SilverStar Insights

for your wealth

By Tim Hudson, CFP®, CLU, ChFC, CRPS® April 2018

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In our *SilverStar Insights* newsletter, we combine our tax planning reports, financial market commentary, and other important financial news into a single quarterly publication throughout the year.

In our last newsletter, we provided the ***2018 Tax Planning Guide***. If you missed it, you can view a copy on our website, www.SStarFinancial.com under *Resources* and *Quarterly Newsletters*, or email our office and we will be glad to send you a copy.

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Market View

2018 started out with strong growth, only to see the return of normal market volatility which was absent in 2017.

1st Quarter 2018 Performance of Capital Markets	
S&P 500 - The S&P 500 (Standard & Poor's Index) is a stock market index containing the stocks of 500 American corporations with large market capitalization that are considered to be widely held.	**-0.76%**
Barclays U.S. Aggregate Bond – The Barclays U.S. Aggregate Bond Index is an index of U.S. dollar denominated, investment-grade U.S. corporate, government and mortgage-backed securities.	**-1.46%**
MSCI EAFE – The MSCI EAFE serves as a benchmark of the performance in major international equity markets as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia.	**-1.53%**

Source: Morningstar (Performance from 1/1/18 to 3/31/18)

One issue responsible for bringing back normal market volatility was the aluminum and steel trade tariffs President Trump imposed on imports. Some of our favorite trade partners, Canada, Mexico, the European Union, and others, were excluded from the tariffs, with the intended target being China due to their longstanding unfair trade practices and theft of intellectual property. China has responded by expanding their existing tariffs on U.S. pork and other agriculture products. Many feel that both sides will likely realize that no one wins in a trade war, especially China when they export five times more to the U.S. than they import from the U.S.

Trade tariffs will continue to create headlines in the days to come, but some feel it brings to the forefront the long-ignored unfair trade practices that have been in place for decades. This new awareness of the issues may start to bring better equality of trading going forward.

Next month, this economic expansion will surpass the second longest economic expansion on record (106 months) from the 1960s.[1] Many feel we have experienced this long recovery period because it has been a much slower recovery compared to others in the past.

As we enter a late business cycle, we need to be reminded that economic and market fundamentals drive markets, not time periods. City National Rochdale reports, "the investment landscape is growing more challenging and will likely become more volatile as investors adjust to a more typical late-stage expansion environment of higher inflation, rising interest rates, and less accommodative monetary policy. None of this means there are not more worthwhile gains ahead for investors, but it does highlight the value of active management and the need for investors to become more selective."[2]

JP Morgan suggests, "The economy is entering 2018 in a sweet spot: Unemployment is at a 17-year low, and the stock market's record-setting bull run created more than $7 trillion in new wealth last year, generating a surge in consumer spending. Despite years of above-trend growth, inflation remains tame, a likely sign that the current business cycle still has room for further expansion."[3]

The individual and corporate tax savings from the 2017 Tax Cuts and Jobs Act should also have an important impact in the form of more consumer spending and corporate expansion.

We have many reasons to remain optimistic for 2018, but we need to always remind ourselves that our portfolios should always be properly allocated and diversified according to our unique situation, risk tolerance, time horizon, and investment objectives.

Asset Allocation is Different from Diversification

Many investors, and even some advisors use the terms asset allocation and diversification interchangeably, but they mean different things.

Asset allocation is dividing investment portfolio into many different asset classes that may not be perfectly correlated, meaning they do not necessarily go up and down together. ***The goal of asset allocation is to optimize the mix of various asset classes to help maximize investment returns while minimizing investment risk according to the investor's risk tolerance, time horizon, and goals.*** By minimizing the downside risk of a portfolio, you may have fewer losses to recover from, and therefore, a higher starting point for the opportunity to set new highs in a market recovery. There are five major asset classes and dozens of sub-asset classes that can and should be used in portfolio design. The five major asset classes are stocks, bonds, real estate, commodities, cash, and derivatives.

Diversification is owning different securities within each asset class. We have all heard the adage, "don't put all of your eggs in one basket." We should put our "eggs" in many different securities within each asset class. ***The goal of diversification is to spread the risk between various companies/investment securities within each asset class.***

My favorite analogy is baking a pie. You have many different ingredients (asset classes) in the recipe. Each ingredient by itself can do very little and may taste bitter or sweet because they are not correlated with each other. But when you combine them, they make a tasty pie. If you were to incorporate diversification in this analogy, you would use different name brands (securities) within each ingredient (asset class) to diversify the risk within each asset class.

Asset Allocation is the foundation of investment planning and requires you to examine your tolerance for risk, time horizon, and your goals for the money invested to determine an appropriate allocation for you. A Sample allocation is shown in Figure 1.

1 Tracking the U.S. Business Cycle, Alphalytics Research, (March 2018)
2 On the Radar, City National Rochdale, (April 9, 2018)
3 Glassman, Jim, "6 Key Economic Trends for 2018," JPMorgan.com (accessed April 13, 2018)

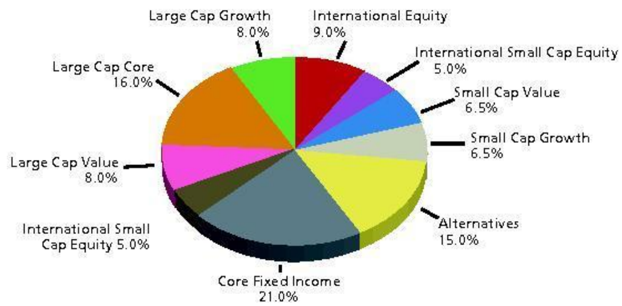

Figure 1. Sample Asset Allocation (not a suggested allocation)

It is unfortunate that many people do not realize the importance of asset allocation and diversification until they experience a large market down turn and major losses in their portfolios. It is far better to be proactive in your planning rather than reactive.

In wealth management, it is also important to incorporate tax and estate planning with your asset allocation to minimize taxes when possible. Since certain investments can generate favorable long-term capital gain and qualified dividend tax treatment, we may want to have more of these investments outside of 100% taxable accounts such as Traditional IRAs and 401(k) plans. And, you may want to keep your more aggressive asset classes in your Roth account since it may experience the most growth and may be tax-free.

If you are planning on leaving your children your investments, a careful analysis should be considered by first knowing the highest marginal tax bracket of you and your beneficiaries. Knowing this will help determine which asset you should spend down and which assets to leave to next generation for tax efficiency. Also, some assets receive a stepped-up cost basis upon your death which is very tax-efficient for beneficiaries.

As you can see, asset allocation is important for not only managing investment risk but also for tax and estate planning.

Financial FAQs

If I combine all of my assets into a single portfolio, would I earn more than the sum of separate accounts? Let's say you have two $500,000 accounts that earned 10% last year for each account. That would be earnings of $50,000 for each account, or $100,000 combined. If you had combined the two accounts into a single $1,000,000 portfolio that earned 10% last year, you would have earned the same $100,000.

Should I pay off my mortgage early?
It depends. If you are a very conservative investor not earning more in your investment portfolio than you pay in interest, have sufficient emergency cash on hand, and if working, are contributing the maximum to your retirement plans, then perhaps it may make sense to put extra money to the mortgage. Note: If you are 65 and have been deducting your mortgage interest and you decide to pay off you pay off your mortgage, be aware that your Medicare premiums are determined by your Adjusted Gross Income (AGI) from 2 years ago. By paying off your mortgage, you may be increasing Medicare premiums 2 years down the road if you itemize on your tax return.

If you expect to earn a higher rate of return in your investment portfolio than you pay on the mortgage, then you may not want to pay extra on the mortgage, unless doing so eliminates the Private Mortgage Insurance (PMI) which is required if your mortgage balance exceeds 80% of the value of the home.

If your mortgage interest rate is 4% and you expect to average 6% on your investment portfolio over time, then you could potentially leverage your money an extra 2% per year.

Another consideration is if you are not contributing the maximum to tax-efficient retirement accounts, then you may want to put the money there to save taxes.

It is a good thing to pay off debt, but it does not always make sound financial sense to do so.

Words of Humor

A Texan walked into a bank in New York and asked for the loan officer. The man says he is going to Europe on business for two weeks and needs to borrow $5,000.

The loan officer says the bank will need some kind of security for such a loan, so the man hands over the keys and documents for his Jaguar, parked in front of the bank. Everything checks out, and the bank agrees to accept the car as collateral for the loan. An employee drives the Jaguar into the bank's underground garage and parks it there.

Two weeks later, the man returns and repays the $5,000, plus $15.41 in interest. The loan officer says: "We are very happy to have had your business, and this transaction has worked out very nicely, but we are a little puzzled. While you were away, we checked you out and found that you are a rich man. You have a good-sized house in up-state New York, a sizable investment portfolio and no debt at all. We are curious as to why you would bother to borrow $5,000?"

The Texan replied: "Where else in New York City can I park my car for two weeks for just $15 and expect it to be there when I get back?"

Source: Snopes.com

Retirement Series Webinars

Wednesday, May 16th at 12:00 noon

Savvy Social Security Planning: What Baby Boomers Need to Know to Maximize Retirement Income

- When should I apply for Social Security?
- How can I maximize my benefits?
- 5 factors to consider when deciding to apply for benefits
- When it makes sense to delay benefits and when it does not
- Innovative strategies for coordinating benefits with your spouse
- How to coordinate Social Security with your other forms of retirement income

The decisions you make today can have a tremendous bearing on the total amount of benefits you stand to receive over your lifetime.

Thursday, May 24th at 12:00 noon

How to Create Sustainable Income in Retirement

- How much income you need in retirement
- How taxes could affect you in retirement
- How to manage retirement distributions
- Why a retirement income plan is crucial
- The pros & cons of the 4 most popular withdrawal methods

Creating monthly income that lasts throughout your retirement is tricky. A wrong decision could subject you to unnecessary taxes, penalties, and inflation.

To RSVP for these webinars, please visit:

www.SStarFinancial.com/Upcoming-events

or email staff@sstarfinancial.com.

Words of Wisdom

"The most important key to successful investing can be summed up in just two words-asset allocation."

—Michael LeBoeuf

We look forward to meeting with each of you during the year as we review your personal situation and investment portfolios. Please let us know if you have any questions in the meantime.

If you know someone who could benefit from receiving this information, please let us know and we will be happy to forward them our newsletters.