Fee Only Financial Planning & Investment Management

December 2017

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Resolute Connections

Happy holidays and here is a toast to ending the year with a big bang. Yes, we along with the press and politicians have bored you for months discussing the various permutations of the various tax bills working their way through congress; what might happen, what won't, who will benefit, who will lose. Well we all can stop theorizing, *What the Tax Bill Means to You* summarizes the legislation that will be finalized this week; and for the most part middle to upper middle class citizens are going to see a lower tax bill for 2018!

Why Rebalance? explains why your investment portfolio should be rebalanced on a regular basis. *Inflation Impact* discusses the insidious impact of inflation as it gradually erodes the value of our dollars, and you're probably aware that this is one of the main reasons for investing in the stock market; something to consider if you are being pitched a fixed income product.

If you have any questions about anything we have covered in the articles below, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com. In the meantime, enjoy the holidays with family and friends and we wish you a prosperous and peaceful 2018.

What the Tax Bill Means to You

We have written about the potential of a new tax law, and the talking heads have been filling the airwaves with hot air on the topic for months. Well, the new tax law has almost been formally ratified by the U.S. House and Senate, but all indications are

that the Tax Cuts and Jobs Act of 2017 will be sent to the President's desk in the next few days. As you probably know, the House and Senate versions were somewhat different. What does the new bill look like?

Despite the promise of tax "reform" or "simplification," the bill actually adds hundreds of pages to our tax laws. And the initial idea of reducing the number of tax brackets was apparently tossed aside in the final version; the new bill maintains seven different tax rates: 10%, 12%, 22%, 24%, 32%, 35% and 37%. Most people will see their bracket go down by one to four percentage points, with the higher reductions going to people with higher income. And the tax brackets, going forward, will be indexed to inflation, meaning that the "real" income brackets will remain approximately the same from year to year.

The new brackets break down like this:

Individual Taxpayers

Income $0-$9,525 - 10% of taxable income
$9,526-$38,700 - $952.50 + 12% of amount over $9,526 (2017 rate ~ 15%)
$38,701-$82,500 - $4,453 + 22% of amount over $38,700 (2017 rate ~ 25%)
$82,501-$157,500 - $14,089.50 + 24% of amount over $82,500 (2017 rate ~ 28%)
$157, 501-$200,000 - $32,089.50 + 32% of amount over $157,500 (2017 rate ~ 33%)
$200,001-$500,000 - 45,689.50 + 35% of the amount over $200,000 (2017 rate ~ 35%)
$500,001+ - $150,689.50 + 37% of the amount over $500,000 (2017 rate ~ 39.6%)

Joint Return Taxpayers

Income $0-$19,050 - 10% of taxable income
$19,051-$77,400 - $1,905 + 12% of the amount over $19,050
$77,401-$165,000 - $8,907 + 22% of the amount over $77,400
$165,001-$315,000 - $28,179 + 24% of the amount over $165,000
$315,001-$400,000 - $64,179 + 32% of the amount over $315,000
$400,001-$600,000 - $91,379 + 35% of the amount over $400,000
$600,000+ - $161,379 + 37% of the amount over $600,000

Taxes for trusts and estates were also changed to:

$0-$2,550 - 10% of taxable income
$2,551-$9,150 - $255 + 24% of the amount over $2,550
$9,151-$12,500 - $1,839 + 35% of the amount over $9,150
$12,501+ - $3,011.50 + 37% of the amount over $12,500

Notice that in the lower brackets, the joint return (mostly for married couples) were double the individual bracket thresholds, eliminating the so-called "marriage penalty"; it is about time! However in the higher brackets, the 35% rate extends to individuals up to $500,000, but married couples with $600,000 in income fall into that bracket. In the top bracket, the marriage penalty is more significant; individuals fall into it at $500,000, while couples are paying at a 37% rate at $600,000 of adjusted gross income.

Other provisions: the standard deduction is basically doubled, to $12,000 (single) or $24,000 (joint), $18,000 (head of household), and in an interesting provision, persons who are over 65, blind or disabled can add $1,300 to their standard deduction.

The bill calls for no personal exemptions for 2018. And the Pease limitation, a gradual phase out of itemized deductions as taxpayers reached higher income brackets, has been eliminated. However, despite the hopes of many taxpayers, the dreaded alternative minimum tax (AMT), remains in the bill. The individual exemption amount is $70,300; for joint filers it's $109,400. But for the first time, the AMT exemption amounts will be indexed to inflation.

Interestingly, the new tax bill retains the old capital gains tax brackets—based on the prior brackets. The 0% capital gains rate will be in place for individuals with $38,600 or less in income ($77,200 for joint filers), and the 15% rate will apply to individuals earning between $38,600 and $452,400 (between $77,400 and $479,000 for joint filers). Above those amounts, capital gains and qualified dividends will be taxed at a 20% rate.

In addition, the rules governing Roth conversion re-characterizations will be repealed. Under the old law, if a person converted from a traditional IRA to a Roth IRA, and the account lost value over the next year and a half, they could simply undo (re-characterize) the transaction, no harm no foul. Under the new rules, re-characterization would no longer be allowed.

For many taxpayers who itemize deductions, the adjusted gross income number will be higher under the new tax plan, because many itemized deductions have been reduced or eliminated. Among them: there will be a $10,000 limit on how much any individual can deduct for state and local income tax and property tax payments. Before you rush to write a check to the state or your local government, know that a provision in the bill states that any 2018 state income taxes paid by the end of 2017 are not deductible in 2017, and instead will be treated as having been paid at the end of calendar year 2018.

The mortgage deduction will be limited to $750,000 of principal (down from a current $1 million limit); any mortgage payments on amounts above that limit will not be deductible. However, the charitable contribution deduction limit will rise from 50% of a person's adjusted gross income to 60% under the new bill.

What about estate taxes? The bill doubles the estate tax exemption from, currently, $5.6 million (projected 2018) to $11.2 million; $22.4 million for couples. Meanwhile, Congress maintained the step-up in basis, which means that people who inherit low-basis stock will see the embedded capital gains go away upon receipt.

Public "C" Corporations saw their highest marginal tax rate drop from 35% to 21%, the largest one-time rate cut in U.S. history for the nation's largest companies.

And pass-through entities like partnerships, S corporations, limited liability companies and sole proprietorships will receive a 20% deduction on taxes for "qualified business income," which explicitly does NOT include wages or investment income. As things stand today, all of these provisions are due to "sunset" after the year 2025, at which point the entire tax regime will revert to what we have now; and we can do this all over again!

Why Rebalance?

You probably know that your investment portfolio is being rebalanced on a regular basis, but you might not know why. Is it for higher returns? For maintaining the agreed-upon balance of investments that is in your risk tolerance comfort zone? Does rebalancing help manage portfolio risk?

The answer to the above is "yes," "yes," and "yes," but with a qualification. Rebalancing an investment portfolio is most importantly a form of discipline, a way to reduce the impact of those dangerous emotions of greed and panic on the investment process.

Rebalancing is necessary because all of the moving parts in your portfolio rise and fall at different times and degrees. During a bull market, stock prices rise faster than bond values, causing them to make up a larger percentage of the portfolio than you signed on for. Similarly, when the bear growls, stocks will fall faster than bonds, causing your portfolio to become more conservative. Real estate investments and commodities often rise or fall at different times than stocks or bonds, pulling your overall percentage allocations away from the target mix.

So what does rebalancing accomplish? When you rebalance, you're selling the assets that rose in price and buying the ones that went down. This discipline results, over time, in consistently buying when an asset goes on sale, and selling when the asset becomes more expensive.

There are three ways to rebalance. The easiest is to use whatever new money is coming into the portfolio, monthly or quarterly, to buy the assets that have gone down, allowing you to make consistently fine adjustments that keeps the portfolio at its prescribed allocations.

Another possibility is to rebalance at certain times of the year—every three, six or 12 months.

Or you could follow the most complicated process, and rebalance whenever assets deviate by more than certain set percentages from the baseline asset allocation.

A recent article on the Seeking Alpha website notes that rebalancing reduces portfolio volatility, because you are not allowing the stock allocation to rise in the portfolio during bull markets (which would set you up for a bigger drop when the market rise turns into a bear market).

An illustration in the article, using a simple mix of 60% stocks and 40% bonds shows that rebalancing using the percentage deviation method would have led to higher overall returns from the beginning of 2000 to January 2016. It found that wider bands produced higher returns (and fewer rebalances), although of course there is no guarantee that this would be the case in the future.

But perhaps most importantly, rebalancing gives you back, over and over again, the portfolio that you expected when you started, the portfolio whose expected long-term returns are incorporated in your financial plan, and the portfolio you were most comfortable with when the investment process was first discussed. And when it comes to making decisions in a time of crisis, having a rebalancing policy in place ensures that they will be made with discipline, rather than emotion.

Inflation Impact

We all know that inflation gradually erodes the value of our dollars, and you're probably aware that this is one of the main reasons for investing in the stock market. If you hide your money safely under your mattress, it becomes incrementally less valuable each year depending on the inflation rate. To keep pace, you have to find ways to make it grow at least as fast as the value of a dollar is falling.

But you may not have heard about inflation as an argument against putting too much of your retirement money in a fixed annuity, which pays you a fixed amount for the rest of your life. That safe, comfortable income stream may work perfectly for you today, but will it be enough to live on 20 or 30 years in the future?

If you're curious how much damage inflation can do to you over longer time periods, look at a free online calculator available here: https://www.calcxml.com/do/ret05. You can input your current age and the income you're receiving, and the site will

calculate what your future income would need to be at some point in the future, just to maintain your current lifestyle.

Let's say you're 65 today, receiving $100,000 a year from an annuity. How much of your future lifestyle will that annuity pay you when you're 90?

Assuming an inflation rate of 3% a year, you would need $209,378 in that year you turn 90 to afford the same things you do today. So your other investments would have to contribute more, in that year, than what the annuity was paying you. Put another way, the annuity would be paying less than half of what you need to maintain your current expenses into the later years of your retirement. If inflation were to average 4%, the future income needed to match today's $100,000 rises to $266,584.

This is not an argument that annuities are to be avoided in all cases; a guaranteed lifetime income may have its place in some financial plans. But a few inputs into this calculator can go a long way toward making the case that investments that grow over time are vitally necessary to afford a comfortable future retirement. The safety of a guaranteed fixed income is a false promise, because it doesn't protect you against the near-certain, incremental danger of yearly inflation.

Source:

Bob Veres Inside Edition Newsletter

For more information on these topics or for a free consultation, contact Resolute Financial, LLC at (978) 463-8771 ext. 1003.

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