Lassus Wherley
Building Better Futures
...a View from the Top

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First Quarter Wasn't Dull!

Here are our thoughts around the financial markets, the importance of updating beneficiaries and an answer to a question about paying down your mortgage. We also include a link to a Bamboozled column on nj.com about tax fraud that provides information you need to know.

The fun continues…as noted in our last View from the Top, we do expect to see continued volatility in both international and domestic stock markets as the year marches on. We also expect to see continued divergence in returns between international and domestic equity investments. International equity markets have posted strong returns in the first quarter of 2015, after the super performance of US equity markets over the last few years. As of the time of this writing, developed international stocks have returned 7.81% as measured by the MSCI EAFE (Europe, Australasia, and Far East) Index, and emerging market stocks have returned 8.56% as measured by the MSCI EM Index. This compares with returns of 2.61% on US large-cap stocks, as measured by the S&P 500 Index, and 5.36% on US small-cap stocks, as measured by the Russell 2000 Index. European equities in particular have performed quite well, with the STOXX Europe 600 Index, a broad measure of stocks across European countries, up roughly 20% (although it is up less in US dollar terms). We had mentioned in the last View from the Top that the onset of large-scale stimulus measures taken by the European Central Bank (ECB) this year could help provide a boost to global equities. The ECB initiated large-scale bond purchases of approximately $60 billion per month in March (similar to the actions taken by the Fed in an attempt to provide liquidity and spur growth domestically). European equity markets have responded in a positive way. This stimulus is expected to

be in place until at least September of 2016 and will amount to over 1 trillion euros in bond purchases.

We expect to see domestic equity markets post reasonable single-digit returns for the year, but it will be a very volatile year. From an economic standpoint, the US continues on the path of slow growth,

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with the length of the US recovery now approaching six years. Although the length of the recovery to date seems like a fairly long time-period in absolute terms, it is actually right on par with the average length for a standard global expansion. Furthermore, the average time-period for a global expansion that follows a severe housing bust is considerably longer than the standard average, at close to 8 ½ years. This, along with various gauges of the economy such as GDP growth, employment and inflation levels, manufacturing, and housing, suggests that there is room for the US expansion to continue for some time.

And for those who are concerned about what happens when the Fed starts raising rates—it shouldn't matter in the big picture as long as you maintain that target asset allocation and broad diversification.

There are a variety of factors that could potentially create a headwind to US stocks posting the double-digit returns we have seen over the last few years. US stocks have done very well for a long time, so they are no longer considered "cheap" from a valuation perspective relative to other equity markets. As stocks in the US become more and more expensive, they become less attractive to institutional investors looking for better value on a relative scale. Furthermore, as stocks become more and more expensive to purchase, the earnings that US companies report become a more and more important component of overall equity returns. We have seen significant downward revisions to consensus earnings growth estimates for US large-cap stocks in 2015, to just under 2%. This downward revision in earnings growth estimates, due in large part to lower oil/energy prices and the stronger dollar, is also a potential headwind. The drop in oil/energy prices has dragged down returns in the energy sector and overall S&P 500 index, as has the stronger US dollar which has the effect of reducing foreign demand for US goods from already ailing economies overseas.

The US has concluded bond purchases meant to provide liquidity to markets domestically and is looking towards higher interest rates in the near future. However, as noted, the ECB has just recently initiated large-scale stimulus measures and is likely to keep rates low for a relatively long time in an attempt to spur growth in European economies. Other economies around the world are also engaged in accommodative monetary policies, which we have seen can have a meaningful impact on equity returns. And for those who are concerned about what happens when the Fed starts raising rates—it shouldn't matter in the big picture as long as you maintain that target asset allocation and broad diversification.

The divergence in returns we are seeing amongst global equities and the differing dynamics of world economies further highlight the importance of a globally-diversified approach that calls for investment in a broad range of asset classes both overseas and domestically. As long-

term investors we stay informed relative to current economic and market dynamics that could impact our clients' portfolios. However, we are always focused on the longer term and not the short term.

An Estate Planning Must: Update Your Beneficiaries.

Frequently we hear about the importance of updating wills and trusts, but rarely about the importance of keeping beneficiary designations up-to-date. While many of us focus on our will, we many times forget to review and update our beneficiary designations. Retirement accounts, life insurance and other accounts with beneficiary designations are generally not governed by the provisions of your will, so it is important to review these documents and make sure they are updated and reflect your current intentions.

If you don't name a beneficiary, your beneficiary may be determined by federal law, state law or by the plan document that governs the accounts.

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For example, IRA plan documents may have a default for the beneficiary designation if the designated beneficiary predeceases the IRA owner. The default options vary among IRA custodians/trustees, and they may not be in line with what you would prefer to happen.

Designating beneficiaries is not a one-time decision. It is not uncommon to read stories about assets with beneficiary designations being distributed to beneficiaries who clearly would not have been the decedent's intended beneficiaries.

For many people, their largest assets (life insurance, IRAs, 401(k)s, etc) pass according to their beneficiary designations rather than their will. For this reason, a comprehensive review is a simple way to ensure that assets go to exactly whom you wish.

Accounts with listed beneficiaries will be paid out according to the beneficiary designations, even if an individual's will dictates different instructions. Many beneficiary forms for individual retirement accounts, defined benefit pension plans and insurance policies are blank, outdated or not properly filled in.

Where to start:

Review beneficiary forms for the following and make sure the individuals, trust or charities you named are your intended recipients. If they aren't, make sure you file an updated form as soon as possible.

Review the following:

- IRA, 401(k), 403(b) or other retirement accounts
- Annuities
- Pensions
- Some brokerage accounts and other investment accounts
- Some bank accounts and CDs

- Life insurance policies
- Disability insurance policies
- Long-term care policies

This list is not all encompassing, but it will provide a good initial checklist.

Reviewing beneficiaries:

Things to check for:

- A primary beneficiary is named
- A contingent beneficiary is named
- All beneficial shares add up to 100%
- All required forms have been properly completed

Consider listing a trust as the primary or contingent beneficiary in lieu of naming a minor.

Please speak with your attorney or advisor when naming your estate as the beneficiary. There are significant disadvantages to naming an estate as beneficiary.

Situations that may require an immediate beneficiary change:

- Death of a primary or contingent beneficiary
- Marriage, divorce, or remarriage
- Birth or adoption of a child
- Major changes in family dynamics

In addition to the income tax impact, receiving a large amount of money all at once may have an adverse impact on a beneficiary's work ethic and lifestyle.

Consider how, not just who.

All of that wealth in your life insurance policies and retirement accounts could have a significant impact on the beneficiary who receives it in one lump sum. In addition to the income tax impact, receiving a large amount of money all at once may have an adverse impact on a beneficiary's work ethic and lifestyle. If the timing is wrong, inherited assets can be lost to creditors, divorce, or bankruptcy. If a beneficiary is disabled and receiving public benefits, receipt of payments from life insurance or retirement benefits can result in disqualification from these very important benefits. In addition to reviewing who is named as beneficiary of your life insurance and retirement accounts, consider how they will receive the funds and whether controlling the manner in which that happens is in the best interest of your beneficiary.

Each individual has a unique plan and unique desires for their legacy. Please contact us if you want to discuss your particular situation.

Here is a great question from one of our clients. Let us know if you have one you would like included.

Question: *With the stock market having done so well, does it make sense to take profits and pay off my mortgage?*

Answer: This is an interesting question and one that we get a lot. The answer is different depending on your situation, but in general, it is useful to think about the risks and

rewards of shifting assets from one bucket to another. The first bucket, the stock market, carries notable risks, but we're generally rewarded with strong returns over time. The second bucket, the house, is an asset we can use and enjoy, but over longer periods of time, the expected return is lower than that of the stock market. In fact, over the last 30 years the average annual real rate of return (adjusted for inflation, expenses and taxes) of US large-cap stocks was 5.97% versus just 0.80% for single-family homes.

Other important factors to consider include interest rates, the remaining life of the mortgage, liquidity needs and your comfort level with carrying debt.

Other important factors to consider include interest rates, the remaining life of the mortgage, liquidity needs and your comfort level with carrying debt. In the current environment, interest rates on most mortgages are at historically low levels. This means that the returns the market needs to generate to "outperform" the mortgage are lower than they've been in a very long time. Assuming that it is more 'profitable' to invest versus prepay the mortgage, other factors such as your comfort level with carrying debt must be considered. Making additional payments to principal in the early years of the loan can have a dramatic effect on the overall interest expense paid over time. This is because in the first 10 - 15 years of a 30-year mortgage, a majority of each payment goes towards paying interest versus principal. Making payments directly to principal, even as low as one or two additional monthly payments per year, can substantially reduce the interest paid over time. However, in the later years of the loan, the bulk of interest expense has already been paid, so additional payments do much less to reduce the overall interest expense. Knowing where you stand in the life of your loan is an important factor.

Your specific liquidity needs are also an important consideration. Generally, portions of a diversified portfolio can be converted to cash quickly if there is a liquidity need. A home, on the other hand, is much less liquid. While there are methods of getting equity out of the house without selling it, these are typically much more complex and costly. Reverse mortgages are often used by individuals to take equity out of their homes without selling the home. While this approach may satisfy the cash need up front, the fees and costs can be substantial and embedded risks are often over looked. Maintaining sufficient liquidity outside of your home is a prudent cash management strategy.

We understand that you may be uncomfortable having a mortgage, especially considering the issues in the housing market in 2007 and 2008. However, it is important to highlight the high opportunity cost of shifting a large portion of investable assets from the stock market into a home. Many times, a mix of the two approaches can make sense. For example, in years when markets per-

form well, you could take some of the profits and make additional payments to reduce your total interest expense while helping to increase your comfort level.

Here's a column that ran on April 16, 2015 on nj.com, that has some information you need to know about tax fraud.

Bamboozled: You Think Tax Refund Fraud Can't Happen To You? Think Again

(http://www.nj.com/business/index.ssf/2015/04/bamboozled_you_think_tax_refund_fraud_cant_happen.html)

Keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term.

Enjoy this hopefully fast-approaching, warm weather.

Diahann

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