



The Berkshires are at last emerging from winter and entering into summer. Trees and flowers are in bloom and the countryside is full of the optimism of new growth. The normal seasonal cycle is repeating itself. Tom's article considers the important tax implications for those of you living in this region but seeking to spend more time in warmer locations such as Florida.

In the investment article this quarter, we reflect on some similarities with a past cycle and look forward to more encouraging economic data which should help boost investor confidence in the stock market. In an election year, politics can be a concern to investors of all political persuasions. At this stage in the electoral cycle, policies remain obscured by political wrangling and it will probably be much later in the year before we have a clearer perception of the detail of policies and their likely impact on the capital markets.

Trevor

Central Banks, Prices & Labor

by Trevor M. Forbes

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of light, it was the season of darkness, it was the spring of hope, it was the winter of despair."



CHARLES DICKENS,
A Tale of Two Cities

It is interesting how history appears to repeat itself, although the precise details may vary. Dickens' masterpiece was published in serial form in 1859, just two years after the Great Panic of 1857. The recession caused by the panic started in the U.S. and extended around the developed world. The source of the panic was a combination of over leveraged companies and state governments in the northern U.S. In policies reminiscent of but not identical to the 2008 / 2009 financial crisis, many banks had to be rescued and the U.S. Treasury enacted a novel form of monetary accommodation. Today it is the Federal Reserve Bank (Fed), not the government, which has the responsibility for monetary policy.

Many economists, however, express concern over the 'experimental' nature of its approach that is now common across the world's main central banks. It is interesting that 1859 was also the year Karl Marx published "A Contribution to the Critique of Political Economy", drawing on this socially disruptive crisis and setting out one of his first arguments against the capitalist system.

Many of the political and economic discussions surrounding the current Republican and Democratic primaries in the U.S. seem to echo issues that were also prevalent in the late 1850s. Extreme positions have, as usual, been taken by the principal protagonists and many

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The Great Northeast?

By Thomas E. Malinowski

Many of you, in addition to owning a home in the Northeast, may also own or rent a home elsewhere on a seasonal basis. Or, some of you may be contemplating acquiring a second home in a more favorable climate. If that other state has a more favorable "tax climate" as well, it may make sense to change your state of residence or domicile to the new state.

Let's take a closer look...with the increase in the federal exemption amount to \$5,450,000, estate taxes at the federal level are becoming less of an issue for most people. This is especially true when considering the "portability" of the exemption, thus allowing a surviving spouse to use any remaining exemption that was not used at the first spouse's death. However, there remains a difference with respect to the state exemption amounts.

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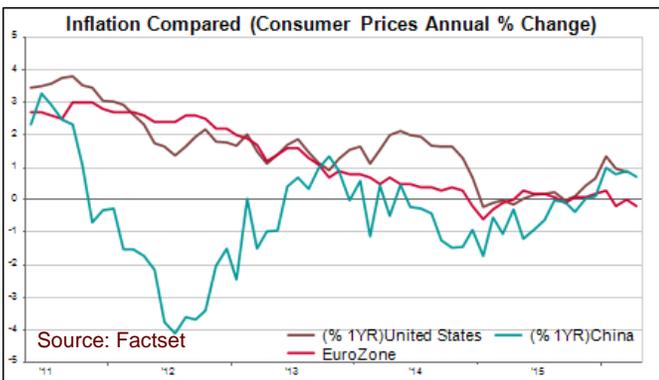
...Banks, Prices & Labor (continued from page 1)

hark back to the lessons to be learned from the social dislocation following the financial crisis of 2008 / 2009. In the same way Dickens and Marx explored the social and income inequalities of a bygone era, today's politicians espouse different solutions which unfortunately, in the words of George Orwell, so often appear "pure wind"!

"Political language -- and with variations this is true of all political parties, from Conservatives to Anarchists -- is designed to make lies sound truthful and murder respectable, and to give an appearance of solidity to pure wind."

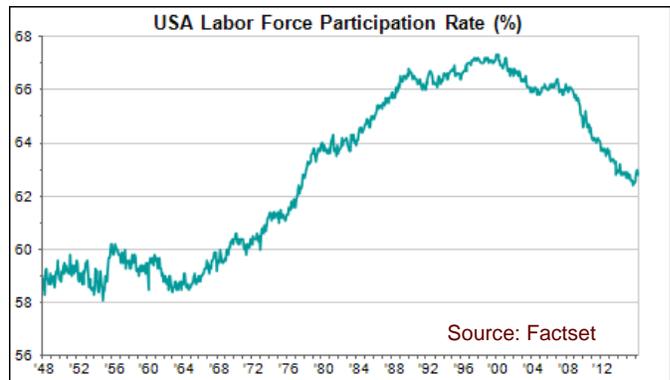
GEORGE ORWELL,
Politics & The English Language

The pace of recovery from the financial crisis of 2008 has been much more gradual while the solutions adopted by the central banks are just as revolutionary and untried as those put in place in 1857. Printing money (the populist term for the central banks' Quantitative Easing or QE'), has long been considered a quick recipe for inflation. Yet six years on from the first such measure policymakers continue to worry about deflation:



While Europe continues to struggle with falling prices, there are some tentative signs that the rate of inflation in the U.S. and China may be starting to recover.

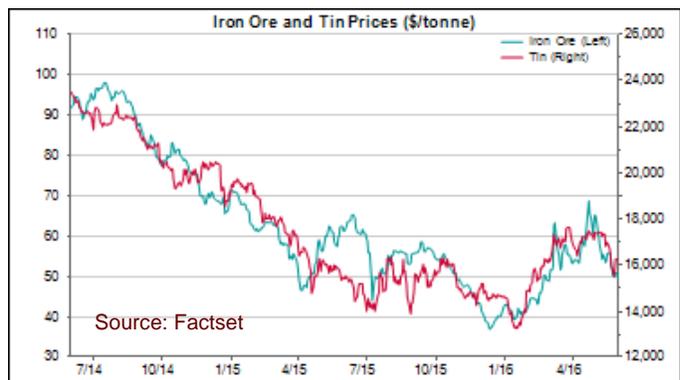
U.S. average hourly earnings are rising and shortages in the labor market have indicated further pressures to come as the unemployment rate heads lower. The issues for policymakers, however, are the data indicating a significant proportion of the workforce has decided to sit the recovery out. This is shown by the labor participation rate:



The recent data shows a slight increase in the participation rate indicating a gradual re-employment of this part of the workforce. It is possible that labor shortages and higher compensation in some industries are helping to reverse the trend.

The Economy

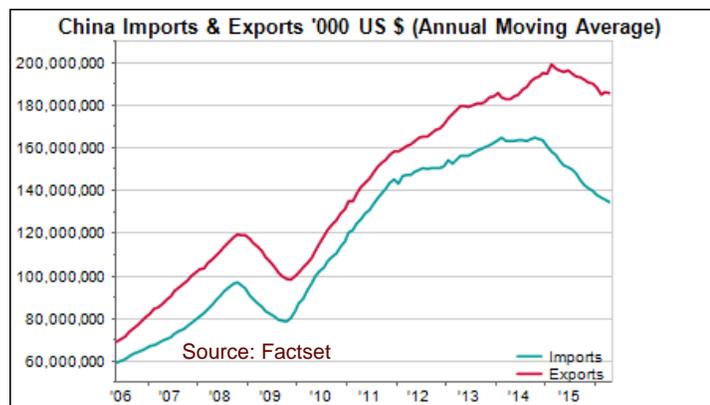
Economic growth meanwhile remains patchy. Globally, China is the conundrum. The spectacular recovery for many commodity prices and shipping rates since January appeared to indicate some recovery in Chinese activity.



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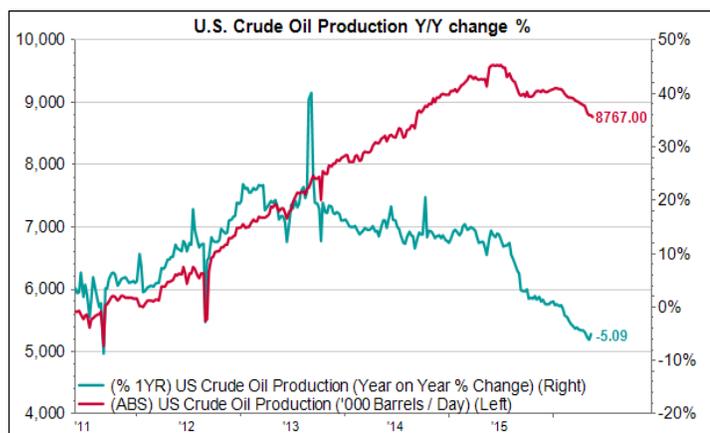
...Banks, Prices & Labor (continued from page 2)

China's trade figures, however, tell a different story. The value of imports at the end of April was at the lowest level for 4 ½ years while exports remain unchanged from mid-2014:



As we have discussed before, this has limited implications for the U.S. economy but significant impact on many Emerging Economies and those dependent on raw material exports.

Despite these headwinds, the U.S. is reporting reasonable, if not exciting, levels of activity. Manufacturing has been affected by the sharp drop in activity in the energy sector and related industries. The number of drilling rigs operating on-shore has fallen over the last two years to the lowest level since 1850:



This chart also shows one of the consequences of this dramatic decline in drilling activity – U.S. oil production has fallen sharply. At the peak of production in mid-2015, global oil supply exceeded (growing) global demand by approximately 1.5 million barrels of oil per day. The drawdown in U.S. supply since then is 900,000 barrels of oil a day, which is a significant contribution to reducing excess supply. At this rate the decline in U.S. oil production will have eliminated global oversupply by the end of 2016. Since the low point in early February, oil prices have risen by 70%. At the current speed of adjustment in the industry it is now possible to expect drill-

ing activity to start to recover later this year and into 2017. This oil sector improvement, albeit from depressed levels, is important for the U.S. economy as it will help the domestic manufacturing industry and reduce pressure on banks from non-performing energy loans.

For corporate earnings, a recovery in activity in the energy sector is important. In the first quarter of 2016, the S&P reported an overall earnings decline approaching 9%. Energy companies and closely related industrials and financials were the principal contributors. For the calendar year, current expectations are that corporate earnings will increase modestly and a much faster growth is anticipated for 2017. Profit margins have benefitted significantly from a continuous drive to reduce costs and the low cost of servicing debt due to the accommodative interest rate policies of the central banks. Although we do expect margin pressure to increase, mainly from higher employment and related costs, consumer demand should help drive revenues.

By the end of 2017 S&P earnings should be more than double the level in 2009, indicating a valuation based on today's prices below the 60 year average:



At this level the equity market continues to offer value. Additionally, the dividend yield on the S&P 500 Index at 2.2% exceeds the 1.75% yield on the 10-year Treasury Bond. We expect company dividends to continue to grow ahead of the prevailing inflation rate over the next ten years. Accordingly, equities continue to provide a good and growing source of income although at the 'cost' of periodic volatility. **§§**



The Great Northeast (continued from page 1)

For instance, Massachusetts retains only a \$1,000,000 exemption, with a top tax rate of 16%, while New York State's exemption amount is presently \$4,187,500 (scheduled to increase to the Federal exemption amount on April 1, 2019) with a top tax rate of 16%. Significantly, Florida imposes no estate tax.

From an income tax perspective, Massachusetts imposes a flat tax rate of 5.1% while New York State's highest tax rate is 8.82%. Importantly, Florida has no income tax at all.

If you decide to establish another state as your state of domicile, it is equally as important to relinquish domicile in your current state.

Generally, your domicile is the place that is your true, fixed and permanent home, determined by established common law principles and your particular facts and circumstances. It is the place that you **intend** to make your permanent home. Consequently, there must also be intent to relinquish domicile in your prior state.

Certain factors that evidence intent are as follows:

1. Do you continue to maintain a home in your former state?
2. Do you maintain a home in your new state?
3. Do you receive your mail in your new state?
4. Do you continue to maintain affiliations with social and/or religious organizations in the former state?
5. Have you registered to vote in the new state?
6. Have you applied for a driver's license in the new state?
7. Have you registered your automobiles in the new state?
8. Have you executed a new will or other estate planning documents in the new state?
9. Have you executed an affidavit of domicile in the new state?
10. Have you filed a final state income tax return in your former state?
11. Does the address listed on your federal income tax return reflect your new state?
12. Have you established a regular "family doctor" relationship in the new state?
13. Has your new state been declared when renewing your passport?
14. Have you stored family records and valuables in your new state?
15. Have you moved most or all of your personal banking relationships to your new state?



If you maintain a permanent place of abode and spend more than 183 days in a state during the year, most states will consider you domiciled of that state. A permanent place of abode includes not only a home owned by you or your spouse, but any dwelling you or your spouse are leasing. It is important to keep a diary or log of your travels, substantiated with relevant documentation, i.e. airline tickets.

Changing your state of domicile may prove to be very valuable to you and your family. However, it is important that you truly intend and make every effort to treat your new state as your state of domicile.

Please feel free to contact our office if you wish to discuss your specific circumstance. **§§**

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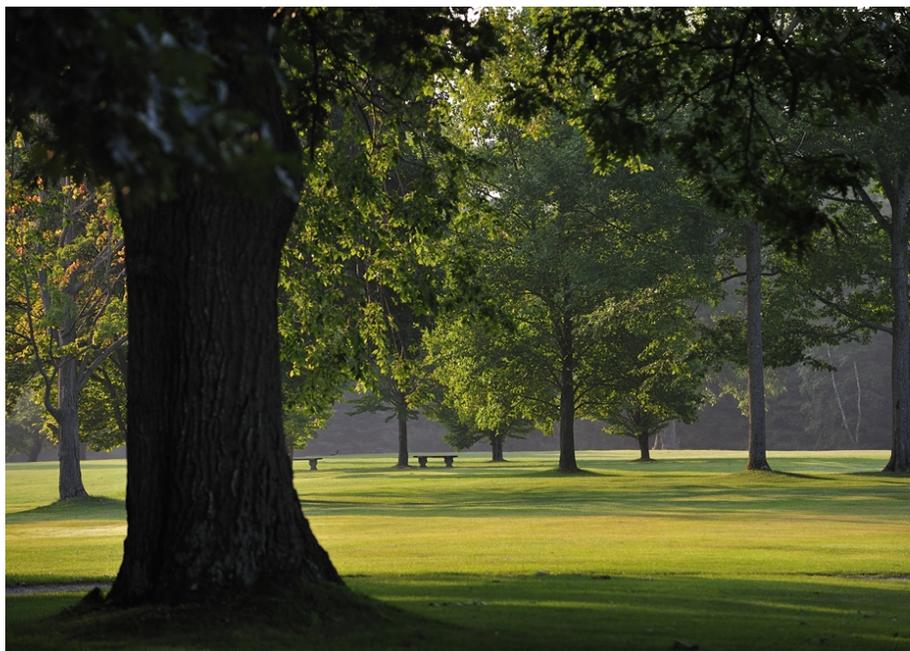
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