RESOLUTE FINANCIAL

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Resolute Connections

With the stock market continuing to ascend to higher levels - the current bull market is the second longest in modern American history - we thought the first article, *"Bearing" in Mind*, might put these perhaps oxygen deprived heights in context. In a similar vein, one market that has outstripped every worldwide stock market is bitcoin, you can hardly turn on your computer today without reading about the remarkable run-up in bitcoin prices, and seeing a plethora of advertisements telling you how you, too, can get on the action. Despite bitcoin's 700% run-up this year, *Bitcoin Bubble* brings up a salient point – should the cryptocurrency be considered an investment at all?

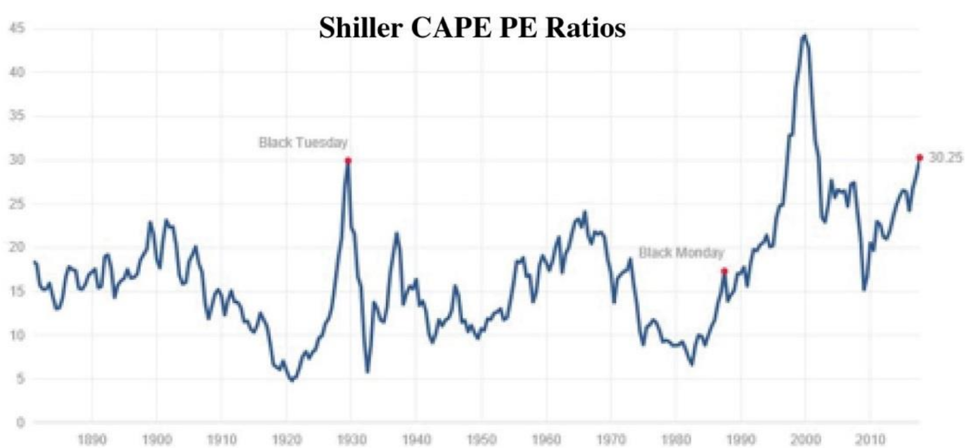
The New Tax Legislation summarizes the legislation that appears to be coming down the pike that will likely impact your 2018 tax return. And *Health and Financial Wellness* makes the case that your health status may be a crucial input into your overall financial plan.

If you have any questions about anything we have covered in the articles below, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

"Bearing" in Mind

One of the oddities of a significant bull market—and this one we're in today qualifies, as the second-longest in modern American history—is that they tend to go on longer than you might expect from the pure market fundamentals. The last leg of a bull market tends to be driven by psychology; people have recently experienced an up market, and so they tend to expect more of the same. They buy at prices they would never consider buying at when the markets have experienced a downturn, driving prices ever higher without regard to the price. As a result, the long tail of the bull market will also see some of the greatest, fastest increases.

Whenever stocks become more expensive than their long-term averages, we enter a time of when a market downturn should not be a surprise. Today, as you can see from the accompanying charts, The S&P 500 index is moving into rare valuation territory. The first chart shows the evolution of the total market capitalization of the S&P 500 compared with U.S. gross domestic product. The second shows the Shiller CAPE price/earnings ratio—a popular measure of stock market valuations. In both cases, you can see that buying company earnings has actually become more expensive than it was before the Great Recession, and may be approaching the rarified territory of the dot-com bubble.



Of course, we have no way of knowing whether the next year will bring us more good news or the long-awaited downturn of 20% or more (the definition of a bear market). Other than market valuations, the signs are positive. American corporations continue to report strong earnings, economic expansion continues steadily albeit more slowly than historical norms, and a greater number of countries are experiencing sunny economic weather. Persistently low interest rates mean that investment dollars virtually have to turn to the stock market for the potential to earn reasonable returns. And, as mentioned before, the end of a bull market tends to be very generous to patient investors.

The key point to remember is that investment markets are, by their nature, volatile and unpredictable. Historically, the market has experienced a 5% correction every 7.2 months and a 10% correction every 26.1 months. We know that a more precipitous bear market (defined as a drop of 20% or more) is in our future, but we have no idea when or how. We do not practice market timing because we believe that long-term investment success comes from patience. When you jump out of the market to avoid a downturn, there is no way to make up for the returns you lost while you were on the sidelines. All we know for sure is that the next correction will represent an opportunity to rebalance and buy positions more cheaply than today's prices—and, if the past is any indication, to sell higher down the road.

Here's a prediction we can all be confident in: over the next few months or years, you will read financial headlines that say the bull market has a long way to run, and others that will say a devastating bear run is imminent. Please remember that nobody has a magic crystal ball. The more important thing to remember is that markets in the past have experienced terrible losses, only to experience new highs a few years later.

Bitcoin Bubble

It is probably not a good sign for an investment when its largest clearing firm takes out an advertisement in the Wall Street Journal asking for more regulatory oversight and warning investors that its investment category is so volatile that futures contracts could create devastating losses. Yet this is exactly what has happened recently when

Interactive Brokers, the clearing firm for the bitcoin cryptocurrency, responded to the Chicago Mercantile Exchange's plans to start listing bitcoin futures.

The dustup is significant for a variety of reasons. First, you can hardly turn on your computer today without reading about the remarkable run-up in bitcoin prices, and seeing a plethora of advertisements telling you how you, too, can get on the action. This, of course, is exactly what one sees at a precipitous market top, and indeed bitcoins are now trading at around $7,800—up more than 700% year to date, compared with a mere 14.6% for a pedestrian investment known as the S&P 500 index.

Second, there are serious questions—despite the "come-ons" and advertisements—about whether bitcoins should be considered investments in the first place. This proposed futures contract is the cryptocurrency's first foray into the mainstream investment world, and some bitcoin owners are now wondering what, exactly, one does with a "currency" that is nothing more than blips in a distributed computer database, whose primary purchase vectors so far have been illegal drugs and illicit weaponry.

Bitcoin owners, meanwhile, are doubtless experiencing some of the same feelings that a Dutch farmer would have gone through in the early 1600s, when the tulip bulb he held in his hand—worth far less than a guilder two years before—could now, in the teeth of a mania, be sold for a nice house or ten times the annual income of a skilled crafts worker. The wise move then would have been to cash out before the collapse. The same may be true today.

The New Tax Legislation

Chances are, you've heard that tax "reform" is right around the corner—that is, if you can call it "reform" when hundreds or perhaps thousands of new pages are about to be added to the tax code. First, the White House released its tax legislation wish list. Now the Republicans in the House of Representatives have passed a proposal called the "Tax Cuts and Jobs Act".

The House bill would reduce the number of tax brackets from seven currently (10%, 15%, 25%, 28%, 33%, 35% and 39.6%) to four: 12% (up to $45,000 income for singles; $90,000 for joint filers), 25% ($200,000 single; $260,000 joint), 35% (over $500,000 for singles; $1 million joint) and 39.6% (above $1 million for single filers; $1.2 million joint). The impact on any individual is complicated; people who are currently in the 15% bracket and the bottom of the 25% bracket would, under the new bill, pay taxes at a lower 12% rate. People who were previously in the 28% bracket would tumble down into the 25% rate. But people making between $20,000 and $40,000, and those between $200,000 and $500,000 would actually experience a tax increase as they move into a higher marginal rate.

It gets more complicated, because there's effectively a fifth tax bracket that nobody is talking about, perhaps because it only impacts the highest-income Americans. Anybody who thinks tax "reform" is making the system less complicated should ponder how this would be calculated; once a person or couple have income sufficient to reach the top bracket, they would subsequently add on a 6% surtax to the amount over that top bracket threshold until the entire benefit of their 12% rate has been phased out. In effect, individuals with taxable income between $1 million and $1.207 million, or joint filers with taxable income between $1.2 million and $1.614 million, would face a special 45.6% tax bracket. After that, they revert back to the 39.6% rate. This is simplification?

The dreaded alternative minimum tax would be eliminated under the new bill; however, the AMT credit carryforwards would still be deductible. The bill would continue the current capital gains rate structure of 0% (for those with up to $51,700 individual/$77,200 joint in taxable income), 15% (up to $425,800 individual/$479,000 joint) and a 20% rate for those in the top tax bracket. The 3.8% Medicare surtax on net investment income (which includes capital gains and dividend income) would be retained, and be added onto the 15% and 20% capital gains rates. So the actual capital gains rates would be 15%, 18.8% and 23.8%.

Meanwhile, the personal deduction and standard deduction would be combined into an expanded standard deduction of $12,000 for individuals, $24,000 for joint filers. Some families with more than three children would lose benefits under this proposal, since their personal deductions under the old system would have exceeded the expanded standard deduction in the newly proposed one. A higher standard deduction, by itself, would reduce the number of people claiming itemized deductions, but in addition, the bill would greatly reduce the list of qualified deductions, reducing the number of itemizers even more. Under the new proposal, people would no longer be able to deduct any state or local income taxes paid, but they WOULD be able to deduct local real property taxes (like a home and/or a vacation home) up to a maximum of $10,000 a year. The mortgage interest deduction would be limited to debt on the first $500,000 of a home mortgage (down from $1 million today).

Miscellaneous deductions like the electric drive motor vehicle credit, the adoption tax credit and the credit for moving expenses to a new job would all be eliminated.

Corporate tax rates would be lowered dramatically. The C-corporation (which is publicly traded companies) would see a maximum 20% tax rate, while pass-through companies like S corporations, partnerships and LLCs would be subject to a maximum rate of 25%--with some very complicated provisions designed to keep their owners from shifting personal income into and through the company to take advantage of potentially lower rates.

Finally, for the very few people who pay estate taxes, the good news is that the exemption limit, currently $5.6 million, would double to $11.2 million per person, $22.4 million for married couples—and the estate tax, according to the language of the bill, would be eliminated altogether in 2024. Gift tax limits would also go up to the exemption amounts.

Would any of this affect your tax bill in 2017? No. The provisions, if enacted, would impact the 2018 tax year.

What are the odds of passage? Who knows? The Senate is reported to have its own ideas about tax “reform” and may be passing their version this week.

Health and Financial Wellness

Your financial plan is about your goals and finances. But is it also about your health?

In a recent blog post on the Forbes.com website, financial planner and medical professional Carolyn McClanahan suggests that your health status may be a crucial input into your overall financial plan.

Why? Because it helps you know how long your money will need to last—in other words, your longevity. If you have significant health issues at an early age, then you can probably spend more during retirement, and use up your nest egg faster, than if you're hale and your family history has close relatives living past age 100.

The default assumption has been that people will live to the age on a standard life expectancy calculator—which would say, for instance, that a person age 49 has a 50% chance of living past age 85. But people who live a healthy lifestyle probably have a proportionately greater "risk" of outliving their life expectancy, while a chronically overweight smoker might be expected to contribute to the other side of the statistics. In general, financial planning clients tend to be smarter and wealthier, which suggests that they'll outlive the statistical averages.

McClanahan routinely estimates that her healthy clients will live to age 100. For people with health concerns, she asks that they visit livingto100.com, which is an online questionnaire/calculator that asks health-related questions and then tells you how long you can expect to live based on more than just the actuarial statistics. She tested it out with her "real" (healthy lifestyle) information and the site estimated she would need to financially prepare for living to age 102. When she gave different information—when she described herself as an overweight, beer-guzzling junk food eater and smoker—her life expectancy shifted to age 63. What a difference!

And, of course, the lifestyle component is only part of it. If you have chronic conditions, if you've been diagnosed with cancer or have other significant health concerns, you can throw the averages out the window. The point: your health and lifestyle can greatly affect the assumptions in your financial plan, and should not be ignored.

Source:

For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.

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