The COMPASS Chronicle

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Retirement Distribution Pitfalls: Not Reinvesting RMDs You Don't Need

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement. This can be even more complicated than accumulating assets.

Pitfall: One of the big mistakes of retirement distribution can be not reinvesting RMDs you don't need. Retirees may experience a situation where the amount they must withdraw from 401(k)s and IRAs for required minimum distributions can take them over their desired distribution threshold. The RMD rules require that people initially withdraw less than 4% of assets at age 70 1/2, but distributions can quickly step up into the 5%, 6%, and 7% range.

Workaround: What people might not realize is that there's nothing saying they have to spend their RMDs; they can reinvest in a taxable account if they'd like that money to stay invested in the market. This can be a wise strategy for retirees who are concerned with legacy planning or long-term care needs down the line. It's possible to build a taxable account that has many of the tax-saving features of a tax-deferred account.

401(k) plans and IRAs are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. This is for informational purposes only and should not be considered tax or financial planning advice. Please consult with a financial or tax professional for advice specific to your situation.

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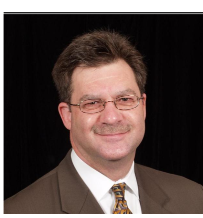

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More about COMPASS Wealth Management, LLC

COMPASS Wealth Management, LLC is a client-focused wealth management firm dedicated to providing superior advice to individuals, families, and corporate retirement plans.

Our wealth management services include investment management, retirement and gift planning, education funding, and other advisory services.

We take pride in offering you expert financial advice along with personalized service. Assisting you in reaching your financial goals is our business and we take that responsibility very seriously.

For details on the selection criteria used to determine the recipients of the FIVE STAR Wealth Manager award, please visit our web site.

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Credit Cards Becoming "Smart"er

By Louis E. Conrad II, CFA

- In response to spiraling credit and debit card fraud losses in the U.S., card issuers have begun to introduce smart cards, a more secure alternative.

With all of the credit card fraud prevalent in the U.S., as evidenced by recent malware attacks at retailers such as Target, Home Depot, and others, protecting users' credit card information has taken on heightened urgency. By the end of 2015, credit and debit card issuers in the U.S. plan to migrate to smart card technology. Nearly 130 countries have already adopted the more secure smart card technology (smart cards are also known as chip cards) that reads a computer chip that is embedded in the card rather than the magnetic strip that is attached to the back of the traditional credit and debit card.

Chip and Signature Cards

Though U.S. card issuers plan to migrate to smart cards by the end of next year, most plan to introduce "chip and signature" cards that require a cardholder's signature to complete a transaction. The predominant smart card used overseas is the "chip and PIN" card, which requires the use of a PIN rather than a signature.

The cost to produce and distribute a traditional credit card is less than $2, while the typical smart card costs $15 – 20. Given the number of credit and debit cards in the U.S., as well as the need to replace the transaction terminals at every retailer in the country, the conversion costs have delayed implementation of smart card technology in the U.S., though the technology was introduced over 20 years ago.

Nearly one-half of the $11.3 billion in global credit card fraud losses in 2012 occurred stateside. U.S. credit and debit card issuers and payment systems have been targeted by fraudsters from around the world because the U.S. system is deemed to be the weak link internationally. The mounting losses that have been suffered in the U.S. have finally forced domestic issuers and retailers to incur the upfront costs associated with the introduction of the long-standing smart cards.

At present only a few U.S. card issuers offer the more secure "chip and PIN" cards, including some federal government-related credit unions, Barclays, Commerce Bank, USAA, and Wells Fargo. Most U.S. financial institutions have begun to introduce "chip and signature" cards, including American Express, Bank of America, Chase, and Citibank. All of the U.S. card-issuing institutions that offer chip-enabled cards also include a magnetic strip on them for swiping if necessary.

How Smart Cards Work

Smart cards are nearly impossible to counterfeit due to the use of an imbedded microchip. The chip securely stores the card data that now resides on the traditional credit card's magnetic strip. In addition, for each transaction, the microchip produces a unique code that allows for secure processing. Since smart cards use cryptograms that are unique to each transaction, stolen card data is of no use to fraudsters.

The use of a smart card is a bit different than the traditional credit or debit card. Instead of swiping the smart card, you will need to insert the card into the card terminal, face up, chip end first, and leave it in the terminal for the duration of the transaction. Then, depending on whether you have a "chip and signature" or "chip and PIN" card, you will either need to sign or enter a PIN, respectively, to complete the transaction. When traveling overseas, you may be prompted for a PIN depending on the type of terminal you are accessing. If you are a "chip and signature" card user, then you will need to inform the merchant that your smart card requires a signature and not a PIN.

Summary

The brave new world of payment processing is expected to bring enhanced security for U.S. credit and debit cardholders. Given the increasing amount of credit card fraud and identity theft in the U.S., these new measures should provide enhanced financial peace of mind in this digital world.

Monthly Market Commentary

As 2014 draws to a close, the U.S. is still experiencing a slow and longer-than-normal recovery.

GDP: The GDP growth rate in the third quarter was boosted to 3.9%, up from 3.5%, and well ahead of expectations of 3.3%. A lot of that improvement was due to high-quality items—more consumer and business spending. Unfortunately, that will make growth that much harder to achieve in the fourth quarter, which is now likely to be less than 3%. That would still leave the full-year GDP growth rate at about 2.3%, not much changed from 2012 and 2013. Consumption, business investment, net exports, and even government made decent-size contributions to overall GDP. As expected, residential housing was relatively disappointing, contributing just 0.1%. During this recovery, it has not been unusual for one category to drive most of the growth, while almost everything else showed limited growth or even a negative contribution.

Employment: The jobs report did far better than expected, with job growth of 321,000 for the month of November, the best result of calendar 2014 and the best report since 2012. However, it's not clear whether this data reflects misplaced seasonal factors or newfound economic strength. November was also a great month a year ago, when 274,000 jobs were added. Indeed, November has generally been in the top half of the 12 months for job growth over the past four years. So maybe at least a portion of the high growth was due to overly aggressive seasonal factors.

Wages: Like the raw employment data, the hourly wage growth was unusually strong in November. Month-to-month wages grew 0.4%, which annualizes to almost 5%. However, monthly data tends to be volatile; looking at year-over-year data, averaged over three months, presents a truer picture of economic activity. The year-over-year, hourly wage growth trend has been consistent at around 2.0–2.1% for the past 12 months.

Consumption and Income: The government restated recent consumption and income numbers so some of the short- term good news has disappeared. In the original government data, incomes went up a whopping 1.4% between March and September while consumption grew a measly 0.6%. The revisions to the six-month data now show that spending increased by 1% while incomes increased just 0.8%. In other words, savings decreased, not increased, over the past six months. In addition, the restated income data would seem to imply that eventually some of the job growth in the period April through June will be revised sharply down.

Housing: 2014 was a rough year for existing-home sales, which now appear likely to fall from 5.1 million units in 2013 to 5 million units in 2014. However, the 2013 data was aided by a rush to close homes before interest rates increased. Slower investor sales, poor weather, higher mortgage rates, and a dramatic price spike all conspired to hit existing-home sales hard in 2014, especially in the early parts of the year. Now interest rates are lower again and the weather has improved some. Sales have moved up from an annual rate of 4.6 million units during the winter to 5.3 million units in October, which just about equaled the best month of 2013.

The pending home sales index, which often portends changes in existing-home sales, was off modestly, just 1.2%, from 105.3 in October to 104.1 in November. However, pendings growth is still ahead of existing-home sales, which means that we can probably expect more improvement in year-over-year existing-home sales. Looking to 2015, Morningstar economists expect existing-home sales to grow at a 6%–8% rate, which would mean about 300,000–400,000 more units than in 2014. That would bring sales to 5.3 million–5.4 million units for the full year.

On the positive side, home prices are growing at a slower rate. This trend, coupled with lower interest rates, should improve affordability, providing an essential boost to this so-far anemic housing recovery.

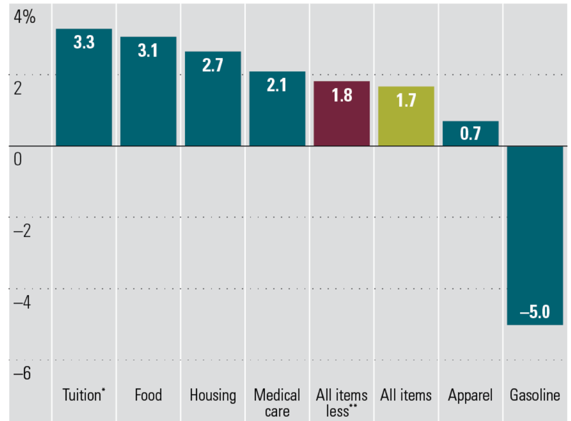
Inflation Can Vary by Category

The general inflation number (the “All items” category) may be a good measure for the economy at large, but the cost of certain goods and services could rise much faster than the average cost of living.

For the past year, tuition, food, housing, and medical care have all experienced much higher inflation rates than the headline number. Gasoline prices, on the other hand, have been declining and are now near four -year lows.

People who need to focus on savings for college or medical care may be left short, as the cost for such items often tends to rise at a faster rate than the average cost of living. Those investors might not be able to keep pace with rising costs if they do not take their real inflation rate into account when planning their investment goals.

Consumer Price Index Components, Year-Over-Year Change



*other school fees and child care **less food and energy

Source: Bureau of Labor Statistics, Morningstar calculations. Data as of October 2014.

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