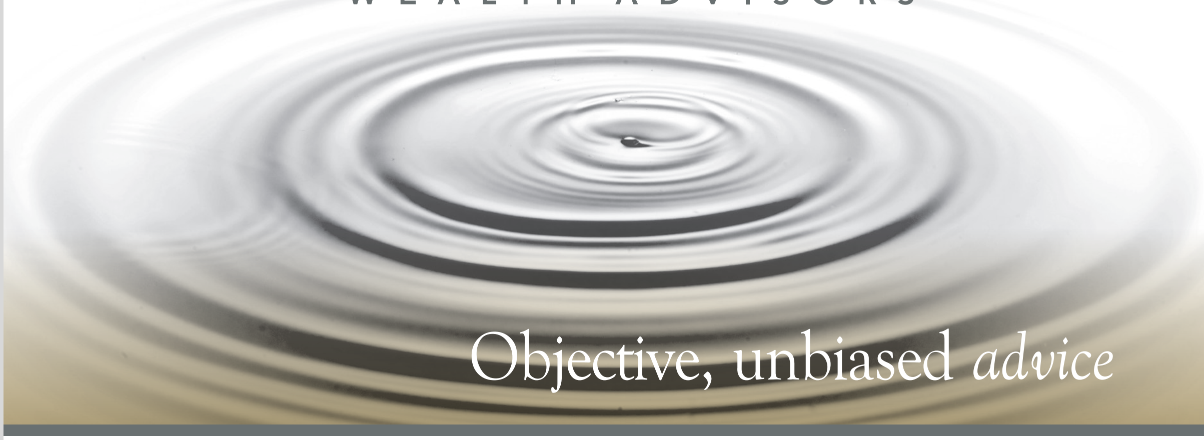
DEIGHAN
WEALTH ADVISORS



23 Years

Deighan Wealth Advisors
1994-2017

MARKET COMMENTARY

As Mainers, we relish our summers. Summer is the big dividend that follows months of endurance. First, snow, then rain, then mud and black flies. When it finally arrives, there`s nothing much better than a Maine summer.

As we savor the fatness of summer, we have to recognize that we are also sitting in the fatness of an economic summer:

- The unemployment rate is expected to be just 4.30% by the end of the year. To put this into context, the unemployment rate has been lower just one other time in the past 40 years.
- The S&P 500 Index has returned more than 9% since the start of the year, and it`s returned nearly 18% over the trailing 12 months.
- Corporate earnings are at 10-year highs, and they`re expected to grow more than 18% this year.
- Consumer confidence is at a 10-year high.
- The Bloomberg Financial Conditions Index, a broad measure of the country`s financial health, is at a 10-year high.
- Consumer confidence is at a 10-year high as measured by the Consumer Confidence Index, which indicates consumer optimism based on our activities of saving and spending.

The economy is not too hot, and it`s not too cold. Like a Maine summer, it`s just about right. Take a moment to enjoy it. After many long years of economic thaw here in America, we`ve all earned the right to enjoy the summer sun on our cheeks.

Now, it would be wonderful if there were some way to control the weather. We could make every day a Maine summer day. Of course, that`s impossible. It`s also impossible to entirely control the economic cycle, but that doesn`t stop economists and politicians from trying.

Like seasons, the economic cycle rotates through periods of expansion and contraction, periods of fat and lean. The average economic cycle lasts for about five and a half years, meaning that we should expect a contraction (recession) about once every five and a half years or so. Unlike the seasons, however, the business cycle isn`t all that regular. Cycles have lasted for as little as eighteen months (1981 to 1982) or as long as ten years (1991 to 2001). Our current cycle is now into its eighth year. In other words, the current cycle is on the long end, but not unprecedentedly so.

Economists and politicians try to control the economic weather by manipulating interest rates, money flow, tax rates, and the like. The goal is to shorten economic winters (contractions) and lengthen economic summers (expansions). Success has been mixed. For example, Alan Greenspan`s Federal Reserve lowered interest rates to help the U.S. economy recover from the 2001 recession. But, that same low interest rate policy lead to structural problems that eventually caused the housing collapse and the 2008 recession.

Today`s Federal Reserve, under Janet Yellen`s leadership, has started to slowly increase interest rates as the economy has improved. At the June meeting of the Federal Open Market Committee (FOMC), members voted to increase the federal funds rate to 1.25% on the upper bound. Despite this increase, interest rates remain low by historical standards.

The Federal Reserve has been able to maintain its low interest rate policy because inflation has been low. The inflation rate in 2016 was only 1.27%, and the rate throughout 2017 is expected to average just 1.60%. Come 2018 and 2019, consensus estimates are for inflation to reach the Fed`s 2.00% target, but that`s still a comfortable rate of inflation. This means we can expect the Federal Reserve to continue increasing interest rates at a deliberate and unhurried pace.

The immediate impact won`t be enough to seriously cool the economy, and the Federal Reserve should be able to keep the weather seasonable. For the foreseeable future, consumers can continue to expect relatively low interest rates on auto loans, mortgages, and other consumer loans. Businesses will continue to have access to cheap money to help fund expansions and capital improvements.

Of further help to the economy could be tax reform. House Speaker Paul Ryan, a Republican from Wisconsin, has outlined some of his party`s tax reform objectives. Chief among them is a reduction in corporate taxes. Such a reduction would be a boon to corporations, increasing earnings and stock prices. Speaker Ryan has also mentioned reductions in small business taxes and estate taxes. The latter could be of particular benefit to many of our clients, while the former could help many Americans.

> "Today's Federal Reserve, under Janet Yellen's leadership, has started to slowly increase interest rates as the economy has improved."

Barring some significantly negative, unforeseen event, our economic summer should persist for a while. Again, at eight years, the current cycle has been long, but not unprecedentedly so. It`s not impossible to think we`re in for a couple more years of "sunny skies."

That said, with every year that good economic weather persists, we wonder what storm clouds might lurk over the horizon. Low interest rates can lead to problems. If interest rates are left too low for too long, then inflation can increase beyond acceptable levels. It could be argued that inflation has already started to rear its head in stock prices. Consumers also tend to over-borrow when rates are low, resulting in increased risky loans and bankruptcies. One of the most acutely negative outcomes of low interest rates over the past eight years has been the impact on traditional savers – people who put their money into savings accounts or government bonds. These savers, typically retirees, have received exceptionally low interest rates on their savings, oftentimes not even enough to keep up with inflation. The result has been a negative real return and a reduction in real wealth.

> "Barring some significantly negative, unforeseen event, our economic summer should persist for a while."

Tax cuts can also lead to problems if left unfunded. Should Republicans enact tax reform that results in significant cuts, then those cuts will need to be funded somehow via a reduction in government payouts and services. This will be difficult to accomplish, especially given our ongoing, costly conflicts overseas. It is also likely to put undue burden on the less fortunate in our country.

> "If interest rates are left too low for too long, then inflation can increase beyond acceptable levels."

Therefore, although we may enjoy this beautiful summer day, like all good Mainers, we think about what we need to get done before winter. The yard needs tending, and a few painting projects need completion. With months of warm weather ahead, there`s much that can still be accomplished before the ground starts to freeze, but only if we make plans and act on them.

Likewise, as portfolio managers, we at Deighan are also preparing, deliberately and without undue haste, for cooler weather. The economy is sunny today, but we know that, like the seasons, economic cycles change. Eventually, this cycle will turn. Part of our job is to "winterize" portfolios before the pipes freeze. So, we continue to maintain an appropriate mix of all-season investments in client portfolios and plan to make a handful of initial reductions in risky positions over the coming months.

It is good fortune to have something. It is better fortune to have something and appreciate having it. We appreciate having your trust, and we acutely recognize that our work directly impacts your fortune. Therefore, even on the brightest of days, we never take you (or the weather) for granted.

Until next time, may you have a truly enjoyable summer. Appreciate it while it`s here, because summer, with all its richness and beauty, truly is fleeting.

ACKNOWLEDGEMENT

Thank you to Matthew Skaves, a former employee here at Deighan, for authoring the Market Commentary for the past two quarterly newsletters with minimal intervention and editing from our resident "Red Pen Queens". Matt continues to be a respected colleague and friend of Deighan Wealth Advisors, and we appreciate his contribution to our quarterly missives. We hope to provide more articles from Matt and other financial colleagues in the future to continue to provide our clients and friends with independent, insightful and relevant information. We welcome your suggestions for topics that you`d like to see covered. Please feel free to email your comments to: info@deighan.com. Also, let us know if you would like to help us reduce our carbon footprint by providing your copy of the newsletter in electronic format. Thank you, and happy reading!

PLANNING CORNER:

The Yin and Yang of Annuity Tax Efficiency

We are often asked to help clients in times of transition and very recently we were asked to help in the sorting out of assets in an estate. Although the client`s deceased mother had a will, leaving everything equally to her two children, almost nothing in the estate passed through the will because all of the assets were transferred by beneficiary designations at the security level. At first blush this would seem to be a simple estate to settle, but upon closer look it was a tax minefield.

> "At first blush this would seem to be a simple estate to settle, but upon closer look it was a tax minefield."

To ensure confidentiality, I will give the client the fictitious name Pat. However, it is important to know that Pat actually urged me to write about our discoveries to benefit others. Pat`s mom and all of her advisors lived out of state. Shortly after Pat`s mom died, Pat and her brother sat down with her mom`s various advisors to discuss the disposition of the many annuities she owned. Time after time they were met with voluminous documents including new account forms containing a lot of blank areas, but yellow highlighted areas for signatures to be added. "It was all very complicated and confusing" Pat said, "Something just didn`t seem right, so I decided to get a second opinion at home."

Pat`s mom, a member of the greatest generation, was a hard worker and serious saver. She likely bought the annuities because of the principal guarantee, the 3% interest rate floor, and the tax deferral of any income until distributions are made. What may not have been as clear to Pat`s mom was that the guarantee was only as good as the insurance company`s financial condition. Thus, owning the annuity was akin to owning a single bond in the insurance company. Annuities are not backed by the full faith and credit of any governmental entity. All insurance companies are regulated by their state and most are financially sound, but if the insurance company fails the annuity falters. Although it is true that state insurance commissioners will step in and try to work out some sort of payment arrangement, in our experience, the original terms, timing and flexibility are often sacrificed. Fortunately, in this case, the companies were sound, so the financial stability of the underwriting companies was not in question.

Yet, the income tax deferral had a dark side. Pat`s mom took minimal distributions from the annuities, but when she did take a distribution she had to take it from the growth of the annuity. This meant that the entire distribution was taxed at her ordinary income tax rate. She was only able to enjoy the tax deferral if she did not take anything out of the annuity. Once she died; however, the tax deferral came to an end leaving the beneficiaries to choose from a menu of rather unsavory choices. Let`s use the example of an annuity purchased many years ago for $50,000, now worth $150,000 as an illustration and examine the choices:

1. The beneficiaries may choose to receive a distribution of the current market value of the annuity. This would result in the beneficiaries recognizing $100,000 in taxable income. Contrast this to a stock or mutual fund portfolio with the same cost basis and market value on the date of death. Contrast this to a stock or mutual fund portfolio with the same cost basis and market value on the date of death for which the IRS allows for the cost basis to be "stepped up" to the date of death value of $150,000. This results in no or minimal income tax recognition for the beneficiaries.

2. The beneficiaries may take the distribution over a five year period. However, in at least one of the annuities, the 3% guarantee rate lapses a year after Pat`s mom`s death and is replaced with the new money market rate at just a fraction of one percent.

3. Finally, the beneficiary can transfer the annuity tax free but only to a new annuity with the same company. Annuities are contracts and each can have different terms. So, a lot of digging and documenting, usually with the assistance of a professional, is necessary to

SOUNDBYTES

Jean Deighan attended a Financial Planning Association of Northern New England meet-and-greet and continuing education event.

Lucie Estabrook attended the week-long Envestnet Advisor Summit in Grapevine, Texas, where she joined hundreds of other advisors from around the country to network and learn best practices for our portfolio management and reporting software.

Karen Mitchell attended the annual meeting of the Bangor-region International Association of Administrative Professionals.

Jenifer Wilson married **John Butler** in a beautiful seaside ceremony in Belfast, Maine on June 17th. She will soon officially take John's last name and become Jenifer Butler. Congratulations, John and Jenifer!

fully appreciate all of the contract options. In the case of one of the largest of the annuities Pat`s mom owned, the company representative strongly recommended a tax-free transfer to a new annuity which, pursuant to a "patented algorithm", would allow the beneficiaries to withdraw the funds partly as income and partly as principal. It sounds good, but the pitch was not revealing that the company representative was really recommending a permanent annuity (the only way to get the special tax treatment) with rather high expenses and withdrawal amounts that can never be changed.

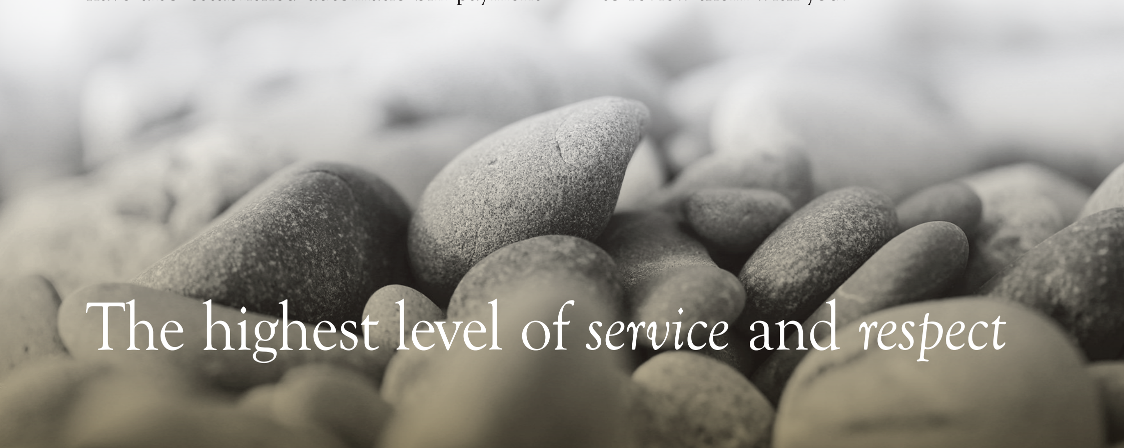
Finally, with rates still historically low, this is not an optimal time to lock in a fixed rate on an annuity contract. When Pat`s mom purchased the annuity in question, interest rates were likely much higher. Although the options may be different from contract to contract, the fixed rate options will generally be breathtakingly low. One company quoted Pat a five year staged payout option with an investment rate of 0.19% (almost zero); a ten year payout rate of 1.5% and a fifteen year payout rate of 2.24%. All are a far cry from Pat`s mom`s 3% guaranteed rate.

"With rates still historically low, this is not an optimal time to lock in a fixed rate on an annuity contract."

To sum it all up, annuities are not simple deals at all, and may have surprising, unpleasant consequences in estate situations. For those who own them, we recommend that you examine them carefully to understand how the annuity will work during your retirement and how it will operate when you pass on. It may be wise in some cases to view an annuity as an asset to consume earlier in retirement, leaving other assets (such as those in IRA`s or Investment Management Accounts) that may have more favorable tax treatment to the next generation. It is no secret that we are generally not annuity fans, but we realize there may be a place for such investments in certain circumstances. What is most important is to make sure you understand how the annuity works, and that it truly works for you.

NEW LETTERS FROM YOUR CUSTODIAN

Schwab, your account custodian, has recently sent emails and letters to clients to confirm standing instructions to "move money" in client accounts. In most cases, these communications are simply to confirm "MoneyLink" instructions on file. MoneyLink allows funds to be transferred from your Schwab account to a bank checking account of the same registered name. For example, a MoneyLink authorization allows cash to be transferred to and from John or Jane Client's Schwab and checking accounts. Some clients routinely use the MoneyLink feature on their accounts, but others rarely use it and it is good to be reminded that it still exists. Some clients have also established automatic bill payment for auto loans, mortgage payments or similar arrangements from their Schwab account. All such arrangements are currently under review by both Schwab and Deighan to make sure that clients are well protected and in compliance with the most recent SEC guidance with respect to custody laws. Clients can expect to receive more communication with respect to money movements within their accounts, and this is a good thing. Please understand that the increased communication is designed for your benefit, just as the custody laws are established for your protection. Do call if you have questions about any communication regarding your financial affairs. We are happy to review them with you.



DEIGHAN
WEALTH ADVISORS

TELEPHONE 207-990-1117

www.deighan.com

DEIGHAN WEALTH ADVISORS
455 HARLOW STREET
BANGOR, ME 04401

JEAN M. DEIGHAN, JD, CFP®
CHIEF EXECUTIVE OFFICER
jeandeighan@deighan.com

JENIFER L. WILSON, CFA, CFP®
PRESIDENT
CHIEF INVESTMENT OFFICER
jeniferwilson@deighan.com

LUCIE E. ESTABROOK, CTFA
VICE PRESIDENT
CHIEF OPERATING OFFICER
lucieestabrook@deighan.com

TYLER D. HOXIE
PORTFOLIO ADMINISTRATOR
ASSOCIATE ANALYST
tylerhoxie@deighan.com

KAREN S. MITCHELL, CAP
OFFICE MANAGER
karenmitchell@deighan.com