FLOWER
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July 2018 Newsletter

Dear Members of Flower City Capital,

We hope you are enjoying your summer and finding time for some rest and relaxation.

As always, we begin with an executive summary:

- Corporate earnings in the US are strong and prices are generally reasonable reflecting improved market fundamentals
- Emerging and International Developed Equity Markets have corrected Year to Date
- US Bonds have also declined as the Federal Reserve continues to raise interest rates
- Market movements over the past quarter have created the opportunity to employ "Tax Loss Harvesting" as a strategy for generating current tax savings

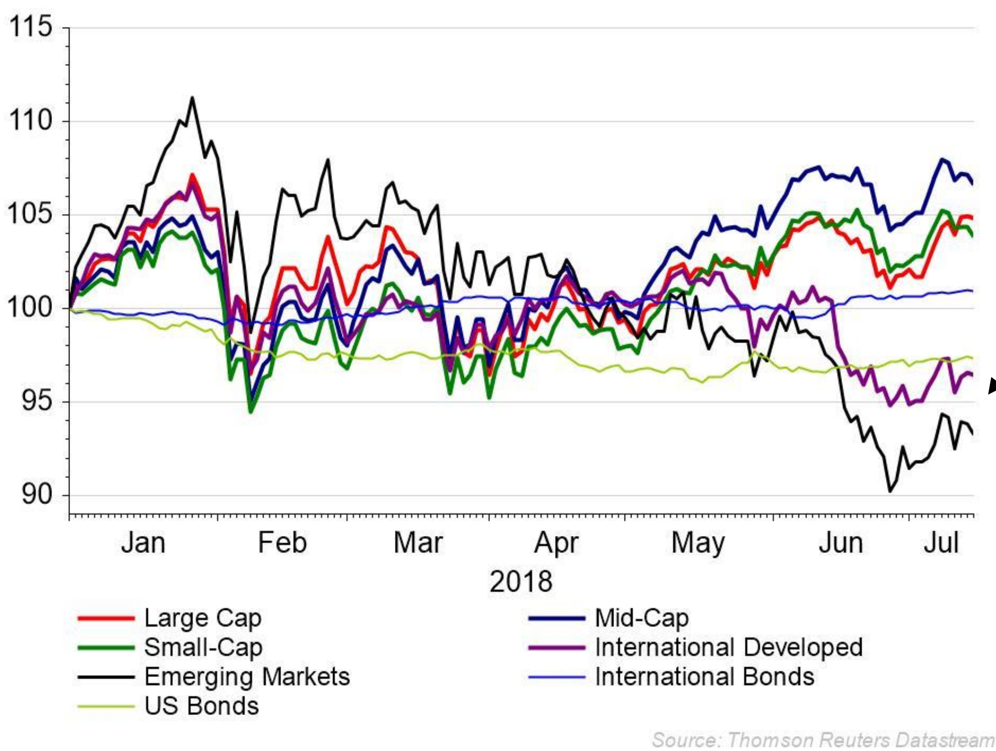
Big Picture View and Implications for Our Portfolios

We diversify portfolios across asset classes. This allows for smoother returns over time for a given level of risk. Below is summary of how the major asset classes have performed YTD.

Emerging and International Developed Markets have declined YTD with the potential impact of negative Trade Policy and continued divergence in global growth.

US Bond prices have also declined as rates rise in the US ahead of other developed economies such as the EU or Japan. Bond prices fall when rates rise because fixed coupon payments become less valuable.

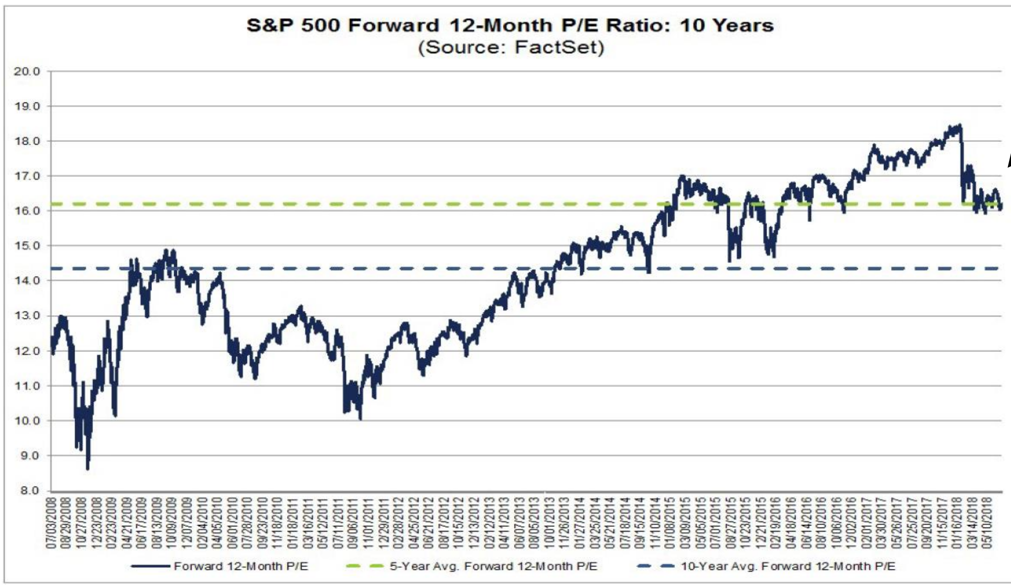
Figure 1. YTD Price Performance Across Asset Class



International Developed and Emerging markets have declined YTD

This year's returns may not feel as exciting as last year, when US markets were up ~20%. So far in 2018, US earnings growth has been strong, up ~20% year over year, but prices have only recently moved up 5% or so and have been largely flat for the year. This is actually long-term positive for the market as it is causing the Price to Earnings (P/E) ratio to decline to recent averages. As a result, market valuations are reflecting healthy consolidation towards more normal levels, not the elevated prices we saw at the beginning of the year. This provides a firmer foundation for future gains or mitigates any future corrections as stock prices don't have as far to fall if they start at a reasonable valuation.

Figure 2. US Equity Forward Price Multiples



Lower price returns and strong earnings growth are making markets more reasonably priced

Risks to the market remain in the forms of decreasing growth/negative economic numbers, damaging trade policy, overheating inflation and conflicting monetary and fiscal policy, however we believe valuations are reasonable and support still exists for risky assets such as equities. We continue to monitor the current market environment for any developments or impacts on our portfolios.

Our portfolios remain largely unchanged with slightly overweight exposure to equities, and a bond allocation that is protected as rates rise while assuming a prudent amount of risk for added yield.

Tax Loss Harvesting

Market movements over the past quarter have created a number of Tax Loss Harvesting (TLH) opportunities within our portfolios. Tax Loss Harvesting is a strategy for generating current tax savings by selling positions at a loss and using those losses to offset income or gains elsewhere. Once the losses are "harvested" investors are not permitted to repurchase that same position within a 30-day window, however investors are able to purchase a similar security with the sale proceeds. The result is a relatively unchanged portfolio in terms of allocation or exposure with a reduced tax burden and more portfolio flexibility.

Emerging Markets are a great example of a TLH opportunity within our portfolios. Emerging Markets outpaced US and other international markets in 2017 but have subsequently declined in

2018, and now trade discounted relative to the US and developed markets. While this may mean it's a good time to buy, it also represents the opportunity to take those losses and deploy them in offsetting gains in other places. This strategy is made easier and more effective by using low cost, passive investment vehicles with minimal transaction costs. It's important to note that the overall exposure to Emerging Markets is not changing, we're just selling funds with losses and buying similar funds in their place to generate the tax loss.

For example, illustrated in the below table suppose a $200,000 position declines 5% producing a $10,000 tax loss. The loss will be used to offset any available capital gains first, then any excess may be applied to ordinary income up to a maximum of $3,000. In this case, the estimated current tax benefit would be $1,950, assuming a 30% marginal income tax rate and a 15% capital gains tax rate.

	Capital Gains Exhausted 1st	**Ordinary Income** Exhausted 2nd
YTD Activity	$7,000	$50,000
$200,000 position down 5%, Tax Loss ($10,000)	($7,000)	($3,000)
Net Impact	$0	$47,000
Tax Savings*	$1,050	$900

* *Excluding trading commissions which range between $0-$5.*

In addition to the direct tax savings, TLH also provides support for portfolio rebalancing by reinforcing "buy low, sell high." Once a position declines and the loss is harvested, any outperforming allocations may be sold with some of the taxes protected in order to bring the underperforming allocation back in line with the target.

It is likely the newly created position will increase in value in the future creating future taxable gains. In this case the current tax benefits would wash with the future tax obligation, and deferral would represent the true value of TLH, especially if tax brackets are expected to be lower.

It may seem counterintuitive to intentionally take losses; however, Tax Loss Harvesting is an effective tool for tax management and is a central part of the tax management process. Therefore, we look for and capitalize on TLH opportunities as an integral part of portfolio implementation. Other areas that we focus on to minimize taxes are asset turnover, asset location and withdrawal sequencing in retirement.

We look forward to further discussing this topic with you and how it may be applicable.

As always please do not hesitate to contact us with any questions, investment or otherwise.

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