

Investor Insights and Outlook

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Beyond 401(k)s and IRAs: Think Tax-Efficiency in All Your Investment Choices

Obtaining a high rate of return is what drives most investors, but managing investment-related tax obligations should be an equally compelling investment priority ~ especially for individuals in the highest income brackets. If you are interested in taking a more proactive approach to managing your tax burden, consider creating an investment plan that fully utilizes a range of tax-efficient strategies.

The Tax-Exempt Advantage

They may lack the flash and dazzle of stocks, but municipal bonds, or "munis," have long been appreciated by high-net-worth investors seeking a haven from taxes and stock market volatility.¹ Interest earned on municipal bonds is typically exempt from federal income taxes and may be exempt from state and local income taxes as well.²

Tax-Efficient Mutual Funds³

Some mutual funds are managed in ways that help reduce the tax impact on shareholders. These funds accomplish their goal by relying on a combination of tactics, such as minimizing portfolio turnover (the

buying and selling of securities held within the fund), selling stocks at a loss to counter-balance gains elsewhere in the portfolio, and buying only those stocks that generate few dividends. Likewise, index funds often are considered to be more tax efficient than equity funds that adhere to a more active management style. Through their strategic mandate of buying and holding the securities held in a specific market benchmark, such as the S&P 500, index funds typically have low portfolio turnover rates.⁴

Shifting Income to Minors

Gifting assets to children via a Uniform Gifts to Minors Act (UGMA) account or a Uniform Transfers to Minors Act (UTMA) account can help reduce your overall income tax exposure. Although tax laws governing these accounts differ by state, in general you can "gift" investments, cash, or other assets worth up to \$14,000 ~ or \$28,000 for married couples ~ to a child, grandchild, or other minor beneficiary in 2014 without incurring a federal gift tax.⁵

Current tax rules state that the first \$1,000 of a child's investment income generally is tax-exempt, the next \$1,000 of unearned

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Advisor Corner

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Longevity Annuities: Coming to a Retirement Plan Near You?

Also known as deferred income annuities, these instruments are purchased by individuals with the intention to secure a lifetime stream of income that begins at some point in the future.

Final rules announced by the Treasury Department on July 1 will allow employers to add longevity annuities to their retirement plan lineup.¹ Specifically, retirement plan participants will be able to convert a portion of their 401(k) or IRA balance into a longevity annuity in exchange for guaranteed lifetime payouts.

Also known as deferred income annuities, these instruments are purchased by individuals with the intention of securing a lifetime stream of income that begins at some point in the future. Under the new ruling, plan participants can use up to 25% of their total account balance ~ or \$125,000, whichever is less ~ and not run afoul of minimum distribution requirements (RMDs) that apply to qualified plans once an account holder reaches age 70½. Prior to this ruling, plan participants would have had to include the value of the annuity contract as part of their account balance when calculating their RMDs. Now, the longevity annuity amount can be excluded from their account balance as long as they adhere to the dollar limits and begin taking income by age 85.

The maximum dollar amount of \$125,000 will be adjusted for inflation over time, in \$10,000 increments. If an individual exceeds the maximum dollar amount, they will be given the chance to correct the situation without being assessed a penalty.

Other Special Features to Come Onboard

While generally insurance companies will not be allowed to push special features that add to the cost of these products, they will be able to sell a feature called "return of premium," a type of death benefit that guarantees, upon the death of the annuity purchaser, that his or her beneficiaries will receive the amount left on the policy, minus any payments already received. Alternatively, insurers may offer a feature that allows the income stream to continue to beneficiaries after the annuity holder's death.

As of yet, it is unclear what the adoption rate of this new offering will be among employers. The Treasury Department reports that only about 20% of 401(k) plan providers currently offer annuities, and few employees elect to buy them when they do have the opportunity.

Source/Disclaimer:

¹An annuity is a long-term, tax-deferred investment vehicle designed for investment purposes and contains both an investment and an insurance component. They are sold only by prospectus. Guarantees are based

on the claims-paying ability of the issuer and do not apply to an annuity's separate account or its underlying investments. The investment returns and principal value of the available sub-portfolios will fluctuate so that the value of an investor's unit, when redeemed, may be worth more or less than their original value. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal.

The New York Times, "Longevity Insurance Joins Menu of Retirement Plan Options," July 1, 2014.

Forbes, "Treasury Green Lights Longevity Annuities in 401(k)s and IRAs," July 1, 2014. © 2014 Wealth Management Systems Inc. All Rights Reserved.



2,860 Reasons to Rethink Predictive Investing

Active management (or predictive investing) may sound great but not everyone agrees.

85% of the top performers from 2003-2008 underperformed from 2009-2013.⁷

Money managers (or fund managers) make bets all the time. They bet on countries, sectors, trends, commodities, economic indices and, of course, individual companies. Problem is, most of them are not very good at it, especially when you factor in fees.

Here's what we know about the challenges of predictive (also known as active) money management.

- **It is expensive**

The average expense ratio of predictive funds is 1.29% vs. an average of .80% for all market-based (also known as passive) funds.¹

- **Most money managers can't consistently outperform**

Over the last 5 years (2009 - 2013), only 39% of U.S. stock funds and 29% of International funds outperformed their benchmarks.² That means most funds were doing worse than simple, unmanaged indices.

- **In those rare instances when a money manager is successful, it rarely lasts**

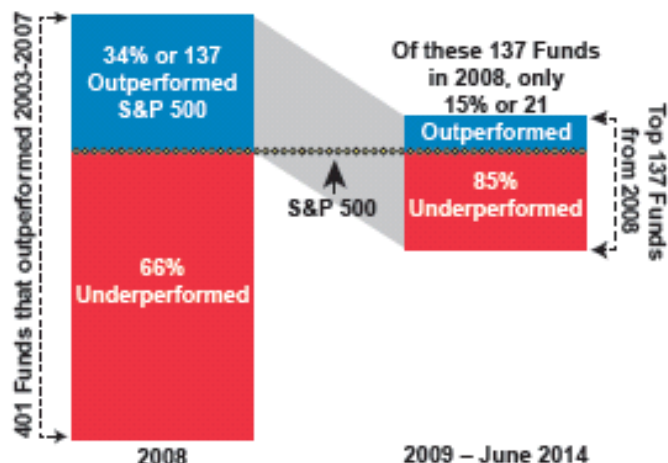
Over the last five years (through March), only 2 out of 2,860 predictive U.S. stock funds stayed in the top quartile of performance in each of the last 5 years. That's right 2 funds!³ The other 99.93% might have enjoyed a good year or two of performance but were unable to produce consistently good performance. And by the way, 852 of those funds (or 30%) merged with other funds or went out of business.⁴

Even if you are lucky enough to invest with a top-performing money manager, chances are he or she won't stay at the top for long.

- **You'd get better results flipping a coin**

While we don't recommend coin flipping, roulette or other games of luck as an investment strategy, pure chance would suggest that at least 3 funds (instead of 2) should have achieved consistent outperformance over the last 5 years.⁵ **This means most managers are doing worse than chance!**

Previous Winners Don't Maintain Performance



There may be great predictive money managers out there, but the data suggests they are few and far between and they have a very hard time remaining great.

In order to give yourself the highest probability of meeting your long-term financial goals, you should work with your financial advisor to create a prudent financial plan instead of gambling on the uncertainties and typically poor track record of predictive managers.

Beating the market is tough, but given the significant long-term growth of markets around the world,⁶ is it a smart idea to even try? Focus on your goals, stick to your plan, invest in globally-diversified asset classes and let the markets work for you. In other words, be a smart investor, not a speculator.

¹ Morningstar 2014

² S&P Indices Versus Active Funds (SPIVA®) U.S. Scorecard, Year-End 2013

³ Does Past Performance Matter? The Persistence Scorecard, S&P Dow Jones Indices, June 2014

⁴ Ibid

⁵ www.nytimes.com/2014/07/27/your-money/heads-or-tails-either-way-you-might-beat-a-stock-picker.html

⁶ youtu.be/yGID_qYf7T8?list=UUSUE4O5jYoVAKRjkJdO4mFA

⁷ Morningstar Direct

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Beyond 401(k)s and IRAs: Think Tax-Efficiency in All Your Investment Choices (continued)

income generally is taxed at the child's tax rate, and unearned income over \$2,000 generally is taxed at the parent's tax rate if the child is under age 19 (or is a full-time student under age 24) at the end of the year.

Taxes and Foreign Investments

It is important to note that there may be special tax consequences associated with investing internationally.⁶ For instance, mutual funds that hold stock in foreign companies have unique tax implications. Both global and international funds may be required to withhold taxes on income distributed to foreign shareholders. In these circumstances, U.S. investors may be entitled to a tax credit for foreign taxes withheld that can be used to offset their U.S. federal income tax obligations.

No matter what your age or investment objective, keeping the tax implications of your investment decisions in mind should be an integral part of your lifelong investment plan. Contact your financial professional before deciding on any tax-advantaged investment strategy.

This article offers only an outline; it is not a definitive guide to all possible consequences and implications of any specific tax strategy. For this reason, be sure to seek advice from knowledgeable tax and/or financial professionals.

¹Investing in stocks involves risks, including loss of principal. Municipal bonds are subject to availability and change in price. They are also subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise.

²Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax free, but other state and local taxes may apply. Any capital gains are taxable for federal and, in some cases, state purposes.

³Investing in mutual funds involve risk, including loss of principal. Mutual funds are offered and sold by prospectus only. You should carefully consider the investment objectives, risks, expenses, and charges of the investment company before you invest. For more complete information about any mutual fund, including risks, charges, and expenses, please contact your financial professional to obtain a prospectus. The prospectus contains this and other information. Read it carefully before you invest.

⁴Standard & Poor's Composite Index of 500 Stocks is an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

⁵These amounts are adjusted for inflation periodically in \$1,000 increments.

⁶Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.



Financial Follies: Gold

When it comes to your Investments, all that glitters isn't gold.

If you're viewing this newsletter online click the image to the left or you can go to our website at www.hallettadvisors.us and click on News Center to find the link to a great YouTube video produced by Loring Ward on the historical performance of gold investments compared to stocks and bonds.

You can also type or past the following link into your browser: <http://youtu.be/TRkXc1mxB94>

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