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Spring 2017

Spring arrived at 12:57 p.m. Eastern time on March 20th, bringing with it the first signs of nature's renewal. In many places, trees and flowers are already in full bloom. Warming temperatures beckon us outside. Birds fill the air with song to create the soundtrack of spring. In Colorado, that means the first sightings of hummingbirds and the unmistakable sound of the woodpeckers in the backyard. In Phoenix, the ocotillo—tall, thorny sticks related to cactuses—put out their first inquisitive leaves and blossom shoots. The blossom shoots will bloom red in early summer, but they are developing now. Let's review the numbers.

	(As of 3/31/17)
Dow Jones Industrials	+ 4.58 %
S&P 500 Index	+ 5.53 %
NASDAQ Composite	+ 9.82 %
MSCI EAFE Index	+ 6.47 %

Major Bond Indexes	(As of 3/31/17)
Lipper U.S. Government	+ 1.40 %
Lipper Short-term Investment Grade	+ 2.03 %
Lipper Corporate A-Rated	+ 4.86 %

Major Mutual Funds Indexes	(As of 3/31/17)
Lipper Large-Cap Core	+ 5.51 %
Lipper Mid-Cap Core Index	+ 4.11 %
Lipper Small-Cap Core Index	+ 1.87 %
Lipper International Index	+ 8.29 %

Source: The Wall Street Journal and Barron's

*Inclusion of these unmanaged indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.

FINANCIAL AND INVESTMENT PLANNING

“You have to remember that the hard days are what make you stronger. The bad days make you realize what a good day is. If you never had any bad days, you would never have that sense of accomplishment!”

— Aly Raisman

In the era of content being available via the internet and cable news stations 24 hours/day, it's often impossible to not be concerned about what's going on in the world. The current headlines often reference the growing conflict with North Korea, Syria, a renewed Cold War with Russia, Brexit, ISIS, the upcoming French elections, and political battles here at home. With all the current geopolitical risk in the world, one may wonder how such events could affect the markets. While no one has a crystal ball, it may help to look at history as a guide. Surprisingly, stocks have held up well when the U.S. and other countries have been in far worse shape than they are now. Ben Carlson from Bloomberg writes, “In the six months following the onset of World War I in 1914, the Dow dropped more than 30 percent. But in the following year, it rose more than 88 percent, which remains the highest annual return on record for the Dow Jones Industrial Average. In fact, from the start of the war in 1914 until it ended in late 1918, the Dow was up more than 43 percent in total, or around 8.7 percent annually.

Hitler invaded Poland on Sept. 1, 1939, which began World War II. When the market opened on Sept. 5, the Dow actually rose almost 10 percent in a single day. When the attack on the U.S. naval base at Pearl Harbor occurred in early December 1941, stocks opened up the following Monday down 2.9 percent, but it only took a month to regain those losses. From the start of WWII in 1939 until it ended in late 1945, the Dow was up a total of 50 percent, more than 7 percent per year.

The Korean War began in the summer of 1950 when North Korea invaded the South. That conflict ended in the summer of 1953. In that time, the Dow was up an annualized 16 percent, or almost 60 percent in total. In the next decade, U.S. troops were sent to Vietnam in March of 1965. The Dow would finish the remainder of that year up almost 10 percent. By the time the last of the U.S. troops was pulled out of Vietnam in 1973, the stock market was up a total of almost 43 percent, or just under 5 percent per year.

The Cuban Missile Crisis had the world on the brink of nuclear war in October of 1962. The confrontation lasted 13 days from Oct. 16, 1962, to Oct. 28. In that two-week period the Dow remained surprisingly calm, losing just 1.2 percent. For the remainder of that year the Dow would gain more than 10 percent. President John F. Kennedy was assassinated a little more than a year later in Dallas. The market opened up 4.5 percent the day after. Stocks finished up the following year, 1964, more than 15 percent.”

While there is no road map in trying to predict geopolitical events, trying to predict how the markets will respond is even harder. Thus, making sweeping financial decisions based on international conflicts may make us feel better, but may not make us better off.

Turning to the U.S. equity markets, we just closed a stellar first quarter. A quiet January was overshadowed by new highs reached in February. While the indices dipped slightly as March came to a close, they ultimately proved positive for the quarter but not necessarily the month. Jeff Saut, Chief Investment Strategist at Raymond James, recently said, “We've transitioned from an interest-driven secular bull market where interest rates come down and price-to-earnings multiples expand to an earnings-driven bull market. We had the earnings trough in the second quarter of last year, earnings flipped positive in the third quarter, and comparisons in the first and second quarter of 2017 are going to look terrific.”

Investor focus seems to be on political events both at home and in Europe, where “Brexit” proceedings have begun in earnest. The stock market has unwound part of the so-called Trump trade. The failure of the House of Representatives to repeal the Affordable Care Act has cast doubt on the ability to move other agenda items, such as broad tax reform. However, tax cuts are still possible – and the economy remains in good shape. The Federal Reserve, focused on the tightening job market, raised short-term interest rates further in mid-March – and is expected to gradually tighten again in the months ahead.

For the first quarter, the estimated earnings growth rate for the S&P 500 is projected at 9.1%, which marks the highest year-over-year earnings growth for the index since fourth quarter 2011 (11.6%). While earnings growth continues to improve, productivity growth has not returned to previous levels. Over the past 5 years, it's averaged just 0.5%. Prior to the credit crisis, productivity increased by about 2% per year. In reference to a recent IMF report (International Monetary Fund), Bill Gross, portfolio manager at Janus, stated, "Slowing business investment/trade and an ongoing level of low to negative interest rates have resulted in a misallocation of capital to low-risk projects and a slowdown in small business creation. Longer-term secular demographic factors such as an aging population also play a significant part since older consumers consume less of almost everything except health care." One area that may help is a favorable repatriation tax. It would likely result in a large amount of the estimated \$2.4 trillion in overseas cash coming back to the U.S. That cash could be used for capital investments and reducing debt. Larger capital investments tend to increase productivity over the longer term. The money being brought back from overseas could also be used for mergers and acquisitions, stock buybacks, dividend increases and other shareholder-friendly actions.

When we look at our past and future GDP growth (the current administration wants 3% GDP), two things stand out – the retirement of baby boomers and legal immigration. Baby boomers started retiring in 2012 and this has decimated the growth in the working age population. From 1960 to 2010, the population aged 16 to 64 grew at an average pace of 1.3% per year. This added the necessary workers to generate average real GDP growth of 3.5%. Since then, real GDP growth has dropped to just 1.3% since 2010. If nothing changes, over the next decade, it's expected to drop further. Remarkably, about 85% of this GDP growth is expected to come from legal immigrants. Future economic growth (productivity growth and labor force gains) will be partially dependent on the retiring baby boomers and our immigration policy.

Looking overseas, Asian equity markets have enjoyed a good first quarter, and opportunities still look apparent with the Chinese National People's Congress reiterating both continuing solid economic growth levels and ongoing internal reform, which helps to make the local economy more dynamic. Still, China's economic transition to a consumer-driven economy is expected to remain bumpy. The outlook for the rest of the world is brighter. The White House has softened its anti-trade rhetoric, reducing the risk that a misstep on trade policy will disrupt supply chains. Evidence of economic improvement in Europe and fewer political risks now that several countries have held important elections have buoyed European markets with several trading at multi-year highs.

Turning to energy and oil, Pavel Molchanov, energy analyst at Raymond James, stated, "The recent drop in oil prices reflects Saudi Arabia's publicly expressed displeasure with the rest of OPEC (and Russia) for their poor level of compliance with the agreed-upon production cut. As a result, the market has become more skeptical about an extension of the agreement beyond mid-year. Oil prices are also weighed down by a strong dollar and high levels of refined product inventories." If the price of oil remains low, consumers will continue to benefit when at the pump.

The fixed income market has flashed a potential warning sign with the yield curve flattening. Despite two Fed hikes since December, the 10-year Treasury yield is only ~100 basis points from its all-time low (1.32%) set in July. Since the mid-March rate hike, yields are down across the curve. The yield curve is flattening as long-term rates remain mostly static but short-term rates are higher. Should this turn into an inverted curve, history suggests we should take heed, since a similar inversion preceded the recessions experienced in 1981, 1991, 2000 and 2008. The demand for fixed income remains solid as evidenced by the strong pace of fund flows into bonds.

In summary, moving forward, economic and financial market headwinds for the next six to twelve months include political uncertainty, a strong dollar and protectionism. On the bright side, top tailwinds include potential tax reform, earnings growth, a low interest-rate environment and positive sentiment overall.

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PERSONAL

While the rest of the kids patiently waited their turn with the instructor on the uneven bars, at the back of the line one child could not contain her excitement – bouncing around like a pogo stick out of control. Like with most new things, there was reservation to try something for the first time, but within minutes of her initial lesson Ava was hooked. She found her new passion – gymnastics. Back home in the Kachkovsky household enthusiasm is contagious. Elle imitates (or at least attempts to) everything her big sister does – hand stands, cartwheels, summersaults, and the general monkeying around. Girls are ever-growing and ever-changing. Hard work this past quarter has yielded great results. Ava is now starting to read and write in Russian. Elle's comprehension in both languages has also improved immensely. Garry couldn't be more proud of his Russian princesses.

March is full of birthdays for the family - grandmother, great aunt, and both grandfathers celebrate in the first five days of the month. And, Elle turned two – that was quick. For the Big Bird theme, Elle's favorite character on Sesame Street, Emily prepared a delicious carrot cake with yellow frosting in the shape of an eight-foot two-inch tall bright yellow canary. A surprise 60th birthday party in San Diego for grandpa Brent brought out friends and family from as far away as Wyoming and Oregon.

The desert is blooming with color, restaurants' sprawling outdoor patios are filled with patrons, and parking lots at trail heads are overflowing with cars. This can only mean one thing – it is winter in Phoenix. The Kachkovsky family took every opportunity to be out of the house the last three months - hiking a variety of trails in the Sonoran Desert, visiting the Zoo, riding bikes and running around in the park. In early March, Garry and Emily attended a Spring Training game at the Tempe Diablo Stadium between the Anaheim Angels and the San Diego Padres. Despite the unseasonably warm day (99° for the high) Emily reveled in the Padres win.

With his feet clipped to the pedals of the mountain bike, Kris dropped down the steep canyon road in Canyonlands National Park. The expansive national park in Utah is 337,598 acres of colorful canyons, arches, mesas, buttes, and spires. The prime architects, water and gravity, sculpted this magnificent landscape. The Colorado and Green rivers wind through the heart of Canyonlands, carving two deep canyons. Both rivers are calm before they meet up at The Confluence, yet, the combined flow of both rivers spills into Cataract Canyon with incredible speed and power. This creates a world-class stretch of white water. Kris, his brother, Steve and three friends (Chris, Russ and Steve) embarked on the 100 mile White Rim trail in Canyonlands over a long weekend. All five were excited to be in the remote country unplugged from cell phones and city lights. With so much to see, the group would often set their bikes down along the way and explore what the canyon had to offer. The highlight of the first day was walking across a natural bridge a few hundred feet above the ground below. Day two brought the cyclists above The Confluence. With winds north of 50 mph, Kris didn't dare go to the edge of the rock overlooking the Cataract Canyon below. The third day brought adventure through a slot canyon - the excitement was not unlike being a kid in a candy store. At this point, Kris had tweaked an old injury and had a sharp pain in his kneecap. He stayed back, while the other four did their best Spider Man impersonations through the narrow slot canyon. As they finished the epic ride, culminating in over 5,900 feet of climbing, the tired mountain bikers knew this was a weekend they would never forget. The physical undertaking of the White Rim Trail, the comradery, the laughs, the shared experience made everyone feel truly alive and blessed.

With ski season winding down, Kris and Angie took their girls skiing one last time at the end of March. Kora (6) and Macy (4) had spring break, so mom and dad decided to spend a few days in Winter Park hitting the slopes. The sisters often say skiing is the best new family tradition. It's amazing how far the girls have come in one season of skiing. With summer fast approaching, the family is excited to start hiking and biking together.



(Kris' brother, Steve, in the slot canyon)

“One of the most tragic things I know about human nature is that all of us tend to put off living. We are all dreaming of some magical rose garden over the horizon instead of enjoying the roses that are blooming outside our windows today.”

- Dale Carnegie

Thank you for your trust, confidence and friendship.

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