



# THE PAPYRUS

Second Quarter 2016

## Living with Your Investments in Volatile Markets

**Y**o-yo markets that are up one day, down the next, continually promising gain or loss, are among the hardest to endure. To be able to stay committed to investing in volatile markets, it helps to step back and ask yourself why you are invested and for

that matter, what exactly investing should mean.

Investing is very different than trading. Investing typically takes one of two forms. (1) We loan money to a business or entity with the expectation  
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## Not on My Watch – Keeping a Great Depression at Bay

**C**ould interest rates in the U.S. go negative? If they do, the rationale may be the memory of the Great Depression.

The Great Depression began 90 years ago in the United States as an ordinary recession in the summer of 1929. Today it is remembered primarily in old photographs and movies, and the pain has faded from public memory. The impact of the Great

Depression still lingers, however, in the minds of economists, and particularly the minds of the economists who manage the Federal Reserve Bank system. If there is one thing they do not want, it is a rerun of the Great Depression under their watch.

Trying to pin down the cause of the Great Depression has spawned countless books, but at its most basic,  
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## Debts Can Live On After You

**T**oward the end, my grandfather paid for everything with a credit card, explaining that if he died, it would be like getting everything free. While great in theory, it only works that way if you die broke or else are very careful how your debts are structured. Dying doesn't always mean the end of your debts. After your death, your estate is expected to settle your debts before assets go to your heirs. Creditors always come first.

If someone has co-signed or acted as a guarantor on one of your loans, they are responsible for the balance after you die. Spouses are also responsible for paying off your debts on joint accounts, regardless of whether they had anything to do with the account. If your spouse is just an authorized user, they will not be required to pay your credit card debts provided you do not live in a "community property" state.

In states which have community property laws, any debts or assets that you've obtained after marrying are also the responsibility of your spouse, regardless of whether he or she is on the loan. Ten states have community property laws: Arizona, California, Idaho Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In Alaska, residents have the option to make their

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# Fully Fund Your Retirement Accounts for 2015 and 2016

Before April 18<sup>th</sup>, fully fund your retirement accounts for 2015, and, we would recommend that you begin to fund 2016 as well. The sooner your accounts are funded, the sooner your money goes to work for you. The table at right shows contribution limits for 2015 and 2016.

Adding to the funds you have saved for retirement has a number of big benefits. The first is that your money grows tax free. Taxes can eat away 40% or more of the earnings on your investments depending upon your tax bracket. That's a big bite out of the funds you have available to benefit from compounding over time. Active investment strategies, where short-term gains are more likely, also benefit from tax-deferral, again avoiding the erosion of funds available for compounding that might be taxed at the investor's top tax rate. Retirement accounts can also minimize the tax bite of passing assets on to heirs. Retirement accounts are protected by law from creditors. Equally important, retirement accounts tend to be "hands-off" accounts. These are funds

that investors tend to dip into only when absolutely essential, creating a

savings discipline that other account forms may lack.

Type of Retirement Plan	Maximum Annual Contributions			
	2015		2016	
	Under Age 50	50 and Older	Under Age 50	50 and Older
<b>Individual Retirement Plans</b>				
Traditional and Roth IRA	\$5,500	\$6,500	\$5,500	\$6,500
<b>Employer-Sponsored Retirement Plans</b>				
401(k), Roth 401(k), 403(b), 457 and SARSEP Plans – Employee contribution	\$18,000	\$24,000	\$18,000	\$24,000
SEP (Simplified Employee Pension) IRA	Employer contribution - 25% of compensation up to \$53,000 Employee contribution up to \$5,500 under age 50; \$6,500 over age 50		Employer contribution - 25% of compensation up to \$53,000 Employee contribution up to \$5,500 under age 50; \$6,500 over age 50	
<b>Small Business or Self-Employed Retirement Plans</b>				
Self-Employed 401k (a.k.a., Solo-401k, Individual 401k, Roth 401k)	Salary deferral of 20-25% of compensation, plus \$18,000 (under 50) or \$24,000 (over 50) in 2015 and 2016 up to a maximum of \$53,000			
SIMPLE (Savings Incentive Match Plan for Employees) IRA - Employee contribution	\$12,500	\$15,500	\$12,500	\$15,500
<b>Coverdell Education Savings Account*</b>				
Per beneficiary under age 18	\$2,000		\$2,000	
<b>Annual Gift Tax Exclusion</b>				
Amount that can be given from an individual to an individual without incurring gift taxes	\$14,000		\$14,000	

## Not on My Watch— Keeping a Great Depression at Bay — continued from page 1

people stopped spending. To limit stock market speculation, the Federal Reserve had increased interest rates, which reduced interest sensitive spending. Then the stock market crash reduced wealth and consumer spending substantially. Banking panics in the early 1930s resulted in cash hoarding that wasn't helped when the Federal Reserve also deliberately contracted the money supply and further raised interest rates. The Revenue Act of 1932 increased American tax rates greatly in an attempt to balance the federal budget, and by doing so it dealt another blow to the economy by further discouraging spending.

How bad was the resulting contraction in spending? Between the peak and the trough of the downturn, industrial production in the United States

declined 47% percent and real gross domestic product (GDP) fell 30%. (In contrast, during the next worst U.S. recession, 1981-1982, GDP fell 2%.) The U.S. experienced the near-total breakdown of a previously affluent economy for ten hard years. There was nothing romantic about the breadlines, peddlers on street corners, shuttered factories, rural poverty, and so-called Hoovervilles where homeless families sought refuge in shelters of salvaged wood, cardboard, and tin. 2.5 million people fled the Plains states as the Dust Bowl stripped topsoil from the land. Unemployment exceeded 20% in a society where 21% of the workforce was employed in agriculture.

While a combination of government policy errors worsened the decline in spending during the Great

Depression, to prevent a second Great Depression, the most common prescription is to keep people spending and limit saving. To keep people spending, the Federal Reserve has two basic strategies – (1) Promote inflation, which feeds the benefit of buying now to avoid paying more in the future. This means avoiding deflation, which would make goods cheaper the longer one waits, and potentially reduce wages. (2) Make saving unattractive.

Removing the incentive to save by dropping interest to zero or below is one tool to do so. The catch is the low interest rates have to offset consumer concerns about the direction of the economy. The slow U.S. recovery is one sign that interest rates have limited utility as consumers stubbornly continue to save and spend judiciously.

that the money will be repaid with a negotiated return or interest rate. (2) We purchase an interest in a business or property with the expectation that management will increase the value of the asset and generate income, providing a return on our investment. In both cases we are making a value judgment as to the likelihood of receiving a future return on our investment.

Trading seeks to take advantage of short-term inefficiencies in the market where return is based on changes in the purchase price of the security, whether bond or equity.

The volatility of prices in the market for debt or equity typically does not change whether or not our decision in purchasing an investment was a good one. A bond purchased from a company with the financial wherewithal to meet its obligations is not a better or worse investment if its price fluctuates in response to market volatility. A company with sound financials and good growth prospects, whose stock was purchased at a good value does not become a bad investment because the market enters a downturn. The reason is all in the word — future. If you believe the company continues to offer future potential, that the economy will grow over time, that demand will continue for the products and services the company offers, then the investment remains a valid one.

This is why buy and hold is a viable investment approach for younger investors with time to weather market volatility. One invests in good companies, whether through stocks or bonds, monitors the companies to make certain their financial and growth prospects remain good, and sells when the reasons for initially investing no longer hold true.

**The problem with a buy-and-hold approach occurs if the investor needs to sell his/her investments in the near future** to meet anticipated financial needs, whether financing an education, starting a business, retiring, or taking advantage of an opportunity that may not come along in another

year or so. The luxury of time to wait for a market recovery disappears and it becomes more important to protect the present value of the portfolio.

This is where active management plays an important role. Active management says we don't know how low the low might be. But we do know that our investor has limited ability to make up losses. We chose to limit the downside of the portfolio by moving out of the market or into lower risk positions when downside volatility increases. When the market appears to have established an uptrend, assets are moved back into desirable investments to take advantage of opportunities to build wealth through appreciation.

In yo-yo markets, active management can suffer whipsaws, short-term movements in the market that result in selling a position only to have to buy back at a higher cost. But given our inability to see the future and the need to limit losses, this is typically considered the lesser risk.

Approaching active management purely as a trading strategy is a very different investment style. The goal in this case is not to invest in good companies or bond issuers based on their future performance, but to take advantage of inefficiencies and irrational market moves to achieve profits. Maintaining a long-term commitment to a trading strategy requires knowing how the strategy works in different markets, and analyzing the current market ensure that the approach is working as it has in the past. If it isn't working, move out of the market to rethink or wait until the right environment for the success of the model is in place.

It's hardest to stay with your investing approach over the long term when you haven't really thought about why you have selected the investments you hold. Or, if you are working with an investment advisor, why your advisor has selected specific investments and what the criteria are for holding or selling. When you understand why — given it makes sense to you — it's much easier to invest through volatile

markets and still sleep at night. Which is why we encourage clients to contact us with their questions. We want to make certain they understand the reasons behind our investment approach. Investing succeeds best as a long-term approach to the market.

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## Debts Can Live On After You

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property considered community property.

Mortgages typically come due on death, unless the surviving spouse can prove financial ability and creditworthiness to take over the loan.

Death can retire federal student loans. It's about the only thing that can. But private student loans made through a bank are typically a claim against your estate.

Is there a way to assure that your heirs receive something from your estate? In most cases, life insurance policies, IRAs, 401(k)s and other tax deferred retirement accounts, along with brokerage accounts are protected from creditors as long as you correctly establish your beneficiaries. If you do not have legal beneficiaries established on your accounts, the balance goes into your estate and is subject to creditor claims.

Can you just give away your assets prior to dying to avoid the claims of creditors? Not necessarily. While you are entitled to give away up to \$14,000 per person without incurring federal gift taxes, if you do this shortly before you die, your creditors could sue the people you gave/or sold assets to at under market value claiming a "fraudulent transfer."

Given you can't take it with you, it makes sense to sit down and figure out how your heirs can take it with them in the event you die. And, it is particularly important to make certain spouses are not burdened with debt they may not be able to afford.

# A Word to Young Investors

**Y**ou have the investor's best friends at your side — Time and Compounding. The sooner you put them to work for you, the easier it will be to build wealth.

When it comes to investing, the most important tool you have is time. A relatively small investment can become a sizable retirement fund given time and the impact of compounding.

Compounding is the process of earning interest on interest and dividends on dividends, over time. At first, your money grows relatively slowly, then with increasing speed as compounding takes effect.

One of the all-time great examples of the impact of compounding is the question... Which would be the better compensation plan?

- \$100,000 per year with 10% annual increases
- One penny the first month, with your pay doubling with each successive month?

In three years, the individual who chose the \$100,000 salary with 10% annual increases would have received \$331,000 in compensation. The individual who chose the penny and saw her income double each month would have received \$343 million dollars. Naturally, that's compounding to an extreme. But the same basic

principle holds true at lower rates of appreciation.

The sooner you put your savings and investment plan into action, the longer your money goes to work for



you. And the longer compounding has to work its math, the more substantial your nest egg can become.

Suppose you start saving \$2,000 a year at age 19 and continue doing so for ten years before you stop adding to your account. At the same time, your twin waits until age 29 to start saving and then sets aside \$2,000 a year for the next 36 years until he is 65. If you both earn 7% annually on your account,

at retirement your investment of just \$20,000 will have compounded to \$337,774. Your twin will have invested more than \$74,000 but ends up with \$318,674, despite saving for 26 more years. The earning leverage of the early years made all the difference.

To enhance the power of compounding, you want to minimize the impact of taxes. After all, every dollar you pay in taxes reduces the amount you have to compound. That's why it's important to invest as much as you can in tax-deferred retirement accounts, or a Roth IRA where earnings accumulate tax free.

Understanding the value of time and compounding is one step toward accumulating a healthy retirement fund, but the most important step is to do something. Until you set up a plan of steady contributions using an investment approach that works for you, you are letting time and the value it can bring slip away.

Nothing happens unless someone does something. Whether it's for your own retirement or a young person's, call me today and let's put a plan in place to build financial security.

*The compounding examples cited above are hypothetical and used for illustrative purposes only. Investment results fluctuate and past performance is not indicative of future results. The possibility of loss exists along with the potential for profit.*



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