2Q15

The Financial Solutions Advisor

Inside this issue:

Contact us:

8700 W. Bryn Mawr Ave.
Suite 410-N
Chicago, Illinois 60631
773.714.1540 *Main*
773.714.1550 *Facsimile*
www.fsadvisorygroup.com

Economic & Market Perspectives

On the heels of a somewhat rough first quarter, many investors are questioning the state of economic growth and wondering if equities still hold value. Our view is that an improving global economy should (eventually) allow for a renewed upturn in earnings prospects, and in equity markets. As such, we believe investors should remain patient.

The financial markets remain jittery, still trying to find their bearings after a massive months-long shift in the U.S. dollar, oil prices and bond yields. As has been the case since the financial crisis began, the main concern among investors is that economic growth will falter. The main catalyst for these worries is now the strong dollar, which many fear will derail the primary global growth engine – the U.S. economy. Some investors fear the dollar will wreck the U.S. recovery before it lifts overseas economies. It is true that the strength of the dollar has depressed corporate earnings expectations and will likely continue to do so.

Investors are also concerned about the pending start of the Federal Reserve's rate hike cycle. While the start of rate hikes will likely cause some temporary turbulence in financial markets, the fundamental backdrop should still be reflationary. The start of the next rate cycle is not about preventing a surge in consumer price inflation in the next year or two, but about unwinding an unprecedented monetary experiment. In other words, the Fed is not going to be raising rates to combat inflation, but rather as a reflection that the economy is strong enough that it no longer needs an emergency, zero-rate policy.

The problem for U.S. equities is that with the Fed preparing to raise interest rates, removing the tailwind of quantitative easing, markets are now reliant on company earnings growth. Unfortunately, there is little to be found. Analyst estimates suggest first quarter earnings for the S&P 500 will be down 5% from this point last year. Companies are struggling with multiple factors, including softer-than-expected economic growth, the rapid appreciation of the dollar and a modest acceleration in wage growth.

Part of the recent soft growth is admittedly a function of two temporary factors: a brutally cold winter and the West Coast port strike. That said, it is worth reiterating how much economic numbers have disappointed of late. U.S. economic surprises continue to run at the most negative level since 2009. The Chicago Purchasing Managers Index plunged in March to 46.3, its lowest level since 2009. ISM New Orders fell to 51.8, the lowest since the spring of 2013. Finally, March's payroll gains were 126,000, below even the most pessimistic expectations, although we continue to believe the underlying fundamentals of the labor market remain strong. All told, first quarter gross domestic product is likely to disappoint, as has been the pattern for most of this recovery. In an environment of generally decent (albeit recently disappointing) growth and gently rising yields, high yield offers attractive potential in a yield-starved world.

Against this backdrop, it should not be surprising that bond yields remain low. This trend has been exacerbated by foreign central bank bond buying and a dearth of new supply. But low U.S. yields are also a function of even lower yields outside the U.S. Currently, 25% of the European sovereign bond market is trading with a negative yield. In France, government bonds of up to three years carry a negative yield. In Germany it is eight years, and in Switzerland 10 years. In this context, a U.S. 10-year bond offering a roughly 2% yield and backed by a strong currency actually seems appealing.

We expect volatility to remain elevated in the coming months as the Fed debates when to start lifting rates and until the earnings outlook improves. The Fed's rate hike cycle should be gradual (despite a historically low starting point), and we do not expect this will create a roadblock to growth for the foreseeable future. Earnings improvements could begin when companies start to benefit from falling commodity prices. Overall, valuations, positioning and leading economic indicators lead us to conclude that cyclical prospects appear favorable for equities over bonds in many cases. Market conditions may remain rocky for some time, but in the end, we think optimism will prevail.

Sources: BlackRock, Nuveem

2015 Returns

S&P 500	*0.95%*
NASDAQ	*2.63%*
Russell Small Cap	*4.32%*
Russell Mid Cap	*3.95%*
MSCI EAFE	*4.88%*
MSCI World	*2.31%*
Barclay US Agg	*1.61%*
Barclay Muni.	*1.01%*

A Registered Investment Advisory Firm
Financial Solutions Advisory Group

Retiring and Relocating? Don't Neglect State Taxes!

If you're retired, or about to retire, you may be thinking about relocating to a state that has low tax rates or provides special tax benefits to retirees. Here's a survey that may jump-start your search for a tax-friendly state in which to spend your golden years.

State income taxes in general

State income taxes typically account for a large percentage of the total taxes you pay. So you may consider yourself lucky if you live in one of the seven no-income-tax states: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. (New Hampshire and Tennessee impose income tax only on interest and dividends.)

But if you're considering a state that does impose an income tax, as a retiree you'll want to know how that state treats Social Security and retirement income.

State income taxes and Social Security

Social Security income is completely exempt from tax in 28 of the states with an income tax (as well as the District of Columbia): Alabama, Arizona, Arkansas, California, Delaware, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Virginia, and Wisconsin.

Some states (for example, Connecticut, Kansas, Missouri, and Montana) don't tax Social Security benefits if income is less than a specified dollar amount (Nebraska joins this list in 2015). And at least three states (Colorado, Utah, and West Virginia) provide a general income exclusion or credit for seniors that takes Social Security into account. Most of the remaining states tax Social Security benefits to the same extent they're taxed under federal law.

State income taxes and retirement income

Of the states with an income tax, most provide at least some relief for retirement income, but this can range from a credit of less than $500 (Ohio and Utah) to an exclusion for all or most retirement income (Hawaii, Illinois, and Mississippi). Only a handful of states, including California, Nebraska, North Carolina, North Dakota, Rhode Island, and Vermont, currently tax all retirement income and don't provide any general income exclusion for seniors.

Make sure you understand how your particular type of retirement income is treated. Some states exempt public pensions, but tax private pensions; or exempt public pensions earned in that state, but not public pensions earned in another state. Some states exempt employer retirement benefits, but not IRA income. Others exempt a specific dollar amount of retirement income, but only if you've reached a certain age or have income within certain limits. In some states, military pensions are partially or fully exempt, while in others they're fully taxable. Some states exempt defined benefit pension payments, but tax 401(k) distributions. A good source for information is your state's Department of Revenue website.

Can the state I'm moving *from* tax my benefits?

What happens if you spent your working life in a state like California that fully taxes retirement income, but you relocate after you retire to Florida, a state that has no income tax? Can California tax your pension benefit? While the answer used to be unclear, federal law now clearly prohibits states from taxing certain retirement income unless you're a resident of, or domiciled in, that state.

Whether you're considered a resident of, or domiciled in, a state is determined by the laws of that particular state. In general, your residence is the place you actually live. Your domicile is your permanent legal residence--even if you don't currently live there, you have an intent to return and remain there. So in our example, if you're no longer a resident of, or domiciled in, California, that state cannot tax your pension benefit under federal law.

The law applies to all qualified plans (for example, 401(k), profit-sharing, and defined benefit plans), IRAs, 403(b) plans, 457(b) plans, and governmental plans.

The law provides only limited protection for other (nonqualified) deferred compensation plan benefits. So-called "top-hat" plan benefits that are paid over an employee's lifetime, or over a period of at least 10 years, are covered by the law. But stock options, stock appreciation rights (SARs), and restricted stock are not; states are free to tax these benefits even after you relocate.

Other considerations

Remember that states impose many other kinds of taxes (for example, sales, real estate, and gift and estate taxes). Some states offer special tax breaks to seniors, like property tax reductions or additional exemptions, standard deductions, or credits based on age. For an accurate comparison among the states, you'll need to consider your total tax burden. A tax professional can assist you in this task.

Economic and Market Strategy

BEYOND ZERO: In Europe, there are currently around US $2 trillion worth of government securities carrying a negative yield, mostly AAA-rated bonds with relatively short maturities from countries like Germany, France and Austria. This unprecedented situation prompts a series of questions:

HOW DID WE GET HERE? Central banks have pushed rates close to zero with the intention of giving firms and individuals confidence to borrow, consume, and invest. However, due to low inflation, real rates have begun increasing again in areas where easier monetary conditions are needed most. Additional aggressive easing in the Euro area (as well as Japan) has been powerful enough to weigh on bond yields even in the US, where the Federal Reserve is gradually moving away from an expansionary monetary policy setting.

WHO IS WILLING TO HOLD NEGATIVE-YIELDING BONDS? Despite the obvious deterrent of a negative return, some institutional investors are mandated by stakeholders or regulators to hold fixed income assets. Although investors can seemingly hold cash with a zero return, the cost to safely store cash suggests that cash returns are actually also negative. In general, investors searching for relatively low-risk investments are facing increasingly dim options.

WHAT ARE THE BROADER ASSET IMPLICATIONS? At the same time that bond yields have declined to very low or negative levels, duration (interest rate sensitivity) has by definition also increased,

Continued on page 3

Helping Your Parents Manage Their Finances

As the U.S. population gets older, more people, particularly baby boomers, are confronting a dilemma. As parents age, their ability to manage their own finances may decline. That can make it more likely that they may neglect the life savings they've worked so hard to accumulate or make costly mistakes with them. Even worse, they're more likely to fall victim to one of the fraudulent schemes that frequently target seniors. "Financial Fraud and Fraud Susceptibility in the United States," a September 2013 report prepared for the FINRA Investor Education Foundation, found that seniors were 34% more likely to lose money to fraudsters than were those in their 40s.

And yet many seniors, especially those who have always been independent and/or money-savvy, may be reluctant to accept advice or help from their children, or even discuss living expenses, health care plans, investments, or general estate planning. Sadly, postponing that discussion can increase the difficulty of tackling whatever problems may eventually arise.

What's behind parental reluctance?
Suggesting that parents might benefit from assistance, either from their children or a professional, may remind them of their own mortality. People are living longer; if they're still active and involved, they may have difficulty accepting that their current good health and financial comfort may not always continue.

Also, some seniors may be reluctant to discuss finances because it can reinforce a sense of loss; this could be especially true if they can no longer drive or participate in activities they enjoy. Admitting that they need help with financial issues may make them feel as though one more area is no longer under their control. If this is the case, they might respond to the idea that addressing important issues now--planning for ill health or an incapacity--could give them greater decision-making power over their quality of life later.

Parents also may be uncomfortable discussing finances with only one child, preferring to involve all siblings. In this case, you may need to either try to reach a consensus about which child is best equipped to help, or divide responsibilities among siblings. For example, one child might assist with billpaying and day-to-day expenses while another reviews investments or handles health insurance, Medicare, and Social Security.

In some cases, parents may respond to the idea that taking action sooner rather than later can help prevent the loss of much of their hard-earned savings to taxes or scams. If they're uncomfortable discussing finances with you, you could suggest working with a third party who can review their situation and make recommendations that could then be discussed jointly.

When to offer help
Here are some signs that a parent might need some assistance: confusion about whether direct-mail offers are advertising or bills; failing to pay bills or file documents properly, especially if someone has always been highly organized; complaints about being unable to make ends meet; talking about the merits of certain investments, especially unfamiliar ones and especially if a parent hadn't previously exhibited much interest in investing; unusual behavior, such as making unexpected large purchases or spending a lot of time gambling.

Be sure to rule out other physical problems, such as an infection or difficulties with vision or hearing, before assuming that mental confusion is automatically a sign of dementia.

A start is better than nothing
If parents are reluctant to discuss specific figures, try to make sure that key information, including online account information and passwords, is on paper, and that someone else knows the location of those items and will be able to access them if necessary.

You might start providing assistance in stages. Offer to review checking account statements and/or credit card bills to ensure they're not paying for services they want to cancel or didn't request; this may give you insight into the overall state of their finances. Because seniors may be more willing to discuss issues such as health insurance and preferences regarding long-term care or end-of-life decisions before other topics, building trust in these areas could increase comfort levels on both sides with other matters.

If a trust has been set up, a trustee might be the logical person to handle finances, since he or she may eventually have to deal with trust-related issues anyway. The same is true for someone who has been granted a durable power of attorney, even if he or she doesn't yet have full responsibility for managing finances. And in a worst-case scenario, children can petition a probate court to name a conservator or guardian. Whatever approach you take, one of the key challenges of this process is to respect a parent's dignity while protecting his or her ongoing well-being.

Economic and Market Strategy *Continued from page 2*

leading to a seemingly ever-worsening risk-reward trade-off for fixed income investments. Naturally, investors have increasingly looked elsewhere for yield, typically first turning to the closest proxies for fixed income. This has resulted in an increase in preference for bearing liquidity risk, credit risk, and business cycle risk.

WHAT ARE THE RISKS TO ASSET MARKETS? We see two major risks of negative rates: 1) Given the difficulties of valuing assets with zero, or negative, discount factors, the potential for "bubbles" is high, particularly for "high duration" assets, and 2) In the search for income, investors may underprice liquidity risk and/or take on excessive leverage.

WHERE DO BOND YIELDS GO FROM HERE? Until inflation starts to rise, pushing real rates lower again, there will be pressure in Europe and in small open economies in the region to keep policy rates low. Negative short-term rates should promote a steepening of yield curves. In our view, as inflation gradually rises, the pressure to keep policy rates negative should subside.

Source: Goldman Sachs Global Investment Research

How do I purposefully disinherit an heir?

While you can easily disinherit a nonheir by not mentioning him or her in your will, the rules are more complicated when it comes to your heirs. Merely not mentioning the name of a child or spouse in your will might not disinherit him or her, and doing so can even open the door for a will contest. In a will contest, the heir who is left out could argue that he or she was mistakenly overlooked. The outcome of a will contest depends in part on your state's law regarding an omitted (referred to as "pretermitted") spouse or child.

To be sure that your intent to disinherit an heir is unequivocal, you should consider including a disinheritance clause in your will. Such a clause can discourage the disinherited heir from contesting your will. This clause would indicate the exact name of the heir you wish to disinherit, and explicitly state that the reason he or she is not included is because you wish to disinherit him or her.

Be aware that, in most states, you cannot disinherit your spouse completely. If you live in a community property state, your spouse automatically owns one-half of the community property, which generally includes property that either of you acquired during your marriage. In all states, spouses are protected from disinheritance because they're allowed to claim a statutory share (also known as "electing against the will"). A statutory share can run anywhere from one-quarter to one-half of an estate, regardless of the terms of your will.

Even though you have the right to disinherit a child, be aware that this right is restricted by laws granting certain inheritance rights to minors and protecting children of any age from accidental disinheritance.

If you are concerned about whether your heir can manage an inheritance but don't want to disinherit him or her, you might consider a trust for the benefit of the heir.

You should consult an estate planning attorney if you're considering disinheriting an heir, or if you have concerns about whether your heir can manage the inheritance.

Do I have to pay an additional tax on investment income?

You might, depending on a few important factors.

A 3.8% net investment income tax is imposed on the unearned income of high-income individuals. The tax is applied to an amount equal to the lesser of:

- Your net investment income
- The amount of your modified adjusted gross income (basically, your adjusted gross income increased by an amount associated with any foreign earned income exclusion) that exceeds $200,000 ($250,000 if married filing a joint federal income tax return, and $125,000 if married filing a separate return)

So if you're single and have a MAGI of $250,000, consisting of $150,000 in earned income and $100,000 in net investment income, the 3.8% tax will only apply to $50,000 of your investment income.

The 3.8% tax also applies to estates and trusts. The tax is imposed on the lesser of undistributed net investment income or the excess of MAGI that exceeds the top income tax bracket threshold for estates and trusts ($12,150 in 2014). This relatively low tax threshold potentially could affect estates and trusts with undistributed income. Consult a tax professional.

What is net investment income?

Net investment income generally includes all net income (income less any allowable associated deductions) from interest, dividends, capital gains, annuities, royalties, and rents. It also includes income from any business that's considered a passive activity, or any business that trades financial instruments or commodities.

Net investment income does not include interest on tax-exempt bonds, or any gain from the sale of a principal residence that is excluded from income. Distributions you take from a qualified retirement plan, IRA, 457(b) deferred compensation plan, or 403(b) retirement plan are also not included in the definition of net investment income.

Morgan Stanley Long-Run Return Forecasts

Source: Morgan Stanley Research, RIMES, Bloomberg

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.

Please contact us if you would like to receive this publication by e-mail.

8700 W. Bryn Mawr Ave.
Suite 410-N
Chicago, Illinois 60631
773.714.1540 *Main*
773.714.1550 *Facsimile*
www.fsadvisorygroup.com