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What Is This Thing Called “MyRA”?

In his State of the Union address President Obama ordered up a new government-backed, tax-favored retirement account. Whether this really can be created simply by executive order is an unresolved question, but for now we’ll just try to describe this thing called “MyRA.”

MyRAs are targeted at workers without access to an employer-sponsored retirement plan (pension, profit sharing, 401-k, etc.). Initial availability is through such employers via payroll deduction, and eventually to anyone with direct paycheck deposit and single income under \$129,000 or household income under \$191,000.

Like a Roth IRA, interest earned in a MyRA isn’t taxed if it stays in the account at least five years. The more novel element is the underlying investment: a government guaranteed account crediting the same interest rate as the Government Securities Fund in the Thrift Savings Plan for federal employees. That particular rate has been at 2.5%, well above prevailing rates on such stable-value investments as money market funds, certificates of deposit, or U.S. Treasury bills.

However, federal employees in the Thrift Savings Plan are subject to the usual restrictions on retirement plan withdrawals, while MyRA contributors will be allowed to pull money out any time with no tax or penalty. This too is like a Roth IRA, and the same employees could certainly contribute to a Roth. In fact, a MyRA balance can be rolled to a Roth IRA any time, and must roll to a Roth once the balance hits \$15,000.

For many workers whose employers don’t offer a retirement plan, a good old deductible contribution to a traditional IRA might be a better bet. Up-front tax savings make it easier to afford the set-aside. IRA investors might end up giving back some of their tax savings if they have to withdraw money prematurely, or they might not. And having at least a little disincentive for pulling the money out can be important in building a nest egg.

In short, the only thing really new here is the tax-exempt, taxpayer-subsidized interest bump for a certain class of savers on a small amount of savings. Think of it as an emergency fund with an option to become a retirement plan. ■

30 Years In Business

Reflecting on Capital Financial Planners’ history, following are some fun facts from the last 30 years:

- Letters were written using a typewriter, though it wasn’t long before Judy introduced a personal computer to the office. Of course, PCs at that time were basically glorified typewriters and did little of what we are able to do today.
- Our stock and mutual fund research was all on paper and was out of date the moment it was received, as it arrived via the US mail.
- Stock transactions were made by phone.
- Mutual fund purchases were made by US mail.
- Eventually, we accessed stock quotes using a rooftop satellite dish that updated quotes every 15 minutes or so. A separate “receiver” with computer monitor was needed especially for this.

When we ultimately adopted broadband internet, we ditched the satellite dish in favor of real-time quotes we could receive based on our business with Charles Schwab & Co. through a quirky online program. We received a call one day from Schwab inquiring about our use of the program, at which time we learned that the program provider charged Schwab by the quote. By updating quotes for hundreds of securities every 10 seconds on multiple computers, Schwab received a bill for \$12,000 that month. Fortunately, both Schwab and we were able to laugh about it, and we moved on to a less costly online quote system. ■

Required IRA Withdrawals: To Wait or Not to Wait

A year ago we covered a special tax break for seniors who direct IRA distributions to charity. These Qualified Charitable IRA Distributions (QCDs) had been restored by the American Taxpayer Relief Act, but only for tax years 2012 and 2013. So what about this year?

The QCD provision has not been extended for 2014, but Congress has shown a propensity for sticking it back into the mix at the last minute. That can be a little awkward for those who dutifully take care of the required distribution early in the year, but would prefer to make a QCD if they could. Unfortunately, once you take receipt of an IRA distribution, it's a little hard to claim it as a QCD later.

Under the expired provision, taxpayers 70½ or older could make gifts of up to \$100,000 directly from an IRA to public charities and exclude those distributions from taxable income. This was a boon to seniors who do not itemize deductions and would like to see some or all of their required IRA distribution go to a charity rather than receive it all as taxable income.

So what's the strategy for 2014 RMDs? You might consider waiting to see if QCDs are restored. But do be sure to mark your calendar – maybe around December 1st – to take your RMD before year-end, one way or another. Failing to do so can trigger a severe tax penalty. ■

An Echo, Probably Not a Replay

Investors may be surprised by distinct echoes of the Cold War resounding from the crisis in Ukraine. It's worth reflecting on the dynamics of that era not only with respect to Ukraine, but also regarding the historic impact of geopolitics on many emerging markets. Especially for eastern Europe, Southeast Asia, and some African countries, the easing of Cold War tensions helped open the door to more rapid integration into the global economy and rising living standards.

The hope, and the likelihood, is that Ukraine is but an echo of old superpower rivalries rather than a harbinger of a new era of confrontation. The sabre rattling has been pretty one-sided as Russia shows its acute sensitivity to Western defense and economic structures extending right to its border. Time will tell whether Ukraine can find its political and economic footing given its particular internal stresses that invite exploitation by outsiders.

Unlike during the Cold War, relatively few emerging nations find themselves in that vise today, Syria and Egypt notwithstanding. Ukraine at least has established an interim government that appears committed to new national elections in May. Europe and the U.S. are showing renewed interest in helping to underwrite its success. And while Russia still holds a veto on the U.N. Security Council, its voting share on the International Monetary Fund board is less than 3%; a veto requires 15%.

Perhaps it is a sign of some progress that this confrontation may largely confine itself to the economic battlefield. Russia is a key creditor to Ukraine which is a customer for Russian gas. Russia's actions in the crisis have prompted investors to unload Russian stocks and forced its central bank to boost interest rates to stem a run on the ruble. Europe depends on Russian energy resources, but U.S. policymakers have greater flexibility due to our recent surge in oil and gas production. And that's wholly a result of commercial enterprise rather than any military or strategic planning by government.

All that said, tensions and disruption in any emerging markets tend to raise the perception of risk in all emerging markets. Last year's concerns were focused on countries that looked vulnerable to the Federal Reserve's tapering. On this score, Brazil, Turkey, India, Indonesia, and South Africa were dubbed the "fragile five." Nations are often late in making needed policy adjustments, but emerging countries' underlying fundamentals and flexible markets can quicken their response to such changes. The fragile five have made monetary and fiscal adjustments that should be constructive regardless of Fed policy. Better growth prospects and an easing of imbalances appear to be taking hold.

Now the prospect of political instability could constrict the flow of global capital into some countries' financial markets and direct investment opportunities. Venezuela and Argentina appear to have pursued destructive policies masked for a time by the major commodities boom of the 2000's. And Russia's own treatment of outside investors has been mixed at best.

Twenty-five years ago the MSCI Emerging Markets Index represented just 10 countries and 1% of global equity market capitalization. Today it covers 800 securities across 21 markets and about 11% of global market cap. Recent underperformance is simply another reminder that volatility is part of the price for some of the world's more intriguing growth opportunities. ■

Diversification: The Long and the Short of It

This quarter's Investment Performance Review falls on the fifth anniversary of the low point of the market sell-off in 2008 and early 2009. And the numbers definitely show it, especially those for mainstream stocks and real estate related funds. Large-, mid-, and small-cap equity funds show average cumulative gains of about 200% over that half decade.

This reflects the dynamics of buying low and selling high. It also reminds us of a deeply disturbing time. Everyone remembers those panicky days of the financial crisis, and the way all kinds of financial assets took a drubbing together. For many it felt like the familiar strategy of portfolio diversification had "failed" in the worst way. Students of modern portfolio theory described it as "all correlations going to 1," a bit of an exaggeration but a rude awakening nonetheless.

Last year (2013) posed a different challenge to the case for broad diversification. While mainstream equities had a stellar year, several other categories struggled. Five years ago the complaint was that "diversification didn't help." Recently it may seem like diversification was just a drag.

The most frequently cited study on this issue is Determinants of Portfolio Performance by Gilbert Beebower, Gary Brinson, and Randolph Hood. A few decades ago they parsed the performance of 91 pension plans for the period 1974-1983 and again for 1978-1987. Both studies supported the idea that the mix of assets rather than individual security selection that should be a primary focus for investors.

Concentrated portfolios can, and often do, outperform their more diversified counterparts for a while. And there are times when nearly all major asset categories struggle together. But these tend to be short-term phenomena, and the ability to time them with repeated success is a rare talent indeed.

Returning to the numbers, the 10-year column makes the point pretty effectively. Diversification does not work every time, but it tends to do its work over time. ■

Investment Performance Review Table

Investment Performance Review	TOTAL RETURN * (dividends and capital gains reinvested)			
	--- Annualized thru Apr. 21, 2014 ---			
Major Mutual Fund Categories *	1 yr.	3 yr.	5 yr.	10 yr.
Large-Cap Stocks (Core)	21.9%	13.2%	17.7%	6.8%
Mid-cap Stocks (Core)	24.4	11.6	19.4	8.4
Small-cap Stocks (Core) †	27.2	11.9	20.4	8.5
Foreign Stocks (Multi-cap) †	16.3	6.1	13.9	6.2
Emerging Market Stocks †	3.2	-2.5	12.0	9.4
Natural Resources	30.9	4.4	15.3	11.2
Real Estate Related	2.5	10.0	21.9	8.8
Flexible Portfolio	8.6	5.5	11.6	6.2
General Bond	1.0	5.4	7.3	5.9
Int'l Fixed Income †	0.4	2.4	6.7	5.1
High-Yield Taxable Bond †	6.4	7.5	14.6	7.3
General Municipal Debt	-0.5	6.5	6.2	4.0

* Source: Lipper, as reported in the Wall Street Journal, April 20, 2014.
Past performance is NOT indicative of future results.

In for the Duration

The original Broadway production of A Chorus Line ran for 6,137 performances over 15 years. Predictions of higher interest rates and a blow-up in the bond market may eclipse that run one of these days. Yet higher rates seem inevitable, so what's the best play for the bond portion – the supposed bulwark – of a balanced portfolio?

We got a taste of the risk last year as long-term Treasury bonds dropped nearly 13% in value on a one-percentage-point rise in yields. So portfolio managers are keeping an eye on something called "duration." That's a measure that reflects the approximate percentage change in the market price of a bond or bond fund in the event of a one-percent change in interest rates.

The Barclays U.S. Aggregate Bond Index, the broadest benchmark for the fixed-income market, has duration in the range of five to six years. That indicates the index would take a 5-6% hit on a 1% interest rate move. Long-term Treasury bonds have duration of about 16 years, i.e., their sensitivity to rising rates is notably greater.

As rates rise, coupon interest can be reinvested at those higher rates. Total return is the combination of bond interest, reinvestment of that interest, and change in the bond's value. Considerable research indicates that across a wide range of interest rate change scenarios, a collection of bonds – perhaps a mutual fund or laddered portfolio – that maintains a moderate five-to-six-year average duration should see portfolio total return converge toward its initial yield if that portfolio is held for that period.

That also assumes a relatively high quality portfolio such as investment grade corporate or municipal bonds. The research probably didn't figure on there being many defaults in the portfolio; just moderate duration and a little patience. ■



Strong Markets Boost Giving

The Atlas of Giving reports that Americans donated \$417 billion to charity in 2013, up 13% over 2012. The stock market's performance was cited as a key factor along with rising employment, real estate values, and a general rise in confidence.

Two of the country's largest donor advised funds (DAFs) reported that appreciated securities accounted for a larger share of new contributions. That's not surprising. Lots of stocks had gains, and contributing appreciated securities is a very tax-efficient way to give.

The DAF structure adds convenience and strategic planning to one's philanthropic endeavors. Assets transferred to DAF accounts generate an up-front deduction for the market value, avoiding the capital gains tax that would be due if the securities were sold. Donors retain the ability to direct future grants to the qualified charities they support.

The Atlas of Giving also reported a significant shift of assets by wealthier donors from family foundations to DAFs to save costs and simplify administration. Another market year like 2013 may be a tall order. But a DAF can be established with a relatively modest initial contribution, just to be ready. ■