JSW Financial™

E-newsletter
November 2016

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Ops Center: Year-End Deadlines & Financeware 3.0

A few reminders as we get closer to the end of the year.

- **RMDs:** IRS rules require everyone who will be 70.5 or older by December 31, 2016, to take a Required Minimum Distribution (RMD) annually from your IRA. The IRS can impose a 50% penalty for not taking out the calculated RMD amount. If you have not satisfied your RMD for this year, please **contact us as soon as possible.**
- **Charitable Gifts:** If you are considering making a year-end charitable contribution by using one of your accounts, please contact us before **December 15*** to get the process started.
- **Roth Conversions:** The end of the year also marks the deadline for Roth Conversions and Backdoor Roths (contributing to a Traditional IRA and then converting to a Roth). These requests should be received by our office no later than **December 15*** to ensure processing by year end.

Also, COMING SOON! New edition of Financeware, the Wealthcare planning tool. Read more in the December newsletter about exciting new interactive functionality for you in the client portal and new plan features like the "Dream Board."

*Requests received after the December 15 deadline will be processed on a best-efforts basis.

Communications Survey

The past two years have been full of change at JSW Financial. It is hard sometimes to contain our excitement, show some restraint, and yet keep you updated on our progress.

We would like to get your feedback on our communication techniques and frequency of contact. Please take a moment to answer a few quick questions to help us improve our communication with our clients by clicking here to take a short survey.

Smartest Way to Take Withdrawals in Retirement

Joel and I have been teaching a weekly seminar for the Lifelong Learning Institute at Virginia Tech during the month of October. The courses are designed for "curious adults 50 and over in the New River Valley" who enjoy learning. Our course is called "Simple Ways to Improve Your Financial Wellbeing" and we have covered topics ranging from retirement income strategies to trusts and estate planning to investing and financial myths. One of the topics that this group was particularly interested in learning more about was retirement income. Specifically, they wanted to know which accounts to look to first to supplement their income in retirement. Here's what we told them:

1. Required Minimum Distributions: If you are age 70½ or better and have a qualified retirement account like a Traditional/SEP/SIMPLE IRA, 401(k), or 403(b), you are required in most cases to withdrawal a required minimum distribution each year. Those who have inherited beneficiary IRAs are also required to take this mandatory distribution. Since it's required, look here first and take the minimum.
2. Taxable Accounts: After satisfying your required minimum distribution, the next place to look is those taxable, or non-retirement accounts. See if there are any losses that you can harvest and either apply them to offset your realized gains or use $3,000 to offset against your income on taxes and carryforward any remaining losses. Even if you don't have losses, this is still a great option for withdrawals, especially if you're in a high tax bracket. When you withdrawal from a taxable account, you may have to pay capital gains taxes of 15-20% if you realized a gain when you sold assets to free up cash. If you withdrawal from an IRA or qualified retirement account, the entire amount is taxable as ordinary income, which could be as high as 35%.
3. Tax Deferred Accounts (IRA, 401(k), 403(b), etc.) – The next place to look is your tax-deferred retirement accounts beyond your required minimum distributions. The withdrawal will be taxed as ordinary income.
4. Roth IRAs – Finally, the last place to look to supplement your retirement income is your Roth IRA. You have already paid taxes on the assets in these accounts and they are growing tax free. You will not have to pay taxes on them even if you sell and realize a gain, receive income or dividends, or make a withdrawal. Since most of us agree that taxes are likely to increase over time, this is a great location for appreciating assets and would be the final place to consider for withdrawals.

Of course, there are exceptions to every rule and we need to look at distribution strategies on a case by case basis, but the order above outlines a common strategy that would apply to most investors. When you request withdrawals from your investment accounts, our team considers the different strategies and works with you to choose the best one for your unique situation.

If you'd like to know more about the Lifelong Learning Institute at Virginia Tech, visit their website at http://www.cpe.vt.edu/lifelonglearning/index.html. They offer a wide variety of courses in the fall and spring on interesting topics including art, current issues, and technology.

– **Ashley Coake**

'Tis the Season for Tax Loss Harvesting

If you have taxable accounts with us, we are temporarily adjusting the trading strategies in your accounts so that you are able to take advantage of any tax loss harvesting opportunities that may come available as we close out the year and elect our next president.

As Ashley explained in the September newsletter, tax loss harvesting can be a valuable tool in your portfolio. This process allows you to "harvest" investment losses when the market makes significant dips by selling current holdings that have losses and purchasing alternative securities that can play a similar role in your portfolio at a low price. As the market rises, you regain the value in your account and you keep the losses you "harvested". These can then be used to offset capital gains from other investments or $3,000/year of regular income to reduce your tax liability.

This process can be complex, ensuring the alternatives you move to are appropriate for your portfolio and meet the IRS requirements for differentiation. As well as ensuring the required timelines between trades are met so that you do not fall into the traps of "Wash Sale Rules", eliminating the tax benefits of losses you were trying to harvest or taking on unnecessary complexity in your taxes (which can cost you!).

Not to worry, we take all of this into consideration for you.

If you have taxable accounts in your JSW Financial portfolio, you will see the following temporary changes. For the next few weeks, we are suspending the automated rebalancing in your accounts and directing all automated monthly deposits into the fixed income assets within your portfolio. This will put your portfolio into an optimal position to take advantage of significant but short dips in the market that may take place after the election. It also has the benefit of small additional protection against a market drop right after the election which is often experienced historically.

No need to do anything on your end. We will monitor and take appropriate actions on your behalf. This is a part of the service we provide to you. **However, do let us know if you have realized any gains or losses on any other assets this year, such as real estate or accounts held elsewhere, so we can work together with you and your tax preparer to make sure we are optimizing this strategy.**

– **Sarah Moravec**

Some Good News About Taxes

I just returned from the Virginia State Bar's 35th annual Trusts & Estates seminar. It was very interesting and I came away guardedly optimistic about the direction of the public policy debate regarding estate and gift taxes. My comments will address two topics. First, the recent tax law changes that have actually been enacted and, I believe, are net positives for everyone. Second, I will cover the proposed estate and gift tax changes that have come out of the presidential campaigns and annual Federal budget deliberations.

<u>Recently enacted changes</u>:

- The $5.4 million estate tax exemption has been made permanent (it was going to "sunset" without legislative action)
- Gift tax exemption - the same, $5.4 million
- "Portability" of a decedent's unused estate tax exemption has been made permanent as well (again, scheduled to sunset)
- "Qualified charitable distributions" from an IRA - made permanent
- The estate tax exemption for 2017 is increasing to $5.49 million in 2017!

Some definitions and observations: "Sunset" means these provisions would have been effectively repealed without congressional action and the previous estate tax law (2009 exemption and rates) would then apply.

"Portability" means that a surviving spouse may use a deceased spouse's unused estate tax exemption, in addition to his/her own exemption. This solves - finally - the problem of the "wasted" estate tax exemptions and eliminates the need for all the complicated planning we used to do to avoid that.

"Qualified charitable distributions" are direct distributions from an IRA to a qualified charitable organization. This distribution 1) counts as the RMD, and 2) is not taxed to the IRA owner as income. How sweet is that?

And as you may have heard me say in our client education series, with a $10+ million exemption per married couple, the estate tax has been effectively repealed for most people.

<u>Proposed changes - Estate and Gift Tax</u>

Consider all of these for context - but focus on the basic exemption. The administration proposal is contained in its most recent budget submission to Congress. Comparison of these plans may surprise you.

***Bernie's Plan*:**
39% rate (new) for *taxable* estates over $750,000
45% rate on estates $3.5 to $10 million
50% rate on estates $10 - $50 million

55% rate on estates in excess of $50 million
10% surcharge on estates over $500 million
$1 million gift tax exemption
Basic estate tax exemption: $3.5 million, without indexing
Portability?

Hillary's Plan:
Increase rates to:
50% on estates over $10 million
55% on estates over $50 million
65% on estates over $500 million
Portability? Yes
$1 million gift tax exemption
Reduce basic exemption to $3.5 million, no indexing

Administration Proposal:
Return to 2009 tax rates and exemptions
Top Estate, Gift and GST (generation skipping tax) rate is 45%
$1 million gift tax exemption
$3.5 million exemption for estate and GST tax, no indexing

Trump's Plan:
Repeal estate and gift tax

Where's the good news?

Here's my key takeaway, and why it's GOOD.

The estate tax is celebrating its 100th birthday - total repeal is unlikely. There does seem to be convergence around this idea: portability plus an exemption of $3.5 million per taxpayer. What does that mean? A married couple could, at their death, pass $7 million of assets free of estate tax, even under the most aggressive tax-increase scenarios.

And here's a little context as a lagniappe:

Year	Estate Tax	Gift Tax	Gift Exclusion	Top Rate	Estate/Gift Tax
1980	$161,000	$161,000	$3,000	70%	70%

Is your mind blown yet? That's right, the estate and gift tax exemptions were $161,000 back in 1980. 70% was the top rate for estate and gift taxes that year.

My advice to clients: the estate tax has been effectively repealed for most people. It's all about wealth transfer planning now. Because people are living longer than ever, the (boring) stuff I used to talk about as a trust officer waaaaay back in the 80's (remember the 80s?) has never been more important. All of our clients need:

- A will or trust to dispose of their assets at death
- A disability plan (a durable power of attorney, maybe a living trust)
- A healthcare directive (make end-of-life decisions less stressful for your family)

If you need to discuss your estate plan, call us, email or just drop by the office.

– **George Taylor**

Joel's Corner: The Election Will NOT Impact the Stock Market…in the Short Run

October 27, 2016

Not surprisingly, the most common question I get these days is, "What is the election going to do to the stock market?"

First of all, I have no idea! That's not really true; what I do know is that any decision one makes based on their expectations of the election that is counter to what we have designed in your particular plan, has a high probability of ending poorly.

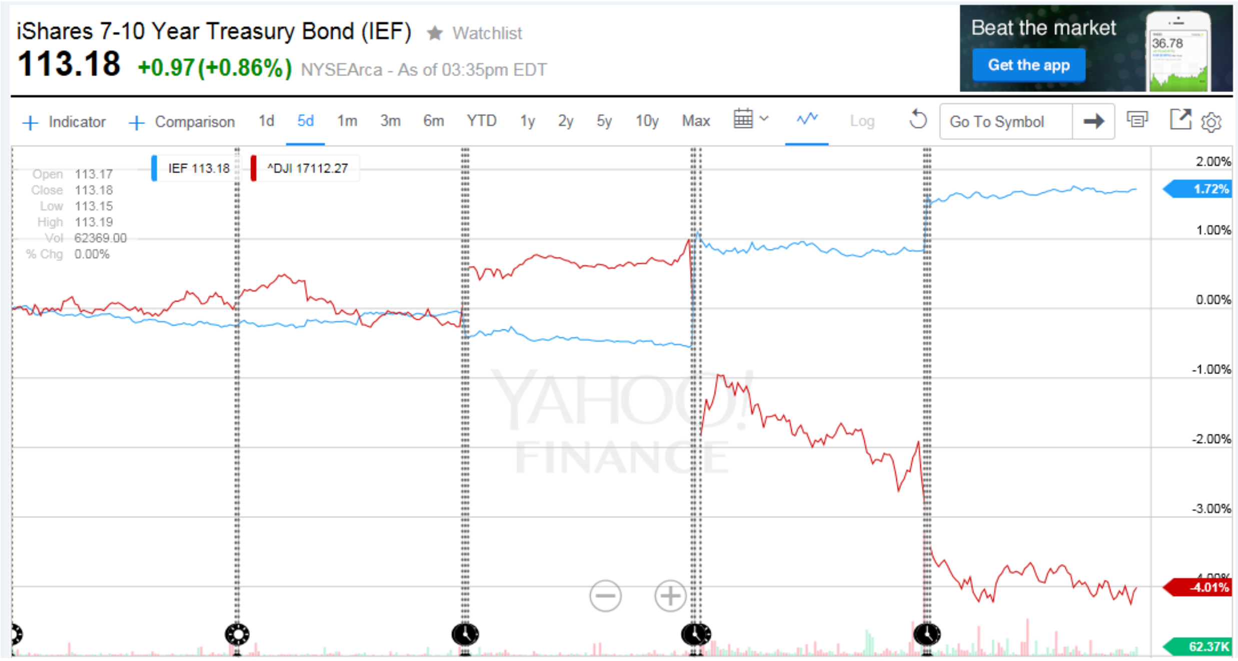
Second, we are very well positioned to take advantage of a falling market (should that happen) with our Wealthcare strategies. For every 3% the market falls, we will consider selling fixed income (bonds) and buying stocks! We will be buying those stocks from investors who don't realize most of what you hear about the impact of presidential elections on their portfolios are simply myths. (See the Brexit graph below) Let's take a look at what history tells us, not what the talking-head geniuses on cable are discussing.

What History Tells Us About Presidential Election Cycles? For the past 182 years, the stock market has gone up and down with some interesting patterns for the four-year election cycle. In the first two years, recessions, bear markets or wars tend to occur. Usually the economy improves with accompanying bull markets in the second two years. Since 1833, the stock market (Dow Jones; there was no S&P in the beginning) increased an average of 6% the year of the election; however, it gained 10.4% the year before the election. During the honeymoon period of the first year in office, the market averaged 2.5% and not much better the second year, 4.2%.

But the data has been a little whacky since President Obama came into office. In 2008, the market dropped 34%, not including dividends. Then, the first year of his second term, the market shot up 27% and gained another 7.5% the second year. Last year the market lost 2.2% compared to the average of 6% for the year of the election.

This why I opened with, "I have no idea!" What is consistent is that "this election in general has been like no other election in history…in all respects." For sure, this is history in the making and a good enough reason to vote, simply to tell your great grandkids, "I voted that year!", kind of like saying, "I was at Woodstock!"

Look at how our fixed-income investments (Treasury Bills) performed the week of the Brexit. Your treasuries are in blue and the stock market (the Dow Jones) is in red. The vote was on Thursday. By the following Monday, the market was already heading back up. Try to recall your feelings about your portfolio when you heard the market had fallen 3.5 % on that Thursday!



A Flawed Theory: Divided Government is Better? Another theory is that it is better to not have one party control all three parts of government. This way no one party can do a lot of harm to the country leaving markets unbridled to flourish: things like the Fed, taxes, Obamacare and others. The problem is the data does not support this theory.

Let's examine three situations going back to 1928:

1. For the first two years of office, the S&P went up an average of 16.9% when one party controlled both houses of Congress and the White House.
2. For the same period, when one party controls the White House but the other party controls both houses (like the past four years), the S&P went up 15.6%.
3. Finally, when the houses are split, the S&P only went up 5.5%. Exceptions to this were 2010 and 2012, when the S&P rose 19% and 42% respectively.

But a divided Congress doesn't always lead to sub-par returns. In the two-year periods following the 2010 and 2012 elections, the S&P 500 rose 19% and 42%, respectively. I simply pray for civility and integrity to return to our political bodies!

The Party Determines the Direction of the Stock Market. This is simply another myth because normal stock fluctuations greatly impact the stock market more than the miniscule return changes due to the party in power. It really does not matter which party is in control.

Claims that Republicans in control help businesses, and thus your stock portfolio, is simply not borne out by the data. Since 1900, when Democrats were in control, the Dow Jones has been up 9% on average, compared to a 6% annual average when Republicans were in control. So don't beat up your investment advisor because he is of an opposite party than yourself.

The Political Ouija Board. A final interesting exercise is one I presented to my Rotary Club last June. Basically, it says the direction of the stock market for the last three months leading up to the election determines the winner. If the stock market is down for this period, the challenging party will win (Donald Trump); if the market is up for this period, the incumbent party will win (Hillary Clinton).

The data for this is really interesting! Since 1928, there have been 22 presidential elections. In seven of eight elections preceded by three months of stock market losses, the challenging party won the White House. In 14 of those 22 elections, the market was up for the three months prior and the incumbent party won the White House 12 out of 14 times. Granted, there were three exceptions: 1980, 1968 and 1956.

So what is the stock market currently predicting? August 1, 2016, the Dow Jones was at 18,400; today, October 27, 2016, (12 days before the election) it is at 18,170. According to the data source (Stack), this analysis has correctly predicted the presidential election winner 86.4% of the time. Scary! … and a little different than what we hear from the talking media heads!

In my opinion, since the difference is within the margin of statistical error, the election is a coin flip today and it definitely will not be anyone's landslide. It will be VERY close!

Do not hesitate to call or email me or the team with your concerns going into these next two weeks. It's going to be ugly, but we will be fine.

Until next time,

Joel

Investment advice is provided by Wealthcare Capital Management LLC, an SEC registered investment advisor.

Citations:

http://www.kiplinger.com/article/investing/T043-C008-S003-how-presidential-elections-affect-the-stock-market.html

Yahoo Finance, market comparisons

Wealth Care 2nd Quarter Performance Summary