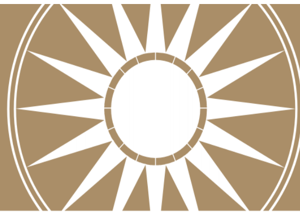

Mentor Monthly Missive

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Staying educated by listening

In the wealth-management business, it's essential to stay up to date. Investment and tax environments are in constant flux, and the best way to keep up with trends is to listen.

I just returned from Las Vegas – listening, not gambling (well, maybe a little) at the NAPFA national conference. Every year this prominent fee-only financial planning organization provides my colleagues and me with a week-long opportunity to keep up-to-date with what's going on in the industry. Every year I come away better-educated and highly energized with regard to helping people make the right decisions about managing their wealth.

Sessions covered such topics as new investment strategies, the Alternative Minimum Tax, managing Medicare options, the impact of Obamacare and planning for one's digital estate. I also had an opportunity to visit with representatives of highly respected vendors in the business, including Vanguard, TIAA-CREF, Morningstar and Charles Schwab & Co. Inc., as well as many long-time friends in the business.

Staying educated means actively listening – to experts as well as to clients. I'm looking forward to applying what I learned as I advise them on their investment portfolios, tax plans, retirement and estates.

John S. Davis, CFP

Meet our Wealth Managers

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Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

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How Can Grandparents Help with College Costs?

If your grandchildren are fortunate enough to have you chip in with their college costs, there are a few things you need to be aware of before you start writing checks.

The most straightforward way for a nonparent to help a student pay for college is with a cash gift. Gift tax rules in 2013 allow any individual to give another individual up to $14,000 per year ($28,000 from a couple) without the gift counting against the lifetime estate tax exemption. A problem with this approach is that your contribution will be taken into consideration when the student applies for need-based financial aid. Cash given directly to a student the year before he or she applies may be considered student income, reducing need-based aid by as much as 50% of the amount given. Furthermore, money held in the student's name is treated as a student asset, reducing aid by another 20%. Cash given to the parents also counts against financial aid, albeit at a much lower rate of up to 5.64%. To potentially avoid any financial aid impact with a cash gift, keep in mind that the Free Application for Federal Student Aid takes into account income from the prior year in determining need-based aid. Hence, consider giving the money when you know the student will not be applying for aid next year.

Another approach is to offer to help pay back the student's loans. By waiting until the student is done with school, you avoid financial aid concerns and help ease his or her debt burden as the student enters the workforce. This strategy may be particularly useful for students with subsidized loans, which don't begin to accrue interest until after graduation.

Grandparents may also open a 529 college-savings account in the name of a student. One of the advantages of this approach for the account owner (the grandparent) is that many states offer income tax deductions on 529 contributions, though you must typically make the contribution to your home state's plan in order to earn the deduction. Another benefit is that the IRS allows a five-year acceleration of the gift tax exclusion for such contributions, allowing an individual to contribute as much as $70,000 in a single year to a 529 in a student's name. A disadvantage to this approach is that distributions from a 529 owned by someone other than the student or his or her parents are counted as student income and may reduce the amount of need-based financial aid available by $0.50 for every dollar distribution. Waiting to use 529 distributions from a grandparent-owned account until the student's final year is one way to avoid this problem.

One final option that some grandparents might consider is paying tuition directly to the university on the student's behalf. This has special appeal for those who want to give large amounts but who are worried about gift tax consequences. The good news is that payments made directly to the university to cover tuition are exempt from the gift tax, although additional costs such as room and board are not. Unfortunately, direct tuition payments may be counted as either income against the student's financial aid allocation (reducing it by 50%), or as a financial resource available to the student (reducing financial aid dollar-for-dollar). Hence, this only makes sense for students who are not concerned about need-based aid or if the payment is made during the final year of school.

Tax law is ever-changing and can be quite complex. It is highly recommended that you consult with a financial or tax professional with any tax-related questions or concerns. An investor should consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing. More information about municipal fund securities is available in the issuer's official statement, and the official statement should be read carefully before investing. 529 plans are tax-deferred college savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax.

Monthly Market Commentary

Economic data, corporate earnings, and corporate forecasts continued to be a mixed bag even as the S&P 500 rallied past 1,600 in April. Markets reacted favorably when central banks made announcements to address some of the market weaknesses (European bankers reduced their target interest rate and the Fed affirmed that it had no plans to reduce its interventions in the near future). Markets did crash on April 23 in a matter of minutes, albeit briefly and temporarily, when the AP's Twitter account was hacked and sent a fake tweet, causing a swift drop reminiscent of the 2010 flash crash. Overall, Morningstar economists believe that the U.S. economy is neither booming nor busting. Nothing in the numbers would indicate that much has changed when looked at from a year-over-year, averaged basis—the underlying 2% growth rate continues to be largely unchanged.

GDP: First-quarter real GDP in 2013 grew by 2.5%, well below the 3%-plus expectation that many economists had, but still much better compared with an abysmal fourth-quarter growth of 0.4% in 2012. GDP growth was mostly dragged down by continued poor government spending and a larger-than-expected trade deficit. Unfortunately, the worst of the government impact may still be ahead of us, since the first-quarter numbers do not include any impact from the sequester.

Employment: April's total non-farm payroll growth beat expectations, with 165,000 jobs added. More importantly, sharp revisions in the March and February employment numbers saw an impressive net positive revision of 114,000 jobs. Despite all this good news, careful analysis shows more of the same slow and unsatisfying growth, stuck between 1.9% and 2.1% (three-month year-over-year average) for nine consecutive months. The unemployment rate in April edged down slightly to 7.5% from 7.6% the month before.

Housing: On a year-over-year basis, all 20 markets in the Case-Shiller Index saw price appreciation in February, although the growth was not evenly distributed across cities. Phoenix, San Francisco, Las Vegas, and Atlanta all grew by more than 15%, while other cities such as New York, Chicago, and Boston grew by less than 5%. Inventories are still very tight at a time when demand is up because of an improved economy, leading to higher home prices. Higher prices should continue to bring more houses on to the market and bolster consumer confidence. In addition, higher home prices have caused more homeowners to step up their remodeling expenditures, and should also allow more potential employees to move to new cities for employment opportunities.

Manufacturing: According to data from Markit, a worldwide research firm, manufacturing in April declined in the U.S., China, and Europe. The data showed monthly acceleration and improvement through January 2013, after which three months of decline brought it back to where it started in November. Morningstar economists believe that seasonality and a slumping commodities cycle are responsible for the softness worldwide, and not the all-important consumer-demand factor, which drives manufacturing. However, the impact of manufacturing on the macroeconomic picture tends to be strongest in extreme boom-or-bust situations. The U.S. economy is currently doing neither at the moment.

Auto: Auto sales in April dropped modestly to 14.9 million units from 15.25 million units in March 2013, but this was still better than the 14.1 million units from April 2012. Morningstar's auto sector analysts are not overly concerned with the sequential decline as fluctuations are normal, and there are still plenty of reasons to buy a new vehicle, such as low interest rates and a recovering housing market. They continue to maintain full-year sales expectations of 15.2 to 15.5 million units.

Making Up for Retirement Shortfalls

Given the backdrop of economic uncertainty and the rise in both life expectancy and medical costs, prospects look difficult for those facing retirement shortfalls. Fortunately, a financial advisor can show you how pulling these key levers can help your retirement nest egg last.

Work Longer: Working longer is one of the easier solutions for those facing retirement shortfalls, allowing you to contribute to your savings for a few more years.

Reduce Spending During Accumulation Years: One of the best ways to save more is to spend less. Setting explicit goals with a financial advisor, having a clear understanding of your net worth, and carefully tracking expenses are essential to reducing your spending.

Reduce Planned Expenses in Retirement: Your retirement nest egg may last longer if expenses, such as home costs during retirement years, are reduced.

Optimize Your Asset Allocation: As you near retirement, a portfolio that is too conservative can be just as risky as one that is too aggressive. Retirement can be a 30-year prospect, long enough to consider a specific allocation to stocks, which, although they are more volatile, offer higher return potential over time.

Delay Taking Social Security: If you're healthy and expect to live long, waiting until age 70 to receive Social Security benefits can result in a higher payout.

Returns and principal invested in stocks are not guaranteed. Please keep in mind that diversification does not eliminate the risk of experiencing investment losses, and that investing in securities always involves risk of loss. Please consult with a financial professional for advice specific to your situation.

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