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U.S. Retirement Market Trends: Assets Continue to Pour into IRAs, Target-Date Funds

By Randy Myers

A number of trends are reshaping the retirement plan landscape in the United States. Retirement assets are growing, but more so in Individual Retirement Accounts than anywhere else. Assets in defined contribution plans are going up, but only because of capital market gains; in that segment, withdrawals have begun to outpace contributions. Meanwhile, target-date funds continue to collect the lion's share of new contributions to 401(k) plans.

Overall assets in U.S. retirement plans are growing at a smart clip and are projected to reach $28.9 trillion by 2020, up from $22.2 trillion in 2016, said Jessica Sclafani, director, retirement practice, for research firm Cerulli Associates, speaking at the 2018 SVIA Spring Seminar in Orlando, Florida.

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Using Behavioral Finance to Drive Outcomes for Retirement Plan Participants

By Randy Myers

The retirement industry has long used a variety of metrics to measure the success of employer-sponsored retirement savings plans, including the percentage of eligible employees participating in a plan, how much they are saving, and how often they are engaging with their plan.

Voya Financial, a diversified financial services firm and plan provider, now looks beyond those metrics to measure success by participant outcomes rather than participant inputs.

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Health Savings Accounts: At the Intersection of Health Care and Retirement

By Randy Myers

For many retirees, health and financial wellness increasingly go hand-in-hand. Funding health care expenses can be challenging in retirement, even with Medicare assistance, and in worst-case scenarios can jeopardize a retiree's financial security.

An attractive tool for meeting these challenges, says Daniel Bryant, founder and CEO of Sheridan Road Financial, an independent investment consulting and retirement advisory firm, is the health savings account ("HSA").

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U.S. Retirement Market Trends: Assets Continue to Pour into IRAs, Target-Date Funds

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Sclafani said public and private employer-sponsored plans accounted for about 64 percent of retirement plan assets in 2016, but are expected to account for only about 59 percent by 2020. Meanwhile, assets in Individual Retirement Accounts are expected to grow to $11.9 trillion by 2022, up from an estimated $8.4 trillion in 2017. However, she noted, much of the new IRA money simply represents assets that are being transferred from workplace plans to IRAs as the baby boomer generation continues to retire.

Sclafani noted that the only segment of the retirement plan market whose market share is expected to contract between 2016 and 2022 is the corporate defined benefit plan segment. While total assets in defined benefit plans will go down only slightly, she said, the segment's market share is expected to contract to 10 percent from 13 percent.

That market-share downturn is not terribly surprising, given that corporations have been freezing or terminating defined benefit plans for a couple of decades now in favor of defined contribution plans. Somewhat more surprising is that distributions from defined contribution plans began to exceed contributions in 2013, a phenomenon that Cerulli forecasts will accelerate between now and 2022. Contributions fell to 96 percent of distributions in 2013, and are expected to contract to 88 percent by 2022. Nonetheless, total assets in defined contributions are still rising, due largely to capital market gains.

For plan sponsors who encourage participants to remain in their defined contribution plans after they stop working, Sclafani said, one of the biggest challenges will be figuring out how to help those participants convert their savings into a steady stream of income. Right now, Sclafani elaborated, most defined contribution plans don't have a true retirement income solution as there's often a significant disconnect between the way plan sponsors, plan participants and plan provides define income solutions.

Within the 401(k) market, Sclafani said, assets in target-date funds totaled $1 trillion in 2016 but are projected to reach $3.1 trillion by 2022. Target-date funds were collecting 50 percent of all new 401(k) contributions in 2016, but that figure is expected to reach 85.4 percent by 2022, at which point they would represent about half of all 401(k) assets—up from 22 percent in 2016. Three companies—Vanguard, Fidelity and T. Rowe Price—accounted for 63 percent of target-date fund market share in 2016.

Looking ahead, Sclafani said, the next big developments in the target-date space are likely to center on the introduction of hybrid target-date/managed account investment options, configured either as "dynamic [qualified default investment alternative, or] `QDIA'" investments or "personal" target-date funds. With dynamic QDIAs, plan participants are defaulted into a target-date fund when they join a plan and are then switched into a managed account product when they reach a certain age or when their account balance hits a certain level. With a personal target-date fund, the fund's glide path is tailored to the individual based on a variety of data points about them, including not just their age but also their income and non-plan assets. "The idea is that they are improving upon the target-date fund structure to further individualize it for the participant, but in a way that doesn't require the participant to engage," Sclafani said.

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Stable Value Funds Carving Out Role in Target-Date Funds

While target-date funds are attracting the lion's share of new contributions to 401(k) plans, that doesn't preclude an opportunity for stable value. In addition to the growing number of larger plans that are creating custom target-date funds within their investment lineups that use stable value, many stable value fund providers are using stable value funds in their off-the-shelf target-date fund offerings.

Save the date: SVIA's Fall Forum, October 8-10, 2018 in Washington, DC

U.S. Retirement Market Trends: Assets Continue to Pour into IRAs, Target-Date Funds

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Many plan participants need some sort of nudge to improve their retirement outlook. Sclafani noted that in a survey it conducted last year, almost half of all participants were saving less than 6 percent of their salary for retirement.

When Cerulli asked them what would motivate them to increase their contributions to their 401(k) plan, 72 percent cited "taking full advantage of employer matching contributions." That was followed by a salary increase or bonus, which was cited by 56 percent of participants.

Although the retirement plan market is growing, Sclafani cautioned that federal legislators seeking to reduce federal deficits may continue to eye the market as a source of revenue by considering legislation that would eliminate the tax deductibility of plan contributions. That "Rothification" idea, which was pulled from the tax reform law passed in late 2017, would remove a strong incentive for workers to participate in retirement savings plans, Sclafani said. By way of evidence, she noted that while about 42 percent of the 401(k) plans Cerulli tracks in a survey with the Spark Institute offer a Roth option, in which contributions aren't tax-deductible, only about 13 percent of the participants in those plans contribute to a Roth account.

Making sure that retirement plans work as intended is important to plan sponsors, Cimini concluded, asserting that there's an increasing awareness among sponsors that "having a workforce that can't retire will eventually affect their bottom line in a negative way." SVIA

Using Behavioral Finance to Drive Outcomes for Retirement Plan Participants

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Using this standard, it seeks to ensure that everything it does boosts the percentage of pre-retirement income participants receive once they stop working.

This focus on outcomes is one of three fundamental underpinnings to Voya's approach to using behavioral finance theory to help plan participants get more from their retirement plans, explained Jeff Cimini, head of retirement product for the company, during a presentation at the 2018 SVIA Spring Seminar in late April. The second is science; it seeks to make decisions about the products it offers based on rigorous, unbiased research. The third is digital technology, which it leverages both to test, measure and apply new initiatives more quickly, and to deliver faster, more cost-effective and more personalized service to plan participants.

Voya's research in these areas, which has included partnering with renowned academics from leading universities, has led to some surprising findings. Among the highlights:

Higher automatic deferral rates don't necessarily discourage plan participation rates. Many employers who automatically enroll employees in their defined contribution retirement plans set the employee's default deferral rate at 3 percent of salary. They worry that higher deferral rates might prompt employees to opt out of the plan. In fact, Cimini said, Voya's research, conducted with behavioral economist Shlomo Benartzi of UCLA, shows that opt-out rates don't materially change until the default rate goes above 11 percent of salary.

Many retirement plan participants devote shockingly little time to engaging with their plans. During the enrollment process, Cimini said, participants typically spend less than a minute and a half deciding how they will invest their money. Meanwhile, a 10-year study found that 78 percent of participants never change their asset allocation mix or ongoing deferral rates.

Participant engagement trumps automation. Many plan sponsors have sought to improve participant outcomes by adopting design features such as auto enrollment, auto escalation of participant contributions, and the use of target-date funds as a default investment option. While all those features can help improve outcomes, Cimini said Voya has begun to see evidence that participants who engage with their plans enjoy better outcomes than those who leave it on autopilot.

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Using Behavioral Finance to Drive Outcomes for Retirement Plan Participants

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In one study, it looked at two distinct groups of plan participants within a pool of 5 million participants. The first group consisted of "instinctive" participants who were automatically enrolled in their plans, spent less than two minutes on their plan's website, did not consider their retirement income, did not explore alternative savings rates, and were projected to replace less than 50 percent of their working income in retirement.

The second group of "reflective" participants had enrolled in their plans 30 years ago, had logged into their accounts in the past year, and had explored their projected retirement income and the impact of different savings rates. Across all levels of income, Cimini said, "reflective" participants were on track to replace a higher percentage of their pre-retirement income in retirement. "We know it has a very positive impact if we can just get more participants engaged and out of the auto (mode)," Cimini said. "The autos provide a fantastic lift over zero … and get you to about 50 percent success rate. But they don't get you to the full need, which we think is accomplished through engaging the participants in these programs."

Language matters. When encouraging participants to save more for retirement, Voya now tries to frame the decision not as one that reduces current income but rather one that boosts retirement income. In fact, Voya has found that by reframing the enrollment decision as "purchasing future income" instead of "deducting money from my paycheck," average deferral rates upon enrollment jump by two percentage points, to 7 percent from 5 percent.

Cimini said Voya has reshaped much of its participant communications activities to reflect the findings of its behavioral finance research. It's also tried to combine behavioral finance theory with digital technology to make it easier for participants to realize improved outcomes from their retirement plans. When participants go to a Voya-managed plan website, for example, they land on a home page with a graphic depiction of how much of their income they'll likely be able to replace in retirement. But they also see sliders linked to key factors that could impact that outcome, such as how much they're saving, how much they expect their investments to earn, and when they plan to retire—all of which they can easily experiment with. Finally, to make it easy for them to take action that could improve their financial health in retirement, participants see a one-click "Make Change Now" button that will implement any changes that look appealing to them. SVIA

Health Savings Accounts: At the Intersection of Health Care and Retirement

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Speaking at the 2018 SVIA Spring Seminar, Bryant and Roy Ramthun, president and founder of HSA Consulting Services, explained that HSAs are highly tax-advantaged savings and investment vehicles aimed specifically at helping Americans meet their health care expenses. Qualified contributions to an HSA are tax deductible, just like contributions to a traditional 401(k) plan. But unlike a traditional 401(k), withdrawals from an HSA aren't taxed, either, as long as they are used for health care expenses. Those expenses can be claimed when they are incurred, at a later date, or never. Any money left in an HSA upon the account holder's death will pass to the surviving spouse if there is one, or to the account holder's estate for the benefit of his or her heirs. One caveat: HSAs are available only to individuals covered by a high-deductible health insurance plan.

Introduced 15 years ago with a focus on paying current out-of-pocket health care expenses, HSAs are increasingly being marketed as a long-term savings and investment vehicle that can complement a retirement savings plan. Maximum utility is realized if they're actually used to pay for health care expenses. Suppose, for example, a retiree is in the 35 percent federal tax bracket and incurs a $4,000 medical bill. To pay that bill from a 401(k), she would have to withdraw $5,400 from her account. To pay it from an HSA, she would only have to withdraw $4,000, for a net savings of $1,400. Ramthun said participants in 401(k)

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Health Savings Accounts: At the Intersection of Health Care and Retirement

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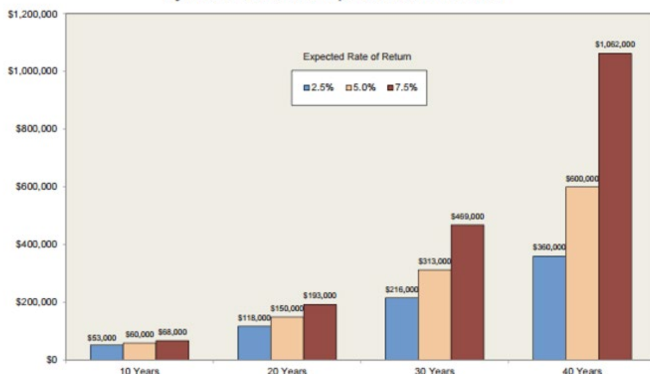
plans, once they're contributing enough to that plan to take full advantage of any matching employer contributions, might want to consider maxing out contributions to an HSA before topping off their 401(k) contributions.

Individuals who suspect they might not need all the money in their HSA for health care expenses needn't worry, Ramthun continued. Suppose, for example, a retiree incurs no big medical expenses, or simply wants to use the money in her HSA account for a non-medical expense. As long as she is 65 or older, there is no penalty for doing so; a withdrawal from an HSA for non-medical purposes is simply taxed as ordinary income, just as if it would be if it were coming from a traditional 401(k) account. (If the account holder is under the age of 65, however, she would pay those taxes plus a 20 percent penalty.)



Ramthun noted that many Americans assume Medicare will cover all of their health care expenses after they retire, when in fact it covers only about 60 percent. Individuals are on the hook for Medicare premiums, deductibles, copays, coinsurance, dental and vision expenses, over-the-counter medications, long-term care and supplemental insurance premiums where applicable. A 65-year-old couple retiring this year, he said, could be expected to incur, on average, $280,000 of out-of-pocket health care expenses in retirement.

"You can't have great healthcare with no financial care," said Bryant. "Those two worlds are colliding. And the nexus at which they go together is the HSA. The idea that we're all saving money for retirement to buy that house in Tahoe or Sugar Bush is just not reality for 90-some percent of Americans. They're saving money for retirement to pay for health care expenses. That's what employees are thinking about every day." SVIA

The Nexus of Health Care and Financial Security

By Randy Myers

The cost of health care is often cited as a threat to the financial health of retired Americans. What's less publicized is how caring for someone else in poor health can impact a person's financial wellness, both before and into retirement.

A new study by the Transamerica Center for Retirement Studies and the Transamerica Center for Health Studies—both parts of the Transamerica Institute—documents the risk. It finds that acting as a caregiver, while often emotionally rewarding, can have a toll on the caregiver's financial well-being.

In a talk at the 2018 SVIA Spring Seminar, Hector De La Torre, executive director of the Transamerica Center for Health Studies, said the new study surveyed more than 3,000 non-professional caregivers. Among that group, 44% reported that their financial well-being is either fair or poor. Nonetheless, nearly a third—30 percent—said they are spending between $100 and $500 a month out-of-pocket on their care recipient, and 18 percent said they are spending more than $500 a month. Nearly one in five—18 percent—reported dipping into their retirement accounts to make ends meet while acting as a caregiver.

Caregiving also can have an impact on a caregiver's career. Sixty percent of the surveyed caregivers said they are employed, and among

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that group 76 percent said they had made an adjustment to their employment as a result of caregiving—with 28 percent reporting an adverse reaction from their employers. Thirty percent of working caregivers said they've used paid time off to care for a loved one, 26 percent said they've missed work days, and the same percentage said they've reduced their hours or job responsibilities.

While 65 percent of caregivers said their own health had remained basically unchanged since they became caregivers, 17 percent said it had declined. A surprising 15 percent said their health had improved, with many in that group saying that caring for someone else had prompted them to take better care of themselves.

More than half of caregivers—55 percent—said their caregiving duties have left them emotionally or physically exhausted, and 88 percent said they wanted more information to help them with their responsibilities. In response to those findings, De La Torre said, the Transamerica Institute has produced a 28-page guide for caregivers, available free on its website at transamericainstitute.org.

Whatever the consequences of providing care for someone else, De La Torre said, the survey found that most caregivers entered into that role with little thought to their own needs. "Sixty-nine percent say they paid little or no consideration to their own financial situation before they decided to become a caregiver," he reported. "Something happens suddenly—an accident or a medical condition comes on—and they step up and they just keep doing it over time."

Among the most common caregiving duties performed are household chores (cited by 89 percent of the survey respondents), social communication (72 percent), health-related duties (69 percent), personal care (62 percent), medical-related activities (49 percent) and paying bills and tending to other financial issues (43 percent). A little more than a third of the surveyed caregivers reported spending 100 hours or more per month on caregiving. SVIA

Living with Tax Reform: Employee Benefits and Executive Compensation

By Randy Myers

By now the outlines of the Tax Reform and Jobs Cuts Act of 2017 are well known. The Act dramatically lowered the corporate income tax rate to a flat 21 percent from a marginal top rate of 35 percent, and temporarily lowered tax rates for individuals. It also converted the U.S. from a worldwide to a territorial tax system, meaning that companies operating in the U.S. are no longer taxed by the U.S. on profits earned outside the country.

What's been less appreciated outside tax circles, says Rosina Barker, partner with the law firm of Morgan, Lewis & Bockius LLC, is how many possible tax law changes were not included in last year's tax bill—including several important areas related to employee compensation and benefits—and how much work remains to be done before those that were included can be fully implemented.

The new tax law, Barker said at the 2018 SVIA Spring Seminar, "needs a lot of fixes, both by regulators and by Congress," to address technical issues that were overlooked in the rush to pass it. She warned that some of those fixes are unlikely to come soon, due both to the volume of work they will entail and to manpower shortcomings at the Internal Revenue Service.

"The IRS is a big service full of highly capable attorneys," Barker said. "(But) its budget has been cut significantly over the last few years. The man- and woman-power ability to deliver regulations has been severely curtailed. So, we're all going to limp along for a while."

While Congress isn't similarly shorthanded, Barker said she expects that it is unlikely to take action soon, either, in many areas of the tax code where

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Living with Tax Reform: Employee Benefits and Executive Compensation

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it still needs to weigh in. "For example, the surtax on so-called Cadillac health plans has been delayed since its initial effective date. Every year it's delayed or pushed out another year or two. (It) is now slated, under the latest budget act, to come into effect in 2022 … (but) instead of dealing with it, I think Congress will just let that limp along for a while."

One big change to the tax code that was deleted from the new tax law related to the proposed "Rothification" of 401(k) retirement savings plans, which would have eliminated tax deductions for contributions to those plans in exchange for allowing tax-free withdrawals. Barker said it was generally opposed by Democrats, and some Republicans, who worried that it would create a disincentive for American workers to save for retirement. Because it would accelerate tax revenues in the near-term, though, Barker said the idea may be revisited at a later date.

Congress also chose to remove from the final bill language that would have eliminated the deferral of taxes on vested nonqualified deferred compensation—a change that most observers believe would have killed nonqualified deferred compensation arrangements.

One change that was implemented in the compensation area was a modification of Section 162(m) of the federal tax code, which prevents publicly traded companies from taking a tax deduction for compensation above $1 million to a "covered employee." In the past, that term referred to the CEO plus the next three most highly compensated executives, excluding the CFO. However, companies could continue to claim a deduction if the compensation took the form of a performance-based bonus or commission. Now, the deduction is eliminated even in those cases, and the definition of a "covered employee" has been expanded to include anyone who has ever been the CEO or CFO, or one of the next three most highly compensated officers, after 2016. The "covered employee" designation now lasts for life, too, which Barker said could require some clarification from the IRS in some instances.

"Once an individual is the CEO of a publicly traded company, the compensation delivered by the company (to that person) is always subject to the $1 million deduction cap—when he retires, when she retires, is no longer CEO, maybe chairman of the board, maybe retired, maybe dead and amounts are paid to his or her surviving spouse or children," she explained. "This, of course, creates a technical nightmare as companies are bought and sold, companies go public, and companies go private. Remember, private companies are not subject to the $1 million cap on compensation. (But), we don't expect any regulations on this any time soon, again, because of the difficulties of the issue and the many, many demands on the attention of the IRS."

Elsewhere, the new tax law prohibits employees who had any portion of their compensation clawed back by their employer—perhaps due to an income restatement or a violation of company policies—from claiming a deduction to recover the taxes paid on that compensation.

Looking ahead, Barker said President Trump's Executive Order 13789 could have a big impact on the regulatory front. As explained in the Federal Register, the order directs the Secretary of the Treasury "to identify significant tax regulations issued on or after January 1, 2016, that impose an undue financial burden on U.S. taxpayers, add undue complexity to the federal tax laws, or exceed the statutory authority of the Internal Revenue Service." Undoing a regulation requires proceeding through a regulatory process, Barker said, but "that machinery has started."

Finally, Barker said a memorandum issued by the associate attorney general of the U.S. to the heads of civil litigation on January 25, 2018, also has the potential to be highly impactful. "I know it didn't make any headlines, but it imposes new principles for Justice Department litigators defending other agency positions in litigation," Barker said. "In the regulatory space in which I operate—the tax space and the ERISA space—there are lots and lots of rules (where) everybody acts as if they are governing law, but (they) have never been committed to regulation. They're in notices, they're sometimes in private letter rulings,

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Living with Tax Reform: Employee Benefits and Executive Compensation

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sometimes in websites. This executive order tells the Justice Department, 'You cannot defend in court any government position which is not a final regulation, or, if it's sub-regulatory guidance, does not explain a regulation.' This is a big deal. I'm in the middle of a bunch of audits, like tax and ERISA audits for clients … (and) I'm kind of in limbo now because a lot of these regulatory activities have just gone away. From the point of view of the regulated community, this is powerful stuff, it's under the radar stuff, and it's being replicated in every area of the federal government."

Barker concluded by saying she expects more softening of the existing regulatory structure, and that regulations to be issued under the new tax reform act will be forthcoming from the Internal Revenue Service and the Treasury Department. "But it will be slow," she said. "And in the meantime, there'll be a certain amount of economic turmoil in the regulated spaces those regulations will touch when they're finally implemented." SVIA

How The Walt Disney Company Views Leadership

By Randy Myers

There are many stories about how Walt Disney created one of the world's iconic entertainment brands. One that veteran Disney employee Steven Tinn likes to tell involves Disney's first test ride on the Jungle Cruise ride that opened at Walt Disney World in Orlando, Florida, in 1971.

After stepping off the ride, in which guests ride through a "jungle" on small boats, a senior manager asked Disney how he liked it. Not very much, it turned out. The ride was supposed to take seven minutes, but Disney had timed it at three-and-a-half. He complained that he felt like he'd seen the beginning and end of a movie but had been rushed through the middle—that he hadn't been told the whole story. And that wasn't the experience Disney was looking to offer his guests.

After allowing Disney to explain which story elements needed to be illuminated in the ride, the senior manager spent weeks training the cast to deliver the full experience Disney wanted. When Disney repeated his test ride several weeks later, he rode not on one of its boats, or two, but on all seven—and liked what he saw. He left with two thumbs up for the employee who'd engineered the transformation.

That story, Tinn says, illustrates Disney's commitment to quality and consistency—and to the experience of the customer.

Tinn is a senior business facilitator with the Disney Institute, an arm of The Walt Disney Company that delivers leadership training to other companies, organizations and individuals interested in Disney's approach to leadership. Repeating the Jungle Cruise story during a presentation at the 2018 SVIA Spring Seminar in Orlando, Tinn explained that The Walt Disney Company believes its business results are driven by a strategic focus on business functions and opportunities that other companies too often overlook. Put less formally, "We have learned to be intentional where others may be unintentional," Tinn said. By way of illustration, he cited some of the myriad details that went into the development of the Cars Land area of Disney California Adventure in Anaheim, right down to the hours of training given to each "cast member" so that they know how to think, and talk, like someone who lives in a town whose inhabitants are cars.

A second fundamental tenet of Disney's approach to management, Tinn said, holds that "leaders establish, operationalize and sustain the values and vision by which their organizations thrive." The point, Tinn said, is that contrary to what the dictionary says, leadership isn't a noun, it's a verb. Those who hold themselves out as leaders, he said, have to take action; they have to "operationalize and sustain" their company's vision and values. And they have to instill in every employee a common purpose.

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How The Walt Disney Company Views Leadership

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Importantly, Tinn added, leadership isn't reserved for those who hold leadership roles.

"Disney believes that every single great thing that has ever happened at this company is based on fantastic leaders," Tinn said. "But we don't believe that they always came from people who were leading people. We believe that you have a sphere of influence in the work that you do, whether you're scooping popcorn, whether you're a custodial host, whether you're leading those teams, whether you're an individual contributor. We ask our leaders all the time, 'Are you engaging your teams in this way? Are you helping them understand that they are the subject matter expert, they have a lot that they can bring, that they are the ones that can really, in their own sphere of influence, do something bigger and greater?'"

Over time, Tinn said, the vision of Disney's top leaders has varied as the company has evolved. Walt Disney started by wanting to make animated films, then to improve them by adding color and sound, and then to create a full-length animated feature. Later, he wanted to bring those movies and the stories they told to life in a way that theater owners couldn't or wouldn't, which led him to develop his eponymous theme parks.

A few CEOs later, Michael Eisner focused on expanding the company to include more resort hotels and theme parks, as well as cruise ships and international destinations. Today, Disney Chairman and CEO Bob Iger continues to build on that vision, Tinn said, with the added goal of making Disney the most admired company in the world. But both Eisner and Iger, he said, have sought to stay true to Walt Disney's values, which put people and their happiness—customers and employees alike—first.

To be sure, Tinn concluded, leadership isn't easy. But communicating a company's vision and values in ways that resonate with the intended audience can help. "The more a vision can be expressed in a vivid, imaginative way, the more it will motivate people to action in the present," Tinn said. "Make sure you choose your words carefully, so that they make an impact." SVIA

The Global Economic Expansion: What's Next?

By Randy Myers

Is the U.S. economy peaking?

The current economic expansion is already the third longest on record—about three times longer than the average—and Dan Roberts, chief investment officer for investment management firm MacKay Shields, says there are several signs it's nearing a top. Among the most significant: The Federal Reserve is raising short-term interest rates, which it's done shortly before every recession since World War II, and the yield curve is flattening—another phenomenon that's preceded every recession since WWII.

Roberts, who also serves as executive managing director and head of global fixed income for MacKay Shields, cautioned attendees at the 2018 SVIA Spring Seminar that the warning signals aren't fully synchronized yet, and a recession doesn't appear imminent. He noted that beyond flattening, the yield curve actually turns negative before most recessions, and then starts to steepen again right before the recession starts. But, he cautioned, if the Fed raises short-term rates another 75 basis points between now and the end of the year, as many Fed watchers are expecting, the curve could become inverted by the year's close. After all, the spread between 2-year and 10-year Treasuries was only about 50 basis points at the end of April.

Meanwhile, spreads between Treasuries and high-yield bonds also tend to turn higher two to six quarters before a recession, Roberts said. Right now, those spreads are low by historical standards—in the range of 320 to 350 basis points—and haven't started to climb.

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The Global Economic Expansion: What's Next?

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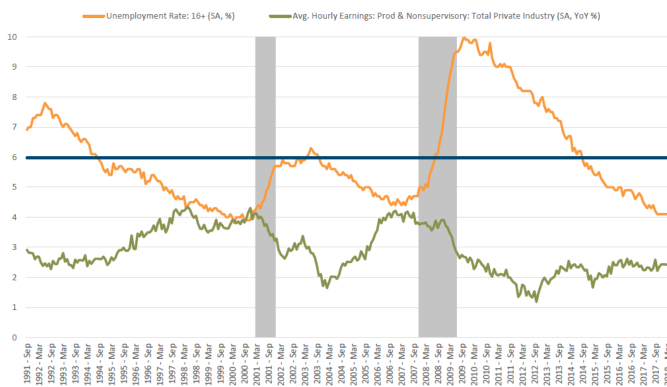
Unemployment rates also tend to turn up about two to six quarters ahead of a recession, Roberts said, following a sustained decline. In the wake of the Great Recession of 2008-2009, the unemployment rate has been falling for nearly nine years, and by April had hit 3.9 percent. That represents its lowest level since December 2000.

September 31, 1991 — March 31, 2018



Source: Bureau of Labor Statistics / Haver Analytics

Every economic cycle is different, of course, and Roberts pinpointed a few characteristics unique to this one, starting with the Fed's balance sheet, which has ballooned from about $750 billion in 2008 to about $4.2 trillion today. That increase was attributable to the Fed's massive efforts to stimulate the economy by buying fixed-income securities to help keep interest rates down. All that buying did, in fact, keep downward pressure on interest rates for the past several years, but the bond market no longer has that headwind at its back now that the Fed has ended its bond-buying program.

Meanwhile, workers' wages in the U.S. haven't gone up as much as one might have expected during the long contraction of the unemployment rate, a phenomenon Roberts attributed in part to demographics. As high-earning baby boomers begin to retire, he said, they're being replaced by lower-earning younger workers.

While demographics—and technological disruptions—are skewing wage growth and inflation lower than in the past, Roberts said he does expect inflation to pick up, which could prompt the Fed to raise short-term interest rates even faster than people have been expecting.

In terms of how all these developments are impacting his firm's investment portfolios, Roberts said he and his colleagues have been trimming marginal risk as prices for risk assets continue to rise and economic risks continue to increase, and are focusing on high-conviction ideas. SVIA

Political Analyst Charlie Cook Sees Democrats' Chances of Claiming House on Upswing

By Randy Myers

When veteran political analyst Charlie Cook, editor and publisher of The Cook Political Report, spoke at the SVIA Fall Forum in October 2017, he pegged the odds of Democrats reclaiming control of the U.S. House of Representatives this fall at 40 percent.

Fast forward six months, to Cook's return appearance at the 2018 SVIA Spring Seminar in late April, and the Democrats' odds, at least in his view, had risen sharply. He was now putting the Democrats' chances at 60 percent to 65 percent, if not higher. He also was giving them a 40 percent chance of capturing control of the Senate, up from his estimate last October of 25 percent to 35 percent.

Why the revised outlook? While many factors played into his forecast, Cook said the key was President Trump's continued low popularity. He noted that in the past four midterm elections when the president's approval rating was 46 percent or lower, the controlling party suffered an average loss of seven seats in the Senate and 40 in the House.

This year, the Democrats only need a net gain of 24 seats to capture the House. And as of late April, President Trump's approval rating stood at 38 percent in the weekly Gallup poll, while his disapproval rating stood at 58 percent.

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Save the date: SVIA's Fall Forum, October 8-10, 2018 in Washington, DC

Political Analyst Charlie Cook Sees Democrats' Chances of Claiming House on Upswing

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Cook noted that high disapproval ratings for a sitting president tend to result in a strong turnout among voters of the opposing party, and indeed, he said, intensity was running high among Democrats this spring. Intensity levels were lower among Republicans, he said, perhaps because they had been lulled by the idea that they control the White House and both chambers of Congress.

Still, Cook cautioned that circumstances could change by November. Republicans could become energized, he said, if a Supreme Court vacancy were to open up, or if they thought Democrats were pushing the idea that President Trump should be impeached in connection with the special counsel's probe of Russian interference in the 2016 presidential election. Democrats theoretically could become more energized by a Supreme Court vacancy, too, or by a Trump scandal, he conceded, but with the Democratic base already about as pumped up as it could get, there didn't seem to be much room for the intensity level to go up among Democratic voters.

Other ominous signs for Republicans, Cook said, were the results of polls asking voters whether they would vote for a Republican or Democratic Congressional candidate right now, with no actual candidates named. The consensus view is that Democrats need to be winning such polls by a margin of six to eight points if they're actually going to win a majority of the seats in the House in November. In the last such polls by RealClearPolitics and NBC/The Wall Street Journal, Cook said, Democrats led by seven points. A FiveThirtyEight poll put the lead at eight points, while a Fox News poll had it at five. A poll by McLaughlin Associates, the organization that President Trump uses, had it at four points.

Capturing the Senate in November will be a tougher challenge for Democrats than winning the House, Cook said. Of the 26 Senate open seats, 10 are in states that President Trump won decisively in 2016. Conversely, only one open Republican seat is in a state won by Hillary Clinton. SVIA

UPCOMING EVENTS IN 2019

BOARD OF DIRECTORS MEETING

JANUARY 7-8, 2019 (MONDAY – TUESDAY)
THE FAIRMONT HOTEL
2401 M STREET, NW
WASHINGTON, DC
RATE $289

FOURTEENTH SPRING SEMINAR

APRIL 7-9, 2019 (SUNDAY – TUESDAY)
RITZ CARLTON DOVE MOUNTAIN
1500 NORTH SECRET SPRINGS DRIVE
MARANA, AZ
RATE $329

BOARD OF DIRECTORS MEETING

JUNE 3-4, 2019 (MONDAY – TUESDAY)
THE FAIRMONT HOTEL
2401 M STREET, NW
WASHINGTON, DC
RATE $359

ANNUAL FALL FORUM

OCTOBER 14-16, 2019 (MONDAY – WEDNESDAY)
THE FAIRMONT HOTEL
2401 M STREET, NW
WASHINGTON, DC
RATE $324