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An economic and investment update

# THE FINANCIAL INSIDER

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## Build It from the Ground Up— A Blueprint for Retirement

A comfortable and worry-free retirement is the goal of many Americans. However, the biggest obstacle in attaining retirement goals is that people may tend to procrastinate and avoid thinking ahead to formulate a plan of action. As a result, many are left scratching their heads, with little time on their side. How will they attain the funds needed to enjoy their retirement years?

Whatever your age, it is never too soon to look ahead and begin giving thought to your retirement. Planning for retirement has become a more difficult task. Therefore, it's important that you plan well in advance by setting goals and deciding how they will be met.

### Invest for a Future Lifestyle

Although pre-retirement and post-retirement investment portfolios should each

have both income *and* accumulation aspects, your pre-retirement portfolio should be more heavily weighted toward accumulation for later use. It is never too early to begin planning for your retirement. Generally, you will desire to maintain a standard of living consistent with your pre-retirement years. However, you may need about 60-80% of your pre-retirement income to support a comfortable retirement lifestyle.

Proceeds from pension plans and Social Security may account for as little as 35% of the typical retiree's income. Another 25% may be derived from earned income—either full or part-time employment. In order to retire comfortably, the remaining amount needed would have to come from your personal retirement savings or investments.

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## Understanding the Consumer Price Index

The highs and lows of the economy affect people and markets in a variety of ways. While some sectors may be thriving, others may be sluggish. One economic indicator used to gauge the state of the American economy is the **Consumer Price Index (CPI)**, which measures the rate of inflation in the United States.

Inflation, which is defined as a rise in the average price level of all goods and services, can have a significant impact on the economy and your financial outlook. Learning more about the CPI, and how it measures inflation, can provide a strong foundation for understanding not only market and economic swings, but also how U.S. fiscal and monetary policies affect your financial well-being.

### Determining the Market Basket

Each month, the U.S. Bureau of Labor Statistics (BLS) surveys prices for a "market basket" of goods and services, to create an economic snapshot of the average consumer's spending, which is quantified as the CPI. Actual expenditures are classified into more than 200 categories and eight major groups. These include the following:

- **Food and beverages:** common groceries, wine, and full-service meals
- **Housing:** rent, furniture, and fuel oil
- **Apparel:** clothing, shoes, and jewelry

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## Doing Well by Doing Good

A **charitable remainder trust (CRT)** can be a highly effective financial and estate planning tool. The CRT can allow you to: avoid capital gains taxes on highly appreciated assets, however when income is distributed to the income beneficiaries it is taxable; receive an income stream based on the full, fair market value (FMV) of those assets; receive an immediate charitable deduction; and ultimately benefit the charity(ies) of your choice.

Some individuals may be reluctant to transfer significant assets to a CRT because they would rather see their children be the ultimate recipients of the property. However, transferring property to a CRT doesn't necessarily mean your children cannot benefit as well.

Under the appropriate circumstances, and over time, you (the donor) can apply the money you saved in taxes available from your charitable deduction, along with a portion of the CRT's income stream (if necessary), to purchase a life insurance policy inside an **irrevocable life insurance trust (ILIT)**.

After the death of the last income beneficiary, the charity receives the remaining assets in the CRT, while your children generally receive the proceeds of the life insurance policy, *free from income and estate taxes*, upon the death of the insured in accordance with the terms of the ILIT. In some instances, policy proceeds may be equal to, or even exceed, the value of the transferred property.

### General Guidelines

A CRT starts with a contribution of assets—preferably highly appreciated—into an **irrevocable trust**. Once the trust is funded, the **trustee** pays the non-charitable **beneficiaries** (selected by the donor upon establishment) an income each year for their lifetimes, a term of years, or a combination of the two.

If a term of years is involved, the maximum term is 20 years. Income beneficiaries must receive a minimum percentage payout each year equal to at least 5% of the trust's assets, not to exceed 50%. The present value of the

**charitable remainder** interest cannot be less than 10% of the fair market value of the contributed asset's value at inception. Within these broad guidelines, you can select a number of flexible payment options designed to help meet your specific financial, estate, and charitable giving objectives.

### Additional Benefits

Because a CRT is **tax exempt**, the trustee can sell highly appreciated assets on a tax-free basis and reinvest the full proceeds in other assets more likely to meet the growth and income objectives of the trust. Assets donated to the trust are removed from your taxable estate, potentially avoiding significant future estate taxation and likely reducing future **probate** costs. Donated assets are also protected from the claims of creditors. This feature may be particularly attractive to business owners concerned about their personal liability or to those who are sensitive about issues related to the division of assets in a divorce.

The charitable deduction available to a donor may be limited according to the type of property donated, the kind of organization(s) ultimately receiving the gift, the donor's overall tax status, the age(s) of the income beneficiary(ies), and the trust's income payout provisions. If a deduction is limited for the current year's tax return, Internal Revenue Service (IRS) rules allow unused amounts to carry forward for up to five additional, consecutive tax years.

Moreover, since donations of appreciated property are no longer preference items for the **alternative minimum tax (AMT)**, donating such property may now be much more advantageous. (Under prior law, the AMT could, in many cases, have significantly trimmed the potential income tax deduction available for donations of appreciated property.)

### The Choice is Yours

While most people may be resigned one way or another to the inevitability of taxation, many may be unaware that they have a choice regarding the *form* in which their contribution to society is fulfilled. When viewed from the perspective of a choice to channel funds *directly* to select charities rather than through the government, charitable giving takes on a new meaning. The CRT may then become a valuable tool to facilitate your choice. As with all complex financial transactions, you may wish to seek the assistance of your estate planning team, which should include your attorney and financial services professional, to help ensure your wishes are properly met. \$



## Required Minimum Distributions for Traditional IRAs

Saving as much as you can for retirement, as soon as you can, and as often as you can, is crucial to your financial well-being for when you finally exit the workforce. Suppose you have spent a lifetime contributing to a traditional **Individual Retirement Account (IRA)**, and hope to leave your nest egg untouched for your heirs. The Internal Revenue Service (IRS) has certain requirements for you to follow concerning your IRA distributions once you reach a certain age.



first distribution. But, doing so can have tax consequences. In December 2018, you will be required to take your next distribution, which will raise your taxable income for the year, potentially boosting you into a higher tax bracket or even causing your Social Security benefits to be taxable.

The minimum withdrawal amount is calculated by dividing the amount of your account balance by the appropriate life expectancy factor, which depends on your age. The IRS Uniform Lifetime Table below illustrates the amounts for the majority of taxpayers, including individuals who are single, married with spouses 10 years younger or less, and married with spouses who are not the sole beneficiaries of the account and are more than 10 years older than the account owner.

Based on the table below, let's suppose that if you are age 70 and your account is worth \$500,000, then your RMD amount would be \$18,248 (\$500,000 divided by 27.4). Married individuals whose spouses are more than 10 years younger and are named as the sole beneficiaries of their accounts can use a joint life expectancy table to calculate their RMDs. Remember that a required minimum distribution is just that—a minimum—you can always take out more than the required minimum. However, if you fail to withdraw at least the minimum amount, the IRS may impose a 50% penalty each year on the dollar amount that you neglected to withdraw. Based on the example above, if you failed to take your RMD, the IRS could claim the amount of \$9,124.

Distributions from your traditional IRA can be taken without penalty after you reach age 59½, but before you reach this age, a 10% tax penalty may be incurred on early withdrawals. There are some exceptions. Withdrawals taken for the purchase of a first home or for medical or higher education expenses may not be subject to the penalty. In addition, distributions taken in

a series of substantially equal payments over your life or life expectancy may not incur a penalty.

You will work a lifetime to accrue enough savings to attain a desirable lifestyle in retirement. Be sure to consult your qualified financial and tax professionals before RMDs are due in order to determine appropriate choices that are consistent with your overall objectives. \$

|       |      | Uniform Lifetime Table |      |      |      |     |     |     |  |
|-------|------|------------------------|------|------|------|-----|-----|-----|--|
| Age   | 70   | 75                     | 80   | 85   | 90   | 95  | 100 | 105 |  |
| Years | 27.4 | 22.9                   | 18.7 | 14.8 | 11.4 | 8.6 | 6.3 | 4.5 |  |

At age 70½, or by April 1 of the year following the year you reach this age, the IRS mandates that you either empty the account in one lump-sum payment, or take required minimum distributions (RMDs). If you choose to take RMDs, ongoing distributions must be taken at the end of each following year. If your birthday is December 3, 2016 and you turn 70½ on June 3, 2017 you can wait until April 1 of the following year—2018—to take your

## Why a Home May Still Be Your Best Investment

While everyone's situation is different, buying a home that you plan to live in for many years may still be one of the best investments you can make. An uncertain market should not necessarily deter prospective buyers, but rather prompt them to develop a

more realistic perspective on homeownership.

Instead of viewing real estate primarily as an investment vehicle for the short term, potential buyers can recognize homeownership for what it really represents: a long-term financial commitment that can provide a secure, comfortable place to live for many years.

Buying a home can provide a sense of stability because you are no longer subject to the uncertainty of the rental market. Paying a mortgage each month can be likened to a forced savings account. As the mortgage principal shrinks, you accumulate more equity in the home and, eventually, you will own the asset outright.

When you buy and live in a home, you can reap the benefits of what is known as "net imputed rent." Basically, the money you would have paid on rent contributes to the equity you accumulate over time, after maintenance and taxes. The U.S. Department of Commerce

calculates this at approximately 6% per year, which is better than any savings account or CD available today.

Finally, homeowners have the opportunity to minimize their tax liability by taking a tax deduction for any mortgage interest paid for their primary residence.

Although there is no guarantee that your home will increase in value or even hold its value in the short term, it can provide a place for you and your family to live that you can continue to afford and to enjoy for many years to come.

### Providing New Opportunities

Even in an unpredictable economy, the current real estate market can provide opportunities for those with good credit and the funds for a down payment. With relatively reasonable real estate prices and good mortgage rates, this may well be one of the best times to buy a home.

Experts project that the demand for housing may increase in the years ahead. Although new home construction has slowed, the U.S. Census Bureau projects that the number of American households will increase each year by 1 to 1.5 million. Eventually, demand may realign with the supply of new houses.

No one knows what's in store for today's real estate market. However, it does present opportunities for those with a long-term plan to buy a home that will provide a stable lifestyle for years to come. \$



## Policy Loans: A Borrowing Option

Taking a loan from a **cash value life insurance** policy can be a simple method for borrowing money quickly, without some of the qualification issues one may face with other types of loans. The earliest policy loan practices, for example, which were permitted back in the 19<sup>th</sup> century, took the form of loans to pay policy premiums. Later on, cash loans were made available. Today, a policy loan provision is required for policies issued in any state in which the Uniform Standard Provisions Law is in effect for all but short-term policies. While policy loans may fulfill a short-term financial need, they can also affect your long-term goals. Knowing the details will help you make the best decision for your unique situation.

### A Closer Look

Basically, a life insurance policy loan is not a loan at all, but rather an advance of some of the cash value to which the policyowner is entitled by contract. In general, a policyowner has no accumulated funds in his or her name, but policies do illustrate specific values, allowing the holders to appreciate the benefits. However, borrowing from the policy may permanently reduce future proceeds for the policyholder's beneficiaries. Therefore, it is important to determine how a loan, and your repayment schedule, may affect your death benefits.

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## Liquidity and Your Estate

One important goal of estate planning is the proper preparation to help minimize the financial burden and emotional stress on your family and loved ones who may be responsible for and reliant upon the administration of your estate. Building **liquidity** into your estate plan can help to ensure that resources will be available to cover estate settlement costs, as well as any tax due.

Liquidity refers to the ability to quickly and easily convert assets into cash without incurring a significant loss. Funds in a checking

account are considered liquid assets, while real estate would be considered relatively illiquid. If your estate must sell illiquid assets to meet immediate cash needs, it may be forced to do so at a significant loss. In addition to the financial consequences, such forced sales are often difficult for heirs, particularly if it means the loss of a family business, heirloom, or home.

Anticipating and planning for the following expenses can help ease the estate settlement process:

- Final medical expenses
- Funeral costs
- Outstanding bills
- Existing debts
- Income taxes (and any accounting fees)
- Appraisal fees
- Federal and state estate taxes
- Attorney fees

Be sure to consult an estate planning team comprised of an attorney, tax advisor, and financial professional to help you develop the appropriate strategies for your situation. \$



## Policy Loans: A Borrowing Option

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Like most loans, policy loans accrue interest. For tax purposes, interest on a policy loan is considered “personal,” and therefore, is not tax deductible. Interest is charged primarily because the policy premium is computed on the assumption that all funds not used for current costs will be invested by the insurance company at not less than a specified rate of interest. Unpaid interest will be added to, and become part of, the loan principal. In certain circumstances, the accumulation of unpaid interest may cause the amount of a loan to surpass the cash value of the policy. Understanding the implications this may have on your current financial situation, as well

as the potential effect it may have on your beneficiaries, is essential.

One can never be sure when the need for immediate funds will arise. So, you should consider borrowing from your life insurance cash values *only* for worthwhile purposes and plan on promptly repaying borrowed money. In general, many who contemplate borrowing against life insurance policy cash values consider it a last resort. Be sure to consult with a qualified insurance professional to learn more about your policy and tax implications a loan may have in your particular circumstances. \$

## Build It from the Ground Up—A Blueprint for Retirement

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### Fill the “Void”

The amount needed to fill this income “void” will depend on the amount of Social Security you will receive and what income you will have from other sources such as a **company pension plan** or your own **Individual Retirement Account (IRA)**. That is why the steps you take today (investing, diversifying, increasing already existing investments, etc.) will be vital to help fill this gap and secure a comfortable retirement.

### Steps to Take Now

- Contribute the maximum amount to your IRA. The tax law changes give taxpayers more flexibility than ever, but also become more confusing. There are some enhancements to traditional IRAs and the **“Roth” IRA** provides tax-free growth and flexibility of withdrawals after five years. In addition, if your spouse is not working, you might consider getting a **spousal IRA**. However, it is essential that you consult with a qualified professional to determine which course of action best suits your needs (especially when comparing the benefits of the “traditional” IRA to the “Roth” IRA).

- If you have an employer-sponsored **401(k)** or **403(b) plan**, you may wish to maximize your contributions there also. The same applies if you are self-employed and enrolled in a **Keogh, SEP-IRA, or SIMPLE plan**.
- Devise and utilize your own individual investment strategy.

### Individualize Your Portfolio

**Diversification**, or spreading your investible assets among a group of different asset classes (stocks, bonds, and cash), is an investment strategy intended to help protect against a severe crisis every few years and avoidance of the old “feast or famine” characteristic of the investment markets. Diversification is used to create a portfolio by spreading your investible assets among various groups,

including **mutual funds, variable annuities, fixed-return accounts, and money market funds**. Today, the majority of all retirement assets are contributed to tax-deferred retirement plans through employers or through individual retirement accounts. Diversification does not eliminate risk, does not guarantee a profitable investment return, and does not guarantee against a loss. It is a method used to manage risk. Diversification offers returns that are not directly related over time and is intended for the structure of a whole portfolio to reduce the risk inherent in a particular security.

### Periodically Review Your Goals

When you are younger, you may opt for growth-oriented investments. Consider, however, that investment return and principal value of stocks and mutual funds may rise or fall due to market conditions and shares may be redeemed for more or less than their original purchase price. Thus, the degree of comfort you have with market fluctuation should determine your overall investment strategy. As you grow older, you may wish to moderate risk with fixed income investments, particularly if you plan to take distributions soon after retiring. A balanced asset mix should be employed.

A post-retirement portfolio should show a greater allocation of investment resources toward *income-producing* vehicles, with a portion allocated for accumulation, in order to be able to create a greater income in the future; inflation will erode some of the purchasing power of current income-producing investments.

Irrespective of your age, you can use different investment management techniques as you create your own portfolio and consider the different investment alternatives available to you.

### It’s In Your Hands

If you are financially independent at retirement, it can become a time of new opportunities, a time to try a second career, to develop a new lifestyle, or to pursue new dreams and goals. Instead of a period of boredom, worry, and disenchantment, retirement can be your most stimulating, fulfilling time ever—truly your golden years. When the time finally comes and you’ve done the proper planning, the transition will be smooth and you will feel comfortable and secure about it. \$



## Protecting Against Loss with Business Interruption Insurance

How long could you afford to be out of business? Many business owners who would never think of leaving their buildings and contents uninsured overlook how much it would cost them in lost earnings if operations were down for a period of time due to a natural or man-made disaster, or power outage. Continued business income is just as important to a “disabled” enterprise as continued wages are to a disabled individual.



Business insurance may be considered accident or disability insurance for a business, since it helps to maintain a regular flow of earnings after the business has been completely or partially shut down by disasters, including fires, tornados, and theft. **Business interruption insurance** is designed to pay for the lost net profits of the business plus any continuing expenses occurring during “down time” caused by a peril covered by the policy.

There are many different forms of business interruption insurance, and the price can vary greatly based on the level of risk and the potential cost of getting the business up and running again after a disaster

strikes. While business interruption insurance is sometimes included in business owner policies (BOPs), the type and amount of coverage provided by a standard policy may be insufficient for the needs of many companies. So, a complete analysis would be necessary to determine which type of business interruption insurance is best suited to your business needs.

Most manufacturing firms require gross earnings coverage. When the value of a firm’s future gross earnings is properly estimated, any noncontinuing expenses may be deducted

to arrive at a figure that represents the firm’s net profit plus any continuing expenses accrued had no interruption occurred. The continuation of a profit stream is therefore allowed to flow through to the firm, and can even compensate key employees who might otherwise be lured away by competitors during an enforced shutdown.

Many commercial enterprises are unable to afford a closure and must remain in operation even though property has been damaged, either because of the nature of the business or that a shutdown might result in a permanent loss of business. For example, banks, supermarkets, and health care facilities typically need to make arrangements for continued operation even if a permanent location is damaged or destroyed. Under these circumstances, **extra expense insurance** would be more appropriate to help pay more than the normal expenses that are needed to keep the insured in business. Overtime wages for employees, extra travel, and the cost associated with substitute or makeshift facilities could be covered by extra expense insurance, which would contribute to retaining company visibility.

Consider your business interruption policy options carefully. Due to the nature of some businesses, both gross earnings coverage and extra expense insurance may be necessary to cover overlapping areas of exposure. You may be able to lower the cost of the premiums—and reduce the chances that you will have to file a claim in the first place—by taking steps to protect your firm’s premises from natural disasters and crimes. You may, for example, want to consider improving the fireproofing or waterproofing of your buildings, or install a sophisticated security system.

While many plans include a 30-, 60-, or even 90-day waiting period, a review of your company’s situation may reveal that an extended waiting period would cause serious damage to your business. Remember that if the firm were forced to shut down temporarily, your company’s earnings could continue to suffer even after reopening. Be sure to review your business interruption policy for the provision of ongoing reimbursement for lower sales volumes after operations have resumed. The key is to complete an analysis of the specific needs of your business and then obtain the amount of business interruption coverage you need before it is required. \$

## Understanding the Consumer Price Index

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- **Transportation:** vehicle lease and purchase costs, gasoline, auto insurance, and airfare costs
- **Medical care:** doctor's visits, hospital care, and prescription drugs
- **Recreation:** televisions, pets, admissions to events, and sports equipment
- **Education and Communication:** college tuition, postage, telephone services, and computer equipment
- **Other goods and services:** tobacco, haircuts, personal services, and funeral expenses.

Because the CPI assesses expenditures in these fixed categories, it is a valuable tool for comparing the current prices of goods and services to prices from last month or last year.

### Interpreting and Using the CPI

As a measure of inflation, the CPI has three main functions. First, it serves as an indication of economic health and the effectiveness of government policy. To a certain extent, some inflation indicates a healthy economy; however, too much inflation, or no inflation at all, can indicate economic trouble. In fact, the Federal Reserve Board (the Fed) aims for a yearly inflation rate of 2%.

If the CPI constantly fluctuates, Congress and the Fed may take measures to control the amount of inflation and stimulate economic growth. As a result, business executives, labor leaders, and individual consumers may change their spending and saving patterns. For example, the Fed may attempt to curb rising inflation by raising short-term interest rates. This increase in the cost of borrowing money is likely to slow personal and business spending. Conversely, if the economy is not growing, the Fed may attempt to stimulate growth by lowering short-term interest rates. Lowering the cost of borrowing is likely to trigger increased spending among businesses and consumers.

As a second function, the CPI helps determine the "real" value of a dollar over time by

removing the effects of inflation. As prices increase, the purchasing power of a dollar decreases. Therefore, more dollars are needed to purchase the same amount of goods and services. Comparing inflation-free wages and prices allows economists to determine the actual earning and spending patterns of the American consumer, including what percentages of money are being saved or spent in certain areas.

Lastly, the CPI is used as a means of adjusting salaries and government benefits to account for price changes. For example, as a result of collective bargaining agreements, the wages of millions of American workers increase according to the amount of change in the CPI. The CPI is also used to determine the benefits of almost 50 million people covered under government programs, including Social Security beneficiaries and military and Federal Civil Service retirees. In addition, changes in CPI can be seen in the eligibility requirements for SNAP (food stamp) benefits and school lunch programs, as well as in rents, royalties, alimony payments, and child support payments determined by private firms and individuals. Finally, the CPI has been used to adjust the Federal income tax structure to prevent increases in tax rates caused solely by inflation (source: Bureau of Labor Statistics, "Addendum to Frequently Asked Questions," [http://www.bls.gov/cpi/cpiadd.htm#2\\_3](http://www.bls.gov/cpi/cpiadd.htm#2_3)).

### For More Information

Inflation can have a serious impact on the American economy given the effect it can have on government policy, as well as on the spending and saving patterns of businesses and consumers. Understanding and following changes in the CPI can help you identify how the value of the dollar changes and estimate how inflation may affect your future plans. The U.S. Department of Labor (DOL) publishes current BLS information on the CPI each month. For more information, visit the BLS website at [www.bls.gov/cpi](http://www.bls.gov/cpi). \$

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