YOUR FINANCIAL FUTURE

Your Guide to Life Planning

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In This Issue

Highlights

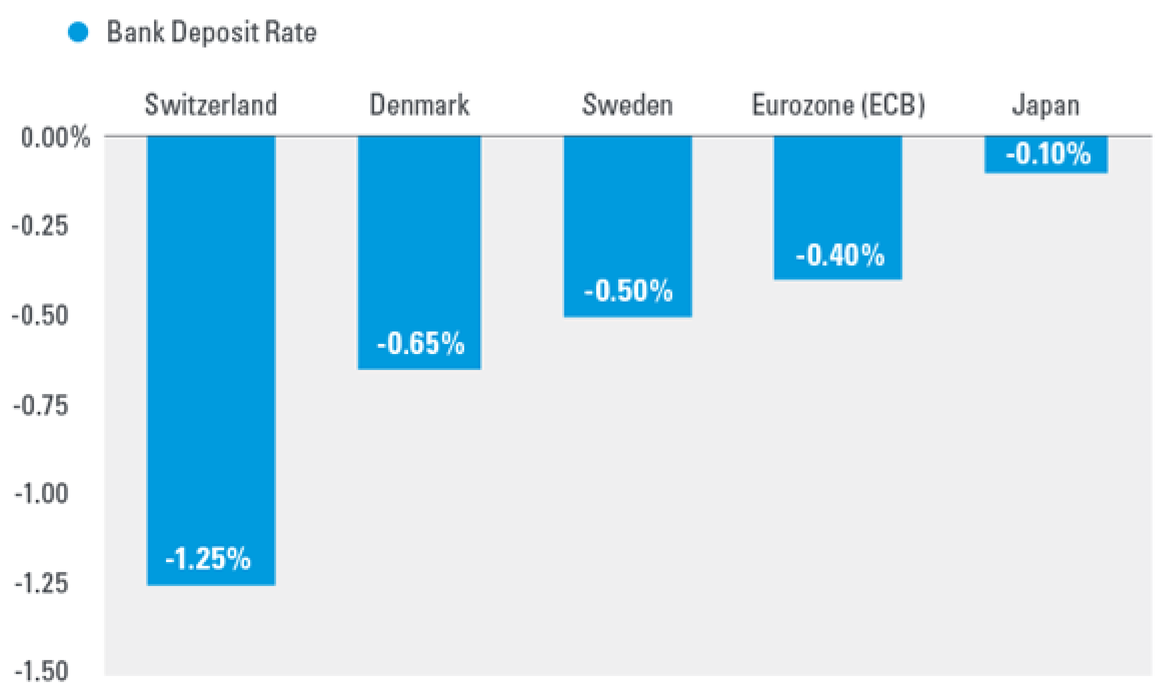
- Negative interest rate policies have had profound implications for bond investors thus far, but limited benefits for the economies intended to gain from them.
- The persistence of negative rates globally may keep demand for U.S. bonds elevated, limit any potential rise in interest rates, and keep bonds expensive for investors.

The Negative Rates Experiment

Negative interest rates are likely to persist as two central banks reiterated their commitment and a third, the Bank of Japan (BOJ), could do the same this week. Sweden's central bank maintained a -0.5% benchmark short-term interest rate and a -1.25% bank deposit rate but boosted its bond purchase program, and the European Central Bank (ECB) took a market-friendly turn as well by announcing easier than expected qualifying terms for corporate bond purchases.

Negative interest rate policies have had profound implications for bond investors thus far, but limited benefits for the economies intended to gain from them. Over the past two-and-a-half years, five countries have initiated the negative rates experiment, with Japan the most recent after cutting rates into negative territory in January 2016 [Figure 1]. By comparison, the Federal Reserve (Fed) pays a +0.5% deposit rate to banks who park excess cash at the Fed.

1 FIVE CENTRAL BANKS CHARGE NEGATIVE INTEREST RATES TO BANKS



Source: LPL Research, Bloomberg 04/25/16

WHY NEGATIVE RATES?

Increasing bank lending is one of the main goals of charging banks negative interest rates to keep their excess cash parked at a country's central bank. The negative rate is intended to motivate banks to lend out funds in an effort to boost economic growth. A secondary, but less publicized, motive is to weaken a domestic currency. The ECB cut bank lending rates into negative territory in mid-2014, less than two months after the euro flirted with 1.40 versus the U.S. dollar, at that time a three-year high. A weaker currency can not only boost a country's exports but may also boost inflation - another goal of central bankers in countries facing deflationary threats.

IS IT WORKING?

Although the jury is still out on the ultimate effectiveness of negative interest rates, early results are questionable. Measured by bank lending to the private sector and inflation, early results are slightly disappointing for the ECB and the BOJ. The ECB's many policy tools-including bond purchases, targeted lending programs, and negative interest rates-are having a positive impact as Euro Area lending to both individuals and non-financial corporations has improved. Despite the improvement, results are still lackluster overall, with lending to individuals up 2.1% annualized and lending to institutions flat at 0% (i.e., stopped decelerating), both annualized through the end of February 2016. This helps explain why the ECB took bold action in March 2016 by cutting rates further into negative territory and boosting its bond buying program.

Inflation readings also show that negative rates are not having the intended effect. Annualized inflation is still hovering near zero in both Japan and Europe, where it has been since the middle of 2015, suggesting that demand remains weak, a problem that negative rates may not be entirely capable of fixing. Deflation may have been averted but inflation has yet to materialize despite aggressive action from central banks.

When the BOJ ushered in negative interest rates in late January 2016, market reaction was decidedly negative. A loss of confidence in central banks was partly to blame for market volatility early in 2016. Rate cuts further into negative territory could erode investor confidence without some signs current policy is working.

OTHER CONSEQUENCES

Instituting negative interest rates policy has had knock-on effects for investors. Keep in mind that the vast majority of banks (in areas where negative deposit rates exist) do not impose negative interest rates on consumer deposits. In some cases, banks look to recoup negative rates by charging higher fees elsewhere or passing them along to institutional clients. Still, the policies have impacted financial markets in a few ways, including:

- **Lower bond yields.** By taking overnight borrowing rates into negative territory, central banks have pushed short-term bond yields into negative territory, forcing investors to extend maturity to obtain higher yields. In response, intermediate- and long-term bond yields have also declined, leading to "flatter" yield curves [Figure 2]. Although this may penalize savers, it is a desired result from a central bank perspective as its lowers the cost of borrowing for many. More than $7 trillion worth of government bonds trade with negative yields, out of a global bond market of nearly $100 trillion (Bank of International Settlements & Bloomberg data 04/25/16).
- **A stronger U.S. dollar.** Short-term interest rate differentials are a key driver of currency valuations. By lowering benchmark interest rates into negative territory, the U.S. dollar strengthened against major currencies such as the euro and yen from mid-2014 through the end of 2015. The U.S. dollar weakened slightly during the first quarter of 2016, but it remains elevated versus major currencies and has created economic challenges not only for U.S. manufacturing but also for international economies.
- **Increased demand for U.S. bonds.** Negative interest rates in Europe, coupled with the ECB's decision to further cut interest rates in March 2016 have been one factor behind outflows from European bond mutual funds, according to Investment Company Institute data. Assets under management in international bond funds have witnessed an approximate 30% decline since the start of the year through the end of March 2016. U.S. core bonds, on the other hand, have witnessed a 25% gain in assets-and this does not include other U.S. bond categories such as municipal, investment-grade corporate, and high-yield dedicated bond funds that have also witnessed respectable gains in assets so far in 2016. Strong demand for U.S. bonds has helped keep U.S. interest rates low despite prospects for Fed rate hikes in 2016 and beyond.

Concerns over global economic growth also played a role in the factors above, but these drivers are all intertwined.

Click here for Figure 2, U.S. & German Yield Curves Have More Often Flattened Following Rate Cuts into Negative Territory

RISKS

The above consequences are also partly in response to some of the risks associated with negative interest rates, including:

- **Bank risks.** Banks function as the grease that lubricates the wheels of the global economy. Negative interest rates

can harm a bank's profits and potentially impair its creditworthiness. Bank funding fears, although calm now, contributed to stock market weakness and Treasury strength in early 2016.
- **A bleak outlook.** Negative interest rates reflect weak economic growth and a potentially deflationary environment in the host country. Therefore, negative interest rates imply a poor investment outlook and may hinder investment necessary to engineer improvement in the local economy.

CONCLUSION

Based on a limited history, negative interest rate policies have yet to show any meaningful positive impact, and at the same time have created unintended consequences and risks from global financial markets. Thankfully, Fed Chair Janet Yellen has pushed back on the idea of negative rates in the U.S. In her press conference following the March 2016 Fed policy meeting, Yellen stated negative rates are not being considered and labeled the experience in other countries as "mixed" with both positive and negative impacts.

This week's Fed policy meeting will not include a press conference or economic projections, only the brief policy statement, and is unlikely to be a market mover. (See our recent *Weekly Economic Commentary* for more on this week's Fed meeting.) The BOJ also meets this week but is not expected to cut rates; however, according to Bloomberg consensus, additional stimulus, which could involve another rate cut, is expected by the end of June 2016. The persistence of negative rates around the globe may keep demand for U.S. bonds elevated, limit any potential rise in interest rates, and keep bonds expensive for investors.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

International debt securities involve special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards. These risks are often heightened for investments in emerging markets.

The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor’s yield may differ from the advertised yield.

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Rethinking Risk -- Common Barometers for Measuring Portfolio Performance

Financial experts have developed many methods for measuring risk, but beta and standard deviation are two of the most popular and useful options.

If you are researching new investment avenues, chances are "evaluating risk" tops your checklist. Financial experts have developed many methods for measuring risk, but beta and standard deviation are two of the most popular and useful options.

Beta calculates how much (or how little) an investment's price varies relative to a specific benchmark. For stocks, the S&P 500 is often used.[1] For bonds, it might be the Barclays U.S. Aggregate Bond Index.[2] The mechanics of beta are fairly simple: The benchmark is always assigned a risk rating of 1.0. So, if a stock has a beta of 1.1, for example, it has been 10% more volatile than the general market. If the market has a return of 10%, an investment with a beta of 1.1 would be expected to return 11%.

Similarly, if the market declines 10%, the investment would be expected to drop by 11%. Since it is calculated in relation to a benchmark, beta may provide a more accurate risk reading for specific asset classes and certain types of mutual funds than for individual securities.[3]

Standard deviation measures how much an investment's return fluctuates from its own longer-term average. Higher standard deviation typically indicates greater volatility -- but does not necessarily indicate a greater risk of loss. How so?

While standard deviation quantifies the variance of returns, it does not differentiate between gains and losses. Consistency of returns is what matters most. For example, if an investment declined 2% every month for a specified period of time, it would earn a seemingly positive standard deviation of zero. Alternatively, an investment that earned 8% one month and 12% the next would have a much higher standard deviation, but by most accounts it would be the preferable investment. The lesson to be learned? Greater volatility in and of itself is not necessarily a bad thing.

One of the key strengths of standard deviation and the reason it is the most commonly used risk barometer, is its universal applicability across asset classes and types of securities.

While understanding the role that risk plays in your portfolio is important, no amount of knowledge can eliminate risk entirely. That's why it is important to manage risk through diversification and other strategies.[4] Contact your financial professional to learn more about managing risk in your portfolio.

[1] *Investing in stocks involves risks, including loss of principal. Standard & Poor's Composite Index of 500 Stocks (the S&P 500) is an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.*

[2] *Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. The Barclays U.S. Aggregate Bond Index is considered representative of most U.S. traded investment grade bonds.*

[3] *Investing in mutual funds involves risk, including loss of principal. Mutual funds are offered and sold by prospectus only. You should carefully consider the investment objectives, risks, expenses and charges of the investment company before you invest. For more complete information about any mutual fund, including risks, charges and expenses, please contact your financial professional to obtain a prospectus. The prospectus contains this and other information. Read it carefully before you invest.*

[4] There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

1-371777

The Charitable IRA Transfer: Permanent at Last

A QCD can be made tax free, can help minimize your taxable estate, and can help fulfill your philanthropic desires -- all while satisfying your annual required minimum distribution.

In December 2015, President Obama signed into law the "Protecting Americans From Tax Hikes Act of 2015." This new ruling made permanent many tax breaks that had been dubbed "extenders" as taxpayers would have to wait -- typically until the last minute -- for lawmakers to reinstate them for another year. Among the most popular of the bunch is the IRA charitable transfer provision. So if you are age 70½ or older and charitably minded to boot, consider tapping your IRA.

The qualified charitable distribution (QCD), also known as an IRA charitable rollover, allows you to donate up to $100,000 per year to qualified charities. A QCD can be made tax free, can help minimize your taxable estate, and can help fulfill your philanthropic desires -- all while satisfying your annual required minimum distribution (RMD).

Benefits of a QCD

Without this provision, withdrawals from traditional IRAs and certain Roth IRAs (including those held for less than five years) would be taxed as income, even if they were directed immediately to a charity. While the donor would receive a tax deduction for his or her donation, various other federal and state tax rules would prevent the deduction from fully offsetting this taxable income. As a result, many donors have chosen not to use IRA assets for lifetime gifts. Now, the qualified charitable distribution permanently eliminates this problem. While there is no tax deduction allowed for the donated assets, they don't count as income either.

You may benefit most from implementing the QCD strategy if you:

- Do not need all of the income from your RMD.
- Want to avoid being taxed on your RMDs.
- Have significant assets in your IRA.
- Make charitable gifts, but don't itemize deductions. Generally, only taxpayers who itemize get federal income tax-saving benefits from charitable donations.
- Make a gift that is large, relative to your income. A QCD is not included in taxable income, therefore it does not count against the usual percentage limitations on using charitable deductions. In addition, by lowering your income, a QCD may potentially help you to lower your tax bracket and avoid higher taxes on Social Security benefits or tax surcharges such as the 3.8% net investment income tax.

Limitations of a QCD

There are limitations to making a QCD from your IRA, including the following:

- You must be at least 70½ years of age when the gift is transferred.
- Total gifts cannot exceed $100,000 per year, per IRA owner or beneficiary. Married taxpayers with separate IRAs can give up to $200,000 total, but no more than $100,000 may be distributed from each spouse's IRA.
- Gifts must be made directly from your IRA to a public charity. Private foundations, supporting organizations, and donor-advised funds are not eligible. You also cannot use the distribution to establish a charitable gift annuity or fund a charitable remainder trust.
- You can only make a donation from your traditional or Roth IRA. They cannot come from other employer-sponsored accounts, such as 401(k)s, 403(b)s, SEP-IRAs, or SIMPLE IRAs. You can, however, roll over funds from your 401(k) or 403(b) to an IRA to contribute to a charity.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

1-486481

The ABLE Act: Helping Disabled Americans Save for the Future

ABLE accounts can be set up starting this year, but as with 529 plans, individual states must take the lead in making them available to individuals and families.

Late last year President Obama signed into law legislation aimed at giving disabled Americans and their families the opportunity to save for education and other related expenses in a tax-friendly vehicle without jeopardizing their federal benefits.

What ABLE Offers

Modeled after 529 college savings plans, money invested in "Achieving a Better Life Experience" (ABLE) accounts can be withdrawn tax free to pay for qualified expenses including education and job training, transportation, health care, and housing.[1] Individuals can amass as much as $100,000 in such accounts without affecting their eligibility for Social Security Income (SSI) and other federal benefits. Further, Medicaid coverage will not be affected by how much money is accrued in an ABLE account.

This legislation marks a major departure from the financial constraints that -- up until now -- prevented people with disabilities from doing what the rest of us take for granted: setting aside money for future use. Prior to this law, to remain eligible for government assistance individuals had to report to the IRS any savings in excess of $2,000. (Assets placed in special needs trusts to be used for the benefit of the disabled person continue to be an exception, and do not disqualify that individual from receiving his or her government benefits.)

Not a Cure-All

Still, some restrictions apply. For instance, to qualify for an ABLE account, an individual must have experienced the onset of his or her disability prior to the age of 26. Each beneficiary can have only one account, and while there are no limits on how many family members and friends can contribute to the account, there are limits on how much can be contributed annually. For 2015, the total annual gifting limit allowed is $14,000, an amount that is adjusted for inflation each year. Any account accumulation totals in excess of $100,000 would trigger a suspension of the recipient's SSI benefits, but Medicaid benefits would continue.

States Must Get On Board

ABLE accounts can be set up starting this year, but as with 529 plans, individual states must take the lead in making them available to individuals and families. Some states, including California, Maryland, and Pennsylvania already have plans in the works.[2] Generally beneficiaries must belong to their home-state plan -- and spending of account assets can occur only in the individual's state of residence -- although exceptions (and individual state tax benefits) may apply.[2] If the ABLE account beneficiary dies, any funds remaining in the account may be claimed by the state to recoup expenses paid by Medicaid.

While the ABLE Act is by no means a cure-all, it does take a small, important step toward helping millions of disabled Americans live a more independent, fulfilling life.

[1]*Disability Scoop, "Obama Signs ABLE Act," December 22, 2014.*

[2]*AARP, "New 529 Plan Created for People With Disabilities," December 22, 2014.*

1-371778

Recognizing and Avoiding Online Scams

Although online crime is a fast-moving target, currently, the primary methods in use by identity thieves are social engineering and phishing -- or typically a combination of both.

According to the Federal Trade Commission (FTC), identity theft is the fastest growing crime in America, affecting nearly 10 million people between 2010 and 2014. Further, the *2015 Identity Fraud Study* released by Javelin Strategy & Research calculated that in 2014 there was a new identity fraud victim every two seconds.[1]

This crime occurs when a thief obtains confidential information -- including passwords, personal ID numbers, Social Security numbers, or an account number used with a financial institution -- and uses it to commit fraud. Identity thieves use a victim's stolen information to open bank and brokerage accounts, run up bills for credit card purchases, obtain loans, and commit other forms of financial fraud.

Criminals obtain a victim's personal information in a number of ways -- both online and off. But as incidents of identity theft grows, so too does the arsenal of tools and sophistication level of techniques used to perpetrate the crimes.

Cybercrime: A Rapidly Shifting Model

Although online crime is a fast-moving target, currently, the primary methods in use by identity thieves are social engineering and phishing -- or typically a combination of both.

As the term implies, social engineering relies heavily on human interaction and often involves tricking unsuspecting victims into breaking normal security procedures. In short, it is a way for criminals to gain access to your computer or mobile device and the sensitive personal data it stores. For instance, a social engineer may use text messaging to contact a mobile device inviting the user to click on a link to a bogus website where the thieves collect user credentials and other personal information.

Similar results can be achieved through a phishing attack, in which the criminal uses email to lure victims to fake websites and then gain access to their passwords and usernames, credit card numbers, and other key data. Phishing emails often appear to be from a legitimate company that the victim recognizes.

In yet another instance, attackers may inject infected "malicious" code onto your computer via email attachments, links contained in emails, infected search engine results, or through videos and documents on legitimate websites, particularly social networking sites. In the mobile device world, criminals can corrupt a legitimate smartphone app and upload it to a third-party site. If users innocently install the app, they expose their devices to assaults by hackers who collect personal user data, change device settings, and sometimes even control the device remotely.

Don't Be a Victim

In today's 24/7/365 world, it is nearly impossible to secure all sources of personal information that may be "out there" waiting to be intercepted by eager thieves. But you can help minimize your risk of loss by following a few simple hints offered by the Federal Bureau of Investigation (FBI):

- Never divulge your credit card number or other personally identifying information over the Internet or telephone unless you initiate the communication.
- Reconcile your bank account monthly, and notify your bank of discrepancies immediately.
- Actively monitor your online accounts to detect suspicious activity. Report unauthorized financial transactions to your bank, credit card company, and the police as soon as you detect them.
- Review a copy of your credit report at least once each year. Notify the credit bureau in writing of any questionable entries and follow through until they are explained or removed.
- If your identity has been assumed, ask the credit bureau to add a statement to that effect to your credit report.
- If you know of anyone who receives mail from credit card companies or banks in the names of others, report it to local or federal law enforcement authorities.

Finally, be very wary of any email or text message expressing an urgent need for you to update your personal information, activate an account, or verify your identity. Practice similar caution with email attachments and downloadable files and keep your computers protected with the latest security updates and virus protection software.

[1] *"Identity Theft and Cyber Crime," copyright 2016, Insurance Information Institute, Inc.*

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