MARKET COMMENTARY

PLANNING CORNER

SOUNDBYTES

PORTFOLIO CHANGES

25 Years

Deighan Wealth Advisors
1994-2019

MARKET COMMENTARY

For as little as $100, you can buy yourself an inversion table (image below), a curious device designed to temporarily relieve back pain. An inversion table is a bit like a workout bench that balances on a pivot. It works by stretching a person's spine using the pull of gravity. The user lays face up on the bench and slowly rotates backwards until their feet are higher than their head. The greater the angle of rotation, the higher one's feet move relative to one's head, and the greater the gravitational pull on the spine.

There is mixed evidence in support of inversion tables. Not everyone agrees they are effective or safe. Opinions tend to range from "miracle cure" to "medieval torture device." From our vantage point, inversion tables look like a good way to get a headache and to become disoriented as the blood rushes from your feet to your head.

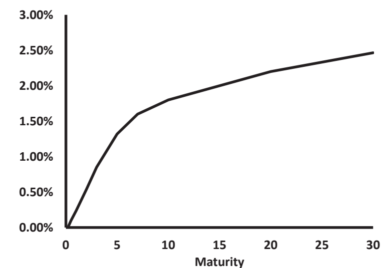
We were reminded of inversion tables in recent weeks, because a portion of the U.S. Treasury yield curve started to invert. Subsequently, the blood rushed to everyone's head, investors got a bit disoriented, and a number of news outlets started to sound warning bells about impending recession. Even though the blood hadn't rushed to our heads, these warning bells did give us a bit of a headache, because we don't view the yield curve's recent movements as being proof that recession is nigh.

What does it mean for the yield curve to invert? To understand this concept, one must first have a picture in one's mind as to what is considered "normal" yield curve behavior.

A yield curve is simply a graphical representation of interest rates (on the y-axis) plotted against time, otherwise known as maturity (or loan length), on the x-axis. Yield curves exist for all types of loan-based investments (government bonds, corporate bonds, municipal bonds, etc.). When we talk about THE yield curve, we're usually talking about the U.S. Treasury yield curve, which plots interest rates for government borrowings ranging from 3 months to 30 years.

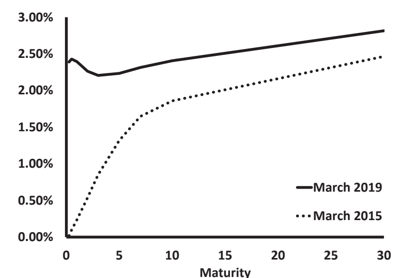
In a normal environment, the U.S. Treasury yield curve is upward sloping. In other words, an investor gets a lower interest rate when she lends money to the federal government for 3 months than she does when she lends money to the federal government for 30 years. The reason for this is logical; there is more opportunity cost associated with lending your money for longer, and there is more overall risk – more uncertainty about inflation and other factors. It's the same reason why a 3-month certificate of deposit might only pay 1.25% when a 30-year mortgage costs 4.75%.

Normal Yield Curve



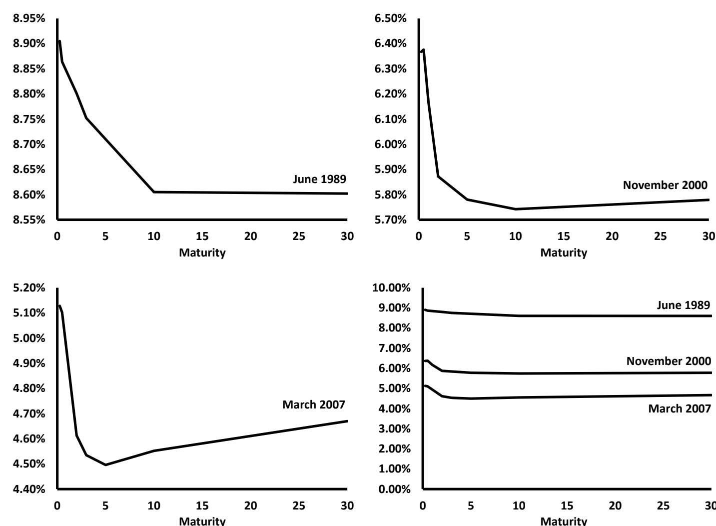
However, as the economy starts to expand, and as inflation starts to rise, the Federal Reserve will often raise short-term interest rates. The Fed will do this to keep inflation contained. When the Fed raises rates, this has the effect of lifting up the short-term portion of the curve relative to the long-term portion of the curve, resulting in what is called a "flattening" of the yield curve. If a normal yield curve is like a person standing up next to their inversion table, then a flat yield curve is like a person laying on their inversion table in a horizontal position. In the current economic cycle, the Fed started raising rates in 2015. Since then, the Federal Funds Target Rate has increased from 0.25% (on the upper bound) to 2.50% (on the upper bound). The result has been a flattening of the yield curve:

Yield Curve in March 2015 versus March 2019



Notice something interesting about the 2019 yield curve above? It's not inverted! Not really. Not yet. Yes, it has a little convex shape in the middle. But, in order for the yield curve to truly be inverted, long-term rates would need to be lower than short term rates. The curve would need to look like a person lying on an inversion table with their feet way up in the air. For context, here is what the yield curve looked like at its most inverted points in advance of the last three recessions:

Inverted Curves Prior to the Last Three Recessions



Note that, for the above economic cycles, recessions began in December 2007, March 2001, and July 1990 – anywhere from five months to one year after the yield curve was FULLY inverted in each case. Which brings us to the findings of Arturo Estrella and Frederic Mishkin. In 1996, these two researchers at the Federal Reserve Bank of New York published a study in Current Issues in Economics and Finance titled, "The Yield Curve as a Predictor of U.S. Recessions." Estrella and Mishkin looked at the spread (or the difference) between interest rates on the ten-year Treasury note and the three-month Treasury bill and determined the following:

In short, Estrella and Mishkin found that the probability of recession only meaningfully increases when the yield curve becomes significantly inverted, such that subtracting the 3-month rate from the 10-year rate results in a sizeable, negative spread. Even when the yield curve inverts to such a degree, it only signals that a recession is likely to happen sometime within a one year period. Not within a month or even within a quarter.

At the end of March, the spread between the 10-year Treasury note and the 3-month Treasury bill was a positive 0.045%. Based on Estrella and Mishkin's model, this would imply about a 25% likelihood of a recession occurring within the next one year. When the 10-year rate briefly dipped below the 3-month rate toward the end of March, causing the blood to rush to everyone's head and setting off a chain of fear-mongering news headlines, the spread barely inverted to a negative 0.007%. As of today's writing, the 10-year rate is back above the 3-month rate, meaning the yield curve is not inverted.

Hardly worth the anxiety! But scary headlines do sell papers (or digital ads in this day and age).

Are we due for a recession after the second longest economic expansion on record? Yes, absolutely. A recession will happen at some point, but, by and large, the economy remains pretty healthy. Jobless claims are low, consumer confidence is near all-time highs, and new business starts have been robust.

Probability of Recession Using the Yield Curve Spread

PROBABILITY	SPREAD	PROBABILITY	SPREAD
10%	0.76%	60%	-1.13%
20%	0.22%	70%	-1.46%
30%	-0.17%	80%	-1.85%
40%	-0.50%	90%	-2.40%
50%	-.082%		

Of course, there are areas where the economy is showing signs of softening, and this is consistent with a flattening yield curve. Housing starts have started to slow, as have existing home sales, and both durable goods orders and the Purchasing Manager's Index have started to slip from recent highs. Importantly, however, none of these indicators are low in absolute terms. In fact, they remain close to cyclical highs. Rather, they've simply started to soften. Therefore, barring something unforeseen, we do not expect a recession within the next year.

The stock market seems to agree with us. After selling off in the fourth quarter of 2018, the S&P 500 Index rebounded 13.6% in the first quarter of 2019. This was the best start to a year in nearly a decade, and the S&P 500 now sits just below its all-time high. This strong performance reinforces what we wrote in our December market commentary, that to exit the stock market during periods of volatility is to expose oneself to great opportunity cost. Therefore, we remain fully invested in stocks, and we continue to favor high quality, dividend-paying companies as well as growth companies with strong cash flows.

On the fixed income side of client portfolios, we see less reason to take risks. While interest rates are now neutral according to the Fed, they remain low by historical standards. Rather than take additional credit risk to reach for yield, we've chosen to invest in high-quality bonds and FDIC insured certificates of deposit. Being conservative on the bond side of the equation has allowed us to remain fully invested on the stock side of things.

Rest assured that we remain ever vigilant. Should something happen that causes us to lose faith in the strength of the economy, then we will take steps to reduce risk in client portfolios. Preserving capital is an important part of what we do. At the same time, preserving capital is not all that we do. To overcome inflation, spending, and other factors, we must work to grow assets whenever we can. This requires prudent risk taking when there are positive returns to be had. And it means taking the financial press with a grain of salt.

Until next time, may you have a wonderful spring. Best wishes for happy investing.

– Deighan Wealth Advisors

PLANNING CORNER

Let's Talk About Long-Term Care Costs

The good news is that we are all living longer, extending the opportunity for leading rich and fulfilling lives. The troubling news is that the cost of long-term care is rising, and more of us will need additional care in our final days. At least 70% of people over the age of 65 will need some form of long-term care services in their lifetimes. (Maine Partnership for Long-Term Care). This can range from part-time in-home care, to family care, assisted living, or skilled nursing, sometimes with additional personal care attendants. One common fear in planning for retirement is that the cost of long-term care will consume the resources we have worked so hard to save. Getting educated about options for paying for long-term care can help us enjoy our healthy days, without fear of being unable to afford an expensive decline in health.

Medicare Does Not Pay for Long-Term Care

Medicare is a federal health insurance program for the elderly and disabled. Medicare is medical insurance that covers inpatient hospital stays, and certain physician services, outpatient care, and prescription coverage under Part D. Medicare does not pay for long-term care, other than up to 20 days in a skilled nursing facility, if the person is admitted after at least a 3 day hospital stay and requires medical care, as opposed to custodial care. Medicare may provide partial coverage of up to an additional 80 days of institutional medical care. When Medicare benefits cease, an individual must pay privately for care, unless long-term care insurance or some other benefit is available.

Medicaid Benefits Can Pay for Long-Term Care
Medicaid is a federal and state program that provides medical insurance for people with limited income and resources, and often provides coverage for those benefits not paid for by Medicare, including the cost of assisted living and skilled nursing facilities. The state Medicaid program in Maine is called MaineCare. For long-term care purposes, a single individual in Maine needing Medicaid benefits must have less than $10,000 in countable assets; a spouse of a nursing home resident residing at home can have up to an additional $123,600 in countable assets. Your primary residence is an exempt asset and not counted as part of the asset limit. There are several other exemptions from countable assets, but generally, cash savings, investment, and retirement accounts will need to be spent down before qualifying for Medicaid benefits.

Long-Term Care Insurance
Though price varies by region, the average annual cost of long-term care in Maine is about $120,000. A private room in an assisted living facility will cost about $60,000 per year. 24 hour in-home care can easily run $12,000 per month or more. Long-term care insurance typically provides coverage for in-home, assisted living, and nursing home costs.

Long-term care policies have gotten a bad rap over the years, as premiums have sky-rocketed and insurers failed. Long-term care insurance is expensive, and at the end of the day, it's a risk–many cannot justify the high cost of a policy that they may never need. Coverage tends to be cheaper the younger you purchase a policy. Wait too long, and a policy will be unattainable, either financially or by medical qualification.

The benefit of long-term care insurance is not necessarily to pay for every dollar of long-term care, but to help preserve your other assets while assisting with the cost of care. Comprehensive coverage with inflation protection or lifetime benefits is often prohibitively expensive. But such thorough coverage may not be necessary to ensure the care you need is paid for without draining your assets entirely.

The average stay in a skilled nursing facility is about two and a half years. (National Care Planning Council). Alzheimer's dementia is on the rise as we live longer, and often comes with increased care costs as the illness progresses. The cost of lifetime coverage through long-term care insurance may not justify what is most likely to be about a three year need for coverage.

> "The average stay in a skilled nursing facility is about two and a half years."

The lookback period for transfers of assets upon Medicaid application is currently sixty months. This means that when a person is otherwise without assets or insurance to pay for long-term care and applies for Medicaid benefits (having spent down to the asset limits described above), the State will look back at the last five years to determine if any transfers of assets were made by the applicant which hastened their eligibility for Medicaid. The value of any transfers will be run through a calculation determined by the State, and a penalty period will be determined of a number of months the applicant will not qualify for Medicaid benefits because assets were transferred that could have been used to pay for care. Five years of long-term care insurance could provide time for proper planning to transfer and protect assets, utilize long-term care insurance coverage, then qualify for Medicaid benefits upon exhaustion of the policy if more than five years of care is needed. Asset protection planning is complicated and wrought with complex rules. You should consult with an elder law attorney if you intend to protect assets from the cost of long-term care via transfer of assets.

Three to five years of long-term care coverage are likely to meet your needs without exhausting your hard earned assets. You might consider coverage that fills the gap between the average cost of care and your monthly income, so that principal assets are not spent down. Other options provide additional benefits to address some of the detractors of long-term care insurance.

Maine Partnership for Long-Term Care
The Maine Partnership Program is a collaboration between the State and private insurers to provide additional incentive through comprehensive benefits and consumer protections for individuals to obtain long-term care insurance and reduce the burden on MaineCare programs to cover the cost of care. Qualified partnership policies provide for disregard of assets that would otherwise require spenddown before achieving Medicaid eligibility.

For every dollar of benefits paid under a Partnership policy, one dollar of assets is not counted toward Medicaid eligibility. For example, if an individual received $500,000 in long-term care benefits through a Partnership policy, upon exhaustion of the policy, the individual could apply for Medicaid and retain $500,000 in addition to the asset limit required by the State (explained above). That disregard amount will also be exempt from any estate recovery proceeding brought by the State after the death of a Medicaid recipient.

Partnership policies provide the same benefits and cost the same as non-Partnership policies. Partnership policies also provide mandatory age appropriate inflation protection. To find out more about Maine Partnership Policies, contact partnershipforlongtermcare.com/maine-partnership. The website also provides information on determining whether a current policy is a Partnership policy, and links for quotes on qualified policies.

Hybrid Life Insurance
Often people will decline long-term care coverage due to high premiums that will be wasted if a person dies without needing institutional care. While that risk is inherent in all insurance, a relatively new product helps reduce the distaste of gambling on high premiums.

These "hybrid" whole life insurance policies provide long-term care riders. There is no risk of increased premiums, as the rate is locked in at purchase. If

SOUNDBYTES

We were excited to announce that in February the official transition of Deighan Wealth Advisors ownership from **Jean Deighan** and **Jenifer Butler** to the new ownership team of **Lucie Estabrook**, **Jennifer Eastman** and **Jenifer Butler** was completed. Jean will stay with the firm as a Senior Advisor for the next few years. The full press release can be accessed at www.deighan.com.

Jenifer Butler spoke to members of the *Student Portfolio Investment Fund ("SPIFFY")* at the University of Maine. SPIFFY manages $3.2 million in stocks, bonds and international funds. Students gain valuable skills from SPIFFY including leadership, financial knowledge, teamwork, familiarity with the Bloomberg terminal, and investment strategy.

We all enjoyed the fantastic *11th Annual Bangor Symphony Soiree* on March 23. This event gets better each year! Topping off the great food and wonderful social occasion was the announcement of BSO Music Director and Conductor Lucas Richman's five-year contract extension. Bravo!

long-term care is needed, the policy provides a benefit defined at purchase. If long-term care is not needed, or the policy is not exhausted during life, the remainder provides a life insurance benefit to beneficiaries named by the owner.

These policies are not without their drawbacks. They are usually single premium policies – not everyone can afford that kind of lump sum premium payment. The policies often pay a low rate of interest and may not have inflation protection. However, they are sometimes more readily available for older insureds who may have difficulty medically qualifying for a traditional long-term care policy.

Other Alternatives for Long-Term Care Insurance

You are not alone if you do not have long-term care insurance yet; only about 7.2M Americans carry a policy. (AARP). The best time to look for a policy is in your 50s or early 60s – or younger if you can commit to long-term premiums (which will be lower for younger insureds). If long-term care insurance is out of reach, whether for financial or medical reasons, there are other ways to think smart about the cost of long-term care.

- **Short-term care insurance.** A short-term policy paying for 3-12 months of skilled nursing care may be more affordable, particularly if you plan to remain at home in the care of family as long as possible.
- **Veteran's benefits.** Some Veterans qualify for long-term care coverage at a regional Veteran's Home. Do not assume you or a spouse qualify because of prior military service. Contact your V.A. representative to determine what benefits you may be eligible for.
- **Annuities/immediate annuities/medicaid annuities.** There are specific annuity vehicles that will provide an immediate income stream to pay for the cost of care, and provide an avenue for spenddown of funds that would leave you eligible for Medicaid sooner than if principal assets were spent down on care. The annuity payment may be directed to a spouse living at home, or may offset the cost of care, the rest of which could be paid through other benefits.
- **Legal planning.** Options are available to legally transfer countable assets to an irrevocable trust and protect them from spenddown on long-term care needs. However, the rules and regulations regarding transfers and trusts are very complicated, and change frequently. Consult an elder law attorney who can explain the options and the pros and cons before transferring any assets.
- **Save to pay for private care.** Certainly if you ask your children, they will tell you to use your hard-earned money to obtain the best care money can buy in your final days. Careful planning can help maximize your income to assist with the cost of monthly care, leaving a small portion to be made from principal assets, extending the funds available to pay for needed care.

Chances are that you will need some kind of long-term care in the end of life. Weighing your needs and options will bring confidence and assurance to you and your family that all will not be lost to the cost of long-term care, while ensuring that you can get the best care when you need it the most.

PORTFOLIO CHANGES

Removed

McDonald's (MCD): We saw attractive returns for clients over the three years that we've held McDonald's. However, we think that the company's growth story for the next few years doesn't look nearly as appetizing. We see a current share price that exceeds fair value and think that there are healthier long-term growth opportunities elsewhere.

PIMCO Short-Term Bond Fund (PSHAX): we've held PSHAX in most client portfolios for several years. While we respect the seasoned management team's expertise, we are gradually exiting bond mutual funds and ETFs for the time being. Bond funds offer clients diversification, professional management and steady income, but they lack a fixed maturity date. When bond markets head south, bond fund holders can't comfortably wait on the sidelines with a known bond maturity date as they can with individual bonds. We've grown increasingly uncomfortable with the uncertainty lurking in bond fund portfolios, and potential liquidity issues. Since we view the bond portion of client portfolios as the keel on the ship providing stability through stormy seas, we have decided to replace most bond funds with high-quality individual bonds, CDs and US Treasury and agency issues.

Added

Walt Disney Co. (DIS): We see a world of wonder for Disney's growth opportunities in media and streaming services following their merger with FOX. The acquisition of creative rights for popular FOX properties includes X-Men, Deadpool, and Fantastic 4 and should provide significant story lines for development. A majority stake in Hulu streaming service complements Disney's upcoming Disney+ service. We saw an attractive entry point to the Magic Kingdom in terms of share price and used MCD sale proceeds to pick up shares of this top-notch entertainment company.

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