Wealth Rx
wealth and wellness tips to help you live better
March 2016
Wm WEALTH MANAGEMENT

Rates go negative

In mid-February, the Bank of Japan (BOJ) – Japan's central bank – lowered its funds interest rate to -0.1 percent. It meant the BOJ would begin charging private Japanese banks for holding on to excess cash reserves.

This Negative Interest Rate Policy (NIRP) is not unique to the BOJ. By "going negative," Japan joins the European Central Bank and the central banks of Sweden, Switzerland and Denmark.

Why are so many central banks doing this? Economic growth in several developed countries has recently slowed down as businesses have grown accustomed to low rates. Central bankers hope that pushing rates down into negative territory will help their economies resume expansion.

How it works

To understand how NIRP is supposed to help, try imagining what would happen if your personal bank accounts had negative interest rates. How would you react to paying to save money each month? What changes would you make to your finances?

You probably would reach the same conclusion as most people: "I need to minimize the money in my accounts." One option would be to invest the money so that it has a chance to grow; another option would be to spend it on a major purchase before you need to pay any interest.

These are essentially the same responses governments are hoping to incite from investment banks and large corporations. Economic slowdowns cause businesses to focus on saving money when central banks need them to spend it. The savings penalty created by negative rates squeezes hoarded cash out of corporate accounts and into new business investments.

NIRP also provides a strong signal that a central bank will do whatever it takes to promote healthy inflation and fight against a slowing economy. This means a NIRP can become a type of rallying point for businesses, creating enough confidence in future growth that companies proactively expand and turn their growth expectations into reality.

Effects at home

The BOJ's move to negative rates has raised questions about the future of America's monetary policy. In a world where several central banks have continued to lower rates, the United States has been trying to raise them. Economists and investors wonder whether America will be able to continue bucking the downward trend or if its rate hikes need to be stopped.

Rising interest rates often accompany economic success. Because the United States' economic recovery has drastically outpaced most other developed economies since 2009, it needed to start increasing its interest rates first. As its economy improves, its interest rates should need to be raised.

However, central bank rates must be compared to each other. Although the United States has only recently started raising rates, rate cuts in other countries have led some to believe that its relative rates are increasing too quickly. If the relative rates climb too much, the dollar could become too strong and other countries would stop buying U.S. goods, hurting the chances of further U.S. growth.

Will America go negative?

While anything could happen in the future, most experts currently believe U.S. rates will not go below zero. The U.S. Federal Reserve has said it studies negative rates and simulates them for bank "stress tests" but doesn't envision needing them. After years of aggressive quantitative easing and zero percent interest rates, it's unclear what new benefits negative rates would even provide for the U.S. economy.

It's also important to remember that countries can influence rates in both directions. As the world's two largest economies, the United States and China are in a position to help stimulate other economies through trade. If their growth and consumption become strong enough, the world economy will improve and rates in other countries will be brought above zero.

the February market

at a glance

U.S. Large Cap	U.S. Mid/Small	Foreign Large	Bond Market
(S&P 500)	(Russell 2000 Index)	(NYSE International 100)	(Dow Jones Equal Weight U.S. Issued Corporate Bond Index)
1,932.23	**1,033.90**	**4,333.22**	**347.84**
(-0.41%)	**(-0.14%)**	**(-4.47%)**	**(1.33%)**

February 2016 market data

in action

- The U.S. Bureau of Labor Statistics reports that average hourly earnings rose sharply in January, increasing by 0.5 percent from the month before. Economists attributed the large jump to higher employment rates and new minimum wage laws in many states.
- Moody's Investor Service downgrades Brazil's credit rating by two levels, officially making its sovereign bonds "junk." Brazil had already received junk ratings from the other two credit rating agencies, Standard & Poor's and Fitch Ratings.
- Thanks to the 2015 surge in the Chinese stock markets, Beijing surpasses New York as the "Billionaire Capital of the World." Beijing is now home to 100 billionaires; New York has 95.
- The U.S. Department of Commerce authorizes Cleber LLC, a tractor company, to build a factory in Cuba. It is the first factory a U.S. business has opened in Cuba in over 50 years.
- After seeing its Q4 profits drop more than 90 percent year-over-year, oil giant BP announces plans to cut more than 3,000 jobs before the end of 2017. Nearly all major oil and gas companies have announced workforce reductions during the past few months as oil prices remain at decade lows.
- China announces plans to lay off as many as 1.8M coal miners and steel workers in an effort to reduce industrial overcapacity. While unable to provide a specific time frame, Chinese officials said the process will take years.
- International Business Machines Corporation (IBM) agrees to buy Truven Health Analytics for $2.6B. It is the latest in IBM's steady acquisition of health-data companies as it works to improve the diagnostic capabilities of its "Watson" supercomputer program.
- Home-flooring producer Lumber Liquidator sees its market value tumble as the Center for Disease Control releases estimates showing that chemicals in some of the company's laminate flooring poses a cancer risk of six to 30 cases per 100,000 individuals. Lumber Liquidators stopped selling the contaminated flooring in early 2015.

Taxes and your portfolio

Taxes are an inevitable part of investing. The tax code complicates investment planning, and the impact of taxes has been steadily increasing as investment planning becomes more individualized.

With careful planning, you can minimize the effect that taxes have on your investments.

Types of taxes

A list of potential taxes could affect your investments, portfolio and net worth. Some of the more critical ones are as follows:

Interest

Interest you earn on investments (typically from bonds and large cash holdings) is subject to tax rates that are the same as your ordinary income tax rate.

Dividends

You'll have to pay taxes on dividends that come from stocks you own, but dividends are taxed with preferential treatment in comparison to ordinary income and interest income. To receive this treatment, the dividend must meet several requirements to be considered a qualified dividend.

Capital gains

When the value of your investments in stocks, bonds and other assets increases from the purchase price and you sell it for a profit, you'll trigger a capital gains tax. Similar to dividends, long-term capital gains are taxed at lower rates than ordinary income.

Estate tax

For investors with significant holdings, estate taxes can have a substantial effect on the total value they can pass on to heirs or charity. Planning for estate taxes is especially important, and there are many strategies to maximize the value of portfolio holdings.

Tax-advantaged accounts

Retirement Accounts

One of the most prominent ways to take advantage of tax-friendly regulations is to contribute to retirement accounts. These accounts can include 401(k)s or 403(b)s (depending on the type of employer), Individual Retirement Accounts (IRAs) and Keogh plans. All of these accounts qualify for preferential tax treatment and therefore are often referred to as qualified accounts. The benefits of deferring taxes can dramatically compound over time. For example, $1,000 invested in an IRA at a tax-deferred rate of 8 percent grows to $10,063 over 30 years. In a taxable account (assuming 28 percent tax rate), the funds would grow to only $5,366.

Roth and traditional IRAs are both effective ways to save for retirement. With a Roth IRA, you contribute money that has already been taxed in exchange for the ability to make tax-free withdrawals upon retirement. In a traditional IRA, your contributions are pre-tax, but you pay taxes on distributions later on. But how do you choose between the two? Your choice depends on how you think your future tax rate compares to your current tax rate. If you assume your individual tax rate is not going to change between now and retirement, then the net result will be the same regardless of which type of IRA you choose. When looking at changing tax rates, it is most important to focus on both the changing landscape of tax rates as a whole, as well as how changes in your income will affect which tax bracket you fall under. Generally, as people age they earn more money and enter higher tax brackets. In this case, and assuming no change in the overall level of taxes, it would be more beneficial to pay the taxes now, at a lower rate. However, if you believe that your tax rate will decrease, then traditional IRAs will be more beneficial.

Educational Accounts

Coverdell and 529 plans are tax-advantaged accounts that are similar in nature to 401(k) and IRA accounts. The difference is that Coverdell and 529 accounts can only take advantage of tax deferral if they are used for qualified educational purposes. Like retirement accounts, this characteristic can help maximize the funds that are set aside for educational funding needs. There are many different rules for these plans depending on their type and the state the account is initiated in, so appropriate planning is important before initiating educational accounts.

Tax-advantaged investments

In addition to tax-advantaged accounts, you can also choose tax friendly investments. For instance, municipal bonds are an ideal way to invest in fixed income while limiting the effect of taxes. Municipal bonds are any bonds issued by a U.S. city or other local government. The interest received by bondholders is generally exempt from federal income tax and from income tax in the state in which they are issued. On the other hand, municipal bonds are usually priced higher to account for these tax effects. However, the tax exemption on interest income will be more beneficial for individuals with significant income. Therefore, investing in municipal bonds may minimize the tax effect on investments for individuals in higher tax brackets.

In addition to taxes, you should also be aware of the effects of transaction costs and fees on your investments' growth. Tax-advantaged accounts help to alleviate these costs as well, making them practical for investors who want to save for retirement or education expenses. The uncertain outlook for taxes as they relate to investment planning makes it critical to stay up to date with new developments, and discuss strategies to minimize your tax burden with your financial and tax advisor.

March

is a great month to . . .

It's National Nutrition month. Started by the Academy of Nutrition and Dietetics, the initiative focuses on building awareness around healthy food choices. This year's theme is "Savor the Flavor of Eating Right" which presents the message that preparing food that is good for you does not have to sacrifice the style and flavors you like. Good nutrition and good taste can go together.

Learn how to balance nutrition with taste at **eatright**.

National Consumer Protection Week

National Consumer Protection Week is March 6-12th of 2016. Created to encourage consumers to make better informed decisions, the website provides information and tips for a vast array of topics from federal and state government as well as nonprofit partners.

Check it out at **www.ncpw.gov**

About Hooker & Holcombe Wealth Management

Contact:

Jonathan Gruber, AAMS®
Director, Wealth Management
860.856.2128
JGruber@hhconsultants.com

Katerina Nikolaou, CFP®
Financial Advisor
860.856.2067
KNikolaou@hhconsultants.com

h&h®
hooker & holcombe