The COMPASS Chronicle

Summer 2017 *Highlighting important wealth management issues*

Live Longer And Prosper In Your Golden Years

Are you part of the baby boomer generation that now is surging into retirement? Or are you a member of "Generation X," which isn't far behind? In either case, some traditional ideas about retirement no longer may apply.

For one thing, people now live longer than in the past, which means that their golden years will last longer, too. The average life expectancy for someone in the U.S. who now is age 65 is 84.3 years. And that number, which has grown steadily for many decades, is expected to go even higher.

Maybe the "new" 65 is 70 or even 75.

What is the main implication of this change? By living longer, it's likely you'll have to save more for retirement, or figure out ways to stretch your dollars further if you want to maintain a comfortable lifestyle. If you do nothing, you could run the risk of outliving your retirement savings. You'll also have a lot less, if anything at all, to pass on to your heirs.

Fortunately, there are several potential solutions to this dilemma. Consider these six options:

1. Invest for the longer term. You're already in it for the long haul. But some additional tinkering with your investment portfolio may allow your assets to last even longer. For example, you could minimize some risks of a market downturn by making sure you have a well-diversified portfolio. Of course, there are no guarantees against a loss of principal, especially in a declining market.

2. Bulk up your 401(k) and IRAs. Assuming you're still working full-time, do whatever you can to boost your annual contributions to your 401(k) plan and IRAs. For 2017, someone age 50 or over can contribute a maximum of $24,000 to a 401(k) and $6,500 to an IRA. (The 2017 figures are $18,000 and $5,500, respectively, for younger savers.) Your IRA contribution could be split between a traditional IRA and a Roth IRA.

3. Postpone Social Security benefits. Although you can receive your full Social Security retirement benefits at your "full retirement age" (FRA)—age 66 for most baby boomers—you're entitled to even higher monthly benefits if you postpone taking benefits until as late as age 70. This may be preferable if you expect to live a long time.

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COMPASS Corner

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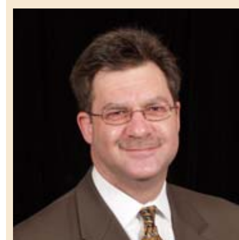

U.S. stocks completed their best first half performance since 2013 with the Russell 3000 Index, a broad measure of U.S. stocks, gaining 3.0% during the second quarter and 8.9% for the first half. While the stocks of smaller companies have gained this year, they have lagged their larger brethren after a strong showing in 2016. International stocks were the best performers for both the second quarter and year-to-date periods. As represented by the MSCI EAFE Index, stocks among the international developed countries generated returns of 6.1% for the second quarter, twice that of U.S. stocks, and 13.8% year-to-date, though more than one-half of these returns has been due to a depreciation in the U.S. dollar.

Bonds continued their strength as prices rose and interest rates drifted lower from their year-end peak. The Bloomberg Barclays U.S. Aggregate Bond Index rose 1.45% and 2.27% for the three- and six-month time frames, respectively.

The recent performance of the U.S. capital markets appears to be in conflict. Whereas the bond market has rallied this year, in part a reflection that President Trump's legislative agenda has been delayed, the stock market also continued its rally on the expectation of Trump's pro-business platform. The stock and bond markets cannot both be correct in the short term. COMPASS believes that the bond market is correct in its assessment and, consequently, the stock market is susceptible to a pullback.

How Now, Dow Jones Industrials?

You see it reported every day in the financial news: The Dow Jones Industrial Average (DJIA). And the Dow made headlines back on January 25, 2017, when it cracked the 20,000-point mark for the first time in its history. But what exactly is the DJIA and what do the fluctuations in points really mean?

The DJIA is a long-time barometer for the way the stock market is moving although it's not the only one, and it may not be the best measure of the thousands of stocks listed on the major exchanges. Some experts consider the Standard & Poor's (S&P) 500 and the NASDAQ to be more reliable indicators. Nevertheless, even if you don't put much store into whether the DJIA goes up or down on a given day, it does have an interesting history.

The Dow measures the movements of just 30 stocks. Traditionally, those have included the "blue-chip" companies considered to be the bedrock of the American economy. So, when the DJIA finally punched through the 20,000-point mark, it may have seemed like a triumph for the economy as a whole.

The roots of today's DJIA can be traced back to before 1900. Charles Dow, co-founder of *The Wall Street Journal*, simply added up the closing prices of one share of each of a dozen companies he had selected to measure, and then divided the total by 12 to arrive at a daily average. Subsequently, the list was expanded to include 30 of the top industrial companies, with the daily average computed by dividing the total price of those stocks by 30.

But the math became trickier over time as stocks began to split and share prices became skewed. The solution to keep the DJIA going was to make periodic adjustments in the figures in order to keep the average historically consistent. Despite this change, this indicator still is referred to as an "average," although these days it isn't.

What's more, the ever-changing list is no longer limited to industrials. It now includes major retailers, technology companies, and financial services firms.

Also, of course, the percentage gains grow smaller as the total number of points goes higher. For instance, when the Dow reached the 6,000-point level more than 20 years ago, that represented a 20% increase from the 5,000-point mark. But the jump from 19,000 points to 20,000 points, another 1,000-point gain, was just a 5.3% increase.

In any event, don't discount the psychological and emotional impact that swings up and down in the Dow may have. You can't help hearing it on the news every day and it often affects investor judgment, especially when the economy is in turmoil or is booming. ●

Sowing Tax Seeds For Capital Gains

Most investors know all about the tax reasons for "harvesting" capital losses. But if you're considering a sale of assets that have gained in value, keep in mind that harvesting long-term capital gains can offer tax advantages as well.

Capital gains and losses from securities transactions, as well as other disposition of capital assets, are used to offset each other. Thus, if you're showing a net capital gain for the year, you might realize a loss, especially at the end of the year. The loss can negate the gain plus up to $3,000 of highly taxed ordinary income. And any leftover losses can be carried over to use the following year.

On the other side of the ledger, short-term capital gains from sales of securities you've held for a year or less are taxed at ordinary income rates. But gains that qualify as long-term—from selling securities you've held longer than one year—are taxed under special rules.

If you're in one of the two lowest ordinary income brackets of 10% and 15%, your maximum tax rate on long-term capital gains is 0%. If you're in higher brackets, the news isn't quite as good, but in most cases long-term gains still are taxed at just 15%. And even if you're in the top income bracket of 39.6%, your maximum tax rate on long-term capital gains is 20%.

Suppose you're a joint filer with taxable income of $100,000 this year. That puts you in the 28% bracket. Harvest a long-term capital gain of $10,000 from a securities sale, and you'll owe tax of $1,500. That compares with a tax bill of $2,800 if you realize a $10,000 gain on short-term holdings.

But even long-term gains count as "net investment income" (NII) and could be subject to an

Spell Out Plans For Inherited IRA Assets

Do you have substantial assets in your IRAs? It's important to be smart about beneficiary designations, and maximizing tax benefits, while avoiding potential pitfalls. But it's also essential not just to fill out all of the paperwork and forget about it. Instead, take the time to discuss your plans with family members.

Spouses who inherit traditional IRA assets have more flexibility than other beneficiaries, though non-spouses, too, can benefit from careful planning to determine the best ways to pass along money in an IRA. Here are key points to cover in your family discussions:

The first thing to do is to bring everyone up to speed on the differences between spouses and other beneficiaries.

1. Spousal beneficiaries: Spouses who are IRA beneficiaries can move the money into their own IRAs and treat it just like other assets in those accounts. They can do this without owing any tax, and if they haven't yet reached age 70½, they won't have to take the required minimum distributions (RMDs) that must begin after you reach that milestone. (But if your spouse who died already was taking RMDs, you'll need to make that withdrawal for the year of death.)

That doesn't mean a spouse can't withdraw some or all of the money in the inherited account. But any distribution will be taxed, probably as regular income. So it's generally better for tax purposes to take a series of distributions stretched over several years.

2. Non-spousal beneficiaries: If you bequeath IRA assets to your children or to anyone other than your spouse, those beneficiaries will have to follow different rules. They can't roll over the money tax-free into IRAs of their own. Instead, they must arrange to receive a series of distributions based on their life expectancies or empty out the inherited accounts within five years. Because beneficiaries tend to be younger than the deceased IRA owner, they often can use the strategy of withdrawing funds gradually over their life expectancies, an approach often referred to as a "stretch IRA."

But those non-spouse beneficiaries *will* have to take annual RMDs regardless of how old they are. Because the amount of those yearly withdrawals depends on the inheritor's age, younger beneficiaries will be able to take smaller RMDs than those who are older. But if they fail to take an RMD in any year they'll be hit by a penalty of 50% of the amount that should have been withdrawn. They'll also owe regular tax.

The amount of these RMDs will be based on the account balances on December 31 of the prior year and a factor based on the beneficiary's projected life expectancy in IRS-prescribed tables. You have until December 31 of the current year to receive your RMDs, which generally will be calculated and paid out by the custodian of your IRA.

Of course, non-spousal beneficiaries, too, can choose to withdraw more than the required amount or to take a lump-sum distribution of everything in the account.

With these basic rules in place, there can be several strategies to maximize tax and other benefits. For example, naming younger beneficiaries could extend the life of a stretch IRA and reduce the amount that is lost to taxes. One way to do that, if your children don't need the funds, is to designate your grandchildren as beneficiaries. Or you could name a child as a primary beneficiary and a grandchild as a contingent beneficiary. When you pass away, the child would have the option to "disclaim" the inheritance, passing it along to the contingent beneficiary and thus lengthening the payout schedule. As long as assets remain within the IRA they won't be subject to current taxes.

The family members who inherit IRA assets then can make their own beneficiary designations immediately, selecting a spouse or a child to inherit the account. Your beneficiaries also will be able to avail themselves of strategies for extending the life of the IRA.

These rules cover assets in traditional IRAs. There are different requirements for Roth IRAs, from which most distributions, even by beneficiaries, are tax-free. The original account holders don't have to take RMDs, although beneficiaries are required to withdraw money each year according to schedules based on their life expectancies. ●

additional 3.8% surtax. That tax applies to your NII or the amount by which your modified adjusted income exceeds $200,000, or $250,000 for those who file jointly, whichever is less. That extra tax could reduce the advantage of harvesting long-term gains.

And if you do realize a long-term gain, think twice before taking a loss on another holding to offset that gain. Capital losses are more valuable if they're used to absorb highly taxed short-term gains. If you've already taken a loss, you may want to consider whether it would make sense to use it by harvesting a short-term gain.

These rules could change, if and when Congress passes any of the tax reforms currently being debated. As possible changes come into focus, we can help you decide whether to make specific transactions you're contemplating this year. ●

Q's And A's About Financial Aid

Will your teenaged child be applying to colleges soon? Although you may be concerned about the ever-rising cost of higher education, your student may qualify for financial aid through various sources. In fact, billions of dollars are handed out each year, and more than half of full-time students get aid through grants and scholarships and roughly one-third via loans.

Here are the answers to some common questions about financial aid:

Q. Do we make too much money to qualify?

A. This is a concern for many parents, but don't assume you won't qualify for aid, which can come in many different forms. Your child's eligibility will depend on your family income, whether you have other family members, medical expenses, and other circumstances. Your chances may be better than you think.

Q. How do we apply for aid?

A. If you want to get financial help, your child needs to submit a Free Application for Federal Student Aid (FAFSA). The FAFSA determines eligibility for federal and state grants to students, work-study programs, and federal loans. You should complete the form as soon as possible after October 1 of the year before your child will enter college.

Q. Are there other forms to complete?

A. Possibly. Some schools also require students to submit the CSS Financial Aid PROFILE. And certain colleges and state agencies may request that other forms be filled out.

Q. How can I estimate the financial aid we will receive?

According to the College Board, the best way to estimate how much financial aid a college will offer you is to use the college's "net price" calculator, usually posted on its website. A net price calculator provides an estimate of your net price at the college (i.e., the cost of attendance minus the financial aid).

Q. Does my child have to be an A student to receive aid?

A. Not necessarily. While some colleges offer merit scholarships based on performance in high school, most governmental aid is need-based. But your kid can't be flunking out, either. In addition, to retain financial aid through college, your child needs to remain in good academic standing.

Q. Does applying for financial aid affect the chances of being admitted?

A. Usually not, although some schools may favor applicants who can pay the full cost of education. Normally schools base admission decisions on other factors, including academic performance and activities. But keep in mind that a school's available aid can be exhausted quickly, so have your child apply promptly.

Q. Can financial aid be revised?

A. Yes. This year's determination may not apply to future years, and colleges may review your financial aid package if your personal situation changes. If you have a pressing need for additional aid, you should let the financial aid office know. ●

Prosper In Your Golden Years

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4. Slow down RMDs. After you reach age 70½, you normally have to take required minimum distributions (RMDs) from traditional retirement plans such as 401(k)s and IRAs. The minimum amount you must withdraw is based on your life expectancy and the account balance on December 31 of the prior year. If you can resist the temptation to take more than you're legally required to you'll preserve more of your assets for retirement.

5. Consider the tax implications. When you need to start withdrawing funds for retirement, where should you turn first? This is a complex decision that requires careful thought as far as taxes are concerned. For example, if you anticipate being in a higher tax bracket during retirement than you are now, you might withdraw funds from taxable accounts first and Roth IRAs last, so the Roth funds can keep growing tax-free. If you expect your tax bracket to plummet, you might do the opposite. Financial and tax advisors can help you devise a strategy that works for you.

6. Work for a longer time. If you still think your retirement is underfunded, you might postpone retirement by working full-time for an extra few years, or you could use the earnings from a part-time job to supplement your retirement income. Also, working longer may postpone RMDs. ●

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