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FINANCIAL ASSOCIATES

First Quarter 2019

Guide...Protect...Preserve

Uncle Sam Wants You Investing In Poor Areas

Capital gains are a good problem but a tax problem nonetheless. An excellent new way to defer paying tax on a capital gain is by investing in an area designated by Uncle Sam as an Opportunity Zone (OZ).

When you invest in a business or real estate project in an "OZ," capital gains taxes on selling stocks, a business, or any other investment can be deferred. You put pre-tax dollars to work in an OZ, which delays the capital gain taxes owed, and the extra investment of pre-tax dollars — if it generates profits — defrays your capital gain.

In effect, Uncle Sam wants you to become a venture capitalist in a low-income place. However, you take on the risk that the investment might go bust.

A burgeoning marketplace of OZ funds has developed and enables you to invest the proceeds of a capital gain into a fund set up to invest in an OZ. Getting in on a fund isn't cheap, however, and $1 million minimum investments are common. Immediately, your reinvested capital gain is tax-deferred, putting an additional 15% or 20% more into your OZ investment.

To be clear, capital gains on the federal level are taxed at the 15% rate, and at 20% for married couples filing jointly with more than $488,851 of adjusted gross income ($434,551 for singles). If you're in that tax bracket and sell a business or securities with a $1 million gain, instead of paying $150,000 or $200,000 in capital gains taxes, you can defer taxes owed by investing in an OZ.

You don't have to pay the gains tax until you sell your interest in the opportunity zone (OZ) fund. If you stay in the fund for five years, you pay tax on only 90% of your delayed capital

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Key Tariffs, Rates And Economic Facts To Note In Fearful Times

Tariffs, interest rates, and recession struck fear deep in the heart of investors as 2019 was beginning. A market crash, a world financial crisis, or something worse. Here are some facts to help you keep perspective in these fearful times.

Assuming a trade war with China, JP Morgan earlier this year concluded it would result in a $125 billion tariff on $500 billion worth of imports on Chinese goods, but shave U.S. economic growth in 2019 by just one-tenth of 1%, according to an October 8, 2018 by Bob Davis, a senior editor at *The Wall Street Journal*.

Frightening headlines about Fed monetary policy have widely reported that, with the yield curve inverted, a recession is on the horizon. Actually, what the yield curve central bankers care about most — the one used to predict a recession — has not inverted. The financial press often mistakenly reports on the two-year versus 10-year Treasury bond when the yield curve that's most relevant in forecasting recessions is the 90-day Treasury.

No one can predict the next market turn and past performance is not a guarantee of the future of your investments. However, key economic fundamentals, like monthly orders by purchasing managers at large companies, were near a record high in November; real wage gains, which have repeatedly broken record high for three years, according to the Bureau of Labor Statistics, grew in the 12 months through October by 1.1%. These are not signs of a recession.

Mary Jane Callaghan &
Mitch Glicksman

Is Amazon Keeping The Inflation Rate Low?

Amazon's 2017 annual 10(K) federal financial filing reported $4.1 billion in net operating income. But the profit was entirely attributable to Amazon's tech infrastructure line of business, Amazon Web Services (AWS). Amazon's retail sales business reported a loss.

Unless you're a professional securities analyst or MBA, it may not be easy to discern that Amazon lost money on its main business from the company's required 10(K) annual public disclosure filing with the U.S. Securities and Exchange Commission. But it's disclosed in this table on page 69 of Amazon's 10(K) for 2017. AWS earned a $4.3 billion profit on $17.5 in net sales revenue, while total profits were $4.1 billion on well over $100 billion of sales.

Amazon could afford to take a loss on its retail business. It's a long-term investment in gaining market share. Losses taken on dominating internet retailing were offset by AWS, Amazon's business of building the infrastructure of the web, which has been very profitable.

With its strategy to expand retail market share based on razor-thin profit margins, Amazon transformed retail sales and consumer behavior over the last decade. Before buying at a traditional retail store, consumers now routinely check their phones for a lower price online. The increased efficiency of internet sales enables consumers to buy goods at insanely low prices. While Amazon became the Crazy Eddie of the internet era, it has caused disinflation.

Inflation has always been a somewhat mysterious factor in the economy. It's hard to understand its causes, and harder to control. Officials at the U.S. Federal Reserve Board have conceded in recent years their surprise at the persistently low inflation rate. Amazon is likely a factor in why prices are not rising fast in the economic boom.

This is not a recommendation to buy or sell Amazon securities but an observation about the internet retailer's impact on the U.S. rate of inflation and its implications for economic growth. In the second quarter of 2018, the government reported a 2.9% surge in productivity because real wages *after* inflation declined, lowering the cost of an employee to companies by nearly 1%, according to the Bureau of Labor Statistics quarterly report through June 2018.

Declining unit labor costs amid real wages is a positive for economic growth, and internet retailing is an influence in the economy to keep an eye on. Among the swirl of forces that affect inflation, ranging from international oil politics to the Federal Reserve, your Amazon shopping cart is playing a role. ●

Amazon's 2017 Financials; A Cause Of Disinflation

Information on reportable segments and reconciliation to consolidated net income (loss) is as follows (in millions):

	Year Ended December 31, 2015	2016	2017
North America			
Net sales	$ 63,708	$ 79,785	$ 106,110
Operating expenses	62,283	77,424	103,273
Operating income	$ 1,425	$ 2,361	$ 2,837
International			
Net sales	$ 35,418	$ 43,983	$ 54,297
Operating expenses	36,117	45,266	57,359
Operating income (loss)	$ (699)	$ (1,283)	$ (3,062)
AWS			
Net sales	$ 7,880	$ 12,219	$ 17,459
Operating expenses	6,373	9,111	13,128
Operating income	$ 1,507	$ 3,108	$ 4,331
Consolidated			
Net sales	$ 107,006	$ 135,987	$ 177,866
Operating expenses	104,773	131,801	173,760
Operating income	2,233	4,186	4,106
Total non-operating income (expense)	(665)	(294)	(300)
Provision for income taxes	(950)	(1,425)	(769)
Equity-method investment activity, net of tax	(22)	(96)	(4)
Net income	$ 596	$ 2,371	$ 3,033

Net sales by groups of similar products and services is as follows (in millions):

Source: Amazon's 2017 10-K report, page 69.

Sun Starts Setting On Solar Tax Credit From Uncle Sam

The sun is shining on the tax credit for solar power but this federal tax credit that lightens your tax burden significantly starts sunsetting in 2020.

The good news is that the cost of solar panels and equipment is dropping, down about 6.5% in 2018, and putting in solar panels can cut your utility bills by a lot. The bad news is the upfront cost isn't cheap — an average of $13,188 in 2018, according to EnergySage, a marketplace for solar equipment.

Luckily, federal tax credits can cut your cost. That $13,188 upfront cost is after taking the tax credit. Far more valuable than a deduction against your taxable income, a credit reduces your tax dollar for dollar. But you better hurry to beat the phase-out of the credits.

Currently, the tax credit reduces the net cost of a solar system in residential and commercial properties by 30%. In 2020, that drops to 26%, and drops again in 2021 to 22%. The credit then zeroes out in 2022. The break for commercial use does remain, but only at 10%.

One small saving grace is that some states, local governments, and utilities also offer rebates and other tax incentives that can further lower the solar system costs. In the meantime, while the credit lasts, qualifying expenses include the panels themselves, the wiring to connect them to your home electrical system, and the cost of the labor in the installation.

If you don't have a big enough tax liability to use the full credit to cut your tax bill, the amount left over can be carried forward to the next tax year. The home served by solar power does not have to be your principal residence, and no limit is placed on the dollar amount of your credit, which is good if you own a large home.

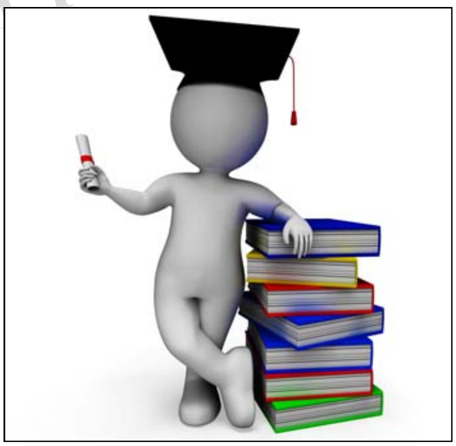
A caveat: Should you rent out your home for part of the year, you have to reduce the credit for the time you're not present. In an example from TurboTax, if you live in the house for just three months, your credit is one quarter of the

HSA Or FSA: Which Is Better For Medical Savings?

Health insurance deductibles and co-payments, plus uncovered items like your child's braces, can put a dent on your bank account.

That's why flexible spending and health savings accounts, where you put money away tax-free to pay for out-of-pocket health-care expenses, generally are good ideas. What's better, the saved money from an FSA and an HSA lowers your reported taxable income, just like contributing to a retirement account. Which is the best for you, though, an FSA or an HSA?

First let's look at how they are constructed. You can get into these health accounts during your employer's open enrollment period, which usually runs through December.



You also can enroll if you have a "qualifying life event," such as a change in marital status, a new child, or the death of a spouse or dependent. And if you take a new job, you can sign up within 30 days.

Most employers don't offer both an FSA and an HSA and, usually if they do, you can't get into both. If you have a choice, knowing the differences is important. Among other things, you can put more money into an HSA and roll it over into a new year. But an FSA lets you take money out even before you have contributed it.

Flexible spending accounts. For 2018, the maximum contribution you can make is $2,650 and this rises to $2,700 in 2019. That's not a lot, but if your spouse has health coverage, he or she can take out another FSA.

A big downside is the use-it-or-lose-it rule. Should you fail to spend all the money in your fund by year-end, you lose it. As a result, you have to estimate how much you'll need to pay yourself in the coming year.

At least companies have the option of giving employees until March 15 to spend leftover money or even keep up to $500 for the next year. Many don't do that, though.

The good thing is that you can start spending the whole sum you designated for the year ahead on Jan. 1, even though your contributions are spread over the coming 12 months. Leave the job and you can't take the money with you, as you would with a retirement account—or an HSA.

Health savings accounts. The advantage here, of being able to sock away more money and not forfeiting the unused amount on Dec. 31, is considerable.

In 2018, a single person can save $3,450 in an HSA and in 2019, $3,500. A family: $6,900 and $7,000. Further, if you're 55 and older, you can put in an extra $1,000 as a catch-up. In addition, self-employed people can create an HSA for themselves, but not an FSA.

But HSAs have their weaknesses. To set one up in both 2018 and 2019, your health plan needs to have a yearly deductible of $1,350 for an individual and $2,700 for a family. That's a bit steep.

Regardless, either plan can be a boon tax-wise. Utilizing FSAs and HSAs are best considered within a strategic tax plan, which is technical and depends on your personal circumstances. We're here to help with any questions. ●

amount you'd benefit by had you lived in the place year-round: So, for a system costing $10,000, the 30% credit is $3,000, but you as a part-time resident and landlord get only $750. Rent out the house for the entire year, and you get zilch.

Certainly, some systems cost more than others. For instance, if you have a rectangular south-facing roof, your installation is simple. Yet if the roof is broken up by dormers, skylights and multiple levels, putting in a system is trickier, and more expensive. Nonetheless, whatever you end up paying, the shiniest deals are available now, so you may want to act before the sun starts to set on solar tax credits from Uncle Sam. ●

Bitcoin, Chasing Your Tail, And Investing

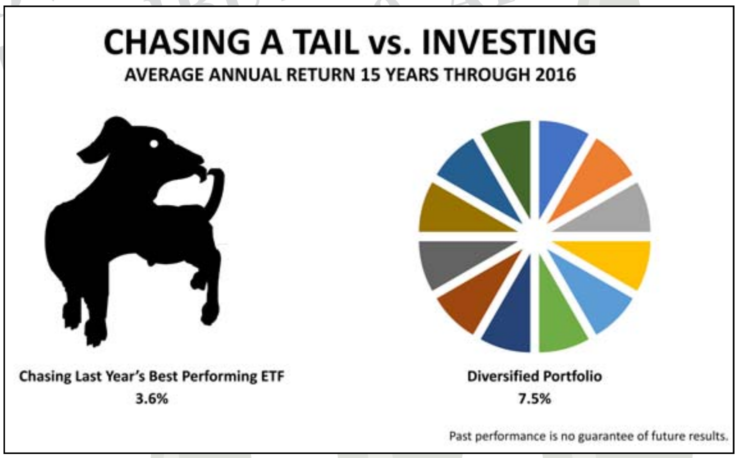
Thinking about Bitcoin? Could be a good time to hop on, right? Wrong! Usually, by the time the average investor jumps on a gaudy, freewheeling bandwagon, it's too late. The price spike has already occurred. If the investment is a fad, a sickening plummet may well await you.

Bitcoin blasted to a record high at rocket speed, hitting $19,783 on December 17, 2017, before plunging 25% in the next 10 days. The crypto-currency may yet be destined for greatness over the long-term, but its supersonic ascent and subsequent nosedive look much like other notorious investment fads.

In 1637, Dutch investors lost their bloomers on tulip bulbs. During tulip-mania, prices for bulbs reportedly rose from November 1636 to February 1637 by 2000%, according to academic research published on Wikipedia.

These objects of desire were flowers. It made no sense. The crash of the bulbs shattered lives and has ever since served as a beacon in financial history, warning investors of the risk in chasing performance.

Investing in Bitcoin makes little sense considering that it is one of many crypto-currencies being mined on the Internet. The value of a crypto currency is set by supply and demand and supply is set by a software program that's not tied to a sovereign state. Transactions are easily hidden from tax authorities. Ultimately, crypto-currencies compete with sovereign nations, which is why some governments are starting to move to regulate them. In the time this was written, not only had the price of Bitcoin plunged 25%, but South Korea became the first nation to ban all anonymous crypto currencies and regulate the rest.



Bitcoin's ascent was easy to spot as a mania, but the modern-day danger inherent in chasing hot performing investments is often far less apparent. For example, say you bought the No. 1 performing Exchange Traded Fund annually for 15 years through 2016. Sound like it could be a strategy for success? Think again, according to Dr. Craig Israeslen, Ph.D., who teaches portfolio design techniques to financial professionals. Your average annual return was 3.6% — less than half the annual return of a broadly diversified portfolio invested across 12 different types of assets equally and rebalanced systematically every year over the same 15-year period through 2016.

Human nature makes people susceptible to investment manias, shiny bright objects like Bitcoin, and chasing last-year's winners. It's why people will always need investment professionals to stay focused on economic fundamentals, quantitative analysis, controlling fear and greed. ●

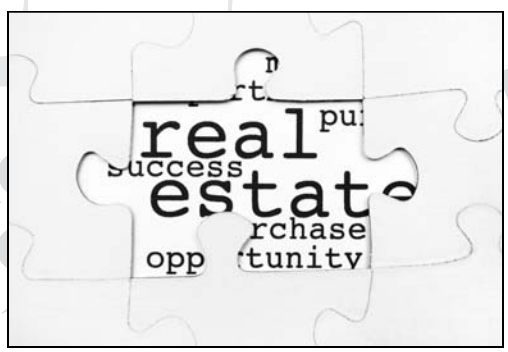
Investing In Poor Areas

(Continued from page 1)

gains. If your investment lasts for seven years, you pay tax on 85% of the gains. And if you stick around for 10 years, the appreciation on the OZ investment is tax-free when you exit the fund (assuming that the investment has increased, that is).

Let's say that a jewelry-making start-up you invested in has doubled in value. In addition to the capital gains reduction, your investment showed a tidy appreciation that you pocket without a tax bite. Along the way, you presumably would get a piece of any income the investments throw off, such as rent from a real estate development.

Some of these OZ areas are more down-and-out than others. The most prominent is Long Island City, a waterfront section of the New York borough of Queens, which just happens to be where Amazon is going to place one of its two new headquarters. Once a seedy stretch of vacant warehouses and factories, Long Island City had been gaining cachet even before the Amazon announcement in November. For the past few years, expensive residential high-rises have been sprouting up amid the post-industrial desolation. It stands to reason that an opportunity-zone investment in Long Island City has a better chance of yielding a great return than a slum in Buffalo, N.Y. Other gentrifying OZs include Oakland, Calif.; East Austin, Texas; and South Norwalk, Conn.



OZ investing may sound inspirational, but this is new turf in tax and financial planning. It requires personal tax planning and investment research to ensure investments have promise, are not too expensive and are aligned with your risk tolerance as well as social objectives, and we are happy to answer any questions. ●

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