1Q20

The Financial Solutions Advisor

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Economic & Market Perspectives

2019 Recap

The theme for 2019 was “choppy and frustrating, but no recession.” We got the “choppy” and “no recession” parts right, but it’s hard to argue that the past year was frustrating for investors, with stocks experiencing one of the best years in history. Thanks in part to a somewhat surprising turn in Federal Reserve policy, U.S. stocks returned more than 30% for 2019 (as measured by the S&P 500 Index) and global stocks weren’t far behind. Looking back on 2019, it seems we can break the year into three phases: Phase 1 was the recovery from the horrible conclusion of 2018; phase 2 was the third quarter flirtation with recession in the U.S. and globally as manufacturing activity deteriorated significantly and trade worries came to the forefront; and phase 3 was the recovery and final year-end rally in stocks and other risk assets. In our view, the year’s most noteworthy developments were 1) the massive Fed reversal from tightening into year-end 2018 to actually cutting rates three times in 2019, 2) the slow and steady cutting of earnings expectations and 3) the roller coaster ride associated with the U.S./China trade dispute. As the year draws to a close, the broad macro backdrop looks in many ways better than it did 12 months ago. The global economy appears to be on more solid footing, thanks largely to an impressively strong U.S. consumer sector and labor market. But we worry about relatively weak global manufacturing and trade and the tendency of the yield curve to invert. However, the U.S. or global economy is unlikely to slip into recession in the coming 12 months. And some of the big risks, like trade disputes, Brexit uncertainty and U.S. budget negotiations seem clearer now than they were a year ago. In fact, one of the biggest risks today may be that stocks have already priced in much of the good news.

2020 Outlook

The theme for 2020 is uncertainties diminish, but markets struggle. We intentionally draw on the fact that we see both positives and negatives for stocks as we head into the coming year. As we indicated earlier, some key risks look more manageable, while other fundamental factors may be working against the markets. Economic growth could pick up as we head into 2020, but we don’t think stocks will come close to the lofty results they reached this past year.

Source: Nuveen

2019 Returns

S&P 500	*31.49%*
NASDAQ	*39.46%*
Russell Small Cap	*25.52%*
Russell Mid Cap	*30.54%*
MSCI EAFE	*22.01%*
MSCI World	*27.67%*
Barclay US Agg. Bond	*8.72%*
Barclay Municipal Bond	*7.54%*

For College Savings, 529 Plans Are Hard to Beat

Raising kids is hard enough, so why not make things easier for yourself when it comes to saving for college? Ideally, you want a savings vehicle that doesn't impose arbitrary income limits on eligibility; lets you contribute a little or a lot, depending on what else happens to be going on financially in your life at the moment; lets you set up automatic, recurring contributions from your checking account so you can put your savings effort on autopilot; and offers the potential to stay ahead of college inflation, which has been averaging 3% to 4% per year.[1] Oh, and some tax benefits would be really nice, too, so all your available dollars can go to college and not Uncle Sam. Can you find all of these things in one college savings option? Yes, you can: in a 529 plan.

Benefits

529 college savings plans offer a unique combination of features that are hard to beat when it comes to saving for college, so it's no surprise why assets in these plans have grown steadily since their creation over 20 years ago.

Eligibility. People of all income levels can contribute to a 529 plan — there are no restrictions based on income (unlike Coverdell accounts, U.S. savings bonds, and Roth IRAs).

Ease of opening and managing account. It's relatively easy to open a 529 account, set up automatic monthly contributions, and manage your account online. For example, you can increase or decrease the amount and frequency of your contributions (e.g., monthly, quarterly), change the beneficiary, change your investment options, and track your investment returns and overall progress online with the click of a mouse.

Contributions. 529 plans have high lifetime contribution limits, generally $350,000 and up. (529 plans are offered by individual states, and the exact limit depends on the state.) Also, 529 plans offer a unique gifting feature that allows lump-sum gifts up to five times the annual gift tax exclusion.

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Key Retirement and Tax Numbers for 2020

Every year, the Internal Revenue Service announces cost-of-living adjustments that affect contribution limits for retirement plans and various tax deduction, exclusion, exemption, and threshold amounts. Here are a few of the key adjustments for 2020.

Employer retirement plans

- Employees who participate in 401(k), 403(b), and most 457 plans can defer up to $19,500 in compensation in 2020 (up from $19,000 in 2019); employees age 50 and older can defer up to an additional $6,500 in 2020 (up from $6,000 in 2019).

- Employees participating in a SIMPLE retirement plan can defer up to $13,500 in 2020 (up from $13,000 in 2019), and employees age 50 and older can defer up to an additional $3,000 in 2020 (the same as in 2019).

IRAs

The combined annual limit on contributions to traditional and Roth IRAs is $6,000 in 2020 (the same as in 2019), with individuals age 50 and older able to contribute an additional $1,000. For individuals who are covered by a workplace retirement plan, the deduction for contributions to a traditional IRA phases out for the following modified adjusted gross income (MAGI) ranges:

	2019	2020
Single/head of household (HOH)	$64,000 - $74,000	$65,000 - $75,000
Married filing jointly (MFJ)	$103,000 - $123,000	$104,000 - $124,000
Married filing separately (MFS)	$0 - $10,000	$0 - $10,000

The 2020 phaseout range is $194,000 - $204,000 (up from $193,000 - $203,000 in 2019) when the individual making the IRA contribution is not covered by a workplace retirement plan but is filing jointly with a spouse who is covered.

The modified AGI phaseout ranges for individuals to make contributions to a Roth IRA are:

	2019	2020
Single/HOH	$122,000 - $137,000	$124,000 - $139,000
MFJ	$193,000 - $203,000	$196,000 - $206,000
MFS	$0 - $10,000	$0 - $10,000

Estate and gift tax

- The annual gift tax exclusion for 2020 is $15,000, the same as in 2019.

- The gift and estate tax basic exclusion amount for 2020 is $11,580,000, up from $11,400,000 in 2019.

Kiddie tax

The SECURE Act repeals the Tax Cut and Jobs Act (TCJA) change in the Kiddie tax and is effective for 2020 and beyond. The Act reverted the taxation on this type of income to the tax rates of the parents for years beginning after 2019, with the option to use the new rates for 2019 and amend 2018.

Standard deduction

	2019	2020
Single	$12,200	$12,400
HOH	$18,350	$18,650
MFJ	$24,400	$24,800
MFS	$12,200	$12,400

The additional standard deduction amount for the blind or aged (age 65 or older) in 2020 is $1,650 (the same as in 2019) for single/HOH or $1,300 (the same as in 2019) for all other filing statuses. Special rules apply if you can be claimed as a dependent by another taxpayer.

Alternative minimum tax (AMT)

	2019	2020
Maximum AMT exemption amount		
Single/HOH	$71,700	$72,900
MFJ	$111,700	$113,400
MFS	$55,850	$56,700
Exemption phaseout threshold		
Single/HOH	$510,300	$518,400
MFJ	$1,020,600	$1,036,800
MFS	$510,300	$518,400
26% rate on AMTI* up to this amount, 28% rate on AMTI above this amount		
MFS	$97,400	$98,950
All others	$194,800	$197,900
*Alternative minimum taxable income		

Significant Retirement Savings Law Changes Are Coming in 2020

Congress has passed significant changes to retirement savings law that will affect individuals in or nearing retirement, new parents, small business owners and employees, and could have a major impact on estate planning.

The changes include increasing to 72 from 70½ the age at which individuals must begin taking required minimum distributions (RMDs) from their retirement accounts; lowering barriers for small business owners to create a savings opportunity for their employees; and changing the rules for inherited retirement accounts that could spur revisions to estate plans.

The retirement savings bill, known as the SECURE Act, was included as part of the massive government spending bill that was approved by Congress in a flurry of last-minute deal-making in mid-December. The 1,773-page bill was one of two bills to fund government operations that averted a government shutdown that would have taken place on December 20, when a temporary agreement to fund the government was set to expire.

The bill was approved by the House of Representatives on December 17, and the Senate followed suit on December 19. President Donald Trump signed it into law on December 20.

The SECURE Act, an acronym for the "Setting Every Community Up for Retirement Enhancement," was approved overwhelmingly by the House in May, but was stuck in limbo for months in the Senate until supporters pushed for the bill to be included in the must-pass year-end package.

Key provisions in the retirement savings portion of the bill include:

- **Change to RMD age:** The law raises to 72 from 70½ the age at which individuals must begin taking RMDs from their retirement accounts. **Important:** The new law only applies to people who turn 70½ *after* December 31, 2019. If a person turned 70½ in 2019, the law does not apply—that person must take an RMD in 2019, 2020 and beyond.
- **Contributions to traditional IRAs after age 70½.** The law ends the prohibition on contributing to an individual retirement account (IRA) after 70½. Individuals may continue contributing to an IRA at any age, as long as they have earned income.
- **New rules for inherited retirement accounts:** Under current law, inherited retirement accounts (often referred to as "Stretch IRAs") can distribute those assets over the beneficiary's lifetime. Under the new law, those assets must be distributed within 10 years. This provision has potentially significant estate planning implications. There are exceptions for spouses, minor children, disabled individuals and people less than 10 years younger than the decedent. The bill does *not* affect existing inherited accounts. It only applies to accounts that are inherited in 2020 and beyond.
- **Penalty-free withdrawals for birth/adoption expenses.** New parents can withdraw up to $5,000 from an IRA or an employer-sponsored retirement plan to pay for birth and/or adoption expenses, through the first year after the birth or adoption. Taxes still need to be paid on pre-tax contributions, but no penalties apply to the withdrawal.
- **Part-time workers can participate in a 401(k) plan**. Employees must have worked at least 500 hours a year for three consecutive years in order to be eligible.
- **Lifetime income disclosure**. The bill requires the Department of Labor to propose rules for a new disclosure to plan participants that will illustrate the participant's projected monthly income in retirement based on current retirement assets. It's designed as a kind a "progress report" to show employees how they are doing on saving. The rule-making process for this is likely to take a year or more, followed by an implementation period, so it could be 2021 or 2022 before this becomes standard.
- **Makes it easier for annuities to be offered in 401(k) plans**. The new law lowers barriers to offering annuities in employer-sponsored plans, though plans are not required to do so.
- **Change to 529 plans**. Assets in these college-savings plans can now be used to repay up to $10,000 in student loans.
- **Provisions to help small businesses**. Several provisions in the bill are designed to make it easier for small businesses to offer retirement plans to their employees, including a provision that will allow unrelated small businesses to band together in so-called "multiple employers plans" to offer a plan to employees.

What should investors do?
Investors who have turned or will turn 70½ before December 31, 2019, should ensure that they have taken their RMD or have plans to do so prior to the deadline of April 1, 2020. If you turn 70½ on or after January 1, 2020, you will not need to begin taking required minimum distributions until 2022.

Investors who have estate plans that include leaving retirement accounts to heirs should consider reviewing those plans with a financial planner to determine whether any changes need to be made based on the new law.

Investors over 70½ who have earned income should consider discussing with a financial planner whether the new rule permitting ongoing contributions to an IRA makes sense for their situation.

529 Plans Are Hard to Beat (continued)

In 2020, this amount is up to $75,000 for individual gifts and up to $150,000 for joint gifts — with the potential to avoid gift tax if certain requirements are met. This can be a very useful estate planning tool for grandparents who want to help pay for their grandchildren's college education in a tax-efficient manner.

Tax benefits. The main benefit of 529 plans is the tax treatment of contributions. First, as you save money in a 529 college savings plan (hopefully every month!), any earnings are tax deferred, which means you don't pay taxes on the earnings each year as you would with a regular investment account. Then, at college time, any funds used to pay the beneficiary's qualified education expenses — including tuition, fees, room, board, books, and a computer — are completely tax-free at the federal level. This means every dollar is available for college. States generally follow this tax treatment, and many states also offer an income tax deduction for 529 plan contributions.

Tax implications for funds not used for qualified expenses. If you use 529 plans funds for any reason other than the beneficiary's qualified education expenses, earnings are subject to income tax (at your rate) *and* a 10% federal penalty tax.

Getting started
529 college savings plans are offered by individual states (but managed by financial institutions selected by the state), and you can join any state's plan. To open an account, select a plan and complete an application, where you will name an account owner (typically a parent or grandparent) and beneficiary (there can be only one); choose your investment options; and set up automatic contributions if you choose. You are then ready to go.

[1] *College Board, Trends in College Pricing, 2014-2018*

Qualified Charitable Distributions: Using Your IRA to Give From the Heart

The Tax Cuts and Jobs Act roughly doubled the standard deduction ($12,200 for single filers and $24,400 for married taxpayers filing jointly in 2019) and indexed it for inflation through 2025. As a result, far fewer taxpayers will itemize deductions on their tax returns, and some people may be disappointed that they no longer benefit from writing off their donations.

If you are 70½ or older, you can use a qualified charitable distribution (QCD) to donate from your IRA and get a tax break, whether you itemize or not. Not coincidentally, this is the same age you must begin taking annual required minimum distributions (RMDs), which are normally taxed as ordinary income, or face a 50% penalty on the amount that should have been withdrawn.

QCDs satisfy all or part of any RMDs that you would otherwise have to take from your IRA. Better yet, QCDs are excluded from your income, so they help lower your adjusted gross income (AGI) as well.

How QCDs work

The IRA custodian must issue a check made out to a qualified public charity (not a private foundation, donor-advised fund, or supporting organization). In some cases, the IRA custodian may provide a checkbook from which you can write checks to chosen charities. Be aware that any check you write will count as a QCD for the year in which it is cashed by the charity, whereas a check from the custodian counts for the year in which it is issued. You can take an RMD any time during the year you turn 70½, but you must wait until after you are 70½ to make a QCD. The QCD exclusion is limited to $100,000 per year. If you're married, your spouse can also contribute up to $100,000 from his or her IRA. You cannot deduct a QCD as a charitable contribution on your federal income tax return — that would be double-dipping.

A QCD must be an otherwise taxable distribution from your IRA. If you've made nondeductible contributions, then each distribution normally carries with it a pro-rata amount of taxable and nontaxable dollars. With QCDs, the pro-rata rule is ignored, and taxable dollars are treated as distributed first.

Tax perks for givers

If you no longer itemize, you could reduce your tax bill by donating with QCDs from your IRA instead of writing checks from your standard checking account. And if you still itemize, QCDs might prove more valuable than tax deductions. That's because they can help address tax issues that might be triggered by income from RMDs.

For example, an itemized deduction reduces your taxable income by the amount of the charitable gift, but it does not reduce your adjusted gross income. This is a key distinction because the 3.8% tax on net investment income, Medicare premium costs, taxes on Social Security benefits, and some tax credits are based on AGI.

Also, charitable giving can typically be deducted only if it is less than 60% of your adjusted gross income. But with QCDs, you may be able to give more than 60% of your AGI and exclude the entire amount (up to the $100,000 cap) from your taxable income.

Time for a rollover?

Qualified charitable distributions are available from traditional IRAs, Roth IRAs (with taxable amounts), and inactive SIMPLE or SEP IRAs, but they are not allowed from employer retirement plans such as 401(k)s and 403(b)s. Thus, you might consider rolling funds from an employer plan to an IRA if you want to take advantage of a giving strategy that involves QCDs.

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