

# The COMPASS Chronicle

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Highlighting important wealth management issues

## Five Documents At The Core Of An Estate Plan

Every estate plan is unique because of a particular family's circumstances. Still, most people share many primary objectives that may be reflected in five documents often found at the core of a plan.

If your current estate plan doesn't include these five items, you might need to fill the gaps. And if you don't yet have a comprehensive estate plan in place, it's probably time to make that a priority. Mortality can sneak up on anyone.

**1. Financial power of attorney:** A power of attorney is a legal document that authorizes another person to act on your behalf. A financial power of attorney enables the "attorney-in-fact"—the person specified to act for you—to conduct your financial

affairs. Many states have a standard form for financial power of attorney.

Usually, the power of attorney is "durable," meaning that it remains in effect in the event you are incapacitated. But you might use a non-durable power of attorney for specific purposes, such as to have someone manage your portfolio temporarily. Keep in mind that a power of attorney is enforceable only when it has been established before its creator becomes incompetent.

**2. Health care power of attorney:** Like a financial power of attorney, this authorizes a designated person to act on your behalf in the event you're unable

to make your own decisions—in this case, about your medical care. This goes further than a living will, which generally applies only if you're terminally ill or on life support, based on the prevailing state law.

Your attorney-in-fact for a health care power of attorney needs to be someone you can trust to act in your best interests. Typically, that would be a spouse, a child, or another close family member. But you'll also need to name contingent and successor agents.

**3. Health care directives:** Although there are several other kinds of health care directives that you might include in your estate plan, the most common version is a living will. Without it, family members may be left in a

quandary about end-of-life decisions involving your care. This can lead to turmoil and questions could even end up being decided in court.

Often a health care power of attorney is coordinated with a living will, or the two may be combined in a single document. Some states have forms combining these elements and reflecting other personal choices such as whether to donate your organs.

**4. Will:** No matter how sophisticated your estate plan is, you'll likely circle back to the need for a will to tie everything together. A will can be



## COMPASS Corner

Louis E. Conrad II, CFA®



Stock markets around the world continued to advance during the fourth quarter, repeatedly reaching record

levels. The current bull market, at almost nine years old, is now the second-oldest and second-strongest in U.S. history. The U.S. market hasn't suffered from a 5% or greater pullback since early 2016 and volatility has been uncharacteristically low.

The Russell 3000 Index, a broad proxy for the U.S. stock market, gained 6.3% for the fourth quarter and 21.1% for 2017. Larger, growth-oriented stocks, such as technology stocks, performed best during the year, advancing roughly 30%. International developed market stocks also enjoyed a strong year, with the MSCI EAFE Index appreciating 25.0%, though they didn't quite keep pace with U.S. stocks in the fourth quarter, increasing 4.2%.

Bond returns were generally negligible during the fourth quarter, though they performed better for 2017 overall as interest rates declined slightly year-over-year. The Bloomberg Barclays U.S. Aggregate Bond Index gained 0.4% and 3.5% for each period, respectively. High-yield bonds and, to a lesser extent, floating rate bonds, both held in client portfolios, outperformed the returns of the broader bond market.

Separately, I am pleased to announce the addition of Theodore J. ("TJ") van Gerven to COMPASS Wealth Management, LLC. TJ joined COMPASS in November as an Associate Wealth Manager. He was formerly associated with RBH Global Wealth Partners of Reston, Virginia.

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# This Tax-Free Rollover Goes Right To Charity

The tax law provides a unique planning opportunity for retirees who have to take required minimum distributions (RMDs). You're allowed to transfer funds directly from your traditional IRA to a qualified charitable organization without paying any federal income tax on the distribution. Although the contribution isn't tax deductible, it does count toward your RMD for the year.

This tax break—sometimes called a “charitable rollover”—had expired and been reinstated several times. Thanks to the Protecting Americans from Tax Hikes (PATH) Act of 2015, however, the tax provision is now permanent.

Under the PATH Act, someone who's at least age 70½—the age at which RMDs must begin—can instruct an IRA custodian to move up to \$100,000 of funds from that person's IRA to a favorite charity. A married couple can transfer up to \$200,000, assuming they're both old enough to begin taking RMDs.

Can't you accomplish the same result by taking a taxable IRA distribution and then donating that amount to charity? Not exactly. There

are several other factors to consider, including annual limits on deductions for donations to charity, plus potential tax return complications. What's more, the direct rollover is valuable to non-itemizers who aren't eligible to deduct charitable contributions. And this method is simpler.



There are, however, a few more details to attend to with this approach. To qualify for the tax exclusion, the distribution must be made directly from the IRA trustee to a qualified charitable organization. You're not allowed to use the funds temporarily before transferring them to the charity's coffers.

In addition, the contribution must otherwise qualify as a charitable donation. If the deductible amount decreases because of a benefit received in return—for example, the value of a dinner at a fundraiser—or the deduction would not be allowed due to inadequate substantiation, you can't take the exclusion.

A bonus is that you're required to start taking RMDs in the year after the year in which you turn age 70½. If you take a charitable rollover, you can meet this obligation without paying the usual tax on an IRA distribution.

This tax law provision also applies to Roth IRAs, though it may not be advisable to take this approach with a Roth. Roth IRA distributions to account

holders over age 59½ are usually tax-free, and it doesn't make sense to use money that isn't taxed to make a donation that isn't deductible. But a portion of a distribution may be taxable if your Roth hasn't been in existence for at least five years. In that case, it might be reasonable to transfer the taxable amount directly to a charity. ●

## Four Tax Strategies In Retirement

If you're like most people, you've invested in a crazy quilt of assets ranging from stocks and bonds to real estate to precious metals. Amid this dizzying variety, the prevailing tax rules can provide further complications, especially after you've retired.

One overarching rule is that you must begin taking “required minimum distributions” from retirement plans such as 401(k)s and traditional IRAs after age 70½. Because these distributions are generally taxed at ordinary income rates, you could be facing a higher tax bill at just the wrong time.

But there are ways to ease the pain. Consider these four strategies for reducing the tax bite in years when you have to take RMDs.

**1. Harvest capital gains.** When you sell securities and other capital assets, your profits are taxed under special rules for capital gains. The maximum tax rate on long-term gains (on sales of assets you've held longer than a year) is 15%, or 20% if you're in the top tax bracket for ordinary income.

That lower rate is a benefit in itself. But another aspect of the law could help even more. Capital gains—including short-term gains,

which are taxed as ordinary income—are offset by capital losses, and if you've taken any losses earlier in the year, you might take profits now on short-term holdings, knowing they'll be absorbed by the losses. It's usually better to use losses to offset short-term rather than long-term gains because of the higher tax rate for short-term gains.

**2. Harvest capital losses.** With a capital loss, you can offset capital gains plus up to \$3,000 of ordinary income. If that still doesn't use all of your losses, you can carry over the excess to the following year. Typically, investors look to harvest

# 5 Steps To Realize An Early Retirement Dream

**H**ave you dreamed about getting out of the rat race and retiring early? You could live a simpler life, pursue personal passions such as travel or recreation, and reduce your stress level. But you might think an early retirement is just for multimillionaires and out of your reach.

Think again. Early retirement doesn't have to be a pipe dream. It could become a reality through some diligent planning and dedication to your goals. These five steps may push you along the way:

**Step 1:** Plan on spending less. Don't give up if retirement planning calculators show you'll need much more than what you believe you conceivably can set aside. You can put a sizable dent in the "nut" you have to crack by significantly reducing your spending habits.

Remember that you won't be incurring commuting costs and a high-priced wardrobe for your job once you leave work. Furthermore, if you're hoping to travel around the world, you may be able to do it on a tighter budget than you thought. And simplifying your lifestyle—for example, maintaining just one car (or not even having one) instead of two—will provide savings.

Of course, life likely will throw you some curveballs, so be prepared for that, too. Build a cushion into your plan.

**Step 2:** Downsize your home. Part and parcel of the first step to early retirement is a reduction in housing costs. For most people, this is the single largest drain on savings. Do you really need that rambling colonial in the

suburbs if your kids are grown and out of the house? This can be especially beneficial if the mortgage is paid off. You can sell the home at a sizable gain, move to a less expensive place, and pocket the difference.

Consider a retirement community if you're age 55 or older. If that's not the right fit, look for housing that's affordable but gives you the flexibility you want. For some early retirees, it's an apartment in a city with easy access to restaurants and stores.

**Step 3:** Secure adequate health insurance. One of those curveballs could be your health. Even if you're in reasonably good shape as you enter early retirement, there's no way to predict what will follow. And your retirement could last longer than you initially expected.

Medicare kicks in at age 65 and you can supplement it with another policy. Prior to that age, the Affordable Care Act (ACA) has made it easier for some people to retire early, but the future of the ACA, in this current climate, is in jeopardy. Conduct in-depth research to find health insurance policies that provide the necessary coverage at a cost you can handle. Depending on your situation, you might opt for a high-deductible plan. In any event, you can't go without health insurance!

If you expect to be traveling extensively, include this in your health insurance considerations. For instance, you

may decide to obtain temporary travel insurance, based on your destinations.

**Step 4:** Maximize your investments. Saving more for retirement—and that includes how you invest your funds—may enable you to call it quits early.

Of course, everyone's situation is different. Put together a diversified portfolio that is aimed at your objectives while taking into account your personal risk tolerance. Frequently, your assets will involve a mix of stocks, bonds, mutual funds, and perhaps other investments such as real estate and exchange-traded funds (ETFs).

International investments, too, may be part of that mix, though such holdings bring special risks, including the potential that economic and political turmoil and currency fluctuations could affect the value of your investments.

**Step 5:** Count on taxes. Finally, don't dismiss taxes as a factor. Even if tax rates fall soon, they could rise again, and taxes always will erode your retirement savings to some degree. One strategy that may help is to move to a state with lower state tax rates.

Cashing in stocks during your retirement will result in capital gains, currently taxed at favorable rates, while distributions from retirement plans such as 401(k)s and traditional IRAs are taxed at higher rates for ordinary income. Also, payouts you take before age 59½ may be hit with a 10% tax penalty. (Roth IRA distributions can be tax-free, but you still may be penalized if you withdraw funds too early.) Remember that you must begin taking required minimum distributions (RMDs) from most retirement plans and traditional IRAs after age 70½. In addition, Social Security benefits may be subject to tax.

These and other steps can help take you closer to your dream of early retirement. ●

*Income-generating investments such as stocks, bonds, mutual funds, ETFs and real estate may offer attractive yields and other benefits, but they are complex investments with unique tax characteristics and significant risks. As a result, these investments may not be suitable for all clients. It is important to understand all the features, characteristics and risks of any particular investment offering under consideration. Consult with a tax advisor before investing in such income-generating investments.*



losses at year-end when they've already realized capital gains in prior months.

**3. Smooth out income.** Although you often can't control when taxable income comes in, you may be able to time some items to your tax



benefit. When possible, consider taking just enough income—some of which may come from selling investments—to "fill up" income to the top of your current tax bracket, trying to stay below the thresholds of a higher bracket.

#### **4. Rely on tax deferral.**

Tax-deferral strategies may help you to reduce your income, and your taxes, for a year or more. For example, if you sell real estate on the installment basis, only part of your gain will be realized in the year of the sale. Or you might simply wait until after the first of the year to sell securities at a gain. ●

# How You Can Manage Risk Aversion

**D**uring the early part of 2017, the stock market was rolling merrily along, with the Dow Jones Industrial Average (DJIA) breaking through the 20,000-point barrier for the first time. But the “Trump bump” won’t last forever and some prognosticators are forecasting eventual doom and gloom. In all likelihood, the stock market will continue to experience ups and downs, just like it has throughout its history.

Regardless of whether the market is going up or down, or staying relatively stable, your portfolio should reflect your personal aversion to risk. Primarily, there are three types of risk to address in this overall philosophy:

**1. Risk of loss of principal:** This is the risk of losing the money you initially invested. Say you buy a stock for \$1,000 that jumps to \$1,200 before it falls back to \$900. If you sell the stock at that point, you will have lost \$100 of principal.

**2. Risk of loss of purchasing power:** You may be willing to limp along with modest returns, but you’re losing money if the inflation rate exceeds your rate of return. For

instance, if you acquire a bank CD paying a 2% annual rate and inflation rises to 3.5%, you’re losing 1.5% in the purchasing power of that investment.

### 3. Risk of outliving your savings:

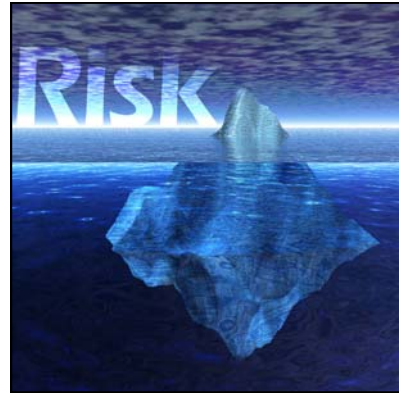
Is your investment plan overly conservative? Remember that the stock market historically has outperformed most comparable investments over long periods, although there are no absolute guarantees. Therefore, you’re likely to fare better with a well-devised investment plan than you would if you stuffed your money under a mattress. Otherwise, you might outlive your savings, especially given recent increases in life expectancies.

Risk assessment surveys can provide some insights. Typically, an analysis will reveal that you tend to be either a conservative, moderate, or aggressive investor, within certain ranges. Your portfolio should reflect this characterization.

If you indicate a more conservative bent, you may want to fine-tune your investments accordingly, taking into account asset allocation and diversification methods. Again, these strategies do not offer any guarantees, nor do they protect against losses in declining markets, but they remain fundamentally sound.

Other potential ideas are to

weight your portfolio more heavily to bonds than you did in your younger days. The technique of “bond laddering,” with bonds maturing at different dates, is a variation on this theme. Similarly, conservative investors may



emphasize dividend-paying stocks and blue chips, as well as mutual funds and exchange traded funds (ETFs) offering diversification.

Every situation is different. Reach out to us to address your specific concerns. ●

## The Core Of An Estate Plan

*(Continued from page 1)*

used for a wide range of purposes, including (but not limited to):

- Dividing your assets and allocating them to your beneficiaries;
- Naming guardians for your children;
- Achieving estate tax benefits;
- Arranging gifts to charity;
- Creating trusts for your beneficiaries;
- Excluding certain family members from inheriting your assets;
- Avoiding a lengthy probate process; and
- Thwarting potential legal challenges.

A will may refer to other documents in your estate plan. If you don’t have a legally valid will and you die “intestate,” your estate will be governed by the laws of the applicable state.

### 5. Revocable trusts:

Finally, your estate plan may include revocable trusts, which let you change terms based on future events or preferences. Such trusts are commonly called living trusts—or, more technically—inter vivos trusts—because you create them while you are alive.

With a revocable living trust, you can transfer assets to the trust to

be managed by a party you designate. The transferred assets aren’t subject to probate.

Other kinds of trusts can also be

created to complement the rest of your estate plan. These trusts might be designed to minimize potential state or federal estate taxes, as well as to protect assets from creditors or in



the event of a divorce.

This list of estate planning basics can be a good starting place for many families. You’ll need the help of an experienced attorney and other advisors to create a plan that fits your family’s needs. ●