The
FINANCIAL UPDATE
DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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Is The Inverted Yield Curve The Financial Fakeout Of 2019?

The day the yield curve inverted, on Wednesday, August 14th, stocks plunged and financial headlines turned grim.

Should you worry? Or is the yield curve inversion the financial fakeout of 2019?

"Longer-term rates below shorter term rates are a clear signal from bond investors that they think the United States economy is on the downswing," reported The New York Times' senior economics correspondent, Neil Irwin, "that its future looks worse than its present." But this widely-reported storyline in the financial press misses important context.

In the past, when the yield curve inverted, it was usually because investors saw fundamental economic measures deteriorating, but that's not happening now. Rear view mirror investing — assuming history will repeat itself — is not smart in current conditions, because unprecedented negative yields in Europe and Japan make the road ahead different this time.

At the same time stocks plunged on recession fears triggered by the yield curve inversion, the retail sales report from the U.S. Census Bureau in the 12 months through July surged 3.7%! That followed a 3.8% spike in June and a 3.1% rise in May. Since 70% of U.S. economic activity is consumer driven, the continued strength in retail sales extinguished recession fears. When consumers are spending like this, a recession cannot be unfolding.

The retail numbers are part of a growing body of evidence that the yield curve may be making a recession look much closer than it actually is. It's a broken indicator.

This doesn't mean the yield curve is not a useful forecasting tool. It just means it's not a useful tool in the current economic situation. A hammer

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How To Avoid State Income Tax On Distributions From IRAs

Do you own a large IRA and live in a state with an income tax? Consider setting up a non-grantor trust in a state with no income tax. While this financial planning tactic may sound exotic, it's common sense and can make a material difference in your life and beyond.

Placing the IRA in a non-grantor trust in a state with no income tax avoids state income taxes. That's big! In addition, beneficiaries of your IRA would also benefit. Your spouse, children and other IRA beneficiaries could expect to get more from your largesse after you're gone.

Under the SECURE Act bill expected to be enacted before the end of 2019, your heirs would be required to distribute the IRA you leave them within 10 years.

According to Financial Advisor News Service, which we are licensed to distribute, naming your IRA beneficiary a non-grantor trust in a state with no income tax may allow your beneficiaries to avoid paying state income tax on the distributions from the IRA.

To be clear, income from your IRA could be free of state income tax by applying this strategy! A recent U.S. Supreme Court decision upheld the legal concept behind this strategy and out-of-state trusts are likely a device that retirees will hear about in the mainstream financial press in the months ahead. This is a fluid new area of legal and financial regulation and requires legal and tax advisors familiar with your personal situation.

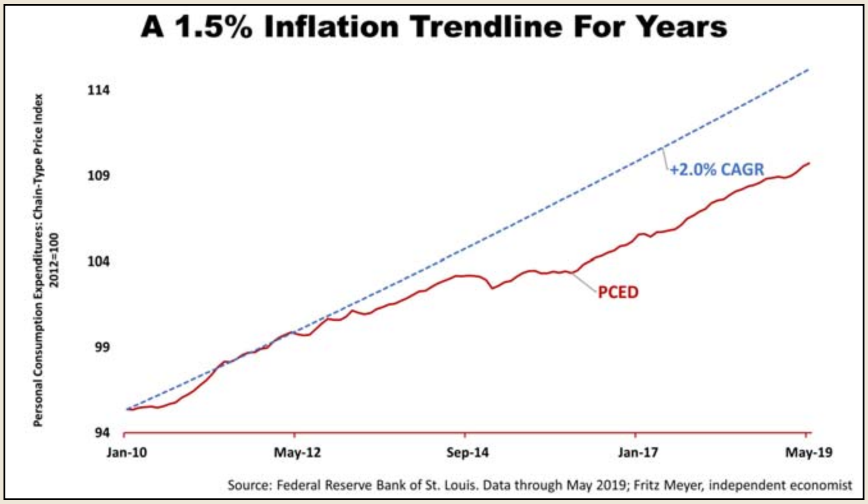
Sincerely,
Day & Ennis, LLC

Amid Record Stock Prices, Fed Policy Is A Risk

Stock prices have soared in 2019, breaking records repeatedly, and the latest economic signals — though less robust — indicate no recession is on the horizon.

Perhaps the biggest risk threatening to end the 10-year old expansion is the Federal Reserve Board's inflation policy.

The Fed incorrectly for over five years has predicted an inflation rate of 2%, and the central bank's June 19th economic release was unrelenting in its forecast.



If the Fed's 2% forecast had been correct since January 2010, the trajectory of the inflation rate would have looked something like this blue line.

In fact, the actual rate of inflation, shown in red, has been approximating the 1.5% growth trajectory.

The last time the Fed's forecast for 2% inflation was correct was in 2011 and 2012, but the Fed's forecast has been off year after year since 2013!

The Fed's broken forecast for inflation has not ended the long expansion, but economic growth has slowed, and the Fed's policy has increased uncertainty.

On December 19th, 2018, amid the trade war with China and growing signs of a global slowdown, the Fed hiked lending rates; it caused a flash bear market plunge of 20% in stocks, chilled holiday retail sales, and growth in new jobs abruptly stopped.

On January 4th, 2019, the Fed did a complete about-face and Chairman Jerome Powell said plans to hike rates further were on hold, seemingly acknowledging that the Fed's economic model was wrong.

Since all recessions since 1954 were caused by a Fed mistake, the Fed is at a crossroads; its inflation policy in the weeks ahead will be key to the expansion continuing. ●

Give To Charity From An IRA To Lower Your Tax Bill

To keep your tax bill down, if you are over 70½, consider a qualified charitable contribution, which makes donations of up to $100,000 from an Individual Retirement Account (IRA) to a fully deductible charity.

A qualified charitable distribution (QCD) lets you donate from a traditional or inherited IRA, provided you meet the age requirements.

A QCD can help you eliminate, or at least reduce, taxes owed on your required minimum distribution (RMD). That's the amount you are required to take out of your IRA account annually after turning 70½.

Example: Your yearly RMD is $20,000, which counts as taxable income. But if you donate that amount to a charity, it's not counted as income, which may drop you into a lower tax bracket.

Moreover, you don't have to itemize to take this tax deduction. That's good news for Americans no longer itemizing deductions on their returns. To be sure, some taxpayers are hurt by the Tax Cuts and Jobs Act's $10,000 cap on state and local tax deductions, so a qualified charitable distribution can make sense.

Three Strategic Mid-Year Tax Tips

With summer 2019 now underway, here are three strategic mid-year tax planning tips.

Itemizing Strategically Is A Thing. In 2018, for the first time, the Tax Cut and Jobs Act (TCJA) nearly doubled the standard deduction to $12,000 for single filers and $24,000 for married couples filing jointly. The number of taxpayers eligible to itemize was slashed by 60% by the TCJA. Only about 12% of taxpayers are still eligible to itemize expenses for medical, dental, home-mortgage and other loan interest, charitable contributions and miscellaneous fees, including those for tax preparation and investment advice. With just a bit of forethought, you can plan to bunch deductions once every three years, or maybe two. Itemizing strategically may materially reduce your income tax bill. If you did not itemize deductions in 2018, bunching itemized deductions in 2019 may boost your total itemized deductions well beyond your standard deduction. If not, you may want to plan on bunching and itemizing next year. The near-doubling of the standard deduction was intended to simplify federal taxation but has actually complicated it. Millions of the nearly 20 million taxpayers no longer eligible for itemizing now must strategically plan to itemize every two or three years.

Donor Advised Funds. One of the ways to boost your deductions this year is by giving to charity, and one of the easy ways is to give through a donor advised fund (DAF). With a DAF, you can split gifts among different charities. You contribute securities or cash and claim the deduction that same year. If you know you will be taking a taxable capital gain on an investment before the end of 2019, it's wise to consider donating appreciated securities to a DAF. You receive a deduction on the amount you contribute and avoid paying a capital gains tax. In addition, the charity receives the full amount of your largesse. If you donate cash or securities to a DAF in 2019, you can take a deduction on your 2019 return but wait to grant the money to a charity next year, or in 2021, and can take the deduction. Brokerages offer with DAFs. They invest your donations but charge an investment management fee and administrative expenses. We offer strategic guidance and can answer your questions about this.

Large IRAs. If you live in a state with an income tax, you might want to consider setting up a non-grantor trust in a state with no income tax. Why? Say you have a $1 million IRA. Placing it in a non-grantor trust in a state with no income tax avoids state income taxes. That's big! At your death, under the SECURE Act bill expected to be enacted before the end of 2019, your heirs would be required to distribute the IRA you leave them within 10 years. According to Financial Advisor News Service, placing your IRA in a non-grantor trust in a state with no income tax allows your beneficiaries to avoid paying state income tax on the distributions from the IRA. To be clear, capital appreciation and dividend income on your IRA can be free of state income tax by applying this strategy! A recent U.S. Supreme Court decision upheld the legal concept behind this strategy and out-of-state trusts are likely a device that retirees will hear about in the mainstream financial press in the months ahead. ●

You don't have to donate the entire amount to a single charity. You can divvy up a QCD among multiple IRS-eligible charities, within the $100,000 annual limit. You don't have to use 100% of your RMD for the donation, of course, and can keep what you need to pay for your living expenses and donate the rest.

QCDs require careful attention to ensure your donation is made from an individual retirement account — not a 401(k) or 403(b). In addition, you may not make a QCD and also itemize charitable deductions. You must pick one. Plus, the charity must not be a private foundation or a donor-advised fund. These technical details are crucial.

Another QCD tip: Make the contribution straight from your IRA. The RMD money must never be in your personal, non-IRA account. Send your IRA custodian instructions to send the check directly to the charity, with the organization's name on the check. Have the IRA custodian send you documentation that you made the donation.

Finally, be sure to make the donation before you take your RMD. Should you take the RMD first, you can't give the money back to the retirement account and will be ineligible to deduct it.

The QCD is a fairly complex solution to lower taxes and requires the advice of a qualified tax professional. ●

Risk And Tax Effects Of An Installment Sale Of A Home

An installment sale of real estate is a variety of seller financing in which the buyer is borrowing from the seller. Why would a seller want to do this? Isn't it better to get the money up front? No, not always, especially when a sizable real estate capital gain would push you into a higher tax bracket.

An installment plan can give a home-seller a way to unload homes in bad market conditions and enable buyers who otherwise would not qualify for a mortgage to buy a home. Installment financing is a familiar concept for big-ticket consumer items, like cars and furniture, but handily applies to dwellings.

Some of this arrangement tracks the standard housing finance playbook. The buyer makes a down payment and agrees to pay the rest over a set term, which can be whatever the two parties want it to be. And they also set an interest rate on the loan.

What's more, to protect the seller in the event that the buyer defaults on loan payments, the buyer takes out a purchase-money mortgage. This is posted with the local property records agency, which establishes the arrangement in case disputes arise. The seller can foreclose if there's non-payment and take possession of the home. Point is, the seller can be well-protected but full and fair disclosure of the terms must be managed diligently.

In tax terms, the results can be favorable to sellers. Sellers owe no income taxes on the portion of the monthly installment payments considered to be the cost basis—that is, the amount the seller originally paid for the home. The amount of the installment payment above the cost-basis is a capital gain, however, and, depending upon the seller's income, is taxed at a 15% or 20% rate, much lower than ordinary income tax rates. Therein lies the tax advantage. The interest portion of the installment payments is subject to ordinary rates.

In addition to avoid being pushed up to a higher tax bracket with a big onetime gain from a traditional sale, higher-income sellers skirt the 3.8% net investment income tax. Sellers subject to this additional tax are singles with adjusted gross incomes over $200,000 and married couples with AGIs above $250,000.

This strategy has its downsides in certain circumstances. If you're a seller of a business property and have taken big depreciation deductions on it, then the installment plan might not work. Depreciation recapture rules could trigger a 25% tax on previous write-offs for depreciation. In addition, mortgage lenders must be prepared to deal with late payments from borrowers, which can become complicated and ugly.

True, a house is not always a home, but it can be a tax savings, if everything goes right. ●

The Financial Fakeout Of 2019?

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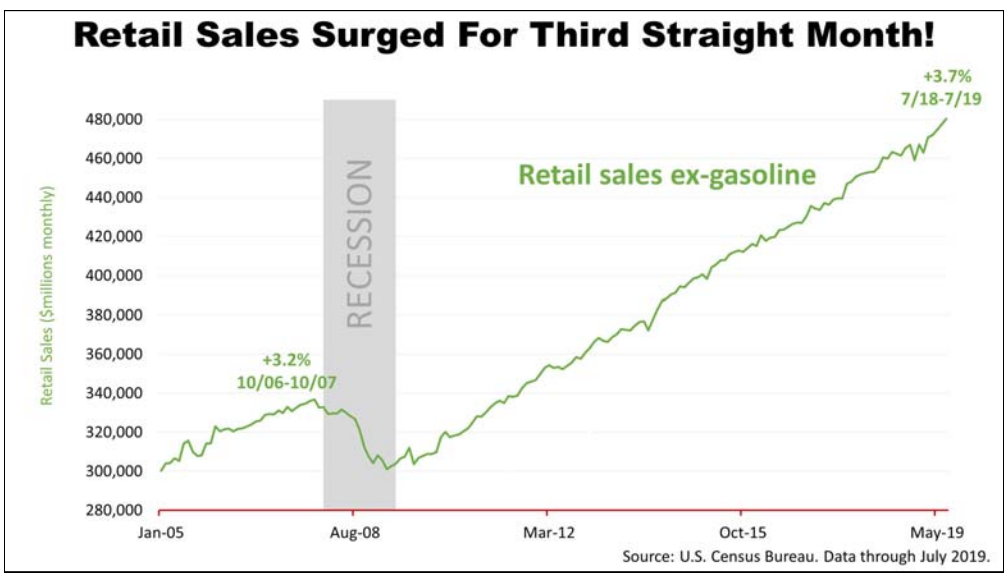
can't fix every problem.

And things really are different this time because the current inversion of the yield is caused by an unprecedented condition: Negative yields in Europe and Japan, which are depressing yields on long-term U.S. bonds!

From a prudent professional's perspective, the inversion is a technical market problem of supply and demand and not a "real" economic problem. It's wise to plan on your retirement portfolio's fixed-income allocations yielding lower returns in the years ahead, but that doesn't mean the U.S. is headed for a recession. Fears about the inversion of the yield curve heightened stock market volatility but that does not mean the decade-long, expansion-fueled bull market is over. It seems likely to turn out to be the financial fakeout of 2019. ●



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