First Merchants
Private Wealth Advisors

PRIVATE WEALTH *perspectives*

VERSION 18.2

I was looking forward to opening this edition of Private Wealth Perspectives with a "spring has sprung" message but for those of us hunkering down in the Midwest, we continue to wait. Even if Mother Nature refuses to cooperate, spring is officially upon us and we are excited to share insights and ideas on creating a secure financial future. Inside you will find excellent articles from our Investment, Fiduciary, Retirement Plan and Private Banking teams. We appreciate the time you invest to hear our ideas and the trust you have placed in our team to assist you in your pursuit.

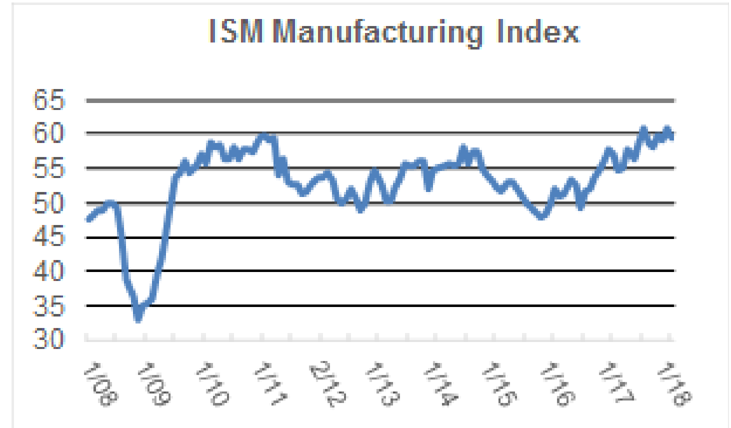
Michael Joyce, President, Private Wealth Advisors

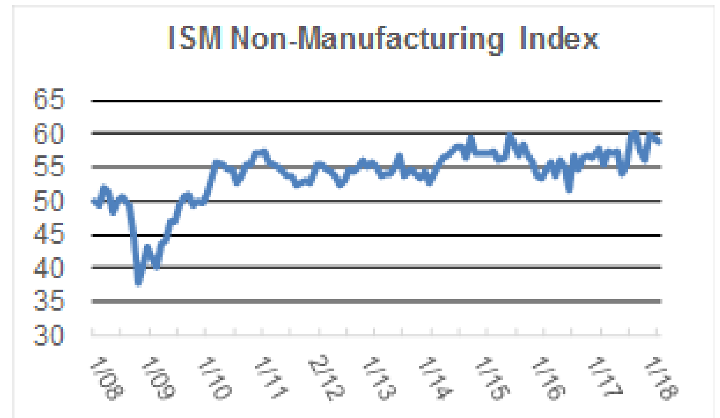
INVESTMENT MANAGEMENT

When Fed Tightening Meets Equity Overvaluation

That equity markets have been relatively price volatile thus far in 2018 may be an understatement. By early February the S&P 500 had made more 1% daily price swings than all of 2017, and has made 27 total so far in 2018 (versus 8 in 2017). Some intra-day price swings in the Dow have been in the magnitude of 1,000 points plus.

We wrote, on several occasions over the last few years that when the Federal Reserve began to "normalize" interest rate markets, and slow or stop their quantitative-easing (QE; attempting to revive an economy by lowering interest rates) effort, it would have an adverse effect on equity markets. As lower rates allowed equity valuations to get well ahead of themselves during QE, the opposite would be true as those rates rose. But to be sure, we also wrote the Fed would not do so until they were satisfied that our economy was strong enough to withstand the inevitable price volatility that would ensue. We believe this is where we find ourselves today; equity markets searching for equilibrium valuation against a backdrop of rising rates, all within the context of an economy growing much closer to its capacity to grow. The following two graphs, the Institute for Supply Management (ISM) Manufacturing and Non-Manufacturing (service sector) reflect a great deal of health in our economy. In particular, the Manufacturing Index has sustained a powerful move since the election, as businesses believe a much more business friendly environment in Washington provides them cover to again make capital investments in their businesses. That's what jobs are made of.





We'd also point out that the lack of price volatility during 2017 was the anomaly, not the gyrations of the last few months. 2017 was a year in which the great economic expectations of November 2016, fueled by ongoing QE, were met and perhaps exceeded by renewed vigor in business capital investment, a front-loaded personal and corporate tax reformation, and a concerted global economic recovery. By all accounts 2017 was as good as it gets, and now it seems odd that a hard fought, average-year equity return of 7-8% would feel like a letdown and be so hard to come by. We believe we have simply stepped back into reality, where no pain means no gain, and capital once again comes with a price tag attached.

Though economic signals in Europe have begun to reflect some slowing, and retail sales in the U.S. is trending more slowly, we still don't see a recession over the near term, which would surely put a damper on the stock market. Recessions normally are the result of an economy growing past its capacity to grow for a sustained period, and though we see tightness in labor markets and in transportation, at this

point they are not enough to cause us to believe a cost-push inflation (the effect of rising costs to corporations being pushed through to consumers) might be a result. Though the Fed has a 2% inflation target, we still believe they would rather allow inflation to run "hot" for some reasonable period of time, rather than pre-empt inflation by raising interest rates too quickly and/or too much and risking suffocating the economy.

Earnings for the S&P 500 may prove to be a two-edged sword, however. Due to recent tax reform the forward Price/Earnings ratio for the index is as low as it's been in years. However, we are mindful that there are times when the volumes of goods sold are more important than earnings growth by itself. In other words, it would be great to see earnings grow in 2018 by the predicted 19%. But if the volume of goods sold doesn't match earnings growth, then the increase in EPS would be more due to the financial stimulus of tax reform than an expanding economy. We'll see.

In short, our opinion is that the intersection of rising rates and overvaluation is where we find ourselves. Like oil and water, they never mix well, and are the driving force behind price volatility. Add talk of a trade and tariff war, news that China is studying whether or not to devalue the Yuan again, increased corporate leverage, and rising default rates in auto loans and you have a market getting a little more nervous. As long as the business environment remains friendly in Washington and our economy continues to respond by generating jobs, we will continue to view volatility as a required, albeit uncomfortable component of a successful long-term investment plan.

Jamie Wright, CFA, Portfolio Manager,

Research Director

PERSONAL TRUST

Why Not "Trust" Yourself

Every estate planner will tell you that you should have a will, and they are right. Basic estate planning documents like a will, power of attorney, etc. are a real necessity for almost everyone. However, many people think of trusts as something only ultra-wealthy people need and that they are unnecessary for "regular" folks like you or me.

A significant transition has been taking place over the last 20 years where more and more people are using revocable living trusts to manage their estates. There are many good reasons for the growth of trusts as the core estate planning document for people from all walks of life.

The traditional benefit of trusts, probate avoidance, continues to be a motivating factor. Avoiding the need for an estate can increase privacy, reduce costs and provide for faster distribution of assets to family.

More and more a key concern is what happens during your life rather than what happens when you die. Due to advances in modern medicine the number of cases of dementia and Alzheimer's has been rising steadily. As a result, people need assistance with their financial affairs while they are still alive. A revocable trust in conjunction with an appropriate power of attorney can allow a smooth transition in the event of incapacity. Bills continue to get paid without interruption, and existing family support can be continued.

Many grandparents assist with college or other expenses for their grandchildren. Others have children or grandchildren with special needs. A properly drafted revocable trust can make sure that your support continues even if you are unable to manage this yourself.

Revocable trusts are extremely flexible and can be modified to suit your circumstances no matter how they might change. They can even be revoked if they no longer serve a purpose. Revocable trusts also do not have to be fully funded or hold all of your assets to be effective. Many trusts are only partially funded at creation with additional assets added later as appropriate. A power of attorney and a pour over will can assure that proper funding will take place if the unforeseen should happen.

There is one major issue that must be addressed in any revocable trust. While you can initially be your own trustee, you must name a successor trustee to take over when you are no longer able. This is probably the most important decision you will need to make and the correct answer depends on your specific situation. For simple situations a family member can be a good choice.

For someone with more substantial assets using a professional trustee has significant advantages. A team with trained investment managers and trust administrators can make sure that your assets are properly managed and that family strife is avoided. First Merchants Private Wealth Advisors has been partnering with individuals and families to provide comprehensive solutions and personal service in pursuit of a secure financial future for 125 years.

A revocable trust can do everything that a will can do and much more, often with less effort, time and expense. If you would like to learn more, please feel free to contact David Forbes at dforbes@ firstmerchants.com or (317) 844.2710.

David Forbes, Director of Personal Trust

RETIREMENT PLAN

The Truth about 401(k) True Ups!

Each year, we predictably get from employers this question; "Why must we true up our retirement plan if we're matching the employee deferrals each pay period? We should be current". Sounds like a fair question! As it turns out, it's fairly common. It happens whenever you're funding the employees' matching contribution throughout the year but the matching contribution in your 401(k) plan document is defined as using the "Plan Year" as a determination period and not "each payroll". This means even though you are sending in matching funds throughout the year to the employee accounts based on each individual payroll, there is generally going to be a "true up" at year end to determine the match limit on full year compensation. Another way to say it is the match formula is to be applied to the annual totals.

Let's look at an example:

Employer matches 100% of the first 3% of employee compensation and includes the match deposits with their bi-weekly payroll submission. Employee Bob Smith makes $40,000 a year and contributes 2% of his compensation the first six months of the year. In dollars, he deferred $400 and received a match of $400. For the second six months, he contributes 10% of compensation equating to $2,000 of deferrals and $600 in matches. For the year, his totals are $2,400 of salary deferral and $1,000 of employer match. All settled, right? Not exactly. Because Bob deferred 6% for the year ($2,400 / $40,000), he is entitled to a full match of 3%. $40,000 x 3% = $1,200. Bob is owed a $200 true up.

If this true up is problematic, you should be able to amend your plan document to calculate the matching contribution on compensation for each payroll, instead of by plan year. This will eliminate your year-end true up requirement.

Kris Feldmeyer, Vice President/Retirement Plan Advisor

PRIVATE BANKING

It's Déjà Vu All Over Again

Just like Yogi Berra, the famous baseball player, once said, "It's déjà vu all over again"! Spring is here again (or at least on the way) and many families are finishing spring break. As things warm up you start looking outdoors, and sometimes indoors, for projects that need to be completed around the house. Some might even start looking for that boat to enjoy on the lake, a new pool, or a pergola to enjoy the outdoors. Whatever your need might be, getting the financing in place should be done in a judicious manner.

First Merchants Private Wealth Advisors can assist with your lending needs. With the changes in tax law, some lending facilities may make more sense than others. We have a team of experienced private bankers who can help with the structure of your debt. Whether you would like a home equity line of credit, a portfolio line, or some other form of credit our team would love to assist. In addition to lending services, our team provides deposit solutions to meet your needs. Please touch base with a private banker or ask your relationship manager how to contact our private banking team.

Nancy Leming, Director, Private Banking

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