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Praetorian Guard

3775 Via Nona Marie, Suite 220 ▪ Carmel, California 93923 ▪ **P:** (831) 622-9600 ▪ **F:** (831) 622-9002 ▪ www.praetorianguard.biz

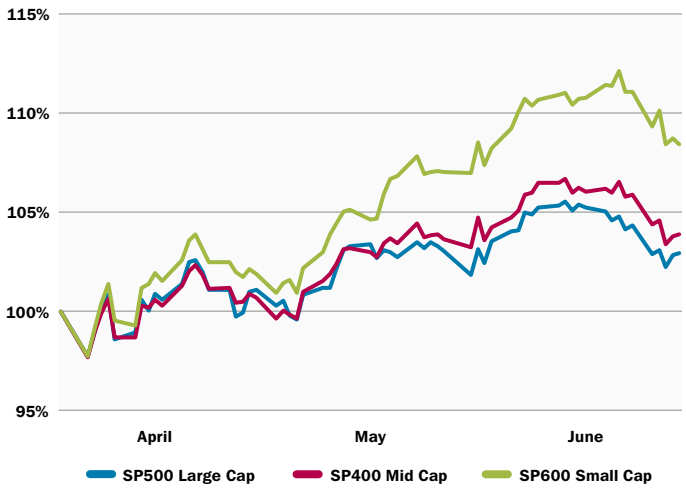
SECOND QUARTER 2018 MARKET REVIEW

By **Marc A. Wehmeyer**

U.S. equity markets rebounded during the 2nd quarter (with small caps leading the way and overcoming largely negative 1st quarter returns) finishing the first six months of 2018 in the green. U.S. small cap stocks (as measured by the S&P 600 Small Cap Index) rose 8.41% for the quarter (+8.66% YTD), significantly outpacing the 3.88% and 2.94% returns of mid and large cap U.S. stocks (+2.69% and +1.67% YTD respectively). The outperformance of small cap stocks can be explained in part by the ongoing concerns over the impact of a possible trade war between the United States and its trading partners, most notably China and the countries of the Eurozone. In general, small companies have a higher concentration of revenue from domestic sources than from exports and therefore are more insulated from the impact of trade tensions compared to large multinational firms.

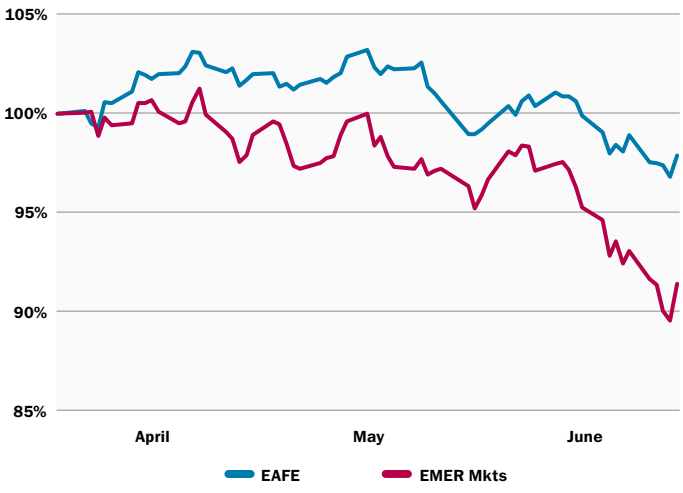
International equity markets suffered in the 2nd quarter worldwide with developed and emerging markets falling 2.15% and 8.62% respectively (-4.45% and -7.78% YTD). A combination of concerns about tariffs, weakening global growth and a strengthening U.S. dollar held back international performance. The Wall Street Journal Dollar Index, representing the performance of the dollar against a basket of international currencies, rose 5.11% in the 2nd quarter and 2.39% YTD. This time last year, international markets were buoyed by a declining U.S. dollar. The reverse is true this year, with the rising dollar exacerbating the decline in international stock returns when priced in U.S. dollars. *(continued on pg.3)*

US Equity Market Performance Q2 2018



Source: Yahoo! Finance

International Equity Market Performance Q2 2018



Source: Yahoo! Finance

BLOCKCHAIN IS HERE TO STAY, BUT SHOULD YOU INVEST IN CRYPTOCURRENCY?

By **Joseph P. Clark**

Blockchain technology is real and it has applications in everything from finance to healthcare to government. Not only can it be used to secure financial transactions, but it can protect health records and voting systems. There are certainly benefits to a decentralized and distributed public ledger of transactions. In this environment, every participant in the network can simultaneously view cryptographic transactions that are chained together by mathematical algorithms thus making it harder to control or manipulate.

The question is whether or not one should invest in the cryptocurrencies that blockchain makes possible. The answer depends entirely on whether or not a person believes that a particular cryptocurrency will become a long-term trusted store of value (in addition to being a store of value, a currency is a medium of exchange and unit of account). Let's take Bitcoin as our example. If it does become a long-term trusted store of value, Bitcoin could trade potentially for $1 million or more according to many "experts"—that is about 120 times its price as of May 21, 2018. If Bitcoin does not become a long-term trusted store of value, its likely price will be close to zero. So…it is extremely speculative. In addition, under current U.S. tax law, bitcoin users generate tax consequences with every transaction. From a tax perspective, the purchase of an item with bitcoin generates either a taxable gain or loss with respect to the bitcoin used. Should you be thinking about this speculative investment, be cautious as it comes with many risks:

1. Speculative investing in cryptocurrency is similar to investing in any other currency or commodity like gold, agricultural products, fine art, or oil. The currency is only worth whatever the market says it is worth. The issue is that you are hoping for price appreciation alone, betting that the price of the currency will go up compared with the U.S. dollar. This is unlike investments in stocks (or bonds or real estate) that also generate cash (paid out to the investor in dividends or reinvested into the business to grow its value). Bitcoin investors can only hope that a bitcoin rises in value faster than inflation. Proponents of cryptocurrency make the case that cryptocurrencies like bitcoin will indeed grow above inflation, claiming that it is a "deflationary currency." This appears to be the case so far, but there is not enough history to make that case definitively. This is unlike stocks, which have been around for centuries.

2. All speculative investments are subject to mean reversion as what goes up, must come down and vice versa. As stated above, a cryptocurrency is a commodity that relies only upon price appreciation alone for investment return and you don't want to be buying at a market top.

3. Try thinking of speculative investing in cryptocurrency as you would buying a lottery ticket. It only costs a dollar, but you could win big. Most often, you'll be a lot better off if you choose a long-term investment strategy that isn't as volatile. You should also diversify as much as you can; this way, you won't "lose your shirt" if one particular speculative investment falls apart. If you choose to put your money into cryptocurrency, the best thing you can do is limit your risk to an amount you can afford to lose.

4. No one knows what will become of bitcoin from a political and regulatory standpoint. It is mostly unregulated at this point, but some countries like Japan, China and Australia have begun weighing regulations. Most governments are concerned about taxation (and their lack of control over cryptocurrencies). Any actions these governments take could have significant impacts on the long-term adoption of these cryptocurrencies.

5. Cryptocurrencies suffer from additional security challenges that traditional investments (such as stocks and bonds) do not. Instead of the usual investment risk of your principal decreasing in value, with cryptocurrencies you may lose your crypto assets entirely. In addition to price volatility, speculative investors in crypto assets have lost money because of: outright theft, software bugs, or even misplacing login information. One way to minimize some of the security risk would be to buy ETFs that hold the cryptocurrencies. *(continued on pg.3)*

BLOCKCHAIN IS HERE TO STAY, BUT SHOULD YOU INVEST IN CRYPTOCURRENCY?

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(continued from pg.2) This doesn't solve the problem entirely though, because hundreds of technology firms raising money in the fevered market for cryptocurrencies are using deceptive or even fraudulent tactics to lure investors. In May, the Wall Street Journal reviewed documents produced for 1,450 digital coin offerings and found 271 with red flags. Warning signs included plagiarized investor documents, promises of guaranteed returns, and missing or fake executive teams. In total, more than $1 billion has been poured into those 271 coin offerings, and speculative investors have so far claimed losses of up to $273 million. Recently, state and provincial regulators in the U.S. and Canada conducted a wide-ranging crackdown on initial coin offerings, resulting in nearly 70 open investigations and 35 pending or completed enforcement actions as of the time of this article. In another July article in the Wall Street Journal, the following information came to light: "According to Chainalysis (a blockchain-analysis firm)… about a fifth of all bitcoin — around $20 billion — is lost, most of it permanently."

Could speculative investing in cryptocurrency be the next big thing, much like internet of the 1990s? Possibly, but it is extremely unlikely you will ever see cryptocurrency in a Praetorian Guard investment model. Should you decide to invest on your own, then "Caveat Emptor", which is Latin for "Let the buyer beware." If we make parallels to the internet boom then bust of the late 1990s, we see that hundreds of companies were formed, but most failed. Valuations took off and then crashed, and a few big winners emerged with much of the gain being captured in the very early stages. There are inherent risks to speculative investing in cryptocurrency, and our goal is simply to ensure that you are informed of those potential risks.

SECOND QUARTER 2018 MARKET REVIEW (continued)

(continued from pg.1) Broad U.S. and international equity indices begin the second half of the year still searching to overtake their January 2018 highs. The second half of the year will include multiple events which could have an impact on equity returns to include posturing by all sides over trade, the results of the November U.S. mid-term elections, fluctuations in energy prices, and perhaps a return of global security concerns to the headlines. Positive resolution or stabilization of any of these issues would likely provide a boost to global equities.

PRESIDENT'S COMMENTARY

By **Dick Hewitt**

"Did he fire 6 shots or only 5? Well, to tell you the truth, in all this excitement I kind of lost track myself." With all the noise originating in Washington DC (political, judicial…you name it) it can be difficult to hear the acceleration of the U.S. economy… but it's there.

Unemployment at both the U-3 and U-6 levels (U-3 is the official unemployment measure and U-6 adds on those workers who are part-time purely for economic reasons) are the lowest that we've seen in a generation plus, even more so for groups that are trying to grab the first rung on the economic ladder.

Corporate profits are solid and helped by the tax cuts of late 2017. Tariffs are a headwind but ultimately logic and economic reality will cause them to be curtailed or eliminated.

We remain positive on the long-term growth prospects for the U.S. economy, expect the second half of the year will be better than the first six months and remain confident that betting against the United States is a terrible wager.

SOCIAL SECURITY & ALFRED E. NEUMAN

By **Dick Hewitt**

The Trustees of the Social Security and Medicare Trust Funds issued their annual reports in the last quarter and there were some headlines worth noting while remembering Mad Magazine's Alfred E. Neuman's slogan, "What...Me Worry?"

Social Security paid out more in 2017 than it took in for the first time since 1982 and this will continue for the foreseeable future, with the shortfall coming from the mis-named "Trust Funds." This accounting creation will be depleted in 2034 (under this year's projections). If and when that actually occurs does NOT mean Social Security will be "bankrupt." Rather it signifies that payroll tax revenue will be sufficient to pay approximately 75% of promised benefits.

The significance of this is that Social Security will be available in some dollar amount for all of today's workers—higher paid individuals can expect a greater decrease than lower wage workers. Second, Congress *will* act at some point because they know their jobs will be on the line and no one wants to go down as having wrecked Social Security. Third, the adjustments to achieve actuarial balance are not that hard to ascertain today: increase the wage amount subject to payroll taxes, adjust the retirement age (both full retirement and early retirement) to reflect greater longevity and update the annual cost of living calculation method.

When that occurs, there will be a long implementation period—historically the last major overhaul was 1983 when the age for full benefits was raised from 65 to 67 and the phase in period was some 44 years. You'll have time to adjust but that does not imply waiting is optimal.

What to do: if your firm has a qualified retirement plan (Traditional or Roth 401K, 403B, etc), make sure you are taking advantage of it—contribute enough to get the full match, slowly increase your contributions each year and if you still have additional dollars, fund a Traditional or Roth IRA.

STIMULUS RESPONSE

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CLOSING THOUGHT

"It took me seventeen years to get three thousand hits in baseball. I did it in one afternoon on the golf course."

— *Hank Aaron*

PRAETORIAN GUARD

A division of Praetorian Wealth Management, Inc.

3775 Via Nona Marie
Suite 220
Carmel, California 93923

Phone: (831) 622-9600
Fax: (831) 622-9002
www.praetorianguard.biz

Investment Professionals

Richard A. Hewitt, CFP ®
President
rhewitt@praetorianguard.biz

Jerry M. Ledzinski II
Managing Director
jmledzinski@praetorianguard.biz

Joseph P. Clark, CFP ®
Director, Eastern United States
jclark@praetorianguard.biz

Marc A. Wehmeyer, CFP ®
Director, Mid-Atlantic Region
mwehmeyer@praetorianguard.biz

Anthony B. Wall, CRPS ®
Director, Retirement Services
awall@praetorianguard.biz

Heidi T. Ketchum
Director of Operations
hketchum@praetorianguard.biz