Edward Jones
MAKING SENSE OF INVESTING

Dear Lake Wales Chamber:

We thought you would be interested in the following commentary from Investment Strategist Craig Fehr about the tax reform bill and what the impact may be on the markets and the economy.

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2018 Tax Reform: What You Need to Know

Congress passed sweeping reform to the U.S. tax system, which is expected to be signed into law soon. This legislation is generally effective for tax years beginning after Dec. 31, 2017, with most of the provisions for individuals set to expire after 2025. Highlights of the bill include reduced individual income tax rates, an increased standard deduction/child tax credit, and a substantial reduction in the corporate tax rate.

Key Takeaways
1. Modest help to growth - Overall, we think the impact to household disposable incomes and corporate profitability poses a potential modest lift - though not a dramatic surge - to already fairly healthy economic growth.
2. Prepare for a return of volatility - Recent stock market gains already reflect some portion of the anticipated benefits, meaning gains going forward will need earnings, investment and spending to respond accordingly. We think this is a positive for investment conditions, but with tax reform now moving from a source of optimistic expectations to reality, we anticipate increased market volatility ahead. Remarkably, the largest dip in the stock market this year has been just 2.8%, the market's first year without a 3% decline. We think volatility will return to normal, including the probability for a temporary but material market correction.
3. This legislation is not without its shortcomings - Lower overall individual tax rates and the higher standard deduction should provide temporary relief for many individual taxpayers. However, details and complexities associated with tax returns will remain, warranting ongoing professional tax advice and management. Additionally, reforms are projected to add to the already-elevated federal debt and the individual income tax cuts are temporary (expiring at the end of 2025), setting up future Washington debates over whether to extend the cuts or raise taxes on U.S. households.

New Tax Bill: Notable Items

- **What is not changing for individual investors:**

- Capital gains - There will be no changes to the current tax rates for capital gains, dividends and interest income.
- Charitable donations remain deductible, if an individual taxpayer itemizes. With the increase in the standard deduction, it may make sense to consult your tax professional regarding future strategies for charitable giving.
- Retirement plans and IRAs - There are no changes to the retirement plan and IRA solutions available to individuals. In addition, no changes have been made to contribution limits and distribution requirements.

- **Lower individual income tax rates -** Seven tax brackets remain, with five getting reductions of between 1% and 4%, including the top marginal rate coming down to 37% (from 39.6%). The standard deduction will increase, which will likely reduce the number of individuals who itemize deductions.
- **Changes to certain investment accounts -** Investors' use of college savings accounts to pay for education expenses will be expanded. In addition to higher education expenses, beginning in 2018, college savings (529 plans) can be used to pay for up to $10,000 of tuition expenses per year, per student, in connection with enrollment at an elementary or high school (public, private or religious).
- **Increased estate and gift tax exemption -** The estate and gift tax exemption amount will be increased to $10 million (as indexed for inflation). This applies to decedents dying or gifts made after Dec. 31, 2017, and before Jan. 1, 2026.
- **Reduced corporate tax rates -** The top corporate tax rate will be reduced to 21% (from 35%) beginning in 2018, and the corporate AMT will be eliminated. Corporate earnings and assets that are repatriated from abroad will be taxed at a reduced rate (15.5% for cash, 8% for illiquid assets).

Keep in mind, this is not an exhaustive list, and the impact to individuals will vary. As a result, it is important to consult with your tax advisor to determine how these changes affect your situation and which tax strategies are most appropriate for you.

Implications for the Market

- **Gas, not jet fuel, for the market's tank**

- A boost to earnings - We expect upcoming stock market gains to be guided by corporate earnings growth, which will get a boost from lower tax bills, adding incrementally to profit margins and earnings growth next year.
- An incentive to put overseas cash to work - S&P 500 companies currently hold more than $1 trillion in cash overseas. With a new tax rate of 15.5% on foreign cash and 8% on illiquid assets, we think some of this may come back to pay down debt, dividends/share buybacks, and additional capital spending. If half of that amount (roughly $500 billion) were repatriated, that would represent 2.6% of annual GDP and 2.1% of the S&P 500 market capitalization, offering a favorable - though not seismic - bump to the economy.
- Sustained economic growth - Consumer spending accounts for nearly 70% of U.S. GDP, so higher take-home pay - from the combination of lower tax burdens and rising wages - could help extend this economic expansion. Since 2008, the rate of nominal personal income growth has been half of the 40-year average. Encouragingly, tax cuts in 1981 and 1986 were followed by notable upturns in personal income growth, though the acceleration in income growth lasted for roughly two years, not a permanent shift to a higher level.
- More moderate returns ahead - The 22% return in the S&P 500 this year has priced in tax reform expectations, with the market pulling forward some of the benefit to future earnings, meaning gains from here may no longer enjoy the boost from the "prospects" of tax reform. U.S. equities already trade at above-average valuations, so mid-single digit earnings growth plus dividends is a reasonable guide for market returns moving forward.

Overall, while this is the largest tax reform we've experienced in more than three decades, we believe it will be mildly positive to economic and earnings growth and should not prompt a change in your long-term investment strategy. However, with the "promise" of tax reform now a reality, we think investors should work with your Edward Jones financial advisor to:

- Prepare for greater market volatility, including a potential pullback
- Set realistic expectations for market returns and risk going forward
- Make appropriate portfolio adjustments to stay on track toward your long-term goals.

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We hope you find this information interesting. If you have any questions, please contact me at (863) 676-8320 to schedule an appointment.

Happy holidays,
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