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PINNACLE QUARTERLY

A Fork in the Road

The Pinnacle Investment Team

VISION
WEALTH PLANNING, LLC

April 2019

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Annual Health Care Expenses In Retirement: Don't Believe Everything You Read

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Director of Wealth Management

Despite a steady drumbeat of media coverage that Baby Boomers aren't saving enough for retirement, a recent PwC survey of Boomers found that their biggest fear about retirement isn't actually running out of money before the end of retirement, but how they're going to handle their health care costs in retirement.

That fear isn't surprising, given annual studies showing what a substantial cost health care expenses in retirement can be. A recent study by the Employee Benefits Research Institute (EBRI) found that a couple retiring today needs a whopping $273,000 to have a 90% chance of covering their health care costs in retirement (including Medicare, Medigap supplemental insurance coverage, and out-of-pocket spending). Fidelity has similarly estimated the cost at $280,000. And these estimates are just for medical expenses, and exclude potential costs for long-term care.

Yet while these dollar amounts may seem like eye-popping "big" numbers, the reality is that retiree health expenses aren't actually needed all at once upon retiring. In fact, the typical savings requirements for retiree health care costs are really little more than a moderate ongoing annual dollar amount.

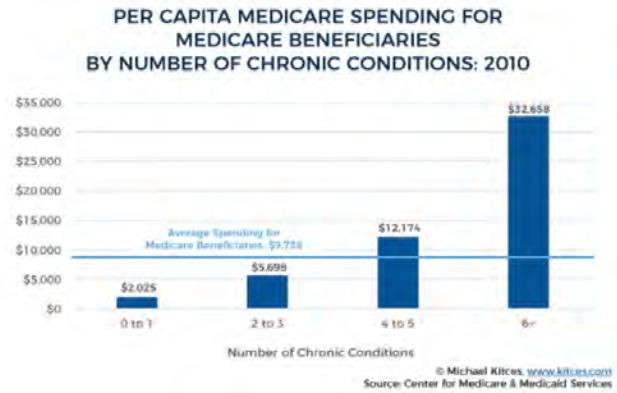
For instance, a recent joint study between Vanguard and Mercer Health and Benefits on planning for retiree health care costs found that for a typical 65-year-old woman, the median annual health care expense in retirement is "just" $5,200/year.

Of course, that expense may continue for 20+ years – adding up to more than $100,000, in lump sum form. But if ongoing health care expenses will be considered as a lump sum, then it's important to consider income streams in retirement as lump sum assets as well. And the "lump sum" value of the average $1,294/month Social Security benefit is nearly $280,000 for males and $335,000 for females (over $600,000 as a married couple!), while couples who each earned the maximum Social Security benefit have a combined Social Security lump sum value of over $1.1 million!

That means as an ongoing annual expense, health care costs in retirement can actually be quite manageable as part of an overall budget. And when evaluated as a lump, they're still far less than just the benefits of Social Security alone, never mind a retiree's actual assets saved for retirement!

Factors That Influence Annual Health Care Costs In Retirement

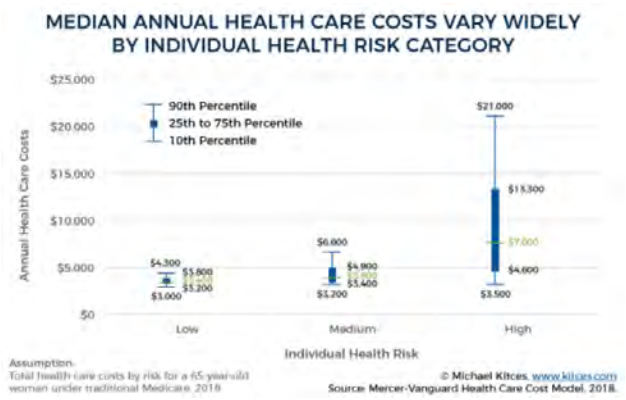
The other reason why it's so important to project health care expenses in retirement as annual expenses rather than a lump sum is that just looking at the lump sum equivalent confuses two key factors that drive (cumulative) health care costs in retirement.



The first major factor is longevity: The longer a retiree lives, the larger the cumulative cost of health care in retirement. Spending $5,000/year for 30 years (from age 65 to 95) requires $150,000 to cover the cost (assuming the growth rate on assets matches the rate of health care inflation rate). A retiree who lives only 15 years requires only half that amount, or $75,000.

The second major factor is simply the amount per year of any particular retiree's health care expenses, which will be impacted heavily by his/her health care status and the existence of any chronic conditions.

For instance, an unhealthy individual with a 15-year life expectancy who spends $10,000/year on health care expenses in retirement may have the same 15 x $10,000 = $150,000 lump sum obligation as an ultra-healthy retiree spending only $5,000/year but anticipating 30 years of retirement spending (where 30 x $5,000 = $150,000 again). But in practice, an unhealthy individual planning $10,000/year for a limited period of time has very different planning needs than some-



one who needs $5,000/year for twice as long, even if it's the same $150,000 lump sum need.

In fact, the recent Vanguard/Mercer study on retiree health care expenses emphasizes how health-related factors are really the primary driver of planning for health care expenses in retirement. Because health care expenses themselves are not evenly distributed across all retirees—common chronic conditions, including hypertension, high cholesterol, arthritis, heart disease, diabetes, kidney disease, depression, Alzheimer's, and dementia among others, actually drive the overwhelming bulk of total retiree health care costs.

For instance, the Vanguard/Mercer model simply separates retirees into low-, medium-, or high-risk categories based on whether they have no chronic conditions, 1 chronic condition, or 2+ chronic conditions and/or are smokers. And on this basis alone, not only is there a substantial difference in the median annual health care, but there is an even more drastic range—a whopping $21,000/year—for those with the highest health risks.

The Impact Of Medicare Premium Surcharges (IRMAA) On Annual Retiree Health Care Costs

In addition to the sheer variability of out-of-pocket expenses driven by various chronic health conditions in retirement, income-based adjustments to Medicare insurance premiums for higher-income individuals can also have a substantial impact. Because Medicare Part B, along with Part D prescription drug coverage, and Medigap supplemental policies, are all guaranteed issue (i.e., not restricted or priced differently based on health conditions), both Medicare Part B and Part D premiums are also impacted by income levels themselves, thanks to the so-called "Income-Related Monthly Adjustment Amount" (IRMAA) rules.

Specifically, the IRMAA rules state that once Adjusted Gross Income exceeds $85,000, there is a roughly $600/year/person increase in Medicare Part B premiums, and another $150/year/person increase in Medicare Part D premiums. And that surcharge amount continues to rise as income rises, capping out at an additional surcharge of nearly $5,000/year/person in 2019!

As a result of these Medicare premium surcharges, the total annual health care cost for an individual can be substantially higher, simply because of the surcharges layered on top of the remaining premiums and potential out-of-pocket expenses.

The Health Care Cost Complications Of Retiring Early

While the data of the Vanguard/Mercer study shows that health care costs are stable and feasible to plan for on an annual basis, thanks to Medicare, the matter is more complicated for those retiring 'early' (i.e., before they become eligible for Medicare at age 65).

Over the past several decades, health insurance has evolved to provide a continuous flow of coverage, from children covered by their parents' plans during their early years, to obtaining their own employer coverage once they were able to work for themselves, culminating in Medicare at age 65 when they were no longer able to work anymore. But that left a gap for those who did not work and lost access to employer-based coverage, for which individually-purchased policies were not always available.

IRMAA MEDICARE PREMIUM SURCHARGES IN 2018 & 2019

			2018				2019			
IRMAA Tier	Individual MAGI	Married Joint MAGI	Part B Premium (monthly)	Part D Premium (monthly)	Total Surcharge (monthly)	% of Total Part B Cost	Part B Premium (monthly)	Part D Premium (monthly)	Total Surcharge (monthly)	% of Total Part B Cost
Baseline	< $85,000	< $170,000	$134.00	Plan Premium	N/A	25%	$134.00	Plan Premium	N/A	25%
1	Up to $107,000	Up to $214,000	+ $53.50	+ $13.00	+ $66.50	35%	+ $53.50	+ $12.40	+ $65.90	35%
2	Up to $133,500	Up to $267,500	+ $133.90	+ $33.60	+ $167.50	50%	+ $133.90	+ $31.80	+ $165.80	50%
3	Up to $160,000	Up to $320,000	+ $214.30	+ $54.20	+ $268.50	65%	+ $214.30	+ $51.40	+ $265.70	65%
4	> $160,000	> $320,000	+ $294.60	+ $74.80	+ $369.40	80%	+ $294.60	+ $70.90	+ $365.50	80%
5	> $500,000	> $750,000					$321.40	+ $77.40	+ $398.80	85%

New Tier in 2019

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THE RANGE OF ANNUAL HEALTH CARE COSTS FOR A 65-YEAR-OLD WOMAN, 2018

	Income below $85,000						Income above $160,000					
Health Risk	Low	Medium	High	Low	Medium	High	Low	Medium	High	Low	Medium	High
Geography, Cost of Living	Low	Medium	High	Low	Medium	High	Low	Medium	High	Low	Medium	High
Supplemental Coverage	None	None	None	Plan F	Plan F	Plan F	None	None	None	Plan F	Plan F	Plan F
10th Percentile	$3,000	$3,200	$3,300	$4,700	$4,900	$5,500	$7,400	$7,400	$7,900	$8,100	$8,300	$10,000
Median	$3,300	$3,900	$7,700	$4,700	$5,200	$6,900	$7,800	$8,300	$12,100	$9,200	$9,600	$11,300
90th Percentile	$4,200	$6,600	$21,800	$4,800	$6,000	$11,000	$8,700	$11,000	$26,200	$9,300	$10,500	$15,500

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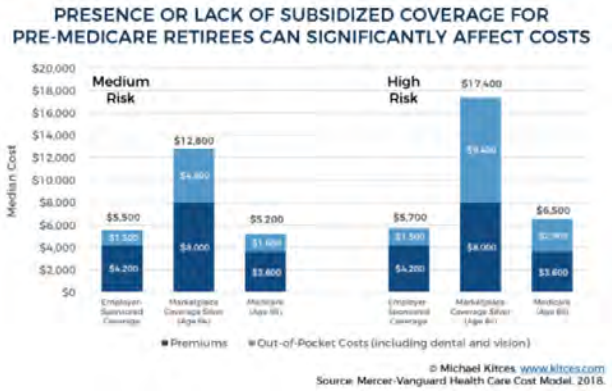
Source: Mercer-Vanguard health care cost model, 2018.

The good news is that, since the rollout of the Affordable Care Act, "early" pre-age-65 retirees do at least have one option assured to access health insurance: state health insurance exchanges. Available either during an open enrollment period, or immediately following the termination of employer coverage, health insurance exchanges mean that early retirees will at least know that they can obtain health insurance in the marketplace and without the risk of being declined or facing exclusions for pre-existing health conditions. In practice, this means that insurance coverage during the working-age years is a combination of employer coverage for those who are working, and state insurance exchanges as a backstop for those who don't have employer coverage.



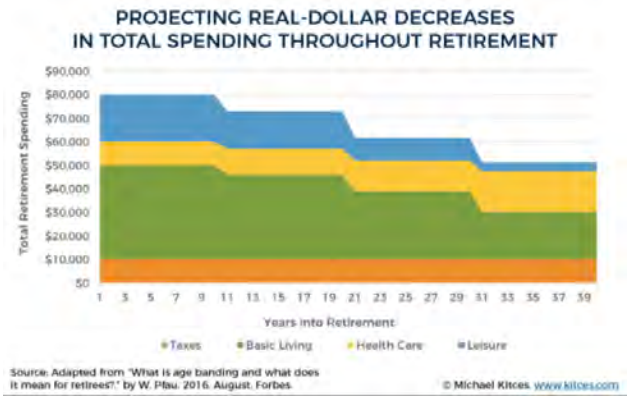
However, the Vanguard/Mercer study does estimate that the median cost of a Silver plan on the exchange for a pre-Medicare 64-year-old is $8,000/year, as contrasted with an average cost of $5,700/year for a Silver plan for a 40-year-old, and a net cost of just $1,300/year for the typical employer plan. And a Silver plan for an early retiree is also substantially higher than the roughly $3,600/year cost of premiums for Medicare Part B, Part D prescription drug coverage, and Medigap Plan F coverage.

At a minimum, this means that 'early' pre-age-65 health insurance many be available and 'plannable,' but retirees planning for health insurance costs in early retirement need to plan for the bump in annual premiums after employer group health insurance ends, but before Medicare begins. That in turn introduces additional planning strategies to manage those premiums by drawing on Premium Assistance Tax Credits, that may be available for individuals with income up to $48,240, or married couples up to $64,960.

Integrating Retiree Health Care Costs With The Rest Of The Plan

Given both the fact that these expenses are specific to the individual, and that medical expenses inflate higher than the general rate of inflation, arguably health care costs should be projected separately from the remainder of retiree expenses. Out-of-pocket expenses for health care also tend to rise over time, simply because retirees tend to have more health events as they get older.

Notably, though, retirement researchers have found that other more discretionary spending in retirement tends to decline in later years, even as health care expenses disproportionately rise. In fact, the Vanguard / Mercer study notes that average spending on health care rises almost 36% from age 55-64-year-old retirees to those who are age 75+, while other spending falls by 29% over the same time period. Except given that health care expenses are ultimately still only a moderate slice of a retiree's total budget, health care expenses rise "just" $1,116 / year, while overall spending falls by $10,498. Which means even if / when / as health care expenses rise in the later years' of retirement, it's more than offset by other retirement spending decreases anyway!



In other words, a key aspect of the Vanguard / Mercer study is that in the end, retirees may be far more distressed about health care expenses than the actual risks they face, both because medical expenses in retirement are actually far more stable than most realize thanks to the availability of Medicare plus Medigap insurance (except, perhaps, for a small subset of the highest risk retirees with multiple chronic conditions who at least face some upside out-of-pocket cost risk), and because discretionary spending tends to naturally decline by far more than health care expenses rise in the later years of retirement.

This article is excerpted from a longer piece by Michael Kitces, and can be read in its entirety at ***Kitces.com****.*

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Avoid These 8 Retirement Planning Mistakes

Deb Kriebel, CFP®, MBA
Partner, Wealth Manager

Mistakes made when planning for your retirement can have disastrous consequences. Better to catch them before they interfere with your future plans.

Here are eight critical (but common) errors you should avoid…

1. Don't retire away from a job; instead, retire to a well-designed retirement plan.

Spend time thinking about what you want to do in retirement. What will you do every day? Will you join a club or volunteer in your community? What are your hobbies? How do you like to spend your free time? If money were no object, how would you enhance your education, participate in cultural activities, enjoy sporting events, or possibly try out some new hobbies? Do you have a bucket list? Are there things on your list that you always wanted to do, but never had the time or money to try out?

Pick the top three priorities on your bucket list and start putting those items into motion now.

2. Don't forget that part-time work can be a good way to phase into retirement… and it's a good way to meet new people.

Think about your hobbies and interests; would it be possible to convert a hobby into a part-time business that generates some income? What are you passionate about? Would you like to embark on an encore career? Have you always dreamed of another career? Take time to explore all the opportunities waiting for you. (Possible suggested reading: Encore: Finding Work that Matters in the Second Half of Life, by Marc Freedman). Schedule a weekend retreat for yourself —a time specifically designed for retirement dreaming and scheming.

3. Don't wait to visit the state where you plan on retiring.

Where are you planning to live in retirement? Will you stay in your current home? Will you move to another state? Will you downsize? Take trips now to your possible, ultimate retirement destination. Plan trips during different times of the year. Discover how the climate and population varies as the seasons change. Explore staying at a Vacation Rental by Owner (VRBO) so you can get to know the neighborhood. Walk around the community and talk with potential future neighbors. Explore the local restaurants, fitness clubs, community colleges, and cultural activities. Can you picture yourself living there? Spend as much time there as you can get away with.

4. Consider building your dream home now.

The time to undertake a major expense is while you're still working. If you encounter cost overruns—and you always do—you can work a little longer. In other words, you could keep working until you pay off your dream home and then retire debt free. By building your dream home now, you can enjoy it longer and share the fun with your family and friends.

5. Think about doing your retirement traveling now.

Traveling can be expensive and often requires a lot of energy. If you're planning an adventurous trip, you might want to do it while you're still healthy and strong. Many trips require long flights, lots of walking and climbing, and you need lots of stamina and strength to conquer the traveling challenges that will undoubtedly come your way. If you're not able to get time off from work to take those trips now or you don't have the funds saved yet, then map out your travel destinations and start setting aside the funds required for those future excursions.

6. Don't forget to rekindle old relationships and strengthen your current personal relationships.

While it might not be a financial consideration, it is a very important part of your mental health. It's well documented that one of the keys to a successful retirement is being content in your personal relationships. Friends, family, co-workers, and neighbors all form an important support network. When you work every day, you don't have the time to nurture old friendships and cultivate new ones, so they get put to the side. In retirement, you'll have the opportunity to reach out to old friends from high school, college, and past careers or neighborhoods to reignite those friendships. You'll have the enjoyment of talking about shared memories and creating new ones at the

same time. The richness of your old and new friendships can help make the difference between an 'okay' retirement and a truly great one.

7. Don't forget to put together your wealth planning team now.

Your team should include a wealth manager, a tax accountant, and an estate planning attorney. Formally open lines of communication and give each party your written consent to share information on your behalf. Work with your estate planning attorney to put together updated Powers of Attorney, Health Care Directives, and Wills/Trusts for your benefit. And don't forget to update your beneficiary designations for your IRA accounts and life insurance policies.

8. Finally, work with your wealth manager to put together a thorough retirement plan.

Your retirement planning process starts with setting your retirement goals and developing a spending plan to accomplish those goals. The process continues with a rigorous quantitative financial plan that analyzes your cash flow projections for the next 20 to 30 years. The analysis incorporates inflation and taxes and includes a Monte Carlo analysis that helps to determine the likelihood that you can spend what you want to spend throughout your retirement. Your wealth manager will map out action steps to help you stay on track, meet your goals and avoid some costly retirement mistakes.

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12 Money-Smart Gifts To Give During Retirement

Michael K. Green, Jr., JD, CFP®, CAP®, CTFA®, CCPS™-ELA®
Wealth Manager

For many professionals, especially recent graduates, student loan debt is not only an expense item on their budget, it is also a major component of their financial trajectory and often a great source of anxiety. Indeed, the data show that in 2018, Americans are more burdened with student loan debt than ever before. In addition to sometimes staggering dollar amounts, those in debt must contend with a complex array of terms and variables when navigating the student loan landscape.

So you've made it to retirement, and realize you have done it with room to spare. A surplus of assets, more than enough to cover your desired lifestyle for many years to come, puts you in a position to have a meaningful impact on the lives of those you love, and on the causes you support. Everyone's situation is different, of course, but here are twelve do-good strategies that may enable you to help those around you in a manner that is tax efficient, and which smoothly coordinates your resources and your goals.

For younger family members, such as grandchildren, education is often a foundational element to their success, but is also a considerable expense. To support that educational foundation getting built, here are some ways you might assist them:

College Savings: Monies placed in a 529 Educational Savings Account enjoy tax free growth and withdrawals if used for qualifying educational expenses. This includes higher education and up to $10,000 of elementary or high school tuition. (Note that state tax laws may vary on the latter.) Many states offer an income tax deduction for contributions made into their state plan. Whether to contribute into a plan in your own name, or in the name of another, can depend upon state deduction laws, financial aid implications, and other variables. In addition, the gift tax rules allow five-year forward lump sum gifting, but filing for this election is important.

School Payments: Private school, college, or graduate school tuition can be paid directly to the school, without being subject to gift tax limitations.

Gifting: In some situations, portfolio assets can be wisely deployed to fund educational costs. If a family member is in a low enough tax bracket (i.e., taxable income of $39,375 or less for single filers in 2019), they may qualify for the 0% capital gains rate. In that scenario, appreciated securities can be gifted to them, and then liquidated at no tax consequence. The proceeds can then be used to pay for school. (Note this is often a

graduate school funding strategy, since something known as the "kiddie tax" is avoided only if the recipient is at least 24 years old.) It is important to keep in mind that this and other gifting may require filing a gift tax form and commensurate gift taxes, if the limits are exceeded.

Student Loan Assistance: For those who have incurred debt in attaining their education, helping in relation to their student loans can give them a meaningful boost in an early stage of their career. Reducing their balances may help them get a better rate when consolidating or refinancing, improve their near-term cash flow, and shorten the duration of their repayment period. Of course, this may require adherence to gift tax filing and tax rules.

In addition to formal schooling, you might also be able to help others in their own wealth building and retirement planning processes, as well as enhance their quality of life. This may include:

IRA contributions: Funding an IRA or a Roth IRA for someone who has earned income, but perhaps limited cash flow, is a great way to start them on the right path for retirement planning. A teenager with a summer job would make a good candidate for this strategy. The longer the time horizon, the greater the potential for wealth accumulation, through the power of com-

pounding. This is also considered a gift, so complying with gift tax filing and rules may be needed.

Market Entry: Funding the purchase of securities in the name of a relative can give them a sense of ownership, and may cultivate an interest in both savings and in the financial markets themselves. A Dividend Reinvestment Plan (DRIP) account, in which earnings are used to purchase additional shares, can be a great start down that path. This may require adherence to gift tax filing and tax rules.

Home Purchase: A home purchase is one of the biggest financial decisions in most people's lives. Assisting an individual or couple with the down payment on a first home may help them attain a better mortgage interest rate, reduce their monthly expenses, and set them on a path of building long-term equity. Again, this may require filing a gift tax form and commensurate gift taxes if the limits are exceeded.

Planned Vacation: Plan a vacation that you, your grown children, and their children might all take together. Funding a trip that the others might not otherwise be able to afford will provide the opportunity to create lasting memories, and draw the family closer despite busy lives.

Beyond family members, you might also seek to improve the world around you, through your support of various charities and causes. With that in mind, you could consider:

Asset donation: Gifting an appreciated publicly traded security to most 501c(3) organizations will provide you with a deduction equal to the full market value of the shares given (up to 30% of your adjusted gross income, with deduction carryforwards of up to 5 additional years). It will also avoid any capital gains taxes that would be incurred if you sold the asset. There are a variety of charitable giving vehicles, and tax-efficient strategies to go with them. Some of them also provide an income stream. A more-detailed discussion on those instruments can be found here.

IRA Rollovers: Known as Qualified Charitable Distributions (QCDs), this option is available to those, aged 70½ or older, who are subject to Required Minimum Distributions (RMDs) on an IRA account. Payments made directly from the IRA to a qualified charity are not counted as taxable income. Depending upon your circumstances and cash needs, you might direct your entire RMD (up to a maximum of $100,000) or a portion of it to your desired charities. Note that you must present this information to your accountant to have the income not be taxed as the 1099-R for a QCD is not coded for charity.

Life Insurance: In some cases, an accumulation of resources can leave you with a life insurance policy that you, or your family, no longer need. In that scenario, you might consider naming a charity as the beneficiary. With some charities, it may also be possible to transfer ownership of the policy to them during your lifetime, and to obtain a tax deduction in the process. (Your results depend upon the type of policy and the particular charity involved, so a thorough evaluation of the tax consequences and other ramifications should be taken before proceeding.)

> **You might also be able to help others in their own wealth building and retirement planning processes, as well as enhance their quality of life.**

Bargain Sale: Through the sale of an appreciated asset, such as real estate, to a charity at less than fair market value, you might secure cash proceeds while obtaining a charitable deduction and reducing capital gains. By doing so, you will also have made a gift of significant impact to that organization.

Obviously, before any gift planning can occur, you first have to confirm that your own financial needs will be met under a variety of future circumstances. The strategies above are neither exhaustive nor applicable to everyone. Please consult your wealth manager for further evaluation of these or other similar strategies.

Hopefully, however, this provides a sampling of some of the potential giving strategies, given your particular circumstances, that can be undertaken in retirement. The hard work, disciplined savings, and forethought that positioned you well for retirement itself can also provide the foundation for you to touch the lives of your loved ones, and those in your community, going forward.

Retired? You've only just begun!

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Retirement Or Your Children's Education: Which Comes First?

Josh Rivers, CFP®
Wealth Manager

In the unlikely event of a loss of cabin pressure, panels above your seat will open revealing oxygen masks. Reach up and pull a mask towards you… Secure your own mask first before helping others.

If you have ever flown on an airline, you have no doubt heard this speech. When I fly with my children, this means I should put my mask on first and then assist them. The logic is clear: You are of no use to your child if you don't take care of yourself first. This concept is the analogy I use to speak to my clients, when they ask me if they should dip into their retirement savings, or stop contributing to their retirement, to help fund their child's college education. Purely from a planning perspective, it is an easy question to answer. But that doesn't change the fact that it's often an emotional decision.

In the 2018 edition of their annual study "How America Values College," Sallie Mae and Ipsos revealed that 8 in 10 families believe a college education is more important than ever, and that 83% of people believe they will earn more with a college degree. Using this data, it is fair to say that the majority of parents want their child to attend college; but how will they pay for it?

Over the years—and against my advice—I have had clients dip into their retirement savings to help their children pay for college. This is something I would never recommend. Retirement for most people is a necessity. There are folks who say they will never retire, but for most, there will come a time when they will no longer be working and will need an income source beyond Social Security. While there are many resources to help make college more affordable, beyond Social Security there are no other safety nets in retirement if you have not saved enough money. If you want to be in a financial position to help your children pay for their education, it makes sense to look after your own finances first. The good news is that fewer parents are using their retirement savings to pay for college… and the view on whose responsibility it is to pay for college is shifting as well.

In their 2018 "How America Saves for College" study, Sallie Mae and Ipsos note that only 10% of those surveyed are planning to use retirement accounts to fund their child's education—this is down from 20% in the 2016 study. They also note that 59% of those surveyed believe their child should have at least some responsibility in paying for their own education—up from 51% in 2016. Over that same time period, those parents surveyed who believe they are solely responsible for paying for their child's education has dropped from 30% to 26%. Interestingly, lower income parents are more likely to feel the need to pay for all of their children's college education than higher income parents. The sad part of this statistic is that those same parents are more likely to dip into their retirement savings and harm their long-term financial independence. Before making the decision to tap your retirement account for college, parents and kids should consider other options that can help lower the cost of college.

Take John and Jane for example. Their daughter Jean will be attending the University of Maryland in the fall. The current cost for tuition for undergrads at Maryland is approximately $27,000 per year. Both of Jean's parents work and make a good income, so she has not qualified for much in the way of financial aid, though she did receive a $3,000 scholarship for each of her four years. Assuming costs don't go up, Jean has to come up with the remaining $96,000 over the next four years. John and Jane have not saved for Jean's education, so they are considering taking the money from their 401ks to fund Jean's education.

They have two options if they are going to take their money from their 401k accounts, and neither is very good. Option 1 is for them each to take a loan from their 401k. Generally, 401k plans will allow you to take a loan from your plan of up to 50% of your account, up to $50,000. The downside to this is that the loan often can be required to be repaid in 5 years, and certain events—like if you were to leave your employer—could trigger the repayment of the balance immediately. If any of the portion of the loan is not paid back, it is considered a taxable withdrawal. This is generally not an ideal scenario, as most college loans outside of a 401k can be spread out over a longer period of time making it easier to return the borrowed principle.

Their second option would be to take the money out of their 401ks directly. This is even less ideal. In addition to a 10% penalty on the early withdrawal, they would

also have to pay taxes on the amount distributed. In their case, to get $96,000 net they would have to withdraw nearly $175,000—including withholding 28% for federal taxes and 7% state taxes. In a $500,000 account, that leaves only $325,000 to earn and grow. In 15 years, at an achievable rate of return on a conservative diversified portfolio of ETFs, or stocks, bonds, and cash, (net of fees and reinvested) that $175,000 could be worth closer to $500,000 had they left it in their retirement plan (or $825,000 in total). By withdrawing this level of capital from their retirement savings, they reduce the account's ability to generate capital growth of the principle, leaving less to withdraw from in later years, and could do major damage to their retirement plans when there are other alternatives to paying for their daughter's education.

Some of the creative ways that kids are employing to help reduce their college costs include living at home, working and attending school at the same time, attending an online college or university, going to school part time and taking longer to finish their degree, or delaying their start date and working to save money for school. There are many ways to make college more affordable and to pay for school without dipping into your retirement savings, so this should only be done as a last resort.

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5 Popular Myths About Debt... And How They Impact Your Credit Score

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Eight out of every ten American adults have some form of debt. Properly managed, debt can enhance a person's lifestyle. For something so common, though, people often have conflicting emotions about it. In fact, debt is the top cause of financial stress in the United States. The situation is not helped by the hysteria and half-truths commonly found in the media. Myths about debt can cause confusion, discomfort, and distress.

Here are some of the biggest myths...

Myth #1: My credit does not matter.

The truth is that your credit does matter, even if you are not planning to obtain new credit. Poor credit could keep you from getting a job or security clearance. Not only does having poor credit make it more difficult to rent an apartment, it could also mean higher utility deposits. Did you know that people with lower credit scores often pay much more for auto and homeowners insurance premiums? In my home state of Florida, having a conviction for Driving While Intoxicated increases your auto insurance premiums by an average of $866 a year, while having poor credit increases premiums by a whopping $2,417 each year.

A few states do prohibit the use of credit scores in determining insurance premiums (Maryland prohibits it for setting homeowners insurance premiums).

Once you understand how important payment history is to your credit score, you can see that being debt-free will not necessarily give you a good credit score since you will not have a significant payment history.

Myth #2: I don't need an emergency fund because I have credit cards and/or a home equity line of credit.

It is true that you can use debt to pay for an unplanned emergency. However, doing so will add debt payments to your monthly expenses at a time when your budget is already under strain. If a person is unable to save to an emergency fund already, how will he be able to pay off that debt?

The typical rule of thumb is to have an emergency fund equal to three-to-six months' worth of expenses, but speak with your Wealth Manager to determine the amount that is right for you.

Myth #3: Once you marry, you are responsible for your spouse's debt prior to the marriage / Your joint debts are separated when you get divorced.

The truth is that you do not automatically assume responsibility for your spouse's debt when you get married. However, if you make payments on your spouse's debt from your own income, and then you separate, you could very well be required to continue those payments until the time the divorce is finalized. In most states, a debt incurred during the marriage will be the responsibility of the spouse who incurred the debt. Upon a divorce, technically the debt remains the responsibility of the incurring party. In practice, however, that debt could still be included in the property settlement depending on the mediator or the judge, and the non-incurring spouse will have his or her settlement amount reduced by half of that debt.

In community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin) a debt incurred during the marriage will be the responsibility of both spouses, even if only one spouse signed for it or the other spouse was unaware. Even if a divorce decree says you are not responsible for a joint debt, it means little or nothing to the lender unless the loan is refinanced and your name is removed. Your ex-spouse may be required by the divorce agreement to make payments, but if your name is still on the loan, your credit will suffer if those payments are not made.

State law differs, so consult an attorney for the laws in your state.

Myth #4: Your heirs will have to pay off your debts when you die.

The truth is that anything that passes to an individual by beneficiary form (such as IRAs and life insurance) or by title will generally be outside of probate and will not be used to pay off your debts. This is one reason why it is important to keep your beneficiary designa-

tions current, so that money does not go into probate unnecessarily. Make sure that your 401(k) and other company retirement accounts also have correct beneficiary designations—I have seen many times when there were no beneficiaries listed.

Anything else in your estate will go into probate and will be used to pay off your debts, then the remaining balance will be distributed to your heirs (absent a will or trust that indicates the contrary).

Debt will reduce the amount of inheritance that your heirs receive. If the debts are more than the value of the estate, then the heirs are not generally responsible, and the creditors will have to write the debt off. The major exception in many states is unpaid medical expenses. Check with an estate attorney for advice on your individual situation. If someone co-signed on the deceased person's debt, then of course the co-signer remains responsible.

Myth #5: Mortgage and home equity interest payments are a great tax deduction.

This was true until recently… the new tax law passed in December 2017 greatly reduced the value of the mortgage interest deduction. Previously, you could deduct the interest on up to $100,000 of mortgage or home equity debt that was used for any other purpose, such as to buy a car or pay for college educations. Beginning in 2018 you can no longer do that.

You used to be able to deduct the interest on up to $1,000,000 in home acquisition debt, but now you can only deduct the interest on up to $750,000 in new home acquisition debt (debt obtained before 2018 is grandfathered in). Most importantly, the tax law almost doubled the standard deduction and lowered marginal tax rates, thereby lowering the value of every itemized deduction.

Itemized deductions are only valuable to the extent that they are greater than the standard deduction and thereby reduce your tax bill by your marginal rate. For

example, if you were a single person in 2017, your standard deduction was $6,500. Itemized deductions up to $6,500 had no tax value because they would not lower your taxes, since your standard deduction was higher. If your itemized deductions were $11,500 though—and assuming you were in the 25% marginal tax bracket—the extra $5,000 of deductions would reduce your taxes by $1,250. If you had $17,000 of itemized deductions, you would reduce your taxes by $2,625.

In 2018, your standard deduction shifted to $12,000 and put you in a 22% marginal bracket. Having $11,500 of itemized deductions is now of no tax value to you since they will not save you any money on your taxes. If you have $17,000 in itemized deductions, that would reduce your taxes by $1,100 (versus $2,625 in 2017). Because of the tax law changes, mortgage interest is not as valuable a tax deduction as it used to be.

Bonus Myth: Credit Scores are hard to understand.

Although many people are uninformed about the factors that impact a credit score, the truth is that it is not hard to understand. There are six factors that make up a credit score. The first three have a high impact and the last three have a lower impact. These are the only factors used to compile your credit score; things like your income, assets, or marital status have no impact on it at all.

1. Credit card utilization is the percentage of available

credit that you use and is the most important factor in your credit score. As the saying goes, a bank is a place that will lend you money if you can prove that you don't need it. For a good credit score, you want to have a credit utilization percentage below 30%.

Many of the misconceptions about credit scores arise from being unaware of the effect of a particular action on credit card utilization. Closing old credit card accounts reduces the amount of your available credit and can increase your credit utilization percentage, which is why closing old accounts can actually lower your credit score. On the other hand, credit limit increases will usually raise your credit score since they decrease your credit utilization percentage.

Paying down credit card balances will quickly improve your credit score, while making extra principal payments on other types of loans will not improve it as fast. Of course, it is best to pay off credit card balances in full every month. If you do carry credit card balances, taking out a personal loan to pay off credit cards is one of the fastest ways to increase your credit score, since the personal loan balance will not be included in your credit card utilization percentage. Debit and prepaid cards do not help your credit score since the information is not reported to credit bureaus.

Although many people are uninformed about the factors that impact a credit score, the truth is that it is not hard to understand.

2. Payment history is the second big factor in your credit score. The best scores come when you make 100% of your payments on time. A 99% history is still acceptable, but anything below 99% has a significant negative effect on your credit score. Once you understand how important payment history is to your credit score, you can see that being debt-free will not necessarily give you a good credit score since you will not have a significant payment history. Since credit card utilization is as important as payment history, you can have a poor credit score even with a perfect payment history if you use 30% or more of your available credit.

3. Derogatory marks (such as tax liens, civil judgments, and bankruptcies) also have a high impact on your credit score. The impact can last up to ten years, but your credit score will start to improve slowly after two years.

4. Age of credit history, which is the average age of all your credit accounts is also a factor. For the best credit scores, your average credit history should be at least seven years. This is why closing a credit card that you have had for a long time or opening new credit accounts could lower your credit score. Length of credit history accounts for about 15% of your credit score.

5. The total number of accounts makes up 10% of your credit score. For the best scores, credit bureaus like to see at least 11 accounts.

6. New credit applications (known as "Hard Inquiries") make up another 10% of your credit score. For the best scores, credit bureaus want to see 2 or less hard inquiries in the last two years. Applying for new

credit will have a small negative effect on your credit score right away, but if approved, that decrease will likely be offset by the positive impact of a lower credit card utilization percentage. Hard inquiries automatically drop off after two years, and your credit score will increase when one does.

Checking your credit is a 'soft' inquiry (since it is not an application for new credit) and will not lower your credit score. You can get a free credit report every 12 months from each of the three major credit bureaus at www.annualcreditreport.com, but it will not include your credit score. You can use a popular app like Credit Karma to follow your credit score (it shows scores from Equifax and Transunion) or go directly to the reporting agency, which is required to supply you with one report per year at no charge.

These are very simplistic, theoretical examples and everyone's tax and credit situation is different.

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MARKET OUTLOOK

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During the first quarter of 2019, markets staged an unexpectedly scorching bounce-back from a tough end of the year in 2018, and in the process, washed away investor fears that had built during the back half of 2018. Domestic and international stocks led the charge with double digit returns; commodities and corporate bonds had a very healthy quarter; and even Treasury bonds found a way to post solid returns during a period that was dominated by risky assets.

Pinpointing the cause of a market move is never an exact science, but investors appeared to focus on a friendly pivot from the Federal Reserve regarding interest rate hikes, and expectations of a coming trade deal with China, as the major catalysts for the rally. They also showed a willingness to look past weakening economic data and earnings around the globe. As investors try to make sense of markets that roared back to life in the face of fading fundamentals, they are now left to ponder whether the market is sensing a future pickup in world growth, or simply luring investors into a late cycle bull market trap.

Scary stuff.

The Fork in the Road

As we start the second quarter, investors are facing a fork in the road, where one path may lead to a new cyclical bull market, and the other to a fragile topping process that is fraught with risk.

How to choose . . .

Left Fork: The Case for a Goldilocks Bull Market

The case for a new bull market lies in the belief that we'll return to a goldilocks macro environment, which can be characterized as an economic backdrop that is not too hot, not too cold, but just right for risk-asset growth. The key inputs for a goldilocks backdrop are low inflation, improving economic growth, and reasonable central bank and government policy. Some in the analyst community believe that is exactly the environment that markets are sensing now, as they have exploded off the December bottom.

The evidence that aligns with this view starts with inflation pressures that peaked last year, but have been easing ever since. Lower inflation reduces expenses for businesses, enhances consumer's purchasing power, and allows central banks to concentrate on policy that nurtures economic expansions, as opposed to restraining growth in order to keep a lid on prices. In 2018, central banks were raising interest rates and removing liquidity from the system, which worked against global economies and world markets. However, this dynamic began changing in early 2019. Markets celebrated a pivot by the U.S. central bank from raising interest rates to pausing its escalation in order preserve the uptrend in the economy. The European Central Bank followed suit, and announced policy initiatives designed to support growth, and arrest the pervasive downtrend in economic growth within the region.

Big Trouble in Little China?

While policy settings in the U.S. and Europe have both helped to renew investor confidence and bolster stock prices, Chinese fiscal and monetary authorities have been busy enacting a steady stream of impactful policy changes, which are clearly designed to jump start their sagging economy. After announcing more than 70 different policy actions over the past several months, there are tentative signs that their economy is stabilizing. China is the second largest economy in the world, and material swings in its growth rate tend to ripple through the entire global financial landscape. The ultimate effectiveness of these policies is likely the key to whether or not global growth picks up in the second half of the year. If this major policy push in China can successfully accelerate economic growth—and inflation stays tame—it is possible that a return to a goldilocks backdrop can occur. Should this happen, it may help fuel a durable bull market in asset prices.

Aside from the potential for a goldilocks macro backdrop, there are some other reasons to believe that a bear market bottom was established in late 2018, and that a new bull market is currently underway. During the quarter, the message from the corporate bond market appeared to be signaling that businesses are healthy, increasing demand for stocks outpaced supply, and investor enthusiasm picked up during the rally. Lastly, there also seems to have been a meaningful change in how the U.S. administration is approaching trade policy, as the combination of weaker economics, market damage, and an impending 2020 election appear to have U.S. officials working harder towards reaching some sort of deal with China. If a deal is struck, this could remove an enormous risk to economic growth by reversing what was arguably a major policy mistake in 2018.

Right Fork: The Case for a Market Topping Process

While equity markets have celebrated changes in central bank and trade policy, it has been remarkable to watch a wide disconnect develop between global economic data, and stock market growth. During the first quarter, data from most of the world has been generally weaker, suggesting that there continues to be a synchronized global slowdown in progress.

The global economy is extremely important, not only for assessing the risk/reward equation between stock, bond, and commodity markets, but for feeding capital directly into U.S. corporate earnings, since many multinational companies generate a large percentage of their earnings from overseas. Some analysts believe the U.S. economy is more insulated from global slowdowns than in the past, due to its relatively small reliance on trade. While that theory worked temporarily in the first half of 2018, it has faltered more recently, as the U.S. economy has started to succumb to the negative effects of the worldwide slowdown. This is evident in a variety of different indicators, including slowing manufacturing data, ebbing long-term investor and consumer confidence measures, and some leading recession indicators that are beginning to flash early warning signals that risks are rising.

Despite increasing signs that the U.S. is entrenched in a slowdown, investment markets currently appear to be looking past the first quarter valley, with an expectation that the back half of the year will reaccelerate. Considering the market run off the December bottom, it seems reasonable to assume that economic data and earnings will show at least a tepid bounce back during the second quarter. The nascent risk for markets lies in what's lurking in the second half of the year. If the economy can't sustain the anticipated near-term bounce, then stocks and risky assets could be vulnerable to a sudden downturn, as investor focus begins to drift from policy relief to a realization that a flagging world economy would create a fresh downdraft for corporate earnings.

Our Current Stance

Back in the first quarter we questioned whether the market had made its bottom or was cycling up into a new bull. Based on historical bear market cycles, the odds were in favor of the market running into heavy resistance and then sliding back towards the December lows as part of a longer bottoming process. While history can be a useful guide to help navigate markets, it is never a guarantee, and so far, the post-bear market experience has not followed the usual tendencies as stocks have enjoyed an almost uninterrupted rebound since making a low on December 26th.

The evidence remains mixed for now, but skewed in a direction that warrants some caution. But we are also reassessing whether we are at an inflection point where the more positive global growth scenario could be at play in driving the most recent rally. If the evidence accumulates so that a goldilocks backdrop has formed, we stand ready to adjust portfolio allocations, intending to take advantage of a potential sweet spot for risk assets that could be developing. At the same time, we'll also continue to be vigilant in looking for indications that the trend of the business cycle is heading downward. Should we see these signs, and any further evidence that the economic cycle is nearing the end, we must also be prepared to de-risk portfolios further to defend against a recession that may come earlier than the consensus believes.

Value Opportunities & Fixed Income Positioning

While we wait to see if an inflection point is at hand, a growing conviction is that international equities may possibly become more of a value opportunity versus domestic stocks. Although there are only tentative signs that global growth is picking up, we have already begun to incrementally lift our positions in global stocks from being underweight to neutral in anticipation of a phase of growth in the future. If more evidence accumulates that China and global growth are healing, it would create an opportunity to turn more aggressive, and overweight this theme as the year progresses. But if the data falters and stocks decline, we may be more inclined to hold onto international assets while paring back on cyclical U.S. stock holdings with higher valuations. Should we get a material decline in risk assets, the current playbook would be to slowly build more global stock exposure intended to set ourselves up for a multi-year run in global versus domestic holdings during the next cyclical bull run.

Bond prices have appreciated recently as interest rates have fallen due to the global growth slowdown, and we have been shifting to neutral levels of interest rate sensitivity after a meaningful rally. We still believe that portfolios should own some bond holdings, given poor data and ebbing inflation, but we recently thought it was prudent to take advantage of the rally in lieu of a potential pickup in global growth that could lead to a sell-off in the bond market. If growth turns up, we will have locked in a profit; and if the economics turn down, we'll still have plenty of dry powder in the form of bonds and cash to apply to assets that will quickly build value during a downturn.

Conclusion

Markets have a knack for proving the masses wrong at major turning points, and the first quarter clearly took most investors by surprise as it delivered a spectacular quarter for risk assets. There is no denying that the quarter was terrific for building wealth, but investors now face the proverbial fork in the road: Did the most recent market move foreshadow a future pickup in economic fundamentals, or did it just reflect an oversold market that was prone to snap back, and now looks vulnerable to disappointment over coming quarters? If the bulls are correct, a perfect sweet spot for markets may be developing on the back of accelerating global growth in a low inflation environment. If the bears have this right, then relief over positive policy changes will likely be short lived, as the market reacts to deteriorating world fundamentals.

We still believe the evidence tilts towards a cautious stance, but are wrestling with the notion that a positive inflection for global growth may be in the offing. If more evidence of growth picking up materializes, then we will look for opportunities to build back risk. But if the evidence shows no bottoming in growth, we may have to bolster defenses to guard against the possibility that an economic contraction may arrive sooner than anticipated.

Yogi Berra once wrote, "When you come to a fork in the road, take it." We believe we are close to an inflection point in the evidence that will dictate which side of that fork to take.

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