HELPING YOU UNDERSTAND THE COMPLEXITIES OF WEALTH MANAGEMENT AND PROVIDING SOLUTIONS AS UNIQUE AS YOUR GOALS

WEALTH MANAGEMENT NEWSLETTER

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In this issue:

DON'T LET RISING INTEREST RATES CATCH YOU BY SURPRISE

You've probably heard the news that the Federal Reserve has been raising its benchmark federal funds rate. The Fed doesn't directly control consumer interest rates, but changes to the federal funds rate (which is the rate banks use to lend funds to each other overnight within the Federal Reserve system) often affect consumer borrowing costs.

Forms of consumer credit that charge variable interest rates are especially vulnerable, including adjustable rate mortgages (ARMs), most credit cards and certain private student loans. Variable interest rates are often tied to a benchmark (an index) such as the U.S. prime rate or the London Interbank Offered Rate (LIBOR), which typically goes up when the federal funds rate increases.

Although nothing is certain, the Fed expects to raise the federal funds rate by small increments over the next several years. However, you still have time to act before any interest rate hikes significantly affect your finances.

Adjustable rate mortgages (ARMs)

If you have an ARM, your interest rate and monthly payment may adjust at certain intervals. For example, if you have a 5/1 ARM, your initial interest rate is fixed for five years, but then can change every year if the underlying index goes up or down. Your loan documents will spell out which index your ARM tracks, the date your interest rate and payment may adjust, and by how much. ARM rates and payments have caps that limit the amount by which interest rates and payments can change over time. Refinancing into a fixed rate mortgage could be an option if you're concerned about steadily climbing interest rates, but this may not be cost-effective if you plan to sell your home before the interest rate adjusts.

Credit cards

It's always a good idea to keep credit card debt in check, but it's especially important when interest rates are trending upward. Many credit cards have variable annual percentage rates (APRs) that are tied to an index (typically the prime rate). When the prime rate goes up, the card's APR will also increase.

Check your credit card statement to see what APR you're currently paying. If you're carrying a balance, how much is your monthly finance charge?

Your credit card issuer must give you written notice at least 45 days in advance of any rate change, so you have a little time to reduce or pay off your balance. If it's not possible to pay off your credit card debt quickly, you may want to look for alternatives. One option is to transfer your balance to a card that offers a zero percent promotional rate for a set period of time (such as 18 months). But watch out for transaction fees, and find out what APR applies after the promotional rate term expires, in case a balance remains.

Variable rate student loans

Interest rates on federal student loans are always fixed (and so is the monthly payment). But if you have a variable rate student loan from a private lender, the size of your monthly payment may increase as the federal funds rate rises, potentially putting a dent in your budget. Variable student loan interest rates are generally pegged to the prime rate or the LIBOR. Because repayment occurs over a number of years, multiple rate hikes for variable rate loans could significantly affect the amount you'll need to repay. Review your loan documents to find out how the interest rate is calculated, how often your payment might adjust, and whether the interest rate is capped.

Because interest rates are generally lower for variable rate loans, your monthly payment may be manageable, and you may be able to handle fluctuations. However, if your repayment term is long and you want to lock in your payment, you may consider refinancing into a fixed rate loan. Make sure to carefully compare the costs and benefits of each option before refinancing.

FUTURE OF THE FEDERAL ESTATE TAX

While no one can predict the future, the possibility of tax reform is once again in the spotlight. If it occurs, it may very well include a repeal of the federal estate tax and related changes to the federal gift tax, the federal generation-skipping transfer (GST) tax, and the federal income tax basis rules.

History of the federal estate tax

In general, an estate tax is a tax on property a person owns at death. In one form or another, a federal estate tax has been enacted or repealed a number of times since 1797.[1]

1 2015 Field Guide to Estate Planning, Business Planning & Employee Benefits.

Estate tax enacted	Estate tax repealed
1797	1802
1862	1872
1894	1902
1916	2010*
2011*	

** For 2010, the estate tax was repealed, but later retroactive legislation provided that an estate could elect to be subject to estate tax in return for a stepped-up (or stepped-down) income tax basis for most property. The estate tax was extended in 2011, with some changes.*

The estate tax has undergone many changes over the years, including the addition of a federal gift tax and a federal GST tax during modern times. A gift tax is a tax on gifts a person makes while alive. A GST tax is a tax on transfers to persons who are two or more generations younger than the transferor. In recent years, property owned at death has generally received an income tax basis stepped up (or down) to fair market value at death.

During the 2000s, the estate, gift and GST tax rates were substantially reduced, and the gift and estate tax lifetime exclusion and the GST tax exemption were substantially increased. The estate tax and the GST tax, but not the gift tax, were scheduled for repeal in 2010 (although certain sunset provisions would bring them back unless Congress acted), but legislation extended the estate tax and the GST tax in 2011. (For 2010, the estate tax ended up being optional and the GST tax rate was zero percent.) The gift and estate tax lifetime exclusion and the GST tax exemption were increased to $5,000,000 and indexed for inflation in later years. For 2013, the top estate, gift and GST tax rate was increased to 40 percent, and the extension and modifications were made 'permanent'.

Federal estate tax

Repeal of the estate tax seems possible once again. If the repeal occurs, it could be immediate or gradual as during the 2000s. Would it be subject to a sunset provision, so that the estate tax would return at a later time? All of this may depend on congressional rules on the legislative process, other legislative priorities, and the effect the legislation would have on the budget and the national debt.

Federal gift tax

If the estate tax is repealed, the gift tax may also be repealed. However, it is possible that the gift tax would be retained as a backstop to the income tax (as in 2010). To some extent, the gift tax reduces the ability of individuals to transfer property back and forth in order to reduce or avoid income taxes.

Federal GST tax

If the estate tax is repealed, the GST tax would probably be repealed (as in 2010). If the gift tax is not repealed, it is possible that the lifetime GST tax provisions would be retained, but the GST tax provisions at death repealed.

Federal income tax basis

If the estate tax is repealed, it is possible that the general income tax basis step-up (or step-down) to fair market value at death would be changed to a carryover basis (i.e., the decedent's basis before death carries over to the person who inherits the property). In 2010, a modified carryover basis (a limited amount of property could receive a stepped-up basis) applied unless the estate elected to be subject to estate tax. It is also possible that a Canadian-style capital gain tax at death could be adopted in return for a stepped-up basis for the property.

THE HEALTH-WEALTH CONNECTION

It's a vicious cycle: Money is one of the greatest causes of stress; prolonged stress can lead to serious health issues; and health issues often result in yet more financial struggles.[2] The clear connection between health and wealth is why it's so important to develop and maintain lifelong plans to manage both.

The big picture

Consider the following statistics:

1. More than 20 percent of Americans say they have either considered skipping or skipped going to the doctor due to financial worries. (American Psychological Association, 2015)
2. More than half of retirees who retired earlier than planned did so because of their own health issues or to care for a family member. (Employee Benefit Research Institute, 2017)
3. Chronic diseases such as heart disease, type 2 diabetes, obesity, and arthritis are among the most common, costly, and *preventable* of all health problems. (Centers for Disease Control and Prevention, 2017)
4. Chronic conditions make you more likely to need long-term care, which can cost anywhere from $21 per hour for a home health aide to more than $6,000 a month for a nursing home. (Department of Health and Human Services, 2017)
5. A 65-year-old married couple on Medicare with median prescription drug costs would need about $265,000 to have a 90 percent chance of covering their medical expenses in retirement. (Employee Benefit Research Institute, 2017)

2 American Psychological Association, February 4, 2015; The Telomere Effect: A Revolutionary Approach to Living Younger, Healthier, Longer, by Blackburn and Epel; and Ageproof: Living Longer Without Running Out of Money or Breaking a Hip, by Chatzky and Roizen.

Develop a plan for long-term health

The recommendations for living a healthy lifestyle are fairly straightforward: eat right, exercise regularly, don't smoke or engage in other risky behaviors, limit soda and alcohol consumption, get enough sleep (at least seven hours for most adults) and manage stress. And before embarking on any new health-related endeavor, talk to your doctor, especially if you haven't received a physical exam within the past year. Your doctor will benchmark important information such as your current weight and risk factors for developing chronic disease. Come to the appointment prepared to share your family's medical history, be honest about your daily habits and set goals with your doctor.

Other specific tips from the Department of Health and Human Services include:

Nutrition: Current nutritional guidelines call for eating a variety of vegetables and whole fruits; whole grains; low-fat dairy; a wide variety of protein sources, including lean meats, fish, eggs, legumes and nuts; and healthy oils. Some medical professionals are hailing the long-term benefits of the so-called Mediterranean diet. Details for a basic healthy diet and the Mediterranean diet can be found at health.gov/dietaryguidelines.

Exercise: Any physical activity is better than none. Inactive adults can achieve some health benefits from as little as 60 minutes of moderate-intensity aerobic activity per week. However, the ideal target is at least 150 minutes of moderate-intensity or 75 minutes of high-intensity workouts per week. For more information, visit health.gov/paguidelines.

Develop a plan for long-term wealth

The recommendations for living a financially healthy life aren't quite as straightforward because they depend so much on your individual circumstances. But there are a few basic principles to ponder:

Emergency savings: The amount you need can vary depending on whether you're single or married, self-employed or work for an organization (and if that organization is a risky startup or an established entity). Typical recommendations range from three months' to a year's worth of expenses.

Retirement savings: Personal finance commentator Jean Chatzky advocates striving to save 15 percent of your income toward retirement, including any employer contributions. If this seems like a lofty goal, bear in mind that as with exercise, any activity is better than none—setting aside even a few dollars per pay period can lead to good financial habits. Consider starting small and then increasing your contributions as your financial circumstances improve.

Insurance: Make sure you have adequate amounts of health and disability income insurance, and life insurance if others depend on your income. You might also consider long-term care coverage.[3]

Health savings accounts: These tax-advantaged accounts are designed to help those with high-deductible health plans set aside money specifically for medical expenses. If you have access to an HSA at work, consider the potential benefits of using it to help save for health expenses.

WHAT IS A ROLLOVER IRA, AND DO I NEED ONE?

Generally, the term rollover individual retirement account (IRA) refers to an IRA that you establish to receive funds from an employer retirement plan like a 401(k). A rollover IRA is also sometimes referred to as a conduit IRA.

When you roll funds over from an employer plan to an IRA, your financial institution may suggest that you use a rollover IRA to receive the funds. Of course, you can transfer those dollars to any other IRA you own at some future date, because there's no legal requirement that you keep your plan distribution in a separate IRA. But even though separate IRAs are not legally required, there are at least two reasons to consider keeping your employer plan rollover separate from your contributory IRAs.

The first reason to maintain a separate rollover IRA deals with federal bankruptcy law. Your IRAs are protected from your creditors under federal law if you declare bankruptcy, but this protection is currently limited to $1.28 million for all your IRAs.[4] The $1.28 million limit doesn't apply, though, to amounts you roll over to an IRA from an employer plan, or any earnings on that rollover. These dollars are protected in full if you declare bankruptcy, just as they would have been in your employer's plan. Obviously, it's easier to track the amount rolled over, and any future earnings, if you keep those dollars separate from your contributory IRAs. So a rollover IRA may make sense if creditor protection is important to you.

The second reason to maintain a rollover IRA is that you might decide in the future that you want to roll your distribution back into a new employer's plan. In the distant past, employer plans could accept rollovers only from rollover (conduit) IRAs—rollovers from contributory IRAs weren't permitted. Now, however, employer plans can accept rollovers from both contributory IRAs and rollover IRAs.[5] Despite this, employer plans aren't required to accept rollovers, and they can limit the types of contributions they'll accept. And while it's becoming less common, some still accept rollovers only from rollover IRAs. So keep this in mind if you are contemplating a rollover back to an employer plan in the future.

3 The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. A complete statement of coverage, including exclusions, exceptions, and limitations, is found only in the policy. It should be noted that long-term care carriers have the discretion to raise their rates and remove their products from the marketplace.

4 SEP and SIMPLE IRAs have unlimited protection under federal bankruptcy law.

5 Nontaxable traditional IRA dollars can't be rolled back into an employer plan.