JFL TOTAL WEALTH MANAGEMENT

July 2018

Monthly Economic Update

Jerry Lynch,

CFP CLU ChFC

Upcoming Mailings

- ✓ Tax Planning For 2018
- ✓ Retirement Accounts

Roth IRAs Maximizing Tax Efficiency

Happy Summer!

Portfolio Rebalancing

This article is for informational purposes only. This information is not intended to be a substitute for specific individualized tax, legal or investment planning advice as individual situations will vary. For specific advice about your situation, please consult with a lawyer or financial professional. The views stated in this letter are not necessarily the opinion of Aurora Private Wealth, Inc. and should not be construed, directly or indirectly, as an offer to buy or sell any securities mentioned herein. Investing involves risk including the potential loss of principal. No investment strategy, such as rebalancing and asset allocation, can guarantee a profit or protect against loss. Rebalancing investments may cause investors to incur transaction costs and, when rebalancing a non-retirement account, taxable events will be created that may increase your tax liability. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance is no guarantee of future results. In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time. This article provided the Academy of Preferred Financial Advisor, Inc. APFA, Inc.©

Investment Advisory services provided through Aurora Private Wealth, Inc., a Registered Investment Advisor. Certain representatives of Aurora Private Wealth are also Registered Representatives offering securities through APW Capital, Inc., Member FINRA/SIPC. 100 Enterprise Drive, Suite 504, Rockaway, NJ 07866 (800)637-3211.

Workshops

- ✓ Tax Workshop
- ✓ Social Security
- ✓ Retirement

305 WEST MAIN STREET, BOONTON NJ 07005 (973) 439-1190
WWW.JFLTOTALWEALTH.NET

Roth IRAs

A Tool to Maximize Tax Efficiency or Start Your Children or Grandchildren on Their Way Toward a Healthier Retirement

Jerry Lynch

Paying taxes is so engrained in our lives that many people do not even think about tax reduction until it's time to file their tax returns. Unfortunately, by that point it's usually too late to implement a strategy for minimizing their tax bill.

It's extremely important that you take your tax efficiency into your own hands. The concept of "let's deal with taxes when the time comes," many times is usually not the best plan. One of the biggest tax benefits available to most investors is the ability to defer taxes offered by retirement savings accounts, such as 401(k)s, 403(b)s and IRAs. Through the use of tax deferrals, investors have the opportunity to grow their wealth faster.

Traditional retirement accounts can offer a potential double dose of tax advantages. For those who qualify, contributions made may reduce current taxable income (when income eligibility requirements are met) and any investment growth is tax-deferred. After age 70½, however, there are required minimum distributions (RMDs) that you must take. Also, upon death, your beneficiaries will be required to pay taxes.

Roth IRAs are different. With a Roth IRA (if income eligibility requirements are met) you can only contribute after-tax dollars. A Roth IRA contribution won't reduce your taxable income the year you make it, however, there are no taxes on your future earnings and no penalties when you take a distribution, provided you hold the account for 5 years and meet one of the following conditions: you are age 59½ or older; are disabled; make a qualified first-time home purchase (lifetime limit $10,000); or have died. Also, be aware that while your earnings may be subject to taxes and penalties if withdrawn before those conditions are met, your contributions can be withdrawn at any time without tax or penalty. Roth IRAs have no required minimum distributions (RMDs) during the lifetime of the original owner so they can also be useful vehicles for estate planning.

Most experts agree that consistent funding of a retirement plan is a healthy activity. The chart in this article shows the 2018 IRS income limits for those who contribute to Roth IRAs.

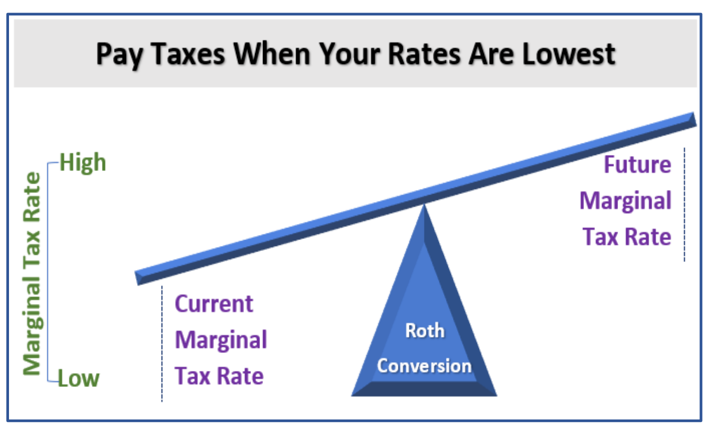
ROTH IRA 2018	
Roth IRA Contribution Limit	$5,500 ($6,500 if over 50)
Roth IRA Income Limits - for single filers	Phase-out starts at $120,000; ineligible at $135,000
Roth IRA Income Limits - for married filing jointly and qualifying widow(er) filers	Phase-out starts at $189,000; ineligible at $199,000

Considering Roth IRA Conversions

Prior to 2010, to be able to convert from a traditional IRA to a Roth IRA, your income needed to be under a certain limit. The IRS rules have changed and there is no longer an income cap for Roth IRA conversions. With the cap removed, regardless of your income, anyone can now convert to a Roth IRA, as long as they pay the appropriate tax on the conversion. If you convert to a Roth IRA, you will have to pay taxes on any tax-deferred deposits and investment gains at the time of the conversion.

Why Convert to a Roth IRA?

Tax-savvy investors want to pay as little income tax as possible. Converting to a Roth IRA may allow you to make a tax move that will save you or your beneficiaries money in the long run.



For example, if you anticipate your income dropping significantly in a certain year (and increasing in following years), you could plan a conversion (or partial conversion) for the low-income year. Since your income is lower, you may be in a lower tax bracket when you convert.

Similarly, if the government announces a tax-rate increase to go into effect in a future year, a conversion in the current year could possibly save income tax.

Converting to a Roth IRA could assure that you will owe no additional income tax on the converted funds—and any money those funds will potentially earn before you withdraw them—during retirement. The balance in your portfolio likely will be what you can take out and use in retirement and you most likely won't have to calculate an after-tax balance.

Partial Roth IRA Conversions

Making a Roth IRA conversion does not have to be an all or nothing decision. Although the rules surrounding partial conversions can be complex, a competent financial professional can help you understand the tax impacts and rules that govern converting some, all, or none of your existing IRA to a Roth IRA. Like any other decision, all of the variables of your particular situation should be considered. You should consider running the numbers for your situation to best determine the impact of making a full or partial conversion to a Roth IRA.

For example, suppose you are a married taxpayer filing jointly with $50,000 of taxable income and you have $300,000 in a traditional Roth IRA. Your marginal tax bracket is 12%. However, if your income increases above $77,400 you move into the 22% bracket. You might wish to convert up to $27,400 of your traditional IRA to a Roth IRA. From a taxwise perspective this could be more attractive than a full conversion, because if you converted the entire IRA this year, you could pay tax on some of the conversion at rates as high as 32%.

Roth Conversions in Low Tax Years Could Be Attractive

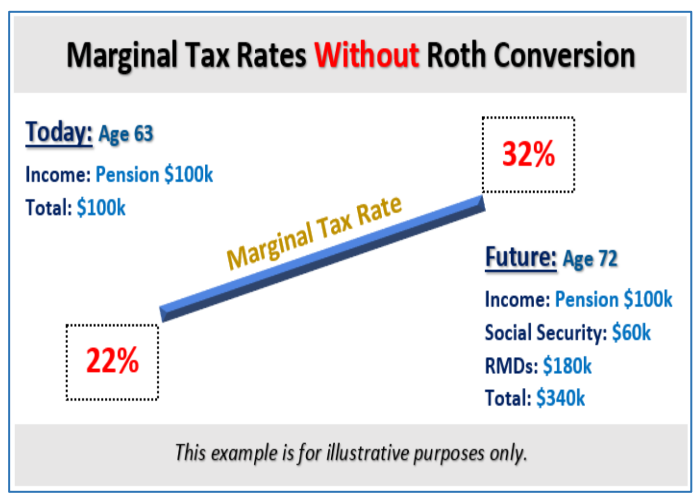
A good time to explore a partial Roth conversion can be during a year when you have a lower income than you expect to have in the future. This could include someone who just retired, is no longer employed, or has made large deductible charitable gifts.

Partial Roth conversions typically make the most sense in low income years. They can be helpful when you are in the early years of retirement (before RMDs & Social Security begin). In this instance, you can consider converting some of your IRA assets to a Roth IRA and paying federal ordinary income taxes (and state taxes where necessary) on the amount converted.

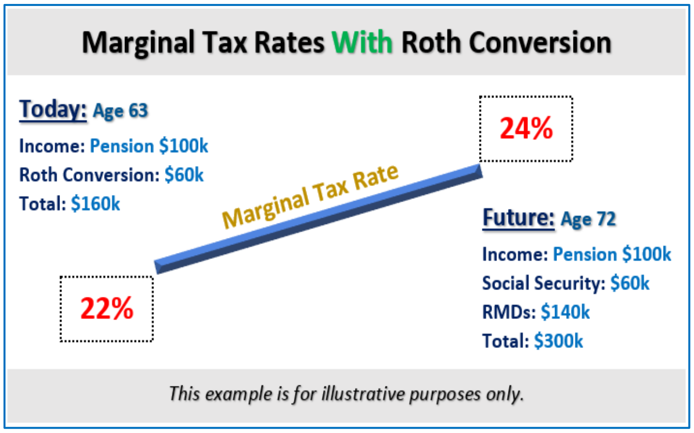
If you do not use Roth IRA conversions when you are in low tax brackets during low income years, you will be forced to take out minimum required distributions (RMDs) from your traditional IRA funds at age 70½, when you might be in a higher tax bracket, thus increasing the amount of taxes you pay during that time. A pre-70½ year old can take advantage of any low tax years if their marginal tax brackets will likely be increasing because required minimum distributions (RMDs) and Social Security might move them to a higher tax bracket in the future.

As an example, let's look at a 63-year old in a married household who files a joint tax return and also has a significantly large traditional IRA. The traditional IRA will begin requiring RMDs at age 70½ and Social Security payouts must begin by age 70 as well. If this household's only source of income is $100K from a pension, this year, they might pay a marginal tax rate of 22%.

In nine years, when the main IRA holder is now 72, the pre-tax IRAs will have had a lot of time to potentially grow. This household could expect to have significant required minimum distributions (RMDs) and Social Security income on top of the $100k pension. If the RMD's at age 72 are about $180,000 and the household Social Security is $60,000, then this household which only had $100,000 of income at age 62 now has $340,000 of income. This could increase their marginal tax rate by 10% to a total of 32%.



On the other hand, if this household were to employ a partial Roth Conversion, it would allow them to pull future income forward taking it out at a 22% rate instead of a 32% marginal rate! By taking an additional $60,000 of income each year for the next nine years, through the converting of $60,000 IRA money to Roth IRA money, they will be required to pay taxes. These strategic conversions will become Roth IRA assets and decrease the size of the traditional IRAs. This lowers future RMDs and with all things equal, it could decrease their total future income and shift their future marginal tax bracket to a lower rate of 24%.



Who Is in a Higher Tax Bracket?

It is generally more advantageous for a decedent to leave assets that do not have an attached income tax liability. Traditional IRAs have embedded tax liabilities. If you or your living parents have assets in a traditional IRA and are planning on leaving them someday to a beneficiary who is in a higher tax bracket, then it might be in your best interest tax wise to consider reviewing a schedule for a partial or full Roth IRA conversion strategy.

A Roth IRA conversion essentially changes an asset with an embedded income tax liability to one with no such tax liability. As a result, a Roth IRA conversion may minimize, or even help avoid, the double taxation if there is a taxable estate. Regardless of whether an IRA owner expects to leave a taxable estate, "pre-paying" the income tax may be attractive in several instances. These can include:

- When the IRA owner's income tax bracket is lower than, or the same as the beneficiary's tax bracket.
- When the IRA owner has a taxable estate and can afford to pay the taxes with funds outside the IRA.
- When there is a long-term time horizon. (Note: converting typically requires a 5-year hold period to avoid penalties and the result is more tax advantageous.)

To discuss your overall retirement distribution strategy call us and schedule an appointment.

Roth IRAs and Your Children (or Grandchildren)

Many people think they can hold off saving for retirement when they are younger and make up the difference later. Savvy investors know this can be a costly mistake. Waiting too long to start saving can make it very difficult to catch up and only a few years can make a big difference in how much you'll accumulate. For some, having a large retirement account might seem like a nice but unattainable goal. It can become more realistic if they know the secret: time. When should you start saving for retirement? It might seem backwards to worry about the last money you'll need early in life, but because compounding over time can be so powerful, starting early gives you more flexibility later on in life. If you have children (or grandchildren) who earn money, now might be a good time to help them start or fund a retirement account. While they can always fund a traditional IRA, if they qualify, a Roth IRA might be an even better choice.

Custodial Roth IRAs

Starting retirement savings early can allow you the potential advantage of growing money in a tax efficient account over a long period of time. Many children work before they reach age 18. The income they earn makes them eligible to contribute to a Roth IRA, which can be an extremely smart move for teenagers. This can also provide an excellent opportunity for you to teach or reinforce with your children the importance of saving money.

Historically, some financial institutions did not let minor children open a Roth IRA. Fortunately, some institutions will let parents act as a custodian on a Custodial Roth IRA for the benefit of their children. Some of the rules regarding Custodial Roth IRAs are:

- In order to be eligible to open a Custodial Roth IRA, the child must meet all the same requirements as an adult would. The minor must have earned income and contributions are limited to the lesser of total earned

income for the year and the current maximum set by law, which for 2018 is $5,500.

- Also, adjusted gross income for the child must be below the thresholds above which Roth IRAs aren't allowed.
- Even though the custodian is the legal owner of the account, the Roth IRA must be managed for the benefit of the minor child.
- As the custodian, you make the decisions on investment choices—as well as decisions on if, why, and when the money might be withdrawn—until your child reaches "adulthood," defined by age (usually between 18 and 21, depending on your state of residence). Once they reach that age, the account will then need to be re-registered in their name and it becomes an ordinary Roth IRA.

If you're the parent of a child who has earned income, a Custodial IRA can be a great way to teach the value of saving and investing. Besides getting a head start on saving, your child may be able to use the funds for college expenses—or even to buy a first home.

There are several ways to make a Custodial Roth happen. For example, you can potentially use your annual ability to gift to children or grandchildren to make this happen. **If your child or grandchild is earning money, call us and we can discuss your options for setting up Custodial Roth IRAs.**

Conclusion

Saving for retirement has and always will be a priority for most investors. Should you convert to a Roth IRA? If so, how much and when? These are good questions that require an examination of your personal situation and goals. This is an area where a highly informed financial advisor can help you make an educated and calculated decision. We realize the decision to convert some or all of your retirement account to a Roth IRA is complex. A Roth IRA can be a very good planning tool. Among its many advantages, Roth IRAs allow your money to grow tax free and withdrawals are tax free as well. Please note that although Roth IRAs can be attractive tax wise, Roth IRAs have rules and limitations. While this article is for informational purposes only and should not be deemed tax advice or an individualized recommendation, we hope that some of these points are helpful to you.

We welcome the opportunity to help you map out a strategy that will be best for your situation. To discuss your personal situation call us and schedule an appointment.

Portfolio Rebalancing in Today's Market: Consider More Than a Formula!

Rebalancing your portfolio can be a good way to help keep your investment strategy on track toward your goals. Doing this on a fairly consistent basis can help the soundness of your portfolio during times of market fluctuations, interest rates changes and life situation changes. With the new tax law changes and the most recent market volatility investors saw in the beginning of this year, now may be a great time to conduct a review of your portfolio to see if it needs any rebalancing.

What Is Rebalancing?

The term "rebalance" makes investing sound as simple as having your tires rotated or your car's alignment checked. The basic concept behind this exercise is mostly straightforward.

According to Investopedia.com, rebalancing is defined as the process of buying and selling portions of your portfolio in order to set the weight of each asset class back to its original state. In addition, if an individual's investment strategy or tolerance for risk has changed, he or she can use rebalancing to readjust the weightings of each security or asset class in the portfolio to fulfill a newly devised asset allocation.

Rebalancing your investment portfolio is a simple strategy and it makes sense to do this at regular intervals so your investments are closely aligned with your long-term financial plan. This generally means periodically reviewing your portfolio's mix of investments. After a market rise, many investors lighten the upside (and downside) potential of equities with hopefully less volatile returns of fixed income when one or the other gets overinflated in your portfolio. While rebalancing does not assure superior performance, it helps keep portfolios updated on targeted asset allocations.

The First Two Steps to Traditional Rebalancing

Traditional rebalancing usually has two simple steps. However, in today's market there is a third step that can be very difficult.

Step One: When you design your investment plan, you decide your ideal mix of equity and income based on your personal situation, including your long-term goals and risk tolerance.

Step Two: As your investment portfolio's value changes, you need to check it periodically to see how your personal mix of investments move with market changes. You should then consider adjusting your holdings to reflect your personal situation by reviewing your goals, age and risk appropriateness. For many investors, tax time is one of the more popular times to perform this checkup.

When you complete the rebalance, your hope is to sell what has increased and could potentially be high and buy what has not reached a greater value and is possibly low. Traditional rebalancing is supposed to give investors the discipline to attempt to do that.

In keeping a balanced portfolio, debt securities have nearly always provided a natural hedge: traditionally bonds have usually gained in value when stocks went down. Their yields have risen proportionately when stocks have gone up (mostly during an improving economy). Rebalancing can provide a continuous readjustment, and as a result, it can keep people from letting emotions rule investments. That rule still holds, even if the asset mix is changing.

The rule of thumb has traditionally been "100 minus your age." It tells you roughly how much equity you should have. Doing that math, at age 40, your equity should be 60 percent and the rest should be fixed income. At 60, those numbers are flipped, with 60 percent in fixed income and 40 percent in stocks. When you have a mix of stocks and bonds in your portfolio, when stocks generate a higher return, they will become a larger percentage of your holdings. Conversely, when bonds do better than stocks, your portfolio balance will shift toward bonds. The allocation you choose should depend on your individual risk tolerance and investment goals.

2017 brought consistent interest rate hikes. There have been Federal Fund rate increases already this year and more are scheduled for 2018. For those with fixed income vehicles, with rates rising and bond prices falling, rebalancing portfolios now is typically a healthy practice in potential risk management and loss prevention.

The Consequences of Imbalance

A popular belief among many investors is that if an investment has performed well over the last year, it should perform well over the next year. Unfortunately, past performance is not always an indication of future performance. This is a fact many investments disclose, but still many investors remain heavily invested in last year's "winning" portfolios and may drop their portfolio weighing in last year's "losing" portfolios. Remember, equities are more volatile than fixed-income securities, so the source of last year's large gains may translate into losses over the next year.

Normal rebalancing rules would suggest that with the large gain in stocks recently, investors should start lightening up on equities and switch to fixed income investments to restore that balance.

But, due to the rising rates, yields for short-term bonds have risen, triggering short-term bond prices to fall. On the other hand, intermediate and long-term bonds have experienced the opposite effect – rising prices and falling yields – as foreign investors turned to short-term U.S. Treasury notes instead. *(Source: money.usnews.com 1/26/2018)*

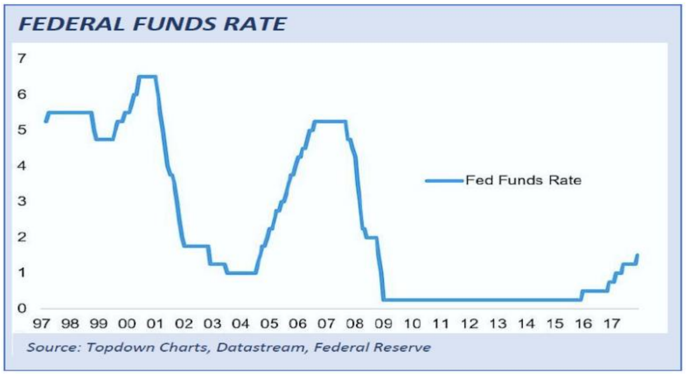
A number of investing allocation experts are currently leery of loading up on more fixed income, especially with the Federal Reserve expected to continue to raise rates.

The Third Step of Rebalancing

Step Three: When you design your investment plan, you decide your ideal amounts for fixed income.

While interest rates are on the rise, they are still historically low.

This can generate "interest rate risk."



As defined by Investopedia.com, "Interest rate risk affects the value of bonds more directly than stocks, and it is a major risk to all bondholders. As interest rates rise, bond prices fall and vice versa. The rationale is that as interest rates increase, the opportunity cost of holding a bond decreases since investors are able to realize greater yields by switching to other investments that reflect the higher interest rate. For example, a 5% bond is worth more if interest rates decrease since the bondholder receives a fixed rate of return relative to the market, which is offering a lower rate of return as a result of the decrease in rates."

Due to increased interest rate risks, some investment professionals have looked elsewhere when appropriate. (i.e. the income-producing side of equities, or preferred shares). "Laddering" with a series of short-term bonds can be another way to address this problem, since low-duration debt reaches maturity in a short time. While one- to five-year securities pay little in yield, at least investors may recover some or all of their invested capital when the security matures, unless they overpaid for the bonds in the secondary market. Longer term bonds may produce higher yields but are more vulnerable when rate changes or market fluctuations occur.

Recent market volatility has reminded investors that this market high could see a correction on the horizon. Short-term fixed income instruments may have lower yields but could be less susceptible to volatility.

Rebalancing Focuses on the Long Term

High level financial strategists like Charles Ellis, Former Chairman of the Yale Endowment who guided Yale's massive endowment with a rebalancing strategy based on diversified investments that provided far above-average returns, advise high-income investors to take pains to make sure they rebalance to suit clients' needs. Ellis says personal advice and individual goal-setting are key components of successful rebalancing strategy.

The long-term strategy behind a disciplined approach is to stick with asset allocations that you review on a periodic basis.

Final Thoughts on Rebalancing Your Portfolio

Your primary goal as an investor should be the overall success of your portfolio.

Changes in your lifestyle may warrant a change to your asset-allocation strategy. Whatever your preference, the following guideline provides the basic actions needed for rebalancing your portfolio:

1. **Record** - If you have recently decided on an asset-allocation strategy perfect for you and purchased the appropriate securities in each

asset class, keep a record of the total weightings you are attempting to hold in each asset class. These numbers will provide you with historical data of your portfolio.

2. **Compare** - On a chosen future date, review the current value of your portfolio and of each asset class. Calculate the weightings of each holding in your portfolio by dividing the current value of each asset class by the total current portfolio value. Compare this figure to the original weightings. Are there any significant changes?

3. **Adjust** - If you find that changes in your asset class weightings have distorted the portfolio's exposure to risk, take the current total value of your portfolio and multiply it by each of the (percentage) weightings originally assigned to each asset class. The figures you calculate will be the amounts that should be invested in each asset class in order to maintain your original asset allocation. You may want to sell positions from asset classes whose weights are too high, and purchase additional investments in asset classes whose weights have declined. When selling assets to rebalance your portfolio, consider taking a moment to consider the tax implications of readjusting your portfolio. If you are adding new money to your portfolio, in some cases it might be more beneficial to simply not contribute any new funds to the asset class that is overweighed while continuing to contribute to other asset classes that are underweighted. Your portfolio might be able to rebalance over time without you incurring capital gains taxes.

Conclusion

Rebalancing your portfolio can help you maintain your original asset-allocation strategy and allow implementation of any changes you may want to make to your investing style. The optimal frequency of portfolio rebalancing depends on your transaction costs, personal preferences and tax considerations, including what type of account you are selling from and whether your capital gains or losses will be taxed at a short-term versus long-term rate. This is where a qualified advisor can provide help.

The primary goal of rebalancing is to focus on minimizing an investor's risk by staying within targeted allocations. It is not a pursuit of maximizing your investment returns.

How often and how much of your portfolio you need to rebalance is where a qualified financial advisor can add value. Simple rebalancing suggests that your entire portfolio is performing well, and sometimes that might not be the case. Essentially, rebalancing tries to help you stick to your investing plan regardless of what the market does.

Our goal is to understand our clients' needs and to monitor their portfolios. Our primary objective is to take the emotions out of investing for our clients. We can discuss your specific situation at your next review meeting or you can call to schedule an appointment. As always, we appreciate the opportunity to assist you in addressing your financial issues.

Help us grow in 2018!

This year, one of our goals is to offer our services to several other people just like you!

Many of our best relationships have come from introductions from our clients.
Do you know someone who could benefit from our services?

We would be honored if you would:

- ✓ Add a name to our mailing list,
- ✓ Bring a guest to a workshop,
- ✓ Have someone come in for a complimentary financial checkup.

Please call TJ Scillieri at JFL Total Wealth Management, (973) 439-1190 and we would be happy to assist you!