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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

January 1, 2014

Outlook & Trends

A new year has once again arrived. Along with other resolutions, the new year marks a good time to get one's financial house in order. To help you along a bit, this issue of *Outlook & Trends* contains the first installment in a discussion of comparing, understanding and managing your retirement plan, plus commentary on current trends.

The Economy

The GDP number for last quarter was a good one – finally. The economy grew at an annual rate of 4.1%. However, (and it seems these days there is always a however) much of the production involved building inventories, which is activity that will tend to reduce reports of future growth. Also, the Fed has apparently become a tad more convinced that the economy might be learning to toddle on its own, if not yet walk, and invoked the previously dreaded QE "taper" with hardly a reaction from the Wall Street folks who reacted so strongly to the idea last May.

Interest rates, including mortgage rates, have been flat to slightly higher, and the rate of existing home sales is about the same as last year at this time, but prices have maintained their healthy rebound.

The Markets

Once again, differing sectors of the investment world performed differently. Domestic stocks again grabbed the headlines, closing the year at a new high. International stocks from developed countries performed less well, but were positive. Emerging markets and bonds were pretty flat, while gold and other commodities generally sagged.

The stock market reminds us of a climber scaling a steep cliff. You cannot tell how far he will go or how long he will keep climbing, but, if he loses his footing or a stiff wind picks up, it could be a long way down. As prices keep rising faster than economic growth, long-term market valuation (currently at the 90th percentile) goes from high to higher. Investors Intelligence measures over 4 times as many bullish advisors vs. bearish advisors. This contrary indicator of sentiment is higher than any time in the last 15 years and suggests that at least a pause may be in order.

Comparing Retirement Plans

Over the next several issues of *Outlook & Trends*, we plan to dissuss retirement savings alternatives. Putting money in, taking money out, and managing it in the interim. We'll start here with a basic comparison of the possibilities. It is often not really clear to many people how much these differ. As we'll discuss next time, with some thought and diligence, you can use the differences in the plans to improve your results.

Other than defined benefit pension plans, which many companies no longer offer, there are four primary vehicles for tax-preference savings: 401(k)s and 403(b)s, Traditional IRAs, Roth IRAs, and Deferred Annuities.

Rather than muddy the water with all the gory details of these plans, we wish to discuss the general concepts and effectiveness of each. All of these have thier own unique quirks, rules, limitations, penalties, and exemptions. Make sure you are aware of them when you use any of these vehicles!

When saving in a 401(k), money is contributed before paying tax. Often an employer will contibute a small amount as well. Earnings grow tax-deferred, and taxes are paid at your ordinary income tax rate on all withdrawals.

There are two varieties of traditional IRAs. You can either contribute money on which you have already paid taxes, or take a tax deduction for your contribution. Earnings grow tax-deferred and taxes are paid on withdrawn earnings and deducted contributions. If you take a deduction for the contributed money, the effect is like saving in a 401(k).

Roth IRAs are the reverse of deductible IRAs. You cannot deduct money that you contribute. Your contributions come from wages on which you have already paid taxes. But earnings grow tax-free, not tax-deferred, so you do not have to pay any taxes on withdrawals. Also, unlike other IRAs and 401(k)s, you are not forced to take distributions.

Deferred annuities are often sold as a tax-deferral option for people who have exhausted their ability to contribute to other retirement plans. Although they are often very complicated instruments, for the purposes of this discussion, deferred annuities are similar to a traditional IRA that is funded with non-deductible money. Money grows tax-deferred, and tax is paid on earnings when they are withdrawn. Also, fees associated with annuities are typically higher than the other alternatives.

While not really a retirement plan, Health Savings Accounts can be an excellent way to build a retirement nest egg, if the earnings are saved instead of being spent on pre-retirement medical expenses. Contributions are tax-free. Earnings grow tax-free and withdrawals for medical expense are also tax-free. At worst, if funds are withdrawn for non-medical purposes, you pay income tax on the withdrawn earnings, like you do with a 401(k) or deductible IRA.

Also, simply investing in stocks provides a tax preference for dividends and long-term gains.

How do these options compare? The following table shows the results for a retired worker who remained in the 28% tax bracket and invested in stocks returning 8% per year. They are listed in order of final value.

Plan	Wage Earnings	Investable Amount	30 Years Later	After Tax on Withdrawals
HSA (spent on medical)	$10,000	$10,000	$100,627	$100,627
HSA (not spent on medical)	10,000	10,000	100,627	72,451
401(k)/403(b)	10,000	10,000	100,627	72,451
Deductible Traditional IRA	10,000	10,000	100,627	72,451
Roth IRA	10,000	7,200	72,451	72,451
Taxable Stocks	10,000	7,200	72,451	62,663
Non Deductible Traditional IRA	10,000	7,200	72,451	54,181
Deferred Annuity	10,000	7,200	72,451	54,181

The surprise may be that the relatively unknown HSA turns out to be the best alternative when it is eventually spent on medical expenses. When spent on non-medical items, HSA results are similar to 401(k)s, deductible IRAs and Roth IRAs. The deferred annuity, heavily sold for retirement purposes turns out to be one of the worst.

The next issue of Outlook & Trends will discuss managing these accounts. In the interim, if you would like to get a jump on the process for your own retirement planning or management, please give us a call. Happy New Year!

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