Fee Only Financial Planning & Investment Management

June 2019

We put your interests first.®

Resolute Connections

In this month's newsletter, *Win, Lose or Tie* discusses the trade war between the U.S. and China, which seems to be escalating lately, and which economy may win out in the end. *Retirement Tweaks* reviews the recently bill passed by Congress that would reform various aspects of America's retirement laws. Essentially the bill contains new provisions that would ease the difficulty small companies have providing low cost retirement plans for employees, and it contains provisions that allow older workers to increase their retirement savings, while at the same time restricting one's ability to pass retirement savings on to heirs; kind of a mixed bag for most.

The market volatility of the past couple of weeks have been caused by the trade issues, but also by the stock market guessing whether the Federal Reserve will cut or increase interest rates. The problem, as *Predictions (Very) Faulty Forecasts* illustrates, is the market is notoriously inept at predicting the next Fed move. Our final article dispels a common misconception outlined in the title - *Is the Government Double-Taxing Social Security Benefits?*

If you have any questions about anything we have covered in the articles, or a specific situation please feel free to give us a call, or visit our website, www.ResoluteFinancial.com.

Win, Lost or Tie

The trade war between the U.S. and China seems to be escalating lately—but is there any way of telling who's winning? A recent article on bloomberg.com provides a scorecard of sorts, and the news isn't good for either side.

One way to measure victory is to look at the size of the trade deficit that the U.S. is running against China. China is still maintaining a high surplus, but the article notes that in March, the gap was the narrowest in three years. So if you believe trade deficits are harmful, this can be considered a narrow victory for the American economy.

Another way to keep score is consumer prices. Tariffs drive up prices on both sides of the Pacific; American tariffs cause American consumers to pay more for Chinese products, and Chinese retaliatory tariffs raise prices for Chinese consumers on any American exports they buy. The article says that the price of items on U.S. store shelves in seven tariff-hit categories went up 1.6% since last July. On the Chinese side, higher tariffs on U.S. imports have had little effect on Chinese consumers because many of them are industrial inputs, rather than end-use products—things like soybeans, gold, liquefied natural gas, cotton and liquefied propane. Some of the newly-tariffed Chinese imports are used to manufacture products which are then shipped to the U.S., where they experience further tariffs that are paid by U.S. consumers. This is a clear victory for China.

What about the psychological impact of the trade war on U.S. and Chinese consumers? The article calls this one a draw; Americans aren't very optimistic about the outcome of a trade war, and Chinese consumers are buying less lately in their domestic economy.

What is the impact on each nation's currency? The Chinese yuan has weakened 7.5% against the dollar, which benefits Chinese exporters by making it easier for them to absorb some of the hit by U.S. tariffs. But if the yuan gets much weaker, it could force the Chinese government to spend some of its reserves. The article calls this one a tie as well.

How are tariffs impacting each country's stock market? Since the start of 2018, Chinese stocks are down almost 14%, while U.S. share prices are up 6%. America has—so far—won this category.

Another measure is economic growth. Both U.S. and China are experiencing signs of GDP weakness in recent weeks, but China's industrial output, retail sales and investment all slowed in April by more than economists forecast. The U.S. is experiencing weaker retail sales, and factory production fell for the third time in four months. The article gives a narrow victory to the U.S.

What about foreign direct investment in the U.S. and Chinese economies? U.S. investment in China has declined only marginally since the start of the tariff war, while Chinese investment in the U.S. has shown a more than 80% drop. As the U.S. misses out on investment, chalk up a victory for China.

The bottom line? The U.S. is ahead in some ways, while China has an advantage in others. But ultimately, consumers in both countries are paying the price of the war. There are no winners; what matters is which side loses more.

Retirement Tweaks

While partisan politics rages everywhere in sight, the U.S. House of Representatives quietly—and nearly unanimously—passed a bill that would reform various aspects of America's retirement laws. The Setting Every Community Up for Retirement Enhancement Act (SECURE Act) was approved by a 417-3 majority of legislators, and the Senate is expected to pass a similar bill by a similar margin in the fairly near future.

The bill contains 29 new provisions, including allowing people who work past age 70 to continue making IRA contributions while they're earning an income, and pushing out the start date to take required minimum distributions from IRAs or 401(k) plans from age 70 1/2 to age 72. (The Senate version would push out the start date to when the IRA owner turns age 75.) The bill would also expand employers' ability to create 401(k) plans in conjunction with other (probably small) businesses, allowing them to share and therefore reduce costs.

Also: there would be a $500 tax credit to smaller employers who encourage automatic enrollment in their retirement plan. Studies show that employees save more under

automatic enrollment than when they have to affirmatively opt in. The bill increases how much workers can have automatically deducted from their paychecks to go into the retirement account, from the current 10% to a proposed 15%.

Meanwhile, the bill decrees that all defined contribution plans (including 401(k)s) would be required to estimate how much income would be generated by each plan participant's current account value—though how, exactly that calculation would be made is still up in the air. Experts have plenty of questions about how this would even be possible. What return assumption would you make over the next 30 years? Over how many years would the income assumption be made for a 20-year-old staffer vs. somebody who's in her 50s?

Currently, there are a variety of reasons why people can start taking withdrawals from their IRAs before they reach age 59 1/2, and the recently-passed legislation would add another one: a total of $5,000 could be distributed, without penalty, from the IRA or retirement plan if the owner experiences the birth or adoption of a child. (The distribution would need to take place within one year of the birth or adoption; otherwise there would be a tax penalty.)

The bill is not all good news. The SECURE Act would raise revenues by changing the rules regarding distributions from inherited IRAs. As the rules stand today, the amount that would have to be taken out could be spread out over the life expectancy of the heir—which, of course, allows people to stretch out the tax-deferral on inherited IRAs for decades. Under the new bill, most beneficiaries would have to take their money out over a 10-year period. (The Senate version of the bill would require any inherited IRA over $450,000 to be paid out over five years.) But the bill would exempt inheriting spouses and minor children from the provision.

Another part of the bill that may wind up being harmful was heavily lobbied for by the insurance industry: creating a safe harbor for plan sponsors to offer annuities inside their 401(k) plans. Companies that decide to offer annuities would be shielded from liability no matter how awful the annuity product they select (and there are quite a few that are pretty awful). Anybody who has seen the expensive, high-sales-commission products offered to teachers in 403(b) plans knows that there is great potential for harm with this aspect of the new bill.

All in all, the new bill is incremental rather than earth-shaking. Not many workers will be working or want to contribute to an IRA after age 70, but some will. Raising the age when people are required to take minimum distributions from their IRA by a year and a half is relatively minor, and making retirement plans easier to set up is good, but most companies have already done that work.

That staid, it is interesting that bipartisan legislation can still get done amid the hysteria going on between the Democrats and Republicans in the current Congress.

(Very) Faulty Forecasts

The U.S. stock market seemed to be trending downward until the Federal Reserve governors' meeting, where word came out that the Fed would hold off on raising rates despite the growing economy, and might even lower rates. Stocks responded by reversing direction and gaining in value, while various pundits were left scratching their heads.

The problem is that "the market" actually doesn't have any idea what the Fed is going to do with interest rates. If you want proof, look at recent history since 2008, at the graph which shows how traders were pricing Fed funds futures (black dotted lines)—which were their best guesses about the rate in the future, vs. the red line, which is the actual rate that the Fed maintained. As you can see, there were a lot of incorrect guests that the Fed would raise rates long before it did, and more recently there have been a lot of incorrect guesses that the Fed would lower rates again.

The market is almost always wrong about what the Fed will do

Source: FRB, Bloomberg Finance LP, Haver Analytics, DB Global Research

The prevailing wisdom seems to be that once the Federal Reserve economists begin to see an economic downturn due to the various trade wars the U.S. has initiated against China, Europe and even Mexico and Canada, it will lower rates to counteract the damage. That's what the smart money is saying. Just remember how often the smart money has been wrong in the past.

Is the Government Double-Taxing Social Security Benefits?

It doesn't seem fair that your Social Security benefits should be taxed by the federal government. Isn't this an example of double-taxation?

Double-taxation of Social Security may actually be a misnomer, but the way the government calculates the taxes and handles your benefits makes it hard to follow. How do you determine how much of your Social Security benefits are subject to taxes? Start by adding half of your Social Security benefits in any given year and add that amount to all your other income—including tax-exempt interest, which is

otherwise not taxed by the federal government. This number is known as your "combined income."

If you're a single filer and your "combined income" is above $25,000 but below $34,000, you'll pay taxes on 50% of your Social Security benefits. The same window is $32,000 to $44,000 for joint filers who combine their income and Social Security benefits to come up with their combined income figure. If your combined income is above $34,000 (single filers) or $44,000 (joint filers), then you can expect to pay taxes on 85% of Social Security benefits.

Meanwhile, the FICA tax that was originally collected from your paycheck should be thought of as a benefit to you when you get older—which means it probably shouldn't be thought of as a tax at all, but more like a contribution to a future annuity.

So, one answer is that there is no double taxation at the federal level; in fact, there isn't even total single taxation, since the government never taxes 100% of your benefits.

But there's another way to look at it. The government is collecting its FICA payments after-tax, unlike an IRA contribution, which is made with pre-tax dollars. IRAs are not subject to double taxation because the money is not taxed initially when the contribution is made, but then is taxed as ordinary income when the money comes out. FICA payments are made with taxable income, and then taxed upon receipt either not at all, heavily or very heavily, depending on your income at the time.

Unfortunately, that's not the whole picture. 13 U.S. states collect taxes on at least some Social Security income. Minnesota, North Dakota, Vermont and West Virginia follow the same taxation rules as the federal government, so you might find yourself paying state taxes, plus federal taxes, on up to 85% of your benefits. Nebraska, Colorado, New Mexico, Connecticut, Kansas, Rhode Island, Missouri, Utah and Montana are a bit more lenient with deductions and exemptions, but also dip their hand into your Social Security checks.

There are ways to lower your taxable income lower in retirement, including having more money in Roth IRAs whose distributions don't show up on the tax form, and

reducing the amount of money in your IRA—which reduces the required minimum distributions. The Senior Citizens League has concluded that 44% of all Social Security recipients are paying no tax on their benefits, and at least some of that is the result of good planning. Those people are indisputable not subject to double taxation. Whether the other 56% are, including those living in states that tax Social Security benefits, depends on your point of view.

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.

Resolute Financial, LLC is an independent Fee-Only Financial Planning and Investment Management firm based in Newburyport, MA with offices in Chelmsford and Lynnfield, MA along with Portsmouth, New Hampshire. The principal financial advisors are all Certified Financial Planners (CFP®) and are members of the National Association of Personal Financial Advisors (NAPFA) an organization of fee only financial planners. As a fee-only advisors we are not paid commissions or fees of any kind by any product provider, mutual fund, or insurance company; we are paid solely by the client. This allows the firm to work for its clients in a fiduciary capacity; therefore, we will act in good faith and in the best interests of the client at all times as required by the NAPFA Fiduciary Oath we have signed. This newsletter contains general information, and is not intended as individual advice.