FIRST QUARTER 2017

1500 Kings Highway N, Suite B-204
Cherry Hill, NJ 08034

1928 Arlington Blvd, Suite 205
Charlottesville, VA 22903

www.cypressplanning.com

Q4 Market Update

(values as of 12/30/2016; % changes for Q4, not YTD)

U.S. Stock Indices

S&P 500	2,239 (+3.25%)
Dow Jones	19,763 (+7.94%)
Nasdaq	5,383 (+1.34%)
Russell 2000	1,357 (+8.43%)

Global Stock Indices

FTSE (London)	7,143 (+3.53%)
DAX (Germany)	11,481 (+9.23%)
CAC (France)	4,862 (+9.31%)
Nikkei (Japan)	19,114 (+16.20%)
Emerging Mkts	862.27 (-4.56%)

Bond Indices (Bloomberg)

U.S. Gov't.	124.14 (-3.84%)
U.S. Corporate	143.68 (-2.95%)
U.S. Hi-Yield	169.79 (+1.55%)
Eurozone	140.33 (-2.94%)
Emerging Mkts	158.67 (-4.15%)

Commodities

Gold (per oz)	1,151 (-12.54%)
Silver (per oz)	15.90 (-16.96%)
Oil (WTI, barrel)	53.75 (+12.64%)

Fixed Income Yields

U.S. 2-Year Treasury	1.20%
U.S. 10-Year Treasury	2.45%
U.S. 30-Year Treasury	3.06%
U.S. High-Yield Index	6.19%

Currency Exchange Rates

Euro/Dollar	1.05
Pound/Dollar	1.23
Dollar/Yen	116.89

Beneficiary Designations: A Primer

As the nation prepares to inaugurate a new president with strongly different viewpoints and policy prescriptions than those who have preceded him, a number of financial rules and regulations have found themselves suddenly on the chopping block. President-elect Trump and potential members of his administration have already openly challenged last year's Department of Labor fiduciary rule, and challenges to the estate tax and other progressive taxes seem destined for renewed debate, if not outright appeal.

Amid all the sound and fury, one potential change to our tax code (and our retirement plans) has gone relatively unnoticed, but it ultimately may have significant implications. The change pertains to the so-called "stretch IRA", a savings withdrawal method that has long provided a tax-deferral boon to those who have been fortunate enough to inherit 401(k) or IRA assets from deceased loved ones.

While legal challenges to the stretch IRA have been common in recent years, previous efforts have mostly withered on the vine awaiting congressional approval. Buoyed by the potential revenue-raising implications of a repeal, though, the Senate Finance Committee voted 26-0 in September to recommend a proposed bill that would kill the stretch IRA, albeit with some caveats. The Senate proposal was subsequently included in a bill named the "Retirement Enhancement and Savings Act", and a vote on the measure could come early in 2017.

So, what is the "stretch IRA", and why does it matter to you? Should the bill cause you to take a second look at the beneficiary designations on your existing retirement accounts (or, perhaps, should you be doing that already)? We'll take a quick look at the basics of beneficiary designations, to help you better understand whom to name, and why.

Why beneficiaries matter

One of the main functions of any well-considered estate plan is to ensure a smooth and expeditious distribution of assets upon one's death. Retirement accounts like 401(k) plans and IRAs are particularly convenient in this regard, since essentially all of them allow the account owner to designate a number of different beneficiaries (both primary and contingent) to whom the assets are required to pass upon the owner's death. A potentially long and costly probate process can be avoided, and legal challenges to beneficiary designations are essentially non-existent.

Beneficiary designations are therefore extremely powerful—not only do they allow assets to automatically avoid probate, they also override any other stipulations made in a will, trust, or other estate planning document. If your beneficiary designations are at odds with your broader wishes, then your will may end up becoming little more than a trivial piece of paper.

For married individuals, an account owner should usually name his or her spouse as the primary beneficiary—spouses have the most flexibility with how to treat inherited retirement accounts, and in many cases (and many states), account owners are required to obtain spousal consent if they wish to name anybody but their spouse as primary beneficiary. That doesn't mean, though, that beneficiary designations should ever be ignored or left up to the courts (or "default" options). Distribution options are always maximized when there is a specific, named beneficiary listed on an account—it's therefore important not only to explicitly list a primary beneficiary, but also to name specific contingent beneficiaries, as well.

The primary benefit of being a "named non-spouse" beneficiary (whether primary or contingent) is the availability of the "stretch IRA". Under the stretch IRA provision, if a named beneficiary properly opens and funds an "inherited IRA", the beneficiary will be eligible to withdraw account funds gradually over time, in accordance with their own life expectancy. For younger beneficiaries who may have several decades of life expectancy remaining (according to the IRS' "Single Life Expectancy" table), this provision allows them to "stretch" the tax-deferral benefit over a long time period, thus maximizing the tax benefits that accrue to them as beneficiaries.

IRA Withdrawal Options
(under current law)

	Spouse	Named Non-Spouse	Trust, Charity, or Non-Named Individual
Traditional IRA	1. Spousal rollover (own IRA) 2. **Stretch IRA** 3. Decedent's life expectancy* 4. Five-year rule	1. **Stretch IRA** 2. Decedent's life expectancy* 3. Five-year rule	1. Decedent's life expectancy* 2. Five-year rule
Roth IRA	1. Spousal rollover (own IRA) 2. **Stretch IRA** 3. Five-year rule	1. **Stretch IRA** 2. Five-year rule	1. Five-year rule

* "Decedent's life expectancy" method only available if decedent died after age 70 1/2

However, if a 401(k) or IRA account has no named beneficiaries (or if all named beneficiaries are already deceased, or if the named beneficiary is a charity or a trust), then the stretch IRA option is automatically eliminated. Whoever does ultimately receive the assets will generally default to the so-called "five-year rule", in which all account assets are required to be distributed within five years of the original account owner's death. Given the potentially sizable benefits of stretching the tax-deferral benefit, this outcome both can and should be avoided.

Implications of the proposed bill

The large tax-deferral benefits of the stretch provision are also the reason for its proposed repeal. While the exact figures remain the subject of debate, members of the Senate Finance Committee estimate a positive budgetary impact of $5.5 billion over a 10-year period. That's not a huge deal in the context of a $3.8 trillion annual federal budget, but it's enough to spark congressional attention, so here we are.

Even if the stretch provision is repealed, however, it's important to note that the impact will be limited. Spousal beneficiaries will still have the option of rolling an inherited IRA into their own IRA, enabling them to withdraw funds based on their own life expectancy. And because Roth IRA distributions are not taxed when they are withdrawn, Congress has no pressing reason to force Roth IRA beneficiaries to withdraw their funds on an accelerated basis—Roth accounts are therefore expected to be left alone by any future repeal of the stretch IRA provision. Certain dollar-amount exclusions may also be instated, but those details are not yet fully known.

In the event that the stretch IRA is in fact killed, IRA beneficiaries—particularly younger, prime-working-years beneficiaries—could find themselves pushed into the highest tax bracket as potentially large, six-figure IRA distributions are added to their other sources of income. One strategy that retirees with large IRA balances might consider is a system of aggressive Roth IRA conversions—especially if spread over a number of years, these conversions can occur at lower tax rates than the high rates that beneficiaries would eventually face, thus saving on total lifetime tax bills. With the future of the stretch provision in doubt, it's now more important than ever to understand the implications of our beneficiary designations, and the tax impacts that inheritances may have on our heirs. Thoughtful strategies on the front end can yield benefits for multiple generations.

ALL NINE MAJOR ASSET CLASSES FINISHED 2016 IN POSITIVE TERRITORY

Equity Overview – 2016 Year in Review

In our Q1 2016 newsletter, we started our recap of 2015's market action by referring to it as "The Year That Nothing Worked", a line that we borrowed from Bloomberg. Indeed, for the first time this millennium, no major asset class registered a positive return of greater than 5%, and a modeled "asset allocation" strategy logged a negative return for the first time since 2008.

By contrast, 2016 could easily have been dubbed "The Year That Everything Worked"—despite nearly constant geopolitical instability that seemingly threatened to disrupt the financial world at any time, markets generally shrugged and moved forward, delivering palpable benefits to diversified investors. Of the nine major asset classes (as identified by JPMorgan Asset Management), five ended 2016 with gains of greater than 10%, and none logged negative returns for the year.

While the returns were mostly modest (nothing like the outsized gains experienced in 2003 through 2006, or even more recent rallies in 2012 and 2013), investors benefited greatly from strong rallies in small-cap stocks and in high-yield corporate bonds, both of which were laggards in 2015. A recovery in commodities (especially oil, which gained nearly 45% for the year after cratering the year before) helped spur performance in the high-yield arena, while also providing a tailwind to stocks in the energy sector. The energy sector was, in fact, one of the leaders of the large-cap equity rally, while health care and technology stocks generally lagged behind.

2016 MAJOR ASSET CLASS PERFORMANCE (TOTAL RETURNS)	
Small-Cap US Stocks	+21.3%
High-Yield Bonds	+14.3%
Large-Cap US Stocks	+12.0%
Commodities	+11.8%
Emerging Markets Stocks	+11.6%
Real Estate (REITs)	+8.6%
Investment-Grade Bonds	+2.6%
Developed International Stocks	+1.5%
Cash/Money Market	+0.3%

Of course, the market story of 2016 cannot be told without at least giving mention to the major geopolitical shocks that captivated so many for so long. The surprise result of June's "Brexit" vote was, as it turns out, just a precursor to the eventual outcome of the U.S. presidential election several months later. The initial market reaction to these events saw a swift and violent selloff and "rush to safety"—in both cases, overnight market action either threatened or in fact triggered automatic "circuit breakers"—only for the initial reaction to be rapidly reversed as markets resumed their prior trend (higher). These rapid "v-bottoms" are not unique to 2016, and they are in fact very common reactions to major news items. Historically, when markets are confronted with unexpected events—Pearl Harbor, the assassination of JFK, Nixon's resignation, 9/11, the 2011 S&P downgrade of America's debt rating—they typically lurch in the short run, before stabilizing and resuming their regularly scheduled programming (sometimes up, sometimes down).

Yes, there's always the potential that it's "different this time", as we're often reminded by market pundits and politicians alike. To be sure, the wave of populism that led to both Brexit and Donald Trump's election-night triumph is a repudiation of the status quo, and a direct challenge to the economic and financial policies that have dominated the last decade. To the degree that recent events can and do shape future economic policies (and growth trajectories), investors should certainly pay heed and respond accordingly. But these sorts of broad shifts generally take years or decades to play out, not weeks or months. Stay tuned.

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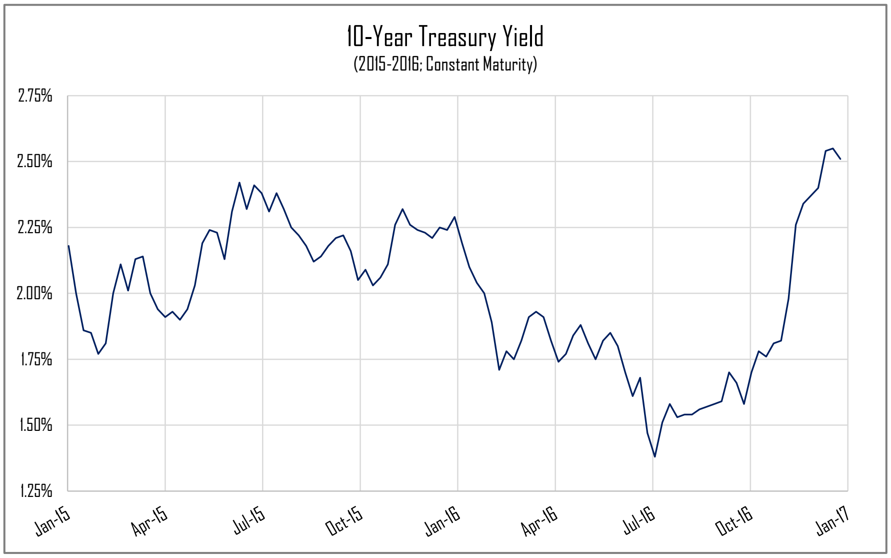
DESPITE MULTIPLE SHARP MOVES, BOND YIELDS MOSTLY ENDED 2016 UNCHANGED

Bonds' Long, Strange Round-Trip to Nowhere – Fixed Income

Heading into 2016, the general consensus among market observers was that bond yields were destined to move higher, with expectations of multiple Federal Reserve rate hikes fueling those predictions. As a new year dawned, though, the market clearly had other ideas. When equity markets swooned to begin the year (the S&P 500 shed nearly 9% in the first six weeks of 2016), bond yields also moved sharply lower, as expectations of aggressive Fed tightening waned. Even as equity markets recovered, bond yields remained at low levels, taking another leg lower when June's Brexit vote spurred an international "flight to quality", as concerns about Euro-area political and financial stability once again spread.



From a level of 2.29% to begin the year, the 10-year Treasury yield marked an all-time low level of 1.38% in early July, before stabilizing heading into November's election. When Donald Trump then gained a surprise victory at the polls, yields immediately and sharply spiked. References to large-scale infrastructure projects in President-elect Trump's victory speech seemed to fuel the initial response, and general political uncertainty has also led to questions about the future path of U.S. fiscal policy (and international relations).

All of these factors could indeed combine to put an end to the 30-year bull market in bonds, but for now, the benchmark 10-year Treasury yield is simply back to roughly where it started the year, hovering around 2.50%. For the long-term, diversified investor, a more pertinent factor might be the ongoing compression between government and corporate yields, especially high-yield bonds. Small tweaks to bond portfolio duration may be warranted, but any large-scale reconsiderations of fixed income strategies are probably still ill-advised.

A Summary of Tax Changes for 2017 – Personal Finance

A new administration could ultimately bring several fundamental changes to our tax code, but those shifts may take years to materialize and take effect. For now, it's best to focus on those tax changes that *are* in fact happening, regardless of the eventual policy prescriptions of the incoming chief executive.

For the most part, tax policy will be unchanged as we head into 2017, as most changes are simply standard inflation-adjustments to existing policy. More than 50 tax provisions will be altered slightly, including an upward shift in all federal tax brackets (for example, the breakpoint between the 15% and 25% tax bracket was previously $75,300 for married couples filing jointly; that threshold has now increased to $75,900).

In addition, standard deductions will now be higher ($6,350 from $6,300), as will income limits and phase-outs for IRA and Roth IRA contributions. The estate tax exemption has also increased, to a new level of $5.49 million (a $40,000 increase over 2016). And perhaps most noticeably, after holding steady for 2016, the Social Security Wage Base (the amount of an employee's salary that is subject to FICA taxation) has increased considerably, from $118,500 to $127,200, an increase of more than 7%.

Among the things that haven't changed, 401(k) and IRA contribution limits remain at their 2016 levels of $18,000 and $5,500, respectively (catch-up amounts are also the same), and tax *rates* remain unchanged.