

Investor Insights and Outlook

VOLUME 5, ISSUE 7

Fraud Attempts on the Rise

Advisors and their clients have increasingly been targeted by scammers who seek to commit fraud via email by asking advisors to trade or move money. The problem is widespread, and scammers' attempts are becoming more sophisticated. As your advisor, it is our duty to determine when email we receive is legitimate—and when it's the work of a fraudster.

There are several changes we are making to ensure your accounts are safe from fraudulent email:

1. **Require verbal confirmation**—Any time we receive an email request we will confirm your instructions over the phone. To make this easier, you can include a preferred number for us to call. We will verify your identity if we call a number that we do not already have on file.
2. **Offer secure electronic approval**—With the help of Charles Schwab,

we are rolling out new ways for our clients to sign some forms electronically. With electronic approval we can send you an email link to your form(s), then you simply need to verify your identity online using Schwab or DocuSign before you sign the form(s).

3. We will only send personal, non-public information via secure email. Please do not send us full account numbers in email messages. A good practice is to send just the last few numbers. An example would be x345 for an account ending in 345.

At this point the electronic document approval is only available for a selection of Schwab forms. We expect to expand on this in the new year.

While no single policy or tool will make you completely immune to fraud, we can work together with you and your account custodians to protect against this type of fraud.

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Advisor Corner

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Focus on Fundamentals: Asset Allocation

The way you divide your investment dollars among stock, bond, and money market investments is known as asset allocation.¹ As simple as this strategy sounds, it is deceptively powerful: Studies have found that asset allocation decisions account for more than 90% of your portfolio's performance over time.²

As we near the end of the year, often a time of reflection, investors who haven't reconsidered their asset allocation in a while may want to give it a fresh look. The following steps will help.

Come to Terms With Asset Allocation

First, be sure you have a handle on the concept of asset allocation, which is often confused with its sister strategy, diversification.³ Assume for a moment that you are assembling a portfolio from scratch. Before you select specific investments, you'll need to decide what percentage of your money to put into each of the major asset classes (stocks, bonds, and money markets). That's asset allocation: spreading your money among asset classes based on your goals, risk tolerance, and time horizon.

All portfolios start with a strategic, or default asset allocation. Your default allocation represents the mix of asset classes best suited to meet your goals over the long term. As a result, a default allocation tends to remain static over time until the individual's investment objectives and/or risk tolerance change significantly. By comparison, a tactical asset allocation is adjusted regularly to reflect temporary leanings toward one asset class or another based on short-term market movements.

Once you have settled on a default asset allocation, it's time to consider diversification.³ The premise is simple: Investing in a single company, sector, country, or even asset class can be exceptionally risky ~ your return will be dependent solely on that investment's performance. To help reduce risk, you diversify, or spread your money among a variety of securities, creating the potential for top performers to compensate for underperformers.

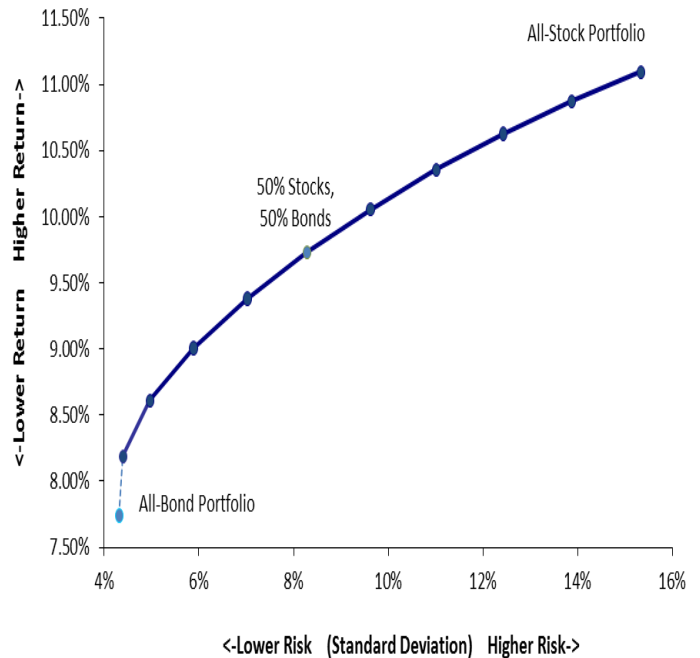
Review Your Asset Mix

Do you have an asset allocation plan in place? To understand why it is so important to have an asset allocation plan ~ and not just a random mix of investments ~ take a look at the chart below. Historically, different asset classes have resulted in different risk/return profiles. The question you have to ask about your current mix is, does the risk/return profile still fit your needs?

Decide Whether You Need a New Mix

Unfortunately answering that question is not as easy as

Managing Risk With Asset Allocation



Source: Wealth Management Systems Inc. For the 30 years ended December 31, 2013. Stocks represented by the total returns of Standard & Poor's Composite Index of 500 Stocks, an unmanaged index that is generally considered representative of the U.S. equity market. Bonds represented by a composite of the Barclays U.S. Aggregate Bond Index. Past performance is not a guarantee of future results.

picking a plot point on a chart. First, you'll need a clearly defined goal ~ "enough money to retire" won't cut it. Take the time to run some estimates using one of the many retirement planning calculators found online.

Then you will need to assess your risk tolerance. To do this you first need to understand the different types of risk: from market risk ~ the possibility that a security will fall in value as the broader market declines; to liquidity risk ~ the possibility that a security cannot be sold at a fair price within a particular time frame.

Next, consider your risk tolerance from two perspectives ~ financial and emotional. For instance, if the market were to decline by 5% in a day, could you handle that loss financially? And just as important, could you cope with it emotionally, or would you lose sleep? There are numerous surveys and worksheets designed to gauge both types of responses.

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Year-End Tax Planning Strategies

Although tax day is still months away, it is not too early to think about ways to curb your 2014 tax bill. Here are some year-end pointers for minimizing or delaying taxes.

A Question of Timing

The most basic form of year-end tax planning involves deferring income and accelerating deductions, keeping in mind the tax consequences for the current as well as the subsequent year. You may wish to explore opportunities to accelerate deductions for charitable contributions, state and local taxes, deductible interest payments, alimony, or other payments for which you can control the timing.

Timing can also play a key role when assessing the tax implications of your investments. For example, if you have stocks that have performed well this year, consider holding on to them at least until January 2015. Doing so will allow you to delay paying taxes on your gains for another year.

Other Investment-Related Tax Strategies

In addition to timing, there are some fairly straightforward steps you can take to potentially reduce the long-term impact of taxes on your portfolio.

Offset gains with losses ~ When you sell securities, the tax on any profits will vary according to the length of time you have held the investment. Securities sold within a year of their purchase can generate short-term capital gains, which are taxed at the investor's ordinary income tax rate ~ up to a maximum rate of 39.6% for the highest earning individuals.

Gains from the sale of securities held for more than one year are considered long-term gains and are taxed at a maximum rate of 15% for most Americans, but that rises to 20% for those with taxable incomes of over \$400,000 (\$450,000 for joint filers). In addition, a new Medicare surtax on net investment income, which includes capital gains, results in an overall top long-term capital gains tax rate of 23.8% for high-income taxpayers.

What is the best way to make these tax rules work in your favor? If you have experienced gains in your portfolio this year, congratulations, but consider selling assets that will generate a capital loss in order to balance out that gain. The IRS allows you to offset capital gains with capital losses to the extent of your total gains ~ and above that, taxpayers are allowed to deduct up to \$3,000 against ordinary income each year. Losses in excess of that limit can be carried over to the next year.

Make the most of tax-deferred investments ~ Investments in tax-deferred accounts such as a traditional IRA offer a two-way tax advantage: You can contribute a total of

\$5,500 ~ \$6,500 if you are 50 or older ~ in earned income to an IRA in 2014, and you will owe no tax on your investment earnings and principal until you withdraw the money, usually in retirement.¹ You may also be able to deduct all or part of your IRA contribution if you meet certain IRS guidelines for income and other eligibility criteria.

Year-end is also a good time to reevaluate employer-sponsored benefits, such as qualified retirement plans that offer tax deferral and typically allow participants to make contributions on a pretax basis, thereby lowering current taxable income. In 2014, the IRS allows individuals to set aside \$17,500 (\$23,000 for contributors age 50 and older) in an employer-sponsored plan.

An important year-end consideration for those holding IRAs or employer-sponsored retirement accounts is whether or not they have taken required minimum distributions. Account holders aged 70½ or older are required to withdraw specified amounts from these accounts each year. If you have not taken the required distributions in a given year, tax laws will impose a 50% tax on the shortfall, so it's important to take the required annual distribution by the end of the year.

Consider tax-exempt investments ~ Municipal bonds have long been appreciated by investors seeking tax-free income. Interest earned on municipal bonds is typically exempt from federal taxes and may be exempt from state and local taxes.² Although "munis" generally pay lower yields than taxable bonds, their tax-exempt status gives them the potential to deliver higher returns than taxable bonds on an after-tax basis.

Income Shifting Through Gift Giving

Year-end is also the right time to make monetary gifts to children, grandchildren, and others. The annual gift tax exclusion for 2014 is \$14,000 per individual or \$28,000 for spouses combined. This strategy works particularly well for those who want to give away significant assets in a relatively short amount of time. For instance, assuming you and your spouse have two children (who are both married) and four grandchildren, you could give away \$224,000 a year ~ \$14,000 from each of you to each family member ~ without affecting your lifetime gift tax or estate tax exemption. Over time, these annual gifts will help to shift considerable assets out of your taxable estate as well as any future taxable income associated with the gifted money.

On the Horizon for 2015

President Obama's 2015 fiscal year budget contains a few provisions that ~ if they materialize into law ~ could have an ef-

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Focus on Fundamentals: Asset Allocation (continued)

The third variable affecting your asset mix is your time horizon. Will you need the money you have invested in four years or 40? Your financial advisor can help you through each of these tasks and then work with you to decide how the information you come up with relates to your asset allocation.

If the two of you determine that your allocation is out of balance, you'll have a couple of options: add new money to the asset class that is underrepresented in your portfolio or shift money from the overrepresented asset class to the others.

Keep an Eye on Your Asset Allocation

Finally, once you have a carefully crafted asset allocation, maintain it. Review it on at least an annual basis, making alterations as your investor profile changes. And rebalance the mix if the performance of one asset class throws it off kilter.

Source/Disclaimer:

¹Investing in stocks involves risks, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the fund. Asset allocation does not assure a profit or protect against a loss.

²Gary P. Brinson et al. "Determinants of Portfolio Performance," *Financial Analysts Journal*, May/June 1991.

³There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

Year-End Tax Planning Strategies (continued)

fect on your best-laid tax and retirement planning endeavors. The most significant of these are: 1) A proposal to cap itemized deductions at a 28% tax rate for top earners; 2) A cap on the aggregate value of qualified plan accounts; 3) Required minimum distributions from Roth IRAs; 4) An elimination of certain Social Security benefit-claiming strategies.

While you can't foresee ~ or control ~ the outcome of these or any other proposed policy changes, there are many tangible steps that you can take to help keep your taxes in check. Work with your financial and tax advisor(s) to make tax planning an integral part of your overall financial plan.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

Source/Disclaimer:

¹Withdrawals from traditional IRAs are taxed at then-current income tax rates. Withdrawals prior to age 59½ may be subject to an early withdrawal penalty.

²Capital gains on municipal bond investments are taxable as short- or long-term capital gains, depending on how long you have held the investment. Income from certain municipal bonds, known as private-activity bonds, must be reported as taxable income if you are subject to the alternative minimum tax.

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