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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

The end of the quarter finds the stock market barely above last year's close. As usual, there have been a number of ups and downs, but there has been no real progress. Economic statistics have also returned to their slow growth ways, unable to sustain a normal growth rate. Our financial planning topic in this issue continues our discussion of retirement plans. Adding funds to retirement plans is easy and typically fairly automatic. Managing withdrawals effectively requires additional forethought and planning.

The Economy

Slow growth continues to be the order of the day. GDP growth slid back to 2% in the fourth quarter of 2014, finishing up the whole year at 2.4%. While the 2014 number is better than 2013's 2.2% growth, the result continues to be less than robust. Worse yet, the Atlanta Federal Reserve Bank's *GDPNow* "real-time" estimate has dropped to 2/10 of one percent, suggesting a virtual stall may have occurred during the January to March period. The bright spot for investors, but not necessarily wage earners, has been corporate profit growth since the recessionary bottom in 2009. Unfortunately, corporate profits actually declined by $22 billion in 2014. This weakness no doubt caught Wall Street analysts off guard. They predicted growth estimates of 13% for the year and based investment decisions on that overstated expectation.

The topic of the day amongst the pundits is "When will the Fed raise interest rates?" The central bank would like to return to a more normal interest rate posture, putting their grand experiment with zero rates and quantitative easing behind them. They typically raise their target rate during economic expansions to keep inflation from getting out of control. But this time there is little inflation. There is also little growth. How can they return to a normal rate structure without putting additional pressure on a struggling economy? It is a quandary.

Additionally, there are many economic cross currents to sort out. Many other countries' central banks have followed the lead of the US Fed, implementing stimulative monetary policies, while the Fed is trying to back off. Expanding the amount of money available in their local currencies, and lowering interest rates have caused the value of their currencies to weaken, and the relative value of the dollar to rise. This has caused US exporters to become less competitive, and reduced the prices of international goods entering the US. Additionally the advent of hydraulic fracturing, or "fracking", has lead to an oversupply of oil in the world markets. Both the dollar increase and the oversupply have led to significant reductions in the price of oil and gasoline. These forces are a benefit to US consumers and travelers, but tough on the energy companies and other companies with international sales. Their market problems have contributed to the overall fall in US profits.

The Markets

Those growth predictions mentioned earlier were the rationale for the stock market's advance last year. Estimates have now been reduced, coming back into line with reality, but that reduction has produced a price/earnings ratio valuation of 17 based on year-ahead earnings estimates. This is 10% higher than the same measure at the 2007 peak. Potentially even more problematical is that the last two times an earnings estimate reduction of this size was seen was in 2007 and 2000, preceding significant bear markets. Is that a growl we hear off in the distance?

This short-term measurement is now in the same fairly rarified status as the longer-term valuation measures, such as Shiller's CAPE and the Tobin's Q ratio, which we have mentioned on several occasions, which are well correlated with future investment returns over the next 10-15 years. Both of these are higher than 2007, 1967, and 1929, only being surpassed by the peak in 2000. These current measures suggest that future results may mirror those earlier times, which were all followed by deep bear markets.

Planning to Manage Your Retirement Withdrawals

Last year we compared the after-tax effectiveness of different retirement savings vehicles in our January 2014 issue, and discussed how to match different asset types with retirement plan tax characteristics in our April 2014 issue. In case you missed them, or would like to refresh your memory, you can re-read them on our website www.linnardfinancial.com. Today's topic, how to manage withdrawals, will finish the series.

Traditional IRAs and 401(k) plans require participants to withdraw money on a defined schedule. The amount increases with age. Likewise, annuities either require fixed payments or a lump-sum distribution at some point. Social Security and pension benefits are also pre-defined. This means that the beneficiary of these plans has no control over the amount of taxable income they receive.

Rather than being stuck with an uncontrollable tax-burden, it would be preferable to be able to select your income sources; to maximize your after-tax income and not be forced into a higher tax bracket as IRA distributions increase, or as an annuity lump sum is received. Avoiding the unpleasant outcome of an unexpected tax increase requires some pre-planning to avoid taxable income spikes. Also, in years when higher spending needs would otherwise require you to withdraw additional taxable retirement plan income, it would be nice to have a pot of tax-free money to draw upon instead to make up the difference.

Where does such a pot come from? It can come from either a Roth IRA or a simple savings or brokerage account. How does the money get into the pot? It may seem counter-intuitive to pay more tax than necessary, but if you expect your tax bracket to be low one year, you can take an additional, low-tax distribution from your traditional IRA or 401(k) at the lower rate and keep the proceeds in a taxable brokerage, mutual fund or savings account. You could also put the funds in a Roth IRA, where they will continue to earn tax-free returns year after year. A partial surrender of a deferred annuity is another possibility.

The exact strategy depends very much on individual circumstances. In cases where a person plans to retire, but expects to defer receiving Social Security benefits until later, there is often a period after wage income stops and before Social Security and required IRA distributions begin. This period typically has a low tax rate that can be used effectively to transfer funds. The strategy of balancing income sources can provide a continuing benefit. If you move taxable funds to a non-taxable Roth IRA, your future taxable income will be reduced, and possibly your tax rate also, providing new opportunities for additional tax-reducing transfers. For some people, taxable income can be reduced sufficiently to even reduce the taxability of Social Security benefits.

The key is to increase your flexibility. Starting early is important. As time goes on, decisions are made to start Social Security and receive pensions. Without knowing, those low tax years pass by. All of these events reduce your options, reduce your later flexibility, and will likely increase your taxes for the rest of your life.

If you would like help looking into your financial future and planning to manage your income effectively, or to learn more about our client goal-centered financial planning and investment management services, please call or e-mail. We invite you to visit www.linnardfinancial.com.

Dave

David C. Linnard, MBA, CFP®
President

Barby

Barbara V. Linnard
Vice President

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.
46 CHESTER ROAD
BOXBOROUGH, MA 01719

LFMP@LINNARDFINANCIAL.COM
WWW. LINNARDFINANCIAL.COM
978-266-2958