3Q17

The Financial Solutions Advisor

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Economic & Market Perspectives

Risk assets (stocks) continued to rally through the second quarter (2Q) with international equity (stock) markets taking the lead relative to the U.S. Emerging Market (EM) equities (stocks) returned 6.4% in 2Q, bringing YTD returns to 18.6%, driven mostly by outsized returns in EM Asia. Similarly, developed market economies returned 6.4% over the quarter and 14.2% YTD. Improving economic and earnings data in international markets are helping drive stock markets upward, and attractive valuations relative to the U.S. add to the prospect of better future returns abroad.

In the U.S., investors started to question the path of Fed rate hikes given weaker than expected inflation data, leading 10-year rates to fall to 2.15% and the Barclays Aggregate Bond Index to return 1.4% over 2Q. High yield also rallied as rates fell, returning 3.2% for the quarter. U.S. large cap stocks continued their upward trajectory, up 3.1% in 2Q and 9.3% YTD, driven largely by the technology sector. Small cap stocks underperformed as the strength of the domestic recovery was called into question after a weak 1Q GDP print, returning 2.5% for the quarter and 5.0% YTD.

Real Estate Investment Trusts (REITs) returned 2.3%, cushioned by flows into higher yielding sectors of the stock market as rates fell. Commodities were the sole negative return as oil prices fell steeply amidst concerns over a supply glut stemming from persistent U.S. production.

Importantly, cash has returned just 0.2% YTD, meaning that investors sitting on the sidelines would have missed out on healthy returns across a wide array of asset classes thus far in 2017.

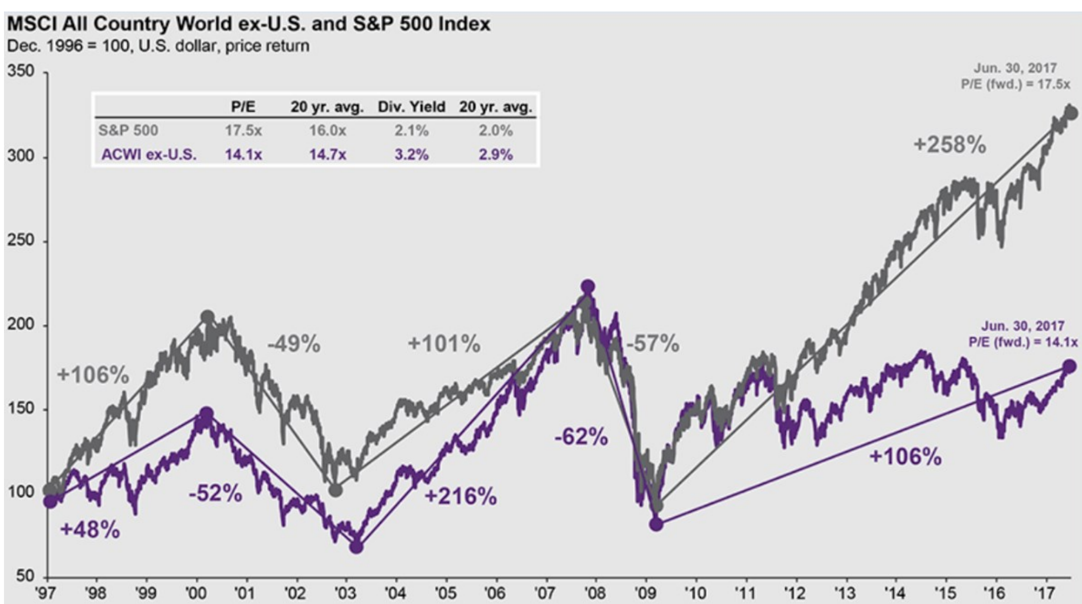
2017 Returns

S&P 500	*9.34%*
NASDAQ	*16.78%*
Russell Small Cap	*4.99%*
Russell Mid Cap	*7.99%*
MSCI EAFE	*13.81%*
MSCI World	*10.66%*
Barclay US Agg. Bond	*2.27%*
Barclay Municipal Bond	*3.57%*

Source: J.P. Morgan Asset Management

U.S. Stocks Continue to Outperform Relative to Global Peers

The Morgan Stanley Capital International World index (MSCI World) is a stock index of 1,650 world stocks that is commonly used as a benchmark for global stock funds. In the graph below, we can see that the S&P 500 carries a forward P/E ratio that is 24% higher than the global MSCI World benchmark (excluding US stocks).



Source: J.P. Morgan Guide to the Markets Q32017

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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.

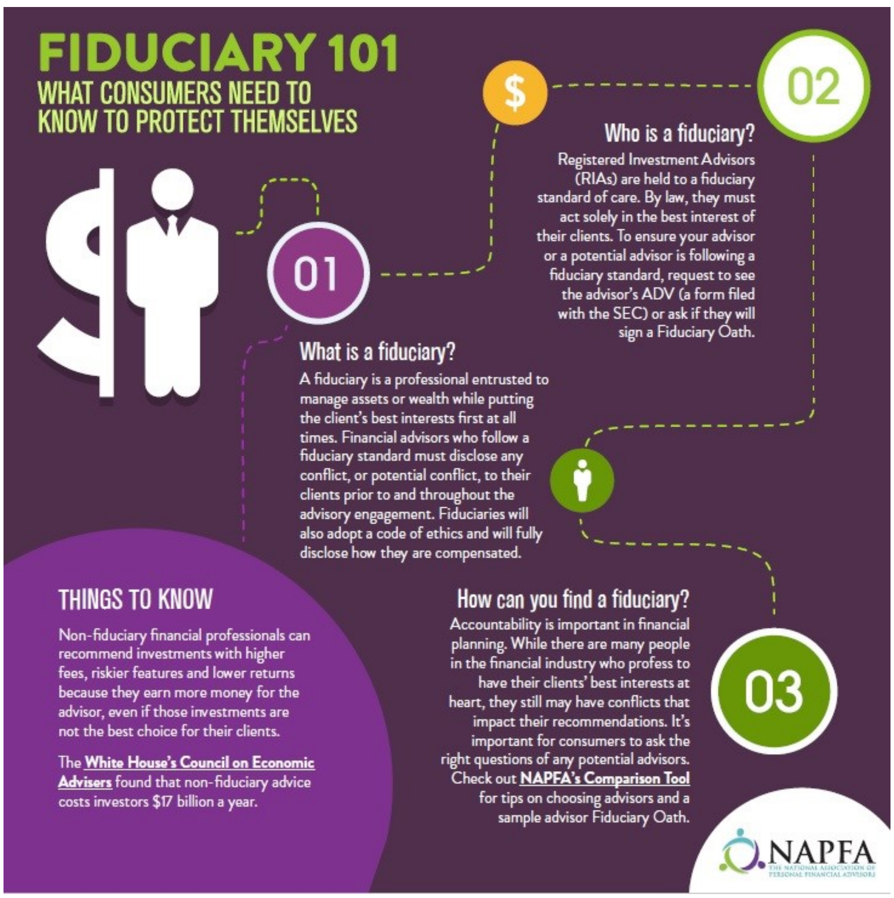
Check your credit card statement to see what APR you're currently paying. If you're carrying a balance, how much is your monthly finance charge?

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 0% 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.

What to Know About the New DOL Fiduciary Rule



Financial Solutions Advisory Group has been conflict free since day 1. We have maintained this standard for the past 15 years, and will continue to maintain this standard going forward. The recent change in regulations has impacted many brokers and insurance agents. The change in regulations has not impacted how Financial Solutions conducts business and serves our clients. If you have any questions about this, please do not hesitate to ask us.

The 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 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]

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 0%.) 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%, and the extension and modifications were made "permanent."

2017 Estate Planning Key Numbers	
Annual gift tax exclusion	$14,000
Gift tax and estate tax basic exclusion amount	$5,490,000
Noncitizen spouse annual gift tax exclusion	$149,000
Generation-skipping transfer (GST) tax exemption	$5,490,000
Top gift, estate, and GST tax rate	40%

Federal Estate Tax
Repeal of the estate tax seems possible once again. If 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.

Can I Roll my Traditional 401(K) Balance Over to a Roth IRA?

Yes, you can make a direct or 60-day rollover from a 401(k) plan [or other qualified plan, 403(b) plan, or governmental 457(b) plan] to a Roth IRA, as long as you meet certain requirements.*

First, you must be entitled to a distribution from your plan. While you can always access your account when you terminate employment, in some cases you may be able to withdraw your own or your employer's contributions while you're still working (for example, at age 59½).

[Note: Your plan may also permit the "in plan" conversion of all or part of your account balance to a Roth account, regardless of whether you're eligible for a distribution from the plan. Check with your plan administrator.]

Second, your distribution must be an "eligible rollover distribution." Distributions that cannot be rolled over include hardship withdrawals, certain periodic payments, and required minimum distributions (RMDs).

Third, you must include the taxable portion of the distribution in your gross income in the year you make the rollover ("conversion"). But that's the price you have to pay to potentially receive tax-free qualified distributions from your Roth IRA in the future.

Fourth, if your distribution includes both after-tax and pre-tax dollars, you can generally direct that only the after-tax dollars be rolled over to the Roth IRA (resulting in a tax-free conversion), while making a tax-deferred rollover of the pre-tax dollars to a traditional IRA.

When evaluating whether to initiate a rollover from an employer plan to an IRA, be sure to: (1) ask about possible surrender charges that your employer plan or IRA may impose, (2) compare investment fees and expenses charged by your IRA with those charged by your employer plan (if any), and (3) understand any accumulated rights or guarantees that you may be giving up by transferring funds out of your employer plan. Also consider all of your distribution options, including leaving the money in your employer's plan, transferring the funds to a new employer's plan, or taking a cash withdrawal.

*If you make a 60-day rollover, your plan will withhold 20% of the taxable portion of your distribution for federal income tax purposes.

Four Things To Do in the Four Years Before College

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.

1 Take stock of your savings

A few years before you need to start paying tuition bills is a good time to look at your college savings. How much have you saved? Are you currently making monthly contributions? Can you increase them? How much will you have saved by the time your child graduates from high school?

2 Get familiar with financial aid...

Get an estimate of your expected family contribution (EFC) by filling out the federal government's FAFSA4caster tool at www.fafsa.ed.gov. Your EFC will depend on your family's income, assets, and household information, like the number of children you'll have in college at the same time.

3 ... and net price calculators

Colleges differ in the amount of merit and need-based financial aid they offer. To get an idea of how generous a college is, run the net price calculator available on every college website to get an estimate of what your out-of-pocket costs will be at that college. This 10-minute endeavor can help you compare the cost of different colleges in an apples-to-apples way.

4 Have a frank conversation with your child about college costs

Share how much you expect to have saved and how much you will be able to contribute each year during college. When talking about loans, make sure your child knows exactly what the monthly payment will be after graduation for different loan amounts. Help your child avoid excessive borrowing.

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