W/C WILSON CAPITAL
INVESTMENT ADVISORY

We feel investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. We hope this makes our commentary informative and educational for all levels of investors. We have also included a glossary at the end of this commentary that defines terms marked with an asterisk (*).

Quarter & Year in Review

Asset Class†	4th Quarter 2016 Return	Full Year 2016 Return
U.S. Small Cap Stocks	8.8%	21.3%
U.S. Large Cap Stocks	3.8%	12.0%
Commodities	2.7%	11.8%
International Stocks	-1.3%	4.5%
U.S. Bonds	-3.0%	2.7%

In terms of 2016 market performance, one could say as went the 4th quarter, so went the year. And what a quarter and year they were for U.S. equities. Both large and small company stocks turned in double-digit returns through the year for the first time since 2013, while the bond market lagged behind most stock indexes. The Barclays Aggregate bond index was especially hard hit in the 4th quarter, returning -3%, the worst one-quarter return since the 3rd quarter of 1981.

The stunning upset victory of Donald Trump for U.S. President was the dominant event of the quarter. The market reaction of the election was both significant and largely unexpected. Polls swayed in the direction of a Clinton victory in the weeks leading up to the election with a lack of significant movement in market returns. This indicated a larger level of comfort in a Clinton presidency as many pundits viewed her as a known entity with her presidency predicted to be largely a continuation of Obama's policies.

This all changed as the results started to roll in on election night and the market started grappling with a Trump Presidency. Though the U.S. stock market was closed, a violent drop in Dow Jones futures contracts* to a low of 758 points seemed to confirm the sentiment leading up to the election and a foreshadowing days of market volatility ahead.

However, in near lockstep with the Brexit reaction from the summer, the initial shock of the election reversed as the markets opened Wednesday morning, starting a mini bull market that continued uninterrupted through the end of December with the Dow Jones gaining over 1,500 points. The boom was especially evident in the financial sector as the Trump agenda indicates easing of regulations enacted after the 2008 financial crisis.

Spotlight: Trump Tax Outlook

As we near inauguration day and the Trump cabinet and policies take form, it appears as though the Trump presidency will be in significant contrast to that of his predecessor.

While Trump's bombastic style and off-the cuff tweets about wall building and eliminating ObamaCare have garnered much of the media attention, some of his most developed plans relate to the economy and tax code. Trump has vowed to make sweeping changes to the personal and corporate tax rates, both of which deserve a closer examination and look at their impact.

Personal Taxes

Trump has indicated the desire to reduce taxes in a plan that would include lower overall rates, increases to the standard deduction, limits to the use of itemized deductions, and elimination of the estate or "death" tax. Below is a chart outlining some of the key proposed changes.

Current Law	Trump Proposal	Beneficiaries of Proposed Changes
7 tax brackets	Reduce the number of tax brackets to 3	All taxpayers would pay lower rates, but outsized benefit to those in the highest tax brackets
39.6% highest marginal tax rate	Lower the highest marginal tax rate to 33%	
Standard deduction is $6,300	Increase the standard deduction to $15,000	Low-middle income taxpayers, especially those without a mortgage
$4,050 exemption per dependent	Eliminate personal exemption	Single taxpayers
No limit to itemized deductions	Limit itemized deductions to $100,000	U.S. government
No law on childcare deduction (personal exemption is similar)	Childcare tax deduction for children under 13	Families with young children, especially those in the lowest income brackets
40% tax on estates greater than $5.45 million	Eliminate the Estate Tax	Wealthiest and also families with farms and private businesses

*All dollar amounts pertain to single taxpayers

This plan, as outlined above, offers benefits for a wide swath of the taxpaying public. The wealthy will certainly benefit a great amount from this plan, but changes to the standard deduction and the addition of a childcare deduction would have significant impact to many middle-income Americans.

Corporate Taxes

Trump has also made promises to lower the corporate income tax and create policies that will make it easier to repatriate foreign corporate profits* back to the United States. Currently, the corporate tax rate in the US is 35%--making it the highest rate among all industrialized nations. This rate has led to many companies implementing the dreaded "financial engineering"* that became commonplace during the Obama administration. Moving forward, the Trump administration hopes to find a rate high enough to keep overall corporate tax revenues steady, while being low enough that companies will no longer look to engineering ways to avoid paying large portions of their total tax bill to the U.S. government. Trump has discussed cutting to a 15% rate that would put the U.S. at the extreme low end of the world corporate tax spectrum (only Ireland is lower at 12.5%). Such an extreme may not be needed to be competitive, as even a rate in the mid-low 20% would put the U.S. in the lowest handful of developed market corporate tax rates.

Takeaways

In all, this plan is very ambitious with many tax cuts and few new areas of revenue. One analysis done by the non-profit Tax Foundation shows the U.S. would face a $5.9 trillion deficit in the 10 years following implementation of Trump's plan. Trump himself acknowledges a shortfall when evaluating this plan with current economic growth rates, but insists that a dynamic measure that accounts for increases in GDP growth and productivity narrows, or even closes, that shortfall. This will surely be a point of contention as Trump takes office and something that we'll be sure to revisit in this letter as we see begin to see the plan and its impact take shape.

Additional Information on Trump's tax plan:

https://www.donaldjtrump.com/policies/tax-plan/

http://taxfoundation.org/article/details-and-analysis-donald-trump-tax-reform-plan-september-2016

Glossary

Futures Market – Financial market where investors can buy and sell contracts that bet on the future price of an underlying investment. Index futures are widely publicized during non-market hours as an indication of how the markets will perform when trading resumes.

Standard Deduction – Set amount of money that is subtracted from annual income reducing the amount of tax owed to the IRS. Differs from itemized deductions where taxpayers list items such as mortgage interest and charitable contributions. Itemized deductions are used if the total amount of items is larger than the standard deduction.

Personal Exemption – Similar to the standard deduction, it is a set amount of income not taxed based upon the number of people in a household. Unlike the standard deduction, it is available to those who choose to itemize their deductions.

Repatriation of Foreign Profits – Under current tax law, companies only pay U.S. income tax when profits are made in the U.S. or profits made outside the U.S. are brought back to the U.S. Many companies avoid paying U.S. taxes by keeping foreign profits overseas. A lower tax rate may encourage companies to repatriate or bring that money to the U.S.

Financial Engineering – Use debt and profits by companies to purchase their own stock back. This increases the amount of profit per share owned. Alternatively a company could use those same profits on research and development or capital improvements.

† Indices used to represent asset classes:
U.S. Large Cap Stocks – S&P 500
U.S. Small Cap Stocks – Russell 2000
International Stocks – MSCI ACWI ex-U.S.
U.S. Bonds – Barclays Aggregate
Commodities – Bloomberg Commodity

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