

Quarterly

NEWSLETTER



OCTOBER 2018

INVESTMENT INSIGHT

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

One of the foundational underpinnings of our investment approach at CCM is the simple premise that “costs matter.” Over the last 30 years, the internal and execution costs of how we manage portfolios has dropped significantly. This has resulted in savings of hundreds of thousands of dollars for our clients. We are diligent in our analysis of costs relative to the value received by our clients.

When investing in mutual funds, the costs of ownership matter. Importantly, these costs need to be measured relative to the value received—which is most commonly evaluated through the lens of the underlying performance of the fund. Mutual funds carry many costs, all of which affect net return to investors. One easily observable cost is a fund’s expense ratio. Expense ratios strongly influence fund selection for many investors, and it’s easy to see why.

The chart on the next page illustrates the outperformance rate—or the percentage of funds that beat their category index—for active equity mutual funds over the 15-year period ending December 31, 2017. As the chart shows, while active funds have mostly lagged indices across the board, the outperformance rate has been greatest for high expense funds. Just 6% of funds in the highest expense ratio quartile beat their index, as compared to 25% for the lowest expense ratio group.

This data indicates that a high expense ratio presents a challenging hurdle for many mutual funds, especially over longer time horizons. One way to think about this is that mutual funds with high expense ratios have a different starting line—one that is back further because of the drag of high expenses.

Continued on page 2

TAX UPDATE:
CRITICAL QUESTIONS
FOR YEAR-END
page 3

INTRODUCING THE CCM
WOMEN’S INITIATIVE
page 4

CCM WELCOMES
DAN EDWARDS,
DIRECTOR OF
ESTATE PLANNING
page 5

THIRD QUARTER
RETURNS

NEWS BRIEFS
page 6

CCM EXPANDS
RETIREMENT
PLAN SERVICES
page 7

MARK YOUR
CALENDAR FOR THE
FALL CLIENT EVENT
WITH JOHN O’LEARY
page 8



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This chart illuminates two stark points—active management (including security selection and market timing) has not proven successful, and high costs are a significant drag on performance, relative to the benchmarks that are designed to show if value is being received for the costs of investing.

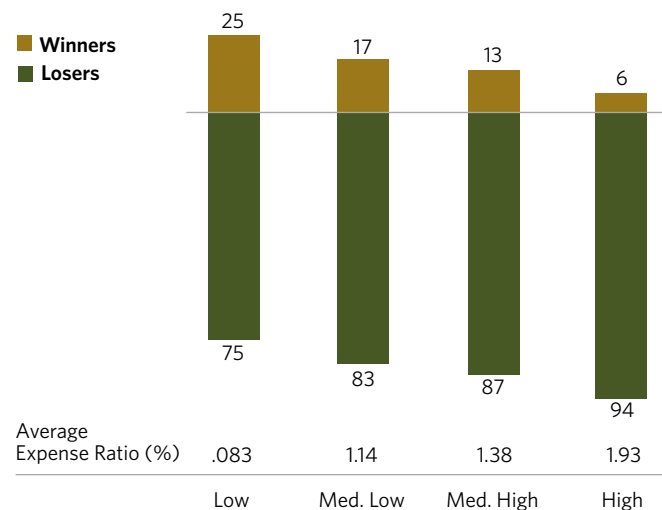
While costs are an important matter, they are not the only variable to consider among indexes or passive asset class funds. For example, when evaluating index funds within the same general area of a market, like U.S. large cap stocks, a factor to consider that can be more important than cost is, which index is the fund attempting to track? Variation in the holdings of such indexes from provider to provider can vary greatly. Some of the most common indexes in the large cap U.S. markets like the Russell 1000, S&P 500, and Dow Jones Industrial Average are very different. The number of stocks in these indexes range widely from 1000 down to 30, and yet they are often used as the same benchmark. Setting aside all of their other differences, cost alone does

not explain the variation in performance across such a wide range of holdings.

When evaluating active management approaches, such as stock picking or market timing, you find that both the total amount of trading *and* the cost per trade may be high. If a manager trades excessively or inefficiently, costs such as commissions and price impact (bid/ask spreads) can eat away at returns. Excessive trading also can lead to negative tax consequences for a fund, which can increase the cost of ownership for investors holding funds in taxable accounts.

In contrast to highly regimented indexing and high-turnover active strategies, employing a flexible investment approach that reduces the need for immediacy—and thus enables opportunistic execution—is one way to potentially reduce implicit costs. Keeping turnover low, remaining flexible, and transacting only when the potential benefits of a trade outweigh the costs can help keep overall trading costs down and thus reduce the total cost of ownership.

HIGH COSTS CAN REDUCE PERFORMANCE
Equity Fund Winners and Losers Based on Expense Ratios (%)



The sample includes funds at the beginning of the 15-year period ending December 31, 2017. Funds are sorted into quartiles within their category based on average expense ratio over the sample period. The chart shows the percentage of winner and loser funds by expense ratio quartile; winners are funds that survived and outperformed their respective Morningstar category benchmark, and losers are funds that either did not survive or did not outperform their respective Morningstar category benchmark. US-domiciled open-end mutual fund data is from Morningstar and Center for Research in Security Prices (CRSP) from the University of Chicago. Equity fund sample includes the Morningstar historical categories: Diversified Emerging Markets, Europe Stock, Foreign Large Blend, Foreign Large Growth, Foreign Large Value, Foreign Small/Mid Bond, Foreign Small/Mid Growth, Foreign Small/Mid Value, Japan Stock, Large Blend, Large Growth, Large Value, Mid-Cap Blend, Mid-Cap Value, Miscellaneous Region, Pacific/Asia ex-Japan Stock, Small Blend, Small Growth, Small Value, and World Stock. For additional information regarding the Morningstar historical categories, please see “The Morningstar category Classifications” at morningstardirect.morningstar.com/clientcomm/Morningstar_categories_US_April_2016.pdf. Index funds and fund-of-funds are excluded from the sample. The return, expense ratio, and turnover for funds with multiple share classes are taken as the asset-weighted average of the individual share class observations. For additional methodology, please refer to Dimensional Fund Advisors’ brochure, Mutual Fund Landscape 2018. Past performance is no guarantee of future results.

Reducing costs and, more importantly, receiving value for cost are some of the primary reasons that we work closely with firms like Vanguard and Dimensional for the implementation of our portfolios on behalf of clients. Vanguard continues to be the leader in index management and strategy execution while managing their funds at cost with no markup to investors. And while Dimensional is not an index manager and may not be the lowest cost option within any given asset class, their approach to building low-cost solutions that consider all aspects of cost and expected returns into their strategies has resulted in 75% of their funds outperforming their benchmarks over the past 15 years.¹

For individual investors, the total cost of ownership of a mutual fund requires a thorough understanding of costs beyond what an expense ratio may tell on its own and therefore can be difficult to assess. For CCM clients, we make sure to look beyond any one cost metric, and instead evaluate the total cost of ownership of an investment solution relative to the expected value that will be received. This is our fiduciary obligation and commitment to you as we manage your portfolio and partner with you to achieve your financial goals.

¹ Source: Dimensional Fund Advisors (2018). Relative Performance of Flagship Equity Funds [Powerpoint slides]. Available at: https://carlsoncap.com/wp-content/uploads/DFA_Flagship-Equity-Funds.pdf

AN UPDATE FROM THE TAX TEAM: *Critical Questions to Consider for Year-End under the Tax Cuts and Jobs Act of 2017*

KEVIN KOSKI, CPA, PRINCIPAL TAX ADVISOR



With the fourth quarter of the year upon us and given the many changes brought to bear by the Tax Cuts and Jobs Act of 2017, it is the opportune time to consider some very key questions as it relates to your 2018 taxes. The answers to these questions are critical in determining appropriate actions to take before the end of the year in order to optimize your tax situation.

- **Will the total of your itemized deductions exceed the new higher standard deduction?**

The increase in standard deduction will result in an emphasis on implementing a stacking strategy for itemized deductions. Under this strategy you would strategically accelerate deductions into a single tax year in order to itemize deductions in that year while then utilizing the standard deduction in other years.

- **What marginal tax bracket will you fall in, and how close are you to the next marginal tax bracket?**

The temporary reduction in federal tax rates will result in an emphasis on implementing a tax bracket utilization strategy. Under this strategy, you would consider strategically accelerating income into a tax year (i.e. Roth IRA conversion, exercise of stock options, realizing capital gains, etc.) in order to take full advantage of potentially lower federal tax rates.

- **Do you have Qualified Business Income for purposes of the new 20% deduction?**

If you generate business or rental income through a sole proprietorship, S Corporation, LLC, or Partnership, it is important to understand if or how it could qualify for a 20% deduction in accordance with recently published IRS regulations. The deduction is subject to various limitations, which include the type of business you conduct, amount of taxable income you report, the amount of wages you pay, and the amount of capital invested in tangible business assets.

- **Do you live in a state (i.e. Minnesota) that has not conformed to the changes in federal tax law?**

Many states have yet to conform to the federal tax law. For example, many residents of Minnesota will still itemize deductions for purposes of Minnesota income tax reporting even though they will utilize the standard deduction for federal reporting. As a result, we are recommending that taxpayers *continue to track all deductions* as they have in the past even if they expect to utilize the standard deduction on their federal tax return for 2018.

We will be working with clients to answer these important questions during upcoming scheduled tax planning meeting and conversations. Please contact us if you have any related questions or if you'd like to discuss how the new tax law will impact your specific situation.

Tax updates featured in previous newsletters can be found at carlsoncap.com/articles

INTRODUCING *The CCM Women's Initiative*

CALLIE GEIST, CFP®, J.D., MBA, INTEGRATED WEALTH ADVISOR
KATY VERMEER, CFP®, SENIOR INTEGRATED WEALTH ADVISOR
KELLY IRVINE, DIRECTOR OF MARKETING & COMMUNICATIONS



The mission statement of Carlson Capital Management and our approach to wealth management naturally recognize and serve all clients, including women, in ways that are customized and distinctive to the needs of individuals and families. This approach is ingrained in the fabric of who we are and has shaped our identity as a firm since our founding.

In recent years, as our team of women colleagues at CCM has grown and expanded with more and more depth and breadth, we began having intentional conversations about our passion for applying the knowledge, skills and experience that we have acquired to better serve the women around us. We asked ourselves what we had to offer other women. We talked about how we can empower women to be confident, comfortable and in control of their finances such that they can accomplish what is most important to them. Through these conversations the Women's Initiative was created and we adopted the goal of "Promoting the financial empowerment of women." We are so excited to formally introduce this Initiative and expand its footprint so as to reach as many women as we can.

At CCM, we firmly believe that financial advice is genderless. That is, financial advice isn't different for women than for men. The purpose of this initiative is not to alter the type or depth of financial insights

provided to women versus men. Rather, we recognize that women may have financial priorities, goals and concerns that differ from those of men. In addition, women may encounter life experiences or situations that merit a distinct approach. By creating opportunities for women to learn, ask questions, reflect, and discuss ideas with one another, we hope to address these needs, help women find their financial voice, and be fully engaged in their financial future.

When the concept of a CCM Women's Initiative originated in 2016, we began by hosting a series of roundtable events where we have invited small groups of women into casual and comfortable environments to learn together, share stories, ask questions and build relationships. We've asked participants for their feedback after each event, and the resounding comment we continue to receive is, "Keep hosting these!" We're excited to take what we've learned from these initial small gatherings and expand upon them in 2019.





Whether female or male, all of us at CCM have the same mission. The added layer brought by the Women's Initiative brings the opportunity for us to connect in new and collaborative ways. In addition to more gatherings, we'll be creating a presence on our website and working on more articles on topics by and for women. In addition, we're engaging all of the women of our firm in greater connectivity around the Initiative. We've also recently hired some wonderful women who we look forward to introducing to clients, including our third female financial advisor, an associate advisor, a director of retirement plan services, three paraplanners, several new client servicing representatives and a technology officer.

We look forward to your input, insight and participation as the Women's Initiative expands and grows.



CCM WELCOMES A *Director of Estate Planning to the Team*

We are happy to introduce DAN EDWARDS, CPA, who has joined CCM in the new role of Director of Estate Planning. As part of CCM's integrated wealth management platform, Dan will work closely with the Advisory Team to deliver estate planning expertise, and as part of the Tax Team, Dan will serve as a tax resource for clients, providing service both individually and collaboratively with other advisors, to develop customized recommendations.

Prior to joining CCM, Dan spent twenty-four years in a Senior Tax Director role with RSM, LLP, a national tax, accounting and wealth management firm. At RSM, Dan was responsible for leading the successful growth of the trust and estate tax practice for their Rochester, Minnesota office. He comes to us with extensive knowledge and expertise in the tax planning and compliance sector through his service as the tax director for individual, trust, estate, and corporate clients. Dan is a Certified Public

Accountant, and a member of the American Institute of Certified Public Accountants as well as the Minnesota Society of Certified Public Accountants.



Dan Edwards, CPA
Director of Estate Planning & Senior Tax Advisor
Rochester Office
University of Iowa Alumnus

As CCM grows to serve clients with additional depth and breadth, we've been working to further define and expand our management and client-servicing structures. As one outcome of this work, we are very pleased to share the news of promotions to expanded roles and responsibilities for the following colleagues:

Charlie Lawson, CPA
Director of Tax Services

Chrissy John
Paraplanner

Sue Rossi
Project Manager

We encourage you to review full colleague biographies at carlsoncap.com/team where you can also connect directly with any colleague at the firm.

AT A GLANCE

THIRD QUARTER RETURNS



	Q3 2018	1-YEAR RETURNS	5-YEAR RETURNS	ANNUALIZED 10-YEAR RETURNS
S&P 500 Index	+ 7.71	+ 17.91	+ 13.95	+ 11.97
US Large Value	+ 5.70	+ 9.45	+ 10.72	+ 9.79
US Small Cap	+ 3.58	+ 15.24	+ 11.07	+ 11.11
US Small Value	+ 1.60	+ 9.33	+ 9.91	+ 9.52
International Large Cap	+ 1.35	+ 2.74	+ 4.42	+ 5.38
International Large Value	+ 1.18	- 0.36	+ 3.14	+ 4.49
International Small Cap	- 0.88	+ 3.73	+ 7.96	+ 9.68
International Small Value	- 0.27	+ 1.20	+ 7.01	+ 9.31
Emerging Markets	- 1.09	- 0.81	+ 3.61	+ 5.40
US Short-Term Bonds	+ 0.26	- 0.38	+ 1.06	+ 2.30
US Intermediate-Term Bonds	+ 0.02	- 1.22	+ 2.16	+ 3.77

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 July 1, 2018 through September 30, 2018.

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 1-5Yr TR USD; Barclays US Agg Bond TR USD.

- U.S. equities were positive in the third quarter, led by large company stocks.
- Health Care (+14.53%), Industrials (+10.00%) and Telecom (+9.94%) were the best performing sectors.
- Materials (+0.36%), Energy (+0.61) and Utilities (+2.39%) were the worst performing sectors.
- International equities were mixed, with large companies rising more than 1% while small companies lost just less than 1%.
- Emerging markets continued to underperform developed markets this year, falling 1.09% in the quarter.
- Rising interest rates suppressed fixed income returns, though both short and intermediate term bonds were slightly positive for the quarter.

COMPANY NEWS & COMMUNICATIONS



CCM TAX & TRUST ADMINISTRATION

INTRODUCES TAXCADDY OPTION

The team at CCM Tax & Trust Administration will be enhancing their services to provide an online organizer software solution called TaxCaddy. TaxCaddy is designed to help simplify the tax preparation and filing process by gathering 1040 tax documents in one place, delivering them to your preparer, communicating with your preparer throughout the process, answering your questionnaire electronically, and signing documents like the e-file authorization.

All tax clients of CCM Tax & Trust Administration will be invited to create a personal TaxCaddy account via email. TaxCaddy is an optional service. Clients choosing not to register with TaxCaddy will receive a traditional tax organizer by mail. To learn more about TaxCaddy, visit taxcaddy.com or contact any member of the Tax Team: carlsoncap.com/team/#tax

YEAR-END REMINDER TO DONORS

As the end of the year approaches, American Center for Philanthropy (ACP) donors should note **FRIDAY, DECEMBER 14, 2018**, as the deadline for submitting a request for a grant distribution from an ACP donor-advised fund to a qualified charity. Submitting request(s) by this date will ensure that the distribution can be fully processed in this calendar year. If you have any questions about gifting please contact Tonya Quade at tonya@americancp.org or 507.321.4027.

American Center for Philanthropy



The American Center for Philanthropy is an independent, non-profit organization established seventeen years ago by the Principals of Carlson Capital Management, who wanted to provide individuals and families an easier and more efficient way to manage their charitable giving, in addition to maximizing tax benefits. Through ACP, donors set up a fund by making an initial contribution (minimum \$5,000). Upon approval of the Board of Directors, ACP then distributes the funds as recommended by the donor. Since its inception, donors of the American Center for Philanthropy have made contributions to public charities exceeding \$30.6 million. For more information, please contact your CCM Integrated Wealth Advisor or visit americancp.org

EMPLOYER OF EXCELLENCE DISTINCTION



On September 27, the Dakota-Scott Workforce Development Board announced they were again awarding CCM the distinction of "Employer of Excellence." CCM was one of twelve employers recognized, and one of four employers with less than 75 employees. We're honored to have been included as an awardee for the past three years.

CCM EXPANDS *Retirement Plan Services*

Growing out of our integrated wealth management philosophy, we've provided retirement plan services to companies of all sizes, and their employees, for many years. Our objective is to build long-term relationships with our retirement plan clients, partnering with them to offer successful retirement plans that are comprehensive, customized, transparent solutions.



Cami Peterson, CPA, QPFC
Director of Retirement Plan Services

In order to serve a growing number of retirement plan clients, we're pleased to announce that we've recently hired a new Director of Retirement Plan Services, CAMI PETERSON, CPA, QPFC. Cami will lead the team managing 401(k) and other qualified plan clients. This includes working with plan sponsors, trustees, investment committee members, and plan administrators, to build and optimize successful retirement plans, and with plan participants to provide them with the tools and resources to give them the best chance for a successful retirement.

Cami brings more than twelve years of experience in the financial services industry to her position at CCM. She began her career by earning her CPA designation and working as a senior accountant for a large corporate accounting firm. She then served as a controller for a large home builder before starting as a financial advisor with a leading Twin Cities financial services organization, and subsequently, a regional RIA. During her time as an advisor, Cami developed a passion for working with business owners and plan fiduciaries to design and deliver high quality, effective 401(k) and other qualified plans. She believes the role of retirement plans is to create successful outcomes for employees and optimize business outcomes for employers. She has the depth of experience within the retirement planning industry which allows for a unique and creative approach to design plans that align with corporate goals and objectives. Cami particularly enjoys working

with plan participants to provide proactive educational opportunities and resources that position them to maximize their retirement accumulation opportunities.

"I couldn't be more excited about being the new Director of Retirement Plan Services for Carlson Capital Management. My focus on corporate retirement plans began immediately after I became a financial advisor and realized I could utilize my knowledge, natural skills and abilities to help those who don't readily have access to advisors. I enjoy working with both plan sponsors and their employees to simplify what can often be a very confusing subject. My philosophy as it relates to plan design and investments is to 'keep it simple.' Utilizing plan design techniques that are grounded in behavioral finance and strong foundational investment approaches, combined with precision execution, is what really drives plan health and employee retirement readiness. Optimizing the outcomes of those plans is what motivates me to do my best work serving clients."

If you're a business owner, serve as part of the benefits committee or investment committee at your company and have any questions about your Plan, or how CCM's Retirement Plan Services Team can help you or your organization, we encourage you to reach out to Cami at cami@carlsoncap.com or 952.230.6709.

PLEASE JOIN US!

AN EVENING FOR FINANCIAL *Insight* · WEALTH *Intention* AND LIFE *Inspiration*

JOIN US FOR an enlightening evening with a presentation and discussion with financial insights from Scott Bosworth of Dimensional Fund Advisors, and a keynote presentation by renowned inspirational speaker John O'Leary.

MONDAY, NOVEMBER 5, 2018

4:30–9:00 P.M.

University of St. Thomas, St. Paul Campus
Anderson Student Center, Woulfe Alumni Hall

Hors d'oeuvres and a cocktail social will be hosted by the colleagues of Carlson Capital Management.

Reserve your seats online at:
carlsoncap.com/olearyevent

or if you do not have online access,
please contact Angie Olson at
angie@carlsoncap.com; 507.321.4014

Reservations can be accepted through October 25, 2018

Alcohol will be served at this event, so we are able to welcome guests aged 21 years and older. We do encourage you to invite adult children and/or parents or other guests who would enjoy the event and meeting the team members of Carlson Capital Management.

Please note your guests' names in your seat reservations.

Renowned inspirational speaker JOHN O'LEARY will inspire you with an epic story of survival. He was a burn victim as a young child with a 1% chance to live. Today he has chosen to embrace his miraculous recovery and share it with the world. His emotional story-telling, unexpected humor and authenticity encourages us all to "live inspired."

johnolearyinspires.com



Scott Bosworth, CFA, VP of Dimensional Fund Advisors, will share how their insight into markets, deep connections to the academic community, commitment to rigorous research, and their focus on implementation and evidenced-based decision making leads them to continue to pursue new insights, both large and small, that benefit our clients.



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507.288.9797


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