

FINANCIALink

Your Money Management Newsletter

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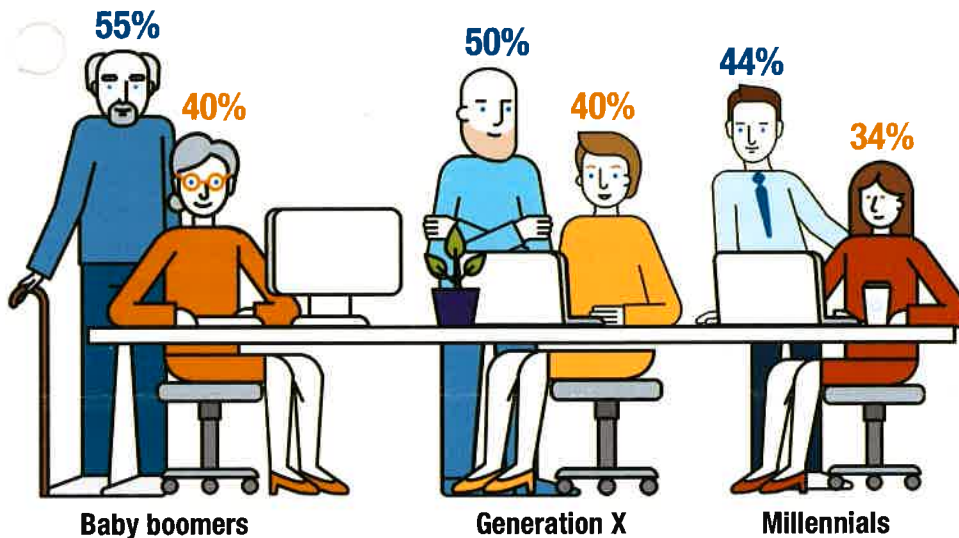


Gregory Taranto, CPA

Are You a Knowledgeable Investor?

On a test of basic investing principles, baby boomers scored higher than younger generations and men scored higher than women. In general, the scores were low, with only male boomers averaging more than 50% correct answers.

Average percentage of correct answers



To take the Investor Literacy Quiz and a shorter Financial Literacy Quiz, visit usfinancialcapability.org/quizzes.php. For investor education tools and resources, visit finra.org/investors.

Source: FINRA Investor Education Foundation, 2018



3.85 million

Number of babies born in the United States in 2017, down 2% from 2016 and the lowest in 30 years. The aging U.S. population is already restraining economic growth, and the declining birth rate suggests that demographics will continue to be a challenge.

Sources: National Center for Health Statistics, 2018; Associated Press, May 17, 2018

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Practical insights for your **FINANCIAL GOALS**

Is a Roth 401(k) Right for You?

First available in 2006, the Roth 401(k) is a relative newcomer to the retirement savings world, and employers were slow to adopt it. That has changed in recent years. A 2017 survey found that seven out of 10 large and mid-size employers with defined contribution plans offer Roth accounts, and another 15% were planning to add the option or considering doing so (see chart).

A Roth 401(k) is a separate account within the employer's 401(k) plan that has tax advantages and limitations similar to a Roth IRA. However, 401(k)s have much higher annual contribution limits (\$18,500 for all accounts combined in 2018 or \$24,500 if you are age 50 or older). And unlike Roth IRAs, there are no income limits for contributing to a Roth 401(k).

If the Roth option is offered in your workplace plan, you might consider its long-term benefits.

Tax Advantage Now or Later

Contributions to a Roth 401(k) account are made with after-tax dollars, so there is no current-year tax advantage. However, distributions — including any earnings — are free of federal income tax as long as they meet certain conditions. Any matching funds from your employer go into a separate pre-tax account and will be taxed as ordinary income upon withdrawal.

Younger workers who are in a lower tax bracket and have many years for potential investment growth may find a Roth account especially appealing. But savers of any age could benefit from tax-free retirement income. When you retire or leave your employer for other reasons, you can transfer your Roth 401(k) balance directly to a Roth IRA, which will allow the assets to continue pursuing tax-free growth. Assets in a Roth 401(k) are subject to required

minimum distributions (RMDs) beginning at age 70½, but you are not required to take RMDs from a Roth IRA which provides more flexibility in managing your retirement income. (Beneficiaries, however, must take RMDs.)

You can contribute to both a Roth account and a traditional account within your employer's plan, or maintain a balance in one while contributing to the other. If your employer plan allows in-plan conversions, you might convert some traditional 401(k) assets to a Roth account, but be prepared to use funds outside the account to pay taxes on the conversion amount.

Qualified Distributions

Because Roth 401(k) contributions are made on an after-tax basis, they're always free of federal income tax when distributed from the plan. But any investment earnings on your Roth contributions are tax-free only if you meet the requirements for a "qualified distribution." In general, a distribution is qualified if it meets a five-year holding period and occurs after age 59½ or after your disability or death.

The five-year holding period starts with the year you make your first Roth contribution to your employer's 401(k) plan. For example, if you make your initial Roth contribution in December 2018, the first year of your five-year holding period is 2018 and your waiting period ends on December 31, 2022. The start date of the five-year holding period will carry over if you transfer Roth assets to a new employer's Roth 401(k) plan. Assets rolled to a Roth IRA are subject to the IRA's five-year holding period.

If your distribution isn't qualified, the portion of your distribution that represents investment earnings will be taxable and subject to a 10% early-distribution penalty, unless an exception applies.

More Employers Offer Tax-Free Option

Percentage of large and mid-size employers with defined contribution plans that offer a Roth 401(k) account option



Source: Willis Towers Watson, 2018

The Tech Sector Could Be Dominating Your Portfolio

The biggest names in technology powered stock market gains and bouts of volatility in 2017, and the trend continued into 2018. The S&P Information Technology sector index posted an 11.2% total return from January through May 2018, compared with a modest 2.0% for the broader S&P 500 index.¹

Wall Street analysts and the business media often refer to well-known technology companies Facebook, Apple, Amazon, Netflix, and Google (now officially Alphabet) collectively with the acronym FAANG. Others use FAAMG, which substitutes Microsoft for Netflix. Apple, Microsoft, Amazon, and Facebook, respectively, are the four most valuable companies by market capitalization in the S&P 500 index; Alphabet is ranked eighth and ninth (based on two different share classes).²

These tech giants are household names because they already play a huge role in everyday life, but they are also bold innovators with lots of cash on hand. They aim to expand their influence further by developing new products (such as self-driving cars and virtual reality) and disrupting established industries.³

The Problem with Popularity

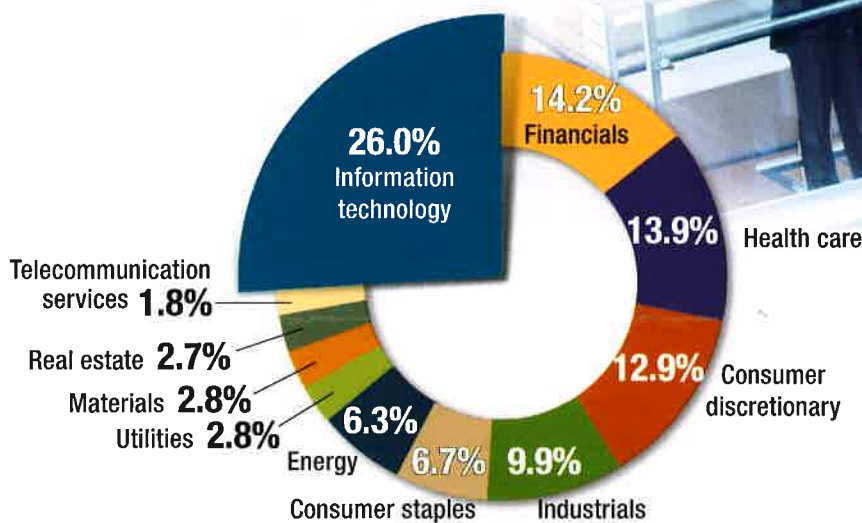
Many benchmark indexes are weighted by market capitalization (the value of a company's outstanding shares), which gives larger companies an outsized role in index performance. The same large-cap tech stocks dominate the index mutual funds and exchange-traded funds (ETFs) that track these indexes, and can also be found among the largest holdings of many actively managed funds.

Spreading investments among the 11 different sectors is a common way to diversify stock holdings. However, investors holding a mix of different funds for the sake of diversification could be surprised by the heavy concentration of popular technology

Stock Market Slices

As of May 31, 2018, tech sector stocks accounted for more than one-fourth of the market cap of the S&P 500.

S&P 500 sector weighting (share of total market capitalization)



The S&P 500 index is an unmanaged group of securities that is considered to be representative of the U.S. stock market in general. The performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in an index.

Source: S&P Dow Jones Indices, 2018 (data as of May 31)

stocks if they eventually fall out of favor and prices fall.

Asset allocation and diversification are methods used to help manage risk; they do not guarantee a profit or protect against investment loss.

Mind Your Sector Exposure

Over time, a core portfolio of diversified equity funds can become overweighted in a sector that has been outperforming the broader market. Some investors with large positions in technology stocks may not be aware of the concentration level in their portfolios. Others could be ignoring the risk, possibly because they are overly optimistic about the sector's future prospects.

Each business cycle is unique, which makes it difficult to predict which sectors stand to benefit in the months ahead. Although there's little you can do about the returns delivered by the financial markets, you *can* control the composition of your portfolio. For

this reason, you may want to review the sector allocation and risk profile of your investment portfolio, if you have not done so lately.

All investments are subject to market fluctuation, risk, and loss of principal. Shares, when sold, may be worth more or less than their original cost. Investments seeking to achieve a higher return may involve greater risk. Sector funds tend to be more volatile than the market in general and may carry additional risks.

Mutual funds and ETFs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1-2) S&P Dow Jones Indices, 2018

3) *The Economist*, June 2, 2018

Community Property Laws: Yours, Mine, and Ours

The question of asset ownership can be contentious in the event of a divorce, but even in the happiest marriage it may be helpful to understand the laws regarding ownership of property obtained before and during the marriage.

Currently, nine states have community property laws: Arizona, California, Idaho, Louisiana, New Mexico, Nevada, Texas, Washington, and Wisconsin. (Alaska allows a married couple to opt for community property status.) In these states, all property earned or acquired by either spouse during their marriage is owned in equal shares by each spouse.

In other states, ownership is determined by “equitable distribution” laws, which means that property is divided fairly though not necessarily equally, typically by a judge if the couple cannot agree. If you have more than one home, the laws that affect your property ownership will depend on the state where you are officially “domiciled” according to IRS rules.

If you are domiciled in a community property state, identifying community property and income can be important when filing separate tax returns. Depending on the state, income derived from separate property may be community or separate. The IRS generally considers the following as separate property. (*Reference to “marriage” in this list also refers to a registered domestic partnership.*)

- Property owned separately before marriage
- Money earned while domiciled in a non-community property state
- Property received separately as a gift or inheritance during marriage



- Property bought with separate funds, or acquired in exchange for separate property, during marriage
- Property converted from community property to separate property through an agreement valid under state law
- The proportion of property bought with separate funds, if part was bought with community funds and part with separate funds

For estate planning purposes, there are no restrictions on how each spouse can give away his or her half of the community property, and a spouse is not required to leave his or her half to the surviving spouse, though many people do. Be sure to consult a legal or estate planning professional familiar with the laws of your state before taking action regarding taxes or property distribution.

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Would you like to discuss the sector balance in your portfolio? Do you have other questions about your investments? Call us for an appointment today.

Working toward a better financial future,