FINANCIAL*ink*

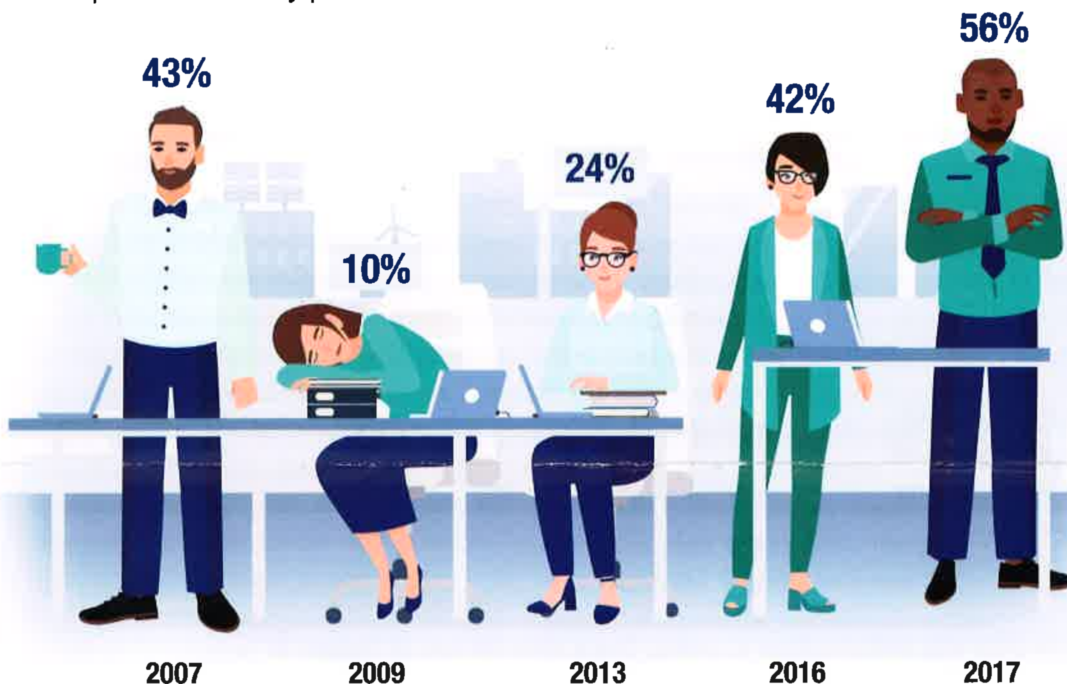
Your Money Management Newsletter

TARANTO FINANCIAL SERVICES & CPAs
1263 Route 31 • Lebanon, NJ 08833
(908) 730-7211 • Fax (908) 735-5524
Email: gtaranto@americanportfolios.com
www.TarantoAssociates.com

Gregory Taranto, *CPA*

Quality Jobs Available?

In 2017, 56% of Americans said it was a good time to find a quality job, the highest annual average since Gallup began asking the question as part of a monthly poll in 2001.



Source: Gallup, 2018

$391 million

Value of refund checks mailed to 6.28 million consumers by the Federal Trade Commission from July 1, 2016, to June 30, 2017, as a result of enforcement actions against companies that defrauded consumers through illegal practices.

Source: Federal Trade Commission, 2017

Securities Offered Through:
American Portfolio Financial Services, Inc., 1263 Route 31, Lebanon, NJ 08833, Member FINRA/SIPC.

Practical insights for your **FINANCIAL GOALS**

Volume 28 • Issue 5

Is Smart Beta Smart for You?

Traditional investment indexes such as the S&P 500 are weighted based on market capitalization, the value of a company's total outstanding stock. This means the largest companies in the index may have much greater influence than smaller companies on index performance — and on funds that track the index. For example, the 10 largest companies in the S&P 500 account for about 20% of the index's performance, as opposed to about 2% for any 10 companies if every company were weighted equally.[1]

Funds that track market-weighted indexes may be the most direct way to participate in broad market performance, but there has been increasing interest in an alternative indexing strategy called *smart beta*, also known as strategic beta or factor-based investing.

Shifting the Weight

Smart-beta funds track indexes that are selected and weighted based on factors other than market capitalization. A given fund might track an existing index or an index that is newly created for that specific fund. Some factors that might be considered are momentum, risk, volatility, earnings, growth potential, price-to-book value, dividend growth or yield, cash flow, and equal weighting of all securities.

Indexes and the funds that track them may focus on a single factor or multiple factors. Some funds categorized as smart beta, particularly those focusing on growth and value, follow indexes that use multiple factors to select stocks but weight the stocks based on market capitalization.

Pushing for Performance

Beta is a measure of a fund's sensitivity to market movements. The goal of most smart-beta funds is to outperform the broader market, either by increasing returns or by managing risk. But if a factor does outperform during one market cycle, it may underperform in the next cycle. This is one of the fundamental challenges of any strategy that attempts to outperform the market. Even within a given cycle, a successful strategy may become neutralized or unsuccessful as other investors adopt the same strategy.

Because of these limitations, smart-beta funds are typically used with traditional broad-based market funds in a diversified portfolio. Diversification is a method used to help manage investment risk; it does not guarantee a profit or protect against investment loss.

The S&P 500 is an unmanaged group of securities 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 investment. Individuals cannot invest directly in an index. Past performance is not a guarantee of future results; actual results will vary.

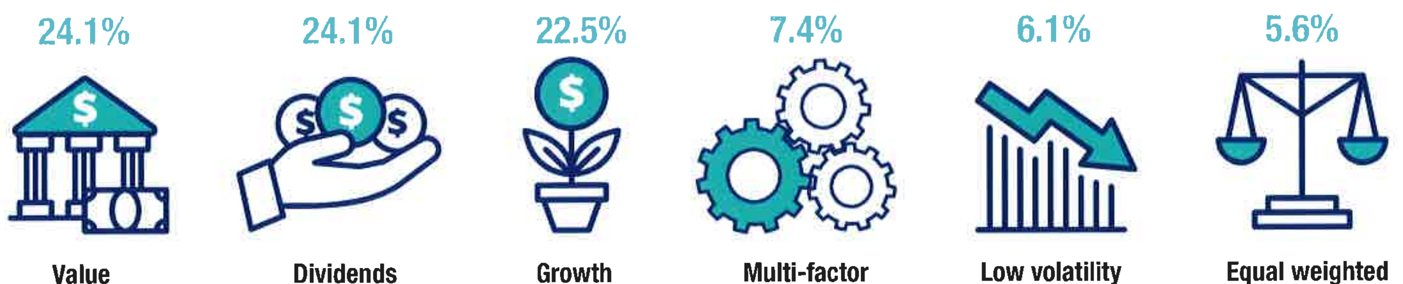
The principal value of mutual funds and exchange-traded funds will fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Supply and demand for ETF shares may cause them to trade at a premium or a discount relative to the value of the underlying shares.

Mutual funds and exchange-traded funds 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) S&P Dow Jones Indices, 2017

Factor-Based Funds

In mid 2017, there were 650 U.S. smart-beta ETFs with $621.9 billion in assets. These were the top six factors used to construct these funds, ranked by percentage of total assets.



Source: Morningstar, 2017 (data as of June 30, 2017)

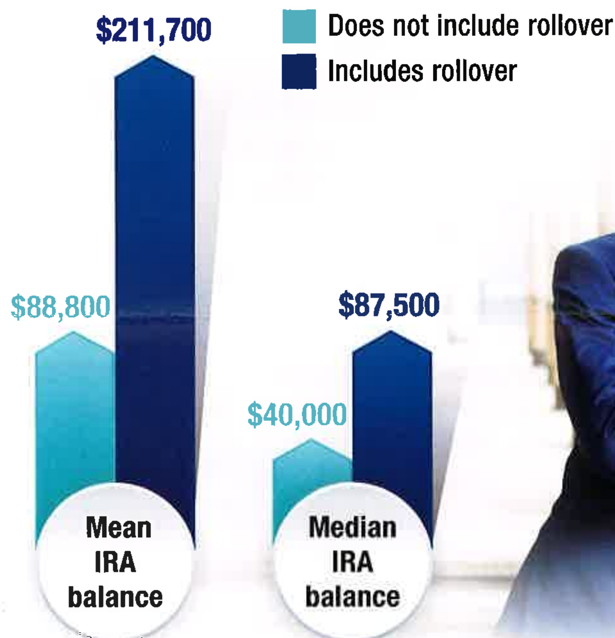
Rules of the Rollover

When you leave a job, you may have up to four options for any funds in your former employer's retirement plan: (1) leave the funds in the employer's plan, (2) roll them to a new employer's plan, (3) roll the assets to an IRA, or (4) take a taxable distribution.

Although there may be good reasons to choose any of these options, rolling the funds to an IRA enables you to maintain control regardless of your employment situation. IRAs typically offer a wider variety of investment choices than employer plans, and you can combine rollover funds with any other funds you already have in an IRA. Or you could open a new IRA to receive the rollover.

Building IRA Assets

In 2017, 57% of U.S. households owning traditional IRAs had executed at least one rollover from an employer-sponsored plan. The most common reasons for rollovers were a job change, termination, or layoff (71%) and retirement (34%).* IRAs that included an employer plan rollover had significantly higher balances than those that did not.



*Includes multiple responses.

Source: Investment Company Institute, 2017

Doing It Direct

In order to avoid current taxation on the distribution, it is best to execute a direct rollover, also called a trustee-to-trustee transfer. In this type of transfer, you never actually take possession of the funds, thus retaining the tax-advantaged status.

To execute a trustee-to-trustee transfer, contact the trustee of the old plan and provide information regarding the trustee of the IRA that should receive the transfer. The trustee of the old plan may execute an electronic transfer to the new trustee, send a check directly to the new trustee, or send you a check made out to the new trustee. If you receive a check, you should mail it to the new trustee as soon as possible.

Indirect Rollover

If you receive the distribution in the form of a check made payable to you, your old plan is required to withhold 20% of the taxable portion of your distribution. This will be credited as withholding when you file your federal income tax return.

You can still execute a rollover of the entire distribution and preserve the tax-deferred status by making a deposit equal to the full distribution in an IRA within 60 days. But you'll need to make up the 20% that was withheld using other assets. For example, if your taxable distribution from the plan is $10,000, the plan will withhold $2,000 and you'll receive a check for $8,000. You can roll $10,000 over to an IRA, but you'll need to come up with $2,000 from other funds. Theoretically, you will receive the $2,000 as a tax refund when you file your return, assuming that all other tax liabilities are met.

Plan to Plan, IRA to IRA

In general, the rules outlined above also apply to rollovers from one employer plan to another, from one IRA to another, or from an IRA to an employer plan. However, you can make only one tax-free, indirect 60-day rollover from any IRA you own (traditional or Roth) to any other IRA you own in any 12-month period. Each additional rollover would be considered a taxable distribution, which is subject to ordinary income taxes plus the 10% early-withdrawal penalty for those younger than 59½.

This limit does not apply to direct rollovers (trustee-to-trustee transfers); nor does it apply to 60-day rollovers to or from an employer plan, or to conversions of traditional IRAs to Roth IRAs. The 20% withholding does not apply to distributions from an IRA, but you must still follow rollover rules to preserve the tax-deferred status.

This information is not intended as investment advice and is not a recommendation for retirement savings.

Chained CPI and Your Taxes

Tax legislation signed at the end of 2017 made dramatic changes to the U.S. tax code for corporations and individuals. One of the most fundamental changes — a new way of measuring inflation — received relatively little attention but could have a significant effect on your taxes over the long term.

A number of key tax provisions are indexed for inflation. These include the income thresholds for tax brackets, standard deduction amounts, retirement plan contribution limits, and many more. Since the 1980s, the measure used to make adjustments has been the Consumer Price Index for all Urban Consumers (CPI-U). Beginning in 2018, the measure will be the Chained Consumer Price Index for All Urban Consumers (C-CPI-U).

Both indexes measure changes in the price of a market basket of goods and services. However, they differ in the way they capture consumer behavior in response to changing prices. For example, if beef becomes too expensive, consumers may purchase more chicken, making chicken a more important category in the market basket for the average consumer. While the standard CPI is only adjusted every two years for this type of shift in category weighting, the chained CPI is adjusted monthly. This results in a lower inflation measure (see chart).

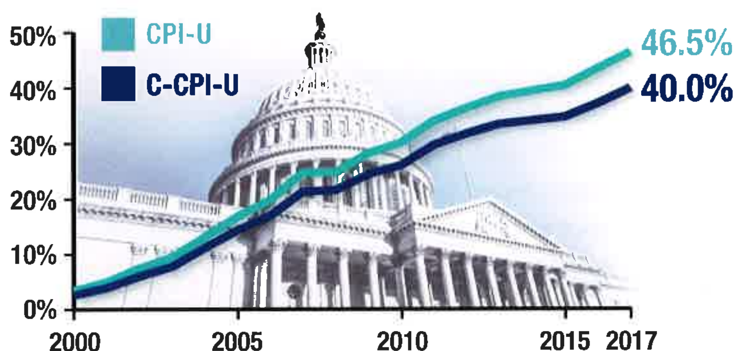
Although the difference for your taxes in any given year may not be noticeable, over time this small difference can add up as a larger percentage of income is pushed into higher tax brackets. One analysis estimated that, due to the new measure, after-tax income will drop about 0.2% to 0.3% by 2027 for people earning between $40,000 and $1 million annually. The difference could become larger in later years as the lower annual inflation measure accumulates.[1]

Many economists believe the chained CPI is a more accurate measure of inflation, and the idea of moving to chained CPI has received bipartisan support over the years.[2] However, the new inflation measure is a permanent change to help pay for permanent corporate tax cuts, whereas most individual tax cuts are scheduled to expire after 2025. It remains to be seen how this will play out for individual taxpayers.

Long-Term Change

Over the 18-year period from 2000 to 2017, the cumulative chained CPI measure of inflation was 6.5% less than the traditional CPI.

Annual percentage change, cumulative



Source: U.S. Bureau of Labor Statistics, 2018

1) *The Wall Street Journal*, November 15, 2017
2) NPR, December 27, 2017

The information in this newsletter is not intended as tax, legal, investment, or retirement advice or recommendations, and it may not be relied on for the purpose of avoiding any federal tax penalties. You are encouraged to seek advice from an independent professional advisor. The content is derived from sources believed to be accurate. Neither the information presented nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. This material was written and prepared by Broadridge Advisor Solutions. © 2018 Broadridge Investor Communication Solutions, Inc.

Do you have assets in a former employer's retirement plan? Call us today to discuss your options.

Working toward a better financial future,