SIENA
WEALTH MANAGEMENT, INC.

Fed Shatters Conventional Economic Wisdom

Conventional economic wisdom holds that the record-low unemployment rate will cause employers to bid up wages, which then will be passed through to consumers in the form of higher prices, triggering rising inflation. However, conventional wisdom is being shattered.

Just as civilization came to understand that the world is not flat, the world just recently realized that the framework for understanding the relationship between inflation and employment, The Phillips Curve, was wrong.

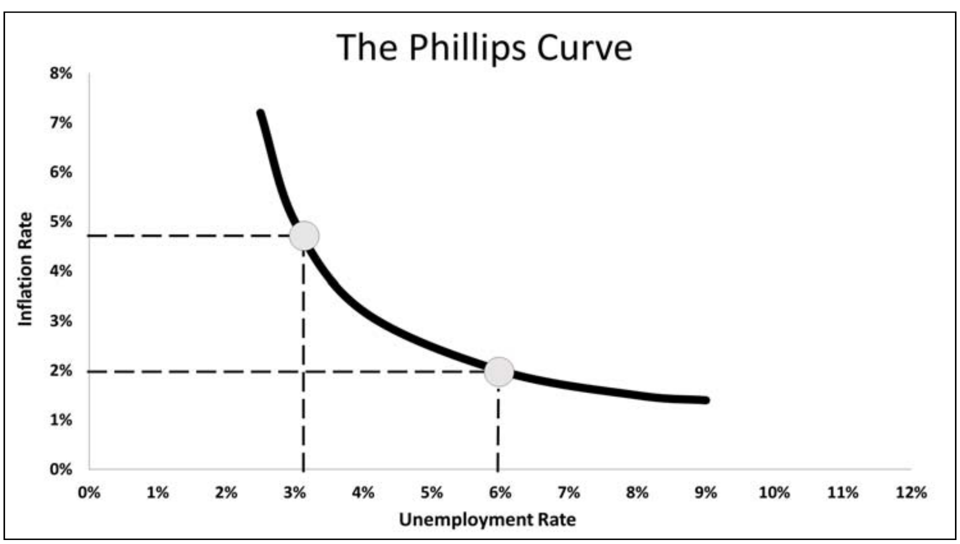
While civilization generally progresses at glacial speed, this is a breakthrough in the world's understanding of economics and it has modern-world consequences.

William Phillips, a professor of economics at the London School of Economics in the 1950s, explained the inverse relationship between unemployment and wages in 1958. When the economy grows the unemployment rate declines, driving wages and spurring higher inflation.

By the late 1960s, the Phillips Curve was the primary framework for forecasting inflation among central banks across the world. Now, however, in a departure from conventional economic wisdom, the Phillips Curve is being rethought by the U.S. Federal Reserve.

Jerome Powell, the chairman of the U.S. central bank, does not expect a sharp rise in inflation, even though unemployment has hit a record-low and wages are on the rise. He believes the inverse correlation between employment and wage inflation isn't as strong as it used to be, and he sets U.S. interest-rate policy.

If the Fed relied on the Phillips Curve, Mr. Powell would likely be trying to head off inflation right now by raising rates more aggressively to slow down the economy.



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Life Is Fragile, So, Please, Value Each Day As Priceless

If you spend your professional life giving financial advice, you learn to appreciate every day.

As financial advisors, the fragility of life unfolds before us every day. At any moment, a client might call amid a family crisis or death.

This is not the kind of thing to bring up at a cocktail party, but this is part of the day-to-day work of a financial professional: a 17-year-old killed in a car crash; a 65-year-old mother of two grown children succumbing to cancer in her husband's arms; and a litany of unspeakable family tragedies happening in slow motion. This is the most important work in the practice of a financial professional.

The specialized knowledge about financial planning that we bring is often thought of only amid a family crisis, and that is what we're here for. It is a privilege not taken lightly.

Your trust motivates the relentless pursuit of your best interest and that is the way we operate. But the main point here, in these 190 words, is not about business; it's that we all should be thankful for every moment of every day and value it pricelessly.

Your team at Siena Wealth Management

Ron Howard – Managing Principal
Mike Demko – Senior Financial Advisor
Mike Weakley – Senior Financial Advisor
Chris Cox – Financial Advisor
Billy Boulett – Client Service

10 Years After The Great Recession

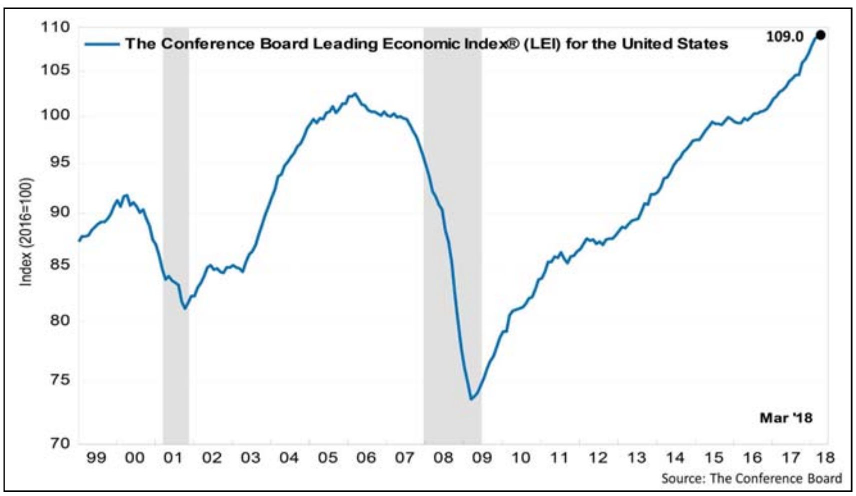
Ten years ago, the economy was bleak. The U.S. was in a recession. The subprime mortgage crisis was undermining Bear Stearns, Lehman Brothers, Countrywide Financial, AIG, and other major financial institutions; General Motors looked like it might go out of business. Then, in a story for the ages, the nation bounced back and led the world out from The Great Recession.

Over the last 10 years, a dollar in America’s 500 largest public companies grew to $2.48. From the stock market’s low point on March 9, 2009, a dollar appreciated in value 4.75 times, to $4.72 – a 372% return!

For the past decade, what makes America exceptional was in plain sight but difficult to see in the moment. It’s never easy to see why U.S. stocks would gain in value. The current period is no different.

Share prices plunged 10.2% in early February, on inflation jitters, and again in March, on fears of a trade war. In April, *The Wall Street Journal* warned of a long period of weakness and cracks in global growth. Things looked bleak.

We’re here to remind you that U.S. leading economic indicators released in April continued a long surge far beyond the highest point of the last expansion. This key forward-looking composite of 10 indicators points to solid growth for the rest of 2018. Despite the headlines, increased market volatility, and a weak first quarter return on stocks, very strong economic fundamentals remain in place. We’re here to help you manage your portfolio for the long run. ●



Your Alma Mater Or Your Family?

The new tax law doubles what you can leave loved ones’ tax free when you die and that’s really bad for your alma mater. Tax breaks for donations to your alma mater may no longer make the grade with you. Here’s why:

Estate Tax Exemption Rises. The Tax Cuts And Jobs Act (TCJA) doubles a married couple’s estate’s tax-exemption to $22 million. Alums now want to maximize their exemptions by leaving $22 million to their children, nieces, nephews and other loved ones before even thinking about a donation to favorite old schools.

Larger Standard Deduction. The TCJA upped the standard deduction from $13,000 to $24,000 for married couples and most Americans no longer will itemize deductions. But that also means you no longer may deduct college donations. Younger alumni will never get into the habit of contributing to their alma mater, disrupting the finance of U.S. educational institutions.

Athletic Deduction Nixed. Before the TCJA, many colleges targeted contributions from alumni who might qualify for good seats at games. The old law allowed donors to deduct 80% of such gifts. Now, the deduction is zero.

Taxing Endowments. Under the new tax code, schools with endowments of $500,000 per student or more and 500 students or more face a 1.4% levy on income. Only a small number of schools are subject to this new tax, but it is a consideration in making college donations.

The Plus Side. The TCJA is not entirely bad for all education-minded donors. Some plusses:

- If you itemize, you may now deduct up to 60% of your adjusted gross income on donations to qualified charities, including your old school. That’s up from 50%.
- You can “bunch” donations you pledge to give over several years. The

How Portfolio Theory Worked In Real-World 2017

For investors, 2017 was a mirror image of 2016. The top performing types of American companies in 2016 were the biggest laggards in 2017. Meanwhile, the worst performing types of U.S. stocks in 2016 were the biggest winners in 2017.

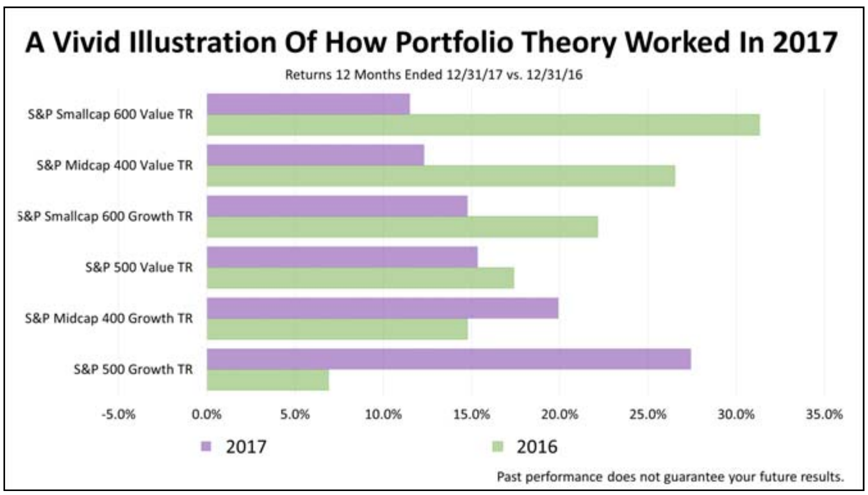
The orderly rotation of the leaders and laggards vividly illustrates how Modern Portfolio Theory worked in the real world last year. Modern Portfolio Theory is a large body of knowledge based on 70 years of research by investment academics. It's a framework for how investing is now taught in the world's best business schools and long embraced by institutional investors. Basically, classifying investments based on their statistical characteristics imposes a discipline for managing assets based on history and fundamental facts about the economy.

Of course, human judgment based on a good sense of history is critical in applying the theory to people in the real world. And all this doesn't guarantee success. It's a theory. But it is the best solution spawned of the research by several generations of the world's best minds for increasing the likelihood of investment success, and it is the framework for investing that this firm believes in.

Applying portfolio theory at the end of 2016 meant lightening up proportionately on the most-appreciated types of assets — small-cap value stocks — and buying more of the types of assets that lagged, the S&P 500 large-cap growth stocks. The exact amount of each type of asset is set based on your personal preferences and appetite for risk.

Usually, when you look at the returns of asset classes from one calendar year to the next, the performance seems random - there is no order to what occurred. The orderly reversal of leaders and laggards from 2016 to 2017 vividly illustrates a key concept in managing wealth prudently. In real-world 2017, then, the theory worked exactly the way it's supposed to — it was uncanny.

Global stock market returns in 2017 versus 2016 reflected a similar mirror image. Although the seven types of U.S. and foreign stocks did not prove the theory quite as perfectly, the biggest winners of 2016, small-cap U.S. stocks, were the biggest laggards of 2017, and the biggest laggards of 2016 were the biggest leaders of 2017.



The real world of investing in 2018 is filled with uncertainty. Tax reform could accelerate economic growth and prompt the Federal Reserve to make a policy mistake by squelching growth or allowing the economy to overheat and inflation to surge.

The political scandal in Washington could devolve into a constitutional crisis or the nuclear standoff with North Korea could erupt with terrifying consequences. A 10% or 15% drop could occur at any time on bad news and the chance of a bear market decline of 20% or more increases as the eight-and-a-half-year bull market grows older.

On the other hand, the bull market could continue in 2018 and beyond, and prices could head much higher. The economy shows no sign of slipping into a recession; leading indicators signal a strong start to 2018; the world economy is growing in synchronicity with the U.S. - the first time that's happened in many years; and the new tax law is expected to boost earnings sharply and that's what drives stock prices.

You can't be sure what the future holds, but seeing how well portfolio theory worked in the real world in 2017 may give you comfort and boost your confidence to stay committed to a program of long-term wealth management and financial planning. ●

deduction can exceed the write off under the standard deduction.

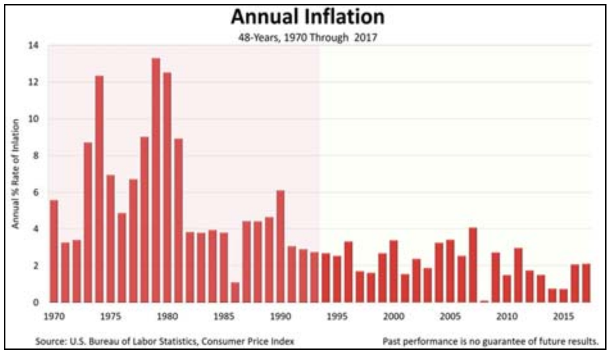
- You can contribute via a donor-advised fund, which entitles you to a large immediate deduction on annual donations you pledge to make over a period of years. If you suddenly strike it rich, this is a great way to go.

Old Ivy has been around since before the income tax and has managed to flourish, but the new economics of supporting education is disrupting the finances of major educational institutions and the effects are yet to be felt. If you have questions about donating money to a school or your priorities in planning your estate, please contact us. ●

Inflation: A Portfolio Risk That Never Dies

The threat of inflation is nothing like the double-digit affair of the 1970s, but it's still there. Dormant for years, inflation may seem irrelevant, but it remains a risk. Here's a short lesson for managing this risk.

In the 48 years after it raged in 1970, inflation was a tale of two times, distinctly different but equal in length. The first 24 years was a high-inflation period and low inflation marked the last 24 years.



The median Consumer Price Index, a widely-watched inflation barometer, was 3.8% for the 48-year span. However, the CPI topped 3.8% just once in the past 24 years, while hitting 3.8% or higher in 18 of the previous 24 years.

The table below shows the average yearly returns for seven distinct types of investments over the two 24-year periods. Some important observations:

- Large U.S. stocks' nominal return in the low-inflation era was 13.08% and, after subtracting the small CPI increase, 10.8%. In the high-inflation years, a 10.8% nominal return shrunk to 4.7% after inflation. High CPI slashed real returns after inflation in half, a frightening risk to a retiree on fixed income.
- Stocks held up well in low-inflation times, because bonds — their chief competitor for investor capital — were yielding less income. Stocks performed okay in high-inflation periods, too. An escalating CPI eroded the value of bonds' interest income. Longer-maturity bonds suffered.
- Money market instruments are never big interest payers. But shorter-term income investments go up with inflation. They've been good for times of rising inflation.
- Real estate performed well in low-inflation years, which foster lower mortgage payments that encourage home buying. Yet real estate also performed in the high inflation era.
- A real wild card for investors in securities over the last 48 years was commodities. Oil companies dominate commodities in this class of securities, but it also reflects prices of gold, food and raw materials. Historically, prosperity increased demand for goods and boosted commodities prices. Low inflation meant the opposite happened.
- It's easy to think commodities are irrelevant, but long-term financial history indicates otherwise. The fact that they were losers after years of good stock returns demonstrate why they remain important in a diversified portfolio. If you did not have some investments underperforming, you're not properly diversified. ●

Inflation And Performance Annually, 1970 - 2017

		Large US Stock	Small US Stock	Non-US Stock	US Bonds	US Cash	Real Estate	Commodities
Low Inflation Years 24 Years with Below-Median CPI	Average Nominal Return	13.08	13.76	10.91	6.39	2.45	12.58	(1.97)
	Average Real Return	10.80	11.44	8.67	4.27	0.41	10.30	(4.03)
High Inflation Years 24 Years with Above-Median CPI	Average Nominal Return	10.82	12.61	11.33	9.03	7.39	14.26	21.98
	Average Real Return	4.70	6.26	5.21	3.00	1.33	7.86	15.13

Source: US Bureau of Labor Statistics, Consumer Price Index; Standard & Poor's Corp.
Past performance is not a guarantee of your future results.

Fed Shatters Economic Wisdom

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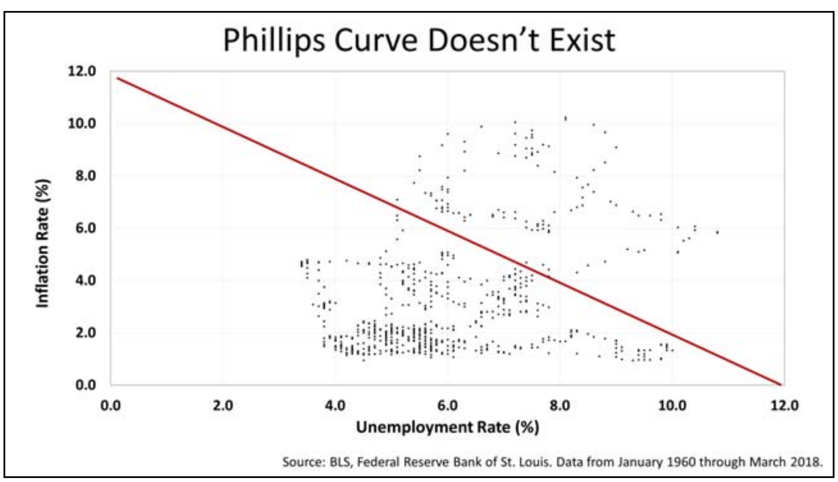
Inflation recently surged to the Fed's target rate of 2% and the unemployment rate dropped to a record low of 3.9%. In addition, the Index of Leading Economic Indicators, a forward looking composite measuring growth literally 10 ways monthly, rose again in April continuing an uptrend and suggesting solid growth continuing through the second half of 2018.

Mr. Powell, who became Fed chair in February 2018, has moved decisively in defiance of conventional wisdom, highlighting humanity's improved understanding of financial economics.

This chart from independent economist Fritz Meyer, whose research we license to share with you regularly, shows the inverse relationship of inflation and unemployment since 1960.



If the Phillips Curve were an accurate forecasting tool, each of the black dots would line up on top of the red line. When Professor Phillips came up with his theory in 1958 it was prophetic, but a half-century later we know so much more.

We're here to help you plan your future based on facts, analysis, and humanity's growing understanding of financial economics. ●