

### Inside this issue:

Economic & Market Perspectives	1
Chart of Interest: Average 10-year rolling returns for stocks at various P/E levels	2
Chart of Interest: High yield has tended to recover from losses with solid gains	2
I'm thinking about storing financial documents in the cloud. What should I know?	2
Changes to Social Security Claiming Strategies	3
What are required minimum distributions (RMDs)?	3
Earn Too Much for a Roth IRA? Try the Back Door!	4

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## Economic & Market Perspectives

U.S. equities rebounded sharply over the past couple of months, with the S&P 500 rising by an impressive double-digit rate. The gains are partly due to investors covering short positions as they have apparently recognized that the economy is in better shape than was feared in January. Investors reacted to dovish comments made by Federal Reserve Chair Janet Yellen in her speech at the Economics Club of New York, which counteracted some more hawkish comments made by Fed officials the previous week. Other asset classes came under pressure, including commodities and oil, causing some skepticism about the recent rebound. The rebound in oil prices has also reduced worries over deflation and provided support to risk assets, including equities and high yield bonds.

1. Strength in the labor market reinforces the view that the economy remains in solid shape. The March jobs report was mostly good news. Payrolls increased by 215,000 last month, and the unemployment rate ticked up to 5.0%. The data suggest more Americans are entering the labor force. Average hourly earnings were better than expected, climbing 0.3%, although they are only up 2.3% for the quarter on an annualized rate. Overall, the data suggest that while the economy may not be accelerating rapidly, it is growing.

2. Manufacturing may be finally shifting into a higher gear. The March ISM Manufacturing Index beat expectations by rising from 49.5 in February to 51.8 in March (any number above 50 indicates growth). This was the highest level since last July. The details within the report were strong, with new orders showing a particularly large increase. It

appears that the recent stabilization in oil prices and the decline in the dollar are improving prospects for the manufacturing sector.

3. The Fed is likely to remain cautious in its rate increase efforts. Janet Yellen's comments indicated that while she acknowledges improvements in the economy, she is also focused on weaker international growth. The Fed is clearly in no hurry to raise rates again. Expectations are to see one increase this summer and probably one additional increase later in the year.

4. First quarter real gross domestic product is expected to be about 2.0%. The economy is enjoying a number of tailwinds, including low mortgage rates, healthy consumer income growth and low energy prices. Weak growth overseas is a drag, however. Real consumer spending levels have sagged a bit in recent months.

5. Near-term weakness in corporate earnings may persist, but results should improve later this year. First quarter earnings results will be released soon, and it is expected that the numbers will show a year-over-year decline. It seems as though corporate profits are bottoming, and expectations are to see better results in the second half of 2016 as headwinds fade from the "oil down/dollar up" dynamic.

6. Non-US equity valuations look attractive relative to US equities. However, the health of China's financial system remains a concern, with large blocks of capital leaving the country on a regular basis. The European Central Bank (ECB) initiated additional stimulus moves intended to spur the Eurozone's

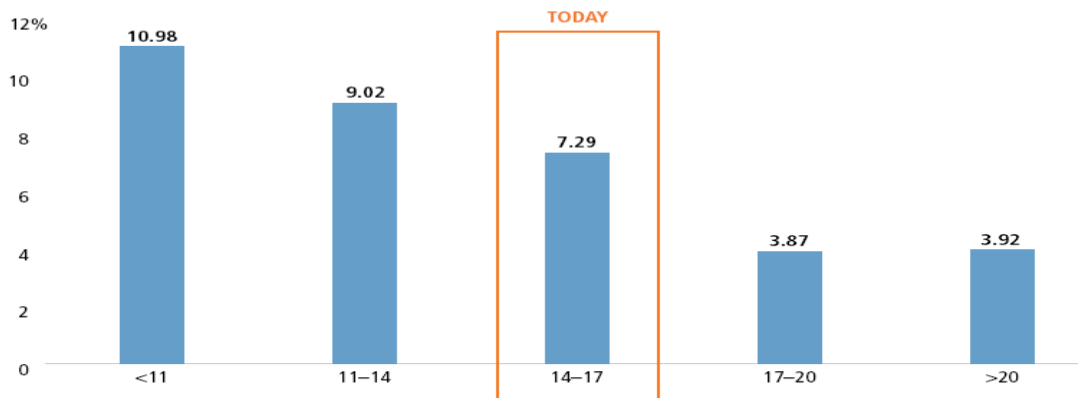
### 2016 Returns

<i>S&amp;P 500</i>	1.35%
<i>NASDAQ</i>	-2.06%
<i>Russell Small Cap</i>	-1.52%
<i>Russell Mid Cap</i>	2.24%
<i>MSCI EAFE</i>	-3.01%
<i>MSCI World</i>	-0.35%
<i>Barclay US Agg</i>	3.03%
<i>Barclay Muni.</i>	1.67%

economy--and it may be working as economic activity picked up in March. Inflation remains at historically low levels and exports continue to hinder sales.

The global economy remains rocky and is still dependent on supportive monetary policy in some regions. In the near term, equities may experience some consolidation given the extreme pace of recent gains. A sustained uptrend in equity prices is not expected until investors grow more confident in the global economy and become convinced that oil prices won't experience a renewed rout.

## Average 10-year rolling returns for stocks at various P/E levels

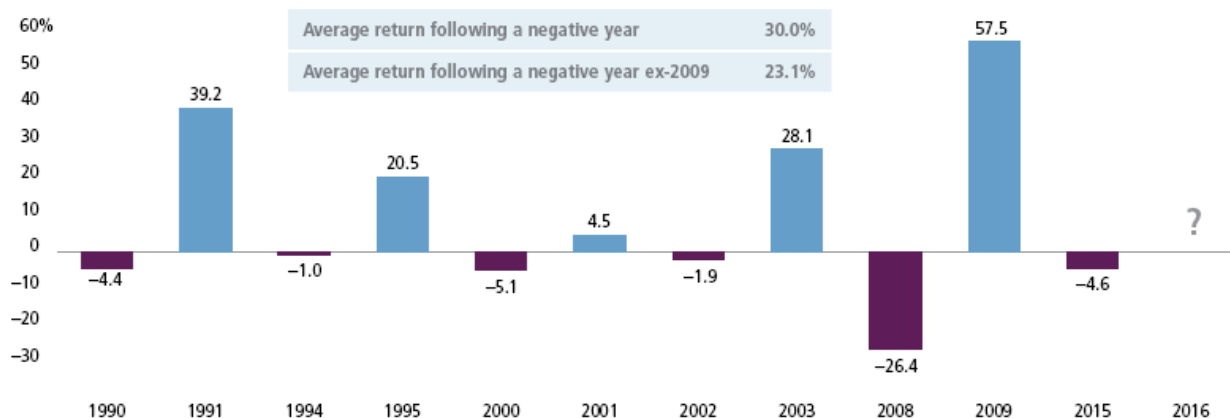


As today's valuations, stocks would post gains over the next decade slightly below their long-term average.

Source: FactSet, Bloomberg

## High yield has tended to recover from losses with solid gains

Performance of the BofA Merrill Lynch U.S. High Yield Master II Index in years with losses and the year following those losses



Source: Bloomberg

## I'm thinking about storing financial documents in the cloud. What should I know?

Cloud storage--using Internet-based service providers to store digital assets such as books, music, videos, photos, and even important documents including financial statements and contracts--has become increasingly popular in recent years. But is it right for you?

Opinions vary on whether to store your most sensitive information in the cloud. While some experts say you should physically store items you're not willing to lose or expose publicly, others contend that high-security cloud options are available.

If you're thinking about cloud storage for your financial documents, consider the following:

- Evaluate the provider's reputation. Is the service well known, well tested, and well reviewed by information security experts?
- Consider the provider's own security and redundancy procedures. Look for such features as two-factor authentication and complex password requirements. Does it have copies of your data on servers at multiple geographic locations, so that a disaster in one area won't result in an irretrievable loss of data?
- Review the provider's service agreement and terms and conditions. Make sure you understand how your data will be protected and what recourse you have in the event of a breach or loss. Also understand what happens when you delete a file--will it

be completely removed from all servers? In the event a government subpoena is issued, must the service provider hand over the data?

- Consider encryption processes, which prevent access to your data without your personal password (including access by people who work for the service provider). Will you be using a browser or app that provides for data encryption during transfer? And once your data is stored on the cloud servers, will it continue to be encrypted?

Make sure you have a complex system for creating passwords and never share your passwords with anyone.

## Changes to Social Security Claiming Strategies

The Bipartisan Budget Act of 2015 included a section titled "Closure of Unintended Loopholes" that ends two Social Security claiming strategies that have become increasingly popular over the last several years. These two strategies, known as "file and suspend" and "restricted application" for a spousal benefit, have often been used to optimize Social Security income for married couples.

If you have not yet filed for Social Security, it's important to understand how these new rules could affect your retirement strategy. Depending on your age, you may still be able to take advantage of the expiring claiming options. The changes should not affect current Social Security beneficiaries and do not apply to survivor benefits.

### File and suspend

Under the previous rules, an individual who had reached full retirement age could file for retired worker benefits--typically to enable a spouse to file for spousal benefits--and then suspend his or her benefit. By doing so, the individual would earn delayed retirement credits (up to 8% annually) and claim a higher worker benefit at a later date, up to age 70. Meanwhile, his or her spouse could be receiving spousal benefits. For some married couples, especially those with dual incomes, this strategy increased their total combined lifetime benefits.

Under the new rules, which are effective as of April 30, 2016, a worker who reaches full retirement age can still file and suspend, but no one can collect benefits on the worker's earnings record during the suspension period. This strategy effectively ends the file-and-suspend strategy for couples and families.

The new rules also mean that a worker cannot later request a retroactive lump-sum payment for the entire period during which benefits were suspended. (This previously available claiming option was helpful to someone who faced a change of circumstances, such as a serious illness.)

**Tip:** *If you are age 66 or older before the new rules take effect, you may still be able to take advantage of the combined file-and-suspend and spousal/dependent filing strategy.*

### Restricted application

Under the previous rules, a married person who had reached full retirement age could file a "restricted application" for spousal benefits after the other spouse had filed for Social Security worker benefits. This allowed the individual to collect spousal benefits while earning delayed retirement credits on his or her own work record. In combination with the file-and-suspend option, this enabled both spouses to earn delayed retirement credits while one spouse received

a spousal benefit, a type of "double dipping" that was not intended by the original legislation.

Under the new rules, an individual eligible for both a spousal benefit and a worker benefit will be "deemed" to be filing for whichever benefit is higher and will not be able to change from one to the other later.

**Tip:** *If you reached age 62 before the end of December 2015, you are grandfathered under the old rules. If your spouse has filed for Social Security worker benefits, you can still file a restricted application for spouse-only benefits at full retirement age and claim your own worker benefit at a later date.*

Basic Social Security claiming options remain unchanged. You can file for a permanently reduced benefit starting at age 62, receive your full benefit at full retirement age, or postpone filing for benefits and earn delayed retirement credits, up to age 70.

Although some claiming options are going away, plenty of planning opportunities remain, and you may benefit from taking the time to make an informed decision about when to file for Social Security.

## What are required minimum distributions (RMDs)?

Traditional IRAs and employer retirement plans such as 401(k)s and 403(b)s offer several tax advantages, including the ability to defer income taxes on both contributions and earnings until they're distributed from the plan.

But, unfortunately, you can't keep your money in these retirement accounts forever. The law requires that you begin taking distributions, called "required minimum distributions" or RMDs, when you reach age 70½ (or in some cases, when you retire), whether you need the money or not. (Minimum distributions are not required from Roth IRAs during your lifetime.)

Your IRA trustee or custodian must either tell you the required amount each year or offer to calculate it for you. For an employer plan, the plan administrator will generally calculate the RMD. But you're ultimately

responsible for determining the correct amount. It's easy to do. The IRS, in Publication 590-B, provides a chart called the Uniform Lifetime Table. In most cases, you simply find the distribution period for your age and then divide your account balance as of the end of the prior year by the distribution period to arrive at your RMD for the year.

For example, if you turn 76 in 2016, your distribution period under the Uniform Lifetime Table is 22 years. You divide your account balance as of December 31, 2015, by 22 to arrive at your RMD for 2016.

The only exception is if you're married and your spouse is more than 10 years younger than you. If this special situation applies, use IRS Table II (also found in Publication 590-B) instead of the Uniform Lifetime Table. Table II provides a distribution period that's

based on the joint life expectancy of you and your spouse.

If you have multiple IRAs, an RMD is calculated separately for each IRA. However, you can withdraw the required amount from any of your IRAs. Inherited IRAs aren't included with your own for this purpose. (Similar rules apply to Section 403(b) accounts.) If you participate in more than one employer retirement plan, your RMD is calculated separately for each plan and must be paid from that plan.

Remember, you can always withdraw more than the required amount, but if you withdraw less you will be hit with a penalty tax equal to 50% of the amount you failed to withdraw.

## Earn Too Much for a Roth IRA? Try the Back Door!

### Background

Roth IRAs, created in 1997 as part of the Taxpayer Relief Act, represented an entirely new savings opportunity--the ability to make after-tax contributions that could, if certain conditions were met, grow entirely free of federal income taxes. These new savings vehicles were essentially the inverse of traditional IRAs, where you could make deductible contributions but distributions would be fully taxable. The law also allowed taxpayers to "convert" traditional IRAs to Roth IRAs by paying income

taxes on the amount converted in the year of conversion.

Unfortunately, the law contained two provisions that limited the ability of high-income taxpayers to participate in the Roth revolution. First, the annual contributions an individual could make to a Roth IRA were reduced or eliminated if his or her income exceeded certain levels. Second, individuals with incomes of \$100,000 or more, or whose tax filing status was married filing separately, were prohibited from converting a

traditional IRA to a Roth IRA.

In 2005, however, Congress passed the Tax Increase Prevention and Reconciliation Act (TIPRA), which repealed the second barrier, allowing anyone to convert a traditional IRA to a Roth IRA--starting in 2010--regardless of income level or marital status. But TIPRA did not repeal the provision that limited the ability to make annual Roth contributions based on income. The current limits are set forth in the chart below:

### Phaseout ranges for determining ability to fund a Roth IRA in 2016\*

Single/head of household	\$117,000-\$132,000
Married filing jointly	\$184,000-\$194,000
Married filing separately	\$0-\$10,000

\*Applies to modified adjusted gross income (MAGI)

### Through the back door...

Repeal of the provisions limiting conversions created an obvious opportunity for high-income taxpayers who wanted to make annual Roth contributions but couldn't because of the income limits. Those taxpayers (who would also run afoul of similar income limits that prohibited them from making deductible contributions to traditional IRAs) could simply make

nondeductible contributions to a traditional IRA and then immediately convert that traditional IRA to a Roth IRA--a "back door" Roth IRA.

### The IRS is always at the front door...

For taxpayers who have no other traditional IRAs, establishment of the back-door Roth IRA is essentially tax free. Income tax is payable on the earnings, if any, that the traditional IRA generates until the Roth conversion is complete. However, assuming the contribution and conversion are done in tandem, the tax impact should be nominal. (The 10% penalty tax for distributions prior to age 59½ generally doesn't apply to taxable

conversions.)

But if a taxpayer owns other traditional IRAs at the time of conversion, the tax calculation is a bit more complicated because of the so-called "IRA aggregation rule." When calculating the tax impact of a distribution (including a conversion) from any traditional IRA, all traditional and SEP/SIMPLE IRAs a taxpayer owns (other than inherited IRAs) must be aggregated and treated as a single IRA.

For example, assume Jillian creates a back-door Roth IRA in 2016 by making a \$5,500 contribution to a traditional IRA and then converting that IRA to a Roth IRA. She also has another traditional IRA that contains deductible contributions and earnings worth \$20,000. Her total traditional IRA balance prior to the conversion is therefore \$25,500 (\$20,000 taxable and \$5,500 nontaxable).

She has a distribution (conversion) of \$5,500: 78.4% of that distribution (\$20,000/\$25,500) is considered taxable (\$4,313.73), and 21.6% of that

distribution (\$5,500/\$25,500) is considered nontaxable (\$1,186.27).

Note: These tax calculations can be complicated. Fortunately, the IRS has provided a worksheet (Form 8606) for calculating the taxable portion of a conversion.

### There's also a side door...

Let's assume Jillian in the example above isn't thrilled about having to pay any income tax on the Roth conversion. Is there anything she can do about it?

One strategy to reduce or eliminate the conversion tax is to transfer the taxable amount in the traditional IRAs (\$20,000 in our example) to an employer qualified plan like a 401(k) prior to establishing the back-door Roth IRA, leaving the traditional IRAs holding only after-tax dollars. Many 401(k) plans accept incoming rollovers. Check with your plan administrator.

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