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The Financial Solutions Advisor

Inside this issue:

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Economic & Market Perspectives

Stocks and other risk assets have looked overextended following their strong run-up since the election. In recent weeks, stocks have been trading sideways and government bond prices have recovered. But we have not seen a significant setback in risk assets or a return to a true "risk off" environment. Nevertheless, we believe risk assets such as stocks and high yield bonds remain vulnerable in the near term, meaning we could see a continued period of consolidation or a more pronounced downturn.

Investors seem to be most concerned about politics as a possible catalyst for a market setback. The debt ceiling issue is resurfacing and real progress is lacking on a 2018 budget agreement. Tax reform may also experience some roadblocks. President Trump has signaled he will be more involved in crafting tax legislation than he was with health care reform. We expect he and his allies in Congress will create legislation that can be passed. However, without the baseline reductions that were part of health care reform, any tax bill must be revenue neutral or expire in 10 years in order to avoid a Democratic filibuster. Ultimately, we expect a tax reform bill will be passed, but it will probably be more limited than many hope.

More than politics, the economy probably presents a more probable roadblock for stocks. We think economic sentiment may be too high and elevated confidence may make investors vulnerable to downside economic surprises. To be sure, we are not expecting a significant economic slowdown, but the nearly non-stop pace of positive economic data is unlikely to continue. At some point, a setback will likely be triggered by a manufacturing decline, soft oil prices, weakening data from China or some other factor, which could spark a "risk-off" phase.

Nevertheless, we remain constructive in the medium- and long-term toward risk assets, but are growing increasingly cautious about the short-term outlook.

Source: Nuveen Asset Management

2017 Returns

S&P 500	*6.07%*
NASDAQ	*12.09%*
Russell Small Cap	*2.47%*
Russell Mid Cap	*5.15%*
MSCI EAFE	*7.25%*
MSCI World	*6.38%*
Barclay US Agg. Bond	*0.82%*
Barclay Municipal Bond	*1.58%*

Rising Equity Valuations Usually Become a Speed Limit… Eventually

A market uptrend can last for a long time if fundamentals follow but risk of a reversal looms if valuations are the main driver without follow-through from earnings.

In the recent rally, equity valuations did drive most of the returns as the pick-up in earnings has been slow. As a result, valuations have increased further from their GFC lows; Shiller P/Es are at 29.5x, up 150% since March 2009. They have never been higher outside the Tech Bubble of 2001 and 1929 from which two of the biggest equity bear markets have started.

Shiller P/E				Subsequent S&P 500 returns (real)					
Percentile		Level							
From	to	From	to	3-month	6-month	12-month	2-year	3-year	5-year
0%	10%	5.1	9.7	4%	9%	15%	20%	31%	50%
10%	20%	9.7	11.2	1%	2%	9%	21%	21%	30%
20%	30%	11.2	12.7	1%	2%	6%	16%	22%	36%
30%	40%	12.7	15.0	2%	5%	7%	10%	14%	21%
40%	50%	15.0	17.1	1%	0%	-1%	-1%	-1%	11%
50%	60%	17.1	19.1	-1%	-1%	-1%	-3%	1%	10%
60%	70%	19.1	21.0	2%	3%	5%	11%	23%	47%
70%	80%	21.0	23.3	0%	0%	1%	4%	9%	11%
80%	90%	23.3	26.5	2%	2%	4%	7%	7%	3%
90%	100%	26.5	45.5	0%	0%	-2%	-5%	-9%	-15%
Average since 1928:				1%	2%	4%	8%	12%	22%

Source: Goldman Sachs

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Grandparents Can Help Bridge the College Cost Gap

For many families, a college education is a significant financial burden that is increasingly hard to meet with savings, current income, and a manageable amount of loans. For some, the ace in the hole might be grandparents, whose added funds can help bridge the gap. If you're a grandparent who would like to help fund your grandchild's college education, here are some strategies.

529 college savings plan

A 529 college savings plan is one of the best vehicles for multigenerational college funding. 529 plans are offered by states and managed by financial institutions. Grandparents can open a 529 account on their own — either with their own state's plan or another state's plan — and name their grandchild as beneficiary (one grandchild per account), or they can contribute to an existing 529 account that has already been established for that grandchild (for example, by a parent).

Once a 529 account is open, grandparents can contribute as much or as little as they want, subject to the plan's lifetime limits, which are typically $300,000 and up. Grandparents can set up automatic monthly contributions or they can gift a larger lump sum — a scenario where 529 plans really shine.

Contributions to a 529 plan accumulate tax deferred (which means no taxes are due on any earnings made along the way), and earnings are completely tax-free at the federal level (and typically at the state level) if account funds are used to pay the beneficiary's qualified education expenses. (However, the earnings portion of any withdrawal used for a non-education purpose is subject to income tax and a 10% penalty.)

Under rules unique to 529 plans, individuals can make a lump-sum gift of up to $70,000 ($140,000 for joint gifts by a married couple) and avoid federal gift tax by making a special election on their tax return to treat the gift as if it were made in equal installments over a five-year period. After five years, another lump-sum gift can be made using the same technique. This strategy offers two advantages: The money is considered removed from the grandparents' estate (unless a grandparent were to die during the five-year period, in which case a portion of the gift would be recaptured), but grandparents still retain control over their contribution and can withdraw part or all of it for an unexpected financial need (the earnings portion of such a withdrawal would be subject to income tax and a 10% penalty, though).

What happens at college time if a grandchild gets a scholarship? Grandparents can seamlessly change the beneficiary of the 529 account to another grandchild, or they can make a penalty-free withdrawal from the account up to the amount of the scholarship (though they would still owe income tax on the earnings portion of this withdrawal).

Finally, a word about financial aid. Under current federal financial aid rules, a grandparent-owned 529 account is not counted as a parent or student asset, but instead as *withdrawals* from a grandparent-owned 529 account are counted as student income in the following academic year, which can decrease the grandchild's eligibility for financial aid in that year by up to 50%. By contrast, parent-owned 529 accounts are counted as parent assets up front, but withdrawals are not counted as student income — a more favorable treatment.

Outright cash gifts

Another option is to make an outright gift of cash or securities to their grandchild or his or her parent. To help reduce any potential gift tax implications, grandparents should keep their gift under the annual federal gift tax exclusion amount — $14,000 for individual gifts or $28,000 for joint gifts. Otherwise, a larger gift may be subject to federal gift tax and, for a gift made to a grandchild, federal generation-skipping transfer tax, which is a tax on gifts made to a person who is more than one generation below you.

An outright cash gift to a grandchild or a grandchild's parent will be considered an asset for financial aid purposes. Under the federal aid formula, students must contribute 20% of their assets each year toward college costs, and parents must contribute 5.6% of their assets.

Pay tuition directly to the college

For grandparents who are considering making an outright cash gift, another option is to bypass grandchildren and pay the college directly. Under federal law, tuition payments made directly to a college aren't considered taxable gifts, no matter how large the payment. This rule is beneficial considering that tuition at many private colleges is now over $40,000 per year. Only tuition qualifies for this federal gift tax exclusion; room and board aren't eligible.

Aside from the benefit of being able to make larger tax-free gifts, paying tuition directly to the college ensures that your money will be used for education purposes. However, a direct tuition payment might prompt a college to reduce any potential grant award in your grandchild's financial aid package, so make sure to ask the college about the financial aid impact of your gift.

Will I Owe Income Taxes When I Sell My Home?

In general, when you sell your home, any amount you receive over your cost basis (what you paid for the home, plus capital improvements, plus the costs of selling the home) is subject to capital gains taxes. However, if you owned and used the home as your principal residence for a total of two out of the five years before the sale (the two years do not have to be consecutive), you may be able to exclude from federal income tax up to $250,000 (up to $500,000 if you're married and file a joint return) of the capital gain when you sell your home. You can use this exclusion only once every two years, and the exclusion does not apply to vacation homes and pure investment properties.

For example, Mr. and Mrs. Jones bought a home 20 years ago for $80,000. They've used it as their principal residence ever since. This year, they sell the house for $765,000, realizing a capital gain of $613,000 ($765,000 selling price minus a $42,000 broker's fee, minus the original $80,000 purchase price, minus $30,000 worth of capital improvements they've made over the years). The Joneses, who file jointly and are in the 28% marginal tax bracket, can exclude $500,000 of capital gain realized on the sale of their home. Thus, their tax on the sale is only $16,950 ($613,000 gain minus the $500,000 exemption, multiplied by the 15% long-term capital gains tax rate).

What if you don't meet the two-out-of-five-years requirement? Or you used the capital gain exclusion within the past two years for a different principal residence? You may still qualify for a partial exemption, assuming that your home sale was due to a change in place of employment, health reasons, or certain other unforeseen circumstances.

Special rules may apply in the following cases:

- You sell vacant land adjacent to your residence
- Your residence is owned by a trust
- Your residence contained a home office or was used for business purposes
- You rented part of your residence to tenants
- You owned your residence jointly with an unmarried taxpayer
- You sell your residence within two years of your spouse's death
- You're a member of the armed services

Can the IRS Waive the 60-Day IRA Rollover Deadline?

If you take a distribution from your IRA intending to make a 60-day rollover, but for some reason the funds don't get to the new IRA trustee in time, the tax impact can be significant. In general, the rollover is invalid, the distribution becomes a taxable event, and you're treated as having made a regular, instead of a rollover, contribution to the new IRA. But all may not be lost. The 60-day requirement is automatically waived if all of the following apply:

- A financial institution actually receives the funds within the 60-day rollover period.
- You followed the financial institution's procedures for depositing funds into an IRA within the 60-day period.
- The funds are not deposited in an IRA within the 60-day rollover period solely because of an error on the part of the financial institution.
- The funds are deposited within one year from the beginning of the 60-day rollover period.
- The rollover would have been valid if the financial institution had deposited the funds as instructed.

If you don't qualify for this limited automatic waiver, the IRS can waive the 60-day requirement "where failure to do so would be against equity or good conscience," such as a casualty, disaster, or other event beyond your reasonable control. However, you'll need to request a private letter ruling from the IRS, an expensive proposition — the filing fee alone is currently $10,000.

Thankfully, the IRS has just introduced a third way to seek a waiver of the 60-day requirement: self-certification. Under the new procedure, if you've missed the 60-day rollover deadline, you can simply send a letter to the plan administrator or IRA trustee/custodian certifying that you missed the 60-day deadline due to one of 11 specified reasons. To qualify, you must generally make your rollover contribution to the employer plan or IRA within 30 days after you're no longer prevented from doing so. Also, there is no IRS fee.

The downside of self-certification is that if you're subsequently audited, the IRS can still review whether your contribution met the requirements for a waiver. For this reason, some taxpayers may still prefer the certainty of a private letter ruling from the IRS.

What's the Difference between a Direct and Indirect Rollover?

If you're eligible to receive a taxable distribution from an employer-sponsored retirement plan [like a 401(k)], you can avoid current taxation by instructing your employer to roll the distribution directly over to another employer plan or IRA. With a direct rollover, you never actually receive the funds.

You can also avoid current taxation by actually receiving the distribution from the plan and then rolling it over to another employer plan or IRA within 60 days following receipt. This is called a "60-day" or "indirect" rollover.

But if you choose to receive the funds rather than making a direct rollover, your plan is required to withhold 20% of the taxable portion of your distribution (you'll get credit for the amount withheld when you file your federal tax return). This is true even if you intend to make a 60-day rollover. You can still roll over the entire amount of your distribution, but you'll need to make up the 20% that was withheld using other assets.

For example, if your taxable distribution from the plan is $10,000, the plan will withhold $2,000 and you'll receive a check for $8,000. You can still roll $10,000 over to an IRA or another employer plan, but you'll need to come up with that $2,000 from your other funds.

Similarly, if you're eligible to receive a taxable distribution from an IRA, you can avoid current taxation by either transferring the funds directly to another IRA or to an employer plan that accepts rollovers (sometimes called a "trustee-to-trustee transfer"), or by taking the distribution and making a 60-day indirect rollover (20% withholding doesn't apply to IRA distributions).

Under recently revised IRS rules, you can make only one tax-free, 60-day, rollover from any IRA you own (traditional or Roth) to any other IRA you own in any 12-month period. However, this limit does not apply to direct rollovers or trustee-to-trustee transfers.

Because of the 20% withholding rule, the one-rollover-per-year rule, and the possibility of missing the 60-day deadline, in almost all cases you're better off making a direct rollover to move your retirement plan funds from one account to another.

What are Bond Ratings?

Bond ratings are an essential tool when considering fixed-income investments. Ratings provide a professional assessment of credit risk, or the risk of default, which can be measured to some degree by analyzing the bond issuer's financial condition and creditworthiness.

Credit rating agencies perform this type of analysis and issue ratings that reflect the agency's assessment of the bond issuer's ability to meet the promised interest payments and return the principal upon maturity. The best-known independent rating agencies — Standard & Poor's, Moody's Investors Service, and Fitch Ratings — use similar scales in descending alphabetical order, ranging from AAA/Aaa for the most creditworthy bonds to C/D for the least creditworthy.

Bonds rated BBB/Baa or higher are considered "investment grade." Lower-rated bonds, commonly called "junk bonds," are non-investment grade; they generally offer higher yields and are considered speculative with higher credit risks. Bond insurance can add a layer of protection, but it is only as good as the insurer's credit quality and ability to pay.

A credit rating is not a recommendation to purchase a bond. Even so, higher-rated bonds in general may be more appealing to investors, and — due to supply and demand — typically have a lower yield than similar bonds with a lower rating. Investors must balance risk and reward when choosing bonds that present a comfortable risk while providing a yield that is appropriate to help meet investment goals.

Ratings are very important to a bond issuer when the bond is first offered for sale, because a higher rating may reduce interest costs. After the initial sale, significant shifts in the issuer's financial condition could result in rating changes that may affect the bond's yield and market value. However, as long as the issuer does not default, a change in a bond's rating would not affect the coupon rate or the principal due upon maturity.

Bonds carry other risks as well, such as market risk, interest rate risk, and inflation risk. However, these depend on factors that are difficult to measure or predict.
The principal value of bonds fluctuates with changes in market conditions. A bond sold prior to maturity may be worth more or less than its original value.

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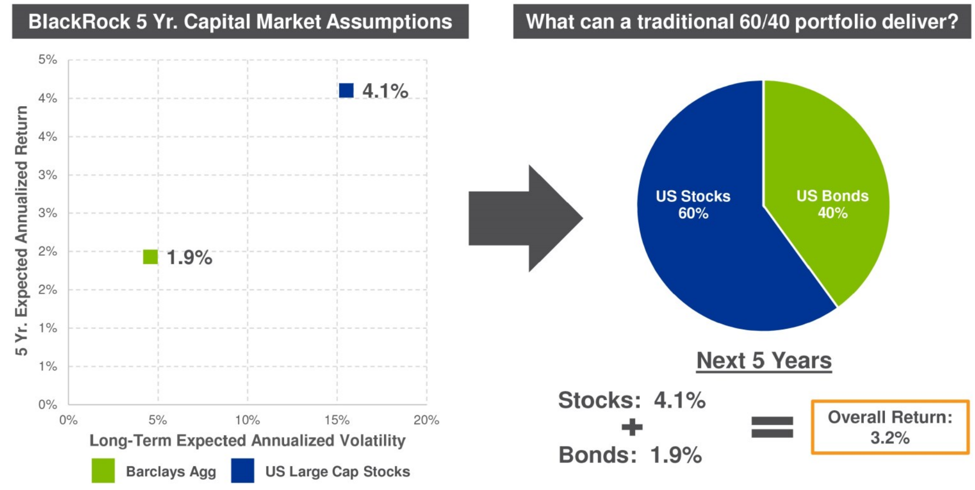
Still in a world where returns are projected to be more modest



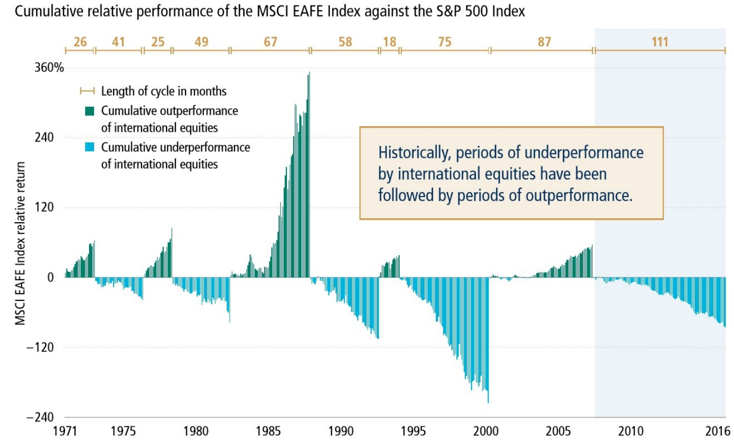
Source: Bloomberg, BlackRock Investment Institute, December 2016. The representative indices for US Large Cap Stocks and US Aggregate Bond are the MSCI USA Index and Barclays US Aggregate Bond Index, respectively. Capital Market Assumption Notes: Five-year annualized return assumptions are in geometric terms. Return assumptions are total nominal returns. Return assumptions for all asset classes are shown in unhedged terms. We use long-term volatility assumptions. We break down each asset class into factor exposures and analyze those factors' historical volatilities and correlations over the past 15 years. We combine the historical volatilities with the current factor makeup of each asset class to arrive at our forward-looking assumptions. This approach takes into account how asset classes evolve over time. Example: Some fixed income indices are of shorter or longer duration than they were in the past. Our forward-looking assumptions reflect these changes, whereas a volatility calculation based only on historical monthly index returns would fail to capture the shifts. We have created BlackRock proxies to represent asset classes where historical data is either lacking or of poor quality. You cannot directly invest in an index. See Important Notes for additional information on BlackRock's Long-Term Capital Market Assumptions.

After their longest period of underperformance, international equities offer relative value

International equity
BEARISH NEUTRAL BULLISH
▼ = OUR 12–18 MONTH VIEW
Darker shading indicates a greater concentration of views within our network.

"U.S. outperformance is cyclical and the current cycle is already longer than the historical norm." — T. Rowe Price, INVEST WITH CONFIDENCE

Cumulative relative performance of the MSCI EAFE Index against the S&P 500 Index



Valuations and dividend yields are more attractive overseas

Top 5 countries in the MSCI EAFE Index by market capitalization	Forward P/E (x)	Dividend yield (%)
Japan	16.02	1.98
United Kingdom	17.07	4.01
France	15.83	3.31
Switzerland	17.87	3.39
Germany	14.62	2.61
United States	18.83	2.09

Source: Bloomberg, FactSet, as of 12/31/16. International equities are represented by the MSCI Europe, Australasia, and Far East (EAFE) Index, which tracks the performance of publicly traded large- and mid-cap stocks of companies in those regions. Total returns are calculated gross of foreign withholding tax on dividends. U.S. equities are represented by the S&P 500 Index, which tracks the performance of 500 of the largest publicly traded companies in the United States. Japan, the United Kingdom, France, Switzerland, and Germany are represented by the MSCI Japan Index, the MSCI United Kingdom Index, the MSCI France Index, the MSCI Switzerland Index, and the MSCI Germany Index, respectively, which track the performance of publicly traded large- and mid-cap stocks of companies in those countries. It is not possible to invest directly in an index. Forward price-to-earnings (P/E) ratio is a stock valuation measure comparing the current share price of a stock with the underlying company's estimated earnings per share over the next 12 months. Past performance does not guarantee future results.