



PARTNERS

WEALTH MANAGEMENT

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Identifying Investment Risk And Coping With It

Are you a risk-taker? To realize rewards, you usually have to take some risks, especially when it comes to finances. But beyond understanding that investment risk and reward go hand in hand, it's important to know how they relate. What is the nature of risk, and how can you handle the different kinds of risk that could affect the performance of your investments?

What is the nature of risk? For many investors, risk is associated with the inherent volatility of the equities markets. You run the risk that your investments will perform worse this year than last year or worse than you anticipated or worse than the markets as a whole.

Risk means you have something to lose—the money you've put into a particular investment or the money you might have made if you had made different choices. You also could run the risk of throwing good money after bad, of buying more of something when the price is low only to see the value fall further.

Although risk and reward are related, there's no direct, predictable connection between the two. You could decide to take fewer risks and still lose money, or you might ratchet up your investment risk without cashing in on higher returns. Nevertheless, it's important to try to keep risk and reward in a balance that fits your situation.

What are the main types of risks? Financial experts often debate

this question, but the pros generally agree that two significant risks facing investors are inflation and emotion.

1. Inflation risk. Essentially, this is the risk that money you earn will lose some of its purchasing power over time. For example, if you buy a five-year certificate of deposit (CD) from a reputable bank, there's relatively little risk that the bank won't live up to the terms of the CD. But there's a much bigger risk that the dollars you receive in five years won't buy as much as they would now.

If you're old enough to have experienced the 1980s, you might recall the days when money market funds paid interest at double-digit percentage rates. However, with double-digit inflation occurring at the same time, most savers barely stayed even.

Inflation risk can present problems to all investors, and especially to retirees. Someone who left work in 1978 might have felt pretty comfortable with a pension paying \$40,000 a year. But that \$40,000 was worth only about \$12,200 in 2013, according to the Bureau of Labor Statistics. This represents a loss of almost three-quarters of the money's buying power.

One way to protect against inflation risk is to include an appropriate ratio of stocks and stock funds in your portfolio. Or, if you're more conservative, you might consider



Thinking Alternatively

Are you looking for investment solutions that can diversify and complement your traditional portfolio of stocks and bonds? Have you considered alternatives such as private equity, senior secured loans, real estate, venture capital, hedge funds, managed futures or event-driven credit?

Alternative investments present the opportunity to potentially increase portfolio diversification and long-term portfolio performance while reducing overall portfolio volatility. They tend to have lower correlations to traditional investments, may offer higher yields and could help a portfolio perform better through varying market conditions.

We are here to help and are ready to provide you with solutions tailored to your unique situation. With a clear understanding of the risks and benefits, you will be able to make well-informed decisions on how best to incorporate alternative investments into your current portfolio. Your specific investment objectives will help guide us to determine which alternatives may be right for you. If you are interested in learning more about the alternative investments opportunities available through our firm, please contact us at 630-778-8088 to schedule an appointment with your advisor.

(Continued on page 4)

Higher-Paying Job May End Up Costing You

Are you thinking about taking a higher-paying job in another state? Better think it through very carefully. That new job actually could end up providing you with less spendable income than you get from your current job.

How's that possible? A number of factors may affect the cost of living in any area, and some job seekers fail to consider overall living expenses in the area where the higher-paying job is located.

In fact, according to Glassdoor, an online job-listing site, almost 70 percent of job hunters say salary is their top priority when looking at a new job offer. Location and commute come in as the second choice at 59 percent. Benefits and perks come in third at 57 percent.

"Often times when people move, they have no idea what the overall cost is," says Kristen Robinson, senior vice president of the Women and Young Investors unit of Fidelity Investments. "They're just looking at the salary increase and thinking, 'Wow, I'm making \$10,000 more a year.'"

Changing jobs can mean having to pay more for some perks or losing some benefits altogether. Health care costs may go up and 401(k) matches

may go down. Or someone in the job seeker's family may have a chronic health condition that could lead to much higher expenses if coverage in the new position isn't as good as at the previous company.



Other factors also enter the picture: property values (whether you own or rent) may be higher in the new area, which could mean increased property taxes and insurance rates or higher rental costs. These increased expenses could add significantly to the cost of living in the new area. Groceries may cost more, as well as gasoline and other everyday living expenses.

All of these factors could cut a \$10,000 annual salary increase considerably – if not completely – or possibly even cause the increase to fall

into negative territory.

Some benefits, including health care costs and 401(k) match, are not negotiable. But Scott Dobroski, a spokesman for Glassdoor, says people considering a job change based on salary should take a hard look at the numbers and decide what perks and benefits are most important. For example, a flexible work schedule may rank high on a job seeker's list of preferences.

Dobroski adds that job seekers also should crunch the numbers to get a better understanding of the overall financial picture. One positive change could be that the new job is located in a state with no state income tax. Seven

U.S. states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—currently don't have an income tax. And residents of New Hampshire and Tennessee are also spared from handing over an extra chunk of their paycheck on April 15, though they do pay tax on dividends and income from investments.

If you're considering accepting a higher-paying job in another state, feel free to contact us. We may be able to help in your decision-making process. ●

Show More Life With A Living Trust

In some financial circles, a revocable living trust has been touted as a staple of estate planning that can even be used to replace a legally valid will. Normally, however, a living trust is viewed as a supplement to a will, not an outright replacement. Here's how this estate-planning technique may serve you best—in life and death:

It's important to understand the basic differences between a will and a living trust. Your "last will and testament" is a legal document determining how, when, and to whom your possessions will be distributed upon your death. It doesn't have any effect until you die. However, a will

normally must go through probate before distributions are made. (Property passing through joint rights of survivorship may be one exception to that rule.)

In addition, a will alone may not achieve all of your estate-planning objectives. For instance, you can't impose any conditions on gifts made through a will.

A revocable living trust also is a legally valid document, and you may be able to transfer securities, real estate, or other property to the trust, and you can give the trustee power to manage it on behalf of the designated beneficiaries. Typically, you might

name yourself as both the trustee and the initial beneficiary of the trust. At the same time, you can designate other family members—say, your spouse, your children, or both—as secondary beneficiaries entitled to receive remaining assets in the trust when it terminates.

With a living trust, you'll retain a high level of control while you're alive. For instance, you may be able to sell trust assets and keep the cash, amend the terms of the trust (for example, by changing secondary beneficiaries), or revoke it entirely. Unlike a will, a living trust allows you to place restrictions on gifts to

Five 401(k) Options When You Leave A Job

If you have participated in a 401(k) plan where you work, you may have accumulated a tidy nest egg for retirement. But what happens to those funds if you switch jobs or retire? Typically, you will have at least five options:

1. Take a lump-sum distribution.

If you have a pressing need for the money, you can arrange to have your investments sold and the proceeds paid to you in a single sum. However, beyond depleting your savings, this also may have negative tax consequences. Most or all of the money may be taxed at ordinary income rates, which can reach as high as 39.6%, and a large payout may result in other tax complications, including a 3.8% surtax on net investment income (NII).

And if you're younger than age 59½, you also may owe a 10% early withdrawal tax, unless an exception applies. You might not have to pay this penalty if you need the money for a divorce settlement or medical expenses, for example.

2. Arrange a series of payments.

If your plan allows it, you might set up a system of periodic payments you receive on a monthly, quarterly, or annual basis. You also can simply withdraw money when you need it.

By taking distributions gradually,

beneficiaries. The trust becomes irrevocable when you die.

The main advantage living trusts have over wills is that the property transferred to the trust doesn't have to go through probate. Depending on the state in which you live, probate can be time-consuming. In addition, unlike a will, a living trust isn't available to public inspection, ensuring complete privacy with respect to the assets it holds and distributes.

But don't assume that a living trust is a panacea. It will require some time

you spread out your tax payments and may pay less. For example, suppose that a lump-sum distribution would push you into the top 39.6% bracket—whereas with a series of payments, you may be taxed at a 35% rate or lower. This also could reduce your exposure to the NII surtax.

3. Roll over to an IRA.

Another option is to transfer funds from a 401(k) to a traditional IRA in your name. As long as the rollover is completed within 60 days, you won't owe tax on the distribution, and you also won't be subject to the 10% penalty tax. In effect, you can take an interest-free loan from your savings for two months, although 20% of any money you withdraw will be withheld for potential taxes. If you repay the funds on time you can recoup that money when you file your tax return. If you miss the 60-day deadline, however, you'll owe income tax on the full amount.

A safer approach may be to use a trustee-to-trustee transfer, in which your funds go directly from the 401(k) to the IRA—your hands never touch the money—and there are no taxes.

If you roll over funds from your

and work on your part to make all of the necessary arrangements. Also, if you devise a "pour-over will" to catch assets not in the living trust, the will must be probated anyway. Finally, despite some claims to the contrary, there are no estate-tax benefits for property transferred to a living trust.

Clearly, a living trust may provide valuable benefits, but it usually works best hand in hand with your will. We can help you work with your attorneys to find a solution that works for you. ●

401(k) to a Roth IRA instead of a traditional IRA, you'll owe tax on the amount of the conversion, just as if you'd transferred money from a traditional IRA to a Roth.

4. Roll over to a new 401(k). If you're changing jobs and your new employer provides a 401(k), you may be allowed to transfer your savings

into a 401(k) account sponsored by the new employer. Your new company also might offer the option of converting to a Roth 401(k)—here, too, you would owe income tax on the amount you convert

to a Roth account.

This kind of rollover also must be completed within 60 days to avoid tax liability. A trustee-to-trustee transfer may be your simplest choice.

In deciding where or whether to move your savings, you may want to compare the investment offerings of the various possibilities. For instance, you might opt to use an IRA if it provides more investment flexibility or better selections than you'd get in the new employer's plan.

5. Keep the funds where they are. Finally, your existing 401(k) might let you leave your money where it is. This option has been discouraged in the past, because you no longer work for the employer and might have concerns about access to your account, but recently it has become more common.

Once again, your preference may depend on the investment choices available through your plan. If you've had good success with the investments in your old employer's plan, you might decide to stay the course. At the very least, you can retain the status quo until you decide on your next step.

Of course, everyone's situation is different. Your financial advisor can help you analyze the particulars of each option so that you can make an informed decision. ●



IRS Closes Valuation Loopholes

The IRS has issued new proposed regulations for valuations of business interests under Section 2704 of the tax code. These long-awaited regulations are designed to close several loopholes for federal estate and gift purposes.

Section 2704 and its accompanying regulations govern the tax treatment of transfers of business interests. Currently, lapses of voting or liquidation rights are treated as transfers in excess of the fair market value (FMV) of all interests held by the transferring taxpayer after the lapse. A “liquidation right” is the right to compel the business entity to acquire all or part of the taxpayer’s equity interest. The lapse of such a right generally occurs when the right is restricted or eliminated. This is referred to as an “applicable restriction.”

However, under an exception in the existing regulations, a lapse generally isn’t subject to this rule if the right isn’t restricted or eliminated. In effect, this means that a lifetime transfer of a minority interest by the majority owner taxpayer is not treated as a lapse, even though the

transfer results in the loss of the liquidation right.

Accordingly, a deathbed transfer may reduce the valuation of a business interest, because the “applicable restriction” is disregarded.

The IRS is cracking down on this technique. It maintains that such transfers have “minimal economic effects,” but result in valuations lower than the value of the interest in the hands of the taxpayer prior to death or the heirs immediately after death. Also, it believes the Section 2704 regs have been rendered ineffective by state law changes, court cases and estate planning techniques avoiding Section 2704.

The proposed regulations include the following provisions:

- The exception should not apply when the transfer resulting in the loss of power occurs on the taxpayer’s deathbed. Therefore, transfers occurring within three years of death that cause a lapse in the liquidation

right will be treated as transfers occurring upon death.

- The proposed regs remove the exception that limits the definition of an “applicable restriction.” If an applicable restriction is disregarded, the FMV of the transferred interest will be determined under general valuation principles.



- The proposed regs add a new class of restrictions for family-controlled entities that would be disregarded under Section 2704. Exceptions for applicable restrictions would continue to apply to this new class.

- The regs clarify that Section 2704 applies to most business entities, including corporations, partnerships and limited liability companies (LLCs).

These new rules will become effective when final regulations are issued. If the valuation of your business interest may be affected, contact your professional advisor immediately. ●

Identifying Investment Risk

(Continued from page 1)

inflation-protection bonds. History has shown, however, that holding even a modest equity stake may increase returns without undue risk when compared to a pure fixed-income portfolio.

2. Emotional risk. It’s easy to let emotions rule decision-making. Almost everyone is subject to bouts of fear and greed, and investors have an innate tendency to be overconfident about their ability to choose winning positions. But simply doing what feels right—or avoiding what feels wrong—can lead to adverse results.

Consider an investor who sits on the sidelines during a bull market, nervous about following the crowd—a

tendency that indeed can be counterproductive. But finally the investor gets tired of losing out and jumps in, buying at the top of the market and without carefully considering the fundamentals of particular investments. Others get into trouble when the market is falling and they sell solid holdings in a panic, losing out on the chance to benefit when they rebound.

The best protection against emotion is to have a carefully considered investment plan and to try to stick with it even when markets are highly volatile. Having a balance of bond funds for stability and income and stocks for growth can help smooth out inevitable market bumps.

How do you manage risk?

Everybody has a different risk

tolerance. A good approach for managing yours is to stick to investment fundamentals. That may be as simple as refocusing on the key principles of diversification and asset allocation.

Diversification spreads your investments over a broad mix of asset classes, an approach that has the potential to reduce risk. Asset allocation is the process of assigning percentages to those asset classes based on your particular needs and risk tolerance, and then rebalancing your holdings regularly to keep them close to their assigned allotments.

There’s no way to avoid risk completely, but you still can generate earnings while staying within your comfort zone. We’re here to provide guidance. ●