The
Financial Update

Day & Ennis, LLC
Fee-Only Financial Planning

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Did The Devil Make You Do It? 8 Retirement Miscues

We're all human, and we all make mistakes. Yet some errors are worse than others, and it's important to try to avoid the kinds of miscues that could derail your retirement.

What sort of mistakes? Of course, these will vary from person to person, but here are eight common foul-ups that often bedevil soon- to-be retirees:

Mistake #1—You have no financial plan for retirement.

Although your plan doesn't have to be carved in stone—and in fact it needs to be flexible—it at least should provide some basic guidelines for your future. A bare-bones plan will look at your potential sources of retirement income and approximate what you can expect to spend—and rough estimates are better than no estimates at all. Figuring out what it may take to live comfortably during retirement is the first step toward getting there.

Mistake #2—You have too much debt.

Perhaps nothing can be more damaging to successful retirement than crushing debt. Avoiding high-interest-rate credit card charges can help you head off the problem. If you spend within your means and borrow judiciously, you'll be able to save more for retirement and won't be burdened by the need to pay off compounding debt.

Mistake #3—You sacrifice retirement planning for education planning.

Saving money for your children's college education is obviously a lofty and worthwhile goal, and starting early can help ease your financial burden when tuition bills come due. But you may not want to make education saving your primary financial priority. Often, parents are able to help pay college bills while still putting away money for retirement, and your kids can help by taking low-interest loans to cover part of their costs.

Mistake #4—You don't keep an emergency fund.

Even if you've been diligent about saving for retirement, remember to expect the unexpected. You might lose your job or face another financial or medical emergency, and having a cash cushion to fall back on can help you avoid dipping into retirement funds—an option that could have short- and long-term tax and financial consequences. The usual rule of thumb is to try to set aside at least six months worth of salary in a rainy day fund.

Mistake #5—You don't have a long-term investment strategy.

You're likely to fare better if you establish a long-range investment plan for retirement rather than trying to boost your portfolio by chasing hot stocks. Time-tested principles such as asset allocation and diversification can help you make steady progress toward your goals, whereas playing investment

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Frame Of Reference Risk

If you've ever compared your portfolio performance to investments that are currently doing well in the markets, you've experienced "frame of reference risk". That's the risk that an investor will unfavorably compare the performance of their diversified portfolio with the returns only on the US stock market. They may then abandon their diversified approach, much to their later regret. It's a pitfall of following the Dow or the S&P 500, rather than following the performance of an overall asset class strategy.

Roger Gibson, author of Asset Allocation, Balancing Financial Risk, has written extensively about frame of reference risk. He says that less volatile and more diversified portfolios are designed to pick up additional returns over time. This is clearly due to the mathematics of compounded returns. Less volatile portfolios suffer fewer and less severe losses and tend to be more efficient generators of total return than more volatile ones. From a purely numerical standpoint, losses matter than more gains. So if two portfolios have identical average returns, the less volatile one will experience better geometric return.

At Day & Ennis, we would be glad to discuss diversification and investment strategy with you at your convenience.

Sincerely,
Day & Ennis, LLC

View All Tax Angles On Dividends

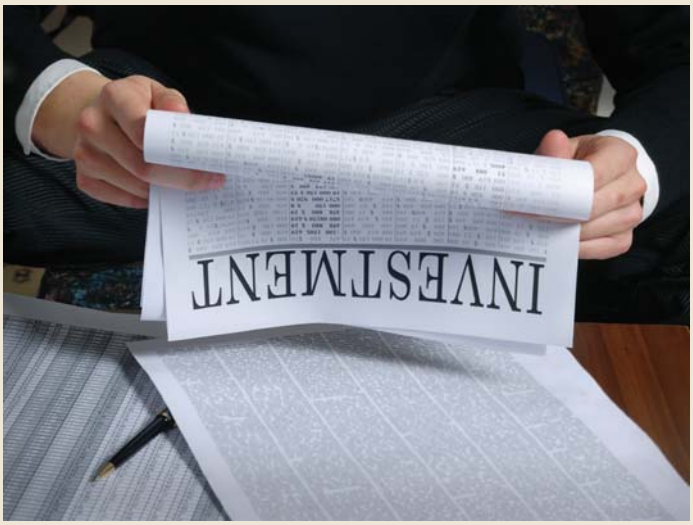
What's the tax deal with dividends? At first glance, it looks to be cut and dried. You receive dividends during the year and you pay tax on the amount reported to you on your Form 1099s. End of story, right?

Not exactly. First, many dividends are eligible for preferential tax treatment, much like long-term capital gains. Second, some astute timing on your part can minimize the tax you owe on dividends. Third, you need to be aware of a common tax mishap that befalls investors.

Here's a quick overview:

1. Qualified dividends. Generally, dividends issued by domestic companies are "qualified" when paid to stockholders and mutual fund owners, and that normally means special tax treatment. In some cases, qualified dividends also may be paid by foreign corporations, including shares represented by publicly traded American Depositary Receipts (ADRs) and shares that are otherwise readily tradable on an established U.S. securities market.

As for long-term capital gains, the maximum tax rate on qualified dividends is 15%, or 20% for investors in the top ordinary income tax bracket of 39.6%. Investors in the two lowest brackets of 10% and 15% may benefit from a 0% rate on qualified dividends.



To qualify for the reduced tax rates, shareholders of common stock and mutual funds must own the stock for more than 60 days, including the "ex-dividend" date (when dividends are paid). The holding period is 90 days for preferred stock. Being sure to meet these requirements could affect the timing of your transactions.

2. Tax timing. Although investors usually aren't concerned with corporate mechanisms, it's important to know the ex-dividend date. After this date, buyers of the securities no longer are entitled to receive dividends. However, as long as you buy a stock before its ex-dividend date, you then can sell the stock at any time, even after the ex-dividend date, and still receive the dividends.

One common tax planning strategy is to arrange to sell mutual fund shares before the ex-dividend date and buy shares after the date dividends are declared. If instead you buy shares just before the ex-dividend date, you will have additional tax liability for the current tax year, even if the value of your shares declines.

3. Reinvested dividends. Most investors choose to have dividends in an investment automatically reinvested. That way, your money keeps earning more money for you. Just be aware that you're paying tax on dividends each year and your tax basis for the investment should be adjusted upward. Otherwise, if you're not careful, you could end up paying tax again when you sell the shares – in effect, a double tax.

As you can see, there are more tax angles to dividends than first meets the eye. Makes sure you understand all of the rules, and act accordingly. ●

Can You Avoid Estate And Gift Tax?

Are you hoping to pass investment assets to your heirs without any tax damage? Under the current rules, you have plenty of leeway to avoid estate and gift taxes on the federal level, although state taxes may be another story. However, keep in mind that your investment returns may outpace the inflation adjustments to the personal gift and estate tax exemption—and this could mean that your wealth will grow enough to be subject to taxes when you die.

There are two main estate and gift tax breaks: the annual gift tax exclusion and the unified estate and gift tax credit.

1. Annual gift tax exclusion. You can give each recipient, such as a younger family member, assets valued up to $14,000 a year without paying any gift tax (or even having to file a gift tax return). The exclusion is doubled to $28,000 for joint gifts made by a married couple. So, if you and your spouse each give the maximum $14,000 to five other family members, you can reduce your taxable estate by $140,000. And you can do this year after year.

The annual gift tax exclusion is indexed for inflation but rises only when the cost of living increases enough to result in a $1,000 bump to the exempt amount. With inflation very low in recent years, increases have slowed to a crawl. The last adjustment was made in 2013, from $13,000 to the current $14,000.

2. Unified estate and gift tax credit. This generous credit can wipe out either estate taxes, gift taxes, or a combination of the two.

After a decade of gradual increases, Congress permanently locked in the exemption amount at an inflation-adjusted $5 million. For 2015, the exemption is $5.43 million (up from $5.34 million in 2014). That means a couple easily can shelter more than $10 million in assets from estate tax, although any lifetime gifts exceeding the annual gift tax exclusion will reduce the amount available to help an estate avoid estate taxes.

But you can't simply take this tax shelter for granted. Remember that your assets may appreciate in value

Avoid Emotional Portfolio Withdrawals

The Standard & Poor's 500 stock index is the benchmark against which most investors measure the performance of their portfolios, but that's not such a good thing. For, although the widely-cited index represents the value of America's 500 largest publicly-held companies, it does not represent the performance you should expect from a retirement portfolio.

Prudence demands diversification of a retirement portfolio far beyond 500 blue-chip stocks into multiple asset classes. Surprisingly, so do history, math, and greed.

It turns out that a multi-asset retirement portfolio historically generates returns almost identical to the S&P 500, but without much of the drama.

Since performance data on a broad range of asset classes first became available 44 years ago, investors in a seven-asset portfolio sidestepped the worst of the terrible dips that befell the S&P 500.

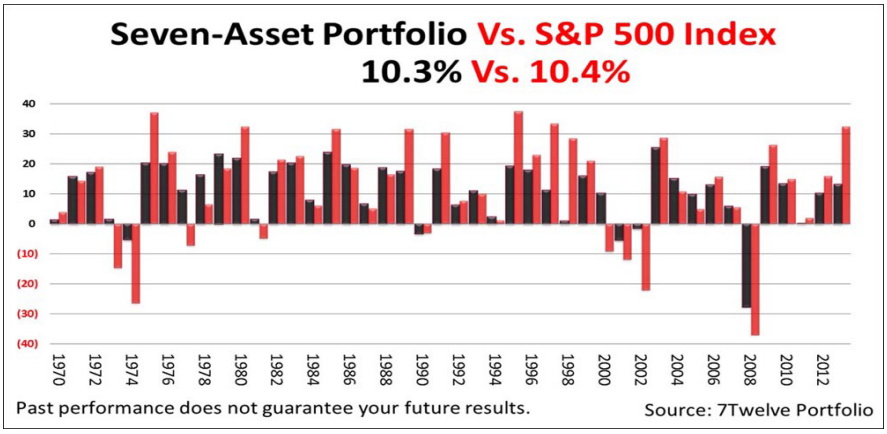
In 2008, for example, when the world financial system teetered on the edge of collapse, the S&P 500 lost as much as 37%. Investors in a multi-asset also suffered frightening losses, but the 28% pullback they suffered was a mere two-thirds of the loss on the S&P 500.

The Math Of Losses In 2008¥

% Portfolio Loss	Portfolios	% Gain Needed To Break Even
-5%		5.3%
-10%		11.1%
-15%		17.6%
-20%		25.0%
-27%	Multi-Asset Portfolio	37.0%
-30%		42.9%
-35%		53.8%
-37%	S&P 500 Index	58.7%
-40%		66.7%
-45%		81.8%
-50%		100.0%
-55%		122.2%
-60%		150.0%
-65%		185.7%
-70%		233.3%
-75%		300.0%

¥Required % Gain = [1 / (1 – % Loss)] – 1

Past performance does not guarantee your future results. Source: 7Twelve Portfolio



Put another way: The 10.4% annualized return on the S&P 500 versus the 10.3% multi-asset portfolio over 44 years are nearly identical, but investors in the multi-asset portfolio earned their return without experiencing the extreme lows of the S&P 500—losses so large they are more likely to compel selling stocks at market-lows and then missing the next bull-run.

The "math of losses" makes it hard for a portfolio diminished by losses to become whole again. Losing 20.0% of a portfolio requires a 25.0% gain to break even. And the math becomes more tyrannical with larger losses.

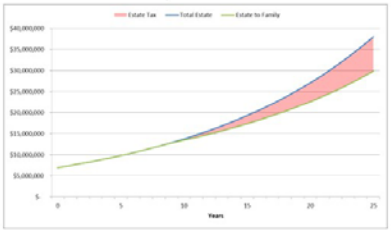
Recovering from the 37% loss in the S&P 500 investors sustained at the market bottom in 2008 required a 58.7% gain. To recuperate from its 28% decline sustained by investors in the multi-asset portfolio required a 37% gain.

It pushes investors into scarier situations and makes it more difficult to have faith that nothing—no natural disaster or political, financial or religious crisis or war—will bring down the world and bring an end to the progress of humanity. ●

Wealth Preservation & Transfer

In General

Example. Consider a couple with $7,000,000 in assets. If inflation is 2% and their assets grow at 7%, within nine years the couple will have estate tax exposure:



at a rate greater the annual inflation adjustments for the estate tax exemption. (Of course, assets also might decline in value.) This is especially true if the recent trend in low inflation persists. For example, suppose a couple has $7 million in assets and earns an annual average return of 7%. If the inflation rate remains at 2%, it will only take nine years for the couple to face federal estate tax exposure.

For those in the danger zone, tax-sheltered trusts and other techniques could help safeguard assets from estate tax. In addition, making annual tax-exempt gifts for several years can help reduce the eventual size of the estate. ●

How To Downplay The Kiddie Tax

From a tax-planning standpoint, it's often good to get investments out of the hands of highly taxed parents and into the accounts of children or grandchildren who are in much lower tax brackets. This can result in overall savings on current taxes while also removing assets from the parents' taxable estate. Of course, you have to be willing to part with your stocks or bonds, but that might make sense for other reasons, too.

Still, there's one problem with this simple solution. A tax-law provision known as the kiddie tax could negate many of the advantages of giving investments to your offspring.

Generally, investment income is taxed to the person who receives it—to the owner of the assets. So if you move stocks or mutual funds into the names of your children, they (rather than you) will be taxed, often at a much lower tax rate than yours. Suppose you're paying at the highest possible rates—you're in the top 39.6% income tax bracket and you also owe the 3.8% surtax on net investment income. That gives you a combined federal tax rate of 43.4%, whereas your son or daughter might be in the 10% or 15% tax bracket for ordinary income. On an investment generating $10,000 a year, having a child own it potentially could save your family the difference between 43.4% and 10%, or $3,340 in tax cost.

But then there's the kiddie tax. For a child who is your dependent and under age 19, or a full-time student under age 24, unearned income from investments that exceeds a specified threshold—$2,000 in 2014—is taxed at the parents' tax rate. So in the example of an investment generating $10,000 a year, $8,000 of the income could end up being taxed at the 43.4% rate, and then your family would lose all but $668 of the overall tax savings.

Nevertheless, there are several ways you can mitigate the effects of the kiddie tax. For instance:

- Keep an eye on the annual threshold. You might limit the asset transfer to an amount that would generate no more than about $2,000 in unearned income. Once the child is old enough to avoid the kiddie tax, you could give more.
- Suggest that your children manage their own holdings to keep investment income at a minimum—for example, by holding municipal bonds or stocks that don't pay dividends. Again, that could change once they're no longer subject to the kiddie tax.
- Consider other ways to transfer income—perhaps by hiring your son or daughter to work for your company. Because wages aren't unearned income, that amount won't count toward the kiddie tax threshold.

In any event, be aware of the possible tax ramifications of family income-shifting. It can be a sound technique for many parents, but you need to consider your own situation, with help from your tax advisor. ●

8 Retirement Miscues

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hunches is likely to produce more losers than winners. And taking a smart, deliberate approach is as important for investing the assets in tax-sheltered retirement plans, such as 401(k)s and IRAs, as it is for taxable accounts.

Mistake #6—You underestimate health care costs.

As people live longer and longer—and as growth in health care costs continues to outpace overall inflation—you'll need to allocate a healthy portion of your savings to personal care. Often, health insurance plans and Medicare will cover much less than you've counted on and you'll need to use your savings to make up the difference. What's more, an extended stay in a nursing home could destroy your retirement nest egg. Consider buying long-term-care insurance to help ward off future disasters.

Mistake #7—You don't factor in taxes.

People often disregard the impact that federal and state taxes can have on their retirement savings. For instance, if you've been accumulating funds in a 401(k) plan and traditional IRAs, when you withdraw money from those accounts to pay your retirement expenses those distributions normally will be taxed at ordinary income rates. In addition, whether you want to or not, you'll have to start taking money from those accounts after you turn age 70½. Your long-term plan for retirement needs to take these taxes into account.

Mistake #8—You count too heavily on Social Security benefits.

After you've paid into the Social Security system during your working career, it's only fair that you reap the benefits. But those monthly payments usually aren't enough to live on comfortably, not by a long shot. It's important to view Social Security as only a supplement to other sources of retirement income—from your investments, company retirement plans, and IRAs.

Making any of these mistakes could cause trouble when it's time to retire. But if you know what to look out for you may be able to avoid problems—and the best time to start fixing things is now. ●

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