WINTER 2018

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WEALTH MANAGEMENT

WEALTH MATTERS.

FROM THE SENIOR TRUST OFFICER

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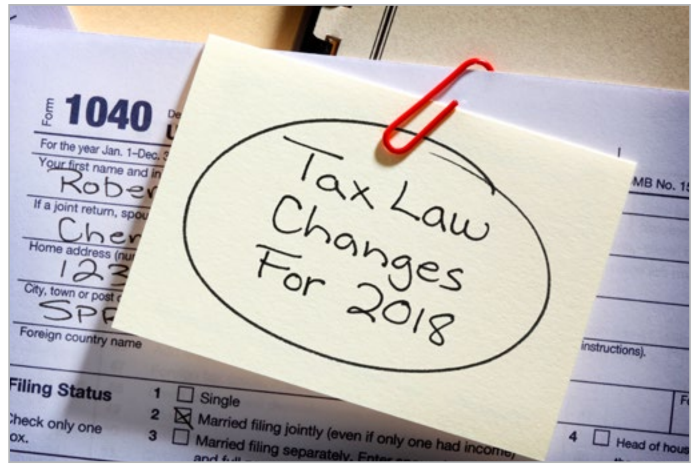
The topic of tax reform has sparked many conversations of varying reactions; from confusion and worry to praise and optimism, we've all experienced different reactions and seek an understanding of how tax reform will impact our own situations. In this edition of Wealth Matters, our authors discuss a number of changes and tips to take into consideration as you revisit your financial plan in light of tax reform. We also recap 2017 market performance and forecast investment trends for 2018.

We hope you enjoy this edition of Wealth Matters.

How Will Tax Reform Impact My Financial Plan?

Most of us are aware that tax reform was signed into law prior to the end of 2017, but few understand how those changes will affect their financial plans going forward. While some of the most significant changes are substantial reductions in tax rates for corporations and closely held businesses, this article focuses on the significant changes for our clients who are individual taxpayers and offers a few implications to consider when revisiting your financial plan with your advisor.



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Ken Kondas has over 33 years of experience in the areas of banking, insurance, investments and financial planning. As a Certified Financial Planner™, Ken specializes in personal and business planning. His office is located in Boardman, Ohio.

Lower Tax Rates

With lower tax rates for individuals, consumers will have more money in their pocket. In the past they have traditionally spent it, which, in turn, stimulates the economy, but this also offers an opportunity to save more. If you are a participant in an employer sponsored retirement plan, consider increasing your deferral. If you have personal debt, this may be an opportunity to pay it down faster. If you have children or grandchildren, this is an opportunity to put more money away for future educational expenses. When increasing savings and investments, it is a good idea to review your portfolio for proper asset allocation.

With the run-up in the market, has your portfolio drifted from its original allocation? It may be time to rebalance.

Tax Deductions

Deductions will be impacted. Changes include elimination of the personal exemption, increases in the standard deduction and the reduction or elimination of certain itemized deductions. One change that garnered significant headlines is the capping of the deduction for state and local taxes (including property taxes) at $10,000. Other changes to note; for investors, advisory fees are no longer deductible, medical expenses in excess of 7.5% of AGI will be deductible in 2017 & 2018 and in excess of 10% of AGI thereafter, and alimony will no longer be deductible by the payer and taxable

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How Will Tax Reform Impact My Financial Plan?

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to the recipient for divorces finalized after 12/31/18. The deductibility of interest on new mortgages has been reduced to $750,000 of loan principal from $1 million, and the deductions for home equity loan interest have been eliminated. All of these changes make it more likely that individuals will elect to use the standard deduction.

529 Plans

The reform also allows 529 plans to offer free withdrawals up to $10,000 per year, per child, for qualified elementary and secondary school tuition expenses. Previously, penalty free withdrawals were only permitted for post-secondary education expenses. Contributions to these plans may be deductible on your state income tax return and qualified withdrawals are free from taxes. This change will increase the appeal of these plans when saving for education.

Roth Conversions

The ability to recharacterize a Roth conversion has been eliminated. In the past, investors had the option of reversing a Roth conversion before filing their taxes. This option no longer exists. Converting to a Roth may still make sense, however, it is more important than ever that you consult with your advisor prior to converting. Roth IRAs still offer some diversification and flexibility from a planning perspective because of the provision for qualified tax free withdrawals in retirement.

Alternative Minimum Tax

Two factors have been changed, the exemption amounts and the phase outs. The exemptions have been raised by nearly a third from $54,300 for single filers and $84,500 for married filing jointly to $70,330 and $109,400 respectively. The phase outs have been increased from $120,700 for singles and $160,900 for couples to $500,000 for an individual and $1 million for a couple. In 2015 4.4 million Americans paid the AMT. The new law will significantly reduce the number affected.

Estate Tax Exemption

The individual estate tax exemption has been doubled from $5.49 million to $10.98 million. It is a good idea to review your estate plan periodically and keep in mind that these changes are only temporary at this point. After 2025 they will revert back to the 2017 exemption.

In summary, tax planning is just one aspect of a well-developed financial plan. If you don't have a plan, now would be a good time to develop one; if you have a plan, now would be a good time to review it in light of these changes. This is a great opportunity to increase savings and investments, diversify how you invest and review your asset allocation. A holistic financial plan developed by your Chemical Bank Wealth Management advisors encompasses all of these items as well as income and asset protection, education funding and retirement and estate planning.

As you gather documents in preparation of filing your tax returns, why not make one more appointment to schedule a consultation with your advisor to develop or review your financial plan? ■

Investment Commentary

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William has over 30 years of experience in the investment industry. As a Trust Investment Officer, William is responsible for portfolio management and security selection for client accounts. His office is located in Traverse City, Michigan.

THE BEST OF BOTH WORLDS

What a year 2017 was in the markets! The S&P 500 Index finished the year with a total return of 21.8%. Mid-cap and small cap stocks trailed their large cap counterparts, producing gains of "only" 18.5% and 14.7% respectively. Developed International stocks as measured by EAFE gained a respectable 25% while Emerging Markets stole the show with an outsized gain of 37.3%. Growth stocks had a particularly impressive year, outperforming value stocks by nearly 17 percentage points. Facebook, Amazon, Netflix, and Alphabet (formerly known as Google) continued their multi-year run of strong outperformance but other lesser known growth stocks enjoyed respectable gains as well. In regards to sector performance, Information Technology led the way with a 38.8% gain. Basic Materials, Consumer Discretionary, Financials, and Health Care all turned in gains right near the S&P 500's 22%, while only Energy and Telecom failed to end the year in positive territory.

In an unusual turn of events, the stock market's intraday trading range amounted to only 0.3%, a level of tranquility that was last seen in 1964. The market failed to pull back even 3% from its highs at any time during the year. Thus, investors enjoyed the dual benefits of above average returns and below average volatility. Those who were primarily focused on the news headlines and the nation's political machinations as the year unfolded were probably surprised by this outcome. These distractions provided cover for the powerful forces that were propelling stocks higher: a global synchronized recovery, rebounding corporate earnings, deregulation, and tax reform. These factors combined to produce the second highest readings ever in both consumer sentiment and small business optimism, invigorating the markets' animal spirits in the process.

Despite the strong stock market, bonds did what one always hopes they will do – produce steady if unremarkable performance to complement the growth potential of stocks while dampening portfolio volatility. Taxable intermediate and longer term bond indices ended the year with total returns of 2.3% and 3.8% respectively. Tax exempt markets produced more robust returns of 5.9%.

COULD STOCKS BE DUE FOR A BIG PULLBACK THIS YEAR?

Midterm Years Can See Large Pullbacks, But Bounce Back

Year Of Presidential Cycle	S&P 500 Average Intra-Year Pullback	S&P 500 Average Return A Year After Lows
First Year In Office	-14.0%	12.1%
Midterm Year	-16.9%	32.0%
Pre-Election Year	-11.5%	15.9%
Election Year	-11.8%	18.3%

Source: LPL Research, FactSet 01/25/18
Date: 1950 - Present

With 2017 behind us, we can now look ahead to what 2018 might look like. Forecasting the future is always a tenuous enterprise, as Yogi Berra once lamented ("It's tough to make predictions, especially about the future"), and this applies no less to the financial markets. That being said, history does provide some potential clues. First, when stocks have risen 2% or more during the first five days of January, the full year has been higher each of the 15 times this has occurred since 1950, and the average gain has been an impressive 18.6%.

THE JANUARY BAROMETER HAS BULLS SMILING

What The Final 11 Months Do Based on the S&P 500's January Return (1950-Current)

	Average January	Positive January	Negative January	January > 5%
Average Return	7.9%	12.2%	1.2%	15.8%
Median Return	8.4%	13.3%	2.5%	17.4%
% Positive	76.5%	87.8%	59.3%	91.7%
Occurences	68	41	27	12

Source: LPL Research, FactSet 1/30/18

Second, there have been 12 times since 1950 in which stocks rose 5% or more during the month of January. During the remaining 11 months, stocks finished with gains 11 out of 12 times. The average gain? 15.8%!

Of course, these statistics speak to possibilities and probabilities, and we cannot assume that this January's greater than 5% gain will end with the same happy outcome. For one thing, we are in a mid-term election year and that has typically resulted in some steeper corrections according to the historical record. Yet, even with the risk of a steep correction, history reveals that returns after mid- term election lows are reached are typically above average.

Finally, Bond yields are rising in a way that we have not seen in some time, largely as a result of the global economic recovery which is picking up steam. In response to higher economic growth and an associated increase in inflation expectations, some central banks have begun the process of normalizing the extraordinarily easy monetary policies that were launched after the 2008 financial crisis. For stocks to keep moving higher, inflation expectations must remain moderate to keep the Federal Reserve's monetary policy from becoming too tight too quickly. ■

Revisiting Charitable Giving Strategies

The Tax Cuts and Jobs Act signed into law prior to the end of 2017 represents a historically significant change to the United States tax code. As a whole it is one of the largest tax cuts in our nation's history, though for individual taxpayers the impact of the new law will vary based on a number of factors. The focus of this article is on the continued relevance of charitable giving as a strategy for reducing personal income tax liability for many of our clients under the new law.

Charitable Deductions in 2018

A primary goal of the tax writers was to streamline the administration, reporting and collection of taxes. To that end, the new law aims to reduce the number of taxpayers who itemize deductions by increasing the amount of the standard deduction to $12,000 for single filers and $24,000 for married couples filing jointly. While the new law will in all likelihood have the effect of significantly reducing the number of taxpayers claiming deductions for charitable contributions, for those who still do itemize deductions, the law increases the potential impact of the deduction by raising the cap on the deduction on cash gifts to public charities to 60% of adjusted gross income, up from 50%, while also allowing for a carry forward of any amount exceeding 60% for up to five years. Appreciated gifts to public charities continue to qualify up to the previous 30% of AGI limitation.

2018 Income Tax Planning Strategies

CONTRIBUTION BUNCHING

For those taxpayers for whom the decision to itemize or take the standard deduction will be a close call on a year-to-year basis, one strategy to consider is "bunching" charitable contributions. In other words, it might be worthwhile to accelerate or decelerate charitable giving to concentrate gifts into a single tax year, then utilize the newly more generous standard deduction in the years which you will not make charitable gifts. This strategy is particularly relevant for those who are expecting a year with significantly higher taxable income than usual.

IRA DISTRIBUTIONS

An increasingly common and highly effective tax strategy that we've covered in previous editions of Wealth Matters is the Qualified Charitable Distribution (QCD) or "rollover gift" from an Individual Retirement Account (IRA). For individuals who are over age 70½, an IRA rollover gift up to $100,000 can significantly reduce taxable income. While the utility of this strategy may be impacted by the change in rates, it remains relevant because it is not effected by the change in the standard deduction. This strategy applies primarily to those who are able to rely upon income sources other than some or all of their Required Minimum Distributions (RMDs) from their IRAs to support their desired lifestyle.

GIFTS OF APPRECIATED PROPERTY

Donation of appreciated assets continues to be an effective strategy for income and capital gain tax planning. With equities and real estate currently holding high valuations, this is an excellent time to consider an appreciated property gift. The donor generally benefits from both the capital gain bypass and an income tax deduction for the fair market value of the gifted asset. This strategy can be combined with the previously mentioned "bunching" strategy to minimize the impact on your available cash.

At Chemical Bank Wealth Management, we believe that the best approach to serving our clients is to actively engage with their professional advisors, including accountants and attorneys to design and execute tailored solutions that will meet long-term financial goals. The recent passage of Tax Cuts and Jobs Act provides a great opportunity to evaluate your current plan and adjust accordingly. Contact a Chemical Bank Wealth Management advisor at 800.808.5404 to review your plan for 2018. ■

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Scott Ripmaster has over 16 years of experience in the areas of finance including securities management, account administration and banking management. As a Trust Officer, Scott is responsible for the administration of personal trust, IRAs, investment management and estate settlement relationships. His office is located in Traverse City, Michigan.