



A Registered Investment Advisor



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The Practical Implications of Investment Theory

Many investment principles used to develop investment portfolios are derived from one investment theory — the Capital Asset Pricing Model (CAPM). What exactly is this theory and how does it apply to your investments?

The CAPM was developed over 50 years ago by Harry Markowitz, who won a Nobel Prize for his work. His theory centers on the concept that adding an asset to a portfolio that is not highly correlated with other assets in the portfolio can reduce variation risk. Before his theory, it was common practice to look for undervalued assets to add to a portfolio. His approach evaluated how a particular asset would impact a portfolio's risk and return. Whether it makes sense to add that investment to the portfolio depends

as much on how the asset's return will vary with returns of other portfolio assets as on its own return prospects.

This theory provides the underlying rationale for asset allocation. The key is that the returns of different assets do not behave in the same manner during different economic times, so adding different assets can reduce the volatility in that portfolio. While the return of a diversified portfolio may be lower than that of investing solely in the best perform-

ing asset, it is typically viewed as an acceptable trade-off for reduced risk. Many people have also realized that it is difficult to identify the best performing asset in any given year, so a diversified portfolio provides more consistent returns.

Some of the investment implications that have been drawn from this theory include:

- ✓ A properly diversified portfolio will combine assets that do not have highly correlated returns.

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Withdrawal Strategies as Important as Planning Strategies

Today's retirees live longer and need to use more personal savings than previous generations. Like the planning that got you here, you also need to develop a withdrawal plan that will give you the best chance for not outliving your assets.

Where to Start — You want a plan that ensures you can meet your expenses and has the potential to keep growing, all while weathering inflation, market volatility, and taxes. The best place to start is to determine how you want to live in your retirement years.

Keep It Growing — Building a strategy for growth is very different in retirement than it was when you were saving for retirement. You will need an asset allocation strategy that uses a target asset mix of investments aligned with your risk tolerance.

Monitoring and Rebalancing — Just like during your saving years, you'll need to monitor your portfolio on a regular basis. It may be wise to rebalance your portfolio due to market conditions or other factors that impact your life. While in the early years of your retirement you may take more risk, as you age, you may want to be more conservative. ○○○



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Practical Implications

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Thus, when one asset is declining, other assets may be increasing or not decreasing as much.

- ✓ Rather than focusing on each investment's risk, investors should consider their portfolio's overall risk.
- ✓ Including a small percentage of a volatile investment may not increase a portfolio's overall risk, provided that investment's returns do not vary closely with other assets' returns in the portfolio.
- ✓ When small portions of stocks are added to an all-bond portfolio, risk initially decreases, even though stocks are more volatile than bonds. Thus, an all-bond portfolio is not the lowest-risk portfolio.
- ✓ Investors should consider how varying percentages of different asset classes will affect their portfolio's risk and return before deciding on an asset allocation.

Managing Your Portfolio

Consider this investment process to incorporate this theory:

- ✓ **Determine your risk/return preferences.** You should assess the potential downside as well as upside for various investments to get a feel for how much risk you can tolerate.
- ✓ **Decide on an asset allocation mix.** Your asset allocation strategy represents your personal decisions about how much of your portfolio should be allocated to various investment categories. After considering your risk tolerance, time horizon for investing, and return needs, you can form a target asset allocation mix. Within broad investment categories, make allocation decisions for each category. Not only will each individual's allocation strategy differ, but your strategy will vary over time.
- ✓ **Select individual investments.** Investigate a wide

When Should You Retire?

Most people know instinctively that deciding when to retire is one of the most important life decisions they'll ever make. What most people don't know, however, is how to actually make that decision.

The traditional retirement age is 65. But some people want to retire early, say at age 55. Others look at how much they'll get from Social Security — benefits begin at age 62, but the longer you delay, the more it pays out.

The most important question to answer is: how many years can you afford the lifestyle you want in retirement? The worst thing that can happen is that you run out of money in retirement. To give you an idea of what's involved in making that decision, here's a summary of the main considerations:

What is your lifestyle going to cost in retirement? This is the most basic parameter to determine. Is your house paid off? Are you going to travel? Do you want to own two homes? What kind of uncovered medical expenses do you expect? Start by putting together an annual household budget.

What sources of income will you have? Will it be only Social

Security, or will it include other regular payments, like a pension, consulting or self-employment, rental income, royalties, etc.?

How much have you accumulated, and what annual income can you generate? Sources of retirement savings often include IRAs, 401(k) plans, and taxable accounts.

Will your income cover your expenses? If so, you *might* be able to retire at the age you project. However, if the rate at which you withdraw money from your retirement portfolio is too high, you run the risk of depleting those resources.

If you determine that your income won't cover your expenses, there are three solutions:

- ✓ Delay retiring while you add to your personal savings and increase the amount you can collect from Social Security.
- ✓ Change the investment mix in your portfolio to potentially increase your rate of return.
- ✓ Aim for a less-expensive retirement lifestyle.

A thorough financial plan runs through all of these calculations and aims at a realistic answer.

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range of options, but make sure you understand the basics of each, examining the risk types as well as their historical rates of return. Your selections should fit in with your overall asset allocation.

✓ **Rebalance periodically.** Over time, your asset allocation will stray from your desired allocation due to varying rates of return on your investments. Determine how much variation you are willing to tolerate, perhaps 5% or 10% from your desired allocation. If portions of your portfolio have strayed more than that, you should take steps to

get your allocation in line. However, first determine if there are ways to do so without incurring tax liabilities. Selling assets from taxable accounts may result in taxable transactions. Instead, you may want to make new investments in underweighted assets, redirect periodic income to other asset classes, or take withdrawals from overweighted assets.

Please feel free to call if you would like to discuss your investment portfolio in more detail.

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Consider These Investment Tax Strategies

Now is a good time to take a look at your tax situation. You still have time to take action that could reduce your income tax liability for 2017. Here are some tips to consider:

✓ **Sell stocks with losses to offset capital gains.** If you have capital gains income but are holding stocks with losses, consider selling those stocks to offset the capital gains. Excess losses may be used to offset up to \$3,000 of ordinary income, and the unused portion can be carried forward until utilized.

✓ **Contribute the maximum amount to your 401(k) plan.** Take a look at your financial situation making sure you are contributing as much as possible to your 401(k) plan. Unless you have a Roth 401(k), contributions are made from pretax dollars. When you invest in a taxable account, you have already paid income taxes on that money, so you will only be investing 65 or 75 cents instead of the dollar that would be going into your 401(k) plan. That difference makes a 401(k) plan tough to beat over the long term. The maximum contribution to a 401(k) plan in 2017 is \$18,000, plus individuals age 50 and over can make an additional catch-up contribution of \$6,000, if permitted by the plan.

✓ **Decide to which type of IRA to contribute and do so as soon as possible.** Decide whether you should contribute to a traditional deductible or Roth IRA. Although you have until April 17, 2018, to make your 2017 contribution, contribute as soon as possible

to allow your funds to compound tax deferred or tax free for a longer time. The maximum IRA contribution in 2017 is \$5,500, with an additional \$1,000 catch-up contribution for individuals age 50 or older.

✓ **Replace loans that generate personal interest with mortgage or home-equity loans.** Personal interest cannot be deducted on your tax return, while mortgage and home-equity loan interest can, as long as the mortgage does not exceed \$1,000,000, and the home-equity loan does not exceed \$100,000.

✓ **Determine whether you should bunch income or expenses for 2017.** Depending on your overall tax situation, it may make sense to accelerate or defer income and expenses. Some deductions that can be accelerated or deferred include payment of property taxes, estimated state taxes, medical expenses, and charitable contributions. Income that can typically be deferred includes self-employment income and year-end bonuses or commissions.

✓ **Donate appreciated stock held over a year to a charitable organization.** You can deduct the stock's fair market value as a charitable contribution without paying the capital gains tax on the sale.

✓ **Sell assets on the installment basis.** You can use this method to sell certain capital assets, particularly real estate, which will typically allow you to recognize the gain as the installments are collected rather than in total in the year of sale. You may also want to consider a like-kind, or section 1031, exchange, which allows you to defer any tax liability.

✓ **Consider transferring appreciated assets to children.** If the children are in the 10% or 15% tax bracket, they can sell the asset and pay no capital gains taxes in

2017. These transfers can be made as part of your annual tax-free gifts, with a maximum tax-free transfer of \$14,000 in 2017 (\$28,000 if the gift is split with your spouse). However, be aware of the kiddie tax rules, which apply to all children under age 19 and to students under age 24. If the earned income of an individual over age 17 exceeds half of his/her support, the kiddie tax does not apply. The kiddie tax refers to the manner in which unearned income is taxed for children. In 2017, the first \$1,050 of unearned income is tax free, the second \$1,050 is taxed at the child's marginal tax rate, and any remaining unearned income is taxed at the parents' marginal tax rate. Once the individual exceeds the age limits, all unearned income is taxed at his/her marginal tax rate.

✓ **Familiarize yourself with all types of income tax deductions, exemptions, and credits.** There are a wide variety available, and you should be aware of any that apply to you. Each has different eligibility criteria, so you need to be familiar with all of them to determine which will work best in your situation.

✓ **Consider your long-term planning needs.** In addition to lowering income taxes for 2017, you also want to find strategies to lower taxes in future years. Thus, it is a good time to review your entire tax situation to see if other changes are warranted. For instance, you may want to invest more in municipal bonds, whose interest income is generally exempt from federal and sometimes state and local income taxes. Or, you may need to reposition assets between your taxable and tax-deferred accounts to minimize taxes once you start taking withdrawals.

Please call if you'd like to review your tax situation in more detail. ○○○



The Costs of Not Planning Ahead

Between 2010 and 2015, the costs of college tuition increased an average of 11% (Source: College Board, 2016), while the average salary increased approximately 9%, according to the Bureau of Labor Statistics. With college costs now surpassing wage increases, the importance of planning ahead is even more evident.

You Miss Out on Tax-Free Growth — Whether you choose a more traditional investment option, a college savings plan, or both, when you begin to save for college long before your children are ready to enroll, you save and grow college funds over time — and depending on your choice(s) of investment, in a tax-free way. The thousands of dollars you potentially miss out on in earnings alone could cover the costs of one or more years of tuition, not even taking into account your accumulated contributions.

You Risk Jeopardizing Your Retirement or Life Savings — Because of expensive tuition costs that continue to increase with each passing semester and/or year, it can be very tempting to borrow large sums of money from your retirement funds or emergency savings to foot the bills. However, if you

don't have the college funds now, it's unlikely that you'll be able to replace these funds once you've withdrawn the money, either significantly prolonging your retirement date or risking further debt should an emergency surface.

Potential Increases in Debt for You or Your Children — According to Sallie Mae, families who plan ahead for college borrow one-third less in loans than those who do not. The average public college graduate owes over \$30,000 in student loans; planning ahead could mean that your son or daughter won't have to begin life with a negative net worth (Source: The Institute for College Access and Success, 2015).

Emotional Strain — Beyond the financial ramifications of not planning ahead is the undue emotional stress you could place on yourself and your family during a time that should really be exciting and rewarding. Part of planning ahead means equipping yourself for the future costs of college and taking necessary measures to manage them, such as budgeting for extra savings and focusing on grades and school activities that may increase scholarship opportunities.

Please call to discuss your college savings plan. ○○○



A Tax-Planning Perspective

There are basically three strategies that can help reduce your income tax bill:

1. Reduce or eliminate taxes. The objective is to receive income in a nontaxable form or to find additional tax deductions, exemptions, or credits.

2. Postpone the payment of income taxes until sometime in the future. By postponing tax payment, your earnings compound on the entire balance, including the portion that will eventually be paid in taxes. You may also be in a lower tax bracket when the taxes are paid. For example, contribute as much as possible to retirement accounts.

3. Shift the tax burden to another individual. The objective of this technique is to transfer assets to other individuals so any income on those assets becomes taxable to those individuals. Typically, however, you have to give up control of the asset. For instance, you can give annual tax-free gifts of up to \$14,000 in 2017 (\$28,000 if the gift is split with your spouse) to any number of individuals. Any future income generated on those gifts then becomes taxable to those individuals. ○○○

Financial Thoughts

Approximately 90% of women will be single at some point during their retirement. Nearly half of those age 75 and older are single because of widowhood, divorce, or never having been married (Source: *AII Journal*, November 2016).

Women are now the primary breadwinners in over 40% of U.S. households, an almost four-fold increase from 1960. Women also

own 30% of all private businesses in the United States, employing over 7.8 million Americans (Source: *AII Journal*, November 2016).

In 2013, the latest year available, the median earnings of working-age women who were employed full-time were \$39,000, compared to \$49,000 for men. The average annual Social Security benefits received by women 65

years and older was \$12,857, compared to \$16,590 for men (Source: *InvestmentNews*, November 21, 2016).

In 2015, 169 million personal records were exposed from 781 breaches across the financial, business, education, government, and health care sectors, a 38% increase from 2014 (Source: *Journal of Financial Planning*, January 2017). ○○○