The Papyrus

Fourth Quarter 2014

Turn Off the Market Reports

When asked what made him a better money manager, one of America's better known portfolio managers announced that it was turning off the market news.

Turning off market chatter can also make one a better investor.

1) News isn't necessarily "reality."

The media has a lot of airtime, news print and now online publications and blogs to fill and an audience that demands answers. A market bounce or drop must be explained. Saying "*A lot of different factors went into today's market move and we will know more about it in another two weeks*" doesn't make the cut. As a result, there's a lot of guesswork to market news. It fills the demand of the moment, but not necessarily the long-term test of validity. News is always vulnerable to the sensational versus the norm. As a result, extreme viewpoints get greater coverage.

2) Markets are messy.

There is a lot more volatility to the daily and weekly movement of the financial markets than most people realize.

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An Inequality that You Create

The current media focus on income inequality has found another advantage the rich have over the poor, and money is once more the culprit. The richer you are, the longer you will probably live.[2] But before money gets too much of the credit, perhaps the same factors that make some people wealthier than others also contribute to better health.

In our last issue, we highlighted three simple steps to getting rich(er). Those same three steps make all the difference when it comes to your health.

Spend less than you make / Eat less than you want

Being overweight is the single most controllable factor contributing to coronary heart disease, high blood pressure, stroke, type 2 diabetes, abnormal blood fats, cancer, osteoarthritis, sleep apnea, obesity hypoventilation syndrome, reproductive problems, gallstones and more. Losing weight requires eating less calories than you use.

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1 News Release - Conversations about personal finance more difficult than religion and politics, according to new Wells Fargo survey. *A third of Americans say they are more worried about their financial health than their physical health.* Wells Fargo San Francisco, CA — February 20, 2014

2 The Richer You Are the Older You'll Get, Josh Zumbrun, *The Wall Street Journal*, Apr 18, 2014

Time to Talk About a Little Matter of Money

Are you losing sleep worrying about money? About 1/3 of Americans say they are, based on a recent survey of consumers sponsored by Wells Fargo.

Two in five (39%) Americans report that money is the biggest stress in their life, 39% say they are more stressed about finances now than they were last year. When asked what they would do differently if they could go back five years, more adults cite regrets about saving and spending (49%) than about shortcomings in all other areas of their life, including taking better care of their physical health, diet and fitness (42%), pursuing different personal relationships (21%), and working more to improve their career (16%).[1]

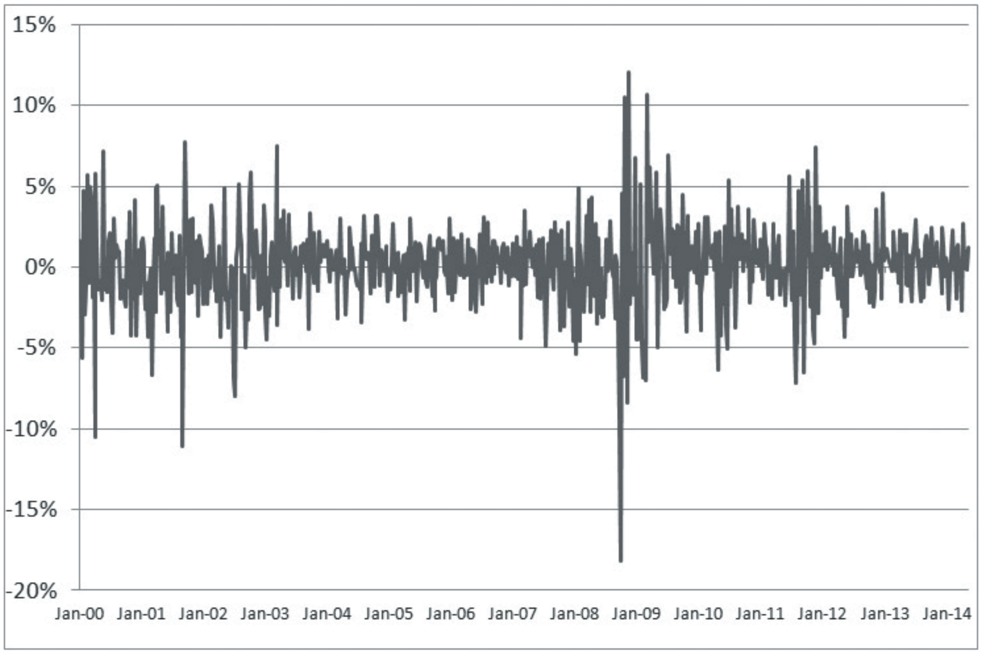
The survey goes on to look at how consumers discuss money, only to find that by and large – they don't. Not with their spouses, their children or their friends.

Somewhere along the line, money moved into the realm of politics and religion – Best not to discuss. So where do you find the help you need to reduce the stress of money worries and make certain you are managing your money properly? Is it possible to sleep better at night?

We can't promise you that we can solve all your money worries, but we will listen with an objective, knowledgeable mind and we have access to resources that may be able to help you further on resolving your concerns. If worrying about money is keeping you on edge, give us a call and let's talk.

Turn Off the Market Reports — *continued from page 1*

Weekly Returns of the S&P 500
January 2000 - June 2014



This chart shows the weekly ups and downs of the S&P 500. Volatility has actually fallen in the last year, but the ride has been anything but smooth. Minor ups and downs tend to be exaggerated in the news coverage, particularly when commentators want to be the first to proclaim a change in market direction.

3) Knowing what you are invested in and why is more important than an index move.

The S&P 500 is made up of 500 different stocks. The Russell 2000, as its name implies, includes the returns of 2000 mid- and small-cap stocks. Every day there are stocks, market sectors and market cap segments that advance and decline. A decline in the S&P 500 is very, very rarely, if ever, a decline in every stock in the index.

When you invest, you should have a reason for selecting that investment. That reason, not a news report on the rise or fall of a market indicator, should set the parameters of a subsequent buy or sell.

4) An exit plan matters more than a commentator's opinion.

We are the last ones to tell you to buy and hold and ignore the market. But there's a difference between daily volatility, news media coverage and a true change in trend. Unless you are a rapid-fire day trader reacting to the intraday volatility (and successful ones are few and far between) you cannot invest successfully by following the daily news, much less the hourly updates.

Turn off CNBC, stop waiting the for latest financial expert's opinion of the day's move and take the time to focus more on why you are invested and what your exit plan is. *Investor's Business Daily* founder William O'Neil espoused an 8% loss limit for any position. There are a lot more sophisticated sell signals, but the idea remains the same. If the position is not working out as you planned, you need to give it enough room to accommodate normal volatility, but lose the least amount possible if you're wrong. And if you are right, stay on for the ride. Don't let a commentator scare you out of a good investment.

The same applies to your relationship with your investment advisor. Know why you selected the individual or firm and how their investment approach is designed to protect your portfolio. If the investment is not working out as you expect given market conditions, meet with your advisor. Find out whether or not the issue is normal volatility and how the investment strategy has historically performed in similar market conditions. Then work with your adviser to determine whether or not you need to change your approach.

An Inequality that You Create

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Start saving early / Start exercising early

Just as saving needs to be a lifelong habit, so too does exercise. Getting in shape and staying in shape is your second most important step to health.

Invest, but manage your risks / Enjoy life, but manage your risks

Don't smoke, avoid destructive behaviors, take your pleasures in moderation, don't let stress get the better of you, and find reasons to laugh.

Money may buy you better medical care, but better health almost always comes down to our own choices. Just as we can choose to be wealthier, so we can choose to be healthier. Make the right choices and you can be healthier and wealthier and live a longer life.

And, before someone cries … "Unfair!" it might be interesting to note that the connection between wealth and health is nothing new. In 1939, a study conducted by Harvard University – the Grant Study – came to the same conclusion, before today's costly medical interventions came on the scene. Why are the wealthy healthier? It comes down to making decisions with an eye toward the future. When you are forward looking and goal oriented, your decisions tend to be better for you.

Taxes Need to Be a Part of Your Investment Plan

When it comes to investing, a gain is always better than a loss, even if you can use losses to offset taxes on gains. With that said, all investment returns are not created equal. The amount you actually take home after taxes depends on the type of return, the investment itself and how the investment is held, i.e. account ownership.

Suppose you invested $100,000 in a high-yield bond paying 6.42% annually and $100,000 in a growth stock that is sold for a 10% gain after two years. At first glance, the high-yield bond seems the better investment, returning $12,840 compared to $10,000 for the growth stock. Assuming these investments are held in a taxable account, which is the better after-tax investment? The answer is going to depend on the investor's tax bracket.

Marginal Income Tax Bracket	Taxes on bond interest	Long- term capital gain taxes	After-tax value of bond yield	After-tax value of capital gain
10-15%	10-15%	0	$11,556-$10,914	$10,000
25 or 28%,	25 or 28%	15%	$9,630-$9,245	$8,500
33 or 35%	33 or 35% + 3.8%	15 + 3.8%	$8,115-$8,297	$8,120
39.6%	39.6 + 3.8%	20 + 3.8%	$6,792	$7,620

Non-qualified dividends and interest are taxed at the individual's "marginal income tax bracket" – the highest rate paid on your income. That can range from 10% to 39.6%. In addition, higher income taxpayers may have a 3.8% unearned income Medicare contribution tax applied to investment income. The highest tax rate that could apply to dividend and interest income is 39.6+3.8= 43.4%.

Capital gains on the sale of an asset will be taxed as either short-term (the asset was held for less than one year) or long-term for assets held in excess of one year. Short-term gains are again taxed at your highest marginal tax bracket, similar to dividends and interest. Long-term gains (the investment is held for more than one year) and qualified dividends are taxed at:

- **0%** if taxable income falls in the 10% or 15% marginal tax brackets
- **15%** if taxable income falls in the 25%, 28%, 33%, or 35% marginal tax brackets
- **20%** if taxable income falls in the 39.6% marginal tax bracket
- **25%** on Depreciation Recapture
- **28%** on Collectibles
- **28%** on qualified small business stock after exclusion.

In addition, married taxpayers reporting in excess of $250,000 in income and single taxpayers with more than $200,000 in income will likely have the 3.8% unearned income Medicare contribution tax applied to their capital gains. If, instead of a stock, the long-term gain was earned on gold bullion, investors would have lost at least 28% of the gain to taxes, regardless of their income level.

How can investors reduce the income tax bite? Using Tax-deferred and Tax-exempt accounts is one way. Capital gains, interest and dividends on assets held in a tax-deferred account, such as a 401(k), IRA or SEP IRA, compound tax-free until they are withdrawn in retirement. When withdrawn, they are taxed at the accountholder's personal income tax rate. With a tax-exempt account, such as a Roth IRA, all gains can be withdrawn free of federal income taxes. IRAs, Roth IRAs, 529 plans, Health Savings Accounts, and Coverdell Educational Savings Accounts and similar investment vehicles also have the advantage of not being subject to the 3.8% Medicare Tax.

Because a tax-deferred account may be taxed at a higher rate than the capital gains tax rate when funds are withdrawn, it can make sense to invest for long-term capital gains outside these structures.

It is important to note that collectibles are prohibited investments in IRAs and other tax deferred and tax-exempt accounts. Collectibles include any work of art, any rug or antique, any metal or gem, any stamp or coin, any alcoholic beverage, or any other tangible personal property specified by the IRS. Gold, silver and platinum must meet certain fineness requirements to be held as investments in these accounts. In addition, restrictions exist as to what types of gold coins can be held by an IRA. Collectibles are taxed at 28% regardless of the taxpayer's gross income. For high income individuals and couples, the 3.8% unearned income tax will also apply to gains from the sale of collectibles.

Income from Municipal Bonds is not applicable toward net investment income thus avoiding the 3.8% tax. Distributions from annuities may incur the 3.8% Medicare Tax.

Rental property investors typically use depreciation to lower their net income and can therefore potentially reduce their marginal income bracket and their exposure to the 3.8% Medicare Tax in doing so. Taxes on capital gains and depreciation recapture on the sale of the property will offset this advantage when it is time to dispose of the property. However, real estate investors have an additional advantage of being able to use 1031 exchanges to defer taxes on the gain on the sale of one property by rolling over their gains into another investment property.

It's common to see financial advice writers fret over the difference in return that a 1% higher management fee will make to overall performance. What is less common to read is how much bigger the bite is that taxes put in our investment results. Understanding how interest, dividends and capital gains are taxed can help you structure your investments and how they are held (i.e. taxable, tax deferred, tax exempt, etc.) to keep more of your gains.

Fear is Not an Effective Motivator…Time to Rethink

Studies proclaiming Americans are failing to save sufficiently for retirement and will find themselves living from Social Security check to disappearing Social Security check appear to be doing little to promote increased saving. Al Gore and other climate change advocates have done their utmost to impress on us the threat global warming, with the intent of changing lives and countries. But nether seems to be having much effect. Why aren't people paying attention?

It turns out that fear is actually a poor motivator. In fact, the more catastrophic the prediction, the more skeptical people become that anything they do will make a difference. It's not that they don't believe the threat, it just seems like an insurmountable challenge.

Fear is actually a de-motivator. It's not something you can go to action on. It's draining and exhausting, and keeps one in a perpetual state of worry instead of action.

Let's Put the Fun Back into Saving

Everyone old enough to remember green stamps and premiums for opening a savings account, give yourself a pat on the back. You grew up in the days of positive thinking, rewards and "good for you-ism." It's surprisingly hard to get rewarded these days for doing the right thing. Instead we're given what often seems like impossible goals with the threat that unless we achieve that goal – *you must have at least $5 million by retirement* – abject poverty awaits. How many financial plans dwell on the unknown of medical costs and health insurance? *Let's scrimp and save now so we can pay the doctor*…sorry, not motivating.

What does "financially secure" mean to you? Does it have the ring of a good time? Probably not. It's actually back to the fear factor. If you are not secure, you are going to be insecure and that sounds rather stressful.

Let's face it, $1 million really isn't much fun. $5 million is a bigger number, but the fun isn't in the zeros, it's what you want to do with that money that is fun.

Rethinking saving means figuring out what it is you want, what you will enjoy about that goal, and then how you plan on getting there. The more enjoyable your end goal is, the more you'll do whatever it takes to get there. Forget about retiring. What is it you want to do? Do you want to sail around the world? Have your own organic garden? Buy a five-year subscription to the opera and see every opening performance? Do you want to be able to keep your home or move somewhere nicer? If retirement is going to revolve around watching every NFL game, how big do you want your television screen to be?

Now you have a goal. You have a positive reward. The next step is to work out how you get to that goal. And, it doesn't have to be an all or nothing. You can set up mini-rewards along the way. Consider planning a special celebration every time you reach an additional $250,000 in savings. Your celebration could be as simple as the purchase of a new barbecue grill or a special weekend getaway or as elaborate as you want as long as it doesn't cut too much into your nest egg.

And don't forget to continue reinforcing the idea of your long-term goal. If your goal is to retire to Florida, deep sea fish and help save the manatee, on your next vacation, visit areas of Florida that you find most appealing, evaluate housing options, find out about recreational opportunities. If you love the experience and can't wait to move, you have even more reason to put a little more in savings.

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