The BV Group Newsletter

1st Quarter 2017

New Year, New Market, New Administration

Last quarter I started this section off with title "Change is the only constant in life". Well, a lot has changed in the last three months. A surprise election result which dramatically moving markets upward. A sharp rise in interest rates that caused a noticeable drop in the value of bonds and a fair amount of uncertainty heading into the New Year as new administration policy starts to be put into place.

With that being said, we are cautiously optimistic about the markets and future growth heading into 2017. Now that the election noise is behind us, we hope the markets will focus on the fundamentals of the economy and corporate earnings. If the market focuses on these factors we feel that you should continue to see growth because we have strong investor sentiment, slight wage growth, labor growth and an opportunity for a favorable corporate tax structure. Despite some of our optimism, we do foresee headwinds for bond and fixed income investments, as we expect interest rates to rise in 2017. (See 4Q Newsletter).

As always, thank you for your trust in what we do and our process. Cheers to a successful 2017!

Front Row Left to Right: Jennifer Young, Briana Berndt
Back Row Left to Right: Rick Verthein, CFP®, Curt Brewer,CFP®,ID

MARKET PULSE (As of 12.31.2016)

Index	QTD	YTD	1 year	3 year	5 year
Dow Jones Ind Avg	8.66%	16.50%	16.50%	8.71%	12.92%
Nasdaq Comp.	1.34%	7.50%	7.50%	8.83%	15.62%
S&P 500	3.82%	11.96%	11.96%	8.87%	14.66%
MSCI EAFE	-0.72%	1.01%	1.01%	-1.60%	6.66%
Barclays Agg Bond	-2.98%	2.65%	2.65%	3.03%	2.23%
Barclays Muni Bond	-3.62%	0.25%	0.25%	4.14%	3.28%
Barclays High Yield	1.77%	16.85%	16.85%	4.58%	7.32%
Citi 3-Mo T-Bill	0.08%	0.27%	0.27%	0.11%	0.09%

2017 Economic & Stock Market Outlook: Focus on Fundamentals

Baird Market & Investment Strategy

2017 Economic & Stock Market Outlook
December 8, 2016

Please refer to Appendix – Important Disclosures.

Focus on Fundamentals

Outlook Summary

After extended period of sub-par growth, foundation for improved economic trends has been laid.

Wages are rising and economic optimism could help fuel rebound in capital spending.

Better productivity trends key to returning to historically normal growth trends.

Return of earnings could help ease valuations concerns for still-young cyclical bull market in stocks.

S&P 500 could reach 2400 in 2017, but rally prospects better in H1 than H2.

Fed may modestly accelerate pace of rate hikes, but relative importance of such moves may fade. 10-year T-Note yield could reach 3.0%.

2016 shaped up to be a very nice year for the markets. As you can see above, performance across almost all asset classes were positive and double digit for most of the equity markets.

Feel free to click the image to the left or click here: https://goo.gl/0iof5W to see what our Investment Strategists are focusing on for 2017.

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Tax Deadlines & Baird Tax Document Mailings

As we wrap up the year and shift our focus to preparing our taxes here are several deadlines to keep in mind:

2016 IRA and ROTH IRA Contributions are due April 17th

- When making contributions you'll want to pay attention to income limits and the phase out amounts. In short, anyone can contribute to an IRA, however you lose the ability to deduct the full contribution if you are married and make over $118,000 combined ($71,000 for single filers)
- You lose the ability to directly contribute to a ROTH IRA if you are married and make more than a combined $194,000 in come. ($132,000 for single filers)
- If you do make more than $194,000 as a married couple or $132,000 as a single filer, be sure to give us a call to discuss the **"Back Door ROTH Strategy".**

Baird Tax Forms will continue to be mailed in Waves. Here are the Tax Statement Mailing Dates.

- **February 15, 2017** – We anticipate the majority of Baird Tax Statements will be mailed by this date. Certain accounts will not receive a Tax Statement by February 15 if year-end tax adjustments have not been received from third parties prior to this deadline (e.g., exchange-traded funds, mutual funds, real estate investment trusts and/or unit investment trusts).
- **March 1, 2017** – Tax Statements for accounts that have since received year-end tax adjustments will be mailed by this date.
- **March 15, 2017** – All remaining Baird Tax Statements will be mailed by this date. Accounts holding real estate mortgage investment conduits (REMICs) and/or widely held fixed investment trusts (WHFITs) will receive a consolidated tax form.

Your tax forms can be sent directly to your tax preparer

- We have found that sending 1099s directly to your tax preparer can save you time when you are pulling together all of the information for your taxes. If you'd like us to send duplicate tax forms to your preparer, give us a call and Jenn or Briana will send you the authorization form.

2017 Fixed Income Outlook

January 5, 2017

A presidential election, an end-of-year interest rate hike and the forecast of additional rate increases have left many bond market participants unsure of what to expect for 2017. We spoke with Craig Elder, Senior Fixed Income Analyst and author of Baird's Fixed Income Weekly, about the new administration, the Federal Reserve and what's in store for bonds in the new year.

Baird:

2016 had been something of a wild ride for the bond markets, especially over the final few months. How would you characterize where we are now?

Craig:

In 2016, the big question for fixed income investors was when the Fed would raise interest rates. Finally in December that question was answered. Going into 2017, not only do we have the question of additional Fed rate hikes, but we also have questions about fiscal stimulus and tax policy added to the mix.

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Baird:
How could the policies of a Trump administration affect the bond market?

Craig:
First I think you have to look at his proposals to reform the tax code. While campaigning, Donald Trump talked about having four individual tax brackets – 0%, 10%, 20% and 25% – and lowering corporate taxes to 15%. Meanwhile, Speaker of the House Paul Ryan discussed having three individual tax brackets – 12%, 25% and 33% – and cutting the corporate rate to 20%. Either of these would make muni bonds less attractive on an after-tax basis. For an example, let's look at AAA munis. A 10-year muni for someone in the 39.6% tax bracket would have an after-tax yield of 4.08%. If you lower that tax bracket to 33%, the after-tax yield is only 3.56% – a 52-basis point difference. That's huge. That muni yield is just not going to be as attractive when compared to other fixed income alternatives like mortgage-backeds and investment-grade corporate bonds.

Baird:
What other Trump administration policies could impact the bond markets?

Craig:
During the campaign, candidate Trump talked about spending a trillion dollars on infrastructure, which would have a huge impact on the municipal market. Is Congress going to agree to that? We'll have to wait and see – I have doubts that Congress will agree to a proposal of that size because the U.S. deficit is already so large. It's also worth mentioning there are two Federal Reserve Board of Governor slots that are currently open. President-elect Trump will get to name his people to those slots, and it is expected those nominees would be more hawkish. In addition, the Fed chair term expires in early February 2018, and the president will get to either renominate Janet Yellen or appoint a new Fed chair.
We believe Speaker Ryan's tax proposals have a better chance of passing through Congress than President Trump's. In addition, the president's nominees and proposals are going to take time to move through Congress, so their impact might not be felt until the second half of 2017 and into 2018.

Baird:
That's a good segue into the Federal Reserve. You mentioned the Fed was committed to raising interest rates. What did we learn from last year's rate increase?

Craig:
Pretty much everyone expected the Fed to raise rates 25 basis points, which they did. The surprise was that they've suggested another three rate hikes in 2017. Of course, in 2016 they were calling for four rate hikes and we got one. Still, our view is that the Fed will raise rates twice this year, most likely in June and December.

Baird:
What is the Fed basing their conclusions on?

Craig:
Inflation, first and foremost. Inflation is still below the target of 2%, but it's edged up 25 basis points over the past year to 1.74%. Fed chairwoman Janet Yellen said they expect to reach that 2% target over the next two years, but market data suggests we could reach it as soon as mid-2017. If inflation does rise above the 2% target, the Fed will likely have to raise rates more quickly.

Baird:
It sounds like all these factors could suppress demand for munis in 2017.

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Craig:
We believe so. As we mentioned, lower tax brackets mean lower after-tax yields on municipals. However, while issuance was strong in 2016, that was driven by concerns over higher interest rates in the future. We feel that issuance will be reduced in 2017, possibly by 15–20%. Expectations are for more of a reduction in refunding activity than in new issuance.

Baird:
What would a drop in issuance mean for our muni clients? Will it be harder to fund projects?

Craig:
We believe interest rates will likely go higher this year, with the benchmark 10-Year Treasury yield moving to the 3%–3.25% level, but we don't believe it's going much higher. Still, issuers will have to evaluate projects on the basis of (1) if their project is really necessary, and if so, (2) will they be able to fund it. We believe it will not be difficult to fund projects, but at a slightly higher cost.

Baird:
What advice would you have for people invested in fixed income?

Craig:
If you're an individual fixed income investor, our first piece of advice is to not panic and liquidate your portfolio simply because interest rates are higher and bond prices are lower. Money market rates remain low and do not provide adequate income. If you've been laddering your bond portfolio, you should continue with this strategy, as you'll have bonds maturing whose proceeds can be reinvested in a higher-interest-rate environment as you maintain the ladder.

Baird:
Does it make sense to reduce your fixed income position?

Craig:
That is an asset allocation decision based on your tax situation, your future demand for money and your risk tolerance. As we discussed, tax policy will likely change, while your future monetary needs and risk tolerance are individually based.
We recommend working closely with your financial advisors on your asset allocation and for updates on what's coming out of Washington and what's coming out of the Fed. Stay the course, but keep your eye on the ball.

Upcoming Baird Wealth Strategies Calls

- **Baird Wealth Strategies –***We will be sending invitations out to clients in targeted emails regarding topics that we feel that you might find interesting. This will be done in order to avoid sending you excess email communication and keeping your inbox clean. If however there is a topic you are interested or would like to know more about, please don't hesitate to let us know.*

  - *January 18th, 2017* – **How Criminals Get Our Information and What We Can Do to Stop Them**
    - *Presented by Jeff Lanza, Retired FBI Agent*

  - *February 15th, 2017* – **Estate Planning for Digital Assets**
    - *Presented by Rick Holman, J.D., CFP®, CLU®*

  - *March 15th, 2017* – **Understanding Social Security and Strategies to Maximize Your Benefits**
    - *Presented by Brian Ellenbecker, CFP®, CPWA®, CIMA®*

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