



# PARTNERS

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## WEALTH MANAGEMENT

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## Countdown To Retirement: Seven Steps To Get Ready

**A**re you among the millions of Baby Boomers counting down the days to retirement? Before you move into the next stage of life, it's important to get all of your financial ducks in line. To prepare yourself, consider these seven practical suggestions.

1. Rebuild the budget. You've probably been living on a monthly budget that takes into account your usual expenditures and income. But that's about to change in a big way. For example, once you stop working, your expenses for a business wardrobe and commuting will also end, but so will the regular paychecks you've been living on.

Come up with a new plan. Identify what you expect to have coming in and going out. Remember that you won't be able to rely on 401(k) deferrals to reduce your taxable income after retirement, but you should still keep saving.

2. Zone in on a homestead. You could be planning to pull up stakes and move to a smaller home, perhaps downsizing from the place where your kids grew up and you might hope to end up in a warmer climate or in a less expensive area (or both). Or perhaps you're contemplating a move to a retirement community. But this kind of upheaval isn't for everyone, and you just might decide to stay put. In any event, your choice will affect numerous other aspects of retirement.

Also, don't assume that you and your spouse share the same vision. If you haven't talked about it yet, bring up the subject before you call it quits.

3. Review your investments. As you head into the home stretch before retirement, compile a list all of the investment assets you own, including amounts parked in taxable accounts, bank savings or checking accounts, and



tax-favored retirement accounts such as 401(k)s and IRAs. Consider whether you will want to keep retirement plan assets where they are when you retire or consolidate them

into other accounts. Similarly, consider the best use of life insurance policies.

One thing to think about is whether to convert your traditional IRAs to a Roth IRA. Although the conversion is taxable, your future withdrawals from the account will normally be tax-free. Check with a professional to crunch the numbers.

4. Settle on Social Security. If you retire before full retirement age (FRA)—age 66 for most Baby Boomers—you'll receive less in monthly Social Security benefits. You can apply for benefits as early as age 62. Waiting until after you reach FRA, on the other hand, can result in bigger monthly benefits. The longer you wait, until you turn 70, the larger your benefit checks will be.

But if you and your spouse will both receive Social Security payments, there

## Performance Expectations

**H**ave you ever thought about the impact your investment expectations have on your ability to be patient and disciplined enough to achieve your long-term financial goals? It is great to have a financial plan but if you allow your emotions to dictate your actions it can have an undesirable end result.

Here are some helpful thoughts to consider when evaluating your own investment expectations:

- Investing in equities (stocks) will return more than safer investments like Treasury Bills
- All stocks do not have the same expected returns
- Certain categories of stocks have higher expected returns than other (*For instance, expected returns are higher for smaller stocks, value stocks and stocks with better profitability characteristics.*)
- Expected returns can appear over long periods of time but, keep in mind, they are not guaranteed
- Expected returns can be negative some years and sometimes for longer periods of time (*similar to what occurred in the US from 2000-2009*)
- The probability of earning a positive return increases with longer time horizons
- There are sensible and empirically sound ways to increase expected returns but expect periods of underperformance along the way

Thought leadership is just another benefit your financial advisor can provide.

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# Giving More To Loved Ones – Tax-Free

**W**hile it may be better to give than to receive, as the adage contends, both givers and receivers should be happy with the new tax law. The annual amount you can give someone tax-free has been raised to \$15,000, from \$14,000 in 2017.

Exempting \$15,000 annually from gift tax, over time, transfers a lot of wealth to those you care about during your lifetime, while avoiding the tender mercies of the tax man, and married couples can have double the fun.

Take the example of a husband and wife with three married children and six grandchildren. The husband can give \$15,000 each to his married children and the same amount to their spouses, and also \$15,000 to the half-dozen grandchildren — totaling \$180,000 — and his wife can do the same for the same 12 beneficiaries. The grand total is \$360,000 per year. No federal tax will be levied on these transfers of your wealth to family as well as friends.

In addition, you can give more than the annual exemption caps for college savings. The Tax Cuts and Jobs

Act (TCJA) permits bunching five years of \$15,000 annual gifts into one year, by plugging it into a 529 college savings plan for a child or grandchild. That's \$75,000 in total. Assets in 529 savings plans grow tax-free, if used to pay qualified education expenses.



Gifts made during your lifetime reduce your exemption from tax on your estate. The TCJA more than doubled the estate tax exemption in 2018 from \$5.5 million to \$11.2 million for individuals, and from \$11 million to \$22.4 million for couples. All of these new levels will increase with inflation, though the formula annually adjusting inflation is less

generous than before.

Lifetime gifts can be made directly or through trusts. With a trust, you place the gift of cash, securities, or other assets in an entity set up to make the transfer of wealth after you die. The assets in the trust avoid probate court, and makes the transfer faster, less costly, less likely to be contested, and generally more sure-footed. Trusts can influence the values of your progeny by requiring the money you leave to be spent for religious, philosophical, or any variety of educational activities.

A trust also shields assets left to your heirs from lawsuits and business creditors. Should your grandchild get divorced, the trust money is shielded.

The friendlier tax treatment of transfers under the TCJA affects your estate plan and how your assets will be spent after you are gone, but it also may change your plan for gifting during your lifetime. Giving assets during your lifetime can be satisfying because you can witness your impact and influence on the future of your family. ●

## Key Facts On Deducting Medical Expenses

**M**edical expenses can run up your expenses a lot. For that reason, the new tax law gives people a break by sweetening the long-time tax deduction for health care, at least for a couple of years.

Before the Tax Cuts and Jobs Act (TCJA), you could deduct medical expenses that exceeded 10% of your adjusted gross income (AGI). For the tax years of 2017 and 2018, the TCJA lowered the threshold to 7.5%. AGI is taxable income minus all deductions, IRA contributions and student loan interest. Of course, the medical tax break is available only to people who itemize.

The trouble is the more generous deduction expires after 2018, when the threshold rises back to 10%. Groups like AARP are lobbying in Washington to get the 7.5% level extended or made permanent, and that could factor into your timing and decisions about medical expenses in the months ahead.

Say your AGI is \$45,000 and you rack up \$5,475 in medical costs. You multiply \$45,000 by 0.075 (7.5 percent) to get your deduction threshold of \$3,375. Only medical expenses above \$3,375 would be deductible. Result: your medical expense deduction is \$2,100 (\$5,475 minus \$3,375).

Some big-ticket items are deductible medical expenses, like long-term care insurance premiums, nursing home payments and Medicare costs — including Medicare Part B, Medigap policies, Medicare Advantage programs and Part D Prescription plans.

In addition, any health insurance you pay out of pocket can be deducted. But that can't include coverage you pay for with before-tax dollars, which is often the case with employer-sponsored medical plans.

Another big deductible item is co-payments for prescription drugs — and also out-of-pocket fees for doctors,

# Soaring Stocks Raises Importance Of Diversifying

The concept of diversification is vital to investors: Don't put all your eggs in one basket so they won't all get smashed if you trip and fall. It's better to spread your wealth over a broad financial spectrum of investments, but avoiding pitfalls isn't as intuitive as it may seem. This is especially important to remember when stocks are soaring and portfolios can get

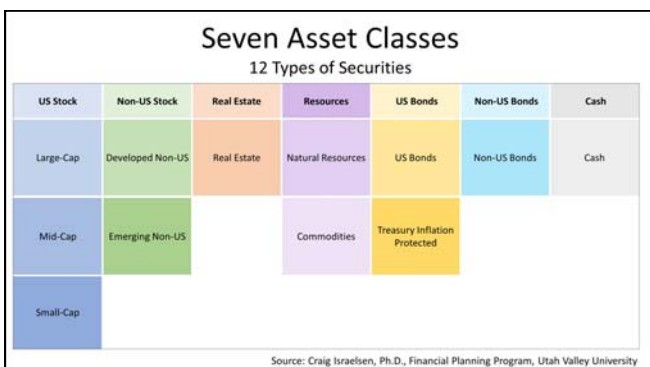
In 2008, when the financial crisis hit, many investors held portfolios loaded up on U.S. stocks. That year, the S&P 500 fell 38%. If more of their holdings had been in bonds, particularly U.S. Treasuries, the crisis would not have hurt their portfolios as badly. The Bloomberg Barclays U.S. Aggregate Bond Index, representing U.S. Treasuries, corporates and other

portfolio surviving longer.

A portfolio spanning seven asset classes and allocated equally across 12 different types of securities provides an example of the rigor, discipline, and wisdom of diversification. Stock mutual funds or exchange-traded funds diversify a portfolio across indexes of large-, small- and mid-sized companies, as well as different types of bonds.

Funds and ETFs, whose holdings mimic indexes to represent broad categories of stocks or bonds cost about 1% a year less than an actively managed mutual fund or ETF. Saving 1% in investment expenses may not sound like much but, it adds up over the long term, due to the magic of annual compounding once hailed by Albert Einstein "as the eighth wonder of the world."

Another way of looking at a diversified portfolio is as a pie apportioned in slices. In this example, the



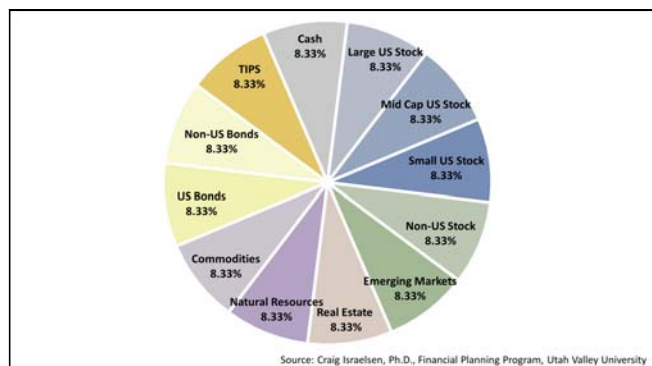
overloaded with stocks and human nature is to get greedy and overly optimistic about a continuation of the current trend.

Retirement investors sometimes think broadening asset allocation is as easy as plunking 401(k) contributions into a fund investing in the Standard & Poor 500, which is called a "broad market index." But 500 stocks is not a diversified portfolio. It diversifies exposure in a single asset class — namely, large U.S. companies with a market capitalization of more than \$10 billion. That's not a broadly diversified portfolio.

investment-grade bonds, gained almost 6% in 2008, as stock investors scrambled to a less risky place for their money.

Diversification is like salsa. You can't make it with tomatoes alone. You blend in onions, garlic, cilantro and jalapeno to create the right recipe for you. Diversifying requires adding more than large-cap stocks.

The classic meat and potatoes portfolio of stocks and bonds became popular in the 1930s. The same way we've learned since then that adding vegetables and salads improves your odds of good health, increased understanding of finance tells us adding additional types of assets to a portfolio improves the odds of a retirement



portfolio is comprised of 12 equal slices of different types of securities. In practice, the apportionment can be tweaked to suit your risk tolerance and personal taste.

Periodically, one component of your portfolio is bound to outperform its historic norm. An 8.33% position grows in value to represent 10%, 12%, or more of the total portfolio and other allocations shrink. Correcting these imbalances periodically recalibrates your portfolio to your goals and preferences. Rebalancing is another mathematical wonder.

The bottom line is that a low-expense quantitative discipline for managing a portfolio, when combined with personal financial planning to pay for long-term goals, does not guarantee you will get everywhere you want to go in life. But it gives you a clear road map to improve your chances for getting there. ●

dentists, physical therapists and other health-care professionals not covered by Medicare or any other health insurance. Add in prescription eyeglasses, hearing aids and wheelchairs, and transportation costs to

and from medical appointments, as well as alcohol and drug treatment programs.

Medical expenses are deductible only if they alleviate or prevent a physical or mental defect or illness, including dental and vision. So, you cannot deduct a gym membership if it is to promote your general wellness. However, if a doctor diagnoses you with a specific medical condition, such as obesity or hypertension, then the expense of the prescribed treatment may indeed be tax-deductible, including a gym membership. ●



# Qualifying For The New Business Owner Tax Break

**U**nder the new tax law, business owners are entitled to deduct 20% of “qualified business income.” The test for qualifying for a tax break on 20% of business income is defined in the Tax Cuts and Jobs Act (TCJA) and summarized here along with a simple illustration.

If you formed your BUSINESS as a sole proprietorship, S corporation, partnership, LLC or similar pass-through entity, you are entitled to the deduction. C corporations don’t qualify for the 20% deduction. Only businesses generating income not taxed at the company level, but directly to the owner.

Qualified business income is the business’ day-to-day, non-investment income. It’s revenue the business generates minus expenses.

QBI doesn’t include interest, dividend income or capital gains on a property sale. Nor does QBI include salary or wages paid either as W-2 wages from an S

corporation or guaranteed payments from a partnership.

However, the 20% deduction is limited to the lesser of:

- 20% of qualified business income, or
- 50% of the total W-2 wages paid by the business.

A separate limit based on the unadjusted basis of certain business assets could also apply, a rare situation.

More important: The 50% W-2 wage cap kicks in when a couple filing jointly has a total taxable income of more than \$315,000 (\$157,500 for singles).

Here’s an illustration of a couple who owns a business with \$200,000 in qualified business income, with no real assets, such as vehicles or real estate, and with one employee who was paid \$50,000 in 2018. The couple would be entitled to QBI deduction of \$40,000. That’s 20% of \$200,000.

Because the couple’s taxable income is less than \$315,000, the wage limitation — 50% of wages paid to their employee — is equal to \$25,000 and would not apply.

Some business owners with more than \$315,000 in QBI may want to consider reducing their W-2 wages or

guaranteed payments to qualify for the deduction, but this requires careful planning and personal consulting beyond this simple illustration. The rules are new and technical, and before changing how your business pays you to qualify for the 20% QBI deduction, it’s prudent to contact us and plan properly. ●

**QUALIFYING FOR THE NEW BUSINESS OWNER DEDUCTION**

A married couple with \$200,000 in business income, who paid employee wages of \$50,000, would be entitled to a \$40,000 deduction.

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## Countdown To Retirement

*(Continued from page 1)*

will be other factors to consider. For instance, a higher-earning spouse might wait longer to claim benefits to provide greater protection for a surviving spouse if the higher-earning spouse dies first.

### 5. Learn all about Medicare.

Usually, retirees opt to be covered by Medicare once they become eligible at age 65. But you will have a number of options to consider, so it’s best to familiarize yourself with the key elements of Medicare before then. Estimating your future out-of-pocket costs, including premiums, deductibles, and prescription drug costs will help you decide which Medicare benefits to opt for and whether you’ll need to supplement Medicare with coverage

from a private insurance plan. Try to investigate all of the possibilities before the time comes to make your decisions.

### 6. Develop a draw-down strategy.

Control the distribution of funds in your retirement by deciding which accounts you want to tap first. Although everyone’s circumstances are different, often the best plan is to withdraw funds from your taxable accounts first (because you’ll owe only capital gains taxes, which are usually much lower than taxes on distributions from 401(k)s and traditional IRAs), then from those other tax-deferred accounts, and finally from your Roth IRAs. This sequence enables you to benefit from tax-free compounding of

investment income within a Roth for as long as possible.

But taxes aren’t the only consideration. You may have other reasons for withdrawing funds from some accounts and holding onto others.

### 7. Meet with your financial advisor.

As you can see, you’ll be facing some difficult decisions during your countdown to retirement, and the financial consequences can be significant. But you don’t have to do it all by yourself.

Schedule a meeting with your advisor to assess and review your situation well before your expected retirement. The countdown to retirement won’t be as nerve-wracking if you’re well prepared. ●

