City State Bank Trusts & Investments
Spring 2018 Newsletter

CITY STATE BANK INVEST

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HOW MUCH RISK CAN YOU TAKE?

Many market shocks are short-lived once investors conclude the event is unlikely to cause lasting economic damage. Still, major market downturns such as the 2000 dot-com bust and the 2008-09 credit crisis are powerful reminders that we cannot control or predict exactly how, where, or when precarious situations will arise.

Market risk refers to the possibility that an investment will lose value because of a broad decline in the financial markets, which can be the result of economic or sociopolitical factors. Investors who are willing to accept more investment risk may benefit from higher returns in the good times, but they also get hit harder during the bad times. A more conservative portfolio generally means there are fewer highs, but also fewer lows.

Your portfolio's risk profile should reflect your ability to endure periods of market volatility, both financially and emotionally. Here are some questions that may help you evaluate your personal relationship with risk.

HOW MUCH RISK CAN YOU AFFORD?

Your capacity for risk generally depends on your current financial position (income, assets, and expenses) as well as your age, health, future earning potential, and time horizon. Your time horizon is the length of time before you expect to tap your investment assets for specific financial goals. The more time you have to keep the money invested, the more likely it is that you can ride out the volatility associated with riskier investments. An aggressive risk profile may be appropriate if you're investing for a retirement that is many years away. However, investing for a teenager's upcoming college education may call for a conservative approach.

HOW MUCH RISK MAY BE NEEDED TO MEET YOUR GOALS?

If you know how much money you have to invest and can estimate how much you will need in the future, then it's possible to calculate a "required return" (and a corresponding level of risk) for your investments. Older retirees who have sufficient income and assets to cover expenses for the rest of their lives may not need to expose their savings to risk. On the other hand, some risk-averse individuals may need to invest more aggressively to accumulate enough money for retirement and offset another risk: that inflation could erode the purchasing power of their assets over the long term.

HOW MUCH RISK ARE YOU COMFORTABLE TAKING?

Some people seem to be born risk-takers, whereas others are cautious by nature, but an investor's true psychological risk tolerance can be difficult to assess. Some people who describe their personality a certain way on a questionnaire may act differently when they are tested by real events.

Moreover, an investor's attitude toward risk can change over time, with experience and age. New investors may be more fearful of potential losses. Investors who have experienced the cyclical and ever-changing nature of the economy and investment performance may be more comfortable with short-term market swings.

BRACE YOURSELF

Market declines are an inevitable part of investing, but abandoning a sound investment strategy in the heat of the moment could be detrimental to your portfolio's long-term performance. One thing you can do to strengthen your mindset is to anticipate scenarios in which the value of your investments were to fall by 20% to 40%. If you become overly anxious about the possibility of such a loss, it might be helpful to reduce the level of risk in your portfolio. Otherwise, having a plan in place could help you manage your emotions when turbulent times arrive.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

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DON'T DELAY: THE POTENTIAL BENEFITS OF STARTING TO SAVE NOW

For long-term investment goals such as retirement, time can be one of your biggest advantages. That's because time allows your investment dollars to do some of the hard work for you through a mathematical principle known as compounding.

THE SNOWBALL EFFECT

The premise behind compounding is fairly simple. You invest to earn money, and if those returns are then reinvested, that money can also earn returns.

For example, say you invest $1,000 and earn an annual return of 7% — which, of course, cannot be guaranteed. In year one, you'd earn $70 and your account would be worth $1,070. In year two, that $1,070 would earn $74.90, which would bring the total value of your account to $1,144.90. In year three, your account would earn $80.14, bringing the total to $1,225.04 — and so on. Over time, if your account continues to grow in this manner, the process can begin to snowball and potentially add up.

TIME AND MONEY

Now consider how compounding works over long time periods using dollar-cost averaging (investing equal amounts at regular intervals), a strategy many people use to save for retirement.[1] Let's say you contribute $120 every two weeks. Assuming you earn a 7% rate of return each year, your results would look like this:

Time period	Amount invested	Total accumulated
10 years	$31,200	$45,100
20 years	$62,400	$135,835
30 years	$93,600	$318,381

After 10 years, your investment would have earned almost $14,000; after 20 years, your money would have more than doubled; and after 30 years, your account would be worth more than three times what you invested.[2] That's the power of compounding at work. The longer you invest and allow the money to grow, the more powerful compounding can become.

THE COST OF WAITING

Now consider how much it might cost you to delay your investing plan. Let's say you set a goal of accumulating $500,000 before you retire. The following scenarios examine how much you would have to invest on a monthly basis, assuming you start with no money and earn a 7% annual rate of return (compounded monthly).

Time frame to retirement	40 years	35 years	30 years	25 years
Retirement accumulation goal	$500,000	$500,000	$500,000	$500,000
Annual rate of return	7%	7%	7%	7%
Monthly contribution needed	$190	$278	$410	$617

So the less time you have to pursue your goal, the more you will likely have to invest out of pocket. The moral of the story? Don't put off saving for the future. Give your investment dollars as much time as possible to do the hard work for you.

[1] Dollar-cost averaging does not ensure a profit or prevent a loss. It involves continuous investments in securities regardless of fluctuating prices. You should consider your financial ability to continue making purchases during periods of low and high price levels. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful. Review your progress periodically and be prepared to make adjustments when necessary.

[2] Assumes 26 contributions per year, compounded bi-weekly. These hypothetical examples are used for illustrative purposes only and do not represent the performance of any specific investment. Fees and expenses are not considered and would reduce the performance shown if they were included. Actual results will vary. Rates of return will vary over time, particularly for long-term investments. Investments with the potential for higher rates of return also carry a greater degree of risk of loss.

TAX CUTS AND JOBS ACT: IMPACT ON INDIVIDUALS

On December 22, 2017, President Trump signed into law the Tax Cuts and Jobs Act, a sweeping $1.5 trillion tax-cut package that fundamentally changes the individual and business tax landscape. While many of the provisions in the new legislation are permanent, others (including most of the tax cuts that apply to individuals) will expire in eight years. Some of the major changes included in the legislation that affect individuals are summarized below; unless otherwise noted, the provisions are effective for tax years 2018 through 2025.

INDIVIDUAL INCOME TAX RATES

The legislation replaces most of the seven current marginal income tax brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%) with corresponding lower rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The legislation also establishes new marginal income tax brackets for estates and trusts, and replaces existing "kiddie tax" provisions (under which a child's unearned income is taxed at his or her parents' tax rate) by effectively taxing a child's unearned income using the estate and trust rates.

Single

If taxable income is:	Then income tax equals:
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000

Married Individuals Filing Joint Returns

If taxable income is:	Then income tax equals:
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000

STANDARD DEDUCTION AND PERSONAL EXEMPTIONS

The legislation roughly doubles existing standard deduction amounts, but repeals the deduction for personal exemptions. Additional standard deduction amounts allowed for the elderly and the blind are not affected by the legislation and will remain available for those who qualify. Higher standard deduction amounts will generally mean that fewer taxpayers will itemize deductions going forward.

2018 Standard Deduction Amounts

Filing Status	Before Tax Cuts and Jobs Act	After Tax Cuts and Jobs Act
Single or Married Filing Separately	$6,500	$12,000
Head of Household	$9,550	$18,000
Married Filing Jointly	$13,000	$24,000

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TAX CUTS AND JOBS ACT: IMPACT ON INDIVIDUALS (CONT.)

ITEMIZED DEDUCTIONS

The overall limit on itemized deductions that applied to higher-income taxpayers (commonly known as the "Pease limitation") is repealed, and the following changes are made to individual deductions:

- State and local taxes — Individuals are only able to claim an itemized deduction of up to $10,000 ($5,000 if married filing a separate return) for state and local property taxes and state and local income taxes (or sales taxes in lieu of income).
- Home mortgage interest deduction — Individuals can deduct mortgage interest on no more than $750,000 ($375,000 for married individuals filing separately) of qualifying mortgage debt. For mortgage debt incurred prior to December 16, 2017, the prior $1 million limit will continue to apply. No deduction is allowed for interest on home equity indebtedness.
- Medical expenses — The adjusted gross income (AGI) threshold for deducting unreimbursed medical expenses is retroactively reduced from 10% to 7.5% for tax years 2017 and 2018, after which it returns to 10%. The 7.5% AGI threshold applies for purposes of calculating the alternative minimum tax (AMT) for the two years as well.
- Charitable contributions — The top adjusted gross income (AGI) limitation percentage that applies to deducting certain cash gifts is increased from 50% to 60%.
- Casualty and theft losses — The deduction for personal casualty and theft losses is eliminated, except for casualty losses suffered in a federal disaster area.
- Miscellaneous itemized deductions — Miscellaneous itemized deductions that would be subject to the 2% AGI threshold, including tax-preparation expenses and unreimbursed employee business expenses, are no longer deductible.

CHILD TAX CREDIT

The child tax credit is doubled from $1,000 to $2,000 for each qualifying child under the age of 17. The maximum amount of the credit that may be refunded is $1,400 per qualifying child, and the earned income threshold for refundability falls from $3,000 to $2,500 (allowing those with lower earned incomes to receive more of the refundable credit). The income level at which the credit begins to phase out is significantly increased to $400,000 for married couples filing jointly and $200,000 for all other filers. The credit will not be allowed unless a Social Security number is provided for each qualifying child. A new $500 nonrefundable credit is available for qualifying dependents who are not qualifying children under age 17.

ALTERNATIVE MINIMUM TAX (AMT)

The AMT is essentially a separate, parallel federal income tax system with its own rates and rules — for example, the AMT effectively disallows a number of itemized deductions, as well as the standard deduction. The legislation significantly narrows the application of the AMT by increasing AMT exemption amounts and dramatically increasing the income threshold at which the exemptions begin to phase out.

2018 AMT Exemption Amounts

Filing Status	Before Tax Cuts and Jobs Act	After Tax Cuts and Jobs Act
Single or Head of Household	$55,400	$70,300
Married Filing Jointly	$86,200	$109,400
Married Filing Separately	$43,100	$54,700

2018 AMT Exemption Phaseout Thresholds

Filing Status	Before Tax Cuts and Jobs Act	After Tax Cuts and Jobs Act
Single or Head of Household	$123,100	$500,000
Married Filing Jointly	$164,100	$1,000,000
Married Filing Separately	$82,050	$500,000

OTHER NOTEWORTHY CHANGES

- The Affordable Care Act individual responsibility payment (the penalty for failing to have adequate health insurance coverage) is permanently repealed starting in 2019.
- Application of the federal estate and gift tax is narrowed by doubling the estate and gift tax exemption amount to about $11.2 million in 2018, with inflation adjustments in following years.
- In a permanent change that starts in 2018, Roth conversions cannot be reversed by recharacterizing the conversion as a traditional IRA contribution by the return due date.
- For divorce or separation agreements executed after December 31, 2018 (or modified after that date to specifically apply this provision), alimony and separate maintenance payments are not deductible by the paying spouse, and are not included in the income of the recipient. This is also a permanent change.

WHAT CAN I LEARN FROM LOOKING BACK ON MY FINANCIAL SITUATION IN 2017

If your financial plan for 2017 didn't work out the way you wanted it to, don't beat yourself up. Instead, ask yourself the following questions to determine what you can learn from reflecting on your financial situation in the last year.

DID YOU MEET YOUR FINANCIAL GOALS AND EXPECTATIONS FOR 2017? Perhaps you started the year with some financial goals in mind. You wanted to establish a budget that you could stick to, or maybe you hoped to build up your emergency savings fund throughout the year. If you fell short of accomplishing these or other goals, think about the reasons why. Were your goals specific? Did you develop a realistic timeframe for when they would be achieved? If not, learn to set attainable and measurable goals for your finances in the new year.

HOW DID YOUR INVESTMENTS PERFORM? A year-end review of your overall portfolio can help you determine whether your asset allocation is balanced and in line with your time horizon and goals. If one type of investment performed well during the year, it could represent a greater percentage of your portfolio than you initially wanted. As a result, you might consider selling some of it and using that money to buy other types of investments to rebalance your portfolio. Keep in mind that selling investments could result in a tax liability. And remember, asset allocation does not guarantee a profit or protect against loss; it is a method to help manage investment risk. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

ARE YOUR RETIREMENT SAVINGS ON TRACK? Did you contribute the amount you wanted in 2017? Or did unexpected financial emergencies force you to borrow or withdraw money from your retirement savings? In that case, you can help your savings recover by contributing the most you can to your employer-sponsored retirement plan and taking advantage of employer matching (if it's available to you). Contributing to a 401(k) or 403(b) plan can help you save more consistently because your contributions are automatically deducted from your salary, helping you avoid the temptation to skip a month now and then.

WHAT FINANCIAL RESOLUTIONS SHOULD I CONSIDER MAKING AS I LOOK AHEAD TO 2018?

A new year is right around the corner, bringing with it a fresh start for you and your finances. What will you do this year to help improve your financial situation?

EVALUATE YOUR SAVINGS GOALS. The beginning of the year is a great time to examine your overall financial plan. Maybe you want to buy a new vehicle this year or save money toward a Caribbean cruise next year. Perhaps you want to focus less on material items and more on long-term goals, such as your retirement savings. Regardless of what you are setting money aside for, make sure you come up with a realistic savings plan that will help you achieve your goals and avoid the risk of significant loss.

PAY DOWN DEBT. Whether you owe money on your credit cards or have student loan payments to make, the start of a new year is a good time to develop a strategy to reduce your overall level of debt. Reducing your debt can help create opportunities to contribute toward other goals throughout the year. But unless you can definitely afford it, don't plan to pay off all your debts in one fell swoop. Set a smaller goal that you'll be more likely to achieve over the course of the year.

AUTOMATE AS MUCH AS YOU CAN. Your plan to pay down debt can be accomplished more easily if you automate your bill paying, saving, and investing. Most banks, credit card issuers, retirement plan providers, and investment companies offer services that make payments automatic — allowing you to worry less about payment dates.

ORGANIZE YOUR FINANCIAL DOCUMENTS. If your overall financial situation is already in good shape for the new year, consider taking time now to clear out and organize your financial records. Do you have important documents, such as your tax returns or passport, in a safe place? Are you holding on to records that you no longer need? Organizing your financial records now can save you time and frustration later if you need to locate a particular document.

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