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Hello!

We wanted to thank those of you who came out and supported our auction on April 8th. It was a successful night and we had a lot of fun! For those who couldn't make it this year, we hope to see you next year!

Just a reminder that it's never too late to schedule an annual review. If you are interested, please feel free to call our office and we will be happy to schedule a time for you to come in.

May 2017

Tax Benefits of Homeownership

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Is Smart Beta a Smart Strategy for You?

Traditional investment indexes such as the S&P 500 are weighted based on market capitalization, the value of a company's total outstanding stock. This means the largest companies in the index may have much greater influence on index performance than smaller companies. For example, the 10 largest companies in the S&P 500 account for more than 18% of the index's performance, as opposed to about 2% if every company were weighted equally.[1]

Funds that track market-weighted indexes may be the most direct way to participate in broad market performance, but there has been increasing interest in an alternative indexing strategy called smart beta (also known as strategic beta or factor-based investing). More than 100 smart-beta exchange-traded funds (ETFs) were launched in 2016.[2]

Shifting the weight

Smart-beta funds use factors other than market capitalization to select and weight investments in order to track an existing or newly created factor-based index. Some factors that might be considered are momentum, risk, volatility, earnings, growth potential, price-to-book value, dividend growth or yield, cash flow, or equal weighting of all securities. (Traditionally, beta is a measure of an investment's volatility, but smart-beta indexes may or may not consider volatility.)

The idea of using factors to select investments is not new. For example, numerous indexes track stocks perceived to have higher growth potential or to offer greater value. However, even if the investments are *selected* based on a factor, such indexes are typically still *weighted* based on market capitalization. Though investments tracking such indexes might be considered in the smart-beta category, a true smart-beta growth or value index would be selected and weighted based on a measure of growth or value.

Long-term strategy

The goal of smart-beta strategies is to outperform the broader market, but even if a factor does outperform during one market cycle, it may underperform in the next cycle. This is one of the fundamental challenges not only of smart beta but of any strategy that attempts to outperform the market. Even within a given cycle, a successful strategy may become neutralized or unsuccessful as other investors adopt the same strategy.

Because of these limitations, smart-beta funds are generally not wise for short-term investors, but they may be appropriate as a long-term strategy in a diversified portfolio. Diversification is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss. All investing involves risk, including the possible loss of principal.

The S&P 500 is an unmanaged group of securities considered to be representative of the U.S. stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific investment. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results; actual results will vary.

The principal value of mutual funds and exchange-traded funds will fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Supply and demand for ETF shares may cause them to trade at a premium or a discount relative to the value of the underlying shares.

Mutual funds and exchange-traded funds are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

[1] S&P Dow Jones Indices, 2017

[2] Morningstar, 2017

Tax Benefits of Homeownership

Limit on deductions

You are subject to a limit on certain itemized deductions if your adjusted gross income exceeds $261,500 for single taxpayers, $313,800 for married taxpayers filing jointly, $156,900 for married taxpayers filing separately, and $287,650 for head of household taxpayers. This limit does not apply for alternative minimum tax purposes, however.

Buying a home can be a major expenditure. Fortunately, federal tax benefits are available to make homeownership more affordable and less expensive. There may also be tax benefits under state law.

Mortgage interest deduction

One of the most important tax benefits of owning a home is that you may be able to deduct any mortgage interest you pay. If you itemize deductions on your federal income tax return, you can deduct the interest you pay on a loan used to buy, build, or improve your home, provided that the loan is secured by your home. Up to $1 million of such "home acquisition debt" ($500,000 if you're married and file separately) qualifies for the interest deduction.

You may also be able to deduct interest you pay on certain home equity loans or lines of credit secured by your home. Up to $100,000 of such "home equity debt" (or $50,000 if your filing status is married filing separately) qualifies for the interest deduction. The interest you pay on home equity debt is generally deductible regardless of how you use the loan proceeds. For alternative minimum tax purposes, however, interest on home equity debt is deductible only for debt used to buy, build, or improve your home.

Deduction for real estate property taxes

If you itemize deductions on your federal income tax return, you can generally deduct real estate taxes you pay on property that you own. For alternative minimum tax purposes, however, no deduction is allowed for state and local taxes, including real estate property taxes.

Points and closing costs

When you take out a loan to buy a home, or when you refinance an existing loan on your home, you'll probably be charged closing costs. These may include points, as well as attorney's fees, recording fees, title search fees, appraisal fees, and loan or document preparation and processing fees. Points are typically charged to reduce the interest rate for the loan.

When you buy your main home, you may be able to deduct points in full in the year you pay them if you itemize deductions and meet certain requirements. You may even be able to deduct points that the seller pays for you.

Refinanced loans are treated differently. Generally, points that you pay on a refinanced loan are not deductible in full in the year you pay them. Instead, they're deducted ratably over the life of the loan. In other words, you can deduct a certain portion of the points each year. If the loan is used to make improvements to your principal residence, however, you may be able to deduct the points in full in the year paid.

Otherwise, closing costs are nondeductible. They can, however, increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Home improvements

Home improvements (unless medically required) are nondeductible. Improvements, though, can increase the tax basis of your home, which in turn can lower your taxable gain when you sell the property.

Capital gain exclusion

If you sell your principal residence at a loss, you can't deduct the loss on your tax return. If you sell your principal residence at a gain, you may be able to exclude some or all of the gain from federal income tax.

Capital gain (or loss) on the sale of your principal residence equals the sale price of your home minus your adjusted basis in the property. Your adjusted basis is typically the cost of the property (i.e., what you paid for it initially) plus amounts paid for capital improvements.

If you meet all requirements, you can exclude from federal income tax up to $250,000 ($500,000 if you're married and file a joint return) of any capital gain that results from the sale of your principal residence. Anything over those limits may be subject to tax (at favorable long-term capital gains tax rates). In general, this exclusion can be used only once every two years. To qualify for the exclusion, you must have owned and used the home as your principal residence for a total of two out of the five years before the sale.

What if you fail to meet the two-out-of-five-year rule? Or you used the capital gain exclusion within the past two years with respect to a different principal residence? You may still be able to exclude part of your gain if your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances. In such a case, exclusion of the gain may be prorated.

Other considerations

It's important to note that special rules apply in a number of circumstances, including situations in which you maintain a home office for tax purposes or otherwise use your home for business or rental purposes.

Is It Wise to Trade Your Pension for a Lump Sum?

About 41 million people are participants (active, retired, or separated vested) of PBGC-insured corporate pension plans.

Source: Congressional Budget Office, 2016

Most private employers have already replaced traditional pensions, which promise lifetime income payments in retirement, with defined contribution plans such as 401(k)s. But 15% of private-sector workers and 75% of state and local government workers still participate in traditional pensions.[1] Altogether, 35% of workers say they (and/or their spouse) have pension benefits with a current or former employer.[2]

Many pension plan participants have the option to take their money in a lump sum when they retire. And since 2012, an increasing number of large corporate pensions have been implementing "lump-sum windows" during which vested former employees have a limited amount of time (typically 30 to 90 days) to accept or decline buyout offers.[3] (Lump-sum offers to retirees already receiving pension benefits are no longer allowed.)

By shrinking the size of a pension plan, the company can reduce the associated risks and costs, and limit the impact of future retirement obligations on current financial performance. However, what's good for a corporation's bottom line may or may not be in the best interests of plan participants and their families.

For many workers, there may be mathematical and psychological advantages to keeping the pension. On the other hand, a lump sum could provide financial flexibility that may benefit some families.

Weigh risks before letting go

A lump-sum payout transfers the risks associated with investment performance and longevity from the pension plan sponsor to the participant. The lump-sum amount is the discounted present value of an employee's future pension, set by an IRS formula based on current bond interest rates and average life expectancies.

Individuals who opt for a lump-sum payout must then make critical investment and withdrawal decisions, and determine for themselves how much risk to take in the financial markets. The resulting income is often not enough to replace the pension income given up, unless the investor can tolerate exposure to stock market risk and is able to achieve solid returns over time.

Gender is not considered when calculating lump sums, so a pension's lifetime income may be even more valuable for women, who tend to live longer than men and would have a greater chance of outliving their savings.

In addition, companies might not include the value of subsidies for early retirement or spousal benefits in lump-sum calculations.[4] The latter could be a major disadvantage for married participants, because a healthy 65-year-old couple has about a 73% chance that one spouse will live until at least 90.[5]

When a lump sum might make sense

A lump-sum payment could benefit a person in poor health or provide financial relief for a household with little cash in the bank for emergencies. But keep in mind that pension payments (monthly or lump sum) are taxed in the year they are received, and cashing out a pension before age 59½ may trigger a 10% federal tax penalty.[6] Rolling the lump sum into a traditional IRA postpones taxes until withdrawals are taken later in retirement.

Someone who expects to live comfortably on other sources of retirement income might also welcome a buyout offer. Pension payments end when the plan participant (or a surviving spouse) dies, but funds preserved in an IRA could be passed down to heirs.

IRA distributions are also taxed as ordinary income, and withdrawals taken prior to age 59½ may be subject to the 10% federal tax penalty, with certain exceptions. Annual minimum distributions are required starting in the year the account owner reaches age 70½.

It may also be important to consider the health of the company's pension plan, especially for plans that don't purchase annuity contracts. The "funded status" is a measure of plan assets and liabilities that must be reported annually; a plan funded at 80% or less may be struggling. Most corporate pensions are backstopped by the Pension Benefit Guaranty Corporation (PBGC), but retirees could lose a portion of the "promised" benefits if their plan fails.

The prospect of a large check might be tempting, but cashing in a pension could have costly repercussions for your retirement. It's important to have a long-term perspective and an understanding of the tradeoffs when a lump-sum option is on the table.

[1] U.S. Bureau of Labor Statistics, 2016

[2] Employee Benefit Research Institute, 2016

[3, 4] *The Wall Street Journal,* June 5, 2015

[5] Society of Actuaries, 2017

[6] The penalty doesn't apply to employees who retire during or after the year they turn 55 (50 for qualified public safety employees).

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Are you ready to retire?

Here are some questions to ask yourself when deciding whether or not you are ready to retire.

Is your nest egg adequate?

It may be obvious, but the earlier you retire, the less time you'll have to save, and the more years you'll be living off your retirement savings. The average American can expect to live past age 78.* With future medical advances likely, it's not unreasonable to assume that life expectancy will continue to increase. Is your nest egg large enough to fund 20 or more years of retirement?

When will you begin receiving Social Security benefits?

You can receive Social Security retirement benefits as early as age 62. However, your benefit may be 25% to 30% less than if you waited until full retirement age (66 to 67, depending on the year you were born).

How will retirement affect your IRAs and employer retirement plans?

The longer you delay retirement, the longer you can build up tax-deferred funds in traditional IRAs and potentially tax-free funds in Roth IRAs. Remember that you need taxable compensation to contribute to an IRA.

You'll also have a longer period of time to contribute to employer-sponsored plans like 401(k)s — and to receive any employer match or other contributions. (If you retire early, you may forfeit any employer contributions in which you're not fully vested.)

Will you need health insurance?

Keep in mind that Medicare generally doesn't start until you're 65. Does your employer provide post-retirement medical benefits? Are you eligible for the coverage if you retire early? If not, you may have to look into COBRA or an individual policy from a private insurer or the health insurance marketplace — which could be an expensive proposition.

Is phasing into retirement right for you?

Retirement need not be an all-or-nothing affair. If you're not quite ready, financially or psychologically, for full retirement, consider downshifting from full-time to part-time employment. This will allow you to retain a source of income and remain active and productive.

* NCHS Data Brief, Number 267, December 2016

What is an ERISA fiduciary?

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to protect employees who participate in retirement plans and certain other employee benefit plans. At the time, there were concerns that pension plan funds were being mismanaged, causing participants to lose benefits they had worked so hard to earn. ERISA protects the interests of plan participants and their beneficiaries by:

- Requiring the disclosure of financial and other plan information
- Establishing standards of conduct for plan fiduciaries
- Providing for appropriate remedies, sanctions, and access to the federal courts

It's the fiduciary provisions of ERISA that help protect participants from the mismanagement and abuse of plan assets. The law requires that fiduciaries act prudently, solely in the interests of plan participants and beneficiaries, and for the exclusive purpose of providing benefits and paying reasonable expenses of administering the plan.

Fiduciaries must diversify plan investments to minimize the risk of large losses, unless it's clearly prudent not to do so. Fiduciaries must also avoid conflicts of interest. They cannot allow the plan to engage in certain transactions with the employer, service providers, or other fiduciaries ("parties in interest"). There are also specific rules against self-dealing.

Who is a plan fiduciary? Anyone who:

- Exercises any discretionary control over the plan or its assets
- Has any discretionary responsibility for administration of the plan
- Provides investment advice for a fee or other compensation (direct or indirect)

Plan fiduciaries may include, for example, discretionary plan trustees, plan administrators, investment managers and advisors, and members of a plan's investment committee.

Fiduciaries must take their responsibilities seriously. If they fail to comply with ERISA's requirements, they may be personally liable for any losses incurred by the plan. Criminal liability may also be possible.

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