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MARKET COMMENTARY

Stocks continued their ascent and finished the year strong. Large cap US stocks in the S&P 500 were up 6.6% for the quarter and 21.8% year-to-date. Small cap stocks posted a return of 3.3% this quarter to bring their 2017 gain to 14.7%. After outperforming most of the year, developed markets international stocks slowed their climb. The MSCI EAFE was up 4.3% for the quarter bringing its return to 25.6% for the year. Emerging market stocks didn't slow and were up 7.5% for the quarter and 37.8% for the year. Meanwhile, longer-term yields bounced between 2.30% and 2.45% for much of the quarter before ending at 2.41%. The Barclays US Aggregate Bond Index was up 0.4% for the quarter and finished the year with a 3.5% return.

Corporate earnings, economic growth and the anticipation of tax reform fueled the stock rally. Earnings grew 6.9% on average for companies in the S&P 500 during the third quarter. They are expected to grow 8.8% in the fourth quarter but are starting to be revised higher. This is promising as the fourth quarters in 2015 and 2016 had their earnings revised down. Before tax reform passed, S&P 500 earnings were projected to grow 11.7% in 2018. Small cap company earnings are expected to grow even more.

GDP growth has averaged around 2% since the start of the recovery in 2009. The final report for third quarter GDP growth was 3.2%. This is the second quarter in a row with GDP growth above 3%. The last time the US had 3% or higher GDP growth for two back to back quarters was in 2014. Some analysts are projecting fourth quarter GDP growth above 3% too. If that is achieved, it will be the first time since early 2005 that the US has seen GDP growth above 3% for three consecutive quarters. Growth in 2018 could also be 3% or more according to some analysts. Consensus is currently below 3% growth but analysts may adjust their estimates higher now that tax reform has passed.

The US economy has been helped by strong consumer spending and business investment, low unemployment, a good housing market, and a weaker US dollar compared to foreign currencies. Congress is looking to increase defense spending which coupled with hurricane relief spending could be $180 billion in 2018. This will likely add fuel to economic growth.

With the passage of tax reform, many analysts are expecting the strong growth to continue through 2018. Tax cuts are expected to result in more spending by individuals thereby increasing demand for products and services. In addition, the tax reform includes incentives for multinational companies to keep their profits in the US. Lower corporate taxes and these incentives is anticipated to result in more business investment here, more mergers and acquisitions, higher dividend payouts and additional share buybacks. Pfizer has already announced a $10 billion share buyback and increased its dividend, and several buyouts worth more than $11 billion were signed in the days following the Senate's vote. (See the back page for more about tax reform expectations.)

Economic strength is not limited to the US as the global economy has also been strong and monetary policy in foreign economies has been accommodative. JPMorgan notes that Japan especially is in a good position for future growth. They also believe that developed markets may outperform emerging markets as they expect China's growth to decelerate and therefore their demand for industrial metals to decline. Many developing economies are commodity driven and more tied to what is happening in China.

As expected, the Federal Reserve raised rates in December. They are expected to raise rates an additional 2 to 3 times in 2018. Inflation is expected to pick up again as the dollar is not expected to continue to weaken. JPMorgan believes inflation will increase to 2%. Rising inflation gives the Fed room to raise rates without derailing the economy. As short term yields increase, longer-term yields will likely follow so that an inverted yield curve does not emerge (where short-term yields are higher than long-term yields). Inverted yield curves are more likely during recessions, not in periods of strong economic growth.

Geopolitical tensions are ever present even though stock markets have not reacted. Barring an event, the other factors at play are likely to support stock prices. Waiting for a pullback before reallocating or investing may not be the optimal strategy. In 2017, volatility was very low and the S&P 500 Index didn't pull back more than 3%. Instead, gradual shifts may be more advantageous. We expect rising short-term yields to give way to higher longer term yields but not necessarily of the same magnitude. International stocks may outperform US stocks again and small cap stocks may outperform large cap stocks, but we still recommend that portfolios stay well diversified.

2017 BENCHMARK RATES OF RETURN

INDEX	FOURTH QUARTER	YTD
S&P 500	6.6%	21.8%
DJIA	11.0%	28.1%
NASDAQ	6.6%	29.6%
Russell 2000	3.3%	14.7%
International	4.3%	25.6%
Fixed Income	0.4%	3.5%

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have.

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FINANCIAL PLANNING

Tax Reform Implications

In the final days of the year, tax reform legislation was passed. It is the largest tax legislation since the 1981 Reagan tax cuts with far-reaching implications. The tax bill includes $205 billion of tax cuts in 2018 as tax rates are reduced for individuals and corporations. Overall, Strategas Research believes the legislation will provide "new incentives for work, savings, and investment".

For corporations, the top tax rate is reduced from 35% to 21%. They will also be able to immediately expense (rather than amortize over a period of years) capital equipment purchases for the next 5 years. There will also be a reduced repatriation tax to bring back the $1.7 trillion of cash held overseas to the US. Companies will be taxed on this cash at 15.5% and they can pay it over eight years. This cash could be used here in the States to invest in their business, make share repurchases, increase dividends, pay down debt, or use it for mergers and acquisitions. Some companies may even pay bonuses; AT&T said it will pay bonuses to 200,000 employees.

As a result, Strategas expects that the S&P 500's earnings per share will increase by $10 in 2018. Zacks Investment Research estimates that the S&P 500's earning growth rate will double in 2018 due to the tax legislation which is impressive since as we noted earlier they were previously projecting 11.7% growth. They also expect small cap stocks to benefit even more than the large cap stocks of the S&P 500. This earnings growth coupled with the 3% or more GDP growth expected will likely extend the stock market rally.

Yields on treasury bonds are expected to increase as well. When tax cuts were done in the 2003, yields jumped in a relatively short period of time. The 10-year treasury yield went from 3.1% to 4.6% in only six weeks because the resulting higher GDP growth had not been priced in.

Individuals will see changes in their personal finances, too. Opponents and much of the media have been portraying the legislation as a tax cut for the wealthy and big corporations so most Americans do not believe they will actually benefit from reform. However, Strategas's analysts calculate that just 5% of Americans will see a tax increase and these are nearly all high income individuals who are losing the ability to deduct their state and local taxes. That means that 95% of federal income taxpayers will see a decrease in their taxes.

Highlights for personal income taxpayers are:

- Income tax rates were reduced and tax brackets modified. The current tax rates are 10%, 15%, 25%, 38%, 33%, 35%, and 39.6%. The new rates are 10%, 12%, 22%, 24%, 32%, 35% and 37%;
- The personal exemption was eliminated but the standard deduction was doubled to $24,000 for joint filers;
- State and local tax deduction is limited to $10,000;
- The child tax credit was also doubled to $2,000 per child under 17;
- Mortgage interest deductibility is limited to interest paid on amounts borrowed in 2018 or after of $750,000 or less. Home equity interest will no longer be deductible; and
- The alternative minimum tax (AMT) only applies to individuals with more than $500,000 of income or families with more than $1 million of income.

According to Republican leaders, a family with two children making $75,000 per year is expected to see their taxes reduced by $2,000 on average.

There has been much talk about corporate tax rates being reduced and how that will affect pass-through entities like S-Corps, LLC's, PC's, partnerships, and sole-proprietors where the business income is taxed to the individual owners. Under the final rules, instead of the corporate tax rate, some owners of pass through entities will receive up to a 20% deduction of their business income. The deduction is subject to limits and restrictions and is phased out at higher incomes so high-income earners may not see any benefit. The calculation can be quite complex so please consult with your tax accountant to see how it would affect your situation.

The estate tax was not repealed but the exemption doubled from $5.5 million per person to $11 million. In 1997, the estate tax exemption was only $600,000 per person so many people had to make estate planning a priority. Over the last 20 years, this burden has been greatly reduced and will affect fewer people. However, it is important to note that unless new legislation passes, the exemption will revert back in 2025 to the $5.5 million per person.

In addition, the health insurance mandate under the Affordable Care Act was eliminated which means that Americans are no longer required to have health insurance coverage if they choose not to.

Pessimism surrounds this tax reform package similar to the Bush tax cuts in 2003. Both had across the board tax cuts and were deficit financed and many thought the tax cuts would not spur growth because it benefited the wealthy and was financed by debt. However, paychecks increased from the lower tax rates, real GDP growth grew 7% quarter over quarter in the third quarter of 2003, and stocks climbed higher for seven months until the Federal Reserve raised interest rates to curb growth.

CAMBRIDGE ADVISORS NEWS

Please help us welcome Trevor Peterson to our team. Trevor is our new intern. He is currently a senior at Creighton University where he is studying finance and marketing and is a part of the Portfolio Practicum class. He will be graduating in May. At Cambridge, he is assisting with investment research and helping to develop some tools for us to use in the investment management of portfolios.

2018 Retirement Contribution Limits

Retirement Plans	2017	2018
401k and 403b Plans	$18,000	$18,500
Catch up contributions*	$ 6,000	$ 6,000
IRAs		
Traditional or Roth IRA	$ 5,500	$ 5,500
Catch up contributions*	$ 1,000	$ 1,000
SIMPLE IRA	$12,500	$12,500
Catch up contributions*	$ 3,000	$ 3,000

*If you are age 50 or older, you can make additional catch up contributions