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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

MAY 2017

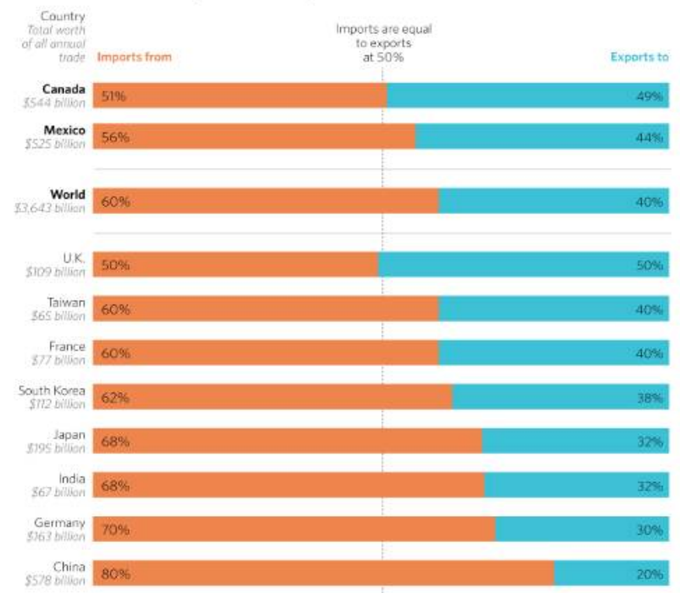
Eat a live frog first thing in the morning, then nothing worse should happen to you for the rest of the day! anonymous

This quote kind of reminds me about the guy who was banging his head against the wall. When asked why he was doing this, he replied because 'it feels so good when I stop'.

So, in talking about, and feeling pain, I came across an analysis on how much our nation's Congress costs you & me; it's $4.1 billion every year. That's what is paid out in salaries for House of Representatives, senators and aides…maintenance on the Capitol and office buildings and costs to run the Library of Congress. So, all in all, taxpayers are spending $29 million/day and we can't even seem to buy non-partisan politics. But, as Will Rogers so astutely observed, 'Americans are lucky that we don't get all the government we pay for'.

Yogi Berra is another 20th century philosopher who once opined, 'when you get to a fork in the road, you should take it'. I wonder if our representatives can take such sage advice? Gridlock seems to be the preference of the day.

Meanwhile trade is on everyone's mind. In terms of economic health, a positive balance of trade or trade surplus is a favorable state as it indicates a net inflow of capital from foreign markets into the domestic economy. When a country has such a surplus, it also has control over the majority of its currency in the global economy, which reduces the risk of falling currency value. Despite the fact that the United States has always been a major player in the international economy, the U.S. has suffered a trade deficit for the last several decades. The chart below gives us a clear view on why this is such a big issue.



In 1975, U.S. exports exceeded foreign imports by $12,400 million, but that would be the last trade surplus the United States would see in the 20th century. Today, our trade deficit is more than $1/2 trillion/year.

What Is the U.S. Trade Deficit with China?

The U.S. trade deficit with China alone was $347 billion in 2016. The trade deficit exists because U.S. exports to China were only $116 billion while imports from China were $463 billion.

The United States imports consumer electronics, clothing and machinery from China. A lot of the imports are from U.S. manufacturers that send raw materials to China for low-cost assembly.

How It Affects the U.S. Economy

This large trade deficit with China has many effects, one of which is that China must buy so many U.S. Treasury notes that it is now the second-largest lender to the U.S. government. Japan is the largest. As of February 2017, the U.S. debt to China was $1.059 trillion. That's 28 percent of the total public debt owned by foreign countries. Many are concerned that this gives China political leverage over U.S. fiscal policy, since it could call in its loan.

(Source: "Major Foreign Holdings of Treasury Securities," U.S. Treasury.)

By buying Treasuries, China helps keep U.S. interest rates low. In the past that has helped fuel the U.S. housing boom, which lead to the subprime mortgage crisis. If China were to stop buying Treasuries today, interest rates would rise. That could throw the United States and the world into recession. But this wouldn't be in China's best interests, as U.S. shoppers would buy fewer Chinese exports. In fact, right now China is buying almost as many Treasuries as ever.

So where does it leave the USA, China and the rest of the world economies. At a stand-off, I guess you could say. A trade war would be devastating for everyone.

On the investment front, we have some very interesting dynamics going on right now. For one, depending on how you evaluate stock and stock sectors, stocks are either fairly value, or over-valued.

Although the S&P 500 is up almost 6% for the year, virtually all of the gains have come from a handful of stocks:

AMAZON
FACEBOOK
APPLE
GOOGLE
NETFLIX
MICROSOFT
NVIDIA
TESLA
ACTIVISION BLIZZARD
PRICELINE

With the existing P/E ratios of these stocks, it's doubtful that many of you have been buyers in 2017. Therefore, it's been tough slogging for almost all investors this year.

The trailing P/E multiple for the S&P 500 currently stands at about 22 times earnings. Not cheap…but not crazy expensive either. Still, it's hard to find value stocks to purchase.

What you need to be aware of right now is that the small investors (who have been sitting on the sidelines for a very long time) have been coming back into the market.

When 'mom & pop' start jumping back into stocks, it's a very bullish short-term signal for investments. But, if we begin to see them forgetting all fears, then it's time to worry. Everyone is then at the party and there's no one left to arrive.

The thing to remember is one cannot be focused only on returns, while looking past risk. Successful investors focus on process over profits and risk over return. The goal is to always to live for another day.

Overall, however, I'm still modestly bullish on the market based on the tailwinds from the Federal Reserve monetary policy and of course, the economy . Currently, I am keeping a close eye on any signals we may get from the *smart money*...which is still net long with their options and futures positions. When they start heading for the exits, you don't want to be far behind them. It's like the old cartoon of a guy wearing a T-Shirt which read, "I'm with the bomb squad. If you see me running, try to keep up".

Will the IRS see through your Beneficiary?

Investors often have trusts as a convenient way for their heirs to receive assets after they die. And generally this works as intended. Everything goes into one pot and each beneficiary takes out his or her share as specified in the trust. IRAs left to your trust, however, can cause complications and could leave your love ones with less than you had planned.

The IRS views a trust differently than the individuals named in the trust. For instance, suppose you are not taking Required Minimum Distributions (RMD) yet, and named your trust as the beneficiary of your three IRAs. In addition, your trust documents specify that your two daughters, ages 45 and 37, are to receive equal portions of the trust assets after you die.

Upon your death, your IRAs will transfer into the trust, and your daughters would receive their shares. However, they will have to start taking RMDs and paying income taxes based on your older daughter's shorter life expectancy, thus penalizing your younger one.

One way to give your beneficiaries better tax treatment is to create separate accounts for each one of them. For example, you could name your spouse as the beneficiary for one IRA and each of your children the beneficiary on other IRAs. This might create work for you now, but the end result could be less taxes and greater flexibility for your heirs.

You should review your trust documents and estate plans with your attorney each year or whenever there has been a significant change in your life.

Are You Losing Money Because of Tax-*Inefficiency?*

Diversification is a well-known method of mitigating market volatility risk and seeking more consistent returns. And this may lead to a mix of different types of investments as a means of providing diversification. But does it matter where your assets are held. In other words, are stocks better in an IRA or a taxable account? What about corporate bonds?

Based on research published in the Journal of Financial Planning, where you hold various types of investments could have an impact on your overall after-tax return. That's because certain asset types are more likely to benefit from the tax-deferred treatment available in an IRA, while others may provide better after-tax returns in a taxable account.

What determines if an asset would work better in an IRA or a taxable account? According to this research, one factor is the amount of an asset's total return that comes from capital gains. Thanks to changes in tax regulations, capital gains (defined as gains achieved on investments held for at least one year) are now taxed at a rate of 15% or 5%, depending on your current tax bracket. (This may change based on the promised tax reform being promised out of Washington). Therefore, investments that generate a significant portion of their total return from capital gains, such as corporate common stock, could potentially benefit from these lower tax rates.

However, if these investments were held in an IRA, their returns would be treated not as capital gains but as ordinary income when removed from the account. Therefore, these gains would be taxed at your ordinary income tax rate, which could be higher than the capital gains tax rate. Assets that tend to generate significant capital gains may be more appropriate for a taxable account, where they would benefit from the lower capital gains tax rate. Conversely, for those assets where capital gains comprise very little of total return and more income (e.g., corporate bonds and preferred stock), an IRA might be a better choice.

Asset appreciation potential is also something to consider, and can have an effect upon the income taxes that might be paid by your beneficiaries in the future. For example, assets held inside an IRA do not receive a stepped-up cost basis at the death of the account owner. On the other hand, assets held outside of an IRA will receive a stepped-up cost basis when the owner of the assets passes away. The point is, the place where assets are held can also affect the future income taxes of your younger family as well!

Please note however, that investments in securities such as corporate stocks and bonds carry market risk, and your principal investment can lose value regardless of the manner the securities are held.

Additionally, the principal and interest payments from corporate bonds are subject to the financial stability of the issuing company. Corporate bonds are also subject to interest rate risk. In other words, your risk tolerance and investment time horizon should also be considered when purchasing investments for your portfolio.

Moving to a new state? Don't forget to move this document with you.

There are many changes you have to make when you move to a new state - driver's license, voter registration, etc. One item that frequently goes unnoticed is your will. There may be differences in the

new state's laws that could make certain provisions of your will invalid. Check them out with an attorney.

Moving is also a great time to sit down with an estate planning specialist to ensure that your estate plan is up to date. Property laws can, and do, vary from state to state. It is especially important to have your estate plan reviewed if you move from a common-law state to one of the community property states like Arizona, California, Idaho, New Mexico, Louisiana, Washington, Nevada, Texas, Wisconsin, and Alaska…and vice versa.

In a common law state each spouse's property is owned individually, while in a community property state, property acquired during the marriage is considered community property. In addition, states may have different rules about powers of attorney or health care directives and when co-owned property may pass to the surviving owner and when it may pass under the will.

Which Source of Funds Comes First – Taxable or Qualified?

When it comes time to tap your savings and investment accounts, clients often wonder which source should come first. In general, many experts advise investors to draw from their taxable accounts first, then tap qualified accounts such as IRAs and 401(k)s further down the road. There is a logical reason for this--prolonging withdrawals from your qualified accounts gives these assets additional time to grow with the benefit of tax-deferral. There are other reasons why this strategy could be efficient from a federal income tax perspective.

Let's say that you have three sources of investment funds, a regular taxable account (which could hold individual stocks, bonds, or mutual funds) and two qualified accounts: a traditional IRA and a Roth IRA. What happens if you tap your traditional IRA? First, all withdrawals from a traditional IRA are taxed at your current income tax rate. Second, a 10% federal income tax penalty will usually apply to traditional IRA withdrawals taken prior to age 59½ (subject to a few limited exceptions explained in IRS Publication 590. Exceptions include but are not limited to: withdrawals for qualified higher education expenses, first-time home buyers, medical insurance premiums for certain unemployed taxpayers, and withdrawals taken by disabled taxpayers).

What about taking money from a Roth IRA? If you are less than 59½ years of age, or you have not held the Roth for more than five years, the distribution could also be subject to the 10% federal income tax penalty. By leaving the money in the traditional and Roth IRAs, you have the opportunity to accumulate tax-deferred investment growth over the life of both the owner and the beneficiaries. Assuming the age and holding period requirements are met, all Roth distributions also come out free of future federal income taxes to the account owner, as well as the beneficiaries.

What if you tap your taxable account first? You will owe taxes on any capital gains you realize from the sale of investments in this portfolio. Assuming you have held the asset for more than one year, your rate will be lower than your current income tax rate (5% for taxpayers in 10-15% brackets; 15% for all tax brackets exceeding 15%). You might also be able to soften the blow of your annual tax bill. As you gradually tap your taxable account, the distributions you receive from these investments will slowly recede, thus lowering your tax burden from dividends and capital gains paid to you. Moreover, your qualified accounts could potentially have longer time to grow with the power of tax-deferral, which could enhance the value of your qualified retirement funds.

Eventually, you will have to take minimum distributions from your traditional IRA once you reach age 70½. Although these distributions will be taxed at your ordinary income tax rate, you could be in a lower tax bracket by then. As previously mentioned, these distributions are taken, in many cases, over the life expectancies of the owner and the beneficiaries. On the other hand, traditional IRAs do not receive a step-up in income-tax basis when they are transferred to younger beneficiaries at the owner's death. Although there is something to be said about the power of deferring taxes, one should also consider future income tax consequences to younger family members before making a decision.

Assuming you have assets in Roth IRAs, you should know that minimum distributions are not required. In view of this and the fact that withdrawals will come out free of federal income taxes (assuming the age and holding period rules are met), you may want to consider your Roth assets as your source of last resort.

Deciding which account to tap first depends on your financial and tax situation now and during your retirement years. **If you would like to review some withdrawal strategies for your various investment accounts, please give my office a call.**