Summer 2018

The Renaissance Report

Providing customized financial, estate and investment management solutions.

It is almost ten years since Lehman Brothers filed for bankruptcy on September 15 2008 and so ushered in the worst financial crisis the U.S. had experienced since the Great Depression of the 1930s. Learning from the example of history, the government and the Federal Reserve Bank (Fed) introduced exceptional financial measures to ensure history didn't repeat itself. The subsequent economic recovery is a clear testament to the success of this policy but as a result, some aspects of the market economy started to change reflecting distortions arising from exceptionally low interest rates and the Fed emerging as one of the largest buyers of bonds. This policy is now being reversed as the authorities judge the economy as being sufficiently robust with a financial system that is fully repaired. We look into the consequences of the policy and the potential impact of a change in direction.

Tom has written an article on the 'Kiddie Tax' which will be of specific interest to readers with children under the age of 19 or full time students under the age of 24. Lastly, we have provided an introduction to the growing Renaissance team many of whom you have got to know well over the last eighteen years but some who have joined more recently.

Trevor

Trevor M. Forbes

Return to Normalcy

Presidential candidate Warren G. Harding pleaded for normalcy during the 1920 presidential campaign. The text of the 29th President's June 1920 speech was to convey a return to American prewar values after the human catastrophe of the First World War.

The context in which we are using the phrase today maybe very different but it can be applied just as effectively to the financial management of the West after the near catastrophic financial crisis a decade ago.

Just as historians search far back in time to identify the seeds of war in the early 20th century, we need to reach back to the late 1980s to see a train of events that led, eventually, to the near collapse of the financial system in the U.S., UK and much of Europe.

We see this most clearly in the subtle changes that took place following the early stages of financial deregulation in the late 1980s. This was compounded by the disinflation following the collapse of communism and the opening up of vast manufacturing capacity in Eastern Europe, Russia and, of course, China.

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Thomas E. Malinowski

Planning to Reduce the Impact of the "Kiddie Tax"

With the passage of the "Tax Cuts and Jobs Act" in 2017, the consequences of the "kiddie tax" became much more significant for many taxpayers. The so-called kiddie tax imposes a greater tax liability on unearned income (interest, dividends and capital gains) for many children and young adults.

This tax applies to an individual who is younger than 19 years of age or younger than 24 years if a full-time student, assuming at least one parent is alive. Any unearned income exceeding a threshold amount ($2,100 in 2018) is subject to this tax.

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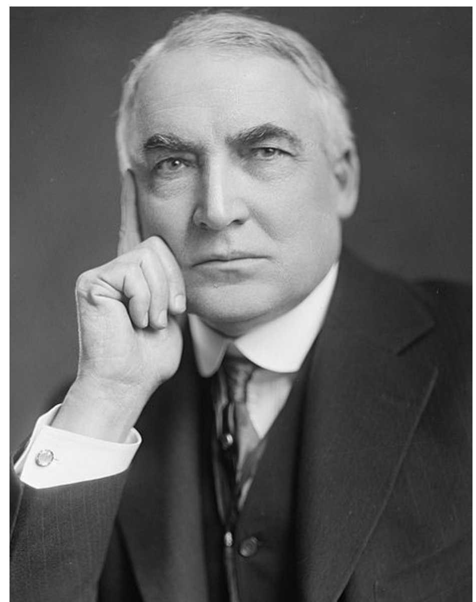

"America's present need is not heroics but healing; not nostrums but normalcy; not revolution but restoration."

President Warren G. Harding
1865 - 1923

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Return to Normalcy

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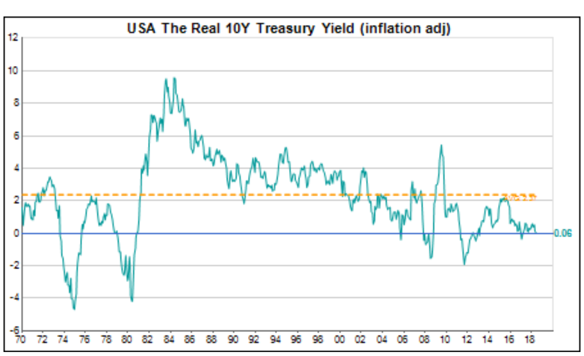
Financial deregulation encouraged hitherto conservative financial institutions to increase risk taking. Disinflation helped to reduce bond yields steadily over thirty years and interest rates eventually reaching levels in the UK not seen for 250 years, while in Europe, government bond yields turned negative which is unprecedented in modern history. It is, perhaps, unsurprising investors began to change their investing habits and company managements revised their approach to capital allocation and approach to financing risk investments. Why bother with hassle of quarterly earnings reports to support an equity investor base when you can borrow from the same investors for a fraction of the cost? Indeed, why bother with the increasing cost of a dividend when servicing debt became almost negligible for the highest quality companies? Maybe go one stage further and reduce the equity cost by borrowing very cheaply, retiring equity through share buybacks and saving the cost of paying a dividend.

And so, debt increasingly became the currency of choice with which to fund not only working capital (the day to day financing of a company) but also risk investment such as capital spending and acquisitions.

Funding capital projects from debt has been prevalent across western Europe, Germany, since World War II. Big financial institutions, such as insurance companies, like the certainty of debt. Private investors are more inclined to take risk but are a relatively minor part of the financial environment in many European countries.

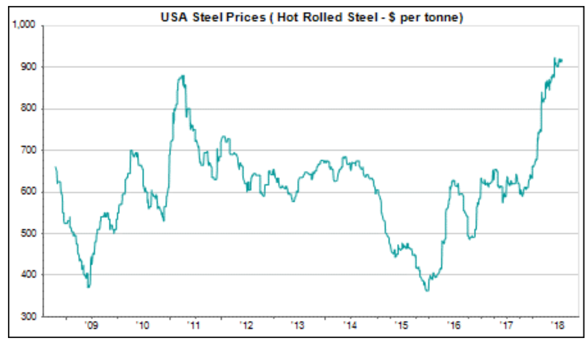
Anglo Saxon economies have tended to shy away from using debt to fund risk investment, preferring equity. The greater participation of private investors in these economies have tended to prefer investing to gain exposure, and benefit, from risk. The long-cherished view of the role of equity investment in the U.S and UK has been seen as a way to benefit from growth in the economy and protect the investor's wealth from the periodic ravages of inflation. Fixed income investing bestows no such benefits – particularly during periods of rapid economic growth and higher inflation.

For the investment markets, the change has been dramatic. For thirty years, bond yields have been declining in the U.S. The following chart shows the steady fall in the ten-year Treasury Yield adjusted for inflation:

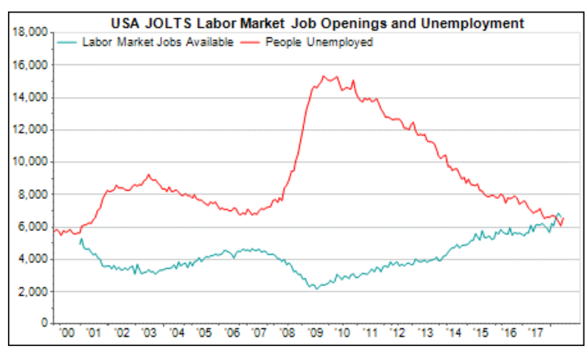


The average is shown by the dotted orange line set at 2.4%. This level represents the average yield above the rate of inflation investors have been prepared to pay over the last fifty years. This is the level that compensates investors for the inflation risk over the ten-year life of the bond.

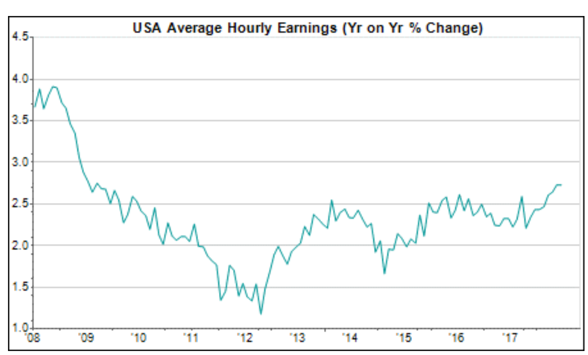
Whatever the political and personality perceptions of the current U.S. administration may be, their impact has been to generate a higher level of economic activity than the norm for much of the last two decades. The White House has shown its willingness to risk higher inflation through tariffs on imports and this can be clearly seen in sharply higher steel prices which are 60% higher than a year ago:



By fueling growth in the U.S. economy, the administration is also risking much higher labor inflation. The latest numbers show 6.3 million jobs available across the U.S. However, there are 'only' 6 million people registered unemployed to fill these positions:



Although average hourly earnings have been rising by a modest 2.7%, the trend is clear:



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Return to Normalcy

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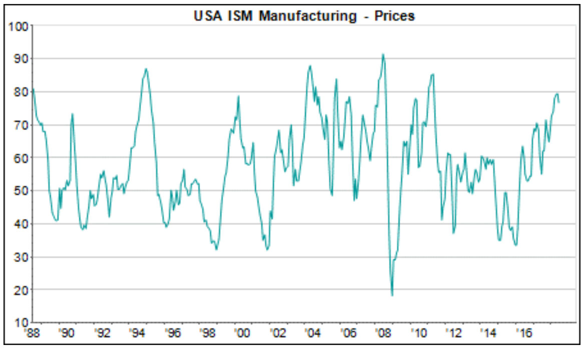
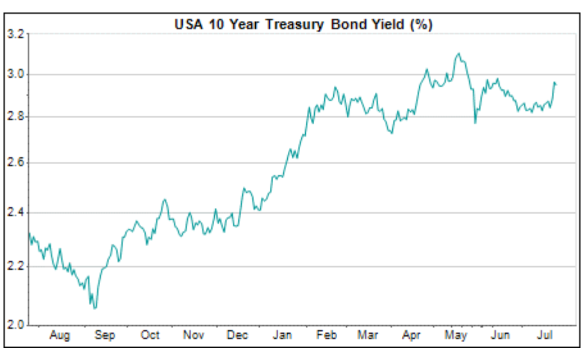
Manufacturers, too, have started to reflect increasing pricing pressure through their expectations for prices. The Manufacturers Purchasing Managers' Index shows prices rising at the fastest rate for seven years and close to the fastest for thirty years:



So, we are starting to experience an economic outlook quite unlike the last thirty years. During that time, inflation pressures were easing steadily, finally resulting in a flirtation with deflation after the financial crisis. Being a fixed income investor has been relatively easy. Income yields may be low but rising bond prices held out the prospect of capital gains - unusual for bonds. It is possible we are starting to experience a reversal of that trend.

The move away from equity to fixed income investing has allowed many companies to retire their outstanding equity. Indeed, around a third of the outstanding shares available on the New York Stock Exchange at the end of 2009 have been 'retired'. Fortunately, investors, especially private investors, have been more interested in increasing their investment in bonds. There are signs this may be changing. Bond yields have moved sharply higher with the ten-year Treasury yield increasing from close to 2% in September 2017 to just over 3% by mid-May this year:



Over the last two years the change has been even more dramatic with the yield more than doubling. As the price of a bond is the inverse of its yield, this has resulted in a fall in the price. So far in 2018, the ten-year Treasury price has ***fallen*** 2.3% compared with a 5.3% ***gain*** for the S&P 500 Index.

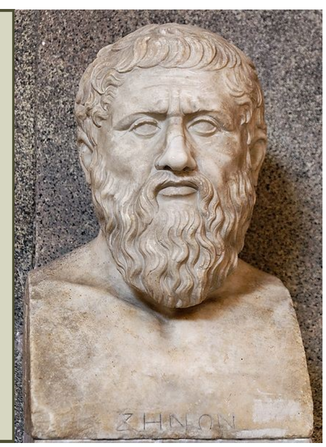
The role bond investments play in an investment portfolio is to help preserve wealth. However, as bond yields move higher, investing in bond funds is likely to risk wealth preservation. In this environment, Renaissance believes investors should take risk in equities but offset some of that potential volatility with a very conservative approach to investing in bonds. This can be best achieved by holding individual bond positions to maturity. In this way, bond investments can help to preserve capital even during a period of rising yields.

Conventional wisdom would have us believe that a rise in bond yields / the cost of money is inevitably bad for equities. Yet, over the last eighteen months we have experienced a rise in bond yields together with a rise in equity prices. This is exactly the pattern we might expect from higher than trend growth that risks higher inflation. Eventually, the Federal Reserve Bank (Fed) may have to increase interest rates sufficiently to reduce the growth potential of the U.S. economy. The appropriate level, often quoted as a return to the 'normal' rate, is subject to much discussion and conjecture. However, a high growth rate economy and higher inflation can, as it has in the past, support a strong equity market for an extended time although this is likely to be accompanied by higher market volatility.

Renaissance believes the key to successful investing in this part of the market cycle is to invest in equities which benefit from economic growth, managements seeking to reduce financial risk and balanced by a very conservative, low risk investment in bonds. ***§§***

"Knowledge is true opinion."

Plato,
Greek Philosopher
427 BC – 347 BC



Client Referrals

Renaissance prides itself on delivering exceptional levels of service and customized asset management solutions. While we are very selective about bringing on new clients, we always welcome referrals from our existing clients and close business partners.

If you believe someone could benefit from working with our team, Chris Silipigno is available to discuss what options might exist. He can be reached at csilipigno@rigllc.com or 413-306-4166.

Renaissance Team Introductions

I am pleased to announce the addition of two new employees to the Renaissance team! In the 18 years that we have been in existence, it has been our mission to offer clients the highest levels of investment expertise, personal and customized financial counsel, and access to the variety of professionals required to effectively protect and grow their assets. Since we regained our independence in October 2016, our business has grown successfully, enabling us to hire three excellent additions to our team. It is my belief that hiring these individuals enhances our ability to deliver exceptional levels of service for all our clients now and into the future.

First, I'd like to introduce Christopher Silipigno as our new Chief Operating Officer. In this new role, Chris will be responsible for providing operational leadership within the firm, as well as coordinating strategic business development efforts across the region.

Christopher Silipigno

Chris' extensive senior leadership experience and financial expertise will serve our clients well at Renaissance. His presence provides increased depth, thereby enabling us to deliver even greater levels of service to our clients. Chris will draw upon his professional experience to enhance our offerings to the non-profit community and our business partners. He will provide Renaissance with long term continuity at a senior level.

"This firm was founded to bring clients a level of financial and investment counsel normally reserved only for ultra-high net-worth individuals and that is certainly still the case today. This really sets them apart from other investment advisory firms and it played a major role in my decision to make the move to Renaissance," says Chris. "The team at Renaissance, many around since the firm's inception, is just excellent and I look forward to helping Trevor and the team build on the foundation they've created"

Chris comes to Renaissance with nearly 20 years of senior leadership positions in both operational and business development functions for non-profit and for-profit enterprises. His experience spans across all facets of the mortgage banking industry, non-profit development, organizational effectiveness and leadership, performance management, and revenue growth areas. Most recently, Chris brought his business acumen to City Mission of Schenectady, an inner-city nonprofit dedicated to helping the homeless, abused, and impoverished to become sustainable. During his tenure, the organization grew exponentially in all measurable areas, receiving regional and national acclaim for its accomplishments. Previous to this role, Chris held multiple positions, at the vice president level, within the banking and finance industry. His accomplishments include building and managing divisions responsible for originating over 750 million in annual loan volume.

Chris received a bachelor's degree, magna cum laude, from SUNY at Albany, a master's degree from George Mason University, and holds his FINRA Series 65 registration.

We are also very pleased to welcome Timothy Shumsky (TJ) to Renaissance! Graduating in Siena College's class of 2018 with a BA in Finance, TJ is joining the firm as a Junior Portfolio Manager. TJ first impressed us with his quantitative skills in the summer of 2017 when he served as an intern on Renaissance's investment team. With the addition of TJ, we add both enhanced research ability and increased overall capacity to the portfolio management side of our organization. Bringing our clients the highest level of expertise has always been a priority for Renaissance and this acquisition aims to continue that tradition.

Timothy Shumsky

During his time at Siena College, TJ was an officer of the Bjorklund Student Managed Fund for two semesters and completed the Bloomberg Market Concepts certification. TJ furthered his academic experiences outside the classroom by presenting at the Ted Winnowski Academic Conference in Business where he won best quantitative business paper.-- Further, he's written multiple investment thesis' for the school's fund website which were also picked up and published by third party sites.

TJ grew up in the Berkshires and has deep roots of volunteer work in the region. He has volunteered for Community Health Programs (CHP) for the past eight years in Family Services, the Children's Attic event, and the Food Bank of Western Mass monthly mobile food distribution. Also, TJ has volunteered with local youth and worked several summers with at-risk youth through the South County Community Center.

Many of you will already have met Terri Hobart who joined Renaissance just over a year ago. Initially she successfully provided assistance in general and portfolio management administration. We have recently promoted Terri to provide direct operational assistance to our Head of Operations, Lori Killeen. She is also the first person most of you will meet at our reception desk when you visit our offices in Lenox.

Terri graduated from secretarial school in Oxford, England and prior to joining Renaissance she held analytical and client service roles in a number of financial institutions. *§§*

Planning to Reduce the Impact of the "Kiddie Tax"

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Under prior law, the unearned income exceeding this threshold would have been taxed at the parent's marginal tax rate. The new tax law imposes a tax not at the parent's rate but at the tax rates for trusts and estates which in many cases result in a much greater tax.

One method of reducing the implications of the kiddie tax is to create a traditional IRA for your child prior to their return due date. To establish an IRA, your child must have earned income, typically wages. A tax deduction equal to the greater of $5,500 or your child's earned income will be available. The limitations on deductibility will usually not apply to a child.

If your child had earned income, he or she is also entitled to a standard deduction equal to their earned income plus $350, not to exceed $12,000. Therefore, with proper planning, the IRA contribution may be used to offset unearned income, thus reducing the exposure to the kiddie tax.

For example: Assume your 18-year-old son, Matt is about to enter college. Based upon sound financial advice you received many years ago, you established a UGMA account to plan for these upcoming expenses (prior to the creation of 529 plans). Also, to help offset these enormous college costs, Matt works part-time at a pizza joint and will earn $5,000 this year. In 2018 the UGMA account generates $7,000 of interest.

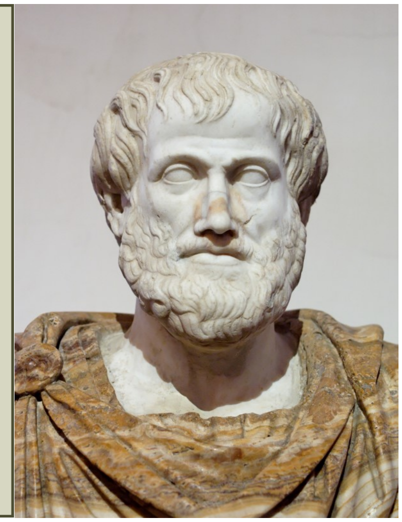
	IRA	No IRA
Wages (earned income)	5,000	5,000
Interest (unearned income)	7,000	7,000
Total Income	12,000	12,000
Traditional IRA Deduction	(5,000)	-
Standard Deduction	(5,350)	(5,350)
Taxable Income	1,650	6,650
Federal Income Tax	165	945

As you can see, not only will Matt's income tax cost be reduced with the IRA contribution, but he will be on the road to begin funding his retirement.

There are certainly many variables at play here so please contact us or your tax advisor before making a move to ensure that this strategy is appropriate for you. ***§§***

"It is during our darkest moments that we must focus to see the light."

Aristotle, Greek Philosopher
384 BC – 322 BC



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