



DIGEST

NEWS AND PERSPECTIVE FOR
GROWING AND PRESERVING YOUR WEALTH

WINTER 2017

Private Wealth
Management

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LETTER FROM MIKE



Let me open this first issue of *Digest* in the new year by wishing you and your families a happy one.

Looking back on 2016, it was a year of outcomes that challenged the consensus. Emotions ran high as people debated and voted, first in the U.K. to decide the future of the Eurozone and then in the U.S. to determine our next president. Uncertainty both before and after each event brought significant bouts of volatility to global markets. Throughout, Baird worked hard to keep it all in perspective for our clients.

Now, in 2017, some uncertainties remain. How might eventual changes in Europe impact the global markets? When will the Fed next raise interest rates here at home? And what could the new administration's policies mean to you, your family and your plans for the future?

As always, you can rely on Baird to stay in front of what's happening in the world, in our industry and in your life so we can continue to provide the best advice for you while helping to separate the news from the noise in this and future issues of *Digest*.

Mike Schroeder
President
Private Wealth Management

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THE CASE FOR CAUTIOUS OPTIMISM

INDICATORS TO WATCH AND STRATEGIES TO CONSIDER IN 2017

New presidential terms are usually filled with policy uncertainty as the promises of the campaign give way to the realities of governing. Although unified Republican control in both houses of Congress and the White House may seem to suggest 2017 will be an exception to this pattern, the timing and scope of specific policy implementation remains subject to the typical Washington, D.C., processes and timetables. So rather than speculate on the long-term investment implications of such unknowns, you may be better served by refocusing on the underlying fundamentals of the market and the economy in 2017.

AN IMPROVING FUNDAMENTAL PICTURE From a weight of the evidence perspective, the stock market appears to be on increasingly

stable footing. Stock prices remain elevated, but the third quarter of 2016 saw the return of earnings growth, and with the economy gaining some steam in the second half of the year, the potential for this trend to continue is certainly present.

Similarly, the seeds for a sustained upswing in economic growth appear to have been planted. The lack of demand that dragged on GDP growth for five consecutive quarters has run its course and export growth has resumed. While the pace of job creation slowed in 2016, this appears to be more related to a lack of available skilled workers than an absence of opportunities. Wage growth accelerated in 2016, and the number of job openings remains near a record high. Still missing has been a return to growth in business investment. ►

ABOUT BAIRD'S INVESTMENT AND MARKET EXPERTS



BRUCE BITTLES CHIEF INVESTMENT STRATEGIST

The author of Baird's market commentary and a frequent contributor of expert insight to national media outlets, Bruce has been Baird's Chief Investment Strategist since 2002.



WILLIAM DELWICHE, CMT, CFA INVESTMENT STRATEGIST

Before joining Baird in 1999, Willie worked briefly as a researcher at the Committee for Economic Development in Washington, D.C.



You can follow Willie's insights via Twitter

@WillieDelwiche.

THE CASE FOR CAUTIOUS OPTIMISM

Continued from page 1

But that could be on the horizon for 2017 if rising interest rates lead companies to focus on more organic growth opportunities instead of focusing on cost controls and balance sheet adjustments as many companies have.

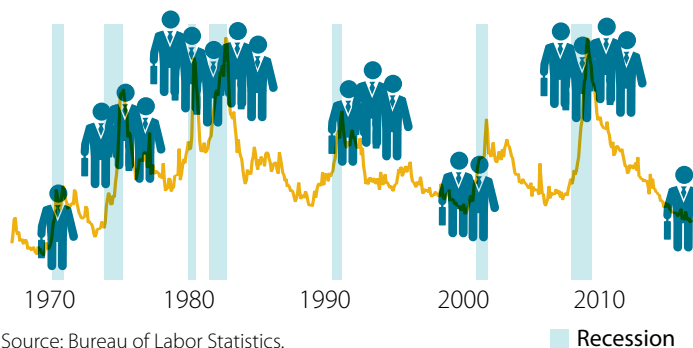
A ROLE FOR RATE INCREASES Calls for interest rate increases have been a recurring theme for years now, but 2017 could see more action by the Fed to normalize policy. As economic growth consistently underwhelmed expectations in the first half of the year (a trend that actually began in early 2015), bond yields moved steadily lower. The turning point may well have been the vote in Britain to leave the European Union ("Brexit"). Fear and uncertainty appeared to reach a climax, and after beginning the year near 2.3%, the 10-year T-note yield dropped below 1.4%.

Like the recent U.S. presidential election, the Brexit vote was uninteresting from an investment perspective precisely because of the uncertainty over the timing and scope of its implementation. The market reaction to it, however, did provide important insight about investor sentiment. Over the course of the second half of 2016, improving economic data (both domestically and abroad) and increasing evidence that inflation is showing signs of moving in the right direction sent bond yields back toward the healthier levels present at the beginning of the year.

The recent rise in bond yields may also be attributable in part to a global shift from monetary stimulus (changing interest rates) to fiscal stimulus (changing policy and spending). Moving interest rates to zero or lower in some parts of the world in an effort to stimulate growth has yielded largely unsatisfactory (although not altogether unsurprising) results. And while fiscal efforts may be moving the needle more than monetary efforts at this point, stimulus alone is not a reliable engine for robust economic growth. That said, if higher interest rates do materialize, they may just help fuel increased investment spending and increased productivity growth. Under such conditions, continued sustainable improvement in the economy could occur.

THE ARGUMENT AGAINST A RECESSION The prospect of renewed economic growth comes as some forecasters have looked at the calendar and started to worry about the next recession. While recessions have emerged with a fair degree of calendar regularity over the past century, it is not the passage of time that makes them more likely. In fact, research from the Federal Reserve in 2016 suggests the exact opposite – the age of a recovery is not itself a useful indicator when it comes to predicting recessions. Instead of looking at the number of months since the last recession, one should look at underlying indicators of stress. Two principal pieces of evidence here are initial ►

INITIAL CLAIMS FOR UNEMPLOYMENT



Source: Bureau of Labor Statistics.

Over the past 40 years, recessions in the U.S. have been preceded by sharp upticks in unemployment. As of November 2016, the trend line for unemployment claims was still headed downward.

jobless claims and the slope of the yield curve. Neither suggests now is the time to look for recession. Jobless claims remain near multidecade lows, and the recent rise in bond yields has steepened the yield curve. At this point, it would likely take an aggressive series of interest rate hikes by the Federal Reserve (which appears unlikely) to put enough stress on the economy to raise the risk of recession.

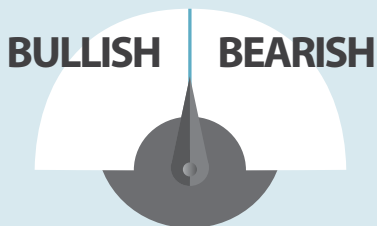
STRATEGIES TO CONSIDER It may not be prudent to change your investment portfolio based on what the new presidential administration may or may not accomplish, but there are

some adjustments you might consider given the weight of the fundamental evidence already in hand. You may want to reduce exposure to bonds (and equity market bond-proxies) and increase your exposure to growth opportunities. This may mean a rotation from high dividend-paying stocks to high dividend-growers. From a sector perspective, you may want to look more at cyclical leadership areas such as Financials and Industrials (which have been under-owned and relatively cheap) rather than traditional defensive areas such as Utilities and Consumer Staples (which remain crowded and historically expensive). [D](#)

THE WEIGHT OF THE EVIDENCE

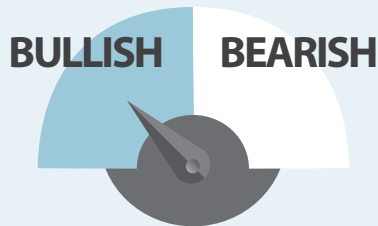
BULLISH WITH A CAVEAT

FED POLICY



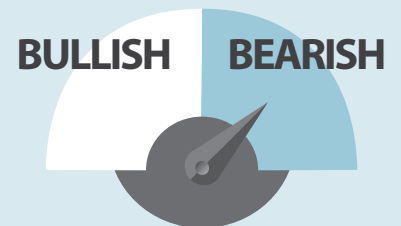
Rate hikes reflect Fed's confidence in economy

ECONOMIC FUNDAMENTALS



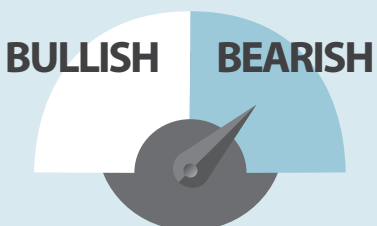
Economic data providing upside surprises as global growth rebounds

STOCK PRICE VALUATIONS



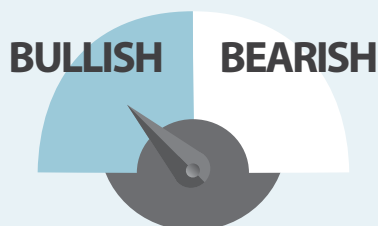
Earnings growing again but valuations remain elevated

INVESTOR SENTIMENT



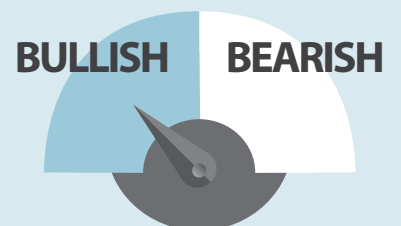
Build in optimism has reached excessive levels, presenting a headwind for stocks

SEASONAL PATTERNS AND TRENDS



Seasonal patterns a tailwind for stocks through first half of 2017

STOCK MARKET BREADTH



Rally participation continues to broaden, with most areas of stock market moving higher together

DOES DIVERSIFICATION STILL WORK?

HINDSIGHT MAY BE 20/20, BUT INVESTING IS ABOUT LOOKING FORWARD

Diversification always looks like a bad idea after the fact – when you compare returns over time, a diversified portfolio is unlikely to ever beat the top-performing asset class or investing style. Investing, though, is about making smart decisions in the face of an unknowable future – and from that perspective, diversification could be critical to building a portfolio for unpredictable times.

WHAT IS DIVERSIFICATION? Diversification is a portfolio strategy that strives to limit volatility by mixing dissimilar asset classes – so when some investments zig, others will zag. Instead of putting all your investment eggs into one basket and hoping for the best, you’re distributing them among several independent baskets, hoping to capture a good portion of broad market increases while mitigating broad market declines. A well-diversified portfolio can also minimize wild swings in the market, making for a much smoother ride as an investor.

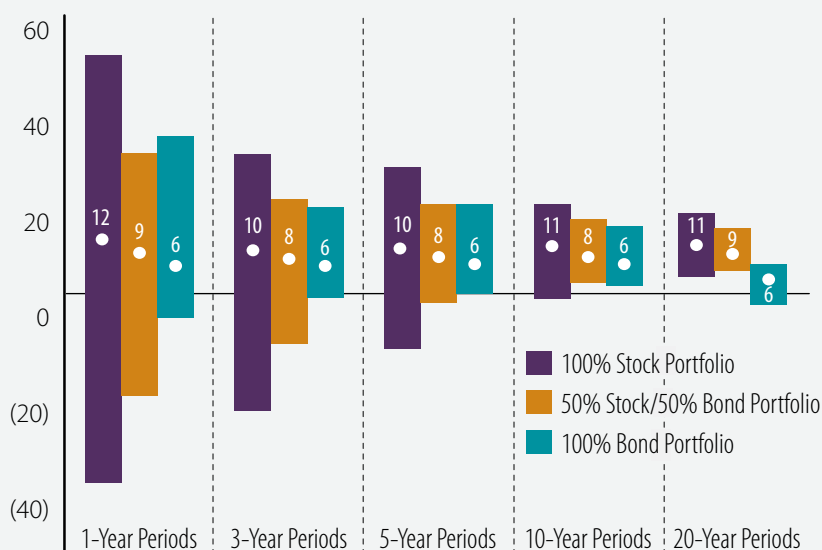
PROTECTION WHEN MARKETS GO SOUTH This downside protection of capital can be particularly powerful in a severe market decline, like that from 2008–2009. While a diversified portfolio may still suffer losses in a down market, those losses are often less severe compared to an undiversified one (see chart). As a result, the diversified portfolio would be positioned to rebound more quickly because it lost less value in the downturn.

DO YOU FEEL LUCKY? Over the last 20 years, there have been only two instances where an asset class was the top performer in consecutive years – large-cap growth stocks (1998–1999) and taxable bonds (2000–2001). The rest of the time, investors who went all-in on the previous year’s top asset class underperformed – sometimes badly. Instead of trying to predict which investments will perform best – and getting the timing just right to take advantage – a diversified portfolio can help offset broad losses, tamp down volatility and produce a more stable return pattern.

FOCUS ON THE BIG PICTURE Diversification also helps investors avoid knee-jerk reactions to the market. It is incredibly difficult to guess what areas will shine and what the next market leader will be – and with their own money on the line, investors will often take the conservative route of chasing the best-performing segments of the market and shunning poor-performing areas. A well-diversified portfolio makes it easier to tolerate slow performers and keep the bigger picture in mind.

Before making any investment decisions, investors need to carefully consider the type of return they need, the level of risk they’re comfortable with and their investment time horizon. A properly diversified portfolio can then be constructed with those goals in mind. **D**


HISTORICAL RETURN RANGES FOR VARIOUS ALLOCATIONS




MAKE TAX SEASON LESS TAXING

TIPS TO TAKE THE PAIN OUT OF PREPARING YOUR 2016 RETURN

Tax season can be stressful enough with the complexity of our tax code and the volume of information needed to accurately prepare your return. So what can taxpayers do to reduce the stress and make tax season a bit easier to manage? Here are three ideas:

 **DON'T JUMP THE GUN** It's natural to want to get your taxes out of the way quickly, but it's important to be sure you have all the information you need first. While W-2s and other tax forms tend to arrive early in the year, taxpayers should look for 1099s reporting investment income to come later. The deadline to issue 1099s is generally February 15, but most firms (including Baird) receive an extension to March 15. Tax forms for accounts that hold only individual stocks or bonds are usually still issued in February, but many mutual funds don't provide final data until much later. Also, tax information for widely held mortgage trusts and real estate mortgage investment conduits always come later. So wait patiently for 1099s from all of your investment accounts before you file.

 **REMEMBER YOUR GIFT RECEIPTS** Taxpayers are required to receive written confirmation of any charitable gift over \$250 before they file their tax return for the year. That may seem strict, but even when confirmation letters are received shortly after a return was filed, tax courts have denied the charitable deduction. If you don't have the documentation for a gift you hope to deduct, contact the charity as soon as possible. You may even want to consider extending your return to give the charity more time.



GIVE 'EM A BREAK A well-organized set of tax documents can make the process much simpler for your tax preparer (and less costly for you). Original documents are best, and while summary schedules are fine, make sure they match the originals. Conflicting information only causes confusion – and delays.

Lastly, once you have received all of your 1099s, do your best to file your tax return as early as you can. Tax-related identity theft is a huge issue, and filing your return early in the season is the best way to combat that threat. **D**



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Tim's insights
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INFOARMOR

TALKING ABOUT YOUR GENERATION PREPARING FOR LONG TERM CARE

Simply put, long term care is assistance for someone who can no longer live independently, often due to physical disability, a cognitive impairment such as Alzheimer’s disease or just the increased frailty that comes with age. The U.S. Department of Health and Human Services estimates that 70% of Americans turning 65 will need long term care at some point in their lives.¹

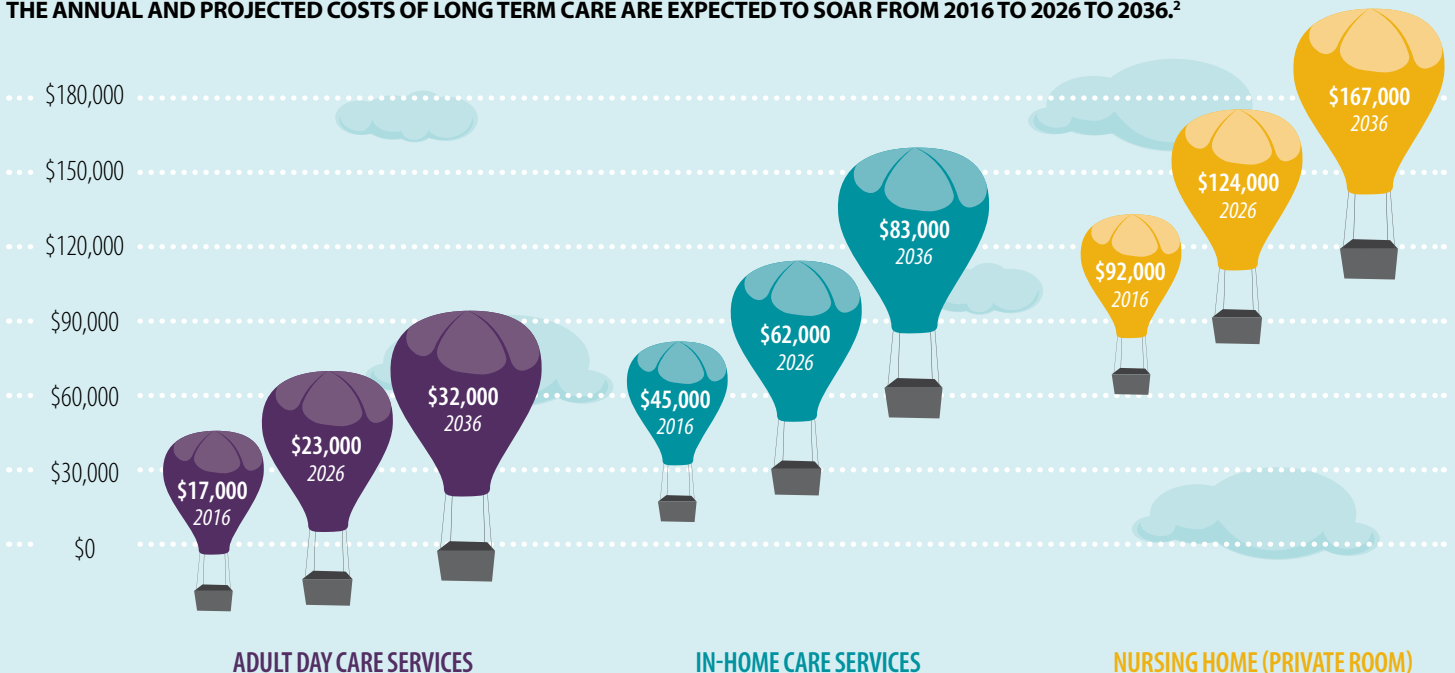
HOW MUCH DOES LONG TERM CARE COST? Costs for long term care will depend on the services you’d need. Today, hiring a professional to provide in-home care for 40 hours a week can cost \$45,000 per year, while nursing home services can cost \$92,000 per year. However, with 76 million baby boomers reaching retirement age over the next decade, the demand – and therefore the cost – for long-term care services is expected to rise dramatically.

WHAT CAN I DO NOW? Whether it’s your own long-term care needs or those of your loved ones, it’s worth having a conversation with your whole family about your expectations for care – who is able to provide care, in what setting and at what cost. Before assuming family and friends can serve as primary caregivers, be sure to consider the emotional, physical and financial tolls that accompany such care.

By working out a solution that considers all the costs of caregiving, you can alleviate the burden long term care can place on you and your family. Your Baird Financial Advisor can work with you to create a plan that meets your unique needs and makes sense for you and your loved ones.

Erica Kroll, CLU®, is an Insurance Specialist for Baird Private Wealth Management. [D](#)

THE ANNUAL AND PROJECTED COSTS OF LONG TERM CARE ARE EXPECTED TO SOAR FROM 2016 TO 2026 TO 2036.²



¹U.S. Department of Health and Human Services. Long Term Care: The Basics.
²Genworth Financial Inc. Compare Long Term Care Costs Across the United States.

TALKING WITH AGING PARENTS ABOUT THEIR FINANCES

PART ONE IN OUR *WOMEN'S WEALTH* SERIES

It's not uncommon for parents showing signs of mental or physical decline to need assistance from their children from time to time, and today that help primarily comes from their daughters. Daughters spend more than twice the amount of time caring for aging parents than sons do,¹ and women make up 60% of all caregivers in the United States.² Here is some guidance on how you can make conversations with your parents about their finances easier and more productive.

BREAK THE ICE SOONER THAN LATER The most important advice when talking with aging parents is to start the conversation early, before there is any mental decline or other late-in-life distractions. If you find your parents are reluctant to talk about their finances with you, try framing the conversation around your own financial planning decisions. By asking for their input on your financial choices, you may get them to open up about their own planning.

ROUND UP THE PAPERWORK A five-minute conversation around the holidays won't be enough to establish a thorough plan with your parents. Set a time and place to discuss with them their lifestyle wishes, health concerns and finances. Your Baird Financial Advisor can

provide you with a Personal Information Guide that can help you keep track of documentation and account information you need.

GET EVERYONE ON THE SAME PAGE Planning for your parents' twilight years may involve other family members and outside professionals. Make sure the whole family understands your parents' wishes – and how much things like medical expenses, housing and end-of-life care can cost. Be sure to introduce yourself to any professionals your parents rely on, such as financial advisors, community care advocates, accountants, attorneys, doctors – even veterinarians and anyone who helps maintain the property.

MAKE REGULAR CHECK-UPS The financial needs of people in their 60s are often far different from people in their 90s. Keep the lines of communication open, and be sure to revisit those plans if you find that their needs or wishes have changed. Stay especially alert for any memory or cognitive decline, as that can make your parents easy targets for scams or identity theft.

Parents don't stand to gain anything by keeping secrets from the kids, especially later in life. These conversations are critical to understanding and meeting your parents' wishes, and far preferable than leaving things to chance. **D**



LAURA THUROW
DIRECTOR OF PWM
RESEARCH, PRODUCTS
& SERVICES

¹Grigoryeva, A. When Gender Trumps Everything: The Division of Parent Care Among Siblings. Working Paper No. 9. April 2014. Center for the Study of Social Organization.

²National Alliance for Caregiving and the AARP Public Policy Institute. June 2015. 2015 Report: Caregiving in the U.S.

FINANCIAL PLANNING CALENDAR

JANUARY 18

Baird Wealth Strategies Topic: Hoodlums to Hackers – How Criminals Get Our Information and What We Can Do to Stop Them

FEBRUARY 15

The first wave of 1099s will be issued by Baird for those accounts holding individual equities, bonds or mutual funds whose final tax information has been provided.

MARCH 1

The second wave of 1099s will be issued by Baird for accounts holding mutual funds, ETFs and REITs whose final tax information was provided after the previous update.

Baird Wealth Strategies Topic: Estate Planning for Digital Assets

MARCH 15

The final wave of 1099s will be issued by Baird for the remaining accounts holding mutual funds, as well as for any accounts holding REMICs or WHMTs.

APRIL 1

Deadline for those who turned 70½ during 2016 to take their required minimum distribution from their retirement plans. Future distributions must be taken by December 31 of the year for which they apply.

Baird Wealth Strategies Topic: Understanding Social Security and Strategies to Maximize Your Benefits

APRIL 18

With April 15 being a Saturday and Washington, D.C., recognizing Emancipation Day on April 17, tax returns are due on April 18. You may also file an application for an automatic six-month extension.

APRIL 19

Baird Wealth Strategies Topic: The Caregiver's Guide to Financial Planning in the Shadow of Dementia

First-quarter federal estimated tax payments are due.

Contributions to IRAs, Roth IRAs and Coverdell Education Savings Accounts for 2016 are due.

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Social media platforms are powerful tools for learning, sharing and discussing almost any topic. A growing number of Baird experts use this technology to share knowledge and perspective with more than 8,000 followers across the web in real time.

Tim Steffen, Baird's Director of Financial Planning, was our first social media thought leader in 2011. He's since been joined by members of our equity research, institutional trading and investment strategy teams.

To meet our social media thought leaders and access their profiles, visit bairddigest.com/social.

DIGEST

Robert W. Baird & Co. does not provide tax or legal services. The S&P 500 index is an unmanaged market capitalization-weighted index of 500 common stocks widely regarded to be representative of the U.S. market in general. Returns include reinvestment of dividends. The Dow Jones Industrial Average is a price-weighted average of 30 high-quality stocks selected for total market value and broad public ownership. A price-weighted benchmark results in the stocks with the highest prices contributing the most to the performance of the benchmark. The returns of this index do not include the reinvestment of dividend income. The NASDAQ index represents over 4,500 stocks traded over the counter. It represents many small company stocks but is heavily influenced by about 100 of the largest NASDAQ stocks. The index is value-weighted and does not include income. Indices are unmanaged and are not available for direct investment.

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