

# Quarterly

## NEWSLETTER



### INVESTMENT INSIGHT

ADAM HOFFMANN, CFP®, AIF®, DIRECTOR OF INVESTMENTS & RESEARCH

Over the holidays, I sat at our kitchen table after breakfast, drinking coffee and reading the paper while my five-year-old rolled, sculpted, and ultimately smashed flat the hot pink Play-Doh that Santa so generously left in her stocking Christmas morning. As her wonderfully messy creative expression came out through this oh-so familiar medium, I commented to her that it would be easy to read her palm with all the lines and creases of her hands so brightly illuminated. Not surprisingly, her response was, “Why would you look at my palm?” And so, after some back and forth about fortune tellers and whether they can truly predict what’s to come based off of lines on palms or crystal balls, she asked, “Daddy, can you see the future?” As much as I wanted to extend the magic and mystique of the holiday season into my own ability to know what the future was going to bring, I honestly replied, “No sweetheart. No one can really see the future.”

The irony of the timing of that conversation was that while I was telling my daughter that a certain type of magic didn’t actually exist, I was about to read the annual “Investors’ Roundtable” in the business section of the *Minneapolis Star Tribune*.<sup>1</sup> For those of you who may be unfamiliar, this annual feature article is similar to many such pieces written in business publications this time of year where a small group of prominent investment professionals are brought together to review the headline events from the past year and provide their own crystal ball predictions on the year to come. Almost without fail, these articles start with an explanation as to why their predictions from the previous year didn’t come through as forecasted and conclude with each soothsayer giving their prophecy for the level of a given stock market index one year in the future. Even though we all know that it’s impossible to see the future, it’s hard not to want to believe an exception may exist and get drawn into the dream.

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<sup>1</sup> <http://www.startribune.com/local-financial-analysts-predict-a-strong-year-in-the-markets/467191463>



Unfortunately, that dream falls short of reality again, as you might expect, with the surprisingly strong and stable year for stocks in 2017 (see chart below, *S&P 500 Growth of Wealth in 2017*), much of part one of the article was spent explaining how the unexpected events and lack of volatility of the year led to the inaccuracy of their guesses from the year before. Their responses this year seemed to say that their assumptions and estimates

were spot on for 2017, it's just that the broader global financial system didn't comply within those parameters. In fact,

the highest estimate from the end of 2016 was less than half of the actual 21.83% return that the S&P 500 index returned in 2017. Further, the VIX (Chicago Board Options Exchange Volatility Index) hit an all-time low in November. In fact, the year was so stable it was only the second year since 1984 that the S&P 500 did not finish a trading day lower than where we started the year. Even with the experience of specific market forecasts missing the mark year after year, the article concludes with nine predictions that outline exactly why the stock market will end 2018 at a particular level.

Sprinkled throughout the article, and seemingly everywhere in the financial press in 2017, was one of the biggest surprises and headline grabbers from the past year: the explosion in the value of Bitcoin and other cryptocurrencies. If stock market or interest rate predictions aren't your thing, there are no shortage of pundits making the case for extreme outcomes of these relatively new financial instruments. Compelling headlines touting the success of newly minted millionaires and billionaires or tales of woe, such as the one about the unfortunate IT worker who lost more the \$100 million of value when he accidentally threw away an old hard drive<sup>2</sup> draw us in and may make us want to believe in lightning in a bottle. With predictions of the value of a bitcoin ranging from as high as \$1,000,000+ to as low as \$0 for 2018,<sup>3</sup> it's hard to get a grasp on

*Even though we all know that it's impossible to see the future, it's hard not to want to believe an exception may exist and get drawn into the dream.*

what to expect in terms of future returns from something that has no real intrinsic value like a stock or a bond without earnings or the promise of interest payments. We take a deeper dive into the fundamentals of both sides of the argument in a new article posted on our website [[carlsoncap.com/articles](http://carlsoncap.com/articles)], but at this time, the incredible volatility, high transaction costs, security risk, and lack of a clear

expected return don't make cryptocurrencies something that can be well argued to be anything other than a highly speculative bet.

It's here that I want to acknowledge I don't intend to imply or project hubris on the Twin Cities investment professionals featured in the 2018 Investors' Roundtable article. I imagine that none of them would actually stake their reputation on a specific stock market level at the end of 2018. I will concede that they are not likely participating in the exercise to demonstrate their ability to read tea leaves or companies' cash flow statements. The point is more about noting the vast prevalence of such data and information, and the importance of not allowing such predictions to influence one's investment strategy.

At CCM, we continually share the tenants of our core investment philosophy with you, not knowing when one country or strategy will specifically be on top, but with the knowledge that those details are unknowable and not under our control. Being able to accept that, we are all more likely to get from here to wherever it is we want to go. For example, when I wrote about the impact of currency on international equity holdings and the importance of avoiding high cost products that hedge the impact of exchange rates from your stock portfolio, I didn't know with any certainty that due to a weakening dollar in 2017, that currency returns would add in some cases double digit benefits to your international stocks holdings.<sup>4</sup> I also didn't know that more than 20 of the funds that were created to hedge the impact of currencies would close over the past year.<sup>5</sup> We simply

knew that avoiding excessive costs in "products" was going to be more beneficial than guessing which way exchange rates are headed. Additionally, when quarter after quarter we've talked about the importance of global diversification, we had no certainty that after three years of negative returns, emerging markets stocks would post back to back double-digit growth with 2017 returns in excess of 36%. We simply knew that over time, countries and economies will behave differently in different environments and it's important to be well positioned to take advantage of these benefits. Lastly, entering this past year there was concern by many in how perceived and real geopolitical instability may negatively impact their financial lives. Rather than pulling out of stocks, avoiding the risks and sitting on the sidelines to see what would happen, we worked with clients to make sure that financial plans were updated and that safety of capital in the appropriate amount of fixed income was in place, and we were all able to participate in the strong gains brought by the 2017 equity markets.

**S&P 500 Growth of Wealth in 2017**



Data represents past performance. Past performance is no guarantee of future results. Chart is for illustrative purposes only. Chart source data is the S&P 500 Index from January 1, 2017–December 31, 2017.

<sup>2</sup> <http://metro.co.uk/2017/12/09/man-threw-away-laptop-with-bitcoin-that-is-now-worth-74-million-7145361/>

<sup>3</sup> <http://fortune.com/2017/12/21/bitcoin-price-value-prediction-bubble>

<sup>4</sup> Source: Morningstar Direct, as of 12/31/17.

<sup>5</sup> [http://www.etf.com/sections/daily-etf-watch/record-closures-healthy-launch-levels?utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=dailynewsletter](http://www.etf.com/sections/daily-etf-watch/record-closures-healthy-launch-levels?utm_source=newsletter&utm_medium=email&utm_campaign=dailynewsletter)

## FOURTH QUARTER AND YEAR-END RETURNS



|                            | Q4 2017 | 1-YEAR<br>RETURNS | ANNUALIZED<br>5-YEAR<br>RETURNS | 10-YEAR<br>RETURNS |
|----------------------------|---------|-------------------|---------------------------------|--------------------|
| S&P 500 Index              | + 6.64  | + 21.83           | + 15.79                         | + 8.50             |
| US Large Value             | + 5.33  | + 13.66           | + 14.04                         | + 7.10             |
| US Small Cap               | + 3.34  | + 14.65           | + 14.12                         | + 8.71             |
| US Small Value             | + 2.05  | + 7.84            | + 13.01                         | + 8.17             |
| International Large Cap    | + 4.23  | + 25.03           | + 7.90                          | + 1.94             |
| International Large Value  | + 3.24  | + 21.44           | + 6.95                          | + 1.15             |
| International Small Cap    | + 6.05  | + 33.01           | + 12.85                         | + 5.77             |
| International Small Value  | + 5.58  | + 30.28           | + 12.59                         | + 5.68             |
| Emerging Markets           | + 7.44  | + 37.28           | + 4.35                          | + 1.68             |
| US Short-Term Bonds        | - 0.30  | + 1.27            | + 1.10                          | + 2.46             |
| US Intermediate-Term Bonds | + 0.39  | + 3.54            | + 2.10                          | + 4.01             |

Data represents past performance. Past performance is no guarantee of future results. Chart is for illustrative purposes only. Returns are based on data from the S&P 500, Russell Investments for US indices, MSCI for international and Barclays for bonds for the time period of October 1, 2017 through December 31, 2017.

Specific indexes used for the table are as follows: S&P 500 TR USD; Russell 1000 Value TR USD; Russell 2000 TR USD; Russell 2000 Value TR USD; MSCI EAFE NR USD; MSCI Value NR USD; MSCI EAFE Small Cap NR USD; MSCI Small Value NR USD; MSCI EM NR USD; Barclays US Govt/Credit 1-5 Yr TR USD; Barclays US Agg Bond TR USD.

- Global stock markets finished 2017 with another strong quarter, while U.S. bonds were flat.
- Emerging markets stocks continued to lead, posting a 7.44% return in the fourth quarter and 37.28% overall in 2017.
- In the U.S., large companies outperformed small companies, both for the fourth quarter and for the year.
- The best performing sector was Consumer Discretionary, gaining 9.87% in the quarter. Technology (+9.01%) and Financials (+8.63%) were the second and third best performing sectors.
- Internationally, small companies outperformed large companies, both for the fourth quarter and for the year.
- The Utilities sector had the lowest return in the fourth quarter, returning 0.21%. Health Care had the second lowest quarterly return at 1.47% and Telecom had the third lowest return at 3.61%.
- Short term interest rates rose in the third quarter, which resulted in a small negative performance for short term bonds.
- Longer term interest rates were flat in the third quarter, which resulted in a slight gain.

## AN UPDATE FROM THE TAX TEAM: *The Tax Cuts and Jobs Act of 2017*

KEVIN KOSKI, CPA, DIRECTOR OF TAX SERVICES



On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act. The changes in the Act represent the most sweeping change to the U.S. tax code in many years and impact individuals and businesses on a level not seen in over 30 years (since 1986, when the Internal Revenue Code was amended). This quarter, we wanted to provide you with a summary of the most relevant provisions. We've also posted this Update article and two additional resources, including the full 570 page report from the Conference Committee, on our website [[carlsoncap.com/articles](http://carlsoncap.com/articles)] should you be interested in reading more.

Our Tax Team is actively analyzing all of the changes and looks forward to working with you in 2018 to help optimize your tax situation.

**New Income Tax Rates and Brackets**  
For tax years beginning after December 31, 2017, and before January 1, 2026, the following seven tax rates apply for individuals: 10%, 12%, 22%, 24%, 32%, 35%, and 37%, as detailed in the illustrations to the right:

**SINGLE**

**CURRENT TAX RATE SCHEDULE**

| Taxable Income      | Marginal Tax Rate |
|---------------------|-------------------|
| \$0-\$9,525         | 10.0%             |
| \$9,526-\$38,700    | 15.0%             |
| \$38,701-\$93,700   | 25.0%             |
| \$93,701-\$195,450  | 28.0%             |
| \$195,451-\$424,950 | 33.0%             |
| \$424,951-\$426,700 | 35.0%             |
| Over \$426,700      | 39.6%             |

**NEW TAX RATE SCHEDULE**

| Taxable Income      | Marginal Tax Rate |
|---------------------|-------------------|
| \$0-\$9,525         | 10.0%             |
| \$9,526-\$38,700    | 12.0%             |
| \$38,701-\$82,500   | 22.0%             |
| \$82,501-\$157,500  | 24.0%             |
| \$157,501-\$200,000 | 32.0%             |
| \$200,001-\$500,000 | 35.0%             |
| Over \$500,000      | 37.0%             |

**MARRIED FILING JOINTLY**

**CURRENT TAX RATE SCHEDULE**

| Taxable Income      | Marginal Tax Rate |
|---------------------|-------------------|
| \$0-\$19,050        | 10.0%             |
| \$19,051-\$77,400   | 15.0%             |
| \$77,401-\$156,150  | 25.0%             |
| \$156,151-\$237,950 | 28.0%             |
| \$237,951-\$424,950 | 33.0%             |
| \$424,951-\$480,050 | 35.0%             |
| Over \$480,050      | 39.6%             |

**NEW TAX RATE SCHEDULE**

| Taxable Income      | Marginal Tax Rate |
|---------------------|-------------------|
| \$0-\$19,050        | 10.0%             |
| \$19,051-\$77,400   | 12.0%             |
| \$77,401-\$165,000  | 22.0%             |
| \$165,001-\$315,000 | 24.0%             |
| \$315,001-\$400,000 | 32.0%             |
| \$400,001-\$600,000 | 35.0%             |
| Over \$600,000      | 37.0%             |

For each of the following, the changes are applied for tax years beginning after December 31, 2017, and before January 1, 2026:

■ **Standard Deduction Increased**

The standard deduction is increased to \$24,000 for married individuals filing a joint return, \$18,000 for head-of-household filers, and \$12,000 for all other taxpayers.

■ **Personal Exemptions Suspended**

The deduction for personal exemptions is effectively suspended by reducing the exemption amount to zero.

■ **Mortgage & Home Equity Indebtedness Interest Deduction Limited**

The deduction for interest on home equity indebtedness (i.e. debt used for purposes other than to acquire or improve a home) is suspended, and the deduction for mortgage interest is limited to underlying indebtedness of up to \$750,000. The new lower limit doesn't apply to any acquisition indebtedness incurred before December 15, 2017.

■ **New Deduction for Pass-Through Income**

The new law adds a deduction of up to 20% for a taxpayer that has "qualified business income" (QBI) from a partnership, S corporation, or sole proprietorship. The deduction is subject to certain thresholds and exclusions based on type of business, amount of wages paid, amount of taxable income, etc.

■ **Child Tax Credit Increased**

The child tax credit is increased to \$2,000 per qualifying child. The income levels at which the credit phases out are increased to \$400,000 for married taxpayers filing jointly (\$200,000 for all other taxpayers). In addition, a \$500 nonrefundable credit is provided for certain non-child dependents.

■ **State and Local Tax Deduction Limited**

A taxpayer may claim an itemized deduction of up to \$10,000 for the *aggregate* of state and local property taxes and state and local income taxes (or sales tax in lieu of income taxes) paid or accrued in the tax year.

■ **Miscellaneous Itemized Deductions Suspended**

The deduction for miscellaneous itemized deductions (i.e. employee business expenses, investment expenses, tax preparation expenses, etc.) that are subject to the 2% floor is suspended.

■ **Alternative Minimum Tax (AMT) Retained with Higher Exemption Amounts**

The new law increases the AMT exemption amounts for joint returns to \$109,400 and for single taxpayers to \$70,300.

For each of the following, the changes are applied for the timeframes noted in each category:

■ **Repeal of the Rule Allowing Re-characterization of IRA Contributions**

For tax years beginning after December 31, 2017, the rule that allows a contribution to one type of IRA to be re-characterized as a contribution to the other type of IRA does not apply to a conversion contribution to a Roth IRA. Therefore, re-characterization cannot be used to unwind a Roth conversion completed in tax years beginning after December 31, 2017.

■ **Corporate Tax Rates Reduced**

For tax years beginning after December 31, 2017, the C corporation tax rate is a flat 21% rate.

■ **Alimony Deduction by Payor Inclusion by Payee Suspended**

For any divorce or separation agreement executed after December 31, 2018, alimony and separate maintenance payments are not deductible by the payor spouse and are not included in the income of the payee spouse.

■ **Medical Expense Deduction Threshold Temporarily Reduced**

The threshold on medical expense deductions is temporarily reduced to 7.5% of adjusted gross income (AGI) for all taxpayers for tax years 2017 and 2018.

■ **Estate and Gift Tax Retained, with Increased Exemption Amount**

For estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026, the Act doubles the base estate and gift tax exemption amount from \$5 million to \$10 million. The \$10 million amount is indexed for inflation occurring after 2011 and is expected to be approximately \$11.2 in 2018.

■ **Expanded Use of 529 Account Funds**

For distributions after December 31, 2017, "qualified higher education expenses" include tuition at an elementary or secondary public, private, or religious school, up to a \$10,000 limit per tax year.

■ **Capital Gains Provisions Conformed**

The adjusted net capital gain of an individual taxpayer is taxed at maximum rates of 0%, 15%, or 20%. The new law generally retains present-law maximum rates on net capital gains and qualified dividends.

Again, this is a high level overview of some of the core provisions of the Act. As always, if you have any questions, please be sure to contact us. Meanwhile, the Tax Team will be more specifically detailing how the new tax law will affect your personal situation when we meet with you this year.

CARLSON CAPITAL  
MANAGEMENT FILM SERIES

*Enriching Lives*

In 2017, a crew spent time with the colleagues of Carlson Capital Management, creating a new film series featuring the team we've built to serve clients with an integrated approach to wealth management. The series, *Enriching Lives*—focuses on the core aspiration of the Vision Statement of CCM.

While the series helps those who don't know us at CCM to be introduced to our firm and our team, we think that clients may also appreciate the insights shared in the films—how serving you inspires us each day, and how our team members work with one another to integrate the financial disciplines to help you accomplish the goals that are unique to you and your family. You may also “meet” someone new or connect a face with the name and voice of a CCM colleague who works behind-the-scenes with your advisory team.

In addition, as CCM has grown over the years, expanding the CCM circle of care to help friends and family members of clients referred by those of you who've introduced us, we invite you to share the films with friends you think may be interested. We'll be pleased to meet them.

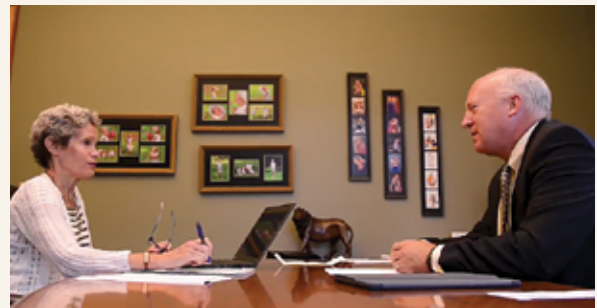
We're excited to share our first film in the series, “Peace of Mind,” which focuses on what it really means to Carlson Capital Management to partner with clients and their families.

*“To the extent we can make people's lives better...what else is there?”*

— GREG CARLSON, FOUNDER AND PRINCIPAL



VIEW THIS FILM AT [carlsoncap.com](http://carlsoncap.com)



## VERMEER PROMOTED TO SENIOR INTEGRATED WEALTH ADVISOR

**W**e are pleased to announce that Katy Vermeer, CFP®, has been promoted to Senior Integrated Wealth Advisor. Katy joined CCM in 2015 with more than thirty years of experience in financial services and for the past twelve years has served clients and their families by advising on all aspects of wealth management. “For me, it is a real privilege to walk alongside families who entrust their financial future to me and to my colleagues at CCM. I never take that for granted,” stated Vermeer. Katy works primarily with clients in the Twin Cities metro area and is part of a team of colleagues at CCM who are leading the CCM Women’s Initiative.



KATY VERMEER, CFP®

*Senior Integrated  
Wealth Advisor*  
Bloomington Office  
DePauw University  
Alumna

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## HOLIDAY GIFT 2017

*We hope this  
holiday season  
has brought  
you peace  
and joy!*



**CARLSON**  
CAPITAL MANAGEMENT

**T**his time of year we all enjoy seeing responses to our holiday card arrive in the mail or through the website. In keeping with our tradition of a CCM Holiday Gift of giving, clients were invited to submit a nomination of an organization where you are engaged as a volunteer or that you support. CCM will be presenting \$1,000 each to ten organizations drawn randomly from those nominated.

The response deadline was January 15, so please watch for an announcement of the nominations drawn for this year’s gift soon!

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## A MESSAGE FROM CCM’S CHIEF COMPLIANCE OFFICER

**A**s part of Carlson Capital Management’s active business continuity plan, each year we remind clients of how we will reach you, or how you can reach us, should there be an event causing significant business disruption at the firm. Following physical safety and data protection, our priority is to be able to effectively communicate with you. Please note the following methods that would be deployed if needed:

- CCM has a long-standing contract with an organization that is equipped to immediately notify all CCM clients via home phone (or voice mail) should an emergency arise. If the system is activated, you would receive a message instructing you on how to reach us.
- Our website home page would also be updated to contain pertinent contact information.

With four separate physical office locations, assets custodied with third parties such as Schwab, TIAA and Vanguard, and all of our electronic data housed at a secure off-site data center, we believe that CCM is well protected from physical incidents. None-the-less please know that we actively review and update our plans in order to help mitigate any potential risks.

—JUSTIN D. STETS, CCM Chief Compliance Officer



The CCM Team congratulates JASON KLEY, CFP®, AIF®, MBA, Senior Integrated Wealth Advisor who has been chosen to serve as President of the Board of the Financial Planning Association of Minnesota. Kley served on the Board for one year as

Director of Financial Education, and one year as President-Elect prior to being named President. For numerous years Jason has been actively engaged as a volunteer in the area of financial education and looks forward to the opportunity to serve in this leadership capacity with FPA of MN. The organization's primary aim is to benefit the public by helping to ensure that financial planning is delivered through proficient, ethical financial planners. [fpamn.org](http://fpamn.org)

TIM JACKSON and LAURA VIRGEN are pictured preparing to deliver gifts from CCM Colleagues to the Northfield Community



Action Center for the Christmas Sharing program. Every year, colleagues from all of CCM's offices enjoy this opportunity to help bring smiles to the faces of children during the holidays. Each child receives a pair of handmade pajamas, a book, puzzle or game, mittens or gloves, and two gifts. [communityactioncenter.org](http://communityactioncenter.org)



On Saturday, December 16, CCM COLLEAGUES volunteered for the festive holiday Jingle Bell Run/Walk at the Northfield Area Family YMCA. The annual event, founded and sponsored by CCM and brought to the community and hosted by the Y, raises funds to provide scholarships for those needing financial assistance to participate in programs offered by the Y. Each year, community members gather and brave the cold for this event of camaraderie and charity. Over its history, the Northfield Jingle Bell Run/Walk has raised \$70,000. [carlsoncap.com/community-commitment](http://carlsoncap.com/community-commitment)



On November 24, JAMES YAWORSKI, CFA, Investment Research & Trading Specialist in CCM's Rochester office, and his wife Brittany, announced the arrival of a beautiful baby girl, HARPER JAMES. A warm welcome to sweet Harper!

**IMPORTANT DISCLOSURE INFORMATION:** Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Carlson Capital Management, LLC ("CCM"), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from CCM. Please remember to contact CCM, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. CCM is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. A copy of CCM's current written disclosure Brochure discussing our advisory services and fees is available upon request.

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