YOUR FINANCIAL FUTURE

Your Guide to Life Planning

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Bond Market Perspectives | Week of August 24, 2015

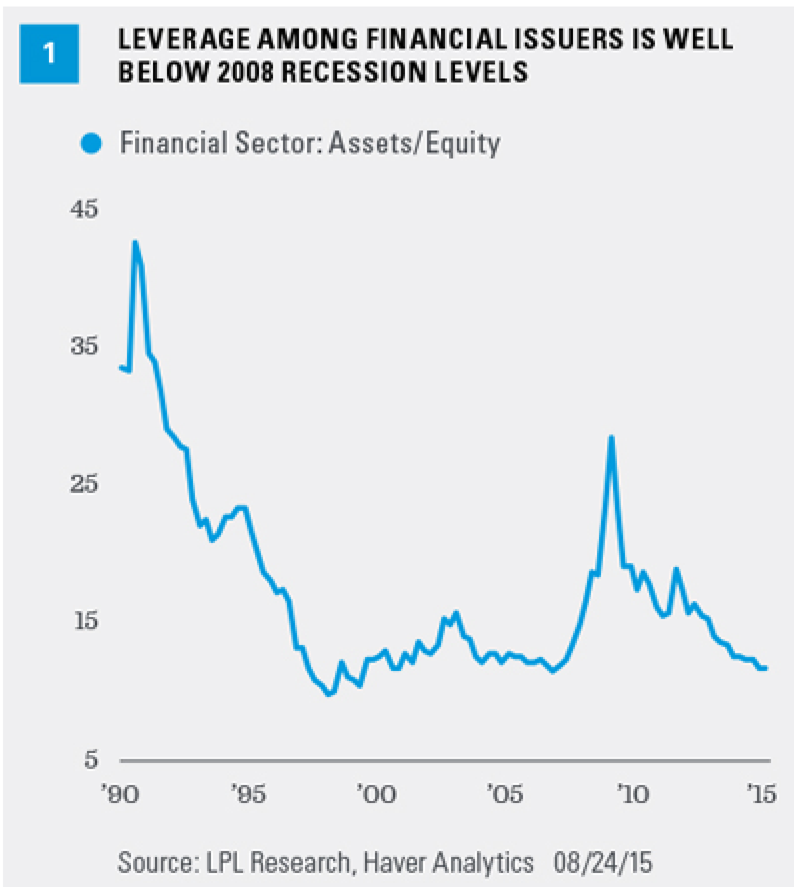
As the U.S. economy enters the second half of this business cycle, a sporadic credit checkup can be just what the doctor ordered. A close look at the high-yield market shows some slight signs of credit quality deterioration emerging, but for now the market, despite recent challenges, shows relatively stable vital signs.

High-yield has taken a prominent role in investors' minds as of late. The weakness in the price of oil led to dramatic spread widening in high-yield energy (+1.75% since the beginning of August), which led to spread widening across the broader high-yield market (+.80% since the beginning of August). The weakness in high-yield, as noted in previous *Bond Market Perspectives*, has been primarily driven by fear of energy-related defaults. As noted last week, the implied default rate on the high-yield energy sector is greater than 15% over a one-year time frame. The actual rate, based on the first six months of 2015, is just 3%. We view such a big acceleration in defaults as unrealistic.

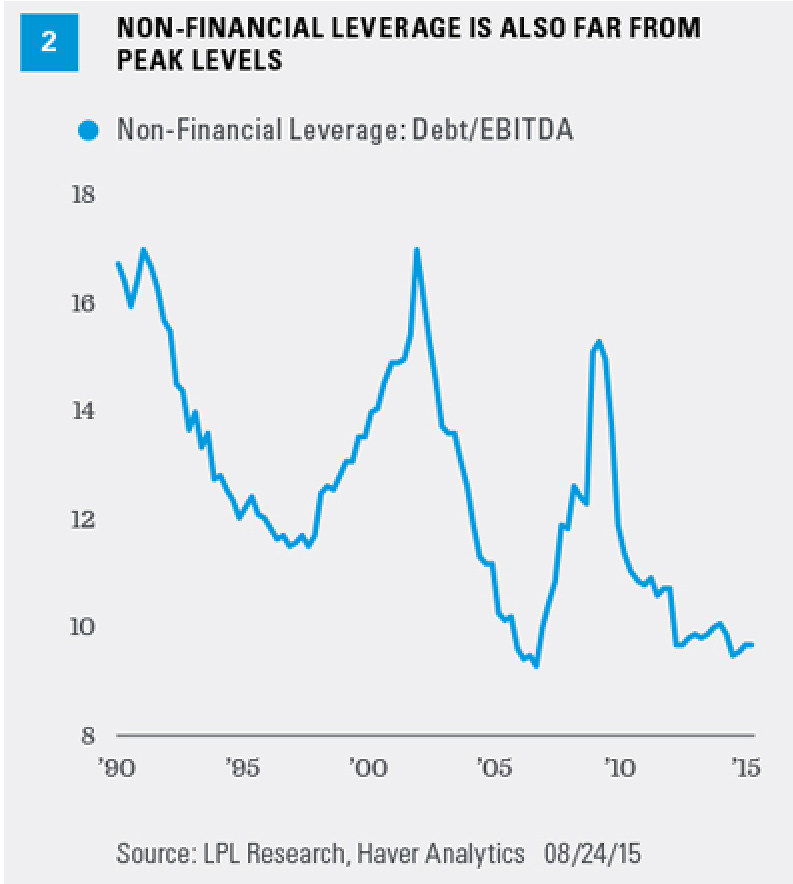
In a market currently driven by fear, it can be prudent to take a step back and evaluate the overall financial health of the high-yield bond market within the context of the credit cycle. In doing so, we may be able to determine whether this fear is justified or perhaps an attractive entry point for value-conscious investors.

FUNDAMENTALS STILL STRONG

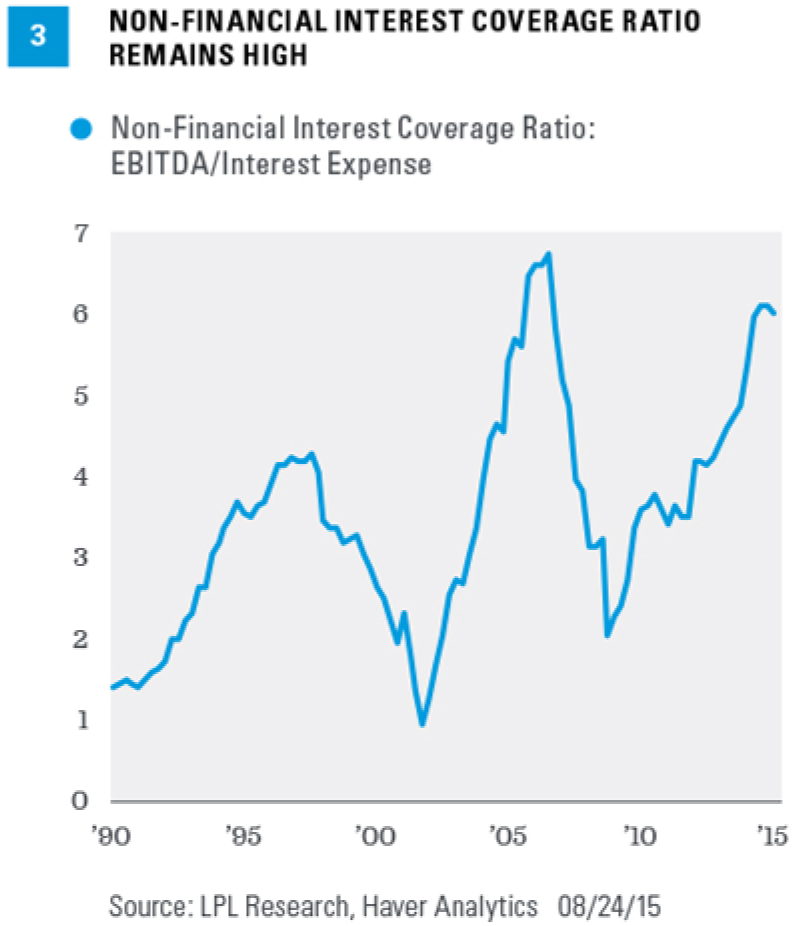
Leverage is a focal measure of the health of the corporate bond markets. Thanks in part to new regulations, the creditworthiness of financial institutions remains very strong even if growth prospects are modest. A look at leverage in the financial sector shows that financial firms are still relatively unlevered compared to the peaks of 2008 and 2009 [Figure 1].



Similarly, leverage employed by non-financial corporate borrowers increased in recent quarters but is still significantly below levels seen in 2008 and 2009 [Figure 2].



Leverage alone does not tell the whole story, however. The cost to service that debt is important, and the interest coverage ratio, a measure of how easily companies can cover interest payments, still remains near a post-recession high as issuers have taken advantage of low interest rates. On average, non-financial firms can cover their interest payments nearly six times over, the highest level since 2006 [Figure 3].



LEADING INDICATOR OF DEFAULTS STILL BENIGN

The Federal Reserve's (Fed) Senior Loan Officer Survey is a good leading indicator of defaults for high-yield bond issuers. Banks have continued to ease lending standards, which should aid liquidity and help keep defaults low [Figure 4].

See Figure 4

HIGH-YIELD ISSUANCE TRENDS

The purpose of new debt issuance can reveal a lot about credit quality trends in the high-yield bond market. Refinancing-related issuance is most favorable from a bondholder perspective, as this is generally considered preferable to more speculative uses like leveraged buyouts, acquisitions, or other shareholder-friendly activities such as special dividends. Refinancing does not result in an increase in leverage, whereas the other uses generally do. In 2015, the proportion of debt used for acquisitions increased modestly from 2014 levels but leveraged buyout issuance, which surged in 2006 and 2007, has failed to come back to life in the high-yield bond market. Growth in capital expenditures remains subdued at 4%, indicating that high-yield issuers, on balance, are relatively cautious about taking on new projects.

RESILIENCE

Despite recent equity market volatility, the reaction from the bond market has been somewhat restrained. High-yield bonds held up better than equities over the past week. From Monday, August 17, 2015, through Monday, August 24, 2015, the Barclays High-Yield Bond Index declined 1.6% compared to the 9.4% decline of stocks, as measured by the S&P 500 Index. The current bout of volatility has led to corporate bonds, both investment-grade and high-yield, underperforming Treasuries. However, considering the damage to stocks last week, high-yield bonds have shown greater resilience compared to equities. Historically, high-yield bonds have exhibited roughly 25-50% of the volatility of stocks. High-yield underperformance relative to Treasuries since late June helps explain this, as the bond market may have better priced in risks earlier this summer.

Current market volatility is exerting downward pressure on corporate bond prices, but weaker fundamentals, or an uptick in defaults, are necessary to justify the now more attractive valuations, in our view. Despite some concerns with excesses at the margins, the overall credit market appears to be on stable footing and, on balance, deserves a relatively clean bill of health.

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.

EBITDA, a measure of a company's financial performance, is a company's net earnings before interest expenses, taxes, depreciation and amortization are removed. The ratio of a company's outstanding debt to EBITDA is a widely-used leverage measure, and compares earnings to the debt burden of the company.

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.

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate, and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity, and redemption features.

Commodity-linked investments may be more volatile and less liquid than the underlying instruments or measures, and their value may be affected by the performance of the overall commodities baskets as well as weather, geopolitical events, and regulatory developments.

The Barclays High Yield Index covers the universe of publicly issued debt obligations rated below investment grade. Bonds must be rated below investment grade or high yield (Ba1/BB+ or lower), by at least two of the following ratings agencies: Moody's, S&P, and Fitch. Bonds must also have at least one year to maturity, have at least $150 million in par value outstanding, and must be U.S. dollar denominated and nonconvertible. Bonds issued by countries designated as emerging markets are excluded.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Credit Quality is one of the principal criteria for judging the investment quality of a bond or bond mutual fund. As the term implies, credit quality informs investors of a bond or bond portfolio's credit worthiness, or risk of default.

Yield Spread is the difference between yields on differing debt instruments, calculated by deducting the yield of one instrument from another. The higher the yield spread, the greater the difference between the yields offered by each instrument. The spread can be measured between debt instruments of differing maturities, credit ratings and risk.

Retirement Planning for Dual-Wage Earning Households

Like any investment portfolio, retirement accounts should work as a unit to help you pursue a specific accumulation goal.

With job changes so prevalent throughout our society, it is likely that a couple may have multiple retirement accounts, including 401(k), 403(b), or 457 plans, rollover IRAs, and possibly defined benefit plans. Because of the variety of investment options offered under such plans, it is important for couples to understand the possible detrimental effects that an uncoordinated retirement nest egg can have on reaching financial goals. Potential red flags include:

Inappropriate investment strategy

Like any investment portfolio, retirement accounts should work as a unit to help you pursue a specific accumulation goal. Success requires a coordinated investment strategy. Is the overall asset allocation appropriate for a couple's objectives and risk tolerance? Are the portfolios adequately diversified? Are they overweighted (or underweighted) in any one asset class or individual security? Do the portfolios complement a couple's taxable investment accounts, real estate, and other assets?

Poorly timed distribution strategy

Couples nearing retirement or already retired must consider the timing of their distributions in light of their income needs, tax situation, and market dynamics. For instance, should they begin taking distributions earlier than the required age to avoid a potentially higher income tax hit later? Should they take periodic distributions; annuitize; or take a lump sum and pay the taxes, then reinvest the proceeds elsewhere? Might it make sense to convert a traditional IRA to a Roth IRA to put off distributions as long as possible and/or receive tax-free income? Which accounts should they tap first, and in what order should the others follow? What if the market is in the midst of a downturn when required distributions must begin?

Fees

Couples should consider the fees associated with all of their retirement accounts and how they might affect returns. Would it make sense to consolidate some accounts to help minimize fees?

Estate planning

Couples planning their estates will face a number of questions surrounding their retirement plans. A key concern centers on the naming of beneficiaries and the income and estate tax treatment of the proceeds. Should the spouse be the beneficiary, or would naming children or a trust as beneficiary be more appropriate?

These are just a few of the questions that couples must grapple with when managing their individual retirement plan accounts. Yet no two couples' financial situations are alike. There is no set formula or mathematical equation that can be applied easily to all circumstances. Keeping track of the range of investments involved is necessary to successfully pursue long-term financial goals -- but doing so is no simple task. It often requires objectivity and professional insight. If you are part of a dual-income family, speak with your financial advisor about how you and your spouse can review and coordinate your separate retirement investments to create an effective, comprehensive plan.

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.

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Three Strategies to Help You Manage Volatility

Equity investors looking to limit volatility may want to consider dividend-paying stocks.

Managing an investment portfolio is a challenge. Recent market cycles have tested many investors' commitment to their long-term investment plans.

Understand that while volatility cannot be eliminated, it can potentially be reduced. The following three strategies can be used to help you reduce the amount of volatility in your portfolio.

Strategy 1: Seek Investments With Low Correlation

Longer term, the market risk associated with an individual asset class, such as stocks, may be reduced by allocating a portion of a portfolio's assets to other types of investments that historically have reacted differently to market and economic events.[1] This is known as "correlation," which measures the tendency of two investments to move together. A correlation close to zero indicates that two investments are largely independent of each other. The closer a correlation is to 1.00, the greater the tendency two investments have had to move in tandem. The table below lists four assets that have had relatively low correlations with U.S. stocks during the past decade.[2] Past performance does not guarantee future results.

	Commodities	Cash	Investment-Grade Bonds	Home Prices
Large-Cap Stocks	0.48	-0.12	0.05	0.17

Strategy 2: Diversify Your Investments[1]

Modern portfolio theory is founded on the assumption that investment markets do not reward investors for taking on risks that could be eliminated though diversification. There are many strategies available for diversifying a stock portfolio. Investors can allocate portions of a portfolio to domestic and international stocks, which may take turns outperforming depending on circumstances in various global economies.[3] An allocation to small-cap, midcap, and large-cap stocks also provides exposure to companies of various sizes. Although there are no guarantees, smaller companies may be nimble enough to exploit untapped market niches and capitalize on growth potential.[4]

Strategy 3: Consider Dividend-Paying Stocks

In addition, equity investors looking to limit volatility may want to consider dividend-paying stocks. Although a company can potentially eliminate or reduce dividends at any time, a dividend may provide something in the way of a return even when stock prices are volatile. When evaluating dividend-paying stocks, it may be worthwhile to review how long a company has paid a dividend and whether the dividend has increased over time. According to a study by S&P Dow Jones Indices, firms that had increased their dividends for the past 25 years outperformed the S&P 500 and also were less volatile during the 5-year, 10-year, and 15-year periods ending June 30, 2015.[5] Past performance does not guarantee future results.

For investors interested in managing volatility, low-correlation investments, diversification, and dividend-paying stocks may be worth considering.

[1] *Asset allocation and diversification do not ensure a profit or protect against a loss.*

[2] *Source: Wealth Management Systems Inc. Large-cap stocks are represented by the S&P 500 Index, commodities by the Standard & Poor's GSCI®, cash by the Barclays 3-Month Treasury Bill Index, investment-grade bonds by the Barclays Aggregate Bond Index, home prices by the S&P/Case-Shiller 20-City Composite Home Price Index. You cannot invest directly in an index. Past performance is not a guarantee of future results. Data is based on the 10-year period ending December 31, 2014.*

[3] *Foreign stocks involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.*

[4] *Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments.*

[5] *Source: S&P Dow Jones Indices. Returns are based on the S&P 500 Dividends Aristocrats. Volatility is measured by a statistic known as standard deviation. Past performance does not guarantee future results.*

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Brush Up on Your IRA Facts

IRAs continue to play a prominent role in the retirement saving strategies of Americans.

If you are opening an IRA for the first time or need a refresher course on the specifics of IRA ownership, here are some facts for your consideration.

IRAs in America

IRAs continue to play an increasingly prominent role in the retirement saving strategies of Americans. According to the Investment Company Institute (ICI), the U.S. retirement market had $24.7 trillion in assets at the end of 2014, with $7.3 trillion of that sum attributable to IRAs.[1] Today, some 41 million -- or 34% -- of U.S. households report owning IRAs.[2]

Traditional IRAs, the most common variety, are held by about 25% of U.S. households, followed by Roth IRAs, which are held by 15.6% of households, and employer-sponsored IRAs (including SEP IRAs, SAR-SEP IRAs, and SIMPLE IRAs), which are held by 6% of households.[2]

Contributions and Deductibility

Contribution limits. In general, the most you can contribute to an IRA for 2015 is $5,500. If you are age 50 or older, you can make an additional "catch-up" contribution of $1,000, which brings the maximum annual contribution to $6,500.

Eligibility. One potential area of confusion around IRAs concerns an individual's eligibility to make contributions. In general, Internal Revenue Service guidelines state that you must have taxable compensation to contribute to an IRA. This includes income from wages and salaries and net self-employment income. If you are married and file a joint tax return, only one spouse needs to have compensation in most cases.

With regard to Roth IRAs, income may affect your ability to contribute. For tax year 2015, individuals with an adjusted gross income (AGI) of $116,000 or less may make a full contribution to a Roth IRA. Married couples filing jointly with an AGI of $183,000 or less may also contribute fully, up to $11,000 for the year. Contribution limits begin to decline, or "phase out," for individuals with AGIs between $116,000 and $131,000 and for married couples with AGIs between $183,000 and $193,000. If your income exceeds these upper thresholds, you may not contribute to a Roth IRA.[3]

Deductibility. Whether you can deduct your traditional IRA contribution depends on your income level, marital status, and coverage by an employer-sponsored retirement plan. For instance:[3]

- If you are single and covered by an employer-sponsored retirement plan, your traditional IRA contribution for 2015 will be fully deductible if your AGI was $61,000 or less. The amount you can deduct begins to decline if your AGI was between $61,000 and $71,000. Your IRA contribution is not deductible if your income is equal to or more than $71,000.
- If you are married, filing jointly, and you both are covered by an employer-sponsored retirement plan, your 2015 IRA contribution will be fully deductible if your combined AGI is $98,000 or less. The amount you can deduct begins to phase out if your combined AGI is between $98,000 and $118,000. Neither of you can claim an IRA deduction if your combined income is equal to or more than $118,000.
- If you are married, filing jointly, and your spouse is covered by an employer-sponsored plan (but you are not), you may qualify for a full IRA deduction if your combined AGI is $183,000 or less. The amount you can deduct begins to phase out for combined incomes of between $183,000 and $193,000. Your deduction is eliminated if your AGI on a joint return is $193,000 or more.
- If neither you nor your spouse is covered by an employer-sponsored retirement plan, your contribution is generally fully deductible up to the annual contribution limit or 100% of your compensation, whichever is less.

Keep in mind that contributions to a Roth IRA are *not* tax deductible under any circumstances.

Distributions

You can begin withdrawing money from a traditional IRA without penalty at age 59½. Generally, deductible contributions and earnings are taxable at the then-current rate. Nondeductible contributions are not taxable because those amounts have already been taxed.

You must begin receiving minimum annual distributions from your traditional IRA no later than April 1 of the year following the year you reach age 70½ and then annually thereafter.If your distributions in any year after you reach 70½ are less than the required minimum, you will be subject to an additional federal tax equal to 50% of the difference.

Unlike traditional IRAs, Roth IRAs do not require the account holder to take distributions during his or her lifetime. This feature can prove very attractive to those individuals who would like to use the Roth IRA as an estate planning tool.

What's New for 2015?

Application of one-rollover-per-year limitation. Beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA in any 12-month period regardless of the number of IRAs you own. However, you can continue to make unlimited trustee-to-trustee transfers between IRAs because these transfers are not considered to be rollovers. Furthermore, you can also make as many rollovers from a traditional IRA to a Roth IRA (also known as "conversions"). To learn more, see Publication 590-A.[4]

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

[1]*The Wall Street Journal, "Battle Continues Over Fiduciary Rule for Retirement Investments," June 14, 2015.*

[2]Investment Company Institute, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," January 2015.

[3]Internal Revenue Service, "Retirement Topics-IRA Contribution Limits," January 22, 2015.

[4]Internal Revenue Service, "IRS Publication 590-B, Distributions From Individual Retirement Arrangements (IRAs).

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Both home equity loans and lines of credit must be settled with the lender if and when you sell your home.

Home Equity Loans Versus Lines of Credit: What's the Difference?

Thinking of tapping the equity in your home to do a renovation, buy a second home, or consolidate debt? Before you decide which borrowing option is right for you, it's important to understand the main differences between the two options.

Home Equity Loan	Home Equity Line of Credit (HELOC)
Fixed interest rate for the life of the loan	Variable interest rate over the life of the loan
Repayment in regular installments over a specific period of time	Option to re-borrow as loan is paid, up to approved credit limit
Typically used for single large purchase, such as a car	Typically used to fund ongoing expenses, such as home renovations, borrowing only as needed
Entire amount of loan received upon approval	Checks can be written at any time, up to approved limit

Comparison Shop

Both types of credit are sometimes referred to as "second mortgages," because, like your first mortgage, they are secured by your property.

Home equity loans are fixed, installment loans. They work more like a mortgage -- you borrow a determined amount for a specific term with a fixed rate of interest. Regular installment payments are made each month for a set amount. Once you receive the lump sum check, you cannot borrow additional funds.

HELOCs are revolving, borrow-as you-go arrangements. They act more like a credit card in that you borrow as you need the money and pay off your balance according to the interest rate being charged, which is variable, and the amount of credit you have used. The term of the credit line is determined by the lender and may be extended/renewed at the lender's discretion. When the term expires, the credit line must be paid in full.

Both home equity loans and HELOCs must be settled with the lender if and when you sell your home.

Match the Type of Loan to Your Need

Generally the choice between the two types of credit depends on your intended use for the money and your time frame for repayment. For instance, if you have a set amount in mind for a specific expense - a wedding, a new septic system or roof -- and you have no further foreseeable expenses, then a fixed rate home equity loan makes sense. If however, your needs are more open-ended -- a major home renovation that will span a year or two, or to supplement a child's college tuition each year for the next four years -- then the more flexible HELOC could be the better option.

Used for Debt Management

Perhaps one of the most popular reasons homeowners tap into the equity in their homes via a loan or a line of credit is to consolidate credit card debt. While recent conditions in the housing market may have deterred some from considering this option, generally speaking, home equity is one of the lowest cost loan options, and unlike credit card debt, the interest paid on home equity loans and HELOCs is tax deductible.

To learn more about tapping home equity or to access current rate tables, visit a consumer-oriented website such as bankrate.com.

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