THE TEAM WITH THE BEST PLAYERS WINS……. Jack Welch

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OUR ONLY CERTAINTY IS – THERE IS NONE!

By William York, VP of Marketing

If you can keep your head when all about you are losing theirs …
If you can wait and not be tired by waiting …
If you can think -- and not make thoughts your aim …
If you can trust yourself when all men doubt you …
Yours is the Earth and everything that's in it.
……………………………*Rudyard Kipling*

As anyone who can read or hear knows – the stock market has been very volatile lately. There is no guarantee that once you invest in the stock market your money will make money. Investments have a **potential** for growth but can be risky as their worth usually changes from moment to moment. Investing in the stock market can be challenging.

In December of 2018 the stock market had a decline that was very close to being called a "bear market". A bear market is described as falling when stock prices drop 20% from the S&P's highest point. Since the New Year, the S&P has rebounded by approximately 13 percent. The last bear market took place in 2007/2008 during "the Financial Crisis" and lasted approximately 17 months. This financial crisis was caused by the usage of sub-prime mortgages and the eventual collapse of the investment bank, the Lehman Brothers on September 15, 2008.

So, what caused the downturn in the market in December 2018? Usually a bear market happens during a weak or sluggish economy with low employment, low business profitability, etc. However, that's not the case right now. **There are many theories but few proven theories.** What we can predict is that as this Newsletter is being written the market is changing…**volatility is the only certainty.**

BE PREPARED

As has been mentioned in previous newsletters – "**Captive Insurance Companies are created to provide a level of risk management not possible in today's commercial insurance market."** Proper investment management teams will employ a strategy that will understand and exhibit an in-depth knowledge of the workings of a Captive Insurance Company and, at the same time, an investment plan to protect against most volatility.

SOLUTION

We saw an unprecedented level of low volatility in 2017. Large corporate tax cuts and strong corporate earnings supported the steady climb in stock prices throughout 2017. This was an abnormal year and volatility is a normal occurrence today. However, market participants should expect a higher than normal level of volatility over the next 6 to 8 quarters. The macro and geopolitical issues are abundant at this time. Protectionism and populism are two prevalent themes that have not been major factors in decades. The trade war in China will take a long time to make any progress with intellectual property and forced technology transfer issues. Income inequality has also become a hotbed which can alter fiscal policy dramatically going into the next election. Corporations are at peak profit margins and wage pressures continue to creep higher.

Portfolios need to address all of these issues. The first step is to ensure investment stability to increase cash positions in order to give the investment professionals some dry powder to take advantage of the significant swings that can occur in the market.

Moreover, investors today can actually earn 2 percent on their cash for the first time in almost a decade. The next step is to increase your time horizon so if you need liquidity over the next few years then you should raise even more cash or stay invested in short term fixed income maturities.

If the market cycle is in its later stages, we should expect a slowdown in growth and lower earnings. The proliferation of passive investing has swung the pendulum so far to one side that almost all retail investors have “market” exposure with some type of asset allocation. That simply means if the market is going to have significant corrections, they should expect similar performance in their portfolios.

We believe that adding more active management will mitigate some of this risk as well as take advantage of some dispersion in returns in specific sectors and individual stocks. Powerful secular themes can be identified and can be much more resilient than just owning an index. We suggest owning a basket of stocks with idiosyncratic characteristics which will have a higher probability of withstanding downturns in the market. Defensive sectors such as Utilities and Consumer Staples will also be helpful. However, investors should seek professional advice on what individual names have good fundamentals and which ones to avoid.

Captive Insurance Investment portfolios are always conservative by their design in order to be aligned for asset/liability management. We cannot emphasize enough how advantageous it is to have companies with dividend income in your portfolio. There are so many areas in the public markets where you can find reasonable dividends in stable companies and other instruments. The structure within the captive creates a very advantageous tax treatment on income of the captive. Moreover, this additional return in the captive will also bolster the portfolio during challenging market environments. A captive portfolio that produces dividends will get favorable tax treatment on its income and then taxed at the lower corporate tax rate. The result is an effective tax rate of only 6.8% on your dividend income from your captive portfolio. The compounded growth and tax deferral type quality of this structure will produce higher returns with lower volatility over a specific period of time.

Our conclusion is that volatility is now the new normal. Likewise, professional management plus insurance knowledge is essential if you want to operate a profitable Captive Insurance Company. Our firm understands these issues and believes that any Captive not managed in this manner is unprepared for today’s financial environment.

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The CPA Journal
A Common Sense Approach to Improved Risk Management
By Joseph W. Tucciarone and Louis Biscotti, CPA, CITP

https://www.cpajournal.com/2018/12/19/captive-insurance-companies/

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