AN Unobstructed View

Summer 2018

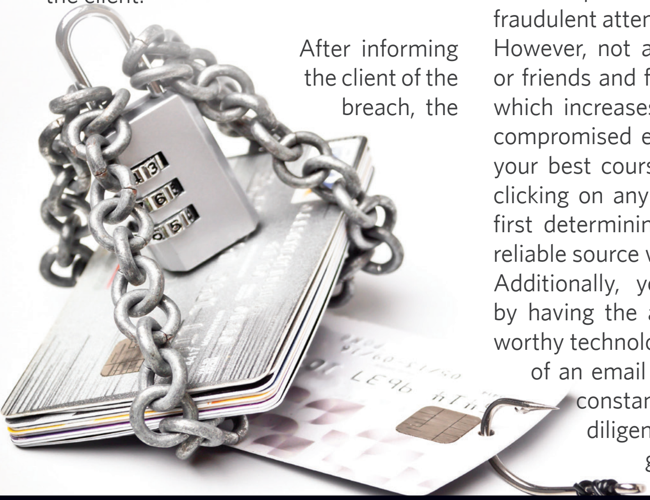
QUARTERLY INVESTMENT INSIGHT FROM HIGHTOWER LAS VEGAS

The Anatomy of a Cyber Attack

According to the FBI's Internet Crime Report, victims lost a total of $1.4 billion in 2017 from cyber-crime. While losses came in many different forms, such as investment scams, identity theft, and credit card fraud, the category that saw the largest dollar loss in 2017 was compromised email. Over $676 billion was lost due to compromised email accounts. We believe it, as we've seen several attempted attacks so far this year.

So how do these attacks work?

Let's take a look at a real life example from just last month. We received an email from a client requesting a favor. The email looked legitimate; the email address was correct, the grammar was correct, and the request for help seemed plausible. Unfortunately, the client's email was compromised. As we replied back to the email to see what help was needed, the scammer said they were travelling and needed access to a gift card. They requested we acquire the gift card and send a picture of the back of the card so they could use it for an emergency purchase. At this point, we knew something was off and immediately called the client.



After informing the client of the breach, the compromised email was accessed and the password was changed. All good, right? Not so fast. When scammers compromise an email, they typically sift through old email exchanges to determine where funds are located and which people are involved. This allows them to make more credible requests. They also add filters to your email account to alert them of potential financial transactions.

Email filters look for words such as "account" or "transfer" in new emails and automatically forward the email to the scammer. The scammer can then intersect the transaction and redirect where the funds are sent, all while appearing to be the client. Simply changing your password is not enough.

In this particular instance, the client had an annual Geek Squad service contract. After our recommendation to inspect the filters, the client contacted the Geek Squad and sure enough, they found multiple filters on the email account.

While this particular attack was not well executed, we've seen others that are truly believable. Luckily, our verification procedures have stopped any fraudulent attempts on our clients' funds. However, not all your service providers or friends and family may be as diligent, which increases the risk of loss from a compromised email. Without question, your best course of defense is to avoid clicking on any link in an email without first determining if the email is from a reliable source with a legitimate purpose. Additionally, you may be well-served by having the ability to access a trustworthy technology help desk in the event of an email breach. Cyber-crime is a constant threat to everyone and diligence is the name of the game.

TWEETS, TARIFFS, AND TRADE WARS

One of the first executive actions after President Trump's "America First" inauguration speech was to remove the United States from the Trans-Pacific Partnership (TPP); an agreement that would have created the world's largest trade pact. A period of calm (at least on the trade front) ensued while the White House focused on other initiatives. However, once the tax plan was passed, the President's attention and tweets quickly turned to trade.

The crux of the President's ire is the significant U.S. trade deficit. A deficit occurs when a country imports more than it exports. Trade is accounted for in something called the current account, which is in the red by nearly $450 billion over the past year. China is the largest contributor to that deficit, so it's no wonder that China has been the President's focus on trade. Sure, there have been tweets and tariffs assessed on some of our other trading partners, but the bulk of the effort has been focused on China.

When viewed in isolation, policy aimed at attacking the trade deficit makes sense...why should another country benefit so much at our expense? The problem is that trade is far more complex. There are winners and losers in any scenario. Workers who lose jobs to overseas manufacturing facilities are a clear loser in free-trade. Without re-education programs focused on developing new skills for displaced workers, free-trade is devastating. On the flip side, cheap foreign goods imported to the U.S. mean lower inflation and more discretionary cash flow for U.S. citizens.

We can endlessly debate the potential benefits and drawbacks of free trade, but perhaps the most significant issue that doesn't get much play is the impact on the U.S. dollar. The dollar has long been the world's reserve currency, meaning that companies and countries throughout the world transact in U.S. dollars and prefer to hold reserves in U.S. dollars. The dollar's reserve currency status gives the U.S. government tremendous power. It allows us to weaponize the dollar and force countries to play by our rules. It also allows us to carry more debt than other countries because the demand for our currency is more stable. That being said, reserve currency status comes at a price.

In order to hold the special place as the world's reserve currency, the U.S. is obligated to supply the world with dollars. Typically, this objective is achieved by running a trade deficit and borrowing funds from other countries. When viewed in this light, our current trade deficit is necessary to maintain the dollar's reserve status. If the President is successful in closing the trade gap over time, the dollar's reserve status may be at risk. Ironically, the country with the most to benefit from a decline in the dollar's dominance is China.

China continues to aggressively pursue policy that will increase its standing not only in Asia, but throughout the world via increased trade. China is investing an enormous amount of capital across Asia to economically integrate the region. The Chinese are also pushing trading partners to settle trade in the Chinese Yuan rather than the dollar. China's policy package on its own will likely lessen the dollar's dominance over time. However, President Trump's trade agenda could end up supercharging China's rise to power.

The short-term movements in the dollar, as well as the pain inflicted on Chinese stocks suggests the U.S. is winning the trade war. However, China is playing the long game and one should not discount the opportunity this trade war could create for the world's second largest economy.

The Traffic Light

How do we manage the funds entrusted to us by our clients? We utilize a top-down approach that starts with our view of where the world is headed. Each quarter, we complete an exhaustive study of many different economic indicators and trends. The Traffic Light is a quarterly summary of these macro-economic issues, and our opinion of them, that form the basis of our research and portfolio management process. While not everything in life can be easily categorized, in this piece we attempt to look for the hopeful (green light) signs in the world economy as well as the more worrisome (red light) issues and everything in between (yellow light).

GREEN	YELLOW	RED
Tax Stimulus	Higher Inflation & Interest Rates	Tariffs & Trade Restrictions
Robust Earnings Growth	U.S. Dollar Strength	Geopolitical Tensions
Strong Labor Market	Slowing Global Growth	Elevated Valuation Levels
Elevated Confidence	Increased Volatility	
Healthy Housing Market	Low Savings Rate	

When we look at the economic backdrop, there are still more reasons to be optimistic than pessimistic. Corporate earnings are booming thanks to tax cuts and elevated consumer confidence. With the unemployment rate under 4%, it's tough to be too pessimistic. That being said, there are always risks that need to be considered.

> **"...WE BELIEVE INVESTORS WILL BE REWARDED OVER THE NEXT FIVE YEARS BY BEING OVERWEIGHT INTERNATIONAL MARKETS."**

Despite rapid earnings growth, U.S. stocks are still well above average valuation levels and are exposed to a valuation correction. International markets appear more attractively valued, especially emerging markets, but are susceptible to a stronger dollar. President Trump's trade tweet tirade (how's that for a tongue-twister) has caused a rush to the dollar and hurt U.S.-based investors' international returns. While the short-term pain is far from enjoyable, we believe investors will be rewarded over the next five years by being overweight international markets. Using Trump-induced international weakness to add to positions makes a lot of sense in our view.

Precious metals have also felt the pain of the trade war, as they tend to have negative correlation to the U.S. dollar. However, precious metals still offer a safe haven in times of global stress and are a decent hedge against surprise inflation. Given the geopolitical tensions across the globe, we believe it makes sense to hold a portion of assets in gold and silver.

Bonds have had a sub-optimal year as interest rates have risen. However, the pain investors' have felt this year is directly related to their maturity exposure. For example, TLT, the long-term treasury exchange-traded fund (ETF) is down over 5% at the time of this publication, while SHY, the short-term treasury ETF, is flat for the year. We have intentionally kept our bond maturities relatively short in order to limit our interest rate risk. As rates rise, we believe we'll have an opportunity to extend maturities, which should increase returns over time.

The next few months will be interesting and investors should brace for more volatility. The run-up to the midterm elections will likely bring plenty of market moving headlines and we shouldn't expect President Trump to stop to tweeting.

WHAT ARE THEY TALKING ABOUT?

YIELD CURVE

The Federal Reserve has hiked interest rates five times since the beginning of 2017. The Fed is largely expected to raise rates two additional times before year end, pushing the overnight lending rate up to 2.5%. Long term rates have also risen, but at a much slower pace. The result is a flattening yield curve.

The yield curve is a line that plots interest rates at different points in time; typically from one month to 30 years. The yield curve should always be upward sloping unless something is wrong. Intuitively, this makes sense. You ought to be compensated more for lending money long term. When the yield curve flattens, the spread between long and short rates declines. This is indicative of future headwinds for the economy. An inverted yield curve is one in which short rates are higher than long rates. Typically, an inverted yield curve is a warning sign of a recession.

As a result of the Fed raising short-term rates at a faster pace than the rise in long rates, the yield curve is flattening. If the curve continues to flatten and eventually inverts, it could signal trouble lies ahead.

In the Media

Mike
Quoted in the Review Journal

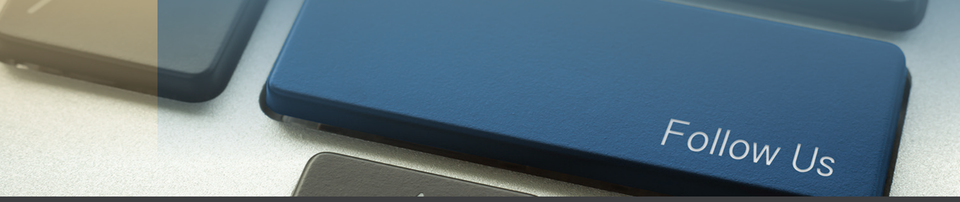
Adam
Featured on KTNV Channel 13 News
On the MoneyLife Show

Check out our other publications for insight into our thoughts and process:

ruminATions:
http://www.hightoweradvisors.com/who-we-are/hightower-advisors/las-vegas/blog/

Thinking & Thriving:
http://www.hightoweradvisors.com/who-we-are/hightower-advisors/las-vegas/thinking-and-thriving/

The Stat Pack:
http://www.thestatpack.com



What's New?

As summer winds down we will certainly celebrate cooler temperatures. We'll also celebrate five years in our new office space. It's hard to believe we've been here that long, but as the saying goes, "time flies when you're having fun!"

Adam decided early this year that he needed to catch up to Mike and Hugh in the professional designation count. He spent the first half of 2018 studying for the Certified Financial Planner (CFP) exam and passed in July. Adam joins Mike as both a CFP® professional and Chartered Financial Analyst (CFA) Charterholder.