Rinehart
WEALTH & INVESTMENT
ADVISORY

December 2016

INSIGHTS

Investment Overview

Bond Market Update: How History Repeats Itself

Bonds are behaving normally given that we are in the later stages of the economic cycle where anticipated rate increases and inflation pressure bond prices. Since Donald Trump unexpectedly prevailed in the U.S. presidential election, the Fixed Income market responded fiercely to a sudden rise in interest rates sending bond prices lower, adversely impacting Fixed Income portfolios broadly. The 10–year US Treasury bond yield soared more than 30 basis points ("bps") from November 9th—18th, 2016, while the Bloomberg Barclays US Aggregate Bond Index retrenched –1.25% over the same time period, alarming many investors with Fixed Income exposure in their portfolios. As Trump champions growth in the US through fiscal stimulus, his election sparked speculation that inflation and interest rates would rise more rapidly. Given the adjustment to the anticipated trend in inflation and associated hawkish interest rate maneuver by the Federal Reserve ("Fed"), the negative bond performance is not surprising; however, the order of magnitude seems a little aggressive at this point, and we expect a moderation in the rate of increase in interest rates as the market digests these sudden adjustments.

Bond Basics

Before delving further into the current environment and factors impacting Fixed Income markets, it is crucial to review some basic bond concepts and look back at history for perspective. First, bond prices move inversely to bond yields (rates). A bond yield defines the amount of interest an investor will receive from a bond in the form of a coupon, just as a dividend yield outlines how much an investor will receive in dividends from a stock. When interest rates rise, new bond

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Wealth Advisory Overview

Year-end tax planning for individuals

In the aftermath of the election, we are now faced with the probability that our tax landscape will change under the Trump Administration and a Republican-controlled Congress. President-Elect Trump's plan calls for fewer tax rates, lower tax rates, and streamlined deductions. Trump proposes to implement three brackets for ordinary income (12%, 25%, and 33%) and retain the 15% and 20% reduced rates on capital gains and qualified dividends. His plan calls for a repeal of the alternative minimum tax (AMT) and the 3.8% net investment income tax. The standard deduction would be increased to $30,000 for married couples filing jointly and $15,000 for single taxpayers. Itemized deductions would be capped at $200,000 for joint filers and $100,000 for single filers. The head-of-household status and personal exemptions would be eliminated. The Trump plan also provides a new above-the-line deduction for childcare expenses of children under 13, as well as eldercare expenses for a parent. Income from carried interests would be taxed at ordinary income rates rather than capital gains rates.

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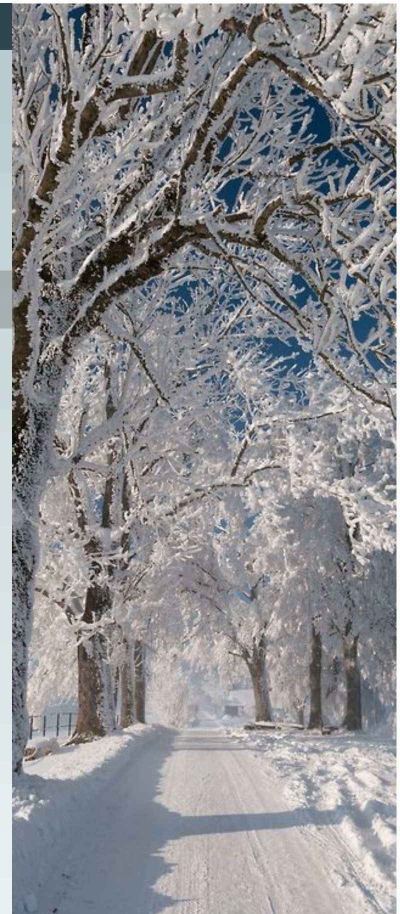

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Special points of interest

- Stock & Strategy Spotlight
- Monthly Index Review
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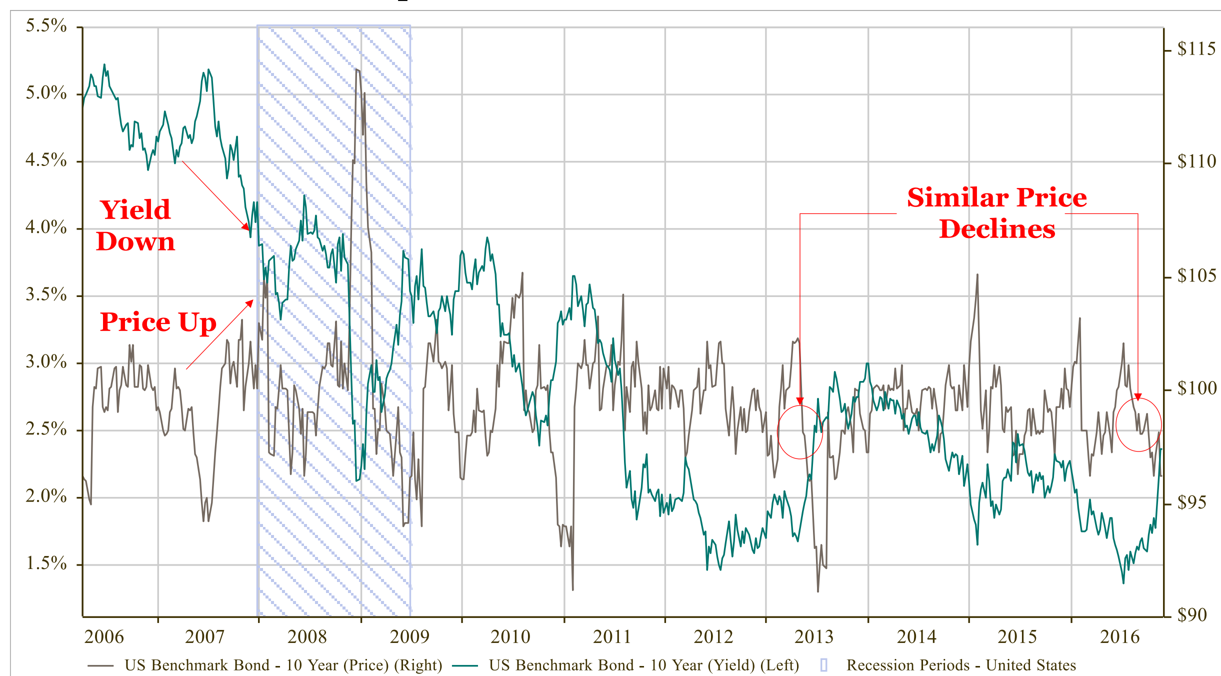
Chart I: Inverse Relationship Between Bond Price & Yield



Source: RWM - FactSet Research

investors receive more interest from a bond and bond prices adjust downward accordingly. The inverse relationship between bond prices and interest rates is known as interest rate risk, one of the two major risks associated with Fixed Income investing. (Reference Chart I displayed above, which portrays the inverse relationship between bond price and yield over time.)

How drastically a bond price moves in responses to a counter move in interest rates is quantified by duration using years as the unit measure. For example, assuming similar credit quality, a bond maturing in 15 years has a relatively higher duration than a bond maturing in two years. Longer-term bond prices respond more violently to interest rate moves than do shorter-term bonds, as a higher duration necessitates a larger bond price decline when interest rates rise. This impact is amplified by a sudden move in rates as opposed to a gradual climb. Portfolios with longer durations will exhibit more volatility when rates move than shorter duration Fixed Income portfolios. For example, the Bloomberg Barclays US Treasury Index for long-term bonds (7-20 years duration) declined -2.44% year-to-date; whereas, short-term US Treasury bonds (1-3 years duration) only declined -0.02% over the same

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Monthly Index Review (USD Total Return)

Data as of November 30th 2016	November 2016	2016 YTD	2015	2014
S&P 500	+3.70%	+9.79%	+1.38%	+13.69%
Dow Jones Industrial Average	+5.88%	+12.62%	+0.21%	+10.04%
NASDAQ Composite	+2.80%	+7.59%	**+6.96%**	**+14.75%**
Russell 2000	**+11.15%**	**+18.00%**	-4.41%	+4.89%
MSCI Emerging Markets	**-4.60%**	+11.28%	**-14.60%**	-1.82%
MSCI EAFE	-1.98%	**-1.86%**	-0.39%	**-4.48%**
Bloomberg Barclays US Aggregate	-2.37%	+2.50%	+0.55%	+5.97%

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Bond Market Update: How History Repeats Itself

time period. (Reference Table I below for additional bond price return data.) Going into the later stages of an economic cycle, intermediate to short-term positioning is prudent despite sacrificing the higher yield associated with long-term bonds.

The other major risk associated with Fixed Income investing is credit risk, or the move along the spectrum of issuer credit quality ranging from least to most creditworthy. The least creditworthy, or junk bonds, often have a higher coupon than the most creditworthy, or investment grade bonds, as junk bond investors demand larger interest payments for taking on elevated risk. The US government is viewed as the most creditworthy body that issues investment grade bonds; whereas, a company that has filed bankruptcy is less reliable and issues junk bonds. When the economy is going well, then interest rate risk is the focus for bond investors. Conversely, when economic growth begins to wane, credit risk is crucial to Fixed Income investors.

Historic Perspective

Interest rate risk, the risk of bond prices declining in response to a rise in interest rates, has been a common factor in investing through economic cycles throughout history. Looking back over several time periods illustrates how bond prices decline in anticipation of interest rate increases. For example, in 2011 the US economy saw improvement from 4Q10 through 1Q11, drawing concern over rising interest rates and a corresponding fall in bond prices as represented by the –0.89% decline in the Bloomberg Barclays US Aggregate Bond Index from October 1st, 2010—March 31st, 2011. We reviewed this decline in bond prices in our February 2011 newsletter titled "The Bonds Are Falling! The Bonds Are Falling!" that is available for your reference in the archive section of our website (www.rinehartwia.com). In this newsletter, we advised clients not to abandon their Fixed Income allocations, which paid off given that following the sharp decline in bond prices from 4Q10—1Q11, bond prices swiftly rallied from 1Q11—2Q11 as depicted by the drastic increase in the dark brown line on Chart I.

Table I: Fixed Income Index Price Level % Change Year-to-Date (YTD)

	Duration (Approximate)		
Indexes:	**Short-Term (1-3 Yrs.)**	**Intermediate (3-7 Yrs.)**	**Long-Term (7-20 Yrs.)**
Bloomberg Barclays US Treasury[1]	-0.02%	-0.86%	-2.44%
Bloomberg Barclays Municipal[2]	-1.40%	-3.26%	-3.79%
Bloomberg Barclays Municipal High Yield[3]	-10.02%	+5.99%	+1.90%
Bloomberg Barclays US Corporate[4]	+0.37%	+0.52%	+3.66%
Bloomberg Barclays US Corporate High Yield[5]	NA	+10.48%	+8.71%

[1] Barclays US Treasury Indexes: 1-3 Y, 3-7 Y, 7-20 Y

[2] Barclays Municipal Index: Short (1-5 Y), Intermediate (5-10 Y), Long (22+ Y)

[3] Barclays Municipal High Yield Index: 3 Year (2-4 Y), 10 Year (8-12 Y), 20 Year (17-22 Y)

[4] Barclays US Corporate Index (1-3 Y), Barclays US Aggregate Credit - Corporate - Investment Grade - Intermediate, Barclays US Corporate (10+ Y)

[5] Barclays US Aggregate Credit - Corporate - High Yield - Intermediate, Barclays US Aggregate Credit - Corporate - High Yield - Long

Source: RWM - FactSet Research

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About Rinehart

Rinehart Wealth & Investment Advisory is an experienced, boutique Registered Investment Advisor dedicated to independent, comprehensive wealth management. Founded in 1985 by Mary Rinehart, the firm, from its inception, has had a singular focus: to provide highly customized investment management and financial planning solutions to clients.

Boutique Firm:

Being a boutique wealth management firm allows us the flexibility to provide more personalized service and offer unique investment solutions to clients in a Fee-Only environment.

Team Approach:

Because each client's situation is different, the team of advisors is hand-selected to ensure areas of expertise are appropriately aligned with the client's specific needs and interests.

Proprietary Investment Research:

The differentiating factor of our portfolio management process is the proprietary investment research driving the portfolio construction. All investment research and analysis is done entirely in-house by our Investment Team.

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Similarly, in 2013 the Fed tapered Quantitative Easing as the US economy was improving, resulting in a rise in interest rates and corresponding decline in bond prices. Specifically, from May 2nd, 2013—July 9th, 2013, the yield on the 10-Year US Treasury bond rose 99 bps from 1.66% to 2.65%, driving the price of the 10-Year US Treasury bond down over -10%. Subsequently, bond prices steadily rose from mid-2013 to mid-2014, which is also apparent given the upward trend of the brown line provided in Chart I.

In conclusion, historically bond prices decline in anticipation of rising interest rates and often revert course shortly thereafter. Additionally, rate tightening tends to occur later in the cycle which means the market inches slowly towards another economic downturn at which point, investment grade bonds will tend to outperform and resume their principal protection function in the portfolio.

Fast-forwarding to present day, the market is now assuming President-Elect Trump's focus on improving the US economy implies elevated inflation with a corresponding higher probability of rising interest rates; hence, the recent decline in bond prices seems solely related to interest rate risk as opposed to credit risk, substantiated by the relative outperformance of high yield bonds (see Table I on page 3). Interest rate risk is most relevant when the economy is growing because economic growth is likely to lead to rising interest rates and a corresponding decline in bond prices, which is normal behavior in the later stages of an economic expansion.

On the other hand, credit risk, or a bond's sensitivity to default, is most relevant when the economy is slowing or in a recession. The Financial Crisis of 2008 is an example of an environment in which bond prices declined due to rising credit risk concerns. As the likelihood increased that a bond issuer would default in 2008, investors demanded higher yield as compensation for holding riskier bonds. The rising yields of risky bonds is typical of a deteriorating market environment. As both credit risk concerns and bond yields increased, the prices of lower-quality bonds declined more than those of higher-quality bonds, which is contrary to what is occurring now. Consequently, we prefer to hold higher-quality investment grade bonds in our client portfolios, attempting to moderate interest rate risk and emphasize high quality investment grade bonds always, which respond relatively less violently to credit risk than lower-quality bonds.

Surveying Fixed Income Experts

The Rinehart investment team recently met with several bond managers to gain a deeper understanding of current volatility within the Fixed Income market as well as discuss tactical portfolio positioning in the later stages of a bull market and economic cycle.

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Stock & Strategy Spotlight

Name	Ticker	2016 YTD
CVS Health Corporation	CVS	**-19.62%**

Description & Investment Thesis

After weeks of conducting thorough due diligence, the Investment Team added CVS Health Corporation ("CVS") to the buy list effective November 29th, 2016. CVS is unique as the only integrated pharmacy health care company capable of impacting consumers, payors and providers by providing innovative, channel-agnostic solutions for complex situations in managing costs and care. The one-of-a-kind structure of CVS' business model generates approximately 60% of revenue from it's Pharmacy segment, providing pharmacy benefit manager ("PBM") services, and approximately 40% of revenue from it's Retail/LTC segment, which primarily consists of retail prescription sales. In addition to CVS' particular business structure, the company is also appealing on a valuation basis. Currently CVS is cheap trading at $75 per share providing approximately 26% upside to our 12-month price target of $96. Although CVS recently lost 40 million in prescriptions due to restricted network agreements that exclude CVS, we believe the negative impact of this loss has already been priced in to the stock. Our greatest concern regarding CVS is the slim possibility of the government or industry eliminating PBMs all together, which would have a significant negative impact on CVS given that CVS' PBM business comprises approximately 60% of the company's revenue. Overall, we believe that the potential upside outweighs the risks, and are either swapping out of Express Scripts Holding Company ("ESRX") and into CVS or initiating a 75 bps position in CVS across all applicable client portfolios.

Investment Overview

Bond Market Update: How History Repeats Itself

Sterling Capital ("Sterling") was founded in 1970 and manages approximately $30 billion in Fixed Income assets. Sterling recently trimmed the duration of their Fixed Income portfolios by selling 10-year bonds and using the proceeds to buy short-term floating rate bonds. Sterling is taking a pro growth, positive stance across sector positioning as well as duration. Historically, when the Fed has raised rates, then the short end of the yield curve has experienced volatility. However, since Trump won the election, the Fed is actually now behind the steepening yield curve, which is a healthy sign for the US economy. A steepening yield curve is a signal from the bond market that it expects stronger economic growth; whereas a flattening yield curve signals expectations for slower economic growth. From a sector standpoint, Sterling is overweight Financials because rate hikes positively impact the sector. Furthermore, when Dodd-Frank becomes less onerous, then regulatory requirements governing financial institutions will be loosened, positively impacting Financials as well.

In speaking with one of the lead Fixed Income portfolio managers at Credit Suisse, she expressed continued confidence in North Carolina municipal bonds with strong credits. The most surprising occurrence that Credit Suisse has witnessed in the municipal bond market recently has been continued strong demand. For instance, new issues on a weekly basis remain oversubscribed. Strong demand coupled with controlled supply is a positive environment for municipal bonds. Another positive sign for the municipal bond market is that recently more than 70% of initiatives, such as expanding a school building, across the US have passed. In order to accomplish these approved initiatives, states will have to issue municipal bonds, thus maintaining a steady supply in the near-term and hopefully come out at higher interest rates. Municipal bonds, as evidenced by the Bloomberg Barclays US Municipal 1—5 Year Index (-0.86%) outperformed relative to corporate bonds, represented by the Bloomberg Barclays US Corporate Investment Grade Index (-1.28%) during the week and a half immediately following the conclusion of the presidential election.

Bonds Continue to Play an Important Role in Portfolio Diversification

Fixed Income is a necessary asset class when creating a diversified portfolio because normally when equities correct due to a slow down in economic growth, investment grade bonds (particularly US Treasuries) tend to go up offsetting what tend to be major declines in equity portfolios. Investment grade bonds provide a necessary element of principal protection designed to offset declines in the equity market, creating a natural inverse relationship. Currently, portfolios are positioned with an intermediate-term duration (modest interest rate exposure) and are outperforming longer duration bonds. This is designed to minimize the adverse impact of a rapid rise in interest rates, while still offering some yield and controlling short-term bond volatility associated with rate increases. Intermediate-term bonds, as represented by the Bloomberg Barclays US Aggregate Intermediate Index, were down –1.05% from November 9th—18th, 2016; whereas, long-term bonds as evidenced by the Bloomberg Barclays US Aggregate Long Credit Index were down –1.69% over the same time period. Previously, the inverse relationship between investment grade bonds and equities had broken down with bond and equity prices rising in tandem, making us reluctant to add considerably to bonds and causing us to delay the full implementation of new bond portfolios. As a result, most portfolios are underweight bonds during this difficult period, resulting in relative outperformance versus an overweight allocation to bonds. As the normal cycle plays out, we anticipate opportunities to add to Fixed Income portfolios, removing the underweight positioning as we wade through the later stages of this market cycle.

Resources

As always, please feel free to reach out to your Portfolio Manager with any investment-related questions. There are additional investment resources available under the "News & Resources" tab on our website (www.rinehartwia.com). Specifically, we'd like to direct you to the replay of our proprietary 3Q16 economic overview, covering the most recent quarter and relevant factors currently at play. Also, our October 2013 Fixed Income whitepaper titled "The Conservative Portfolio Conundrum" complements this month's newsletter with supplemental research pertaining to Fixed Income markets and is available under the archive section of our website.

Wealth Advisory Overview

Year-end tax planning for individuals

What can we do in the next month to prepare?

First and foremost, pay attention to the proposed tax bracket tables for 2017. In most cases, tax rates will decrease. However, there are a few cases where your tax rate could increase. For example, if you are single and earn between $127,500 and $200,500, under the proposed table your rate will increase from 28% to 33%.

Deferring income into 2017 and accelerating deductions into 2016 are wise if you think that your marginal tax rate for 2017 will be equal to or less than your 2016 marginal tax rate. Some tactics for deferring income and accelerating deductions are as follows:

- If you are self-employed and use the cash method of accounting, consider delaying billings until January 2017.
- If you plan to sell a business or appreciated property in 2016, consider an installment sale using a promissory note rather than cash. This defers the gain over the term of the promissory note vs. triggering the entire gain during 2016 under a cash transaction.
- If you are at least 70 ½ or older, you can minimize the tax impact of required minimum distributions (RMDs) from your IRA account(s) by transferring up to $100,000 directly from your IRA to a qualified charity. This lowers your adjusted gross income, which allows you to take advantage of certain itemized deductions.
- Pay your January 2017 mortgage payment in December 2016, but make sure you pay it early enough for the lender to process the payment before year-end.
- Accelerate charitable donations into 2016. If you are not sure which charities you would like to support, you can open a donor-advised fund to take advantage of the tax deduction in 2016 and fund the charities from your donor-advised fund at a later date.
- Pre-pay your fourth quarter state estimated tax liability in 2016 instead of waiting until January 15th. However, you should be wary of the alternative minimum tax (AMT). If you are subject to the AMT in 2016, there is no benefit.

You should be aware of the following tax breaks scheduled to expire after 2016. Congress has typically extended most expiring tax breaks in the past, but this is not guaranteed:

- Deduction (up to $4,000) for qualified higher education expenses
- Deduction for mortgage insurance premiums as qualified mortgage interest
- Temporary 10% credit (with a lifetime cap of $500) for qualified energy-efficient home improvements
- Income exclusion for discharge of qualified principal residence indebtedness; and
- The 30% credit for qualified energy-efficient fuel cell property, small wind energy property, and geothermal heat pump property

At Rinehart, we realize that each client situation is unique and adopt a more individualized tax planning approach that custom tailors solutions to your specific situation. Please contact your Wealth Advisor with any questions and let us know if we can help.

Around Rinehart

'Tis the Season of Giving

In addition to sharing 10% of our profits with various charitable organizations, we also give gifts to Heifer International and Crisis Assistance Ministry in honor of our clients.

Strategic Planning

The Rinehart team will host its annual offsite meeting on December 6th. The meeting will be held at the Duke Mansion Library. We will review a successful 2016 as well as set initiatives for 2017.

Emerging Markets Manager Panel

You are invited to attend Rinehart's exclusive portfolio manager panel featuring four emerging markets managers sharing insights on investing in the dynamic markets of Brazil, Russia, India, China, and others. This exclusive event will take place on February 1st 2017. Contact Brittany Danahey at bdanahey@rinehartwia.com for more information.

Spreading Knowledge.

Daniele Donahoe recently presented at The Private Wealth Southeast Forum, a one-day networking and educational event, focused on asset allocation and asset protection strategies for the private client intermediary and end user. She was joined by three panelists to discuss "Equity Portfolio Trends: Volatility, Smart Beta, ESG, and the Search for Growth." The event was hosted at the Commerce Club in Atlanta, Georgia.

Women's Enrichment Series

Rinehart's next enrichment series, "Raising Smart Kids: Education Planning" will take place at our office on Wednesday, January 25th. We invite you to join us as Sandy Carlson shares some insight on the importance of education planning. Interested in attending? Please email rinehart@rinehartwia.com to reserve your spot. Seating is limited.

Start your Engines.

Rinehart Wealth & Investment Advisory was recently nominated for Charlotte Business Journal's "Fast 50." The winners list will consist of 50 of the fastest-growing private companies in the Charlotte area. We are honored to see our hard work recognized through this recognition.

Holiday Hours

RWIA will be closed Friday, December 23rd as well as Monday, December 26th.

We Wish You a Very Happy Holiday Season and a Peaceful & Prosperous New Year

Rinehart Wealth & Investment Advisory

Wealth management is our only business; therefore, our attention is undivided and our intentions are transparent.

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