Stock Yards Bank & Trust

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INVESTMENT & FINANCIAL INSIGHTS

A NEWSLETTER FROM THE CINCINNATI / NKY MARKET OF STOCK YARDS BANK & TRUST COMPANY

Q1: 2018

Cincinnati/Northern Kentucky Market Update

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I am always excited for a New Year to begin. After all the attention of the holidays and time out of the office, it is nice to be back in rhythm. I have spoken with several of our associates and it does seem to be a common theme. Spending time with family and friends invigorates us and gets us ready to be back in our work mode.

One of the reasons we are ready to return to work is our passion for helping our clients to achieve their financial goals. Your partners at Stock Yards Bank & Trust take your financial well-being very seriously. As clients and Centers of Influence, you are not just a transaction to us but part of a larger relationship. We value those relationships and strive to provide meaningful value that helps set us apart from our competition. We work hard on all aspects of your financial relationships with us. Remember that we have experts throughout our organization that can assist you whether you need help investing your money, developing a plan to transition your wealth, growing or acquiring a business, buying a home, or any other financial need that arises.

2018 is off to a great start for Stock Yards Bank & Trust in the Cincinnati / Northern Kentucky Market! We ended 2017 on a high note and carry strong momentum across all divisions as we enter into the New Year. We are excited to expand our presence in the market with new locations and new financial professionals.

Don't hesitate to let us know how we can help you, your family, and friends. We appreciate our clients and the trust that they put in us! Happy New Year and we look forward to a tremendous 2018.

> **“Remember that we have experts throughout our organization that can assist you whether you need help investing your money, developing a plan to transition your wealth, growing or acquiring a business, buying a home, or any other financial need that arises.”**

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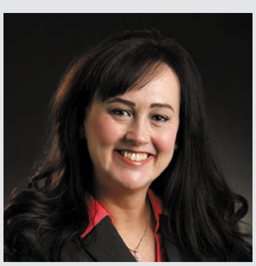

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Economic & Market Outlook: Q1, 2018

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The fourth quarter of 2017 was another positive one for investors. The Standard & Poor's 500 Index rose 6.6% in the quarter and closed out 2017 with a total gain of 21.6%. International stocks were one of the best performers last year with returns as measured by the MSCI EAFE Index of 4.2% for the fourth quarter and 25.0% for the year. Bond investors did not fare as well but still managed a return as measured by the Bloomberg Barclays U.S. Aggregate Index of 0.4% for the quarter and 3.5% for the year – a small return when compared to stocks but impressive when considering the very low level of interest rates. Few market strategists predicted positive returns of this magnitude from financial assets at the beginning of 2017.

What can we expect from the economy and the capital markets in 2018? We are more optimistic about economic growth this year for a number of reasons. First, the economy finally appears to be gathering momentum. Consensus estimates for GDP growth in the fourth quarter of 2017 are around the three percent area. If we meet those expectations, the fourth quarter will be the third consecutive quarter of three percent or better GDP growth and the first time that we have had three consecutive quarters of growth of this magnitude in a decade. Second, the unemployment numbers continue to improve to the extent that the U.S. economy is very close to what is generally considered to be full employment. This has positive ramifications for consumer spending, which makes up over two thirds of our economy and the housing market. Another important factor influencing our optimism is the recently passed tax law. We believe that the press and market pundits are underestimating the economic and market impact of this important piece of legislation. Most American workers will see a decline in their taxes as soon as February when new withholding tables go into effect. This will further stimulate spending. The decline in the corporate tax rate is certain to have a positive impact on corporate profits and the long term competitiveness of domestic companies on the world stage. It has been gratifying to see corporate America respond to lower taxes with announcements of higher wages and bonuses for employees. The combination of higher wages and corporate profits will be positive for consumer and business confidence. Personal and corporate spending will lead to faster economic growth during 2018. Finally, there are more initiatives on the table from the new administration designed to foster further gains in economic growth. These include reduced business regulation, plans to encourage energy exploration and development, and an infrastructure spending plan. All of these initiatives will be positive for our economy.

What does this mean for the capital markets this year? Addressing the stock market first, one of the issues that investors have with the domestic market is valuation. U.S. stocks are trading at high levels based on almost every valuation measure. However, this may be justified by the increasing corporate earnings that result from faster economic growth and declining taxes. P/E ratios, while still high, should adjust back to more realistic levels as a result of increased profits. Earnings are the fuel that drive stock prices higher. The impact of faster economic growth and lower taxes will have a positive impact on corporate earnings in 2018 and beyond. It would be a stretch to see returns from stocks in 2018 similar to what we experienced last year. However, a positive year for stocks based on our economic outlook is highly likely.

The fixed income markets may not be so fortunate. Generally, faster economic growth increases the demand for capital, which results in higher interest rates. In addition, the Federal Reserve has promised that it will continue to increase short term rates and unwind its quantitative easing program. The Fed will shrink its balance sheet by not reinvesting the income or proceeds from maturing bonds and may begin to sell its bond holdings outright. This reduction in demand and increase in supply is generally not good for bond prices. Lastly, wage pressure appears to be increasing as the economy nears full employment. Wage pressure has been a precursor to inflationary pressure in the past. Bond prices are negatively impacted by inflation as investors demand higher rates of interest to compensate for loss of purchasing power. Faster economic growth and increasing inflation may force the Federal Reserve to accelerate the process of raising rates and selling bond holdings more quickly than the markets now anticipate.

We continue to favor common stocks as the financial asset of choice over fixed income and other non-financial assets like collectibles and commodities. We are concentrating our efforts on maintaining portfolios of high quality, dividend paying, and growing companies that are trading at reasonable relative valuations. We prefer moated businesses with unique business models that insulate them from competition. We also prefer conservatively financed businesses with low levels of debt and strong cash flow from operations. We expect that companies with these characteristics will do well in the economic environment we envision and, more importantly, during difficult economic times. When the inevitable recession or stock market correction occurs, high quality companies with strong balance sheets will protect our clients from permanent loss of capital.

What could go wrong with the positive economic scenario we anticipate? The first problem will be coping with an increase in interest rates. The Federal Reserve could increase interest rates too quickly and offset the positive impact of lower taxes and other fiscal policies. Central banks throughout history have been less successful at unwinding liquidity in an orderly manner than they have been at increasing liquidity with monetary policy. Now, the problem that central bankers face will be doubly difficult because of the high level of debt in the United States and around the developed world. The second problem relates to geopolitical risks. Geopolitical tensions in the Middle East and Korea are very high. An escalation of tensions in either area could result in a loss of consumer confidence that would adversely impact global growth. Finally, high debt levels have been an anchor to economic growth. Federal debt levels in the U.S. will increase in 2018 and may stay elevated if tax cuts do not generate the economic growth necessary to offset the loss of government revenue. Higher debt is seldom a good thing for governments or individuals as the cost of servicing the interest and principal has penalized future growth and spending.

Thank you for the confidence you have placed in Stock Yards Bank & Trust to manage your financial affairs. We hope that 2018 will be a healthy, happy, and prosperous year for you and your families. Please contact a member of the Wealth Management and Trust team for a more detailed discussion of our 2018 outlook.

Understanding The Tax Law Changes

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On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act. It cuts the corporate tax rate from 35 percent to 21 percent beginning in 2018. The top individual tax rate will drop to 37 percent. It cuts income tax rates, doubles the standard deduction, and eliminates personal exemptions. The corporate cuts are permanent, while the individual changes expire at the end of 2025.

Here's a summary of some of the ways the Act changes taxation for individuals and businesses:

FOR INDIVIDUALS, THE ACT...

1. Keeps the seven income tax brackets but **LOWERS TAX RATES.** Employees will see changes reflected in their withholding in February 2018 paychecks. These rates revert to the 2017 rates in 2026.
2. **DOUBLES THE STANDARD DEDUCTION**. A single filer's deduction increases from $6,350 to $12,000. The deduction for Married and Joint Filers increases from $12,700 to $24,000.
3. **ELIMINATES PERSONAL EXEMPTIONS**. Before the Act, taxpayers subtracted $4,150 from income for each person claimed.
4. **ELIMINATES MOST ITEMIZED DEDUCTIONS**. That includes moving expenses, except for members of the military. Those paying alimony can no longer deduct it, while those receiving it can. This change begins in 2019 for divorces signed in 2018.
5. **KEEPS DEDUCTIONS** for charitable contributions, retirement savings, and student loan interest. If possible, move any of these deductions from 2018 to 2017. You won't take them if you take a standardized deduction in 2018.
6. **LIMITS THE DEDUCTION ON MORTGAGE INTEREST** to the first $750,000 of the loan. Interest on home equity lines of credit can no longer be deducted.
7. Allows taxpayers to **DEDUCT UP TO $10,000 IN STATE AND LOCAL TAXES**. They must choose between property taxes and income or sales taxes.
8. **EXPANDS THE DEDUCTION FOR MEDICAL EXPENSES** for 2017 and 2018. It allows taxpayers to deduct medical expenses that are 7.5 percent or more of income. Before the bill, the cutoff was 10 percent for those born after 1952.
9. **REPEALS THE OBAMACARE TAX** on those without health insurance in 2019.
10. **DOUBLES THE ESTATE TAX EXEMPTION** to $11.2 million for singles and $22.4 million for couples. The exemption reverts to pre-Act levels in 2026.
11. **KEEPS THE ALTERNATIVE MINIMUM TAX.** It increases the exemption from $54,300 to $70,300 for singles and from $84,500 to $109,400 for joint. The exemptions phase out at $500,000 for singles and $1 million for joint. The exemption reverts to pre-Act levels in 2026.
12. **INCREASES THE CHILD TAX CREDIT** from $1,000 to $2,000. Even parents who don't earn enough to pay taxes can claim the credit up to $1,400. It increases the income level from $110,000 to $400,000 for married tax filers.
13. Allows parents to use **529 SAVINGS PLANS** for tuition at private and religious K-12 schools. They can also use the funds for expenses for home-schooled students.
14. Allows a **$500 CREDIT FOR EACH NON-CHILD DEPENDENT**, helping families caring for elderly parents.

FOR BUSINESSES, THE ACT...

1. **LOWERS THE MAXIMUM CORPORATE TAX RATE** from 35 percent to 21 percent.
2. **RAISES THE STANDARD DEDUCTION TO 20 PERCENT** for pass-through businesses. This deduction ends after 2025. Pass-through businesses include sole proprietorships, partnerships, limited liability companies, and S corporations. The deductions phase out for service professionals once their income reaches $157,500 for singles and $315,000 for joint filers.

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Understanding The Tax Law Changes (continued from page 3.)

By Alexander M. Say, J.D.

FOR BUSINESSES, THE ACT...

3. **LIMITS CORPORATIONS' ABILITY TO DEDUCT INTEREST EXPENSE** to 30 percent of income. For the first four years, income is EBITDA, but reverts to earnings before interest and taxes thereafter.

4. Businesses **CAN DEDUCT THE COST OF DEPRECIABLE ASSETS** in one year instead of amortizing them over several years. It does not apply to structures. To qualify, the equipment must be purchased after September 27, 2017, and before January 1, 2023.

5. Stiffens the requirements **ON CARRIED INTEREST PROFITS**. Carried interest is taxed at 23.8 percent instead of the top 39.6 percent income rate. Firms must hold assets for a year to qualify for the lower rate. The Act extends that requirement to three years.

6. **ELIMINATES THE CORPORATE AMT**.

7. **ADVOCATES A "TERRITORIAL" TAX SYSTEM** versus the "worldwide" tax system currently used– multinationals are taxed on foreign income earned and taxes aren't paid until the corporations bring the profits home. As a result, many companies leave it parked overseas. Under the territorial system, the companies won't be taxed on that foreign profit. Therefore, they will be more likely to reinvest their profits in the United States.

8. Allows companies to **REPATRIATE THE $2.6 TRILLION** they hold in foreign cash stockpiles. They pay a one-time tax rate of 15.5 percent on cash and 8 percent on equipment.

9. **ALLOWS OIL DRILLING IN THE ARCTIC NATIONAL WILDLIFE REFUGE**.

10. **RETAINS TAX CREDITS** for electric vehicles and wind farms.

11. **CUTS THE DEDUCTION** for orphan drug research from 50 percent to 25 percent. Orphan drugs target rare diseases.

12. **CUTS TAXES ON BEER, WINE, AND LIQUOR**.