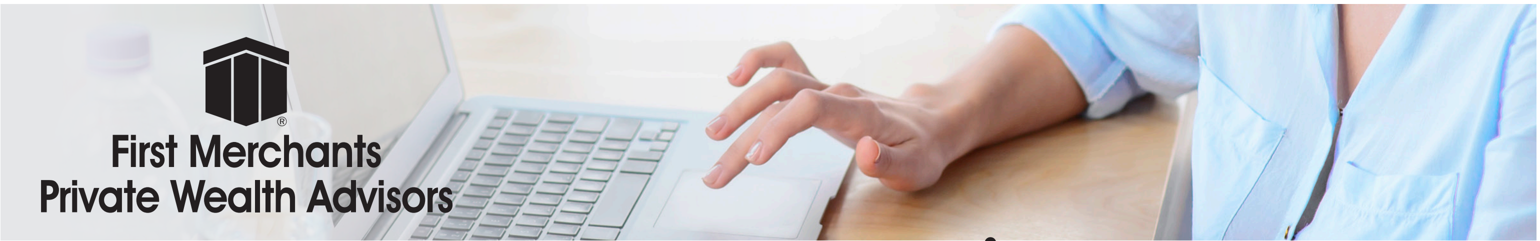


PRIVATE WEALTH *perspectives*

VERSION 18.1

Happy New Year! Every flip of the calendar provides an opportunity for reflection and this year is no different. We look back on 2017 with gratitude for the time we were able to spend with clients in their pursuit of a secure financial future. We kick off 2018 excited to share our latest installment of Private Wealth Perspectives. No surprise but tax reform is featured prominently in this quarter's discussions. We look forward to personally reviewing 2017 and continuing to help guide our clients in their own pursuit.

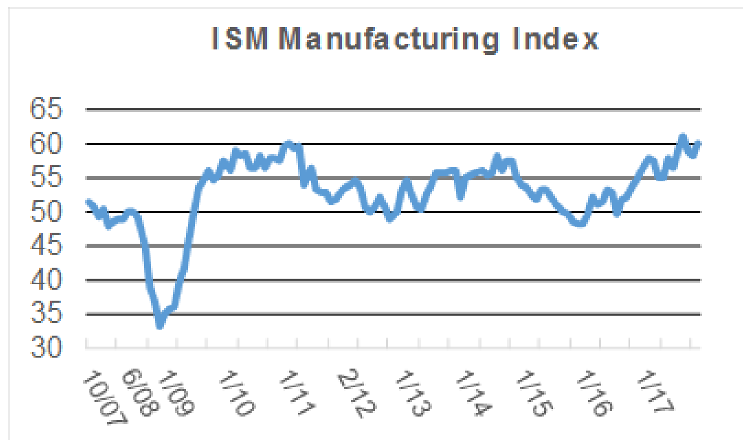
INVESTMENT MANAGEMENT

Four Horsemen

Equity investors managed to put much more space between their portfolio's market value and 2008, by a nice margin. Several things fell into place to make it so; a global economy that began to grow universally, a powerful earnings rebound in the United States, still-low interest rates partially guided by a Federal Reserve that has been masterful in their attempt to normalize rates, and a more-business-friendly Administration in Washington each contributed to a substantial financial return to business ownership. The Standard & Poor's 500 enjoyed a total return (price appreciation plus dividends) of 21.60%, as the Information Technology sector powered results by returning 36.91%, with only the Telecommunications and Energy sectors experiencing slightly negative returns. Even bonds had positive returns – in the face of much speculation regarding the doom of rising interest rates the Bloomberg Barclays Aggregate Bond Index returned 3.54%.

Equity markets realized their substantial returns from two sources – earnings-multiple expansion (the "P" increasing at a faster rate than the "E" in the P/E ratio) and increased earnings. Adding the two together is fairly close to rocket fuel for the equity market. As well, interest rates did not rise enough to become an immediate concern; the 2-year Treasury began the year yielding 1.22% and ended yielding 1.89%, while the 10-year began the year yielding 2.45% and declined by one basis point to end yielding 2.44%.

The Trump Administration ran on an economic program consisting of four pillars; reform/repeal of the Affordable Care Act, reformation of the tax codes for both personal and corporate taxpayers, a roll back of the stifling regulation of the Obama years, and increased infrastructure spending. As we wrote in our communication to clients in early 2017 (The Reflationary Presidency) all or any of these would be good for the economy, and they were – our Gross Domestic Product rose by 1.2% in Q1, 3.1% in Q2, and 3.2% in Q3. Expectations for Q4 are for another quarter of roughly 3% growth. The icing on the cake is depicted on the following graph, which reflects the ISM (Institute for Supply Management) Manufacturing Index. The substantial rise from November 2016 is no mistake, but a lesson that the previous Administration might take to heart.



As we communicated on several occasions in the past, businesses made not much more than capital-maintenance investments rather than investments in new plants, new distribution centers, technology etc. over the last several years, holding back what might have been much better GDP reports. That's the way it goes when a CEO is not exactly sure what new regulatory body blow may be delivered next. So added to all of the above you have businesses much more confident and voila! It's not magic, it's simple economics.

There is no current reason to believe 2018 will not be another positive year, albeit not as stellar as 2017. After a 20% return a mean-reverting return of 6% on equities seems pedestrian. Our economy could slow, but we see no recession; recessions are typically the result of growth in excess of an economy's capacity to grow for several quarters in a row. We also believe earnings could continue a positive trajectory, though not at the 10% clip we likely experienced for all of 2017. We don't see inflation high enough to result in an unexpected and/or substantial rise in interest rates, which would be anathema to the stock market. And geopolitical risk is a factor in our everyday lives; using it as an excuse to not be or not remain invested is a mistake.

We do see an almost-substantially overvalued stock market. It would be nice to see the market take a breather, or even slightly correct to see if earnings growth can shrink the P/E ratio. We see a corporate America that is almost $3 trillion more in debt than it was at the beginning of the year 2008. Unfortunately the proceeds of the debt accumulation went almost entirely to fund stock buybacks, not investment projects that might have supplied the wherewithal to support that new debt. And an article in today's Wall Street Journal relays the not-quite-dire straits Deutsche Bank, the 12th largest global bank, enjoys. The entire financial system in Europe remains decrepit and unaddressed, papered over by Euro printing presses. And demographics will remain a wet blanket for years to come.

At our last portfolio manager's meeting we began "what-if" discussions regarding the economy, stock and bond markets, hence our client's portfolios. We are not ready to make wholesale changes, and have already slightly reduced our allocation to the U.S. and raised exposure to international equities, recognizing that even U.S.-domiciled companies provide much of that exposure. Our feeling is not "this is as good as it gets," rather that we recognize that though the economy is doing well and earnings growth may continue, stocks remain in very overvalued territory at the same time the Fed is raising interest rates. That's never a healthy combination. As we've written in the past, we wouldn't hesitate to reduce risk in our clients' portfolios should the need arise.

Thank you for being a client of First Merchants Private Wealth Advisors. Michael Joyce has assembled an experienced and highly-capable roster of professionals who can provide financial and planning solutions for you, your family, and your business. We all wish you the very best for the New Year.

Jamie D. Wright, CFA, Research Director

PERSONAL TRUST

Happy New (Tax) Year!

In case you were indulging it too much egg nog and missed the news, Congress passed a new Income Tax Act effective for the 2018 tax year. While dissecting exactly what this act means to you depends in large part on your personal situation, there are some basic themes that you may want to think about now.

1. Don't Give Uncle Sam a free loan. The changes to the Federal Income Tax rules will mean predicting your 2018 income tax liability will be much more difficult than in prior years. In some but not all cases your tax liability may very well be lower than it has been in the past. Correctly determining the proper amount of withholding and potential estimated tax payments is more important than ever this coming year. Giving Uncle Sam a large interest free loan is not a good financial plan. Your money is always better off in your hands growing in your investment portfolio rather than sitting somewhere in Washington.

2. Reduce your income if you can. Although the new tax code does seem to reduce taxes, the ability to itemize and deduct certain expenses has also been reduced. For appropriate investors, municipal bonds can be an attractive way to reduce taxes on investment income. Those still in the workforce should make sure that they are taking maximum advantage of retirement plans (401(k), IRA, SEP, ROTH, etc.) to defer taxes on current income until after retirement.

3. Be proactive this tax season. For many of us getting our taxes done is a chore not an opportunity. We gather up our tax information and send it to our CPA or tax advisor and wait to be told what the results are. 2018 is a rare opportunity to take stock of where you are tax wise and make some real adjustments. Unlike past years, just tweaking your withholding or estimated payments and leaving everything else as it was is not a good tax strategy. The new Tax Act will change what you will pay in taxes next year and making smart decisions now can help produce the best possible financial results. This is definitely the year to take some extra time and review your income and expenses with your CPA or tax advisor.

First Merchants Private Wealth Advisors partners with individuals, families and organizations to provide comprehensive solutions and personal service in pursuit of a secure financial future for our clients. We would welcome the opportunity to be of assistance.

David Forbes

What does the new tax bill mean for Retirement Plans?

In the beginning, there were many proposed changes that would have turned the retirement plan world upside down! Including capping the pre-tax 401(k) contributions to $2,400 and any remaining contributions up to the maximum limit would be considered after tax contributions. The good news is, the new tax bill did not make any major changes directly to Retirement Plans.

Review your contributions! For the first time since 2015, the IRS announced higher elective deferral limits for group retirement plans. For 2018, the new limit increased to $18,500 while for those over age 50 or turning 50 this year the limit is $24,500. This does not include any employer contribution you may also receive. IRA limits did not change for 2018.

Review your tax bracket! With the recent passage of the Tax Cuts and Jobs Act, it's now time to review your tax bracket and determine whether Pre-Tax or ROTH investing is most advantageous for you. There are 7 tax brackets. Generally speaking, if you're in the lowest two brackets, then ROTH is the way to go. If you're in the highest two, then Pre-Tax. When in the middle three, you could go with either or both. When in doubt, the thought of having no tax liability during the distribution stage sways me more towards the ROTH route.

I recently read an analogy I can't claim as my own, but would like to share: "Would you rather pay taxes on the seed or the harvest?" The answer is obvious. Paying taxes on the seed and not on the harvest is ROTH investing.

Finally, don't forget about the Tax Savers Credit. The new tax laws did not take away this tax advantage that rewards you for saving for your own retirement. Be sure to ask your tax advisor about filing Form 8880 if you are contributing to a retirement plan or IRA.

We partner with individuals, families and organizations to provide comprehensive solutions and personal service in pursuit of a secure financial future.

Powerful Local Resources

Delivering broad advisory capabilities through local, engaged and empowered leaders.

Comprehensive and Coordinated Approach

Surrounding our clients with a team of experts to deliver financial solutions focused on their long-term financial success.

Standard of Excellence

Delivering proactive service and client advocacy as we look to build strong, intergenerational relationships.

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