Retirement Times

December 2017

Happy Holidays from Partners Wealth Management, Inc.!

On behalf of everyone at Partners Wealth Management, Inc., I'm pleased to wish you the greetings of this special season. Thank you for selecting us as your dedicated retirement plan advisor. We saw plenty of activity in the retirement plan landscape in 2017—with delays and updates to the DOL's Fiduciary Rule to tax reform discussions—and look forward to what 2018 will bring and keeping you abreast of the current events within the industry. We are fiercely proud to be your retirement plan advisor, protecting you as a fiduciary and helping your plan participants prepare for a meaningful retirement. Congratulations for all you accomplished in 2017.

As we do each December, this month's *Retirement Times* highlights excerpts from issues published this year. Please contact us with any questions or feedback; we look forward to serving you in 2018 and beyond!

Warmest Regards,

Karl Cloherty

Karl Cloherty
Financial Advisor

About Karl Cloherty
Karl Cloherty is a Financial Advisor with Partners Wealth Management and a Registered Representative and an Investment Advisor Representative of Kestra Investment Services, LLC. His clients include individuals and families in every stage of life, as well as small to mid-size businesses. The cornerstone of Karl's philosophy is the recognition that everyone's economic and life situations are different. His years of experience and personalized service allow Karl to assist his clients in developing the right financial strategy. As a Financial Advisor, Karl believes in cultivating long term relationships with his clients and an educational approach to his advising.
Karl holds his Series 7: FINRA General Securities and Series 66: FINRA Uniform Combined Securities licenses as well as life and health insurance licenses.

To Bond or Not to Bond?

Solomon Stewart, CFA, Senior Plan Advisor

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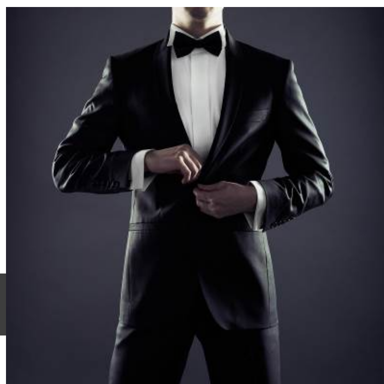

Over the last few years, there has been a fair bit of concern in the market over the general impact of rising interest rates. "You shouldn't be holding bonds because rates will rise soon" goes the logic. But what does this really mean for investors? If interest rates rise, what will ultimately be the impact on investors' portfolios?

To understand this, we first need to understand how all of the moving pieces fit together. At a high level, if interest rates increase, this generally has a negative impact on bond prices, and to get a sense for how large this impact could be, we can look to a bond's duration[1] or interest rate sensitivity[2]. Using the broad Bloomberg

Barclays U.S. Aggregate Bond Index to approximate an investor's diversified bond portfolio, we see that the index has a duration of about 5.5. This means that if interest rates at ALL maturities move higher by 1 percent, the PRICE of the bonds will fall by an average of 5.5 percent.

There are a couple of key distinctions in that statement. The first is that all interest rates need to move together, not just some. The Federal Reserve can move short-term rates, but they have little direct control over 30-year rates, which contribute more heavily to price changes in bonds. The second note is that the price of the bonds will decline for a change in interest rates, but investors also still receive coupon payments[3] or yield[4]. Currently (as of 12/8/16), the yield on the index is about 2.5 percent, which can help to offset losses from bond price movements. Taking these two sources of return together, if all interest rates move higher by 1 percent over the next year, bond investors could see a total loss of 3 percent.

To put this into historical context, the largest total return loss on the Bloomberg Barclays U.S. Aggregate Bond Index, going back to 1976 was 2.92 percent and the index has only been negative on a total return basis in three of those 40 years.[5]

If a relatively significant move higher in interest rates can be expected to result in a loss (no matter how small) for fixed income investors, why take the risk of holding bonds? One way to think about fixed income is like insurance. On your car, you probably pay an insurance premium of about $150 per month, or $1,800 per year. If you are driving a $20,000 car, that annual premium represents 9 percent of your car's value every year for protection against a significant financial loss in the case of an accident. While nobody likes paying for insurance, it's a necessary expense that people understand and fixed income in a portfolio might be the cheapest insurance you can buy.

"Bond insurance" can provide a very strong diversifier to stocks. Going back to 1976, the Bloomberg Barclays U.S. Aggregate Bond Index had a positive total return in EVERY year that stocks had a negative return (and stocks had a positive return every year that bonds had a negative return). Highlighting a couple of examples when the "insurance" paid off, 2008 was a year when stocks (S&P 500) declined 37.0 percent, but bonds returned 5.2 percent and in 2002, stocks were down 22.1 percent and bonds were positive 10.3 percent.[6]

Over the last 40 years, stocks have outperformed bonds, so there is no denying that holding some exposure to fixed income over that time may have underperformed a pure stock portfolio, but the overall volatility of the portfolio would have been lower as well. A portfolio consisting of half S&P 500 and half Bloomberg Barclays U.S. Aggregate Bond Index could have experienced a 1.5 percent lower annual return with 40 percent lower volatility than a pure stock exposure.[7] In other words, 1.5 percent annual "insurance premium" reduced your risk by over 40 percent - that's a lot cheaper than car insurance.

[1]A measure of the sensitivity of the price of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.
[2]Interest rate sensitivity is a measure of how much the price of a fixed-income asset will fluctuate as a result of changes in the interest rate environment. Securities that are more sensitive have greater price fluctuations than those with less sensitivity.
[3]The annual interest rate paid on a bond, expressed as a percentage of the face value.
[4]The income return on an investment, such as the interest or dividends received from holding a particular security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value or face value.
[5]Morningstar through 2015.
[6]Morningstar from 1976 through 2015 comparing the total return of both the Bloomberg Barclays U.S. Aggregate Bond Index and the S&P 500 Index
[7]The annualized return (the returns an investment provides over a period of time, expressed as a time-weighted annual percentage) on the S&P 500 TR index from 1976 through 2015 was 11.35% with a standard deviation (a measure of the dispersion of a set of data from its mean) of 16.4. The same metrics for the 50/50 portfolio of stocks and bonds are 9.85% annualized returns and a standard deviation of 9.6. The volatility value of 9.6 is over 40% lower than 16.4. The 50/50 portfolio simply blends the annual returns of the indexes in equal amounts each year. All data sourced from Morningstar.

About the Author, Solomon Stewart, CFA, Senior Plan Advisor

Solomon Stewart, CFA, joined RPAG in 2014 as a plan advisor. In this capacity, Solomon is responsible for conducting investment due diligence reviews for optimal plan performance, while ensuring ongoing fiduciary best practices in plan design and operations. He came to RPAG with a diverse background in the investment industry and brings with him over eight years of experience. Solomon has worked in both investment and client service roles, and most recently worked for BlackRock's iShares ETF group as a strategist focused on fixed income markets. Solomon is a CFA® charterholder. He holds an MS in Financial Analysis and Investment Management from St. Mary's College of California and a BS in Finance from the University of Arizona.

No Beneficiary Designation. Who Gets the Money?

Michael Viljak, Senior Plan Advisor

Published February 2017

According to a recent Wall Street Journal article, retirement plans and IRAs account for about 60 percent of the assets of U.S. households investing at least $100,000.[1] Both state and federal laws govern the disposition of these assets, and the results can be complicated, especially when the owner of the account has been divorced and remarried. Therefore, it is important for plan fiduciaries of qualified retirement plans to understand their role regarding beneficiary designations and the regulations that dictate.

Under ERISA and the Internal Revenue Code, in the case of a defined contribution plan that is not subject to the qualified joint and survivor annuity rules[2], if a participant is married at the time of death, the participant's spouse is automatically the beneficiary of the participant's entire account balance under the plan. A participant may designate someone other than his or her spouse as the beneficiary only with the spouse's notarized consent.

If the owner of a retirement plan account is single when he or she dies, the assets go to the participant's designated beneficiary, no matter what his or her will states. In addition, the assets will be distributed to the designated beneficiary regardless of any other agreements including even court orders. If the participant fails to designate a beneficiary, the terms of the plan document govern the disposition of the participant's account. Some plan documents provide that in the absence of a beneficiary designation the participant's estate is the beneficiary, while others provide for a hierarchy of relatives who are the beneficiaries. Because of the variances in plan documents, it is important that fiduciaries review the terms of their plan document when faced with determining who the beneficiary is in the absence of the participant's designation.

The beneficiary determination can become complicated when a retirement plan participant divorces. Where retirement benefits are concerned, both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code contain provisions requiring plans to follow the orders of state courts overseeing domestic disputes that meet certain requirements. These orders are referred to as "qualified domestic relations orders" (QDROs).

Until recently, the federal courts have failed to adopt a reliable and uniform set of rules for adjudicating disputes among beneficiaries with competing claims. Some courts, adopting a strict reading of ERISA, simply pay the benefit based on the express terms of the plan; while others, with a nod to such concepts of "federal common law," look to documents extraneous to the plan (e.g., the divorce decree, a waiver, or some other document) to make the call. In Kennedy v. Plan Administrator for DuPont Savings and Investment Plan, the U.S. Supreme Court settled the matter, coming down squarely on the side of the plan document.

The facts in Kennedy are straightforward: A plan participant married and designated his wife as his beneficiary. The plan participant and his wife subsequently divorced. Under the terms of the divorce decree, the participant's spouse surrendered her claim to any portion of the benefits under the participant's retirement plan. As sometimes happens, the participant neglected to change his beneficiary designation under the plan to reflect the terms of the divorce. As a result, his ex-spouse remained designated as his retirement plan beneficiary. Upon the death of the participant, the plan administrator, following the terms of the plan document and the beneficiary designation, paid the participant's account to the ex-spouse. Predictably, the participant's heir (his daughter in this instance) sued on behalf of the estate. The

Supreme Court ruled that under the terms of the plan document, the designated beneficiary receives the participant's death benefits, and in this case, the ex-wife was the designated beneficiary entitled to the participant's account.

Another common example occurs following a divorce, when a plan participant designates his or her children as beneficiaries. If the participant later remarries, and dies while married to the second spouse, the second spouse is automatically the participant's beneficiary unless he or she consents to the participant's children being designated as the beneficiaries.

There are steps that plans can take to make the beneficiary process less prone to error. For example, a plan document can provide that divorce automatically revokes beneficiary designations with respect to a divorced spouse. It also behooves plans to review their communications materials to help ensure that participants are made aware of the rules that apply to the designation of beneficiaries.

Many plans that have had to deal with issues like these have decided to take inventory of their current beneficiary designations on file and attempt to remediate any deficiencies directly with the participants. Some have also requested their recordkeeper to insert a note in participants' quarterly statements reminding them to confirm their beneficiary designation is current and accurate. Both are good ideas.

As a plan sponsor you have the best wishes of your participants in mind and helping ensure their beneficiary designations are in order is another way to protect them and help ensure their intentions are carried out. Consider distributing this month's accompanying participant memo that reminds participants of the importance of keeping their beneficiary designations up to date.

[1]*Family Feuds: The Battles Over Retirement Accounts*
[2]*This commentary addresses only plans that are not subject to the qualified joint survivor annuity (QJSA) rules. Typically, retirement plans are designed not to be subject to the QJSA rules by meeting the following requirements: (1) upon death, 100 percent of the participant's vested account balance is payable to the surviving spouse; (2) the participant does not elect a life annuity; and (3) the participant's account balance does not include any assets subject to the QJSA rules, such as a transfer from a money purchase pension plan. Please contact your consultant for questions related to defined benefit pension plans and money purchase pension plans subject to the QJSA rules.*

About the Author, Michael Viljak, Senior Plan Consultant

Michael Viljak joined RPAG in 2002 and has over 30 years of experience in the pension field, on both the wholesale and retail levels, focusing on retirement plans ever since their inception in 1981. Michael has an interest in fiduciary related topics and was part of the team that created RPAG's proprietary Fiduciary Fitness Program™. He also authors many of the firm's newsletter articles, communication pieces and training modules.

Participant Corner: Financial Wellness Series—Part 5: Retirement 101

This month's employee memo is the fifth of our seven-part series on financial wellness and covers the basics participants need to know about retirement plans. Download the memo from your Fiduciary Briefcase at fidcuiarybriefcase.com.

What is it? Your employer's retirement savings plan is a defined contribution plan designed to help you finance your retirement. As a participant in the plan, you own an individual account within the plan that you contribute money to for your retirement.

What are the limits? For the year 2018, you can contribute a total of $18,500 towards your retirement plan. Individuals age 50 and over can contribute an additional $6,000.

Salary deferral advantages. Participating in your company's retirement savings plan allows you the benefit of saving via payroll deduction on a tax deferred basis. Every dollar you save goes directly into your retirement savings account. Tax deferral on both savings and asset growth via payroll deduction helps you save more money and pay less tax upon distribution at retirement.

Tax deferred growth. Not being taxed on the growth of your assets helps accumulation during your working years. With your qualified retirement savings plan you not only defer taxes on the amount you save, but earnings on your savings is also tax deferred until distribution.

Employer contributions. Employer contributions, if offered, help you accumulate assets for retirement and can add considerably to your retirement account balance. You are also not taxed on your employer's contributions until distribution. As an example, if you employer contributes say, 25 percent on your contribution, that is the equivalent of earning a 25 percent return on that portion of your contribution, in addition to whatever return your investment generates.

Portability. If you change employers at some point in your career, you typically can keep your assets in the current plan, roll your assets over to your new employer's plan or roll your assets into an IRA.

To remove yourself from this list, or to add a colleague, please email us at nfo@partnerswealth.com or call (630) 778-8088.

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A Proud Member of

Financial Wellness

How is your financial health? Is it time for a check-up?

We are excited to present a seven-part series on financial wellness that will cover several financial struggles Americans face and solutions to overcome them.

Part V: Retirement 101

All approach retirement, some sooner than others. To enjoy your retirement years and not be a burden on family members, it is essential that you save sufficient assets to carry you through your retirement. No one knows precisely the amount of assets you will need for a comfortable retirement, but the more you save now, the more comfortable you are likely to be at retirement.

Here are the essentials to know about your retirement plan:

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Portability. If you change employers at some point in your career, you typically can keep your assets in the current plan, roll your assets over to your new employer's plan or roll your assets into an IRA.

For more information on your retirement plan, please call our plan's advisor at (630)778-8088 or email at karl@partnerswealth.com.

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