The Light

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Volatility Is Back—But It's OK

By Tim Rowsey, CPA, Investment Advisor Rep.

In the first quarter of 2018 investors experienced something that they had not seen much in the prior year – market volatility. What exactly do we mean by market volatility? When the market shows significant fluctuation in value, either up or down, that is volatility. For most investors upside volatility is great. We all like to see the value of our holdings increase. The downside volatility is another thing entirely. That is where the emotions of fear and uncertainty start to come into play. In order to better understand volatility and what is normal, we thought we would look back over the last 10 years, and also look at some newer tools that help track and monitor volatility.

The 2017 year saw an unprecedented amount of stability and growth in the stock market. It was also notable for the unusually low amount of volatility in the market. This came as somewhat of a surprise to many people because there was certainly major uncertainty relating to North Korea, politics in the US, and major scandals relating to mistreatment of women. In spite of all of the social and political noise in the world, the market showed consistent, steady growth. The S & P 500 grew every calendar month in 2017. The VIX index, which we will discuss below, also fell to an all-time low.

There are several ways which volatility can be measured and we want to take a look at two of them.

The Chicago Board Options Exchange (CBoe) is the largest US options exchange. They offer an index called the VIX index, which is a key measure of the market expectations of near-term volatility. This is tied to the S&P 500 stock index options prices. This index is also commonly known as the "fear gauge" or "fear index."

The long term average price for this index is just over 20. As the market struggled in 2008 the index ran as high as 80. For most of the 2017 year the index ran in the 8 to 12 range and twice hit all- time lows. Of the lowest closing levels in the

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New Tax Law

By Tim Rowsey, CPA, Investment Advisor Rep.

On December 22, 2017, the Tax Jobs and Cuts Act of 2017 became law. This was the most significant tax overhaul in 30 years. The total impact on taxpayers of this bill is beyond the scope of what we can cover in this article. However, we did want to highlight at least some of the most significant items that will impact a large number of people. In general, this law will reduce the tax burden of most taxpaying Americans.

Probably the most significant change in the bill is the reduction of tax rates. Most married taxpayers with taxable income between $20,000 and $300,000 will see about a 3% lower tax rate on that income. Here is a chart showing the new tax rates along with the approximate matching of the old rate:

Old Tax Rate	New Tax Rate	Single Filers	Married Filing Jointly
10%	10%	Up to $9,525	Up to $19,050
15%	12%	$9,526 to $38,700	$19,051 to $77,400
25%	22%	$38,701 to $82,500	$77,401 to $165,000
28%	24%	$82,501 to $157,500	$165,001 to $315,000
33%	32%	$157,501 to $200,000	$315,001 to $400,000
35%	35%	$200,001 to $500,000	$400,001 to $600,000
40%	37%	$500,000+	$600,000+

In January the IRS released new withholding tables based on the new tax rates. Many employees may have seen their federal withholding decrease and their net paychecks go up due to this new law.

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Volatility (continued from page 1)

history of the index, over 80% of them occurred in 2017. Recent market fluctuation and volatility have once again driven the VIX back to slightly above its historic long term average. In the first quarter of this year there were several days with price jumps of over 20% on the index.

Another way to measure volatility is to look at the number of times that an index such as the Standard and Poor's 500 changed in value by more than 1% in one day of trading. We looked back at the daily value change of the S & P 500 since January 1, 2010. Over the seven years, from 2010 thru 2016 on average there were 32 trading days that the average increased more than 1%. During that same time period the S & P averaged 28 days with a decline of greater than 1%. With approximately 250 trading days a year, on an average year nearly one out of four trading days showed an increase or decrease in value of over 1%. This was the normal volatility from 2010 thru 2016.

Then came 2017. For the entire year in 2017 there were only 8 days with fluctuations of more than 1%. Four days in 2017 with an increase greater than 1% and four days with a decrease of 1% or more. This may have lulled investors into the false impression that market fluctuation was a thing of the past.

The first quarter of this year saw a return to prior patterns of volatility. In the first quarter we saw 20 total days of greater than 1% value change in the S & P 500. This included a week in February with both a 3.75% decrease and a 4% decrease. If we compare this year's recent volatility to 2017 it may seem like the market is falling apart or doing something much different than the past. The truth, however, is that 2017 was really the unusual year. Historically, valuation changes in the market (volatility) are quite normal.

One reason we are not overly concerned about the volatility in the market is these swings in value give prudent money managers opportunities. Top quality equity investments are available to be purchased at discount prices when the overall market declines. In addition, if an investor were to stay out of the market because of volatility, they not only miss the average of 32 greater than 1% down days, they also miss all of the up days as well. Over the 7 years 2010 thru 2016 in spite of all of the volatility, the S&P 500 still managed to average over a 13% per year average return.

The bottom line on volatility is that in the markets it is normal and nothing to fear. It also may be a path to even greater returns in the long run for a patient investor who is not distracted by short term changes in market value. ■

Tax Law (continued from page 1)

Personal and dependent exemptions have been eliminated starting in 2018. For the 2017 year, taxpayers were allowed an exemption of $4,050 for themselves and each dependent. This change by itself would increase the taxable income for taxpayers. However, in conjunction with changes in child credits and standard deduction amounts, it will not have a negative impact for most tax filers.

The standard deduction has also been changed dramatically. In 2017, the standard deduction was $6,350 for a single person and $12,700 for a married couple. In 2018, this increases to $12,000 for a single person and $24,000 for a married couple. There is an additional $1,300 per person add-on for individuals over age 65. This change will dramatically reduce the number of people who will need to itemize deductions.

For those who may continue to itemized deductions there have been some changes to what is allowable. There is now a limitation on the deduction of state, local, and property taxes. This deduction is still allowed but will now be limited to a maximum deduction of $10,000. This has a larger impact on taxpayers in high tax states or who have substantial mortgage and real estate tax expenses. Other changes in itemized deductions are elimination of the deductibility of home equity interest (except in some limited cases) and expansion of charitable contribution deduction up to 60% rather than 50% of adjusted gross income.

Medical expenses are deductible for 2017 and 2018 if they exceed 7.5% of AGI. The limit on this deduction will go to 10%

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of AGI in 2019. The deduction for miscellaneous itemized deductions subject to the 2% floor has also been eliminated. This includes employee business expenses, tax prep fees, union dues, and investment expenses.

Another significant change is to the child credit. In the past, there was a $1,000 tax credit for children under age 17. This was phased out for married couples with income exceeding $110,000. The new law allows for a credit of $2,000 per child and the phase out does not begin for a married couple until income exceeds $400,000. Of this improved credit, $1,400 is refundable.

A new $500 credit for dependents who do not qualify for the child credit has been created. This would be available for children who are older than 16 but who can still be claimed as a dependent. Other non-child dependents such as an elderly parent who is claimed as a dependent would also qualify. This credit is not available to the taxpayers or their spouses.

The final, most significant change relates to pass-through entities and a potential 20% reduction in the taxability of that income. This would be available to self-employed taxpayers as well as income from partnerships and S corporations. For example a self-employed taxpayer who makes $100,000 may qualify for an income deduction of 20% of that total. This would reduce their taxable income by the $20,000 deduction. This is an extremely complex provision of the law with some limitations based on W-2 income and other factors. We won't attempt to cover all of the details in this article.

Other major items in the new law:

- Capital gains rates stay the same
- Educator expense deduction of up to $250 per year are retained
- Student loan interest is still deductible
- IRA deductions stay the same
- Health care penalty will be eliminated but not until 2019. Taxpayers who did not have coverage in 2017 and 2018 will still be subject to the penalty unless they qualify for an exemption.
- Education deductions for the American Opportunity Credit and the Lifetime Learning Credit are retained; however, the Tuition and Fees Deduction has expired

With this significant overhaul in the tax law most taxpayers should see a reduced tax liability in 2018. ■

Market Recap

How the major indices performed in the 1st Quarter 2018:

DOW JONES INDUSTRIAL AVERAGE
1st Quarter return -1.96% YTD return -1.96%

S & P 500 COMPOSITE
1st Quarter return -0.76% YTD return -0.76%

RUSSELL 2000
1st Quarter return -0.08% YTD return -0.08%

BARCLAYS AGGREGATE BOND
1st Quarter return -1.53% YTD return -1.53%

*All indices are reported Total Return which includes Dividends

Market Update

By Tim Rowsey, CPA
Investment Advisor Rep.

The first quarter of 2018 was full of volatility for equities.
Stocks jumped out to a strong start in January with both the Dow Jones Industrials and the S&P 500 setting new all-time highs. In February, all of the gains and more were lost and a correction (market decline of over 10%) happened for the first time in two years. When the dust settled for the quarter all of the major indexes were down. The Dow Jones Industrial Average lost 1.96% on a total return basis (including dividends). The S & P 500 was also down 0.76% for the quarter. Small cap stocks, as represented by the Russell 2000, also were down with a 0.08% decline.

Bonds also decreased for the quarter.
The Barclays Aggregate Bond Index fell by 1.53% for the quarter. The Fed increased the benchmark interest rate another .25% in March as was widely expected. They are still projecting three rate increases for 2018 including the one just completed. Jerome Powel, the new Fed Chairman, seems to be taking a very measured and cautious approach in his new role.

Tech stocks faced some turbulence at the end of the quarter.
Questions about privacy rocked Facebook and many other tech names were also caught in the downdraft. Much of the growth last year was driven by the so called FAANG stocks: Facebook, Apple, Amazon, Netflix and Google. Many of these stocks rebounded sharply on the last trading day of the quarter. The next few weeks will see the start of earnings' season when companies disclose their earnings for the first quarter of 2018. This will be the first time the impact of the lower corporate tax cuts will show on company profits. We are optimistic that this could be good news for the markets. ■

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