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Financial Perspectives

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Understanding The New Department of Labor Fiduciary Rule

David F. Moreno
Associate Vice President – Investments
6300 S. Syracuse Way
Suite 210
Greenwood Village, CO 80111
Telephone 303-770-6621
Toll Free 855-620-6621

Amid all of the political noise over the past year or so, you may not have noticed that a new regulation related to retirement savings accounts was issued. In April 2016, the U.S. Department of Labor (DOL) published a rule redefining who becomes a "fiduciary" when providing investment advice to a retirement investor. A fiduciary is a person or entity that has the duty to act in the best interest of the person they are hired to serve. The regulation is commonly referred to as the "fiduciary rule" and it applies to every investment firm and financial advisor providing services to retirement accounts.

Some provisions of the rule just recently took effect on June 9. The rule itself is very complex, but the overall intent is to ensure that financial advisors are acting in your best interest. Here at Benjamin F. Edwards & Co., we have always believed that you – your needs, your goals, and your objectives – should come first.

Some, but not all, services provided by a financial advisor are considered fiduciary services under the DOL fiduciary rule. Financial advisors may play different roles, depending on the type of account relationship you establish with them. As a result of the DOL fiduciary rule, some financial institutions have chosen to restrict the sale of certain investment products, such as limiting mutual fund availability to only certain fund families or share classes, or allowing them to be purchased only through fee-based accounts. Additionally, some financial institutions are requiring their brokerage account clients to move to fee-based accounts, while others are pushing clients to use so-called "robo advice" accounts where investment advice is provided by a computer algorithm.

We continue to offer both commission-based brokerage services and fee-based advisory services, so you have the right to choose how you want to work with us and how you will pay for the services you receive. If you would like additional information about the DOL fiduciary rule or the fiduciary services we can provide to retirement account investors, please contact your Financial Advisor and ask for our report, *Fiduciary Services and Your Retirement Accounts*.

The Federal Reserve's Outlook for Interest Rate Increases is Likely to be a Significant Uncertainty for the Markets

Due to the lengthy financial crisis, the Federal Reserve Open Market Committee (FOMC) stood firm in holding interest rates low for seven years. As one component of an accommodative monetary policy, the Fed's target funds rate held at zero to 0.25%. In a widely-anticipated move, the Fed began its very slow and calculated rate hike process on December 16, 2015, exactly seven years to the day from when the Fed first lowered interest rates to near zero.

At that time, they raised rates by a modest 0.25% to a target range of 0.25% to 0.50%. In the Fed's admission that the economic turnaround continued to be on weak footings, it raised rates just three more times since then, on December 14, 2016, March 15, 2017 and most recently on June 14, 2017, all by the same modest 0.25%. Currently, the federal funds target rate is in a range from 1.0% to 1.25%. The next FOMC interest rate decision is July 26. There are then three more critical dates remaining in 2017: September 20, November 1 and December 13.

Two of the variables the Fed is closely monitoring for rate increases are labor market conditions and a return to 2.0% inflation. The May 2017 employment numbers produced mixed results. After ADP reported a 253,000 gain in private sector payrolls – the largest monthly increase since 2014 and well above the expected rise of 180,000 – the Government's official numbers produced a more conservative result. Nonfarm payrolls rose by just 130,000 during May, well below the 182,000 gain that was forecasted. The overall U.S. Unemployment Rate, which is computed separately, fell to 4.3% from 4.4% in April. Many economists believe these numbers give credence to additional rate hikes this year as the Fed pegs the long-term average unemployment rate at 4.7%.

A lower unemployment rate can have an impact on rising inflation. Consumers' purchasing power continued to improve during May as average hourly earnings were up 2.5% year-over-year. The second revision to first quarter 2017 Gross Domestic Product (GDP) was revised upward to a 1.2% annual rate from the prior 0.7% estimate, well above the consensus rate of 0.9%. Personal consumption was indicated higher, consistent with the May jobs report. The GDP Price Index was revised to a 2.2% annual rate. Nominal GDP growth – real GDP plus inflation – was revised higher to a 3.4% annual rate. These estimated inflation rates may also give credence to additional Fed interest rate rises in the second half of 2017 as monetary policy becomes less accommodative. At its most recent meeting, the Fed announced intentions to begin winding down its $4.5 trillion balance sheet.

Fixed income and equity investors need to be aware of how their investments could be impacted by a continued gradual increase in interest rates and how to look for opportunities in an increasing interest rate environment. Bond prices and interest rates are inversely related, so when interest rates rise, bond values decline and when interest rates fall, bond prices increase. This is known as **Interest Rate Risk**, and this can impact a fixed income investor who decides not to hold a bond to maturity or decides to make changes to their portfolios. With an increase in interest rates, newly-issued bonds carry a higher coupon or stated interest rate. Bonds with lower coupons therefore adjust downward in price due to the inverse relationship and to compensate for the increased attractiveness of higher coupons for those seeking income from bonds and for portfolio diversification. **Duration Risk** can impact a bond's value should interest rates continue to rise this year. This is the sensitivity of a bond's price to a 1% change in interest rates. In general terms, the longer the maturity term for the bond (with the same coupon), the higher the duration, and the more sensitive a bond's price is to an increase in interest rates. So, a 30-year bond will fall in price much more than a 5-year bond. However, bonds with the same maturity can have different durations depending on the coupon. Lower coupon bonds of the same maturity have a higher duration and are more sensitive to a change in interest rates and could be impacted more by possible higher interest rates this year. For an in-depth discussion of bond prices and duration, please ask your Financial Advisor for a copy of our recent Fixed Income report *Understanding Interest Rate Risk and Duration*. **Call Protection** is also an important consideration at the current time. Investment grade issuers may decide to refinance debt at lower rates if there is a perception that slow interest rate increases may continue. It is important to evaluate your call protection and the impact bond calls would have on your current income flow. **Credit Risk** is another consideration when examining your bonds in advance of potentially higher interest rates. Bonds with lower credit ratings can yield more to compensate for higher *default risk* or the inability to pay off the bonds at maturity. Bonds with low credit ratings can have a shorter term to maturity and lower durations. Coupled with possible improving economic conditions, such bonds could be less vulnerable to a rising interest rate environment.

If we look back to the reaction of the Dow Jones Industrial Average (DJIA) following the first three prior interest rate increases, a pullback of 620.54 points, or 3.51%, took place in the two days immediately following the initial rate hike in December 2015. The index regained most of the drop by December 29. For the December 14, 2016 increase, the DJIA pulled back just 8.83 points and closed higher by December 19. Earlier this year, the DJIA fell about 288.80 points, or about 1.38% in the five days following the interest rate hike. It took until April 25 before the DJIA closed above the March 15 high. The DJIA price on the date of the interest rate hike was near the 21,000 closing level first achieved on March 1, 2017. If history is a guide, the DJIA could be more vulnerable to pullback if trading near all-time highs, even with a relatively small 0.25% hike in interest rates. Mixed economic news is likely to exacerbate the market uncertainties. Of perhaps even greater importance for the Fed decisions for the remainder of the year is the lack of progress the Trump Administration has been able to make to date on a replacement for the Affordable Care Act, tax reform and economic stimulus through infrastructure spending. This could increase market sensitivity to interest rate hikes. If movement on these campaign hot buttons can be made, additional interest rate increases this year could be more easily accepted by the markets.

In a low interest rate environment, many investors are willing to take on the added risk in stock ownership compared with low yields from bonds. High quality dividend paying stocks help to compensate for this risk through their higher income streams compared with lower-yielding bonds. With favorable earnings outlooks, such equity investments can become more attractive for the growth and income investor. Sectors such as utilities, consumer durables, real estate and telecoms could continue to produce positive returns if rate hikes are gradual and the risk/return remains reasonable to investors. Larger or more frequent rate hikes could hinder this perceived advantage. More economically-sensitive sectors could do better as they are not considered to be fixed income surrogates, including consumer discretionary, industrials, technology and materials. Financials could be a beneficiary if the spread – what the financials pay to borrow and what they charge to lend – remains favorable. In order for stocks to remain attractive relative to bonds as interest rates rise, earnings growth must continue to keep pace. Zacks Investment Research recently reported that for the First Quarter of 2017, 72.6% of the companies in the S&P 500 beat earnings estimates and 65.2% exceeded revenue projections. Standard & Poor's Capital IQ is currently estimating a 6.3% year-over-year increase in operating earnings for the 500 Industrials. The full-year earnings gain is pegged at about 10.0% with about a 5.8% revenue increase.

Teaching Kids the Value of Saving

Everyone knows the difficulty of convincing children to save; even adults recognize it's more fun to spend! But instilling valuable savings habits in kids of all ages is vital in nurturing their financial futures.

To help the children or grandchildren in your life understand the value of saving, starting young is a must, as even children under the age of six conceptually understand the power of a dollar. To start them off, buy a piggy bank and have them periodically add coins to it. Occasionally, you can count together how much they have to help them realize that a little at a time adds up quickly. Additionally, take a minute the next time you're shopping to explain to them the cost of some daily household items or groceries – particularly ones they can relate to.

Kids between ages seven and 12 tend to start asking for more and more things. You may remind them, "money doesn't grow on trees" but that doesn't stop them from bombarding you with want after want. Children can receive the rewards of monetary responsibility through an allowance. Whether it's weekly or monthly, help formulate a plan and discuss their goals; maybe it's buying a new game or some other special treat. You could also make it simple and start a jar system to help them keep track – find two jars and label them "Save" and "Spend." Then, together, agree on how much money should be divided into each category.

Teens think they know it all. What do their parents know? Nothing! While we know that's not really the case, it's good to remind them they still have much to learn when it comes to finances. You can open a credit or debit card for them – or even give them a prepaid debit card – and collaborate to create a detailed budget. Explain where the money is coming from, that credit cards are not "free" money. It's much easier to spend when you can't see cash fleeing your wallet. If they have a job, have them set up automatic deposit so part of their paycheck goes directly into savings for things they may want to buy in the future, like a cell phone or a car, for example. Studies show only about 20% of adolescents between 12 and 18 with earnings are expected to contribute to household expenses, so give them a chance to help. It is also very likely that college students do not know much more about finances than adolescents in high school. Use this as a motivation to open a discussion about their future. Explain how you're saving to pay for college and what expectations you may have about their own contribution.

To help the kids in your life prepare for their futures, it's never too early to start saving.

Market Recap

Market Summary (As of May 31, 2017)

	Year-to-Date	Trailing 12-Months	3-Year Annualized	5-Year Annualized
DJIA	6.31%	18.11%	7.91%	11.13%
Nasdaq	15.15%	25.27%	13.47%	17.00%
Russell 2000	0.96%	18.65%	6.49%	12.46%
S&P 500	7.73%	15.01%	7.83%	12.98%

Sources: Benjamin F. Edwards & Co. and Bloomberg

	U.S. Treasury Yields
Two-year	1.29%
Five-Year	1.76%
10-year	2.21%
30-Year	2.86%

Source: Bloomberg (as of June 1, 2017)

U.S. Stocks

Performance of S&P 500: Index Price Returns for Periods Ended May 31, 2017

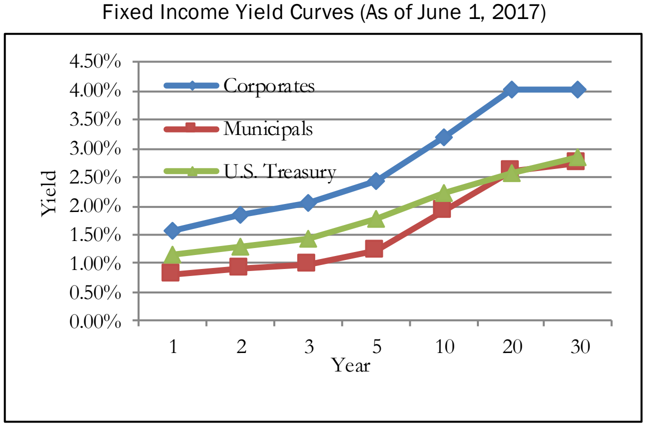
Sector	Weightings	Year-To-Date	Trailing 12-Months	Five-Year Annualized
Info. Technology	23.20%	19.67%	31.80%	16.59%
Health Care	13.90%	10.12%	6.71%	16.02%
Financials	13.70%	-0.33%	20.64%	15.41%
Cons Discretionary	12.50%	11.72%	15.11%	16.33%
Industrials	10.20%	7.04%	19.07%	13.97%
Cons Staples	9.40%	9.36%	7.88%	10.86%
Energy	6.00%	-13.58%	-3.49%	0.11%
Utilities	3.30%	10.07%	9.48%	8.46%
Real Estate	2.90%	3.16%	0.54%	7.14%
Materials	2.80%	6.43%	13.01%	9.28%
Tele. Services	2.20%	-10.11%	-4.97%	2.60%

Ranked by highest to lowest index weightings; Weightings may not equal 100 due to rounding
Source: S&P®

- It appears the consumer has become more cautious since the start of the year and a turnaround in consumer sentiment will be one determinant of market performance as we move into the second half of 2017. The University of Michigan reported its Consumer Sentiment Index dropped during the first part of June and came in at 94.5, the lowest level since last November, and down from May's final reading of 97.1. A survey of consumers indicated the ongoing-strife within the Trump Administration may be eroding investor confidence as the current conditions and expectations components showed weakness. The Index was still up about 1.1% versus the same period last year.
- While Brexit talks may have appeared to be on the back burner for the past several months considering the devastating events that have taken place in Manchester and London as well as the elections in the United Kingdom, the Brexit discussion is still very much alive, and its overall impact on world economies is unknown. The European Union continues to operate "under the assumption that the U.K. still wants to leave the bloc completely as outlined by Prime Minister Theresa May before her election setback". The E.U. has also worked out "softer Brexit options" should the U.K. go down a different path. Some economists say it may be September before a path is determined. Both French President Emmanuel Macron and Germany's Finance Minister Wolfgang Schauble recently said the door to the E.U. remains open should the U.K. decide to abandon Brexit.

Fixed Income

Fixed Income Yield Curves (As of June 1, 2017)



Sources: Bloomberg, Bloomberg US Corporate (A) Fair Value Index, Thomson Reuters MMI

- The Federal Reserve Open Market Committee (FOMC) has recently completed their second interest rate increase of 2017. The interest rate of last resort for banking institutions, "the discount rate" is now set at a range of 1.00% - 1.25%. This increase of the discount rate is indicative of a stronger U.S. economy that is not in need of the tremendous accommodation or assistance that was necessary after the financial crisis. As a result, short term 1-3yr interest rates have risen, curiously, at the same time we have seen 10 and 30-year treasury bond interest rates reduce. The inability of congress and the administration to complete their two major initiatives of healthcare and tax reform have contributed to the tempered growth expectations in the economy. Thus, we see lower inflationary pressures.
- The municipal market has followed the treasury market, in terms of longer maturity yields reducing due to inactivity in the tax reform initiative. An additional driver for lower yields has been a supply and demand imbalance as new issuance in the municipal market is down approximately 20% from the same time in 2016. This reduction of supply has been a driver of lower municipal yields for the majority of the year, and will likely continue through the summer.

CONTRIBUTING AUTHORS Theresa Fry; Senior Vice President and Manager, IRAs and Retirement Planning | Ed O'Neal; Vice President and Manager, Retirement Plans | Kortney Christensen; Executive Vice President, Director of Sales & Marketing | Bruce Buerkle, CFA; Senior Vice President and Manager, Securities Research Support | Joel Wiesehan; Vice President and Manager, Fixed Income | Lydia Welty; Sales & Marketing Intern

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Diversification does not guarantee a profit or protect against loss.

Investing in securities entails certain risks, including the potential loss of all or a portion of the proceeds invested. Individuals should consider their specific financial needs, investment objectives and risk tolerance before making an investment.

Equity investments refer to buying stocks of U.S. companies as well as companies outside of the U.S. The market capitalization of U.S. companies is used to group large, medium (mid) and small companies. The investment return to the owner of stock (shareholder) is in the form of dividends and/or capital appreciation. Shareholders share in both the upside potential and the downside risk. Dividends are not guaranteed and are subject to change or elimination.

Mutual funds and ETFs are sold by prospectus. Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from your financial consultant and should be read carefully before investing.

There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations and the impact of varied ecomonic conditions.Distributions from REIT investments are taxed at the owner's tax bracket.

An investment in a 529 plan will fluctuate such that an investor's shares when redeemed may be worth more or less than the original investment. Investors should carefully consider a 529 plan's investment objectives, risks, charges and expenses before investing. This and other important information can be found in the 529 plan issuer's official statement, which should be read carefully before investing.

The return of principal for bond funds and funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Lower rated bonds are subject to greater fluctuations in value and risk of loss of income and principal than higher rated bonds.

Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline of the value in your investment.

An index is not managed and is unavailable for direct investment. The Dow Jones Industrial Average (DJIA) is an index that shows how 30 large, publicly owned companies based in the United States have traded during a standard trading session in the stock market. The Nasdaq Composite Index measures over 5,000 NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The Russell 2000 is a stock-market index measuring the performance of 2000 small-capitalization stocks. The S&P 500 Index covers 500 industrial, utility, transportation and financial companies in the U.S. markets. S&P®, Standard & Poor's® and S&P 500® are registered trademarks of the Standard & Poor's Financial Services LLC.