Financial Insights

From The Richards Group

The Richards Group
Financial, Insurance & HR Solutions

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4th Qtr 2015 ***Strategies for Building Your Financial Security***

Third Quarter 2015 Market Recap

The hot days of August did not bode well for stock markets. During the quarter major indexes dropped 10% or more during a week in mid-month. The Greek crisis faded from the headlines in July while China's struggles moved back to the fore. Fears of an imminent hike in short-term interest rates flared throughout the quarter, but by September's end, there had been no move to change the direction of Federal Reserve policy. Trading throughout the quarter was volatile, with repeated swings up and down. The broader economic news remained positive: the number of jobs grew, total output grew, and prices remained steady.

Through 9/30/15*	Quarter	1-Year	3-Year Annualized	5-Year Annualized	Closing Value
S&P 500	-6.94%	-2.6%	10.0%	11.0%	1920.03
Dow Jones Industrials	-7.58%	-4.4%	6.6%	8.6%	16284.70
NASDAQ Composite	-7.35%	2.8%	14.0%	14.3%	4620.17

**Price only. Does not include dividends. Source: Wealth Management Systems Inc. The S&P 500, Dow Jones Industrials, and NASDAQ Composite are unmanaged indexes. It is not possible to invest directly in an index.*

Past performance is no guarantee of future results.

Economy Watch Economic output -- or GDP -- ended up increasing at an annual rate of 3.9% in the second quarter when all the results were tallied. Unemployment stood at 5.1% as the quarter closed. The Consumer Price Index was near 0% for the previous 12 months.

Washington Watch Political turmoil among Republicans in Congress actually helped set the stage for passage of a bill to prevent a government shutdown at the end of September. Speaker of the House John Boehner announced his resignation, which cleared the way for a bipartisan, if short term, budget agreement.

Fixed Income Markets Federal officials took no action on the short-term rates they can directly influence, so money market and savings deposit rates remained near zero throughout the quarter. Inflation appeared dormant so there was little pressure on investment-grade bond prices, and their yields varied in narrow ranges, closing about where they opened the quarter. On September 30, the benchmark 10-year Treasury yield was about 2.08%. The average Baa-rated long-term corporate bond yield was about 5.35%.

How Taxes and Inflation May Affect Your Retirement Portfolio

Benjamin Franklin famously stated that the only two certainties in life are death and taxes. But there's at least one more that could probably be added to the list: inflation. Inflation is the sustained, ongoing increase in the general level of prices for goods and services. As prices rise over time, the purchasing power of every dollar goes (cont p. 4)

Plan Ahead for Gift Giving

Special occasions often call for gift giving: a graduation in May, a wedding in June, an anniversary in July, and birthdays throughout the year. Each event seems to sneak up on us -- and our budgets. Retailers plan for holidays and seasonal sales, so why not do a little gift planning of your own?

Here are a few tips for your planning list:

Save now. Gift buying will seem more manageable if you've been saving for it a little at a time. Whether you set up a formal gift account and contribute to it regularly or just stash away a few extra dollars here and there, it's good to accumulate cash that is earmarked for gift giving.

Put a cap on spending. Work out a gift-giving budget for the year that includes a comfortable spending limit as well as a detailed list of individual gifts with spending caps for each. Then stick to it.

Avoid credit traps. If you must charge your purchases, put them on your bank credit card. Department store cards typically charge a much higher interest rate. And make sure you watch out for the "buy now, pay later" offers. Although tempting at the time, it is very easy to forget about a DVD recorder you bought in November if the first payment isn't due until March.

Two for one. When you find a great deal on something nice, buy two -- one for yourself and one to give away. Then, when a birthday or other unexpected event pops up and catches you by surprise, you'll be prepared with a gift. Importantly, you will have avoided the last-minute (and often expensive) rush to buy something quickly.

Take advantage of post-holiday sales. In Canada, the United Kingdom, and other Commonwealth countries they call it Boxing Day, but here it's just the day after Christmas. For those truly die-hard shoppers, it can be the best shopping day of the year. Stores slash already reduced prices even more to make way for spring inventories.

Gift giving is one of the easiest ways to overspend. But if you do a little planning before you shop, you'll approach each occasion with your budget and generosity intact.

Give the Gift That Keeps on Giving

If you'd like to give a child money but want to do something more lasting than writing a check, consider setting up a custodial account under either the Uniform Gifts to Minors Act or Uniform Transfers to Minors Act (UGMA/UTMA) through a bank or investment company.

Custodial accounts can help finance a child's future and lessen the giver's tax burden. Here are a few details you should be aware of.

The UGMA/UTMA Facts:

- There are no income limits affecting eligibility to fund a custodial account.
- You can gift up to $14,000 per child, each year ($28,000 for married couples) to as many children as you like without owing gift taxes. Beyond those amounts, gifts may be subject to federal gift taxes.
- Gifts made to UGMA/UTMA accounts are considered irrevocable; once the child reaches legal age (18 or 21, depending on the state), he or she gains full control over the assets.
- Since custodial accounts belong to the child, account assets may decrease the amount of financial aid a child can receive.

Beware the "Kiddie Tax"

Tax rules affecting UTMA/UGMA accounts bear careful consideration. Under the so-called "Kiddie Tax" rules, a child's investment income over a certain level is taxed at his or her parents' rate rather than the child's lower rate (typically 5% for most children).

The Kiddie Tax includes dependents up to the age of 19 and those up to the age of 24 who are full-time students. Any investment income earned in excess of $2,000 will be taxed at the parents' higher tax rate.

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.

When More Risk Equals Less Risk

If we asked you to name the most risky asset class, which would you pick - emerging markets[1]? Commodities[2]? High-yield bonds[3]?

Each investment has unique risks, but volatility of returns is one measure that can be applied to all. At its simplest level, volatility is the likelihood that an investment's return will change from one period to the next. It is often represented by a statistic called standard deviation. When the standard deviation is large, the investment is considered relatively risky because it can vary a great deal from time to time. When it is small, the investment can be considered stable because its returns show relatively little variation.

Comparing Standard Deviations

For example, the standard deviation for the S&P 500, a broad measure of U.S. equities, was 14.67% for the 10-year period ending December 31, 2014.[4] In comparison, the standard deviation for the MSCI Emerging Markets index for the same span was 23.74%.[4] That means that during good years in stock markets in China, India, Brazil, and other developing economies, investors could reap rewards that outpace U.S. stocks. However, the potential for losses in emerging markets is generally higher than for domestic companies. On the other end of the market continuum, the standard deviation for fixed-income securities like those tracked by the Barclays Aggregate Bond index was 3.22% for the same time period, a fraction of that of stocks.[4]

Of course every investment is unique and there is no guarantee that any investment will perform as it has in the past. But each investment can also move up and down at different times. This suggests that adding a risky investment to an individual portfolio may not necessarily be bad and may actually prove beneficial over many years.

Match Investments to Goals

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your goals. Is your primary goal preservation of principal? Generating income for current expenses? Building the value of your principal over and above inflation? How you answer these questions will enable you to find an appropriate balance between the return you hope to achieve and the risk you are willing to assume.

Examine your time horizon for meeting your goals, and consider how comfortable you may be riding out short-term losses in the value of your investments. Remember, the longer your time horizon, the more volatility you may be able to tolerate in your portfolio. At the same time, long-term investors need to be concerned about inflation.

The Risk of Not Investing Appropriately

When thinking about how to balance risk and return in your portfolio, don't forget that the risk of loss is not the only kind of risk. Give some thought to the risk of investing too conservatively and not reaping a high enough return to provide for your financial future. Also be aware of investing in instruments that may be too risky for your shorter-term goals. The Richards Group can help you select vehicles that are suitable for your goals.

Using Risk to Its Full Potential

In life, almost every attempt at success involves some risk -- and your investment strategy is no different. By devoting time to examining your goals, conducting some research, and working with a financial advisor, you can learn how to manage risk in your portfolio by choosing appropriate investments.

[1]Emerging markets are generally more volatile than the markets of more developed foreign nations, and therefore you should consider this increased market risk carefully before investing. Investors in international securities may be subject to higher taxation and higher currency risk, as well as less liquidity, compared with investors in domestic securities. Returns are in U.S. dollars and reflect effects of currency fluctuations.

[2]Exposure to the commodities market may subject investors to greater volatility as commodity-linked investments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity.

[3]Lower-quality debt securities involve greater risk of default or price changes due to changes in the credit quality of the issuer. They may not be suitable for all investors.

[4]Wealth Management Systems Inc., Morgan Stanley Capital International, and Barclay's Capital. For the period indicated. The Standard & Poor's Composite Index of 500 Stocks is an unmanaged index that is generally considered representative of the U.S. stock market. The MSCI Emerging Markets Index is a free float?adjusted market capitalization index that is designed to measure the equity market performance of 23 emerging market country indexes. The Barclays U.S. Aggregate Bond Index is a broad-based index that is considered to be generally representative of investment grade bonds being traded in the United States. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

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We Ask.
We Listen.
We Find Solutions.

How Taxes and Inflation May Affect Your Retirement Portfolio (cont. from p 1)

down. Due to inflation, one dollar in ten years will likely purchase less than the same dollar would today.

How Inflation Is Measured

The rate of inflation in the United States is measured by the Consumer Price Index (CPI), which calculates monthly changes in the prices paid for a representative basket of goods and services. Over the past three decades, inflation in the United States has risen at an annualized rate of 2.69%.[1] This has shrunk the purchasing power of $1 in 1985 to just $0.45 today.[2]

It is critical to understand the effects of inflation on a retirement portfolio, because a retirement account in the future probably won't have the same purchasing power that it has today. For example, a $1 million portfolio today would need to grow to $1.7 million in 20 years to have the same purchasing power.[2]

But inflation is not the only potential hazard to the long-term purchasing power of your retirement nest egg.

The Tax Man Cometh

Let's go back to Mr. Franklin, because taxes may also impact how much money you actually get to put in your pocket when you begin taking distributions from your retirement account in the future.

Many retirement plans allow participants to save money on a tax-deferred basis, but this isn't the same thing as saving on a tax-free basis. When you contribute money to a traditional IRA or 401(k), for example, your contributions are excluded from your current taxable income. In other words, you don't have to pay tax on the money today, but instead are deferring this tax until you begin taking distributions from the account typically during retirement.

In comparison, contributions to a Roth IRA or 401(k) are included in your current taxable income. And since you are paying taxes on the money now, you don't have to pay taxes again when you withdraw the funds during retirement.[3]

Pay Me Now, or Pay Me Later

One of the decisions you must make as part of your retirement strategy is whether to invest on a tax-deferred basis, and pay taxes when you withdraw the money, or invest tax free and pay the taxes now?

No one has a crystal ball to predict whether tax rates will be higher or lower in the future. That is why it is important to work with a financial planning expert who, using sophisticated retirement planning tools and software -- and taking your individual circumstances, risk tolerance, and goals into consideration -- can help you work through various inflation and tax scenarios to determine the most appropriate strategies for you.

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[1]United States Department of Labor -- Bureau of Labor Statistics. For the 30-year period ended June 30, 2015.
[2]Wealth Management Systems Inc. based on price inflation for the 30-year period ended June 30, 2015.
[3]Withdrawals from qualified plans taken before age 59½ are generally subject to a 10% additional federal tax -- on top of any regular income taxes owed -- although there are a few exceptions to this rule.

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