Financial Advisory Service, Inc.

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FAS Monthly Economic & Market Update

November 2017

As of October 31, 2017

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Economic Conditions

The US economy grew at an annual rate of 3% in the third quarter of 2017, according to the advance estimate released by the US Department of Commerce at the end of October. After a 3.1% increase in the second quarter of 2017 this marks the first time we've seen 3% growth or greater in two consecutive quarters since 2014. Increased consumption, private inventory investment, federal spending and exports were all positive contributors to Q3 growth. Imports, which are a negative contributor to GDP, decreased in Q3, most likely due to the continued weakening of the US Dollar. The long-term growth rate of the current expansion is still averaging about 2.2%. Now that a tax plan has been proposed by the administration, investors are hopeful it will provide an additional boost to the economy. Alternatively, the Fed will most likely continue their efforts in keeping inflation reigned in by raising rates in December and starting the process of shrinking their balance sheet by allowing maturing bonds to roll off without reinvesting the proceeds which could cause rates to increase further.

Market Conditions

Index Returns	Oct '17	YTD
S&P 500	2.22%	15.03%
DJIA	4.34%	18.29%
NASDAQ	3.57%	24.98%
MSCI EAFE	1.46%	18.92%
Barclays Aggregate	0.06%	3.20%

It was another positive month for stocks as the S&P 500 and Dow Jones Industrial Average notched monthly increases for the seventh month in a row. Consumer confidence reached its highest level since 2000 last month and the equity markets followed suit as the Dow reached 12 new record highs and returned 4.34% for the month. While some may point to new highs in consumer confidence as a contrarian indicator, potentially signaling that a recession is on the horizon, we are all aware that the past is not necessarily an indication of future events. Additionally, as the Wall Street Journal noted, "consumer confidence readings have [historically] stalled out over consecutive months before ultimately turning lower." It's important to look at a broad range of economic indicators when gauging the strength of the markets and the economy. While consumer confidence has hit multi-year highs, the Economic Surprise Index, an index that measures how closely economic data corresponds with expectations, reached its highest reading since the second quarter of 2017 as several economic data points have had readings that were better than expected. The S&P 500 returned 2.22% in October while the NASDAQ returned 3.57%. Fixed income again remained fairly stagnant yet slightly positive, unlike in September, returning 0.06% last month.

Tax Reform

House Republicans released the details of the tax reform bill, titled the Tax Cut and Jobs Act, last Thursday Nov 2. Since then, we have seen both praise and criticism from both sides of the aisle of what is the biggest overhaul of the U.S. tax code in over 30 years. Along with proposing that the corporate tax rate be cut to 20% from its current level of 35% and reducing the number of personal income tax brackets from seven to four, there are several details in the plan that will most likely affect tax payers at all levels of income. With as polarizing as media outlets seem to be as of late, we want to break down the current tax reform proposal with a non-biased view to help our clients better understand how they can expect this plan to affect them.

Personal Income Tax Brackets

Currently, the seven personal income brackets range from 10% to 39.6% with a standard deduction of $6,350 and $12,700 for single and joint filers, respectively, and personal exemptions of $4,050 per person. Under the proposed tax law the tax brackets will be condensed into four brackets ranging from 12% to 39.6% with a standard deduction of $12,200 and $24,400 for single and joint filers, respectively. The personal exemption would be eliminated completely. Refer to the graph on the next page which details the tax bracket changes.

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Tax Reform

As you can see from the graphic on the right, the changes to the tax brackets should provide tax relief for almost all filers. While the lowest tax bracket does increase from 10% to 12%, the benefit of the increased standard deduction should outweigh the cost of the increase in tax rate. However, it is worth noting that there are some stipulations that could negatively affect high income earners. The GOP slipped wording into the bill that essentially "phases out" the benefit of the 12% tax rate for individuals earning more than $1M and married couples earning more than $1.2M. This is accomplished by taxing all income between $1.2M and $1.6M (for married filers) at an additional 6% until the benefit of the 12% tax rate on the first $90,000 of income is essentially clawed back. All income above $1.6M would then be again taxed at the 39.6% rate. This is a point of contention within the GOP with its opponents deeming it a "stealth tax."

Current		Proposed 2018	
10%	$0 - $9,325 $0 - $18,650	12%	$0 - $45,000 $0 - $90,000
15%	$9,326 - $37,950 $18,651 - $75,900		
25%	$37,951 - $91,900 $75,901 - $153,100	25%	$45,001 - $200,000 $90,001 - $260,000
28%	$91,901 - $191,650 $153,101 - $233,350		
33%	$191,651 - $416,700 $233,351 - $416,700	35%	$200,001 - $500,000 $260,001 - $1M
35%	$416,701 - $418,400 $416,701 - $470,700		
39.6%	$418,401+ $470,701+	39.6%	$500,001+ $1M+
Stdandard Deduction	$6,350 $12,700	Stdandard Deduction	$12,200 $24,400
Personal Exemption	$4,050 $8,100	Personal Exemption	N/A N/A

*Filing Single
Married Filing Jointly

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Tax Reform

Child-Tax Credit

Currently as it stands, single and joint filers are eligible for a $1,000 child-tax credit per child with phase outs beginning at income levels of $75,000 and $110,000, respectively. The House bill increases that amount to $1,600 per child; and while it may not be at the level that proponents of this topic like Rep. Kevin Yoder and First Daughter Ivanka Trump were pushing for, it does expand the eligibility for the child credit with phase outs beginning at $115,000 and $230,000. Additionally, the bill creates a credit of $300 for each adult family member and includes the primary taxpayer and any non-child dependents such as college students. This credit, however, is set to expire after 2022.

Deductions

Perhaps one of the most controversial changes in the proposed tax bill is the elimination of the state and local tax (SALT) deduction. Under the new tax code the state and local tax deduction will be eliminated and would limit the state and local property tax deduction to $10,000. This is another area of the proposed bill that has been met with extreme push back, specifically from representatives in states with high income taxes, such as New York and New Jersey. The deduction of mortgage interest would still be allowable but

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would only apply to interest on debt of $500,000 and below, as opposed to the current limit of $1M. It would also no longer apply to home-equity loans or second homes. This change would only affect upcoming loans as all existing loans, including refinanced loans, will be grandfathered in. It could, however, affect home prices, specifically in areas where the majority of homes are second homes. Another popular deduction that will be disallowed under the new tax code is the write off of medical expenses above 10% of adjusted gross income (AGI). With healthcare costs increasing at their current rates, this is another area of contention that could affect as many as 9 million households, or 6% of tax filers, according to the Tax Policy Center.

Pass-Through Income

Pass-through income, such as income from S corporations and partnerships, are currently taxed at individual tax rates. Under the new tax code, in an attempt to help small businesses, the bill would allow 30% of pass-through income to be taxed at a flat 25% with the first 70% being taxed at the individual's personal tax rate. However this preferential treatment of pass-through income would not apply to professional service firms such as law firms and financial services firms. All pass-through income generated from professional service firms would be taxed as labor income.

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Tax Reform

Corporate Tax

While the corporate tax code may not affect our clients directly, it will certainly affect everyone in the U.S. indirectly with regard to economic growth. Proponents of corporate tax reform will attest that it is the most crucial part of the GOP's tax bill, arguing that it will lead to increased capital spending which in turn should lead to higher wages and increased productivity. At 35%, the U.S. currently has the highest tax rate compared to all developed countries in the world. By cutting the corporate tax rate to 20%, supporters of the bill agree that it should not only encourage corporations to repatriate profits back to the U.S. (including a one-time repatriation tax of 12% on cash and 5% on illiquid assets currently parked overseas), but would also lure foreign companies to bring some of their production from overseas to the U.S. Additionally, U.S. companies would owe no taxes on foreign income, as the U.S. would switch to a territorial tax system as opposed to a worldwide tax system. So companies would pay the foreign local tax rate in the country in which revenues were generated and bring profits back to the U.S. at no additional cost. To prevent companies from shifting profits overseas to countries with favorable tax systems and bringing profits back with no additional taxes, the bill would essentially impose a 10% tax on high profit foreign subsidiaries whose incomes are above a specified threshold.

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Tax Reform

As most of us are aware of, the final version of a bill almost never looks identical to the original proposal. There are several aspects of this bill that are currently being debated among congressional leaders and changes are being announced almost daily. What we have listed out are the details that we are currently aware of and we can almost guarantee that some of the items we have discussed in this update will be changed or modified in some way. We will continue to keep you informed on the changes to the current tax code and what you can expect with regard to your taxes moving forward. Please feel free to contact us with any questions you may have.

Disclosures & Index Definitions

Under style performance boxes, indexes referenced in the equities section for large, mid and small reference the Russell 1000, Russell MidCap and Russell 2000 stock indices, respectively. The Barclays US Government, Barclays Credit and Barclays High Yield fixed income indices refer to Gov't, Corp, and HY, respectively. Short, Intermediate and Long refer to the time frame of the investments and their positions on the yield curve.

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All dates are as of October 31, 2017 unless stated otherwise.

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Index Definitions

The **S&P 500 Index** is based on the market capitalizations of 500 large companies whose stocks are listed on the NYSE and NASDAQ. This is widely regarded as the single best gauge of large cap US Equities.

The **Dow Jones Industrial Average** is a price-weighted average of 30 actively traded blue-chip stocks, primarily industrials. It is used as a barometer of how shares if the largest US companies are performing.

The **NASDAQ** is a market capitalization weighted index of the more than 3000 common equities listed on the NASDAQ Stock Exchange. These securities include American Depository Receipts, common stocks, real estate investment trusts, and tracking stocks.

The **MSCI EAFE (Europe, Australasia, Far East) Net Index** is recognized as the pre-eminent benchmark in the US to measure international equity performance. It comprises the MSCI country indices that represent developed markets outside of North America, Europe, Australia, and the Far East.

The **MSCI Emerging Markets Index** captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 822 countries, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The **Barclays US Aggregate Index** is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS, and CMBS.

All index information has been gathered from public sources who are assumed to be reliable, although we cannot guarantee the accuracy or completeness of those public sources.