TAYLOR INVESTMENT SERVICES LLC
2017 Q1 LETTER

INTRODUCTION

The domestic stock market started the year by moving sharply higher. On a consolidated basis TIS lagged our relative to our large company benchmark mainly due to cash levels as 10 year domestic treasury rates continue to rise and now stand at 2.42%. Plus accounts lagged but by a smaller margin.

The Model accounts, including investments in fixed income oriented preferred stocks (but excluding US treasury securities and ultra-short term bonds), are currently about 50 to 60% invested with most Plus accounts at 70%-80% or more. My goal is to keep Plus stock balances at least 15% higher than Model accounts, though in 2017 I am targeting a minimum 75% allocation. If you wish to change your option, please let me know.

All return references in this report refer to consolidated numbers with blended fee rates. Performance and allocations for individual accounts, especially those below $200,000, may differ significantly. This report was written in the last week of March. Canadian stocks are listed with their Toronto Stock Exchange symbol with a "-t" extension.

A BRIEF IRA PRIMER

Any discussion on IRAs could get complex and confusing very rapidly, especially considering there are entire books on the subject. Yet, clearly IRAs are a key building block for a well-planned financial future so it is imperative to have a broad overview of the topic: let's discuss the various types, see how these accounts are often funded, and then look at tax consequences. I'll then close with 'three important points' and how IRAs can mesh with various life stages. Note: I am assuming that IRAs 'grow' which is not a foregone conclusion.

IRA types include:

- Traditional IRA. Funded typically from direct contributions or by transfer from another existing account, traditional IRAs grow tax free with most withdrawals taxed at regular rates.

- Rollover IRA. Usually funded from a 401k or another Rollover IRA, this account also grows tax-free but again most withdrawals are taxed at regular rates.

- Roth IRA. Most folks fund Roth IRAs either directly or from a Roth 401k. Like the others they grow tax-free but with Roth's – if conditions are met (age 59 ½ and Roth IRA opened for 5 years) - withdrawals are also *tax-free*. Let's repeat that **– withdrawals are TAX-FREE** (by today's law at least), making this IRA very unique and attractive.

- Coverdell ESA. Mostly funded by parents or grandparents for children; the account grows tax-free with distributions also tax-free when used for specific education expenses, up until a certain age for the child involved.

- Inherited IRA (both IRA and Roth IRA). Also known as Beneficiary IRAs, these are successor accounts from a deceased owner. Distributions from Beneficiary IRAs are taxable while Beneficiary Roth accounts are not; unlike the others, regardless of age beneficiaries must take yearly distributions each year (though no early withdrawal penalty described below applies to a specified amount).

A FEW THOUGHTS ON IRA DISTRIBUTIONS

Laws on IRA distributions are very cumbersome but here are a few things to keep in mind:

- Account for Taxes. Distributions from traditional and rollover IRAs are taxed as ordinary income at regular tax rates. As an example, if your bracket is 25% you pay 25% of any distribution to Uncle Sam, with your state likely to take a cut too (usually 7% in South Carolina). In effect, a $10,000 distribution becomes $6,800 after-tax, and your situation could be more draconian.

- Avoid withdrawal penalties. Taxes are bad enough, but most early withdrawals get socked with an additional 10% penalty (usually those before age 59.5). This gets ugly very quick, though there are special situations for periodic withdrawals but this choice should be reviewed with your tax advisor.

- Know Your RMD. For traditional and rollover IRAs, clients reaching age 70.5 must take yearly required minimum distributions (RMD). How much is based on the account balance the previous year divided by a factor provided by the IRS. Note that the factor drops each year, so the RMD get larger each year if the account itself also keeps rising.

- Don't sweat the RMD computation. Usually RMDs are computed automatically by a custodian, or TDA in our case (if housed at TDA), though get your tax advisor to confirm any figure.

- Call me or I will call you. TIS contacts clients about RMDs (including Beneficiary distributions) in late October; I need to know when you want the funds and the federal and state withholdings, if any.

- Set up transfer authority for easy access. Get paperwork done and we can automate transfers for any schedule you prefer.

- Take our original contributions to Roth IRAs at any time without penalty (assuming the value of the account at least equals the contributions). This essentially means that there is little downside to funding a Roth because the original money is always available.

THREE IMPORTANT POINTS

There are many other IRA wrinkles, with more types (e.g., SEP-IRAs), distribution exceptions, beneficiary options, Roth conversions, and other topics; call me to discuss any issue and I'll help as I can.

But let's emphasize two main points from this discussion and add one final critical thought:

1. If you can (and qualify), consider funding a Roth on a regular basis – I can't think of a more attractive account.

2. Getting money from an IRA is easy – we just need to set up the paperwork, but be aware of any tax consequences or penalties.

3. Check your beneficiaries! *Do this at least once a year and certainly before any life changes.* See the cover letter on how to check this online and get with me to make changes.

IRAs AND YOUR STAGE OF LIFE

Our family owns many different IRAs, including Rollover (transfer from my wife's 403b), Roth (funded each year), SEP (my workplace retirement plan), and Beneficiary IRAs, with my children having both Coverdell ESAs (for college, and these can be used for any specific child regardless of beneficiary) and their own Roth IRAs (from work at TIS LLC and other jobs).

Every situation is unique, but here's a guide tied to various stages in life, assuming you qualify and have investigated all workplace benefits such as a 401ks and implications of financial aid for college and the like; obviously this is not intended to be authoritative for every situation.

- If single and working, fund a Roth IRA each year.
- If newly married with at least one working spouse, fund Roth IRAs for both parties each year.
- For married with kids, fund a Roth IRA for both parties and fund Coverdell's for each child (and also investigate your state 529 plans). Remember that a Roth IRA for working teenagers can grow for decades.
- For retired people, enjoy your assets but consider helping children or grandchildren fund either Roth IRAs or Coverdell's – the money is effectively gone but your decedents will appreciate your generosity (they better!).

MAJOR ADDITIONS

Here is a list of major additions to the portfolios, though not all trades appeared in every account. Most of these trades enlarged existing positions.

Facebook (FB – fast grower). An early calendar drop in the shares due to misplaced growth fears gave us an opportunity to increase our holding in fast grower technology company FB which features a wonderful balance sheet, high free cash flow, and dynamic top line growth.

CGI Group (GIB – stalwart/asset play). I've added to this moderately growing consulting company as debt has been reduced and bookings have begun to pick up.

Google (GOOG – fast grower). Another early calendar addition, Google features a strong balance sheet and high free cash flow though fears about ad placement pressured the shares late in the quarter though this was a similar dynamic which pressured FB before the problem was solved.

Priceline (PCLN – fast grower). Even after vaulting in price the last year travel company PCLN's shares remained reasonable for a company with strong currency adjusted top line with fat cash levels and large free cash flow.

Roper Technologies (ROP – fast grower). ROP specializes in acquiring high free cash flow recurring business models which gives them the wherewithal to pursue other high cash flow recurring business models which has led to very strong historical returns. After several large acquisitions debt is high but the company is focused on integrating recent acquisitions and reducing debt levels. I like the company would welcome a drop to make our position size more meaningful.

Texas Instruments (TXN – stalwart). A solid if not spectacular holding semiconductor company TXN offers a strong balance sheet, high free cash flow, a consistent buyback and dividend, and modest but accelerating sales growth in recent quarters.

Vanguard Financials ETF (ETF - VFH). Banks are likely beneficiaries of any interest rate changes and this ETF offers wide exposure to financial companies though note that the top 10 holdings of this ETF (7 of these are banks) represent almost 44% of assets.

Vanguard FTSE Developed Markets ETF (ETF - VEA). Late in the quarterly I added to VEA which is an ETF composed of mostly European and Asian companies weighted primarily by market value. This is the first major direct international presence in TIS portfolios in a while (other than our Canadian exposure), though I've kept the position small (and the ETF is available mostly commission-free if held at least 30 days). After a sustained rise the USD seems ready to pause and international economies, particularly Europe, have strengthened in recent months. Like VFH, this is the sort of position I will sell if a better idea arises, but I like the broad exposure and Vanguard's typical low cost.

MAJOR LIQUIDIATIONS

I reduced two positions in the quarter including various closed end preferreds which are considered mostly interchangeable (BCV-A, GAB-J, GGN-B, GGZ-A, and GUT-C) and TMX group (X-t). Any sustained rise in interest rates will likely pressure our closed end preferred positions while TMX reached my targets though I added back as the price fell later in the quarter.

CONCLUSION

As always, I hope this review has given you a better understanding of my investment philosophy and your portfolio composition. I appreciate the trust you have placed in my firm to manage your assets. If you have any questions or comments, please don't hesitate to contact me.

Paul Taylor, TIS LLC