The COMPASS Chronicle

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Highlighting important wealth management issues

Don't Ignore These Seven Retirement Saving Ideas

Everyone knows it's important to save for retirement. But what are the best ways to do it while minimizing the impact of taxes on your savings? These seven practical strategies can help:

1. Focus on 401(k) salary deferrals. If your employer offers a 401(k) plan, allocate as much of your salary as you can to payroll deductions. For 2017, the IRS allows you to defer as much as $18,000 of your compensation, or $24,000 if you're age 50 or over. If you've been putting in the bare minimum the past few years, it may be time to dig a little deeper. The impact of investing your contributions, which compound without current tax, may far exceed your expectations.

2. Take advantage of your employer's match. Many companies agree to match part of what you contribute to a 401(k), up to a stated percentage. For instance, your employer may match half of the first 6% of your compensation that you put into your plan. So if you earn $100,000 a year that would add $3,000 to the account each year. And while employer contributions sometimes are subject to a vesting schedule, with some money held back until you've worked for a company for several years, there's no downside to increasing your contribution to take advantage of this benefit.

3. Learn the rollover trick. If you've been building up your 401(k) or another kind of employer-sponsored account, you'll need to decide what to do with that money when you leave the job. Although you could take part or all of the payout in cash, you'll be depleting your retirement savings and owe income tax on the money you withdraw. It's usually better to leave the funds in the existing plan, transfer them to a plan at your new company, or "roll over" the funds to a traditional IRA—any of which can let you continue the tax-deferred earnings. You won't be taxed as long as you complete the rollover within 60 days. To avoid having tax withheld, which you would have to recoup on your tax return, you can arrange a "trustee-to-trustee" transfer.

4. Consider a Roth conversion. Your traditional IRA could come to represent a significant portion of your retirement savings, particularly if you've rolled over funds from other accounts. Deferring taxes on that money until you withdraw funds during retirement can be beneficial, but another approach is to convert some or all of your IRA to a Roth IRA. Though you'll have to pay taxes now on the conversion, future distributions after age 59 may be tax-free. You could

(Continued on page 4)

COMPASS Corner

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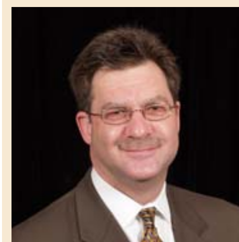

The stock market turned in its best quarterly performance in several years during the first three months of 2017. The Russell 3000 Index, a broad proxy for U.S. stocks, generated a total return of 5.74% during the first quarter, whereas international stocks, represented by the MSCI EAFE Index, gained 7.25%, boosted by weakness in the U.S. dollar during the quarter (the local currency return of the MSCI EAFE Index was only 4%). At quarter's end, market participants appeared to be growing increasingly wary of whether President Trump's agenda of tax and regulatory reform, as well as infrastructure spending were at risk following the Administration's inability to get a vote on its health care plan.

The yield on the 10-year U.S. Treasury ended the quarter at 2.40%, about where it began 2017. The bond market eked out a small gain of 0.82% for the first quarter. High-yield bonds continued to perform well, in concert with the stock market.

Given the 12% move in U.S. stocks since the election and the near-term challenges facing the new Administration in getting legislation passed, COMPASS believes that the market is susceptible to a 5% – 10% pullback. A pullback at the higher end of that range would only take the U.S. stock market back to its pre-election levels. However, should President Trump's agenda begin to gain traction with legislation on Capitol Hill, the stock market would react positively.

This Type Of Trust Is A Failure

Trusts come in many shapes and sizes, but you could divide them into two broad groups—grantor trusts and non-grantor trusts. There's also a third type, however—the "intentionally defective grantor trust," or IDGT, that is designed to break tax rules for estate planning purposes.

With a grantor trust, the grantor —the person who creates it —retains considerable power over how it's administered, including the rights to amend, revoke, or terminate the trust. The grantor also maintains control over the trust assets. Typically, the grantor is a beneficiary of the trust income and principal. For instance, the grantor could be the primary beneficiary, with other family members entitled to the remainder. The grantor also can act as the trustee responsible for administering the trust.

With non-grantor trusts, however, grantors give up all of those rights. They aren't entitled to the income or the principal and, usually, payouts from the trust go to other family members. Also, the grantor cannot be the trustee of a non-grantor trust.

Now consider the tax implications. Because grantors retain control over grantor trusts, they're taxed for the income the trusts produce. For grantors in higher tax brackets—including the top bracket, with its 39.6% tax rate—the income tax consequences can be significant. In contrast, income earned by a non-grantor trust is taxed to the trust itself, not to the grantor.

But that can be a problem because trusts pay comparatively high tax rates. For instance, that top 39.6% rate kicks in when trust income exceeds $12,500 in 2017. Compare that to the $470,700 threshold for the top rate for a married grantor who files a joint return, or $418,400 for a single filer. That can translate into very high taxes for a non-grantor trust.

But that's where an IDGT may come to the rescue. As long as the grantor retains certain powers, the grantor, rather than the trust, will be taxed on trust income—even if none of that income goes to that person. An IDGT trust is set up so that it will purposely fail to qualify as a non-grantor trust, thus avoiding the higher taxes that come with the non-grantor designation.

What about estate and gift taxes? Money you transfer to an IDGT is treated as a taxable gift, but there's a current individual exemption of $5.49 million in 2017 that could reduce or eliminate your tax liability for the gift. (There also are other ways to structure this transfer so that it's not considered a gift at all.) In addition, the assets you transfer into the trust are no longer in your taxable estate, whose value will be reduced further by the annual taxes you pay on trust assets.

But IDGTs are complex arrangements, and you'll need the help of an experienced estate planning professional to create a trust that fits your needs. Seek expert assistance. ●

Avoid Squabbling Over Your Estate

Don't assume that you're immune from the sort of dire consequences that can tear apart a family after you're gone. What often starts as a minor beef over a few prized possessions can turn into a full-fledged war. Things can get even worse if distant relatives show up out of the blue, staking their claim. But you might be able to avoid future family squabbles by addressing these issues now. Start by listing your assets and deciding who will get what and when.

Here are several areas that may require some extra attention:

Business ownership. This can be complex if you run a company and have to decide who will be named as your successor. Figure out the best person (or persons) to take the helm. If that arrangement disproportionately benefits one or more heirs, you might designate other assets to go to the others to keep things fair. One possibility is to use a buy-sell agreement facilitating the sale of business interests. Note that it may be crucial to start by establishing the value of any business you own.

Vacation homes. Transferring rights to a principal residence is often straightforward, but what about that cabin in the woods or your seaside cottage? If you have several children, splitting ownership may be a problem if one child's family expects to get more use out of the place. If you can't work out an equitable solution, consider selling the vacation home and dividing the proceeds.

Second marriages. Suppose you've remarried (perhaps more than once) and you or your spouse—or both of you—have children from a prior marriage. Depending on how your will is worded, all of the children from both sides of the family may share evenly in the estate. As an alternative, you could use a trust as a vehicle for passing assets to particular beneficiaries you've chosen.

Top Results For Social Security Benefits

What's the payoff for working most of your life and paying Social Security tax into the system? When your time to retire finally comes, you'll be eligible to receive Social Security benefits based on your work history and when you choose to begin receiving benefits. If you're married, you may have additional options for Social Security, even if one spouse has worked little or not at all.

A particular couple's optimal strategy depends on your age, the age of your spouse, and your health status, among other factors.

Your basic options for receiving benefits are to start early, begin benefits at your full retirement age (FRA), or to delay benefits until later.

- You can begin receiving Social Security retirement benefits as early as age 62, but if you do, you'll lock in smaller benefits than you would have gotten if you'd waited longer. If you retire at age 62, your benefit will be about 25% lower than if you waited until FRA.
- If you wait until FRA (also called "normal retirement age") to apply for benefits, there's no reduction. Your FRA depends on the year in which you were born. For most post-World War II Baby Boomers, the age is 66. However, FRA increases gradually and tops out at age 67 for those born after 1960.
- Finally, if you postpone your benefits until after FRA, you'll receive an increased monthly payment. For each year you wait, you'll get about 8% more, until you reach age 70. (Waiting past 70 doesn't increase your benefit amount.)

These basic rules apply to individuals. If you're married, you can claim benefits based on your own work record or you can get 50% of the benefit your spouse is entitled to, if that's higher.

Because Social Security benefits are guaranteed for life, starting early with a smaller benefit still could deliver significant income over your remaining years. Yet you may collect more overall if you start later or if you live for a long time. According to the Social Security Administration (SSA) the average life expectancy of someone at age 65 is now 84.3 years for a male and 86.6 years for a female.

What should a married couple do? Every situation is somewhat different, but consider these three common scenarios:

Scenario 1. Adam and Eve are close in age and income. Because they're both in good health and enjoy their jobs, they plan on working past FRA. They also have enough savings, plus their work income, to sustain them easily until age 70. Currently, Adam has a life expectancy of age 88, while Eve's is age 90. If they elect early benefits at age 62, they would be entitled to an estimated lifetime benefit of almost $1.25 million. But if they wait until age 70 to apply for benefits and then live as long as expected, they could receive close to $125,000 more.

Scenario 2. In our next example, Romeo and Juliet have shorter life expectancies due to health issues. Currently, Romeo has a life expectancy of age 78 and Juliet has a life expectancy of age 76. If they claim benefits at FRA, it's estimated that the couple will receive almost $100,000 more than if they delayed benefits until age 70, based on their life expectancies.

Scenario 3. Jack and Jill are both in their early sixties. Jill is in better health than Jack. If they start benefits at age 62, let's say Jack would get $1,500 a month and Jill $750 per month. Those amounts would rise to $2,000 monthly for Jack and $1,000 for Jill if they claim benefits at FRA. However, by delaying benefits until age 70, Jack will receive about $2,650 a month. What's more, if Jill outlives Jack as expected, she is entitled to benefits based on 50% of Jack's higher monthly amount. Depending on how long Jill lives, her total benefits easily could increase by $50,000 or even more.

One of these scenarios might be similar to your situation, but you'll need to factor in your own variables —including how long you want to or need to work, as well as other financial and personal considerations and your health status—as you consider the best times for you and your spouse to begin receiving Social Security benefits. ●

Jewelry and other valuables. When it comes to handing down your assets, don't leave any stone unturned, especially if it's a rare diamond. Catalog all valuables and family heirlooms and make sure you've accounted for the major pieces in your will.

Of course, it's your business, house, and valuables, and you can do whatever you want with them. But it probably won't hurt—and it most likely will help—to open a dialogue with other family members. You may be able to head off potential problems by clearing the air instead of letting things fester.

One of the best things you can do is spell out your wishes clearly in your will and attach a letter of instruction for clarification. In some cases, it also makes sense to film a video showing that you were of a "sound mind" at the time that you made these decisions. ●

It's A Question Of Proper Balance

Do you tend to put off certain chores—maybe cleaning the gutters, organizing your files, or changing batteries in smoke detectors? Most people can add another item to their to-do list: rebalancing a portfolio. However, unlike neglecting some of the others, failing to rebalance could result in significant financial losses.

Why do you have to rebalance in the first place? If you keep your holdings intact without making any changes, your preferred asset allocation will eventually get out of kilter. As a result, you could be exposing yourself to considerably more risk than you expect or consider acceptable.

Let's say you've determined the optimal approach for your current needs is to maintain a portfolio with 50% allocated to stocks, 30% to bonds, and 20% to cash and other vehicles. (This is a purely hypothetical example and not indicative of any specific portfolio.) If the value of your stocks has increased during the past year, your portfolio might now have 75% in stocks, 15% in bonds, and 10% in cash and other investments. Stocks are historically more volatile than other assets, and with that heavier concentration, you may not feel comfortable with your risk exposure. To get back to your previous allocation, you could sell some shares and put the proceeds into bonds and cash.

Similarly, if the value of your stocks has declined so that they represent only 35% of your portfolio, you may want to convert some of your other holdings into stocks.

There are several other direct and indirect reasons for rebalancing. Consider these three:

- It encourages you to cash in profits from investments that have done well and shift those funds to other investments that have merit but have yet to increase in value.
- It gives you the opportunity to review the mutual funds in your portfolio to see whether they're still performing up to your expectations.
- It can smooth out investment returns. All asset classes are cyclical, so rebalancing removes some of the inherent volatility associated with investing.

How often should you rebalance? For many investors, it makes sense to do it twice a year to keep a portfolio on track. Certainly, you should rebalance at least once a year. Another approach is to rebalance whenever an asset class deviates from its target percentage by a specific amount—perhaps five percentage points. For example, a portfolio with a 50% target allocation in stocks would be rebalanced any time the value rises to 55% or sinks to 45%.

Rebalancing is an important part of long-term investment management. It ensures that you are buying asset classes when they drop in value and don't overweight investments that have appreciated. Over a long period, it can make a major difference in a portfolio's performance and risk exposure. In addition, rebalancing can be managed for tax efficiency. Our firm handles rebalancing for clients we work with. ●

7 Retirement Saving Ideas

(Continued from page 1)

spread out that tax hit by making the conversion over several years.

5. Go directly to a Roth. If you meet the requirements, you can establish and contribute directly to a Roth IRA. For 2017, the maximum contribution (to all of your IRAs, Roth or traditional) is $5,500, or $6,500 if you're age 50 or over. So if you're age 55, you could decide to contribute $4,000 to a Roth and $2,500 to a traditional IRA. The sticking point here is the income limit for contributing to a Roth IRA—in 2017, the phase-out begins at $118,000 of modified adjusted gross income (MAGI) for single filers and $186,000 of MAGI for joint filers.

6. Maximize benefits from taxable accounts. Although the tax law favors 401(k) plans and IRAs, "taxable" accounts can bring tax benefits, too. Long-term capital gains from securities sales are taxed at a maximum rate of 15%, or 20% if you're in the top ordinary income tax bracket of 39.6%. And you can use losses from asset sales to offset capital gains (both long-term and short-term) and up to $3,000 of ordinary income.

7. Balance your portfolio. Beyond choosing the right kinds of accounts for your retirement savings, it's also important to have a solid long-term plan for investing that money. Try to make sure that you strike a good balance between meeting your objectives and staying within your personal risk tolerance. Then review your portfolio choices at least once a year and adjust as needed to reflect changes in your circumstances or the performance of different kinds of assets. ●

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