Lassus Wherley
Building Better Futures
...a View from the Top

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Where Do We Go From Here?

Here are our thoughts on the results of the election, interest rates, some planning moves for the end of the year, the financial markets in 2016 and an answer to a great question from a client.

For many of us 2016 has certainly been a year of surprises and of increased stress. Starting with the headlines around Brexit and then the results of the election here in the US.

I am reminded of the quote by Thomas Paine on December 23, 1776, describing the beginning of the American Revolution. "These are the times that try men's souls. The summer soldier and the sunshine patriot will, in this crisis, shrink from the service of their country; but he that stands by it now, deserves the love and thanks of man and woman." Whether you were a Trump supporter or a Clinton supporter or you didn't really care for either, the world of the future is going to be a challenging one.

We have entered a period in the US that is being marked by much turmoil and increasing uncertainty as appointments are made for cabinet-level positions. Many of those who are being nominated for these positions are individuals without knowledge or experience in the area they will be responsible for managing. This is certainly a concern for many and will continue to cause serious stress. Even for those who supported President-Elect (PE) Trump, there are concerns being expressed that there are too many conflicts of interest and there is not yet a clear vision of what we should expect from this administration.

In the short term we are seeing markets with a combination of a

Santa Claus rally and hoping the new administration is going to be as business friendly as many think it will. There are always concerns about a new administration and, certainly more concerns are raised when you have one party in control. However, given some of the recent events, I would suggest that PE Trump isn't really part of

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the Republican Party and has shown himself to be more of an Independent. There has been much discussion about Medicare, Medicaid, and Social Security reform. Some of these discussions are raising concerns about the direction of this administration, but the reality is we don't yet know where PE Trump stands on the specifics of these issues. What we do know is where the Republican Congressional leaders stand. We are concerned about any major changes that will impact millions of individuals in a negative way, including the potential rollback of ACA or the Affordable Care Act.

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We will keep you posted as we see areas such as tax reform evolve and we review to determine the impact. We are currently reviewing the initial proposal on Social Security reform which has brought in some controversial recommendations including means testing. We will follow this proposal and others very closely as the new year evolves to see how these plans begin to take shape and roll out. We will also keep our fingers crossed that PE Trump will find a way to break his addiction to Twitter before he moves into the White House.

Where We Have Been

That we find ourselves in interesting times relative to the overall political, economic, and market environment is likely an understatement. Although we have some level of added clarity surrounding some of the key themes that have driven uncertainty in the markets over the recent past (namely the election and monetary policy), a relatively high degree of uncertainty remains. As uncertainty continues, we expect to experience elevated volatility at least in the short term. Before we get into more detail relative to these key themes, reactions from the markets thus far, and our thoughts on potential impacts going forward, we'd like to review how markets have performed leading up to the election.

US equity markets followed three months of positive returns in June, July, and August, with essentially flat performance in September, negative returns in October and strong returns in November. US Large Cap stocks, as measured by the S&P 500, were up 0.02% in September followed by a -1.82% return in October and a 3.70% return in November. US Small Cap stocks, as measured by the Russell 2000, had stronger returns in September, posting a 1.11% return for the month; however, they also gave back more in October with a -4.75% return before rebounding with a very strong return of 11.15% in November.

Looking at equity returns globally, Developed International Stocks, as

measured by the MSCI EAFE, returned 1.23% in September followed by -2.05% in October and -1.99% in November. Emerging Market stocks, as measured by the MSCI EM, posted positive returns of 1.29% and 0.24% in September and October, respectively before retreating by -4.60% in November. On the fixed-income side, the Bloomberg Barclays US Aggregate Bond Index posted returns of -0.06% and -0.76% in September and October, respectively with a -2.37% return in November, while the Bloomberg Barclays Municipal Bond Index returned -0.50%, -1.05, and -3.73% in September, October, and November, respectively. Our emerging market fixed-income fund returned 12.46% year-to-date through the end of November. The varied returns of both equity and fixed-income markets continue to make the case for a well-diversified global portfolio of investments, as well as a long-term view when investing.

Capital market reactions to the election of Donald J. Trump as the 45th President of the United States have been a mixed bag globally. US markets have gained ground since the day following the election, after the futures market for the Dow Jones Industrial Average briefly dropped as much as 800 points the night of November 8th. The S&P 500 has gained roughly 2.8% from November 8th through the end of November, with the Russell 2000 up almost 10.6% in that same time frame. The reaction of overseas markets has not been as favorable, with the MSCI EAFE Index (International Large Cap) down roughly -1.3% over the same time frame, and the MSCI EM Index (Emerging Markets) down roughly -4.4%. Fixed-income markets have also not reacted favorably post-election, with the Bloomberg Barclays US Aggregate Bond Index down roughly -2.4% from November 8th through the end of November, and the Bloomberg Barclays Municipal Bond Index down roughly -4.4%. Emerging market bonds gave back some of the significant returns posted year-to-date, with a roughly -5.1% return since November 8th through the end of November, as measured by the JP Morgan Emerging Market Bond Index.

The significant divergence in returns between domestic and international (primarily emerging market) stock investments post-election is largely due to the policies that PE Trump has discussed and may implement when he takes office. Although we are primarily in wait-and-see mode as far as the details surrounding the polices that a PE Trump may implement, the idea of tax cuts for individuals and corporations, infrastructure spend-

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ing, and rolling back financial regulation to some extent have been key drivers for the positive returns in US equity markets post-election. Generally speaking, these policies are currently being viewed by US equity markets as positive for economic growth and corporate earnings in the immediate future. This same perspective has also worked to raise inflation expectations for the future and cause volatility in fixed-income markets. Bond prices have an inverse relationship to interest rates. As interest rates and interest rate expectations go up, the price of bonds goes down. With the Fed having raised interest rates this month as was widely expected and higher inflation expectations in the future, this inverse relationship between interest rates and bond prices has sent bond markets down in the short term. Emerging market bonds have been hit the hardest due in large part to concerns over trade policy and the potential impact on emerging market nations.

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Another potential driver of volatility that the market does not seem to be pricing in currently is the potential impact of immigration policies. Generally speaking, higher labor force participation rates and increased productivity are primary drivers for growth. To the extent that immigration policies are not supportive of this, growth could be negatively impacted.

A lot of open questions remain, and investors and the markets at large are still sorting through a very high degree of uncertainty. Given the uncertainty that still exists and all the various factors that could have a meaningful impact on the economy and markets, it is as important as ever to remain well-diversified and avoid the urge to react to volatility in the short term.

Continue to keep us posted concerning your needs so that we can ensure that there is sufficient cash on hand for the short term, and please continue to reach out to us with any questions that you may have.

Tax Planning for 2016

It's that time of year with the end of the year fast approaching. As your 2016 tax picture becomes more evident towards the end of the year, taking some traditional steps such as accelerating deductions and postponing income (or vice versa, depending on your 2017 outlook) can substantially change your bottom line. And there are other strategies you could take advantage of and some pitfalls to avoid. Lastly, the upcoming change of the POTUS (that's President of the United States, if you aren't aware) regime and its promise of big tax changes make for some especially challenging forecasting.

Accelerating Deductions/ Postponing Income

If you anticipate that you will be in a lower tax bracket in 2017 than you were in 2016, this is a strategy that might make sense for you. Some steps to take include making any anticipated 2017 charitable contributions in 2016 and pre-paying your property and state income taxes. Although you can't deduct prepaid interest, you can pay your January mortgage payment in December because the interest due in January is interest due on December's loan balance. Another option would be to sell some investments that have gone in the wrong direction and cur-rently have a loss in value. After you offset capital gains you can take a net loss of $3,000 against ordinary income each year with any excess being carried over to future years.

On the income side, if you have any control over when a bonus or other income would be paid, put it off until January. If you are a cash-based business owner, delay billing a customer until 2017. And, of course, maximize that 401(k) contribution!

This strategy not only takes ad-vantage of reducing taxable in-come in a high-bracketed year, but also could bring you below some income thresholds which limit itemized deductions, disallow cer-tain credits, or subject you to the Net Investment Income tax.

If you are in a low tax bracket in a particular year, consider converting some dollars from a traditional IRA to a Roth IRA.

Accelerating Income/ Postponing Deductions

If your income in 2017 is expected to put you in a higher bracket, this is your strategy. Take that bonus now! Or take any planned retire-ment distributions (if not subject to a 10% penalty). You could also sell some investments that have significant gains.

You can also put off paying your state estimated tax payments until January (if allowed by your state) and think about delaying any large business asset purchases that you could immediately expense.

More Strategies to Consider

If you're 70½ or older, you can satisfy your minimum required dis-tribution from retirement accounts by making a charitable contribu-tion. The amount then is not in-cluded in your income. This strate-gy has the potential to affect how much of your Social Security is taxed and how much you will pay for Medicare Parts B and D. This strategy is even more helpful if your deductions aren't high enough to itemize. Make sure the charity sends an acknowledgement to you.

If you have some extra dollars and would like to make a charitable contribution, consider putting some money in a donor-advised fund. You get the deduction in the current year but can disburse the

funds in future years.

If you are in a low tax bracket in a particular year, consider converting some dollars from a traditional IRA to a Roth IRA. You will have to pay the tax on it now, but it will grow tax-free and you won't be taxed if you need to take distributions from the Roth in retirement. You can also change your mind up to a certain point later on and move the funds back to your regular IRA. This is one of those rare do-over opportunities in the tax code.

Lastly, when estimating your income in any given year, don't forget to consider whether you are subject to the Alternative Minimum Tax (AMT) - this can change everything!

If you plan to gift money to your adult child who is in the 10-15% tax bracket, consider gifting him/her appreciated securities. When he/she sells, the capital gains tax rate is 0%. You can gift up to $14,000 in 2016 to any individual without gift-tax consequences. If married, your spouse can also gift that amount to the same person.

Pitfall Avoidance

Some situations to be aware of that often trip taxpayers up:

The education credit and tuition deduction can only be taken in the year the bill is paid, which is not necessarily the year school is attended.

Are your taxes paid in sufficiently this year through withholding and estimated taxes? In order to avoid an underpayment of estimated tax penalty each quarter, you must pay 25% of the following:

90% of the current year's tax liability, or

100% of the prior year's tax liability (110% if you are married and make more than $150,000 per year, or if you are single and make more than $75,000 per year).

Withholding is considered paid evenly throughout the year, so if you find yourself underpaid near the end of the year, you can boost your withholding.

Don't forget to use any money you have contributed to Flexible Spending Arrangement (FSA). These accounts are "use it or lose it" accounts. Some employers have grace periods or the option to roll over $500 to the following year. Check with your employer.

Lastly, when estimating your income in any given year, don't forget to consider whether you are subject to the Alternative Minimum Tax (AMT) - this can change everything!

What About 2017?

We are getting some hints of what the President-Elect and Congress tax proposals will be. We are very likely looking at lower tax brackets and a very different taxable income calculation. Whether big changes will take effect in 2017 or later is yet to be seen. This makes forecasting future tax liabilities very

difficult, but we will continue to review information as it is available.

Here is a great question from one of our clients in New Jersey. Let us know if you have one you would like included.

Question: *What does the change in New Jersey Estate Tax Law mean and will it affect me?*

Answer: In October 2016, Governor Christie signed a bill that will remove New Jersey from the top of the list as one of the worst states in which to die. At $675,000, New Jersey currently has the lowest threshold for taxing estates in the US. This will change beginning on January 1, 2017, when the New Jersey estate tax exemption increases from $675,000 to $2 million. Additionally, on January 1, 2018, the New Jersey estate tax is scheduled to be fully repealed. The New Jersey inheritance tax, which applies to inheritances received by certain family members (e.g., siblings, nieces, and nephews) and non-family members remains in effect.

This will change beginning on January 1, 2017, when the New Jersey estate tax exemption increases from $675,000 to $2 million. Additionally, on January 1, 2018, the New Jersey estate tax is scheduled to be fully repealed.

The change to the estate tax was part of a compromise bill that increased New Jersey's gas tax by 23 cents a gallon in exchange for a package of other tax cuts. The new bill also:

Reduces New Jersey's sales tax from 7% to 6.875% in January 2017 and to 6.625% in January 2018.

Increases the gross income tax exclusion for retirement and pension income for residents age 62 and older.

Creates a new income tax deduction for veterans.

With the new law, New Jersey residents who die in 2017 will not be subject to estate tax unless their estates exceed $2 million. Beginning in 2018, the New Jersey estate tax is repealed and no state tax would be due on estates of any size. Although New Jersey's estate tax is scheduled to be eliminated, please keep in mind that the federal estate tax remains in effect for those who die with estates in excess of $5.45 million (or $10.9 million for a married couple).

Estate planning will still be important for New Jersey residents despite the tax change. While tax is often a catalyst for engaging in wealth transfer planning, there are many other reasons to have a sound estate plan in place, including:

Naming guardians for minor children.

Naming executors and trustees.

Identifying who receives assets.

Establishing trusts to safeguard and manage assets.

We anticipate that the changes to

New Jersey's estate tax law will benefit many residents, including many of you. If you have any questions about the new law and its potential impact on you and your family, please call us and we will be happy to discuss this with you.

Of course, there is no guarantee that this won't change in the future so we plan based upon the current laws in effect. Laws can always be revised or even appealed based upon the leadership in power.

Keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term. We recognize the uncertainty surrounding us with the rocky transition taking place in Washington, DC and know that the world is changing very quickly. So please let us know if you have questions we can answer for you or concerns we can help you address. And remember to take that deep breath when the world starts to get to you.

Have a wonderful holiday season and a very happy New Year!

Diahann

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