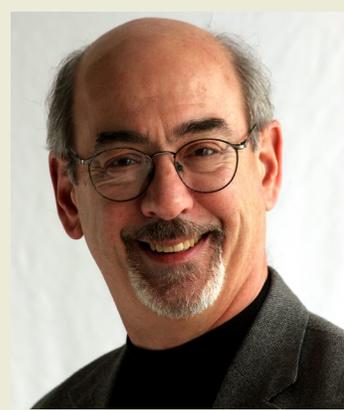


# THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life



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Well, the conventions are over, the Olympic games are complete, and the Labor Day weekend is upon us. Kate and I have the privilege of spending this last weekend of summer attending the wedding of our niece Danielle Schulz to a wonderful young man, Colin Foster, in Milwaukee. This is the first time since 1984 that we will be staying in a hotel in Milwaukee and visiting as "out-of-towners". I'm sure it will feel a bit strange even if the surroundings continue to feel very comfortable.

August has been a relatively non-eventful month in the financial markets with the biggest stir being caused by Fed comments suggesting that interest rates may be raised again soon. We'll see.

Enjoy the holiday, enjoy September, and be well!

Bruce Heling, CFP CPA  
August 29, 2016

## September 2016

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Bringing the Personal to Financial Planning

## Quiz: Test Your Interest Rate Knowledge



In December 2015, the Federal Reserve raised the federal funds target rate to a range of 0.25% to 0.50%, the first rate increase from the near-zero range where it had lingered for seven years.

Many economists viewed this action as a positive sign that the Fed had finally deemed the U.S. economy healthy enough to withstand slightly higher interest rates. It remains to be seen how rate increases will play out for the remainder of 2016. In the meantime, try taking this short quiz to test your interest rate knowledge.

### Quiz

**1. Bond prices tend to rise when interest rates rise.**

- a. True
- b. False

**2. Which of the following interest rates is directly controlled by the Federal Reserve Open Market Committee?**

- a. Prime rate
- b. Mortgage rates
- c. Federal funds rate
- d. All of the above
- e. None of the above

**3. The Federal Reserve typically raises interest rates to control inflation and lowers rates to help accelerate economic growth.**

- a. True
- b. False

**4. Rising interest rates could result in lower yields for investors who have money in cash alternatives.**

- a. True
- b. False

**5. Stock market investors tend to look unfavorably on increases in interest rates.**

- a. True
- b. False

### Answers

**1. b. False.** Bond prices tend to *fall* when interest rates rise. However, longer-term bonds may feel a greater impact than those with shorter maturities. That's because when interest rates are rising, bond investors may be reluctant to tie up their money for longer periods if they anticipate higher yields in the future; and the longer a bond's term, the greater the risk that its yield may eventually be superceded by that of newer bonds. (The principal value of bonds may fluctuate with market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost.)

**2. c. Federal funds rate.** This is the interest rate at which banks lend funds to each other (typically overnight) within the Federal Reserve System. Though the federal funds rate affects other interest rates, the Fed does not have direct control of consumer interest rates such as mortgage rates.

**3. a. True.** Raising rates theoretically slows economic activity. As a result, the Federal Reserve has historically raised interest rates to help dampen inflation. Conversely, the Federal Reserve has lowered interest rates to help stimulate a sluggish economy.

**4. b. False.** Rising interest rates could actually benefit investors who have money in cash alternatives. Savings accounts, CDs, and money market vehicles are all likely to provide somewhat higher income when interest rates increase. The downside, though, is that if higher interest rates are accompanied by inflation, cash alternatives may not be able to keep pace with rising prices.

**5. a. True.** Higher borrowing costs can reduce corporate profits and reduce the amount of income that consumers have available for spending. However, even with higher rates, an improving economy can be good for investors over the long term.

## How to Get a Bigger Social Security Retirement Benefit



Sign up for a my Social Security account at [ssa.gov](http://ssa.gov) to view your online Social Security Statement. It contains a detailed record of your earnings, as well as benefit estimates and other information about Social Security.

<sup>1</sup> Social Security Administration, Annual Statistical Supplement, 2015

Many people decide to begin receiving early Social Security retirement benefits. In fact, according to the Social Security Administration, about 72% of retired workers receive benefits prior to their full retirement age.<sup>1</sup> But waiting longer could significantly increase your monthly retirement income, so weigh your options carefully before making a decision.

### Timing counts

Your monthly Social Security retirement benefit is based on your lifetime earnings. Your base benefit--the amount you'll receive at full retirement age--is calculated using a formula that takes into account your 35 highest earnings years.

If you file for retirement benefits before reaching full retirement age (66 to 67, depending on your birth year), your benefit will be permanently reduced. For example, at age 62, each benefit check will be 25% to 30% less than it would have been had you waited and claimed your benefit at full retirement age (see table).

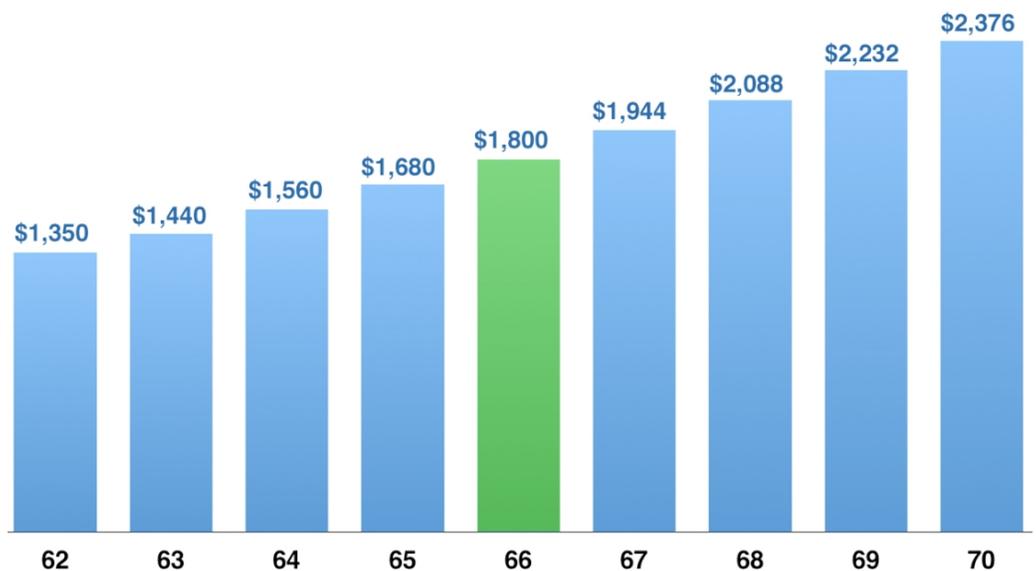
Alternatively, if you postpone filing for benefits past your full retirement age, you'll earn delayed retirement credits for each month you wait, up until age 70. Delayed retirement credits will increase the amount you receive by about 8% per year if you were born in 1943 or later.

The chart below shows how a monthly benefit of \$1,800 at full retirement age (66) would be affected if claimed as early as age 62 or as late as age 70. This is a hypothetical example used for illustrative purposes only; your benefits and results will vary.

Birth year	Full retirement age	Percentage reduction at age 62
1943-1954	66	25%
1955	66 and 2 months	25.83%
1956	66 and 4 months	26.67%
1957	66 and 6 months	27.50%
1958	66 and 8 months	28.33%
1959	66 and 10 months	29.17%
1960 or later	67	30%

### Early or late?

Should you begin receiving Social Security benefits early, or wait until full retirement age or even longer? If you absolutely need the money right away, your decision is clear-cut; otherwise, there's no "right" answer. But take time to make an informed, well-reasoned decision. Consider factors such as how much retirement income you'll need, your life expectancy, how your spouse or survivors might be affected, whether you plan to work after you start receiving benefits, and how your income taxes might be affected.



## Five Things to Know About Inherited IRAs



**You are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. Spousal beneficiaries, however, may be able to assume actual ownership of an inherited IRA.**

**\*If the traditional IRA owner died after age 70½ and did not take an RMD for the year of his or her death, you must also withdraw any remaining RMD amount for that year.**

When an IRA owner dies, the IRA proceeds are payable to the named beneficiary--or to the owner's estate if no beneficiary is named. If you've been designated as the beneficiary of a traditional or Roth IRA, it's important that you understand the special rules that apply to "inherited IRAs."

### It's not really "your" IRA

As an initial matter, while you do have certain rights, you are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. You also need to calculate the taxable portion of any payment from the inherited IRA separately from your own IRAs, and you need to determine the amount of any required minimum distributions (RMDs) from the inherited IRA separately from your own IRAs.

But if you inherited the IRA from your spouse, you have special options. You can take ownership of the IRA funds by rolling them into your own IRA or into an eligible retirement plan account. If you're the sole beneficiary, you can also leave the funds in the inherited IRA and treat it as your own IRA. In either case, the IRA will be yours and no longer treated as an inherited IRA. As the new IRA *owner* (as opposed to *beneficiary*), you won't need to begin taking RMDs from a traditional IRA until you reach age 70½, and you won't need to take RMDs from a Roth IRA during your lifetime at all. And as IRA owner, you can also name new beneficiaries of your choice.

### Required minimum distributions

As beneficiary of an inherited IRA--traditional or Roth--you must begin taking RMDs after the owner's death.\* In general, you must take payments from the IRA annually, over your life expectancy, starting no later than December 31 of the year following the year the IRA owner died. But if you're a spousal beneficiary, you may be able to delay payments until the year the IRA owner would have reached age 70½.

In some cases you may be able to satisfy the RMD rules by withdrawing the entire balance of the inherited IRA (in one or more payments) by the fifth anniversary of the owner's death. In almost every situation, though, it makes sense to use the life expectancy method instead--to stretch payments out as long as possible and take maximum advantage of the IRA's tax-deferral benefit.

You can always elect to receive more than the required amount in any given year, but if you receive less than the required amount you'll be

subject to a federal penalty tax equal to 50% of the difference between the required distribution and the amount actually distributed.

### More stretching...

What happens if you elect to take distributions over your life expectancy but you die with funds still in the inherited IRA? This is where your IRA custodial/trustee agreement becomes crucial. If, as is sometimes the case, your IRA language doesn't address what happens when you die, then the IRA balance is typically paid to your estate--ending the IRA tax deferral.

Many IRA providers, though, allow you to name a successor beneficiary. In this case, when you die, your successor beneficiary "steps into your shoes" and can continue to take RMDs over your remaining distribution schedule.

### Federal income taxes

Distributions from inherited IRAs are subject to federal income taxes, except for any Roth or nondeductible contributions the owner made. But distributions are never subject to the 10% early distribution penalty, even if you haven't yet reached age 59½. (This is one reason why a surviving spouse may decide to remain as beneficiary rather than taking ownership of an inherited IRA.)

When you take a distribution from an inherited Roth IRA, the owner's nontaxable Roth contributions are deemed to come out first, followed by any earnings. Earnings are also tax-free if made after a five-calendar-year holding period, starting with the year the IRA owner first contributed to any Roth IRA. For example, if the IRA owner first contributed to a Roth IRA in 2014 and died in 2016, any earnings distributed from the IRA after 2018 will be tax-free.

### Creditor protection

Traditional and Roth IRAs are protected under federal law if you declare bankruptcy. The IRA bankruptcy exemption was originally an inflation-adjusted \$1 million, which has since grown to \$1,283,025. Unfortunately, the U.S. Supreme Court has ruled that inherited IRAs are not covered by this exemption. (If you inherit an IRA from your spouse and treat that IRA as your own, it's possible that the IRA won't be considered an inherited IRA for bankruptcy purposes, but this was not specifically addressed by the Court.) This means that your inherited IRA won't receive any protection under federal law if you declare bankruptcy. However, the laws of your particular state may still protect those assets, in full or in part, and may provide protection from creditors outside of bankruptcy as well.

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## How is GDP calculated in the U.S.?

GDP, or gross domestic product, is a measurement of the total value of all goods and services produced in the United States over a given

time period. It is used by economists, government officials, market forecasters and others to gauge the overall health of the U.S. economy.

Although there are several ways of calculating GDP, the *expenditures approach* is the most common. It focuses on final goods and services purchased by four groups: consumers, businesses, governments (federal, state, and local), and foreign users.

The calculation and a description of its components follow:

### **C+I+G+(X-M)**

**Consumption (C):** Also known as personal consumption, this category measures how much all individual consumers spend in the U.S.

**Investment (I):** Not to be confused with investments in the stock and bond markets, this is the amount businesses spend on fixed assets (e.g., machines and equipment) and

inventories, as well as the amount spent on residential construction.

**Government (G):** This category tracks the amount the government spends on everything from bridges and highways to military equipment and office supplies. It does not include "transfer payments"--for example, Social Security and other benefit payments.

**Exports (X):** This is the value of goods and services produced in the U.S. and purchased in foreign countries.

**Imports (M):** This is the value of goods and services produced in foreign countries and purchased in the U.S.

Historically, the U.S. has run a "trade deficit," which means imports have outpaced exports.

Once the final GDP values are calculated, the percentage change is calculated from one time frame to the next, generally quarter to quarter or annually. Reported quarterly by the Bureau of Economic Analysis, these percentages can influence both investment markets and policy decisions.



## What is the most important component of GDP in the United States?

We often hear in the media that consumer spending is crucial to the overall health of the U.S. economy, but exactly

how important is it? Representing approximately two-thirds of overall GDP, consumption--the almighty consumer--is the largest driver of economic growth in the United States. Of the nearly \$18 trillion in U.S. GDP (2015), American shoppers are responsible for a piece of the pie worth about \$12 trillion.

Consumption is tracked by the Bureau of Economic Analysis, and is reported as Personal Consumption Expenditures (PCE) in its monthly "Personal Income and Outlays" news release. Since the late 1960s, PCE as a percentage of overall GDP has crept up from a low of approximately 58% to nearly 70% today.

PCE is divided into goods and services. The services category typically represents the largest part of PCE, accounting for more than 65% over the past two years. Examples of services include health care, utilities, recreation, and financial services.

Goods are broken down further into durable and nondurable goods. Durable goods are those that have an average life of at least three years. Examples include cars, appliances and furniture. Nondurable goods are those with an average life span of less than three years and include such items as clothing, food, and gasoline.

Durable goods represent approximately 10% of total PCE, while nondurable goods make up about 20%.

So the next time you're out shopping, for anything from a bottle of ketchup to a new car, consider that you're doing your part to fuel our nation's growth.

Sources: World Bank.org, accessed June 2016; Federal Reserve Bank of St. Louis, 2016; Bureau of Economic Analysis, 2016