Cypress Financial Planning, LLC

FOURTH QUARTER 2018

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

1928 Arlington Blvd, Suite 205
Charlottesville, VA 22903

www.cypressplanning.com

Q3 Market Update

(values as of 9/28/2018; % changes for Q3, not YTD)

U.S. Stock Indices

S&P 500	2,914 (+7.20%)
Dow Jones	26,458 (+9.01%)
Nasdaq	8,046 (+7.14%)
Russell 2000	1,670 (+3.26%)

Global Stock Indices

FTSE (London)	7,510 (-1.66%)
DAX (Germany)	12,247 (-0.48%)
CAC (France)	5,493 (+3.19%)
Nikkei (Japan)	24,120 (+8.14%)
Emerging Mkts	1,047.91 (-2.02%)

Bond Indices (Bloomberg)

U.S. Gov't.	2,162.22 (-0.59%)
U.S. Corporate	2,834.06 (+0.97%)
U.S. Hi-Yield	2,000.04 (+2.40%)
Eurozone	251.62 (-1.05%)
Emerging Mkts	1,071.03 (+1.61%)

Commodities

Gold (per oz)	1,192 (-4.85%)
Silver (per oz)	14.61 (-9.05%)
Oil (WTI, barrel)	73.16 (-1.31%)

Fixed Income Yields

U.S. 2-Year Treasury	2.81%
U.S. 10-Year Treasury	3.05%
U.S. 30-Year Treasury	3.19%
U.S. High-Yield Index	6.19%

Currency Exchange Rates

Euro/Dollar	1.16
Pound/Dollar	1.30
Dollar/Yen	113.80

Know Your Penalty Exceptions

Tax-deferred retirement accounts are an integral part of any well-designed financial plan, but they do come with certain drawbacks. Some individuals who have been particularly aggressive deferring income into 401(k) plans or IRAs might eventually find that a significant portion of their net worth—if not essentially all of it—is tied up in one type of retirement account or another. If a major expense then comes up unexpectedly, having too much cash invested in a retirement plan can be a significant limitation.

That's because with a few exceptions, any "early" withdrawal from an IRA (a distribution taking place before the account holder has reached age 59 ½) is subject not only to ordinary income taxes, but also to a 10% penalty on the amount withdrawn. However, the Taxpayer Relief Act of 1997 (the same act that created the Roth IRA, among other tax credits and relief programs) established a number of exceptions to that 10% penalty for withdrawals from an IRA. What, then, are the exceptions, and when can they be used to your advantage? We'll discuss the four main categories of exceptions established by the 1997 Act, and how (or if) you can use them to help cover your own expenses.

Qualified education expenses

The first exception category is reserved for qualifying higher education expenses, as defined by IRS code. An account holder can, without penalty, withdraw funds at any age if those funds are used to cover tuition and related expenses at an IRS-approved institution (generally speaking, any post-secondary school that meets federal student aid requirements, either public or private). The withdrawal (and payment) must be for an academic period beginning in the same tax year as the withdrawal, or in the first three months of the next tax year. Finally, the education expense exception can be used for the account holder's own education, or that of his/her spouse, children, or grandchildren. Note that the education exception *is not* available for funds invested in a 401(k) plan, only an IRA.

There are certain questions as to which types of expenses can qualify for the exception, but tuition and required fees, books, supplies, and other required equipment are generally considered to qualify. Room and board expenses are a somewhat murkier area, but IRS guidance suggests that room and board will qualify as long as the student is enrolled at least half-time in an approved degree-granting program.

Qualified first-time homebuyers

The second category is reserved for first-time homebuyers, and it is limited to a lifetime exception of $10,000, to be used toward a down payment on the purchase of a primary residence. Again, this exception *is not* available for funds invested in a 401(k) plan, only an IRA. While IRS guidance is somewhat limited, the wording of the exception does indicate that if a married couple purchases a home together, each spouse can use their own $10,000 exception, for a total of $20,000.

Notably, despite the name, this exception does not specifically require that the residence in question be the first home that the individual has ever purchased—in order to qualify, the IRA holder need only have not owned a principal residence at any time during the previous two years. Therefore, it's at least theoretically possible for someone who has previously owned a home to still qualify for the first-time homebuyer exception. Either way, the exception can only be used once per taxpayer in their lifetime.

SEPPs

A third category is most useful for individuals considering early retirement, utilizing an approach called "Substantially Equal Periodic Payments" (SEPPs). SEPPs allow account holders to begin accessing retirement funds immediately at any age, provided that the payments are made as part of a series of ongoing annual payments (essentially, an annuitization of the retirement account). The rules surrounding SEPPs—and how to calculate appropriate annual amounts—are complex and beyond the purview of this discussion.

However, regardless of the withdrawal method and amount, once a system of SEPPs is established, the account holder will need to continue making annual distributions for at least five years or until he or she reaches age 59 ½, whichever is longer. During this period, distributions larger than the established SEPP *are not* allowed, and if a larger distribution is made, prior SEPP distributions become retroactively subject to penalties. Therefore, SEPPs are most useful for early retirees who need a stable stream of income, rather than for active workers or individuals looking to cover a large one-time expense. Unlike the two previous categories, SEPPs are available in 401(k) plans, provided that the account holder is no longer employed by the 401(k) plan sponsor.

Hardship withdrawals

The final category is one that most individuals hope they will not have to use, since these exceptions all essentially require that something bad first occur. There are four main "hardship withdrawals" that can qualify for a penalty exception, including the death of the account holder, the permanent disability of the account holder, amounts withdrawn to cover medical expenses in excess of 10% of Adjusted Gross Income (AGI), or health insurance paid during a period of unemployment. Note that simply losing a job (or having major medical expenses) might not necessarily qualify an individual for a hardship withdrawal; certain thresholds (or other prerequisites) also need to be met.

Availability of Retirement Account Early Withdrawal Exceptions

	Category	401(k) Plans	IRAs
Qualified Higher Education Expenses		NO	YES
Qualified First-Time Homebuyers ($10,000)		NO	YES
SEPPs		YES	YES
Hardships	Death of Participant/IRA Owner	YES	YES
Hardships	Total & Permanent Disability of Participant/IRA Owner	YES	YES
Hardships	Unreimbursed Medical Expenses (>10% AGI)	YES	YES
Hardships	Health Insurance Premiums Paid While Unemployed	NO	YES
Separation from Service (after age 55, or 50 for some public employees)		YES	NO

Other considerations

Just because an exception is available doesn't mean that it should be used. After all, even absent a penalty, ordinary income tax will still be owed on any Traditional IRA withdrawal. It's also important to note that IRAs and 401(k) plans have different benefits and drawbacks: among other things, IRAs cannot offer loans, but 401(k) plans can, although 401(k) plans have fewer available penalty exceptions.

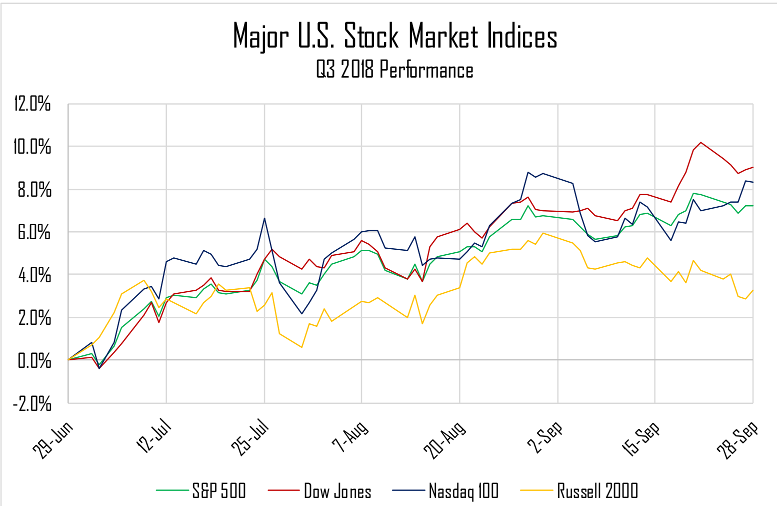
Also, while these IRA exceptions apply to both Traditional and Roth IRAs, Roth IRAs are unique in that taxes and penalties can only ever apply to investment earnings accrued within the account—the initial contribution amount to a Roth IRA can *always* be withdrawn without tax or penalty, making the Roth a very powerful and nimble tool for retirement savers with uncertain or lumpy expenses.

Regardless, any withdrawal from a retirement account must be carefully considered, since tax-deferral benefits, once lost, are often lost forever. At Cypress, we are always looking for ways to maximize the benefits of tax-deferred retirement accounts for our clients, while also preserving flexibility and liquidity.

FEWER STOCKS ARE PARTICIPATING IN THE MOST RECENT RALLY TO RECORD HIGHS

Equity Overview – Domestic Equity Markets

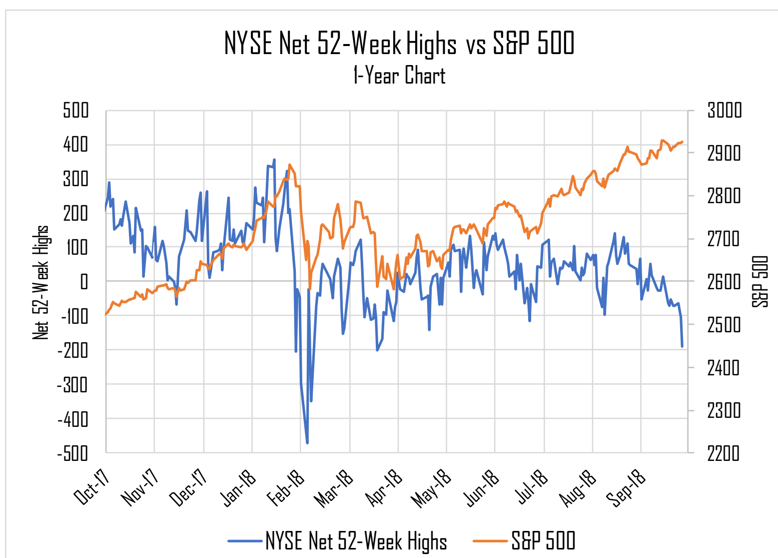
The third quarter was an exceptionally strong period for the markets, as all of the major U.S. indices saw steady gains, spending essentially the entire summer in positive territory. The broad-based S&P 500 gained more than 7% to close the quarter north of 2,900, marking multiple new record closing highs along the way. Most major market sectors participated in the rally, with health care stocks (+14%) leading the way. The S&P now boasts a year-to-date gain of 9%, edging into double-digit territory after including dividends.



But while the record quarterly closing high should be cause for celebration for investors, particularly with employment numbers and GDP growth rates seeming to confirm a continuing economic boom, all is not necessarily well underneath the surface. As the overall index continued to post new all-time highs in September, fewer and fewer stocks seemed to be benefiting from the headline gains. Indeed, as the S&P cleared 2,900 for the first time in history, most individual stocks were not trading at their own 52-week highs, let alone all-time highs. A survey of all NYSE-listed stocks found that even as the market made new highs, more individual stocks were actually trading on their 52-week *lows* than were trading on their 52-week highs. That marked underperformance was particularly acute in the small-cap Russell 2000, which could only manage a 3.26% advance for the quarter, only about a third of the figure enjoyed by the blue-chip Dow Jones Index.

It's certainly not typical to see these types of divergences when the markets are trading at such lofty valuations, and the narrow leadership seems unlikely to be sufficient to give the market fuel for another leg higher, at least in the near term. To some degree, the concerning spread can be explained by the continued rise in interest rates, as some of the market laggards (those that are trading on their 52-week lows) are concentrated in rate-sensitive industries (utilities, real estate, telecom), as well as lower-quality firms that rely on higher-yielding debt financing, particularly in the energy sector. Notably, banks have also underperformed throughout 2018, with the financial sector trading flat for the year even as the broader market has rallied.

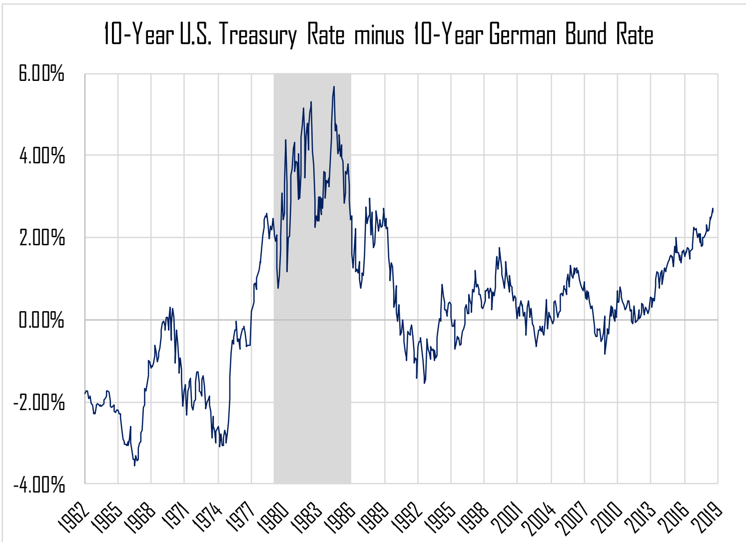
These divergences don't necessarily portend imminent doom for the market, especially not as most corporate earnings remain strong. Often, these kinds of effects can simply resolve themselves via a period of consolidation and sideways trading, which can often be healthy in a protracted bull market. Still, if these all-time highs are to be considered a bullish signal, more individual stocks will likely have to step up and lead the way.



U.S. TREASURY BOND YIELDS ARE MUCH HIGHER THAN THEIR GLOBAL COUNTERPARTS

International Bond Spreads Continue To Widen – Fixed Income

At its September meeting, the Federal Reserve once again hiked the overnight Federal Funds Rate by 0.25%, to a new target range of 2% to 2.25%. It was the third such rate increase of 2018, and yields of all maturities have continued to creep higher. Yields on 10-year U.S. Treasury bonds recently broke above the 3% mark for the first time since 2011, breaching a level that had previously stood as a lid on rates.



The rising rate environment, however, stands in stark contrast to the broader global environment, in which most other countries' sovereign debt yields remain at or near record low levels. As a result, the spread between rates on U.S. and German 10-year bonds have widened to levels that had only been seen once before in history, during the early 1980s when Fed chair Paul Volcker aggressively raised rates to try to break an era of "stagflation". The average U.S. 10-year yield between 1979 and 1985 was 11.75%—a far cry from today's levels—and since that time, U.S. bonds have never yielded so much more than their European counterparts.

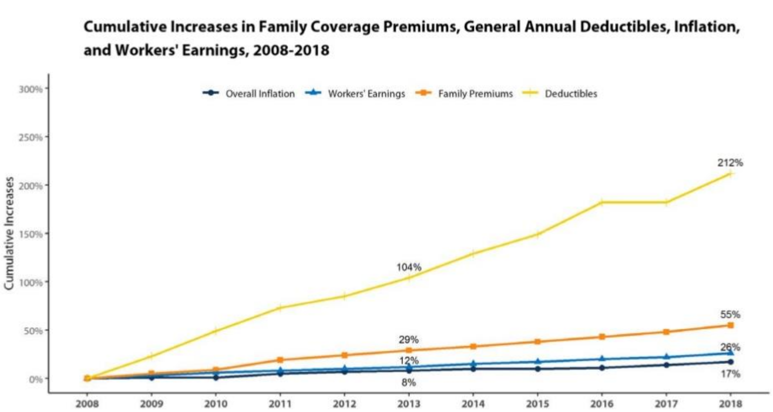
While the spread does not necessarily have to narrow any time soon, it seems that some convergence is eventually inevitable, either via increasing global yields or declining U.S. rates.

Health Care Deductibles Rise As HSAs Remain Popular – General Finance

As health care costs across the board continue to rise, insurance companies and employers who provide health benefits are struggling to find ways to keep that coverage affordable. In an effort to keep headline premiums low, employers—and employees—have increasingly turned to plans with higher deductibles, either by choice or out of necessity.

According to research from the Kaiser Family Foundation (KFF), the average deductible on an employer-based family insurance plan has increased by more than 200% over the last decade, more than 12 times the general rate of inflation (and more than 8 times the increase in average employee earnings). This trend essentially means that more families are choosing to self-insure, which puts the burden on individual employees to ensure that they have enough liquid cash available to cover unexpected (or even expected) medical costs.

Further research from KFF finds that 29% of covered employees are now opting for high-deductible health plans (HDHPs), up from just 8% a decade ago. Given those trends, it's more important now than ever that employees understand the benefits of Health Savings Accounts, and how to use them wisely as part of their broader financial plan.



Source: Kaiser Family Foundation