SilverStar Insights

for your wealth

By Tim Hudson, CFP®, CLU, ChFC, CRPS®

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Contact Us:

SilverStar Financial, Inc.
Located within Cy-Fair FCU
16727 FM 529 Rd.
Houston, TX 77095

(281) 477-3847

www.SStarFinancial.com

As the end of the first year under the new Tax Law approaches, we should re-evaluate our tax planning to close out 2018 and carefully consider our options for 2019. Please refer back to our January newsletter where we provided the ***2018 Tax Planning Guide*** that addresses many changes in the new tax bill effective in 2018. You can view a copy on our website, www.SStarFinancial.com under *Resources* and *Quarterly Newsletters*.

NOTICE: Please be advised that we will be changing our name to SilverStar Wealth Management, Inc. and relocating our office to the Cy-Fair Federal Credit Union location at Skinner Road (near Highway 290) in Cypress during the fourth quarter of this year. We will send notices when this change and move takes place.

Market View

2018 Year-to-Date 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.	**10.56%**
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.	**-1.60%**
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.	**-1.43%**

Source: Morningstar (Performance from 1/1/18 to 9/30/18)

U.S. stocks have been rewarded this year from a strong economy while bonds and international stocks have faced the headwinds of rising interest rates and a strong U.S. dollar.

The Tax Cuts and Jobs Act (TCJA) is fueling strong corporate earnings in the U.S. economy, driving growth stocks higher. The U.S. Gross Domestic Product (GDP) rose to 4.2% in the second quarter, from 2.2% in the first quarter of this year[1]. This growth is driving the positive economic fundamentals as this expansion is going into its ninth year—the second longest economic expansion on record.

Time will not dictate when this expansion ends; the economic fundamentals will. This expansion will continue until the economic conditions deteriorate enough to bring sufficient fear that brings about additional reductions in economic fundamentals.

1 "U.S. Economy at a Glance," *bea.gov*, (accessed October 6, 2018).

This strong current economic growth is also fueling a stronger U.S. dollar. The U.S. dollar is up 11.5% year-to-date over emerging market currencies.[2] This strength in economic activity is also creating some inflationary fears causing a steady rise in interest rates by the Federal Reserve. The increase in interest rates affects the value of bonds because as interest rates rise, bond values decrease. We witnessed an increase in bond values as interest rates dropped from the high rates of the 1980s, now the inverse is taking place as rates rise.

Trade tensions are also affecting the U.S. dollar. As The Wall Street Journal reports, "Sentiment about the U.S. currency has improved since the resolution of negotiations to rewrite the North American Free Trade Agreement, which culminated Sunday with a revised agreement, now called the U.S.-Mexico-Canada Agreement. The revised pact removes risks that higher tariffs will slow growth in the region and have an adverse effect on a number of industries, such as automobiles."[3] The trade issues with China remain.

The strong dollar, rising interest rates, and trade tensions are attracting foreign assets which are putting downward pressures on international stocks and bonds.

We believe it is important to maintain an appropriately allocated and diversified investment portfolio containing many asset classes, rather than trying to chase the returns of a single asset class. All asset classes have their turns at different times. As J.P. Morgan states, "a need for caution in the most richly-valued U.S. assets and a willingness to look overseas to areas where the value of assets has not grown so rapidly relative to the output produced."[4] International stocks are trading at values much lower than U.S. stocks and may present opportunities over time as they revert to their historical average value.

Year-end Tax Planning Guide

Year-end tax planning is essential every year, but is especially critical this year due to the new Tax Cuts and Jobs Act (TCJA). This new tax law brings many changes which should be considered before year-end, and as you approach 2019, as well as the more significant long-term picture. Many people will see a reduction of 2-4% in their marginal tax brackets with some brackets expanding to provide additional tax savings. With these tax reductions scheduled to sunset after 12/31/2015, it presents an urgent need to review the tax-saving opportunities for today and the future.

First of all, it is critical to know our current and anticipated ***Real After-Tax Net Worth*** by multiplying your pre-tax retirement account balances by your current or anticipated highest marginal tax brackets to see what you may have left after taxes.

Examples:
A pre-tax 401(k) or IRA with a balance of $1,000,000 and the owner in a 24% marginal tax bracket presents a *Real After-Tax Net Worth* of *$760,000* ($1,000,000 less $240,000 in taxes)

An after-tax Roth 401(k) or Roth IRA with a balance of $1,000,000 and the owner in any marginal tax bracket presents a *Real After-Tax Net Worth* of *$1,000,000* if the distributions are qualified—the 5-year holding period and age 59½ rules are met, then there are no taxes.

Pre-tax or After-tax Retirement Plan Contributions? The annual limits for 401(k), 403(b), and 457 (pre-tax and Roth after-tax) retirement plans are $18,500 plus a catch-up contribution of $6,000 for those age 50 or older.

A critical mistake for some is to be fixated on the lower pre-tax savings of today on the seed (contributions), only to be taxed later on the whole harvest (100% of the balance) when taxes may be higher.

Required Minimum Distributions (RMD) are required at age 70½ from pre-taxed IRAs, and ALL 401(k)s and 403(b)s, whether you need the money or not. The lower tax rates today should prompt many to re-examine if pre-tax is the best solution for all of their retirement investments. This decision requires careful consideration of your current and projected situation, in addition to your opinion on future tax rates. There are also numerous estate planning strategies to consider regarding your tax bracket versus your heir's tax brackets. Please consult your tax professional.

2 "Business Cycle Intelligence Report," *Alphalytics Research*, (September 2018).
3 Daniel Kruger, "U.S. Dollar Rises as Strong Data Boost Sentiment," *The Wall Street Journal,* (accessed October 3, 2018).
4 David Kelley, "Notes on the Week Ahead," *J.P. Morgan Market Insights,* (September 24, 2018).

IRA or Roth IRA contributions? The annual limits for IRAs or Roth IRAs are $5,500 plus an additional $1,000 for those age 50 and older. *You have until your tax filing deadline to make IRA contributions.*

IRA. Everyone who has "earned income" (and their spouse) can contribute to an IRA. If they participate in a retirement plan at work, their IRA tax-deducted (pre-tax) contribution may be limited or phased out depending on their Adjusted Gross Income (AGI). You cannot contribute to an IRA after age 70.

Roth IRA. Everyone who has "earned income" (and their spouse) can contribute to a Roth IRA. The eligibility is phased out for Singles with AGI of $120,000-$130,000, and for Married Filing Jointly of $189,000-$199,000. These contributions are after-tax, but distributions are potentially tax-free if the Roth IRA has been established for five years, and you are age 59 ½, or you are a beneficiary. You can contribute to a Roth IRA after age 70 with earned income if eligible. Roth IRAs do not have the RMDs.

Roth Conversions? If you are in a lower marginal tax bracket today than you expect to be in later years, then you may want to consider converting a portion of your IRA to a Roth IRA. The decision to convert requires you to know which marginal tax bracket you are in and what dollar capacity you have before you go into a higher marginal tax bracket. You must convert before year-end for the current tax year. The TCJA has disallowed Roth Conversion Re-characterizations starting in 2018, so the best time to convert may be later in the year.

The Roth IRA can provide tax-free distributions after the Roth IRA account is five-years old and you are at least age 59½ at the time of distributions. Roth IRAs also do not have the Required Minimum Distribution (RMD) requirements at age 70½ as Traditional IRAs and 401(k) (Pre-tax and Roth) retirement plans have.

If converting a Traditional IRA to a Roth IRA, you will owe ordinary income taxes on any previously deducted Traditional IRA contributions and on all earnings. A conversion may place you in a higher tax bracket than you are in now. Because Roth IRA conversions may not be appropriate for all investors and individual situations vary, we suggest you discuss tax issues with a qualified tax advisor.

Charitable Contributions? There are numerous ways to make tax-efficient charitable contributions to non-profit organizations before year-end for tax savings.

Donation of Cash. Cash contributions are tax-deductible up to 60% Adjusted Gross Income (AGI).

Donation of Capital Gain Property (stocks and land). Appreciated investments that you have owned for over one year can be donated to a charity that will avoid taxable gains. You will be able to deduct the value of the stock up to 30% of your AGI and carry forward excess amounts. If you owned the stock for less than one year, your deduction will be limited to your cost basis—what you paid for it. If the stock is below its cost basis, you may want to sell the stock and write off the loss and then donate the cash for a cash contribution deduction.

Donor Advised Funds (DAF). An immediate tax-deduction is available to those who donate to a DAF without having to determine where or when charitable donations are made.

Qualified Charitable Distributions (QCD). Individuals age 70½ can make a QCD directly from their IRA to charity up to $100,000 per tax year, satisfying all or a part of their RMD, while avoiding the taxation on the amount distributed to charity. The payment MUST be payable directly from the IRA custodian to the charity.

Standard Deduction or Bunched Deductions? With the Standard Deduction for individuals being raised from $6,350 in 2017, to $12,000 in 2018, and, married filing jointly going from $12,700 in 2017, to $24,000 in 2018, makes it more challenging to be able to exceed this amount and itemize. However, if you have sufficient deductions, bunching them may allow you to exceed this amount in one year while going with the standard amount in another.

Health Savings Accounts (HSA)s? HSAs were created as part of the Medicare Modernization Act of 2003 for those enrolled in High Deductible Health Plans (HDHP)s. Rising medical care cost is a major concern for most people. HSAs can help address this concern by allowing those participating to contribute certain amounts pre-tax to an HSA account to be used for qualified medical expenses and funds not used can be carried forward for future years. Below are the limits:

2018 HSA Contribution Limits			
Single	Single (Age 55+)	Family	Family (Age 55+)
$3,450	$4,450	$6,900	$7,900

Medical Expenses? 2018 deductible medical expenses need to exceed 7.5% of AGI, but in 2019 and beyond, this threshold will rise to 10%.

Financial FAQs

Why doesn't my investment portfolio track the S&P 500 stock index? The S&P 500 represents 500 of the largest U.S. stocks and is widely used as a barometer of the U.S. Large Capitalized (large-cap) stocks. There are many stock indices representing many different stock asset classes including large-cap, mid-cap, small-cap, global, and international stocks. Some indexes focus on value stocks while some focus on growth stocks, or a combination.

Some stocks do better than others at certain times, and no one can accurately predict when a specific asset class will perform well. Therefore, it is essential to ensure that you have a broad exposure to many different stock asset classes, as well as other many other fixed income (bonds) asset classes to help manage volatility within your portfolio.

Harry Markowitz won the Noble Memorial Prize in Economic Sciences in 1990 with his work in Modern Portfolio Theory (MPT). MPT is a "financial theory that attempts to maximize **Portfolio Expected Return** for a given amount of **Portfolio Risk**, or equivalently minimize risk for a given level of expected return, by carefully choosing the proportions of various assets."[5]

We know that asset allocation is important because we have always heard "do not put all of your eggs in one basket." Having numerous asset classes in your portfolio can help to manage the volatility of your portfolio over time.

Humor Matters

Preacher's Wife
A couple was going on a vacation together, but the wife had an emergency at work. So they agreed the husband would go as planned, and his wife would meet him at the hotel the next day.

When the husband got to his hotel and had checked in, he thought he should send his wife a quick email letting her know he'd got there ok.

As he typed in her email address, he made a typo, and his email was sent to an elderly preacher's wife instead. It just so happened that her husband had sadly died just the day before.

When the grieving old preacher's wife checked her emails, she read the one from the holiday maker, let out an awful, loud, piercing scream, and fainted on the floor.

At the sound of her falling, her family rushed into the room. They tended to her and then looked at her computer and saw this email on her screen:

Dearest Wife,
Just checked in to my room. Everything is prepared for your arrival tomorrow.
P.S. It sure is hot down here.

Source: laffgaff.com

Words of Wisdom

"The only thing that is constant is change."
– Heraclitus, the pre-Socratic Greek philosopher

5 *PortfolioMethod.com*, (accessed October 7, 2018).