July 2019 Newsletter

Korbitz Financial Planning Newsletter

Korbitz Financial Planning LLC

Eric S. Korbitz, CPA/PFS, CFP®
PO Box 170049
Milwaukee, WI 53217
414-979-1040
Eric@KorbitzFinancialPlanning.com
www.KorbitzFinancialPlanning.com

Clients and Friends: I hope this finds you enjoying your summer, no matter what part of the country you are in.

This newsletter contains a variety of articles that I hope you will read. The first is an article discussing legislation that is currently being considered by the US Senate, which would affect nearly every American.

The second article discusses an investing topic that I bring up at almost every review. That is, the need to diversify investments throughout the world.

The third article talks about the Federal Reserve, and may provide you with some additional background on this organization that has been in the news quite a bit lately.

Finally, the two articles on page 4 discuss the concept of real return on your money, and answers the age old question of how long might it take to double your money.

I hope you enjoy the rest of the summer!

Eric

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Should You Invest Internationally?

How Does the Federal Reserve Affect the Economy?

What's the real return on your investments?

How long could it take to double your money?

The SECURE Act

There is legislation making its way through Congress that you should be aware of, as it has very large potential consequences for many Americans.

The legislation is called The Setting Every Community Up for Retirement Enhancement Act of 2019, or The SECURE Act.

This legislation was passed by the House of Representatives on May 23, 2019, with a vote of 417-3, but has not been acted upon in the Senate, as of this writing.

The provisions that have gotten the most attention are as follows:

First, there is a repeal of the maximum age for making Traditional IRA contributions. Currently traditional IRA contributions cannot be made once you reach age 70 ½. If enacted into law, this would permit taxpayers who are over age 70 ½ AND still earning a paycheck to make Traditional IRA contributions.

Second, there is a provision which will make it easier for part-time employees to contribute to a 401(k) plan. This is a good provision, as it makes it easier for employees to save money.

Third, the provision which has gotten the most attention is the increase in the age at which taxpayers must begin taking Required Minimum Distributions. Under current law the account owner must begin taking distributions from IRA and other (non-Roth) retirement plans in the year that they reach age 70 ½. Under the SECURE Act this age is raised to 72. This seems like a beneficial provision, but first let me tell you about the other side of the equation.

Fourth, the length of time that certain beneficiaries (mainly adult children and other relatives) have to withdraw from an inherited IRA is reduced from a lifetime distribution (roughly from the time of inheritance until the recipient is about 84-85 years old) to no more than 10 years. Under current law, when a non-spouse beneficiary (think child of the account owner) inherits an IRA, they can make withdrawals over their remaining life expectancy. The new law would require that this inherited IRA be distributed over no more than 10 years.

So how might this affect you? Let's say that you are a widow, with two children, and your Traditional IRA balance is $1,000,000. Your children (for easy math) are twins and age 44 when you die.

Under the old rules, each child would receive $500,000, and would be required to have the balance paid out over their remaining life expectancy of approximately 40 years (to about age 84). Thus, each child would receive roughly $12,500 in the first year of distribution. This would generally not push someone into a higher tax bracket, but would generate some additional tax.

Under the new proposed rules, each child would also receive $500,000, but would now be required to have the balance paid out over no more than 10 years. Thus, each child would receive roughly $50,000 in each of those 10 years. This may or may not push the child into a higher tax bracket, but it is certainly more likely that the taxes paid by the child will be higher than under the old rules. Further, this can adversely affect other items, like financial aid for children, and eligibility for Roth IRA contributions. This legislation is most likely to adversely affect beneficiaries who inherit a large IRA when they are in their peak earning years, typically ages 40-60.

What can you do if this legislation becomes law? One option is to convert some of your Traditional IRA money to a Roth IRA. Inherited Roth IRAs will still be subject to the 10 year payout rule, but in general any payouts from a Roth IRA are tax-free.

Another option would be to switch your future 401(k) or 403B contributions to Roth contributions, if your plan allows it. While the Roth contributions would not reduce your taxable income as pre-tax contributions do, future earnings would be tax-free, including those left to your heirs.

This legislation, combined with the current historically low income tax rates, provides yet another incentive to contribute to a Roth IRA/401k/403B or to convert some pre-tax retirement dollars to Roth dollars.

Should You Invest Internationally?

In April 2019, despite some positive economic developments, the International Monetary Fund cut its outlook for global growth in 2019 to 3.3%, the lowest level since 2009. At the time of that report, IMF Managing Director Christine Lagarde said a recession was not expected in the near term.

Source: Bloomberg, April 9, 2019

The risks associated with investing on a worldwide basis include differences in financial reporting, currency exchange risk, and economic and political risk unique to the specific country. These risks may result in greater share price volatility and should be carefully managed in light of your goals and risk tolerance.

Investing in foreign stocks provides access to a world of opportunities outside the United States, which may help boost returns and manage risk in your portfolio. However, it's important to understand the unique risk/return characteristics of foreign investments before sending a portion of your money overseas.

Reasons to go abroad

Here are some of the potential benefits of international investing.

Additional diversification. Other countries may be at a different stage in the business cycle than the U.S. economy. They could recover more quickly (or more slowly) from a recession.

Long-term growth potential. Some of the world's most rapidly growing economies are located in emerging markets that may be reaping the benefits of new technologies, a growing consumer base, or natural resources that are in high demand.

Possible hedge against a weaker dollar. The U.S. dollar has been strong in recent years, but having some investments denominated in foreign currencies may help offset (or even take advantage of) any future dips in its value.

Reasons to proceed with caution

Here are just some of the potential risks.

Politics and economic policies. A nation's political structure, leadership, and regulations may affect the government's influence on the economy and the financial markets.

Currency exchange. Just as a weak U.S. dollar could work for you, additional strengthening in the dollar could work against you. That's because any investment gains and principal denominated in a foreign currency may lose value when exchanged back.

Financial reporting. Many developing countries do not follow rigorous U.S. accounting standards, which often makes it more difficult to have a true picture of company and industry performance.

Risk/return potential

Some international investments may offer the chance for greater returns, but as with other investments, stronger potential comes with a greater level of risk. For example, over the past 30 years, foreign stocks have outperformed U.S. stocks, bonds, and cash alternatives 11 times. However, they have also underperformed 11 times, tying cash for the highest number of lowest-performing years during the same time period.

	Number of highest-performing years, 1989-2018
Cash	4
Bonds	5
U.S. Stocks	10
Foreign stocks	11

	Number of lowest-performing years, 1989-2018
Cash	11
Bonds	6
U.S. Stocks	2
Foreign stocks	11

If you decide to spread some of your investment dollars around the world, be prepared to hold tight during bouts of market volatility. And remember to rebalance your portfolio periodically to help align your asset allocation with your long-term investment strategy.

Performance is from January 1, 1989, to December 31, 2018. Cash is represented by the Citigroup 3-month Treasury Bill Index. Bonds are represented by the Citigroup Corporate Bond Composite Index. U.S. stocks are represented by the S&P 500 Composite Price Index. Foreign stocks are represented by the MSCI EAFE Price Index. All indexes are unmanaged, accurate reflections of the performance of the asset classes shown. Returns reflect past performance, which does not indicate future results. Taxes, fees, brokerage commissions, and other expenses are not reflected. Investors cannot invest directly in any index.

The principal value of cash alternatives may fluctuate with market conditions. Cash alternatives are subject to liquidity and credit risks. It is possible to lose money with this type of investment. The return and principal value of stocks may fluctuate with market conditions. Shares, when sold, may be worth more or less than their original cost. U.S. Treasury securities are guaranteed by the federal government as to the timely payment of principal and interest, whereas corporate bonds are not. The principal value of bonds may fluctuate with market conditions. Bonds are subject to inflation, interest rate, and credit risks. Bonds redeemed prior to maturity may be worth more or less than their original cost. Diversification is a strategy used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

How Does the Federal Reserve Affect the Economy?

The Fed's mission

The Federal Reserve is the central bank of the United States. Its mission is to provide the nation with a safer, more flexible, and more stable monetary and financial system. For more information on the Federal Reserve, visit [federalreserve.gov.](federalreserve.gov)

FOMC meeting schedule

The Federal Open Market Committee meets eight times a year. Scheduled FOMC meetings in 2019: January 29-30, March 19-20, April 30-May 1, June 18-19, July 30-31, September 17-18, October 29-30, and December 10-11.

If you follow financial news, you've probably heard many references to "the Fed" along the lines of "the Fed held interest rates," or "market watchers are wondering what the Fed will do next." So what exactly is the Fed and what does it do?

What is the Federal Reserve?

The Federal Reserve — or "the Fed" as it's commonly called — is the central bank of the United States. The Fed was created in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system.

Today, the Federal Reserve's responsibilities fall into four general areas:

- Conducting the nation's monetary policy by influencing money and credit conditions in the economy in pursuit of full employment and stable prices
- Supervising and regulating banks and other important financial institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers
- Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets
- Providing certain financial services to the U.S. government, U.S. financial institutions, and foreign official institutions, and playing a major role in operating and overseeing the nation's payments systems

How is the Fed organized?

The Federal Reserve is composed of three key entities — the Board of Governors (Federal Reserve Board), 12 Federal Reserve Banks, and the Federal Open Market Committee.

The Board of Governors consists of seven people who are nominated by the president and approved by the Senate. Each person is appointed for a 14-year term (terms are staggered, with one beginning every two years). The Board of Governors conducts official business in Washington, D.C., and is headed by the chair (currently, Jerome Powell), who is perhaps the most visible face of U.S. economic and monetary policy.

Next are 12 regional Federal Reserve Banks that are responsible for typical day-to-day bank operations. The banks are located in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Each regional bank has its own president and oversees thousands of smaller member banks in its region.

The Federal Open Market Committee (FOMC) is responsible for setting U.S. monetary policy. The FOMC is made up of the Board of Governors and the 12 regional bank presidents. The FOMC typically meets eight times per year. When people wait with bated breath to see what the Fed will do next, they're usually referring to the FOMC.

How does the Fed impact the economy?

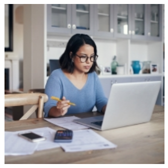
One of the most important responsibilities of the Fed is setting the federal funds target rate, which is the interest rate banks charge each other for overnight loans. The federal funds target rate serves as a benchmark for many short-term interest rates, such as rates used for savings accounts, money market accounts, and short-term bonds. The target rate also serves as a basis for the prime rate. Through the FOMC, the Fed uses the federal funds target rate as a means to influence economic growth.

To stimulate the economy, the Fed lowers the target rate. If interest rates are low, the presumption is that consumers can borrow more and, consequently, spend more. For instance, lower interest rates on car loans, home mortgages, and credit cards make them more accessible to consumers. Lower interest rates often weaken the value of the dollar compared to other currencies. A weaker dollar means some foreign goods are costlier, so consumers will tend to buy American-made goods. An increased demand for goods and services often increases employment and wages. This is essentially the course the FOMC took following the 2008 financial crisis in an attempt to spur the economy.

On the other hand, if consumer prices are rising too quickly (inflation), the Fed raises the target rate, making money more costly to borrow. Since loans are harder to get and more expensive, consumers and businesses are less likely to borrow, which slows economic growth and reels in inflation.

People often look to the Fed for clues on which way interest rates are headed and for the Fed's economic analysis and forecasting. Members of the Federal Reserve regularly conduct economic research, give speeches, and testify about inflation and unemployment, which can provide insight about where the economy might be headed. All of this information can be useful for consumers when making borrowing and investing decisions.

Korbitz Financial Planning LLC
Eric S. Korbitz, CPA/PFS, CFP®
PO Box 170049
Milwaukee, WI 53217
414-979-1040
Eric@KorbitzFinancialPlanning.com
www.KorbitzFinancialPlanning.com



What's the real return on your investments?

As an investor, you probably pay attention to *nominal return,* which is the percentage increase or decrease in the value of an investment over a given period of time, usually expressed as an annual return. However, to estimate actual income or growth potential in order to target financial goals — for example, a certain level of retirement income — it's important to consider the effects of taxes and inflation. The remaining increase or decrease is your *real return.*

Let's say you want to purchase a bank-issued certificate of deposit (CD) because you like the lower risk and fixed interest rate that a CD can offer. Rates on CDs have risen, and you might find a two- or three-year CD that offers as much as 3% interest. That could be appealing, but if you're taxed at the 22% federal income tax rate, roughly 0.66% will be gobbled up by federal income tax on the interest.

That still leaves an interest rate of 2.34%, but you should consider the purchasing power of the interest. Annual inflation was about 2% from 2016 to 2018, and the 30-year average was 2.5%.[1] After factoring in the effect of inflation, the real return on your CD investment could approach zero and may turn negative if inflation rises. If so, you might lose purchasing power not only on the interest but also on the principal.

This hypothetical example doesn't represent the performance of any specific investment, but it illustrates the importance of understanding what you're actually earning after taxes and inflation. In some cases, the lower risk offered by an investment may be appealing enough that you're willing to accept a low real return. However, pursuing long-term goals such as retirement generally requires having some investments with the potential for higher returns, even if they carry a higher degree of risk.

The FDIC insures CDs and bank savings accounts, which generally provide a fixed rate of return, up to $250,000 per depositor, per insured institution. All investments are subject to risk, including the possible loss of principal. When sold, investments may be worth more or less than their original cost.

[1] U.S. Bureau of Labor Statistics, 2019 (December year-over-year change in CPI-U)

How long could it take to double your money?

If you're saving for college, retirement, or a large purchase, it can be useful to quickly calculate how an anticipated annual rate of return will affect your money over time. To find out, you can use a mathematical concept known as the Rule of 72. This rule can give you a close approximation of how long it would take for your money to double at any given rate of return, assuming annual compounding.

To use this rule, you simply divide 72 by your anticipated annual rate of return. The result is the approximate number of years it will take for your money to double.

For example, if your anticipated annual rate of return is 6%, you would divide 72 by 6. Your money can be expected to double in about 12 years. But if your anticipated annual rate of return is 8%, then your money can be expected to double in about 9 years.

The Rule of 72 can also be used to determine what rate of return you would need to double your money in a certain number of years. For example, if you have 12 years to double your money, then dividing 72 by 12 would tell you that you would need a rate of return of 6%.

Another way to use the Rule of 72 is to determine when something will be halved instead of doubled. For example, if you would like to estimate how long it would take for annual inflation to eat into your savings, you could divide 72 by the rate of inflation. For example, if inflation is 3%, then it would take 24 years for your money to be worth half its current value. If inflation jumped to 4%, then it would take only 18 years for your purchasing power to be halved.

Although using a calculator will give you more precise results, the Rule of 72 is a useful shortcut that can help you understand how long it might take to reach a financial goal, and what annual rate of return you might need to get there.