Trust & Investment Bulletin
Winter 2018

Happy New Year!

Michael R. Miller, JD, CFP®
Executive Vice President
Trust Department Head

Winter is here. Cold weather, warm fires, and many hours spent indoors. At this time of the year we seem to have more time to sit and reflect on the good and bad of the prior year and to anticipate the opportunities that the new year will bring. If you are like me, you are already planning for that summer vacation and those times to spend memorable moments with family and friends.

Winter is also the time to ponder your financial future. Are your financial plans in place? Are your resources allocated to your best advantage? Are you on the right path to reach your financial goals and provide security and comfort for you and your family?

At LCNB, we are spending our winter thinking about our friends and customers. How can we positively impact their financial lives in the coming year? How can we continue to earn our place as their trusted advisor? The new year will bring us many opportunities. The new tax act (an overview of which we have included on page 3) should have a positive impact on many individuals, businesses, and the economy in general. But with opportunities come challenges. We look forward to meeting with you to help you overcome the challenges and take advantage of the opportunities in the coming year.

Welcome to winter. Stay warm and let us know how we may be of service to you and your family.

Best Regards,
Mike

Economic Summary

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Executive Vice President
Chief Investment Officer

Despite considerable doubts from yours truly, President Trump and the GOP led congress were able to find common ground on tax reform and pass a bill prior to year-end. As always, the devil is in the details and the long-term implications may not be fully apparent for years-to-come. In the near-term, the bill should provide some immediate stimulus to an economy already running at a decent pace.

Third quarter GDP came in above expectations at an annual growth rate of 3.2%. This marked the second straight quarter above 3% which has not occurred since 2014. GDP growth has averaged just 2.1% since the Global Financial Crisis nine years ago. Perhaps with the stimulus from tax reform and an emphasis on rolling back regulation, growth has now shifted to a somewhat more sustainable 3%-plus level.

With the economy potentially shifting into a higher gear, all eyes will be watching the Fed as leadership transitions from Janet Yellen to Jerome Powell. As we move into the later stages of this economic cycle, the Fed will want to curtail any signs of accelerating inflation.

The latest Consumer Price Index reading is at 2.2%, just barely above the Fed's 2% stated target. Wage pressure typically builds in the later stages of an economic cycle as the labor market tightens. The latest numbers from the Bureau of Labor Statistics show wage gains at just 2.4% on an annual basis. With muted wages and inflation, Powell is widely expected to maintain the current course of interest rate "normalization" through gradual rate increases and balance sheet reduction.

Equity Summary:	4th Qtr	YTD	12 Month	3 YR	5 YR
S&P 500 (Large Cap Domestic)	6.64	21.83	21.83	11.41	15.79
Russell 2000 (Small Cap Domestic)	3.34	14.65	14.65	9.96	14.12
MSCI EAFE (International Developed)	4.23	25.03	25.03	7.80	7.90

The bull market in equity prices continued to charge ahead in the fourth quarter as global economic conditions improved and it became apparent that tax reform would become a reality. Estimates vary, but the Tax Reform Act should add upwards of 10% to S&P 500 earnings in 2018 and beyond. Despite the good news for the domestic and global economies, investors would be wise to heed Warren Buffet's advice from his 2004 annual letter, *"they should be fearful when others are greedy and greedy only when others are fearful."*

Valuation Comparison:	Trailing P/E Ratio	Forward P/E Ratio	Price/Book	Dividend Yield
S&P 500 Index	23.50	18.65	3.45	1.81
MSCI EAFE Index	20.81	15.59	1.86	2.94
MSCI Emerging Mkt Index	16.65	13.17	1.89	2.15

We have remained overweight equity in our asset allocation targets throughout this un-loved bull market that began in 2009. However, as we see signs of greed (Bitcoin!) and overconfidence beginning to percolate, we think it is wise to begin to reduce our equity exposure. While the global economy appears very healthy, domestic valuations are beginning to looked stretched and forecasts all seem to be pointing substantially higher. We have reduced our domestic equity targets to just below neutral but remain overweight international stocks where we see more attractive valuations.

Fixed Income Summary:	4th Qtr	YTD	12 Month	3 YR	5 YR
US T – Bill 90 Day Index	0.30	0.93	0.93	0.43	0.28
BC Municipals 5YR	-0.77	2.97	2.97	1.61	1.66
BC Intermediate Government/Credit	-0.20	2.14	2.14	1.76	1.50

The earth may not be flat but the yield curve might be soon!!

As of February 3rd, Janet Yellen will no longer hold her position as Fed Chair. As previously mentioned Jerome Powell has been named as her successor. Like Yellen, he is seen as having "dovish" monetary policy views and will be more concerned with maximizing employment and less fearful of inflation.

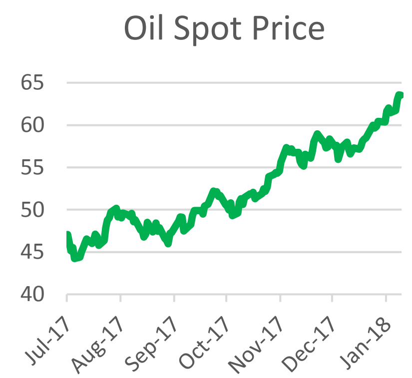
As expected, in December we saw another rate hike from the Fed, increasing the Fed funds rate to 1.25% - 1.50%. Since the announcement of Trump's tax bill, multiple corporations (including Wal Mart) have announced wage increases and bonuses for their employees. As wage inflation seems to be a key metric for the Fed, we expect a March rate hike, followed by a wait-and-see approach by our newly appointed chair. According to the futures market, we can expect to see 2-3 rate hikes in 2018, with an 80% probability of a hike in March.

During the fourth quarter of 2017, the entire treasury yield curve shifted higher. However, the short end of the curve is rising at a quicker pace causing the yield curve to flatten. Where we once saw an opportunity in 2-7-year bonds, the fourth quarter move in interest rates removed some of the slope, or incentive to lengthen. The spread between the 2 year and 10 year treasuries moved from 85 bps at the beginning of the 4th quarter to 52 bps at the end of 2017. We continue to recommend an average maturity that is slightly less than the benchmark.

Chris Robinson, CIMA®
Vice President
Trust Investment Officer

Alternative Investments Summary:	4th Qtr	YTD	12 Month	3 YR	5 YR
Bloomberg Commodity	4.71	1.70	1.70	-5.03	-8.45
Dow Jones Global Real Estate	4.02	16.94	16.94	6.77	7.27
Morningstar Broad Hedge Fund TR	3.37	6.15	6.15	3.49	5.01

Commodity prices continued a strong second half rally with a 4.71% return in the fourth quarter and finished the year in positive territory. Much of the rebound was spurred by rising oil prices. Crude oil prices increased from $46/barrel at mid-year to over $60 by year-end. This 30% move over six months could signal a return of inflation.



It is not surprising to see numerous hedge funds closing as the bull market charges forward. Hedge funds are designed to perform better in volatile, sideways, or down markets. This bull run has been completely devoid of any volatility and, as a result, hedge funds have seen massive withdrawals. Sometimes it pays to go against the grain. For this reason, we recently started adding some exposure to the Touchstone Dynamic Equity fund that has the ability to go long and short and should perform better in choppy markets.

Highlights from the New Tax Act*

The Tax Cuts and Jobs Act ("TCJA") was signed into law on December 22, 2017. While TCJA includes numerous changes, below are some highlights of changes going into effect in 2018, unless otherwise noted:

- Exemption & Standard Deduction. Personal exemptions have been eliminated. However, the 2018 standards deductions are nearly doubled to $12,000 for individuals and $24,000 for married filers. The increase in the standard deductions will likely result in fewer taxpayers opting to itemize their deductions.
- State and Local Taxes. Taxpayers may deduct up to $10,000 per year in *combined* property, state income, and local income taxes. There is an option to substitute state sales tax for state income tax.
- Mortgage Interest. Homeowners may deduct interest for new loans up to $750,000 on first and second homes. Existing mortgages up to $1,000,000 will be grandfathered.
- Medical Expenses. Medical expenses in excess of the floor of 7.5% of adjusted gross income may be deducted in 2017 and 2018. The floor increases to 10% of adjusted gross income thereafter.
- Other miscellaneous itemized deductions. TCJA eliminated other miscellaneous itemized deductions, which previously had a 2% floor. Common examples include tax preparation fees, unreimbursed employee expenses, and investment advisory fees.
- Child Tax Credit. The Child Tax Credit is increased to $2,000 per child under age 17. A portion of the credit ($1,400) is refundable.
- Non-Child Dependents Credit. A new $500 credit will be allowable for non-child dependents, such as an elderly parent, subject to income limitations.
- Estate, Gift, and GST Tax Unified Credit. The 2018 credit is $11.2 Million for individuals. Portability remains in effect, so couples may shield up to $22.4 Million. The exemptions will revert to 2017 levels, adjusted for inflation, in 2026, absent further Congressional action. The annual exclusion gift amount is $15,000 for 2018.

Jaqueline A. Manley, JD, CFP®
Vice President
Trust Counsel

**A white paper is available with information on additional changes due to the new tax act. Please contact Jackie Manley at jmanley@lcnb.com if you would like a copy.*

We hope that we are exceeding your expectations. The best compliment we could receive would be a referral of your friends and family. Please contact Mike Miller @ 513.932.1414, ext. 59101 or mmiller@LCNB.com for more information.