



# Hummel Group Wealth Management

## *Planning Your Financial Future*

### Mid-Year 2016: An Investment Reality Check



Market volatility is alive and well in 2016. Low oil prices, China's slowing growth, the prospect of rising interest rates, the strong U.S. dollar, global conflicts--all of these factors have contributed to turbulent markets this year.

Many investors may be tempted to review their portfolios only when the markets hit a rough patch, but careful planning is essential in all economic climates. So whether the markets are up or down, reviewing your portfolio with your financial professional can be an excellent way to keep your investments on track, and midway through the year is a good time for a reality check. Here are three questions to consider.

#### 1. How are my investments doing?

Review a summary of your portfolio's total return (minus all fees) and compare the performance of each asset class against a relevant benchmark. For stocks, you might compare performance against the S&P 500, Russell 2000, or Global Dow; for mutual funds, you might use the Lipper indexes. (Keep in mind that the performance of an unmanaged index is not indicative of the performance of any specific security, and you can't invest directly in an unmanaged index.)

Consider any possible causes of over- or underperformance in each asset class. If any over- or underperformance was concentrated in a single asset class or investment, was that consistent with the asset's typical behavior over time? Or was recent performance an anomaly that bears watching or taking action? In addition, make sure you know the total fees you are paying (e.g., mutual fund expense ratios, transaction fees), preferably as a dollar amount and not just as a percentage of assets.

#### 2. Is my investment strategy on track?

Review your financial goals (e.g., retirement, college, house, car, vacation fund) and market outlook for the remainder of the year to determine whether your investment asset mix for each goal continues to meet your time frame, risk tolerance, and overall needs. Of course, no one knows exactly what the markets

will do in the future, but by looking at current conditions, you might identify factors that could influence the markets in the months ahead--things like inflation, interest rates, and economic growth projections from the Federal Reserve. With this broader perspective, you can then update your investment strategy as necessary.

Remember, even if you've chosen an appropriate asset allocation strategy for various goals, market forces may have altered your mix without any action on your part. For example, maybe your target was 70% stocks and 30% bonds, but now you have 80% stocks and 20% bonds. To return your asset mix back to its original allocation, you may want to rebalance your investments. This can be done by selling investments and transferring the proceeds to underrepresented asset classes, or simply by directing new contributions into asset classes that have been outpaced by others. Keep in mind that rebalancing may result in commission costs, as well as taxes if you sell investments for a profit.

*Asset allocation does not guarantee a profit or protect against loss; it is a method used to help manage investment risk.*

#### 3. Am I maximizing my tax savings?

Taxes can take a significant bite out of your overall return. You can't control the markets, but you can control the accounts you use to save and invest, as well as the assets you choose to hold in those accounts. Consider the "tax efficiency" of your investment portfolio. Certain types of investments tend to result in larger tax bills. For example, investments that generate interest or produce short-term capital gains are taxed as ordinary income, which is usually a higher rate than long-term capital gains. Dividing assets strategically among taxable, tax-deferred, and tax-exempt accounts may help reduce the effect of taxes on your overall portfolio.

*All investing involves risk, including the loss of principal, and there can be no guarantee that any investing strategy will be successful.*

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Q&As on Roth 401(k)s

Common Financial Wisdom: Theory vs. Practice

I have matured U.S. savings bonds. Are they still earning interest and, if not, can I roll them over to another savings bond?

## Q&As on Roth 401(k)s

The Roth 401(k) is 10 years old! With 62% of employers now offering this option, it's more likely than not that you can make Roth contributions to your 401(k) plan.<sup>1</sup> Are you taking advantage of this opportunity?

### What is a Roth 401(k) plan?

A Roth 401(k) plan is simply a traditional 401(k) plan that permits contributions to a designated Roth account within the plan. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. This means there's no up-front tax benefit, but if certain conditions are met both your contributions and any accumulated investment earnings on those contributions are free of federal income tax when distributed from the plan.

### Who can contribute?

Anyone! If you're eligible to participate in a 401(k) plan with a Roth option, you can make Roth 401(k) contributions. Although you cannot contribute to a Roth IRA if you earn more than a specific dollar amount, there are no such income limits for a Roth 401(k).

### Are distributions really tax free?

Because your contributions are made on an after-tax basis, they're always free of federal income tax when distributed from the plan. But any investment earnings on your Roth contributions are tax free only if you meet the requirements for a "qualified distribution."

In general, a distribution is qualified if:

- It's made after the end of a five-year holding period, *and*
- The payment is made after you turn 59½, become disabled, or die

The five-year holding period starts with the year you make your first Roth contribution to your employer's 401(k) plan. For example, if you make your first Roth contribution to the plan in December 2016, then the first year of your five-year holding period is 2016, and your waiting period ends on December 31, 2020. Special rules apply if you transfer your Roth dollars over to a new employer's 401(k) plan.

If your distribution isn't qualified (for example, you make a hardship withdrawal from your Roth account before age 59½), the portion of your distribution that represents investment earnings will be taxable and subject to a 10% early distribution penalty, unless an exception applies. (State tax rules may be different.)

### How much can I contribute?

There's an overall cap on your combined pretax and Roth 401(k) contributions. In 2016, you can contribute up to \$18,000 (\$24,000 if you are

age 50 or older) to a 401(k) plan. You can split your contribution between Roth and pretax contributions any way you wish. For example, you can make \$10,000 of Roth contributions and \$8,000 of pretax contributions. It's totally up to you.

### Can I still contribute to a Roth IRA?

Yes. Your participation in a Roth 401(k) plan has no impact on your ability to contribute to a Roth IRA. You can contribute to both if you wish (assuming you meet the Roth IRA income limits).

### What about employer contributions?

While employers don't have to contribute to 401(k) plans, many will match all or part of your contributions. Your employer can match your Roth contributions, your pretax contributions, or both. But your employer's contributions are always made on a pretax basis, even if they match your Roth contributions. In other words, your employer's contributions, and any investment earnings on those contributions, will be taxed when you receive a distribution of those dollars from the plan.

### Can I convert my existing traditional 401(k) balance to my Roth account?

Yes! If your plan permits, you can convert any portion of your 401(k) plan account (your pretax contributions, vested employer contributions, and investment earnings) to your Roth account. The amount you convert is subject to federal income tax in the year of the conversion (except for any after-tax contributions you've made), but qualified distributions from your Roth account will be entirely income tax free. The 10% early-distribution penalty generally doesn't apply to amounts you convert.<sup>2</sup>

### What else do I need to know?

Like pretax 401(k) contributions, your Roth contributions can be distributed only after you terminate employment, reach age 59½, incur a hardship, become disabled, or die. Also, unlike Roth IRAs, you must generally begin taking distributions from a Roth 401(k) plan after you reach age 70½ (or, in some cases, after you retire). But this isn't as significant as it might seem, because you can generally roll over your Roth 401(k) money to a Roth IRA if you don't need or want the lifetime distributions.

<sup>1</sup> Plan Sponsor Council of America, *58th Annual Survey of Profit Sharing and 401(k) Plans* (2015) (Reflecting 2014 Plan Experience)

<sup>2</sup> The 10% penalty tax may be reclaimed by the IRS if you take a nonqualified distribution from your Roth account within five years of the conversion.



### Which is the better option, pretax or Roth contributions?

*The answer depends upon your personal situation. If you think you'll be in a similar or higher tax bracket when you retire, Roth 401(k) contributions may be more appealing, since you'll effectively lock in today's lower tax rates. However, if you think you'll be in a lower tax bracket when you retire, pretax 401(k) contributions may be more appropriate. Your investment horizon and projected investment results are also important factors.*



## Common Financial Wisdom: Theory vs. Practice



*It might not always be possible to follow some common financial wisdom.*

*Note: All investing involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.*

In the financial world, there are a lot of rules about what you *should* be doing. In theory, they sound reasonable. But in practice, it may not be easy, or even possible, to follow them. Let's look at some common financial maxims and why it can be hard to implement them.

### Build an emergency fund worth three to six months of living expenses

**Wisdom:** Set aside at least three to six months worth of living expenses in an emergency savings account so your overall financial health doesn't take a hit when an unexpected need arises.

**Problem:** While you're trying to save, other needs--both emergencies and non-emergencies--come up that may prevent you from adding to your emergency fund and even cause you to dip into it, resulting in an even greater shortfall. Getting back on track might require many months or years of dedicated contributions, leading you to decrease or possibly stop your contributions to other important goals such as college, retirement, or a down payment on a house.

**One solution:** Don't put your overall financial life completely on hold trying to hit the high end of the three to six months target. By all means create an emergency fund, but if after a year or two of diligent saving you've amassed only two or three months of reserves, consider that a good base and contribute to your long-term financial health instead, adding small amounts to your emergency fund when possible. Of course, it depends on your own situation. For example, if you're a business owner in a volatile industry, you may need as much as a year's worth of savings to carry you through uncertain times.

### Start saving for retirement in your 20s

**Wisdom:** Start saving for retirement when you're young because time is one of the best advantages when it comes to amassing a nest egg. This is the result of compounding, which is when your retirement contributions earn investment returns, and then those returns produce earnings themselves. Over time, the process can snowball.

**Problem:** How many 20-somethings have the financial wherewithal to save earnestly for retirement? Student debt is at record levels, and young adults typically need to budget for rent, food, transportation, monthly utilities, and cell phone bills, all while trying to contribute to an emergency fund and a down payment fund.

**One solution:** Track your monthly income and expenses on a regular basis to see where your money is going. Establish a budget and try to

live within your means, or better yet *below* your means. Then focus on putting money aside in your workplace retirement plan. Start by contributing a small percentage of your pay, say 3%, to get into the retirement savings habit. Once you've adjusted to a lower take-home amount in your paycheck (you may not even notice the difference!), consider upping your contribution little by little, such as once a year or whenever you get a raise.

### Start saving for college as soon as your child is born

**Wisdom:** Benjamin Franklin famously said there is nothing certain in life except death and taxes. To this, parents might add college costs that increase every year without fail, no matter what the overall economy is doing. As a result, new parents are often advised to start saving for college right away.

**Problem:** New parents often face many other financial burdens that come with having a baby; for example, increased medical expenses, baby-related costs, day-care costs, and a reduction in household income as a result of one parent possibly cutting back on work or leaving the workforce altogether.

**One solution:** Open a savings account and set up automatic monthly contributions in a small, manageable amount--for example, \$25 or \$50 per month--and add to it when you can. When grandparents and extended family ask what they can give your child for birthdays and holidays, you'll have a suggestion.

### Subtract your age from 100 to determine your stock percentage

**Wisdom:** Subtract your age from 100 to determine the percentage of your portfolio that should be in stocks. For example, a 45-year-old would have 55% of his or her portfolio in stocks, with the remainder in bonds and cash.

**Problem:** A one-size-fits-all rule may not be appropriate for everyone. On the one hand, today's longer life expectancies make a case for holding even more stocks in your portfolio for their growth potential, and subtracting your age from, say, 120. On the other hand, considering the risks associated with stocks, some investors may not feel comfortable subtracting their age even from 80 to determine the percentage of stocks.

**One solution:** Focus on your own tolerance for risk while also being mindful of inflation. Consider looking at the historical performance of different asset classes. Can you sleep at night with the investments you've chosen? Your own peace of mind trumps any financial rule.

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## I have matured U.S. savings bonds. Are they still earning interest and, if not, can I roll them over to another savings bond?

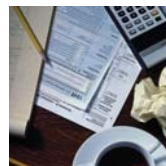
Once U.S. savings bonds have reached maturity, they stop earning interest. Prior to 2004, you could convert your Series E or EE savings bonds for Series HH bonds. This would have allowed you to continue earning tax-deferred interest. However, after August 31, 2004, the government discontinued the exchange of any form of savings bonds for HH bonds, so that option is no longer available.

Since matured savings bonds no longer earn interest, there is no financial benefit to holding on to them. If you have paper bonds, you can cash them in at most financial institutions, such as banks or credit unions. However, it's a good idea to call a specific institution before going there to be sure it will redeem your bonds. As an alternative, you can mail them to the Treasury Retail Securities Site, PO Box 214, Minneapolis, MN 55480, where they will be redeemed. If you have electronic bonds, log on to [treasurydirect.gov](http://treasurydirect.gov) and follow the directions there. The proceeds from your redeemed bonds can be deposited directly into your checking or savings account for a relatively

quick turnover.

Another important reason to redeem your matured savings bonds may be because savings bond interest earnings, which can be deferred, are subject to federal income tax when the bond matures or is otherwise redeemed, whichever occurs first. So if you haven't previously reported savings bond interest earnings, you must do so when the bond matures, even if you don't redeem the bonds.

Using the money for higher education may keep you from paying federal income tax on your savings bond interest. The savings bond education tax exclusion permits qualified taxpayers to exclude from their gross income all or part of the interest paid upon the redemption of eligible Series EE and I bonds issued after 1989 when the bond owner pays qualified higher-education expenses at an eligible institution. However, there are very specific requirements that must be met in order to qualify, so consult with your tax professional.



## Can I make charitable contributions from my IRA in 2016?

Yes, if you qualify. The law authorizing qualified charitable distributions, or QCDs, has recently been made

permanent by the Protecting Americans from Tax Hikes (PATH) Act of 2015.

You simply instruct your IRA trustee to make a distribution directly from your IRA (other than a SEP or SIMPLE) to a qualified charity. You must be 70½ or older, and the distribution must be one that would otherwise be taxable to you. You can exclude up to \$100,000 of QCDs from your gross income in 2016. And if you file a joint return, your spouse (if 70½ or older) can exclude an additional \$100,000 of QCDs. But you can't also deduct these QCDs as a charitable contribution on your federal income tax return—that would be double dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA in 2016, just as if you had received an actual distribution from the plan. However, distributions (including RMDs) that you actually receive from your IRA and subsequently transfer to a charity cannot qualify as QCDs.

For example, assume that your RMD for 2016 is \$25,000. In June 2016, you make a \$15,000 QCD to Qualified Charity A. You exclude the \$15,000 QCD from your 2016 gross income. Your \$15,000 QCD satisfies \$15,000 of your \$25,000 RMD. You'll need to withdraw another \$10,000 (or make an additional QCD) by December 31, 2016, to avoid a penalty.

You could instead take a distribution from your IRA and then donate the proceeds to a charity yourself, but this would be a bit more cumbersome and possibly more expensive. You'd include the distribution in gross income and then take a corresponding income tax deduction for the charitable contribution. But the additional tax from the distribution may be more than the charitable deduction due to IRS limits. QCDs avoid all this by providing an exclusion from income for the amount paid directly from your IRA to the charity—you don't report the IRA distribution in your gross income, and you don't take a deduction for the QCD. The exclusion from gross income for QCDs also provides a tax-effective way for taxpayers who don't itemize deductions to make charitable contributions.