



J.K. Financial, Inc.

REGISTERED INVESTMENT ADVISOR

8222 Douglas Ave Suite 590

Dallas, TX 75225



3rd QUARTER 2018

INSIDE:

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Our first second appearance: Features track flights, maps, lounges, points and more

Don't miss our blog
www.street-cents.com

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Inverted yield curve Accurate predictions over six decades

What is an inverted yield curve? Do you know what it has predicted with extreme accuracy over the last six decades?

This article is a more serious and detailed review of a five-part series originally introduced in late April and through the month of May on our blog at www.street-cents.com. It has been so long since we have had the unique situation of an inverted yield curve we wanted to remind everyone, including ourselves, of the ultimate predictive value an inverted yield curve has had on the U.S. economy over the last many decades.



John A. Kvale,
CFA, CFP®

The prediction with 100% accuracy over the last many decades as (see [Shorter](#), Page 2)

Three key tax code changes....so far!

We are not the first adopters of cutting edge technology or fast movers on new innovations. As such we are very cautious in general and especially with tax planning. At this time there are so many tax moving parts that may be

unanswered and possible IRS changes via clarity may also incur.

What follows are our big three and the possible planning techniques around them.

(see [Increased](#), Page 4)

Where did all the stocks go?

Implications of fewer stocks?

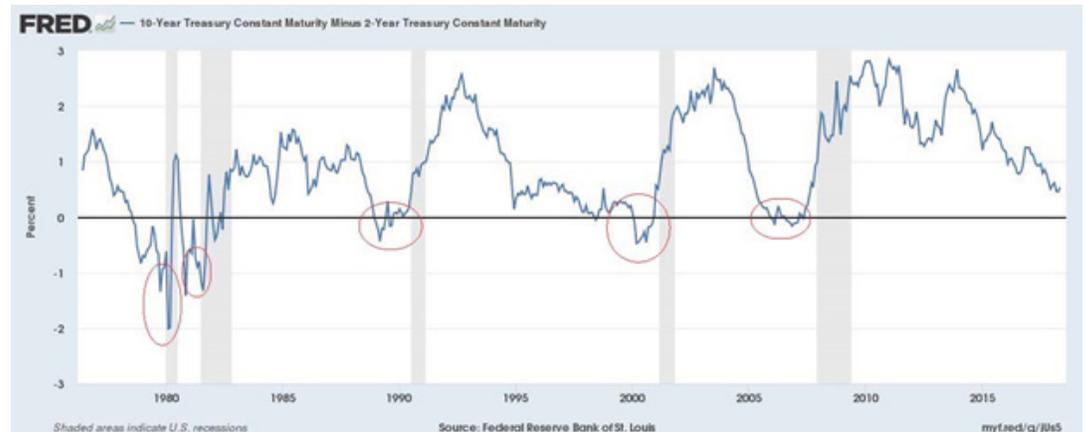
The basic demand and supply economics says that if either get out of whack movement will occur. Said another way if there is too much supply of something, price will likely drop and visa versa. Also, if the demand were to rise or fall, we should expect some type of similar pressure on

(see [If less](#), Page 6)

Inverted yield curve

Shorter borrowing, lending period, the lower the rate

(continued from Page 1) can be seen by the following main and most important chart, is a recession in the U.S. We have circled in red when the yield curve has inverted. The dark areas in time are official recessions in the U.S.

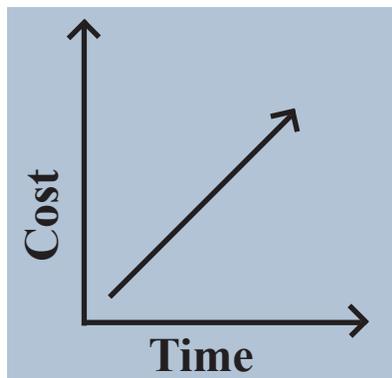


Notice the uncanny predictive behavior?

In normal times, the shorter the borrowing or lending period the lower the rate, all other risk factors being equivalent. Logically, it makes sense that the longer something is lent, borrowed, loaned or out of the owner's possession, the greater the cost, as there is a greater risk of default. This is the reason a 15 year mortgage is less than a 30, and we generally earn less on our checking accounts than we pay for a five year car loan.

The normal yield curve

During economic aggressive boom or growth times, inflation is normally a problem as too much demand pushes up against supply and moves price upward -

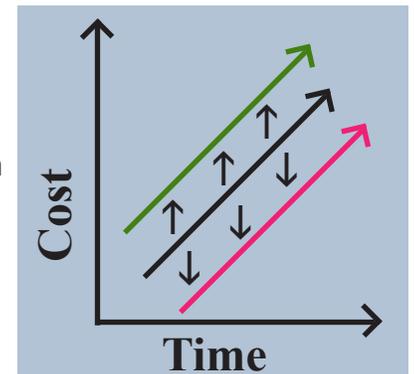


think the Jimmy Carter era of inflation that came with interest rates in the high teens. This is also a more prevalent situation for younger countries in go go growth mode.

As more normal growth times ensue or even a slowdown or recession, demand and offsetting prices tend to fall - including interest rates. There are one off unique situations that may change the normal occurrence- think war or bureaucracy- but for the most normal part, lower growth, lower price = lower Interest rates.

Parallel shifts along the yield curve - supply/demand movement

This chart shows what is called a parallel shift across the curve. The green line represents a higher interest rate situation across all time frames, while the red a lower rate environment. As mentioned earlier, Economics 101 would lead us to conclude during growth times, too much demand chases too little supply, pushing rates up and visa versa.



FOMC - Federal Open Market Committee control

The FOMC or Federal Open Market Committee originally formed in 1935 has the following stated dual mandate - "Foster Economic Conditions that Achieve Maximum Sustainable Employment and Stable Prices."

One of the only weapons (during the great recession others were introduced- but likely to only return in a similar style crisis- purchases of assets along the yield curve) the FOMC has is adjusting the short term or overnight interest rate. This rate would be the very lower left of our chart above and could be thought of as our checking account interest rate. Mostly near zero until recently, as rates were (see **When**, Page 3)

Inverted yield curve

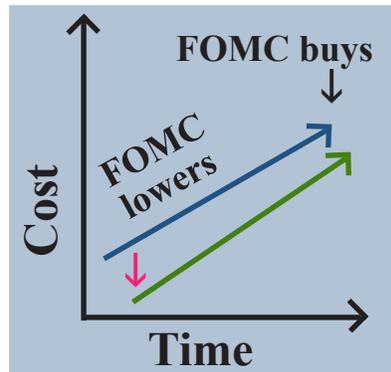
When shorter term yield is higher than longer, recession follows

(continued from Page 2)

slashed to near zero to encourage the economy to strengthen from the damage created during the 07-09 great recession.

In the following chart the blue line would be normal and the green the stimulative, lowered FOMC adjusted yield curve.

Holding rates un-naturally low for too long would lead to not only an overheated economy but also excessive risk taking due to cheap credit made possible by the lower rates.



Where the FOMC adjusts rates

Once rates have been lowered, normalization will ultimately need to occur. Just as in our prior scenario, the FOMC begins adjusting our short term/credit card/over night rates higher.

The inverted yield curve

An inverted yield curve occurs when the shorter term yield is higher than the longer term, an unusual occurrence that happens infrequently. Over the last six decades, when

this event/inverted yield curve occurs a recession has followed.

The usual occurrence is due to the fact that the FOMC has raised rates too fast in capital market participants opinion and longer rates go lower in anticipation of a recession.

This more recent graph from Fred, St. Louis Federal Reserve (below) shows the recent inverted curve and the recession that followed in the coming months.

We know this and the FOMC knows this; Why do they not stop raising?

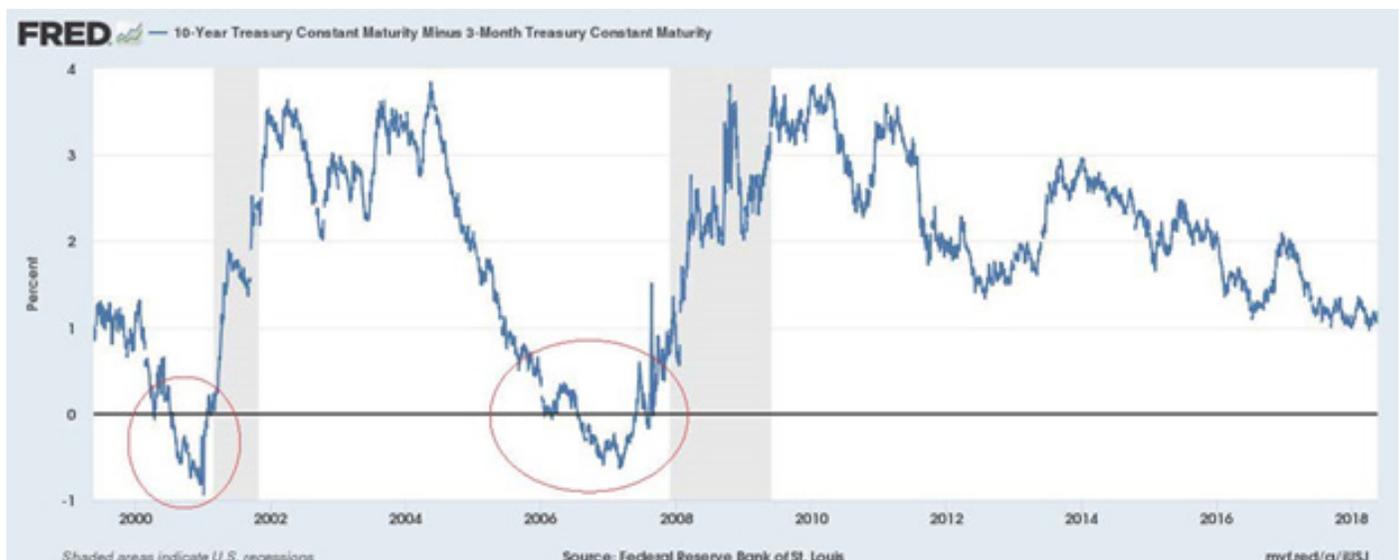
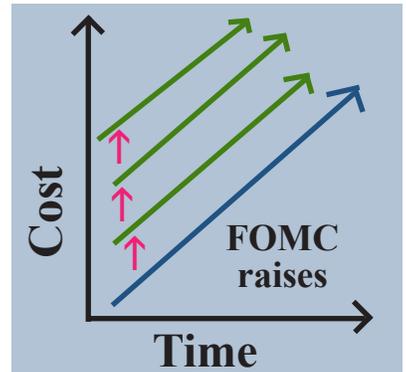
The dual mandate mentioned before pushes the FOMC to raise in order to stabilize prices and rates AND frequently the yield curve changes faster than the Fed can stop.

When this event occurs, historically there have been many naysayers screaming, "It's different this time!"

Time will tell but be careful in listening to the naysayers, if this event occurs!

We will be watching and updating closely as this cycle begins to unfold, the first time in over a decade.

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Increased standard deduction, less itemizing may lower taxes

(continued from Page 1)

Biggest change so far- the increased standard deduction

By far the biggest change, or at least the change that will likely affect the most people is the standard deduction. The IRS estimates that there may be a 60-70% reduction in individual families filing an itemized tax return. This is mainly due to the fact of the giant increase in the standard deduction.

The new standard deduction is \$12k for individuals and \$24k for married couples. Along with reduced deductions- see our third point- we expect many will actually itemize every other year.

Key planning technique- clump

In order to maximize the possibility of getting an itemized tax return, clumping property taxes, donations and other deductions is advised, likely resulting in an every other year of itemized deductions at best.

There will still be situations where itemization will occur but on the whole, many regular itemizers may find it difficult to hit the new higher thresholds. Do keep all of your records and attempt to itemize but with the knowledge clumped deductions and a likely at least every other year of non-itemized tax returns may be in our futures.

Tax rates across the board are lower

This fantastic graphic (see below) from the Tax Foundation shows generally across all types of families and all income levels taxes will be lower. In the details, we look forward to the proof of this as returns come in during next year's tax season.

On a very selective basis, earlier than normal distributions from IRA's may occur due to the much lower effective rate and large standard deduction.

Broadly a loss of deductions

They don't want us to itemize!

As mentioned in point one, itemization will be limited under the new code, not only due to the higher standard deduction but also due to the loss of tax deductions.

- SALT (State and Local Taxes) - limited to \$10k - home property tax limited deduction

- Interest deductions on mortgages over \$750k POST tax updates (grandfathering occurred for those already established)

- Greatly reduced generic write offs - many by small business owners

In closing, overall our collective taxes will likely be down due to all of the items mentioned above. At first it may seem we are losing deductions but the final result should be net less taxes. No one is 100% certain as clarifications may be made as the year continues. We will keep you abreast of updates as they occur.

JK

Impacts of the Tax Cuts and Jobs Act								
	James	Jason	Amber	Kavya and Nick	Sophie and Chad	Soren and Linnea	Laura and Seth	Joe and Ethan
Ordinary Income	\$30,000	\$52,000	\$75,000	\$85,000	\$165,000	\$325,000	\$2,000,000	\$48,000
Marital Status	Single	Single	Single	Married	Married	Married	Married	Married
Earners	1 earner	1 earner	1 earner	1 earner	2 earners	2 earners	1 earner	Retired
Children	No kids	2 kids	No kids	2 kids	2 kids	3 kids	2 kids	n/a
Tax-Deferred Retirement Contributions	\$2,600	\$4,000	\$5,500	\$5,500	\$20,000	\$37,000	\$18,500	\$0
Itemization	Std. Ded.	Std. Ded.	Std. Ded.	Std. Ded.	Itemizing	Itemizing	Itemizing	Std. Ded.
Current Law	\$4,331	\$5,198	\$16,104	\$11,035	\$29,345	\$71,629	\$713,234	\$3,497
Proposed	\$3,953	\$3,306	\$14,327	\$8,782	\$27,122	\$62,012	\$694,330	\$3,227
Tax Liability Change	-\$379	-\$1,892	-\$1,777	-\$2,254	-\$2,224	-\$9,617	-\$18,904	-\$270
% Tax Liability Change	-9%	-36%	-11%	-20%	-8%	-13%	-3%	-8%
% Change in After Tax Earnings	1.26%	3.64%	2.37%	2.65%	1.35%	2.96%	0.95%	0.56%

Note: Tax burden figures do not include employer-side payroll taxes. These results are for 2018, and do not reflect the expiration of many individual provisions. Source: Tax Foundation calculations.

TAX FOUNDATION @TaxFoundati

App of the quarter: TripIt

Our first second appearance: Features track flights, maps, lounges, points and more



About a year ago, we were introduced to a very cool travel app called TripIt. Just after, we previewed this handy app in our newsletter.

As our first repeat appearance App, we think the experience of time and the neat updates made it worth the re-review.

In our first review we featured the logo. We think this is much better.

Many of these features are only available on the \$49/year premium version which has already paid for itself many times over. See the message sent to the cell phone (below).

After a five-minute call to the airline, the savings was captured and paid for the next short trip.

But wait, it gets better.

In January of 2018 this San Francisco based company rolled out some really neat new features.

This from their Jan. 24, 2018 press release-

“TripIt Introduces Real-Time Security Wait Times

TripIt Pro Now Helps Travelers Get to, and Through, the Airport as Quickly as Possible

TripIt took the work out of figuring out how long it'll take to get through airport security. TripIt Pro now monitors security checkpoint lines and lets travelers know how long the wait is for the checkpoints near their gate.

To help travelers plan ahead, TripIt will also send users an alert three hours before a flight

showing them the current wait times—so they know what to expect when they arrive. Travelers can then check the TripIt app for real-time updates.

If a traveler needs to find the nearest checkpoint, or how to get to the shortest security line, they can use the feature's built-in airport map. That map will also show users which amenities are located near each checkpoint, like restrooms, restaurants and shops.”

Recently at a business meeting, TripIt texted my cell and said it was time to head to the airport immediately as traffic was heavier than normal. Not only was it correct but it also made for an easy exit from the meeting – everyone understood.

While no idea how this thing knows what it does, it works like a champ.

Terrific other handy features included – all of which we have

TripIt Pro alert: \$132.00 airfare refund may be available
Today at 8:10 PM



TripIt Pro just paid for itself!

Your flight Southwest Airlines 4915 departing on 4/1/2018 may be eligible for a refund!

Price paid: ~~\$833.94~~
Change fee: \$0.00
Current price: \$701.94
Your airfare credit: \$132.00

Fares change quickly and are not guaranteed.* See details on how to get your \$132.00 refund now!

[Get My Refund](#)

Contact Southwest Airlines: 1-800-435-9792

Confirmation number: PKGVAQ

Happy travels,
The TripIt Pro team

utilized

- Email forward plans to create a complete trip roster of all items- flight, car, hotel, reservations. Just forward your respective confirmation and everything is automatically logged into your app.

- Airport map – used to help easily navigate an airport when changing airlines, requiring terminal change

- Great trip history – all costs, source of reservation i.e. Expedia, Travelocity, Google and all confirm codes

- Lounges available – used multiple times to find the lounge on a long trip, especially handy when an airline you are flying does not have a lounge but another may in your respective location

- Point tracker- Just forward your points email from the respective service and TripIt keeps it for you.

- Map synch feature- Once your reservation is logged into the App, just click on the address and your respective GPS service pops up to give you directions.

While we have no vested interest in this App, we have found it extremely handy and a huge time saver as well as a big money saver with several other flight savings notifications in the last year, all items we are big fans of and hope you enjoy it too.

Save, easy, timely and budget friendly travels.

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If less supply of stocks, price may have upward pressure

(continued from Page 1)
price.

We have long spoken of the valuations of the current capital markets compared to historical valuations.

Here is the latest Price Earnings (PE) Ratio (chart at right) – the most used, bludgeon like valuation method.

Over the longer term the average has been about 15, with a current PE ratio near 25 – historically speaking this would be a high ratio.

Going back to our basic economic discussion from earlier, it would be reasonable to conclude if there were less supply of stocks the price may have upward pressure as well.

Surprising findings

We set out to determine if there were fewer stocks and here is what we found out.

- According to many, the costs have risen dramatically to nearly mid-teens percentage of total public offering.

- Continued initial public offering “pops” – think SNAP – only to fizzle much below initial offering price.

- Increase demands from governance once public.

- Mergers – big public companies getting bigger through acquisition.

- Public company buybacks – While an entire article could be written on this subject, in brief, buybacks lower the total shares outstanding of a company are an appealing use of extra capital as a buyback increases reported earnings all



other items considered AND are more flexible than a dividend. Lowering the dividend is very politically incorrect as it may lead investors to believe there is company weakness, with little to no similar mandates on buybacks.

- Less flexibility being a public company – this especially true from home grown or family run companies

- Adequate access to capital – in recent years capital from various sources such as debt offerings or venture investors has made it less necessary to go public, once a mandate for liquidity.

Given the above findings, it is not surprising to find the total U.S. stock count is down nearly 50% from it’s peak (see

chart below) about two decades ago. Also worth noting from the chart is that world/Global stock count is still rising.

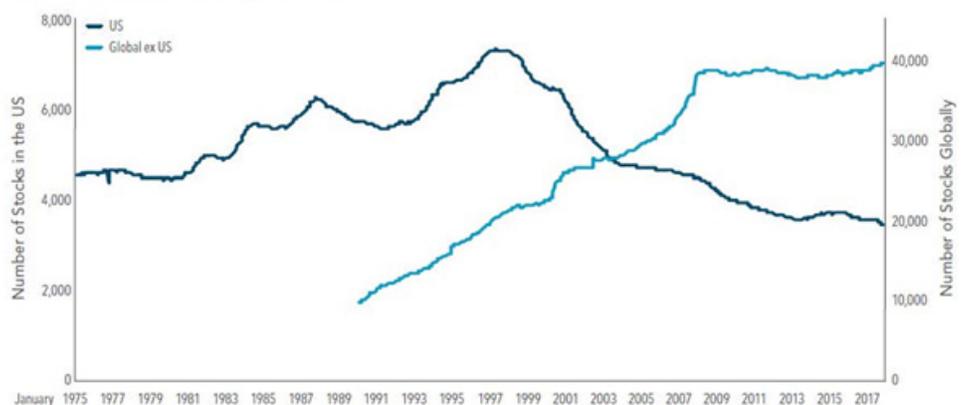
We are not saying public companies are going away, only that supply has been disrupted and on the margin, using our basic economic analysis, should put price pressure on U.S. capital markets.

We are not saying markets will not go down, they most certainly can and will, however normal elevated valuations methods may have less accuracy than in the past.

In closing, one interesting factoid- there are now more indexes to track stocks than there are actual stocks. A lot of irrelevant indexes out there!

JK

Exhibit 1: Number of Stocks, 1975–2017



Summer plans

John, Donald travel, enjoy family time; Donald expands family



Kvale's head to cooler climate

The Kvale family will make their annual pilgrimage to a cooler climate for an extended remote working vacation, this year with multiple interruptions from the dominant sport of the family-tennis.

Yes, Dad was a collegiate golfer and knows very little of tennis - likely better this way anyway. Thank goodness for the Tripit monitoring travel buddy and small airport nearby.

Pierce will not be interrupted by such sports and looks forward to his favorite bike trail while in the cooler climate.

With an odd, earlier-than-normal commencement to fall school, the summer will go fast. Not to worry. The family will also get the treat of many other members joining the extended stay, making for an almost family reunion-like atmosphere.



Donald to welcome new member to family in the fall



Randi and I are excited to announce that this will be our last summer as a family of four! Once Fall arrives, we will be welcoming a new family member to our lives and have two brother's who are very excited to have a baby in the family to love on.

Isaac and Asher are already creating a list of things they can teach him (Isaac's first question to us was when he would be old enough to play baseball with him).

As always, we have lots of family time planned, traveling to Dallas to visit



aunts and cousins.

Isaac completed his first season of T-ball this year and is already asking for trips to the batting cages to work on his swing. Asher is turning in to quite the little ham and loves to sing and dance to everyone's amusement.

Even though it is hot in Houston, we love our weekend trips to the pool and maybe a popsicle or two to help cool us off.

We hope that everyone has a wonderful, fun filled summer!



J.K. FINANCIAL, INC.
REGISTERED INVESTMENT ADVISOR

8222 DOUGLAS AVE SUITE 590
DALLAS, TX 75225

Phone: 214-706-4300
Fax: 214-706-4262
E-mail: info@jkfinancialinc.com



Check out our Blog
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The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing.

Parting thoughts for you...

As summer kicks into full gear, we hope you are enjoying and may find time to utilize our App of the quarter, Tripit, for your summer savings.

Speaking of summer, many of you have already experienced our found money success stories. We have retained a service that will scroll all of the United States for found money. Much like a treasure hunt, we are happily notifying each person we identify of their possible lost funds. Relatives, deceased family members and anyone that may not have a good handle on their finances will be gladly searched. Just reach out to us and

let us know their proper name.

As a reminder, each week we post a fun and fantastic blog post at www.street-cents.com on Monday, Wednesday and Friday at 10:30 a.m. Dallas time. If you are not getting the email notification, please sign up at our blog and make sure the spam filter is not grabbing our insights.

We hope you enjoyed our inverted yield curve article and the conclusion as well as the stock shortage article. We look to continue updates on both items.

Have a great summer and talk to you next quarter, the beginning of fall!



New knowledge sites

Tripit.com - Our App of the quarter website
Google.com/flights- Comprehensive flight pricing multiple airlines
Etsy.com - Great new find used to furnish much of our office improvements

Dates:

July 4 Independence Day-
Capital markets closed
Sept. 3 - Labor Day -
Capital markets closed
Nov. 17 - J.K. Financial,
Inc. Holiday Party - Dallas
Athletic Club. Save the date!