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The Financial Solutions Advisor

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Economic & Market Perspectives

As the first quarter 2018 comes to a close, one theme in particular tops the minds of investors: the return of volatility. Over the course of the past 3 months, the S&P 500 experienced 6 trading days of +/-2% moves, opposed to 2017 when we saw zero such moves, which has resulted in a bumpier ride for stock investors.

After starting the year off with a bang in January, U.S. large cap stocks were down -0.8% through the end of March as investors absorbed the implications of trade tensions, higher interest rates, firming inflation and fiscal stimulus. U.S. small cap stocks did only marginally better, down -0.1% year to date, perhaps because of their smaller exposure to global trade dynamics. Real Estate Investment Trusts (REITs) remain the worst performers, down 6.7% year to date, reflecting their sensitivity to rising rates. Foreign emerging market stocks were a bright spot, up +1.5% despite volatility elsewhere, due to improving and more resilient fundamentals in both economic and earnings growth. Foreign developed market stocks, on the other hand, were down -1.4% alongside U.S. large cap stocks. Commodities fell -0.4% in the first quarter, despite a rally in oil prices, as industrial metals prices fell on the back of tariff announcements.

Given the backdrop of steadily increasing interest rates, bond markets were challenged in the first quarter, with both U.S. bonds and global high yield bonds down -1.5% and -0.4%, respectively. In light of higher volatility, cash outperformed most other asset classes, returning +0.3%.

2018 Returns

S&P 500	*-0.76%*
NASDAQ	*3.15%*
Russell Small Cap	*-0.08%*
Russell Mid Cap	*-0.46%*
MSCI EAFE	*-1.53%*
MSCI World	*-1.28%*
Barclay US Agg. Bond	*-1.46%*
Barclay Municipal Bond	*-1.11%*

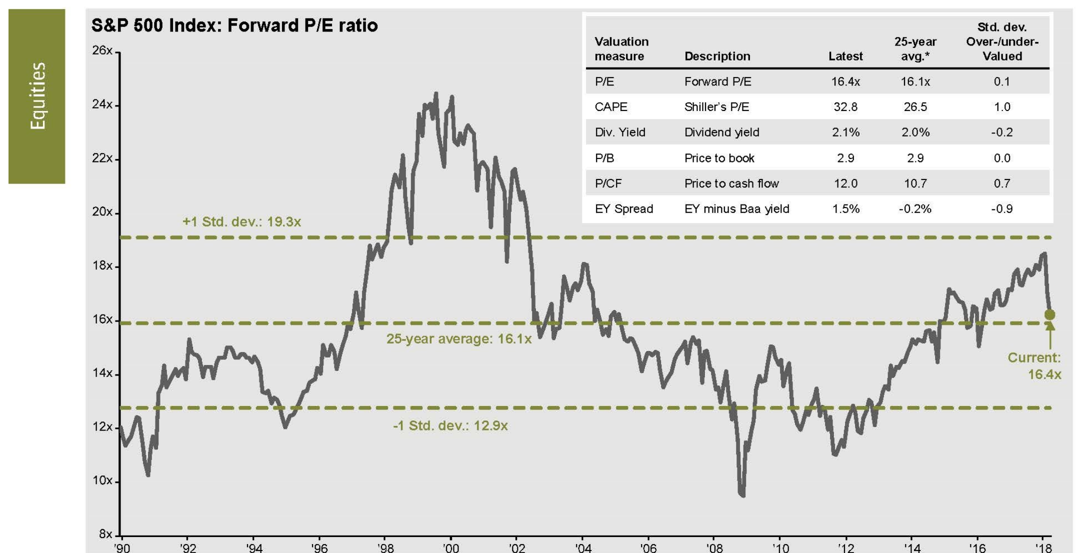
Looking forward, we do expect a bumpier ride relative to last year, and the best way to soften those bumps is through a well-diversified portfolio.

Source: J.P. Morgan Asset Management

Valuations Improve Entering the 2nd Quarter

As it currently stands, many valuation measures show the S&P 500 to be slightly expensive relative to history, with both forward P/E and Shiller P/E ratios trending higher than long-term averages. That said, valuations have recently moved more in line with average, thanks in part to improving analyst estimates of 2018 earnings in the face of tax reform. Please note that a higher E (earnings) relative to P (price of the S&P 500) in a P/E ratio equates to a lower P/E ratio.

S&P 500 valuation measures



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	16.4x	16.1x	0.1
CAPE	Shiller's P/E	32.8	26.5	1.0
Div. Yield	Dividend yield	2.1%	2.0%	-0.2
P/B	Price to book	2.9	2.9	0.0
P/CF	Price to cash flow	12.0	10.7	0.7
EY Spread	EY minus Baa yield	1.5%	-0.2%	-0.9

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The Standard Deduction and Itemized Deductions After Tax Reform

The Tax Cut and Jobs Act substantially increased the standard deduction amounts for 2018 to 2025. It also eliminated or restricted many itemized deductions for those years. You can generally choose to take the standard deduction or to itemize deductions. As a result of the changes, far fewer taxpayers will be able to reduce their taxes by itemizing deductions.

Standard deduction
The standard deduction amounts are substantially increased in 2018 (and adjusted for inflation in future years).

	2017	2018
Single	$6,350	$12,000
Head of household	$9,350	$18,000
Married filing jointly	$12,700	$24,000
Married filing separately	$6,350	$12,000

The additional standard deduction amount for the blind or aged (age 65 or older) in 2018 is $1,600 (up from $1,550 in 2017) for single/head of household or $1,300 (up from $1,250 in 2017) for all other filing statuses. Special rules apply if you can be claimed as a dependent by another taxpayer.

Itemized deductions
Many itemized deductions have been eliminated or restricted. The overall limitation on itemized deductions based on the amount of adjusted gross income (AGI) was eliminated. Here are some specific changes.

Medical expenses: The AGI threshold for deducting unreimbursed medical expenses was reduced from 10% to 7.5% for 2017 and 2018, after which it returns to 10%. This same threshold applies for alternative minimum tax purposes.

State and local taxes: Individuals are able to claim an itemized deduction of up to only $10,000 ($5,000 for married filing separately) for state and local property taxes and state and local income taxes (or sales taxes in lieu of income taxes). Previously, there were no dollar limits.

Home mortgage interest: Individuals can deduct mortgage interest on no more than $750,000 ($375,000 for married filing separately) of qualifying mortgage debt. For mortgage debt incurred before December 16, 2017, the prior $1,000,000 ($500,000 for married filing separately) limit will continue to apply. A deduction is no longer allowed for interest on home equity indebtedness. Home equity used to substantially improve your home is not treated as home equity indebtedness and can still qualify for the interest deduction.

Charitable gifts: The top percentage limit for deducting charitable contributions is increased from 50% of AGI to 60% of AGI for certain cash gifts.

Casualty and theft losses: The deduction for personal casualty and theft losses is eliminated, except for casualty losses attributable to a federally declared disaster.

Miscellaneous itemized deductions:
Previously deductible miscellaneous expenses subject to the 2% floor, including tax preparation expenses and unreimbursed employee business expenses, are no longer deductible.

Alternative minimum tax (AMT)
The standard deduction is not available for AMT purposes. Nor is the itemized deduction for state and local taxes available for AMT purposes. If you are subject to the alternative minimum tax, it may be useful to itemize deductions even if itemized deductions are less than the standard deduction amount.

Year-end tax planning
Typically, you have a certain amount of control over the timing of income and expenses. You generally want to time your recognition of income so that it will be taxed at the lowest rate possible, and time your deductible expenses so they can be claimed in years when you are in a higher tax bracket.

With the substantially higher standard deduction amounts and the changes to itemized deductions, it may be especially useful to bunch itemized deductions in certain years; for example, when they would exceed the standard deduction. Thus, while this might seem counterintuitive from a nontax perspective, it may be useful to make charitable gifts in years in which you have high medical expenses or casualty losses.

In this environment, qualified charitable distributions (QCDs) may be even more useful as a way to make charitable gifts without itemizing deductions. QCDs are distributions made directly from an IRA to a qualified charity. Such distributions may be excluded from income and count toward satisfying any required minimum distributions you would otherwise have to receive from your IRA. Individuals age 70½ and older can make up to $100,000 in QCDs per year.

What Are Some Tips for Creating a Budget and Sticking To It?

It's a common problem for many individuals — wondering exactly where your paycheck goes each month. After paying expenses, such as your mortgage, utilities, and credit card bills, you may find little left to put toward anything else.

Creating a budget is the first key to successfully manage your finances. Knowing exactly how you are spending your money each month can set you on a more clear path to pursue your financial goals. If you become sidetracked when it comes to your finances, consider these tips for creating a budget and staying on the right path.

Examine your financial goals. Start out by making a list of your short-term goals (e.g., new car, vacation) and long-term goals (e.g, your child's college education, retirement) and prioritize them. Consider how much you will need to save and how long it will take to reach each goal.

Identify your current monthly income and expenses. Add up all of your income. In addition to your regular salary and wages, be sure to include other types of income, such as dividends, interest, and child support. Next, add up all of your expenses. Sometimes it helps to divide expenses into two categories: fixed (e.g., housing, food, transportation) and discretionary (e.g., entertainment, vacations). Don't forget to factor in any financial goals you would like to pursue.

Evaluate your budget. Once you've added your income and expenses, compare the two totals. Ideally, you should be spending less than you earn. If this is the case, you're on the right track, and you'll need to look at how well you use your extra income toward achieving your financial goals. On the other hand, if you are spending more than you earn, you should make some adjustments to your budget. Look for ways to increase your income or reduce your expenses, or both.

Monitor your budget. Finally, you should monitor your budget periodically and make changes when necessary. Keep in mind that any budget that is too rigid is likely to fail. Keep your budget flexible as your changing circumstances demand.

Why It's Important to Name a Trusted Contact

Financial industry regulators (namely, the SEC and FINRA) recently created new rules and guidelines for taking care of the investing public. Broadly, regulators created new Financial Exploitation of Specified Adults rules. Specifically, broker-dealers (such as Charles Schwab and TD Ameritrade) will now collect alternative contact information so advisors (such as Financial Solutions Advisory Group) and broker-dealers are able to contact trusted friends or family members in case of emergency.

Imagine for a moment an older loved one in your family. You might be concerned about them becoming a victim of a financial scam. Or perhaps you've noticed early signs of dementia. Their financial advisor or financial institution might be seeing red-flag behaviors that justify these concerns. However, they might not know who to call if problems like these arise. Oftentimes, the individual Client is the only point of contact known to the advisor. Additionally, since the advisory relationship is confidential, Advisors are sometimes reluctant to contact loved ones due to privacy concerns.

A solution to this problem is to create a permission letter or complete a Trusted Contact Form. A Trusted Contact Form is limited in scope: it is not a Power of Attorney, for example. The form simply provides your Financial Advisor with the contact information and permission to begin suitable conversations with someone you trust. For example, an Advisor may call a loved one and share some specific observations about concerning behavior. Of course, Financial Advisors (as well as attorneys, CPAs, and others) are not medical professionals and are best served by sharing objective assessments only.

How to take action?

Consider completing a Trusted Contact Form and share it with your trusted Advisors (financial, legal, etc.).

Tell your loved ones that you've shared their contact information and with whom. Begin a conversation about why you've named them and how you hope they act if the time comes.

Make sure your longer-term backup plan is in place and up to date. This includes an appropriate estate plan and beneficiary designations. It also includes current Powers of Attorney (financial, medical, etc.) as well as Health Care directives.

While it sometimes seems there's a greater distance between loved ones and the world is getting less personal, there are steps we can take to create a network of trust. Simply having a conversation regarding this topic brings us closer together.

Four Tips for Downsizing in Retirement

Going through years of accumulated possessions and memories is probably not how you envisioned spending part of your retirement. It may sound like a daunting and emotionally draining task, but downsizing could be a savvy financial move, especially if you haven't reached your retirement savings goals.

1. Set goals for downsizing

Before you make any decisions, think about why you might want to downsize in the first place. Is it because you want to save on mortgage payments or other monthly expenses? Or are you looking to free up some cash to help pursue your lifestyle goals in retirement? No matter what your specific goals may be, understanding the connection between them and downsizing can help motivate you to follow through with it.

2. Determine the best time to downsize

It's said that timing is everything, so choosing when to downsize will be an important decision to make. One benefit of downsizing early in retirement is that mortgage payments and other related expenses (such as utilities and real estate taxes) could decrease, presuming that you are downsizing to a less expensive residence. This could mean you have extra funds to pursue new hobbies and activities right away in retirement. You might even be fortunate enough to have sufficient funds from the sale of a larger home to pay for a smaller home with cash, thus eliminating or decreasing your mortgage payment, or significantly increasing cash flow.

But there may be advantages to delaying downsizing. If you wait to do it later in retirement, you might have a better sense of just how much you need to downsize to support your current lifestyle. Plus, timing your downsizing plans with a stronger real estate market could mean that you sell and/or purchase a new home at a more opportune time.

3. Be realistic about costs

There are several costs to think about if you are downsizing your home: the worth of your current home, the cost of a new home, and the fees and expenses associated with relocating. Before you start boxing up your belongings, run the numbers. Start by contacting local real estate agents to receive estimates of your home's value. Compare the estimates so you can develop an idea of how much you might be able to get for your home. Research online to see what homes in your neighborhood have sold for recently — this can also help you determine your home's potential selling price.

Take similar steps when you look for your new home. One option that might be available is to rent a new house or apartment for a length of time before buying it. That way, you'll learn whether the home and the location suit you, helping you avoid buyer's remorse.

If you're buying a new home, don't forget to account for the down payment, home inspection, closing costs, and other associated charges. Factoring all of the numbers into the equation may reveal whether downsizing makes the most sense for you and your financial situation.

4. Consider downsizing your belongings, not just your home

For some people, downsizing might simply mean cutting down on clutter rather than relocating. It's easier said than done, particularly if you've amassed many belongings over time. When purging your home, consider the following:

Take your time. Don't feel pressured to clear out your entire home in one fell swoop. Instead, make a plan to do one room or section of your home at a time.

Involve your children. If you have kids, consider asking them for their help. Many hands make light work, and your children may end up expressing interest in items they would like to have.

Sell valuables. Maybe you can't find a new home for that antique necklace you never wear or the rare baseball cards collecting dust in your attic. Consider having those items appraised and selling them to an auction house or online. Depending on how many items you're selling and their worth, you could wind up with quite a bit of money that you can use to help cushion your retirement fund.

Donate gently used items. Find out if there are any local organizations in your community that could benefit from furniture, clothing, or any other possessions in good condition that you want to get rid of. Some donation outlets may even offer free pickup of certain items, saving you time and hassle.

Clear out junk. Chances are you've accumulated items that you simply won't be able to give away or sell. Discard belongings that serve no purpose other than taking up space in your home. You might be surprised by how much room you could free up.

Four Points to Consider When Setting a Retirement Income Goal

At Financial Solutions you'll find a fee-only Registered Investment Advisor (RIA) committed to putting your interests and your needs first, eliminating the commissions and self-serving incentives that get in the way of solid, successful financial planning and investment management.

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No matter what your age or stage of life, targeting a goal for monthly retirement income can seem like a daunting task. Following are four considerations to help you get started.

1. When do you plan to retire?
The first question to ponder is your anticipated retirement age. Many people base their target retirement date on when they're eligible for full Social Security benefits, and for today's workers, "full retirement age" ranges from 66 to 67. Other folks hope to retire early, while still others want to work as long as possible. As you think about your anticipated retirement date, keep the following points in mind.

If you plan to retire early, you'll need significant resources to provide income for potentially decades. You can typically tap your employer-sponsored retirement plan without penalty as early as age 55 if you terminate your employment, but if you try to access IRA assets prior to age 59½, you will be subject to a 10% early withdrawal penalty, unless an exception applies. In both cases, regular income taxes will apply. Also consider that you generally won't be eligible for Medicare until age 65, so unless you are one of the lucky few who have employer-sponsored retiree medical benefits, health insurance will have to be funded out of pocket.

If you plan to delay retirement, consider that unexpected circumstances could throw a wrench in that plan. In its 2017 Retirement Confidence Survey, the Employee Benefit Research Institute (EBRI) found that current workers plan to retire at a median age of 65, while current retirees reported a median retirement age of 62. And although four in 10 workers plan to work until age 70 or later, just 4% of retirees said this was the case. Why the difference? Nearly half of retirees said they retired earlier than planned, with many reporting unexpected challenges, including their own health concerns or those of a family member.[1]

2. How long will your retirement last?
The second important consideration, which builds on the first, is how long your retirement might last. Projected life spans have been lengthening in recent decades due in part to advancements in medical care and general health awareness. According to the National Center for Health Statistics (NCHS), a 65-year-old woman can expect to live 20.6 more years, while a 65-year-old man can expect to live 18 more years.[2] To estimate your own life expectancy based on your current age and health profile, visit the online longevity calculator created by the Society of Actuaries and American Academy of Actuaries at longevityillustrator.org.

3. What will your expenses look like?
The third consideration is how much you will need to meet your basic living expenses. Although your housing, commuting, and other work-related expenses may decrease in retirement, other costs — including health care — will likely rise.

In 2017, EBRI calculated that Medicare recipients with median prescription drug expenses may need about $265,000 just to pay for basic medical expenses in retirement.[3] And that doesn't even include the potential for long-term care. According to the Department of Health and Human Services (HHS), 52% of people over age 65 will need some form of long-term care during their lifetimes, which could add another $69,000, on average, to the out-of-pocket costs.[4]

In addition, remember to account for the impact inflation will have on your expenses over time. For example, say you need an estimated $50,000 to cover basic needs in your first year of retirement. Ten years later, at a 3% annual inflation rate (the approximate historical average as measured by the consumer price index), you would need more than $67,000 to cover those same costs.

4. How much can you accumulate?
This is perhaps the most important consideration: How much can you *realistically* accumulate between now and retirement based on your current savings rate, timeframe, investment portfolio, and lifestyle? Once you project your total accumulation amount based on current circumstances, you can gauge whether you're on track or falling short. And if you appear to be falling short, you can begin to think about how to refine your strategy, either by altering your plans for retirement (e.g., delaying retirement by a few years), saving more, or investing more aggressively.

[1] EBRI Issue Brief, March 21, 2017
[2] NCHS Issue Brief, Number 293, December 2017
[3] EBRI Notes, January 31, 2017
[4] HHS, "Long-Term Services and Supports for Older Americans: Risks and Financing Research Brief," February 2016

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