfolios' sensitivity to interest rates, and we could use the proceeds to commit additional funds to overseas stocks, which look poised to outperform domestic equities in the coming decade. We're not ready to make these trades yet, but our research is underway.

Overall, it has been a great time to be an investor. Short-term volatility will rain on our parade at some point, but the nearby article on Warren Buffett's stock market forecast shows that a long-term outlook will almost always result in a profitable investing experience.

The Market is Going Up!

What if someone told you that there was more upside in the market from today's levels? What if they said it could rise 4,445% from here?

There have been a lot of market forecasts in the headlines lately. Some suggest the market is going higher, others that a downturn is imminent. Perhaps none is audacious as that proffered recently by Warren Buffett. The Oracle of Omaha believes that the Dow Jones Industrial Average is going to 1 million.

There's an old adage on Wall Street that when making forecasts, you either predict a number or a date, but not both. That way, you can never be wrong. For example, a market strategist might declare that the market is going up by 1,000 points. The market may go down by several thousand points first, but eventually the forecast will prove correct.

Warren Buffett has bucked the trend by forecasting both a metric and a date. He believes the market will rise to 1 million within 100 years. On the face of it, such a forecast sounds absurd, but the math shows that the forecast is actually quite conservative. To go from today's level of roughly 22,000 to 1 million, the market would need to achieve an annualized return of only 3.9%. Historically, stocks have returned over twice that amount on an annualized basis.

The fact that the Dow could reach such a lofty height, even over 100 years, shows the miracle of compounding. When I first started in the investment business, a 100-point swing on any given day was a huge move. Today, 100-point moves happen routinely, and they are insignificant. A 10% gain on the market when it starts at 22,000 implies a rise of 2,200 points. However, as the market rises, a 10% gain on a base of say 100,000 implies a 10,000-point gain. So, as the market goes up in value over time, we will see larger daily, monthly, and annual point gains.

What's more, the market tends to go up over time. There are certainly periods when this is not true, but they tend to be short lived. Short-term drops, as painful as they may seem, really become irrelevant for most of us, if we remain long-term oriented. Warren Buffett is merely reiterating that financial rewards are there for those who remain patient and ride out the market's ups and downs.

Of course, the late economist John Maynard Keynes once quipped that "in the long run we are all dead," but I believe along the way we might as well make some money. Warren Buffet is showing that staying invested in the stock market is a great way to do that.

Alternatives in Focus: Reinsurance

Our alternative investment portfolio was looking pretty good through August of this year. All of the funds except one were in the black, and returns were on track for around a 6% gain. Then September hit.

One of our favorite alternative funds invests in reinsurance instruments. The fund is designed to earn steady returns over time from the premiums paid on the insurance policies it backs. However, there are periodic losses that the fund has to pay out, primarily when natural disasters strike.

September saw an unusual number of natural disasters. Hurricane Harvey flooded Houston, Irma caused damage in Florida, Maria ravaged Puerto Rico, and there were a couple of large earthquakes in Mexico. All of this has resulted in a year-to-date loss of close to 10% for the Stone Ridge Reinsurance fund (SRRIX).

We thought this would be a good time to review the fund, and our rationale for owning it.

The bottom line is that expected annualized returns are around 8%, year-to-year volatility is generally quite low, and the returns have no significant correlation to the returns of the stock and bond markets. Downside risk, when it does occur, tends to be less than what you could experience in the stock market. That makes the fund an excellent source of diversification in our more traditional stock and bond portfolios.

The fund invests in catastrophe bonds and quota shares. Both are reinsurance vehicles that tend to make money over time, but incur losses when natural disasters strike. A brief summary of how catastrophe bonds works may be in order.

A municipality, such as Naples, Florida, knows that it will eventually have hurricane damage. The municipality may buy insurance directly to hedge this risk, but at some point, the insurance industry will not write additional coverage on Florida wind storms.

If Naples still wants additional coverage, beyond the insurance it can buy directly, it may issue catastrophe bonds. The legal structure can get complex, but effectively, Naples issues bonds that pay out premiums of say 8% annually for the three-year term of the bond. If no hurricanes hit over this period, the buyers of the bonds get their money back and an 8% return.

If a hurricane of predetermined characteristics does strike during the term of the bond, then the investors potentially get wiped out. This doesn’t sound like such a great investment, but if we as investors allocate funds to coverage of wind storms in Florida, earthquakes in California, ice storms in Europe, and other events around the globe, much of the risk is diversified away.

It is still possible to take large losses in this fund, and the modeled downside risk is around 30% in any given year. That is a big number, but consider that stocks have lost in excess of 50% when they have experienced large downturns. This fund also generally provides less volatility than stocks, but with long-term expected returns that are similar.

Unfortunately, the nature of all investing is that in order to earn a return, we must incur risk. That risk came to pass this year for our reinsurance fund. On the bright side, in the wake of losses, the reinsurance industry tends to rebound quickly. Rates for reinsurance firm up after big losses, and returns are generally strongest during these periods.

As an interesting side note, the finance industry is frequently maligned for its focus on profits at the expense of social good. This reinsurance fund is an exception. During downturns in the fund, the money we invest is used to rebuild communities in the wake of devastating events.

We still feel quite strongly that this fund should be a part of our alternative portfolio, and expect long-term returns to be quite additive to our investment strategy.

What is ACM?

Armbruster Capital Management, Inc. (ACM) is a boutique wealth management firm serving high-net-worth individual and institutional clients. The firm’s innovative “Passive Quant” investment approach incorporates cutting edge financial research to help control risk and pursue superior returns. ACM uses index funds, exchange-traded funds (ETFs), and other investment vehicles to build portfolios designed to reduce investment-related costs and taxes in order to maximize net returns.

Located in Pittsford, New York, ACM is employee owned, independent, and minimizes conflicts of interest. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client’s unique objectives.

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I prefer to be a more active spectator. When I arrive at a race, I start talking to the hometown parents to figure out where the course will go. I then see where I can be of the most use to the runners.

Frequently there is a big uphill on the back of the course. This will be one of the tougher parts of the race, and there won't be many people there cheering the kids on. So, I'll watch the start, then run over to the hill, scream at our kids (particularly my own) to "work the hill" or "make it hurt" or some other such nonsense. I'll then sprint over to the next most important viewing area to continue to be a raving, but supportive, spectacle. I do this throughout the race, and get quite a workout of my own.

Given my coaching background, I often give technique tips to the kids on our team, which I find they actually listen to. When you're really tired, it is hard to put out any extra effort, even on a downhill section. However, if you lean into the hill and lengthen out your stride, you can make up quite a bit of time without a whole lot of additional effort. The kids forget this in their exhaustion, but I "help" them to remember.

Interestingly, even other teams' coaches who might be standing nearby, often pick up on this and start shouting my tips at their own kids, which just feeds my ego and encourages me to be more of a lunatic fan.

I'm not completely clueless, so I am aware that my antics could cause some embarrassment for my freshman son. However, much to my surprise, he mentioned that a few of his teammates, even upper classmen, have commented that his dad's cheering actually helps them get through tough sections on the course. Omar said, "you're like the team mascot". I threatened to wear a cougar costume to the next race, but he thought that might be overdoing it.

Firm News

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We're considering other technology enhancements as well. Soon (I know, I keep saying that), you'll be able to log into your account through our website, and run more robust reports than what you can get through your custodial log in. We'll be rolling that out in the next month or two.

We're also exploring the ability to provide educational materials to our 401(k) clients through a mobile app. That will be particularly helpful if you have employees in multiple offices across various regions.

Finally, mobile check deposits are now a reality. This is really a technology enhancement offered by our custodial firms, but it is a nice convenience, that bears mentioning. There are certainly a number of restrictions, but frequently you can take a picture of a check and have it deposited into your Charles Schwab or TD Ameritrade account directly. I'm generally skeptical of these things, but I've done it with three checks of my own now, and it has worked flawlessly. Give us a shout if you'd like more details.

Overall, it has been a good year for our firm. We have spent most of the past twelve months making the firm stronger and more efficient through technological enhancements. We continue to grow, but have invested heavily in the ability to manage that growth. We just checked off nine years of managing money for our clients, and hope to continue for many, many more. Thank you for your support.

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