Investment Insights

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The Model Wealth Program
Principle-Based Investing

"Principal-based investing means we focus on investment principals that have stood the test of time rather than basing our decisions on short-term market predictions. Our goal is to identify a small number of experienced managers who offer the potential to outperform their peers over a long period of time. Our approach is to combine a well-defined quantitative and qualitative due diligence process with proprietary construction tools to build, manage and monitor our client's portfolios."

The Model Wealth Program is a managed fee-based investment program, available through Cornerstone Wealth Management, LLC. The MWP investment team has developed sophisticated long-term strategies in an effort to manage and control risk, to help investors pursue their financial goals. For more information about the program, contact your Cornerstone Wealth Management representative.

The 2017 Tax Cuts and Jobs Act

Sweeping changes to the tax law

After months of debate, Congress has passed their plan to overhaul the U.S. tax code for individuals and businesses. It's been called the most sweeping piece of tax legislation since 1986. The new law will lower individual income tax rates for the next eight years, allow fewer itemized deductions but a bigger standard deduction, and provide additional benefits to high-income business owners, corporations, and heirs to large estates. The new individual rates and brackets, and a new 20% deduction for pass-through businesses are set to expire at the end of 2025, unless a future Congress chooses to extend them. A corporate-tax-rate reduction and international tax rules were made permanent to encourage long-run planning.

Impact on the economy

Overall, the plan should lead to modestly higher GDP over the long-term. The Tax Foundation estimates 1.7 percent higher GDP over the long-term, 1.5 percent higher wages, 0.9 percent higher after-tax income for all taxpayers, and an additional 339,000 full-time equivalent jobs over ten years. In 2018, GDP growth could reach 2.45 percent, compared to baseline growth of 2.01 percent. (Source: Tax Foundation Taxes and Growth Model, November, 2017)

Timing

The 560-page bill was signed into law on December 22, 2017 and went into effect on January 1, 2018. The changes in the bill first apply to income earned in 2018.

What does it cost?

Overall, the plan should reduce federal revenues by $1.5 trillion over the next decade according to the non-partisan Joint Committee on Taxation December 15th report. Increased economic growth generated by the plan, however, should increase federal tax revenue by $600 billion over the next decade, according to estimates from the Tax Foundation. (Source: Tax Foundation Taxes and Growth Model, November, 2017)

Deductions and exemptions

The plan increases the standard deduction while eliminating personal exemptions

Standard Deduction

Old 2018: $13,000 (married); $9,550 (head of household); $6,500 (single)

New: $24,000 (married); $18,000 (head of household); $12,000 (single)

Personal Exemption

Old: $4,150

New: Repealed

Child Tax Credit

Old: $1,000, starts phasing out for married couples at $110,000 in income; $75,000 for others.

New: $2,000, $1,400 of which is refundable; starts phasing out at $400,000 in income for married couples, $200,000 for non-married households.

Key Impacts:

- The new law will lower individual income tax rates for the next eight years, allow fewer itemized deductions but a bigger standard deduction, and provide additional benefits to high-income business owners, corporations, and heirs to large estates.
- Individuals will get tax cuts that are set to expire in 2025. Some households, particularly upper-middle-class residents of high-tax states, may actually pay more tax than they do now.
- The plan is expected to cost $1.5 trillion over the next ten years, but higher economic growth should offset some of that impact.

New tax brackets

Here are the new tax brackets for the three most popular filing statuses:

Marginal Tax Rate	Single	Head of Household	Married filing Jointly
10%	$0 - $9,525	$0 - $13,600	$0 - $19,050
12%	$9,525 - $38,700	$13,600 - $51,800	$19,050 - $77,400
22%	$38,700 - $82,500	$51,800 - $82,500	$77,400 - $165,000
24%	$82,500 - $157,500	$82,500 - $157,500	$165,000 - $315,000
32%	$157,500 - $200,000	$157,500 - $200,000	$315,000 - $400,000
35%	$200,000 - $500,000	$200,000 - $500,000	$400,000 - $600,000
37%	Over $500,000	Over $600,000	Over $600,000

For comparison, here are the 2018 tax brackets that were scheduled to go into effect had the law not been changed:

Marginal Tax Rate	Single	Head of Household	Married filing Jointly
10%	$0 - $9,525	$0 - $13,600	$0 - $19,050
15%	$9,525 - $38,700	$13,600 - $51,850	$19,050 - $77,400
25%	$38,700 - $93,700	$51,850 - $133,850	$77,400 - $156,150
28%	$93,700 - $195,450	$133,850 - $216,700	$156,150-237,950
33%	$195,450 - $424,950	$216,700 - $424,950	$237,950 - $424,950
35%	$424,950 - $426,700	$424,950 - $453,350	$424,950 - $480,050
39.6%	Over $426,700	Over $453,350	Over $480,050

Deductions and exemptions (cont.)

State and Local Taxes

Old: Deductible for taxpayers who itemize, with limits

New: Caps at $10,000 amount that can be deducted

Allows people to count income or sales tax toward the state and local tax deduction. Allows people to deduct up to $10,000 in a combination of state and local property, income, and sales tax. The cap is not indexed to inflation, eroding its real value over time.

Mortgage-Interest Deduction for Both Primary and Second Homes

Old: Itemized deduction on loans up to $1 million

New: Itemized deduction on loans up to $750,000

Alternative Minimum Tax

Old: A parallel tax system that disallows personal exemptions and state deductions for high-earning households

New: Preserves the AMT but significantly narrows it

Medical Expenses

Old: Itemized deduction for expenses above 10% of income

New: Reduces that income percentage to 7.5% for all in 2017 and 2018

Student Loan Interest

Old: Above-the-line deduction to be used to show a lower income

New: No change

Graduate Student Tuition Waivers

Old: Not taxable

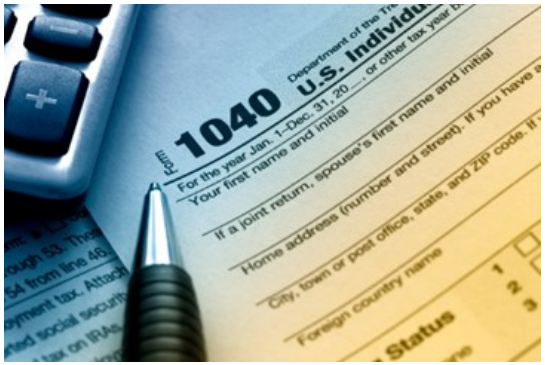
New: No change

Alimony

Old: Deductible for people making alimony payments

New: Not deductible to the payer for agreements signed after 2018

Other changes



Estate Tax

Old: 40% on estates over $5.6 million per individual

New: 40% on estates over $11.2 million per individual

Capital Gains and Dividends

Old: Top rate of 23.8%

New: No change

Pass-Through Businesses

Old: Pass-through business taxes based on individual income tax rates and brackets

New: Business owners get a 20% deduction for pass-through income; phases out for some businesses starting at $315,000 of income for joint filers.

Health Insurance

Old: Penalty for failing to have health insurance

Proposed: No penalty

529 Plans

Old: Proceeds from such tax-free accounts can be used for post-secondary education

New: Proceeds can be used for K-12 and for post-secondary education

Source: Wall Street Journal, Dec 18: What the Republican Tax Plan Means for You

Indexing for inflation

Indexes, tax brackets and other components will use the chained CPI measure of inflation. The move will slow the growth of tax brackets, which are adjusted each year to account for inflation. It is likely that, over time, taxpayers will find themselves facing a higher marginal income tax rate using the lower, chained CPI measure of inflation.

(Source: Tax Cuts and Jobs Act of 2017, Pub. L. 115-97)

DataBank

	1 Yr	3 Yr	5 Yr	10 Yr
U.S. Large Stocks	21.6	11.6	15.6	8.7
U.S. Small Stocks	15.1	10.7	14.4	9.0
U.S. Bonds	4.6	2.3	2.2	4.1
Intl Developed Mkts Stocks	26.6	7.7	6.6	2.0
Intl Emerging Mkts Stocks	35.0	9.0	4.0	1.9
U.S. Inflation (CPI)	2.2	1.5	1.4	1.6

Source: Morningstar. Annualized returns for periods ended December 19, 2017. U.S. large stocks is the S&P 500 Index, U.S. small stocks is the Russell 2000 Index, U.S. Bonds is the Bloomberg Barclays US Aggregate Bond Index, Intl Developed Markets is the MSCI All Country World Index Ex-US, International Emerging Markets is the MSCI Emerging Markets Index. Returns include dividends and interest. Investing involves risk including the potential loss of principal. No strategy assures success or protects against loss. Past performance is not an indication of future results. All indices are unmanaged and may not be invested into directly.

Simplification

It started as 30 words in 1913. It's estimated that Americans today spend more than 6.1 billion hours and $168 billion complying with the tax code. One of the goals of tax reform was simplification. By eliminating a lot of deductions at the same time rates were lowered, the process of completing a tax return may in fact be simpler for many Americans. However, after passage, the tax code is anything but simple, and is still likely to still be about 4 million words and 75,000 pages long. (Source: Wolters Klower).

As Will Rogers once said, "the difference between death and taxes is death doesn't get worse every time Congress meets."

Important Disclosures

The information in this report should not be considered tax advice. For further information on how the new tax law might impact you, consult a tax professional. The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Our View

While there is a wide range of views on this tax reform bill, reasonably sober analysis from sources such as the Joint Committee on Taxation or the Tax Foundation suggests that the new law will generate a bit more economic growth, put more money in the hands of consumers and businesses, and add modestly to the deficit over the next ten years. The stock market, which soared in the months leading up to the bill's passage, has certainly greeted the news with a lot of enthusiasm. Of course, estimates and projections over the next decade are inherently unreliable, and what really unfolds can either exceed those expectations or fall short. Regardless, here's some points for investors to consider:

- First, ignore the hyperbole and hysteria associated with the new tax law. Instead, do the math. Or, better yet, have your tax preparer do the math. Everyone's tax situation is unique, so it's very difficult for any outsider to give you an accurate assessment of how your family's finances will be impacted by the new law.
- Second, if you're very unhappy, or pessimistic regarding the new tax law, realize this too shall pass. The reality is that tax laws are changing all the time and this one will likely be changed again and again by future Congresses, if history is any guide.
- Third, while politicians often create winners and losers by changing the tax code, the stock market tends to reflect the whole pie. Over the long-term, the U.S. economy and corporate profits have tended to grow at a pretty steady pace, and the U.S. stock market has tended to reflect that growth over time. This, despite the many changes to the tax code and many different political leaders calling the shots.

So, our final thought is this: if you had a well-thought-out investment plan before passage of the Tax Cuts and Jobs Act, stick with it. If you didn't, develop one with the help of your Cornerstone Wealth Management financial advisor.

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