The Edge

It’s Tax Season!

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Are you a tax procrastinator, who races for the post office on April 15, or an early bird, who files as soon as possible in anticipation of a refund? No matter what your tax style is, it’s essential to document your income, expenses and potential deductions for the IRS.

To that end, keep your eyes open for the following forms, which should arrive soon:

- **W-2 Forms** — Employers will provide a W-2 Form showing how much you were paid, as well as the amount of income, Social Security and Medicare tax withheld. W-2s also show any contributions made to benefit programs, such as retirement plans and dependent care reimbursement plans.
- **1099 Forms** — These forms are used to report various types of taxable income, and may include:
  - **1099-MISC** — Anyone who paid your business more than $600 during the year is required to provide Form 1099-MISC.[1]
  - **1099-INT** — If you earned interest ($10 or more) on a bank account or certificate of deposit during the year, the financial institution that paid it should provide a 1099-INT.[1]
  - **1099-DIV** — Any interest, dividends, and capital gains earned from individual stocks or mutual fund investments are shown on Form 1099-DIV.[1]
  - **1099-B** — If you sold stocks, bonds, or mutual funds during the year, Form 1099-B reports the transaction and may include cost basis information.[1]
  - **1099-R** — When a pension, IRA, or retirement plan makes a distribution, it is reported on Form 1099-R.[1]
  - **1099-SSA** — The amount of Social Security income received during the previous year is reported on this form.[1]
- **1098 Forms** — Financial institutions, governmental agencies, and cooperative housing corporations report interest and home mortgage related expenses paid during the year on Form 1098. Form 1098-E shows student loan interest.
- **5498 Forms** — Any contributions made to individual retirement accounts are reported on this form. Other versions of Form 5498 report contributions to health savings and Coverdell education savings accounts.1
- **Schedule K-1** — If you received money from an estate, trust, partnership or S corporation during the year, you should receive a Schedule K-1.[1]

Plan Ahead to Avoid Refund Delays

Taxpayers can take steps to help ensure smooth processing of their 2017 tax return. Here are three things to know:

1. **It's important to gather documents.** The IRS urges all taxpayers to file a complete and accurate tax return.
2. **Taxpayers with expiring Individual Taxpayer Identification Number should renew promptly.** To renew, submit a completed Form W-7.
3. **Choose e-file and direct deposit for the fastest refund.** It's the most accurate way to prepare and file.

None of the information in this document should be considered tax advice. You should consult your tax advisor for information concerning your individual situation.

[1] IRS.gov, Forms, Instructions & Publications

Are You a Risk Taker?

When you think of recreation, do you think of bowling or bungee jumping? Swimming or skydiving? A good read or a rollercoaster?

With investing, as in recreation, different people are willing to take different risks. Broadly speaking, investing inherently exposes you to risks, and knowing your risks can help you determine how best to invest.

WHAT IS MARKET RISK?

Market risk is the chance that your investment could lose value because the market doesn't perform as expected. Many factors can influence markets and cause them to fluctuate; among them economic data, geopolitical action, investors' perceptions and unemployment to name a few.

Market risk varies by type of investment. Historically:

- Stocks have provided the highest market risk, as well as the highest returns.
- Bonds are generally more stable than stocks, but have less return potential.
- In general, cash alternatives, like money markets and certificates of deposit, offer the greatest stability and the lowest returns. Of course, past performance is no guarantee of future results.

A good way to help limit market risk is to own a diversified portfolio of investments; however, diversification does not assure a profit or protect against loss.

WHAT IS INFLATION RISK?

Inflation risk is the chance that your savings will buy less over time. If the rate of inflation is higher than the returns your investments earn each year, then your savings will lose purchasing power. Inflation risk can be staggering – just ask an older relative what they paid more for — their first house or their last car?

MANAGING RISK

Before you can manage risk, you must decide how much risk you are willing to take. As a general rule of thumb, conservative investors prefer stable portfolios and are willing to accept lower potential return. Aggressive investors are willing to tolerate greater fluctuation in the value of their portfolios with the expectation of earning higher returns in the long run. Often investors' portfolios become more conservative as they near retirement.

If you would like to discuss any of these strategies in detail, call for an appointment.

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IM&R Team

INVESTMENT MANAGEMENT AND RESEARCH

Interview with Shashi Mehrotra, CIO and COO Legend Advisory

Q. Do you believe the tax legislation will help the markets?

A. Conventional wisdom moved from "tax cuts won't happen to "tax cuts won't matter". We believe the cuts will provide a modest boost to US growth and inflation, although investor overreaction may cause a healthy consolidation providing an opportunity to invest new money at more reasonable valuations.

Q. What is your outlook for 2018

A. We remain bullish on equities as tax reform could raise S&P 500 earnings estimates by about 8% to 10%. Risks have risen in equities and domestic stocks, and we're concerned that the potential of rising inflation could damage valuation measures.

There is also evidence that our markets are priced for perfection:

- The sum of inflation and trailing Price/Earnings (P/E) ratio above 23 indicates market risk, while below 14 implies attractive markets. At the end of the third quarter, it was just over 23, based on a trailing PE of 21 and a CPI of 2.2%.

There hasn't been a 3% or greater correction in over a year, making this the longest bullish run in 90 years. If you go back to 1926 and calculate average corrections, you would notice a 3% or greater correction about once a month. That indicates a correction is on the horizon and it could arrive soon.
Long term, a pause in market advance is normal and healthy. High yield bonds peaked in October, and in some of our IM&R portfolios, we cut our high yield bond exposure months ago in anticipation of sour times.

Q. Are there any areas of concern?

A. Most of the risks on the horizon could be diluted if earnings continue to escalate. According to Thomson Reuters and IBES, earnings per share on the S&P 500 Index in both 2017 and in 2018 should increase at a double digit pace.

In 2018, we expect volatility to escalate and to see more sell offs of 5% to 10%. We also

- The Investors Intelligence Weekly survey reported 4.5 bulls to bears, the highest since 1987.
- The S&P 500 price to book ratio appears expensive when data is observed back to 1926.
- The CBOE Volatility Index hit a record low.
- Margin Debt is at record high levels relative to GDP and in nominal terms double the level established prior to the 2000 market peak.
- The mutual fund cash/asset ratio stands at 2.8%, barely above the record low of 2.6%.

believe that the level of the S&P 500 may breach 3000 by next year. A few catalysts that may drive volatility include earnings retreat, rate revisions, geopolitical uncertainty, rising inflation and slowing economic activity.

We are not confident that we have reached the point of maximum optimism, and will stay with our current allocations until our models indicate otherwise. Clients should remember that being invested is the most critical ingredient to achieving long-term success.

S&P 500 Index is an index of 500 of the largest exchange-traded stocks in the US from a broad range of industries whose collective performance mirrors the overall stock market. Investors cannot invest directly in an index. Inflation is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Inflation is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Price/Earnings (P/E) ratio is the price of a stock divided by its earnings per share that gives investors an idea of how much they are paying for a company's earning power. Consumer Price Index (CPI) measures prices of a fixed basket of goods bought by a typical consumer, widely used as a cost-of-living benchmark, and uses January 1982 as the base year. The price-to-book ratio (P/B Ratio) is a ratio used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share. The Chicago Board Options Exchange (CBOE) Volatility Index shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge." Gross Domestic Product (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. Investments in high yield bonds entail higher risks, including greater credit risks. Their NAVs are sensitive to interest rate movements (a rise in interest rates can result in a decline in value of the investment). Upon redemption, share values may be worth more or less than the original investment. Past performance is no guarantee of future results. The opinions and material presented are provided for informational purposes only. No person or system can predict the market. There is no assurance that the investment goals and process described herein will consistently lead to successful investing. The information shown does not constitute investment advice, does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact respecting any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation.

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