The
FINANCIAL UPDATE

DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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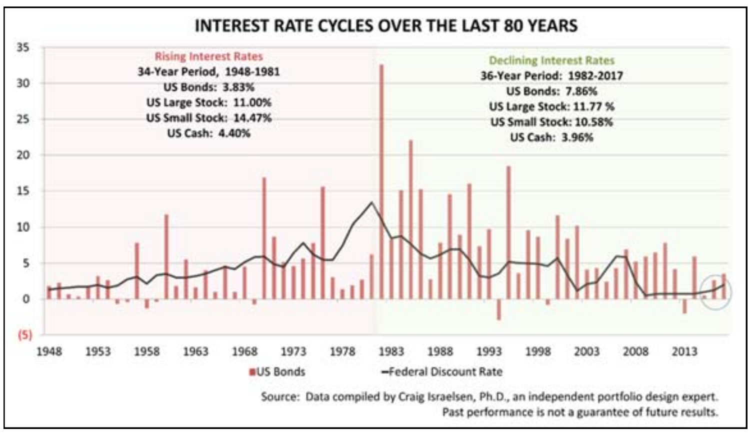
The Interest Rate Inflection Point And Your Portfolio

Interest rates are on the rise, and that means bond prices will decline. Here's a summary of financial history since World War II demonstrating how long interest rate cycles last and how it is likely to affect you.



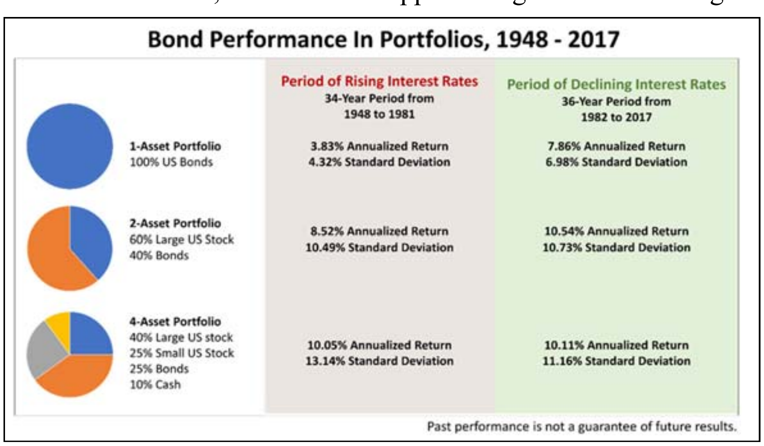
Source: Data compiled by Craig Israelsen, Ph.D., an independent portfolio design expert.
Past performance is not a guarantee of future results.

From the end of World War II to 1981, interest rates rose, as is shown in the black line in the chart. Of course, when interest rates rise, bonds prices fall because bonds paying less than the new, higher rate are less desirable and their prices adjust downward. Thus, from 1948 to 1981, the average annual return on bonds was just 3.83% annually.

Now look at what happened since the declining rate cycle began in 1982 through the end of 2017. As interest rates moved lower, the prices of bonds climbed. Bonds returned an annual average of 7.86%, for this 36-year period. Which brings us to where we are today.

Interest rates started moving up about two years ago, which means bond holdings declined in value. The Federal Reserve, which controls short-term rates — the black line — will continue to push rates higher for many years, if history is a guide. In fact, amid the strengthening economy, the Fed says it expects to ratchet rates higher again and again in 2018.

For investors who, over three decades, have grown accustomed to bonds appreciating at a rate rivalling



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Celebrating Our 20th Anniversary At Day & Ennis

20 years ago, Day & Ennis opened with John Day, a part time secretary and his wife Diana to handle marketing and communications. Our goal from the start has been to provide unbiased, fee-only advice to help our clients achieve financial peace of mind. We still do not sell any products or take commissions.

Our business model has worked well. Today the majority of our new business comes as referrals from existing clients, CPAs and attorneys. We serve over 200 families and small businesses and manage over $260,000,000 in assets. We continue to expand, with clients now in twelve states. This year we've added a branch in Blairsville for the people of north Georgia and nearby areas.

New partners have come along, with Bill Ennis joining the firm in 2003, Stephanie Hall in 2007 and Matt Heller in 2013. Susie Bilimoria, our portfolio accounting manager, has been with us since 1999. Shannon McGehee joined the firm this summer as office coordinator after Mary Martha DeFoor moved with her husband to Alabama.

We appreciate the support we continue to receive from our clients and professional networks. We look forward to serving you in the coming years.

Sincerely,
Day & Ennis, LLC

Qualifying For The New Business Owner Tax Break

Under the new tax law, business owners are entitled to deduct 20% of "qualified business income." The test for qualifying for a tax break on 20% of business income is defined in the Tax Cuts and Jobs Act (TCJA) and summarized here along with a simple illustration.

If you formed your BUSINESS as a sole proprietorship, S corporation, partnership, LLC or similar pass-through entity, you are entitled to the deduction. C corporations don't qualify for the 20% deduction. Only businesses generating income not taxed at the company level, but directly to the owner.

Qualified business income is the business' day-to-day, non-investment income. It's revenue the business generates minus expenses.

QBI doesn't include interest, dividend income or capital gains on a property sale. Nor does QBI include salary or wages paid either as W-2 wages from an S corporation or guaranteed payments from a partnership.

However, the 20% deduction is limited to the lesser of:

- 20% of qualified business income, or
- 50% of the total W-2 wages paid by the business.

A separate limit based on the unadjusted basis of certain business assets could also apply, a rare situation.

More important: The 50% W-2 wage cap kicks in when a couple filing jointly has a total taxable income of more than $315,000 ($157,500 for singles).

Here's an illustration of a couple who owns a business with $200,000 in qualified business income, with no real assets, such as vehicles or real estate, and with one employee who was paid $50,000 in 2018. The couple would be entitled to QBI deduction of $40,000. That's 20% of $200,000.

Because the couple's taxable income is less than $315,000, the wage limitation — 50% of wages paid to their employee — is equal to $25,000 and would not apply.

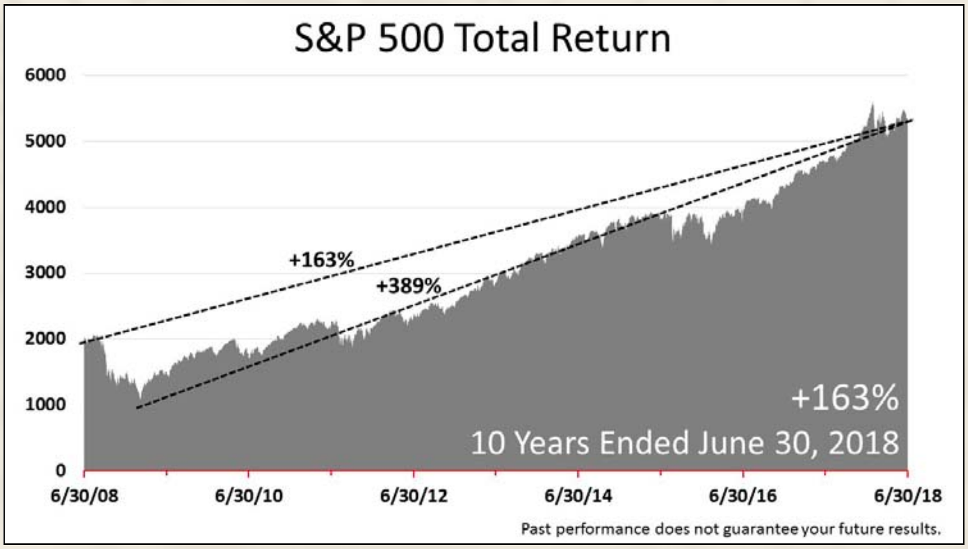
Some business owners with more than $315,000 in QBI may want to consider reducing their W-2 wages or guaranteed payments to qualify for the deduction, but this requires careful planning and personal consulting beyond this simple illustration. The rules are new and technical, and before changing how your business pays you to qualify for the 20% QBI deduction, it's prudent to contact us and plan properly. ●

Ten Things About 10-Year U.S. Stock Market Performance

Although a picture is said to be worth a thousand words, out of respect for your time, here are 290 words about this chart of U.S. stock market performance over an amazing decade.

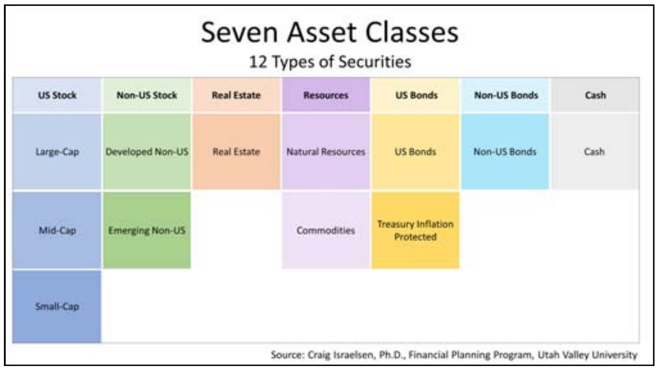
1. Over the 10-year period ended June 30, 2018, the S&P 500 total return index gained +163%, an average annual return of 16.3%, compared to the average annually since 1926 of 10%.

2. From the financial crisis bottom on March 9, 2009, the S&P 500 total return index through June 2018 gained +389% — an average return in those nine years of 43.2%.



Soaring Stocks Raises Importance Of Diversifying

The concept of diversification is vital to investors: Don't put all your eggs in one basket so they won't all get smashed if you trip and fall. It's better to spread your wealth over a broad financial spectrum of investments, but avoiding pitfalls isn't as intuitive as it may seem. This is especially important to remember when stocks are soaring and portfolios can get overloaded with stocks and human nature is to get greedy and overly optimistic about a continuation of the current trend.



Retirement investors sometimes think broadening asset allocation is as easy as plunking 401(k) contributions into a fund investing in the Standard & Poor 500, which is called a "broad market index." But 500 stocks is not a diversified portfolio. It diversifies exposure in a single asset class — namely, large U.S. companies with a market capitalization of more than $10 billion. That's not a broadly diversified portfolio.

In 2008, when the financial crisis hit, many investors held portfolios loaded up on U.S. stocks. That year, the S&P 500 fell 38%. If more of their holdings had been in bonds, particularly U.S. Treasurys, the crisis would not have hurt their portfolios as badly. The Bloomberg Barclays U.S. Aggregate Bond Index, representing U.S. Treasurys, corporates and other investment-grade bonds, gained almost 6% in 2008, as stock investors scrambled to a less risky place for their money.

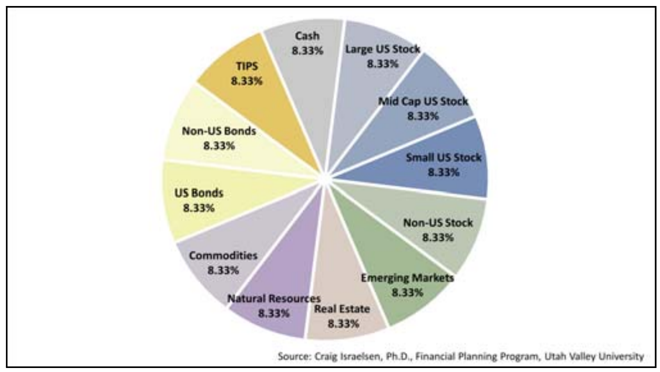
Diversification is like salsa. You can't make it with tomatoes alone. You blend in onions, garlic, cilantro and jalapeno to create the right recipe for you. Diversifying requires adding more than large-cap stocks.

The classic meat and potatoes portfolio of stocks and bonds became popular in the 1930s. The same way we've learned since then that adding vegetables and salads improves your odds of good health, increased understanding of finance tells us adding additional types of assets to a portfolio improves the odds of a retirement portfolio surviving longer.

A portfolio spanning seven asset classes and allocated equally across 12 different types of securities provides an example of the rigor, discipline, and wisdom of diversification. Stock mutual funds or exchange-traded funds diversify a portfolio across indexes of large-, small- and mid-sized companies, as well as different types of bonds.

Funds and ETFs, whose holdings mimic indexes to represent broad categories of stocks or bonds cost about 1% a year less than an actively managed mutual fund or ETF. Saving 1% in investment expenses may not sound like much but, it adds up over the long term, due to the magic of annual compounding once hailed by Albert Einstein "as the eighth wonder of the world."

Another way of looking at a diversified portfolio is as a pie apportioned in slices. In this example, the portfolio is comprised of 12 equal slices of different types of securities. In practice, the apportionment can be tweaked to suit your risk tolerance and personal taste.



Periodically, one component of your portfolio is bound to outperform its historic norm. An 8.33% position grows in value to represent 10%, 12%, or more of the total portfolio and other allocations shrink. Correcting these imbalances periodically recalibrates your portfolio to your goals and preferences. Rebalancing is another mathematical wonder.

The bottom line is that a low-expense quantitative discipline for managing a portfolio, when combined with personal financial planning to pay for long-term goals, does not guarantee you will get everywhere you want to go in life. But it gives you a clear road map to improve your chances for getting there. ●

3. In the nine-year bull run, stocks "corrected" — market-speak for a decline of 10% to 20% — four times, and each double-digit setback came in the last five years.

4. An investor with perfect timing predicted the March 9, 2009 low during the bottom of the 40% drop in prices in the bear market of 2008-9, which no one could, and then held for the next nine years, despite four corrections.

5. An investor with the worst possible timing, who put their retirement nest egg in stocks at market peak a decade ago, just before values plunged by 40%, in the decade, averaged a return of 16.3% annually.

6. The Great Recession decline of 40% was one of the worst bear markets in modern U.S. history.

7. Those within five years of retiring are at the greatest risk to bad timing and can be mitigated by strategically allocating assets, which is crucial to pre-retirees.

8. America's 500 largest publicly held companies more than fulfilled their role as the engine of growth in a broadly diversified retirement portfolio.

9. Understanding 10 years of stock market performance requires knowing statistics, but mostly depends on knowing the history of domestic and global financial assets, along with economic fundamentals driving growth.

10. No one can predict the end of a bear or bull market or the stock market's next big move. ●

10 Things: New Education Tax Breaks For A Child Or Grandchild

1. If you have a child or grandchild, for the first time ever, you can now pay tuition for kindergarten through 12th grade at private, public or religious schools with money saved in tax-advantaged 529 college savings accounts.

2. Thanks to the Tax Cuts And Jobs Act (TCJA), you now can draw up to $10,000 tax-free per student from a 529 plan, which is a tax-advantaged program sponsored by states, state agencies, and educational institutions.

3. While your contributions to a 529 plan are not deductible, earnings grow free of federal income tax on withdrawals to pay for qualified school expenses.

4. You are not limited to 529 plans sponsored by your state. You can choose from a long list of 529s sponsored by other states and choose the right one for you. Call us if you want help with this.

5. A big relief is that the new law leaves the student loan interest deduction unchanged at $2,500. Some lawmakers wanted to scrap it, but the majority rallied to the tax break's defense. Americans owe some $1.48 trillion in student debt, and it's definitely a thing to watch.

6. When student loans are cancelled due to death or disability, they now become tax-exempt. Till now, the debt would be added to the income of a deceased or disabled individual. This new tax benefit is not retroactive, and only affects loans taken from 2018 through 2025. Congress may choose to extend this tax break.

7. The TCJA axes taxes on alimony payments, so custodial parents should have it easier qualifying for need-based aid. Their income won't be as high as what's reflected in tax records, which is what federal aid officials rely on to determine who to help and by how much.

8. Tax deductions for interest on home equity loans and lines of credit were eliminated. These are major sources of education funding, businesses, and a range of other expenses. It's gone.

9. The new federal levy on colleges with big endowments could result in still-higher tuition costs.

10. Education tax breaks were boosted overall by the TCJA, but you almost must be a financial professional to manage the complexities of funding the education of a child tax-efficiently and with low investment expenses. ●

Interest Rate Inflection Point

(Continued from page 1)

stocks, the future seems likely to be very different, which especially affects the demographic bubble of baby-boomer retirees, who have long favored bonds for producing reliable income.

To understand the effect the new rising rate cycle might have on your portfolio in the years ahead, this table gives you the key facts.

The 11% annual return on stocks and the return of about 4% on Treasury Bills stayed approximately the same through both the rising and falling interest rate cycles. However, the 3.8% average annual return on bonds in the rising rate cycle from 1948 to 1981 was less than half the 7.86% annually averaged on bonds during the 1982 to 2017 period. This poses a new kind of risk that many investors have never experienced before.

During the rising rate cycle, when the average annual return on bonds was a measly 3.83%, stocks and 90-day Treasury Bills averaged about the same annual return as they did in the falling rate cycle. The performance of stocks, bonds, and cash over this period demonstrates why diversification and a strategic approach are so important to long-term investing.

Shorter maturity bonds — due in three- to seven-years, as opposed to 10, 20, or 30 — are less susceptible to interest rate risk than longer maturity bonds with more years to run paying your interest before returning your principal.

These illustrations do not reflect the impact of inflation, which adds another dimension and requires a separate discussion. The takeaway here is that rates may be at the start in a new long-term cycle and clients can rely on our advice on the best way to manage this risk. Please do not hesitate to contact us with questions. ●

Large-cap US equity represented by the S&P 500 Index. Small-cap US equity represented by the Ibbotson Small Companies Index from 1970-1978, and the Russell 2000 Index starting in 1979. Non-US equity represented by the MSCI EAFE Index. Real estate represented by the NAREIT Index from 1970-1977 and the Dow Jones US Select REIT Index starting in 1978. Commodities represented by the Goldman Sachs Commodities Index (GSCI). As of February 6, 2007, the GSCI became the S&P GSCI Commodity Index. U.S. Aggregate Bonds represented by the Ibbotson Intermediate Term Bond Index from 1970-75 and the Barclays Capital Aggregate Bond index starting in 1976. Cash represented by 3-month Treasury Bills.

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