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

Much ado about nothing

Ever since the U.S. Federal Reserve ("the Fed") ended its latest quantitative easing program in late 2014, people from all over the world have debated when it would increase interest rates. It seems like every financial news outlet and economist has spent the past year discussing when a rate hike could happen and the potential impact of getting it wrong. Various forecasts and models have been used to "test" each argued outcome of a hike — everything from rapid U.S. growth to global financial disaster. The market became so obsessed that the mere suggestion of an earlier-than-expected September hike caused market volatility to jump in August and helped push the S&P 500 down 10 percent in one week.

The arguments and analysis continued until December 16, when the Fed finally raised short-term interest rates for the first time in almost a decade. The world held its breath and financial markets prepared for anything.

But, the day passed and nothing terrible happened — almost nothing happened at all. The rate was raised minimally and people carried on. Despite months of frenzied coverage and concern, everything was calm and average.

Why did nothing happen?

The most important thing to understand about the December rate hike is that "nothing" was the Fed's goal. Although it was the first increase in nine years, the Fed worked hard to make it as comfortable as possible and gave people the opportunity to prepare. In fact, the Fed had so clearly signaled the hike was coming, it would have caused problems if it left the rate unchanged.

In addition to the heavy signaling and preparation time, the hike was designed to be very small. The target rate was moved from a range of 0–.25 percent up to a range of .25–.50 percent. By using these ranges, the Fed gave rates the opportunity to move closer to the new target before the actual hike took place. This allowed the real rate to change even more gradually than the official quarter-percent move.

The other important thing to recognize is that economies have momentum. It can take years to alter their course or change how they grow. The Fed's short-term interest rate holds a lot of power, but it's only designed to work as an economic nudge. To influence the economy, the Fed must continuously use its short-term rate changes to reflect a consistent, long-term goal for the United States.

Staying on the same page

The Fed wasn't the only party hoping for "nothing" from the rate hike. Banks and investors were doing everything they could to ensure a smooth transition. Changes to interest rates, even ones meant to promote economic growth, can be disastrous for those caught trading in affected markets.

Wall Street has been watching the Fed particularly closely over the past several months. Every document produced by Fed leaders was examined for details, while every economic indicator was analyzed for its impact on future interest rates. As the data came in, institutions and investors changed their market exposure for a post-hike market and, in doing so, created a market that was already adapted for the new rate.

No one knows what the future will bring for the economy and what will happen as the Fed continues to slowly normalize interest rates, but December was an important first step. The hike proved that as long as both the Fed and markets communicate and work together, they can accomplish "nothing" — which can be a very valuable thing.

the December 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)
2,043.94	**1,135.89**	**4,792.37**	**341.4**
(-1.75%)	**(-5.19%)**	**(-3.22%)**	**(-0.35%)**

December 2015 market data

in action

- The U.S. Department of Labor revised a number of third quarter economic statistics from the previous month, including raising annual productivity growth from 1.6 percent to 2.2 percent and annualized GDP growth from 1.5 percent to 2.1 percent.
- Following the birth of their first child, Facebook founder Mark Zuckerberg and his wife announced a plan to donate 99 percent of their Facebook shares to charity during their lives. At the time of the announcement, the shares were worth over $40B, making it one of the largest charitable pledges in history.
- Chemical industry giants Dow Chemical Co. and DuPont agreed on a $130B merger. One of the most significant aspects of the merger is the age of the companies; Dow Chemical is nearly 120 years old, while DuPont is over 210 years old—one of America's oldest companies.
- Finland's government starts a proposal to replace its current welfare system with a government-provided monthly income of €800 (around $10,000 annually) for every adult citizen. Despite being untaxed, the guaranteed income system is projected to improve the Finnish government's budget.
- American pharmaceutical company Pfizer Inc. plans to acquire Irish competitor Allergan, Inc. and move its corporate headquarters to Ireland. Pfizer is using the move to take advantage of Ireland's low-tax environment and has become one of the largest U.S. companies to emigrate using a "corporate inversion."
- A report from Pew Research Center reveals that the U.S. middle class no longer represents the majority of the country, comprising just under 50 percent of the adult population. The report shows that the middle class has been steadily shrinking since it included 61 percent of people in the 1970s.
- An early MasterCard® SpendingPulse™ report shows that holiday retail sales (sales between Thanksgiving and Christmas) rose a strong 7.9 percent from the same time last year. Online sales continued to become increasingly important to retailers, growing 20 percent since last year.

Helping fund a grandchild's education

Being able to dote on grandchildren is one of the advantages of being a grandparent. But some gifts, like a college education, are a bit too big to just be handed out.

For grandparents (or other extended family members) who want to support a child's education there are a number of methods available for use — each with their own advantages and uses. All provide financial support for the student, of course, but each has its own challenges and tax considerations to be taken into account.

Creating and funding a 529 Plan

A 529 plan is a savings account that has been qualified by state governments for the express purpose of saving for a child's education. 529s work a lot like qualified retirement accounts, except use of funds is limited to educational expenses. Since 529s can take contributions from almost anyone, only one account is needed for each future student. If a child's parents have already created an account, grandparents do not need to set up a second 529, they can simply add to the parents' savings.

Tax benefits of 529s vary from state to state, so it is essential that local rules be considered prior to opening an account. There are two types of 529 plans: "college savings plans" and "prepaid tuition plans."

College savings plans are the more common of the two. After the account is created and the beneficiary is selected, contributions are made and the investments are chosen. The investments are permitted to grow tax-free. Accounts are offered by the state but are not necessarily managed by them; state-appointed managers determine the investment funds available for 529s to use. Once the beneficiary begins paying for college, funds may be withdrawn to cover any number of school-related expenses.

There are three notable benefits of 529 college savings plans. First, contributions grow tax free, allowing money to compound quickly. Second, many states offer partial or full state income tax deductions on contributions (if the state has income tax). Third, the account requires that a beneficiary use the money for educational purposes.

The other 529 plan type, "prepaid tuition plans," is much different from college savings plans and is offered by fewer states. Prepaid tuition plans work exactly as their name suggests: they allow an adult to prepay semesters of tuition at a price tied to the tuition's current cost. If tuition prices are expected to rise, this can significantly decrease the amount of money spent on tuition.

Trusts

Trusts are another excellent way to set aside money for a child's education. Though more expensive to establish than a 529, trusts allow their grantors (creators) control over when trust funds are distributed and what investments are selected. This can be highly beneficial for a grandparent who would like to support a grandchild's first business venture rather than fund their college education.

Unfortunately, trusts can become much more complex than 529s and do not offer tax advantages to contributions or investment growth. To avoid reducing future estate tax exemptions grantors should limit their yearly contributions to the annual tax-exempt gift amount, which is set by the IRS on a yearly basis. In addition, beneficiaries must be given the legal right to withdraw gifts for 30 days after they are made. Trusts, therefore, take cooperation and understanding between grantor and beneficiary.

UTMA accounts

The UTMA savings accounts are those allowed by the Uniform Transfer to Minors Act. UTMA accounts are meant to hold gifts made to a minor until he or she reaches an adult age (either 18 or 21).

Though UTMA accounts are extremely simple to create and fund, they have a risky component. Money in an UTMA passes to a recipient's sole ownership when he or she reaches the required age. This means the recipient is allowed to use funds at his or her discretion and is not required to spend it on education.

Giving or paying outright

Apart from variety of account strategies, individuals can simply mail a check to a college and pay off a student's tuition for that year or semester. If the tuition is paid directly to the institution, it is not considered a gift by the federal government and is not subject to gift tax. However, this method can only cover tuition; any further money given to support the child will be considered a gift and will be subject to any gift-tax consequences.

Filling a need

Whatever method grandparents choose to use to help grandchildren pay for college, they need to work in close communication with the parents. The Free Application for Federal Student Aid (FAFSA) takes into account all money held directly (or in trust) by both a student and his or her parents. UTMA and direct gifts put under a student's ownership can quickly lower the amount of aid the government is willing to give a student. Financial support prepared and controlled by grandparent's 529s or trusts are usually not taken into account before they are used. However, once support has been given, it will lower the aid a student receives the following year.

To ensure FAFSA is used to its full potential, it can be wise for a grandparent to withhold distributions for college costs until later in the student's career. For instance, if a grandparent wants to pay for one year of a student's college education, he or she can wait until the last year when its effects on FAFSA will no longer be a concern. If a grandparent pays for only the first year of college, the student will likely be robbed of federal support the next year, making it difficult for him or her to continue a college education.

When it comes to making a grandchild's education a priority, grandparents have a few tools and techniques available to them. By seeking financial advice from our Wealth Management experts and carefully weighing benefits, adults and students can find the most beneficial option available to them.

January

is a great month to . . .

January is national mentoring month. This month-long campaign strives to bring attention to the need for more volunteer mentors and how they help America's youth reach their full potential.

Mentorships are a win-win for everyone involved. Statistics show that mentorships help young people's personal, academic and professional development. For mentors, the rewards include developing communication and leadership skills while helping someone else. Many mentors say that the rewards of mentoring are as great for themselves as their mentee.

To learn more about mentoring and how you or someone you know can participate, go to **mentoring.org**

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