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FINANCIAL ASSOCIATES
Third Quarter 2018

Guide...Protect...Preserve

Fed Shatters Conventional Economic Wisdom

Conventional economic wisdom holds that the record-low unemployment rate will cause employers to bid up wages, which then will be passed through to consumers in the form of higher prices, triggering rising inflation. However, conventional wisdom is being shattered.

Just as civilization came to understand that the world is not flat, the world just recently realized that the framework for understanding the relationship between inflation and employment, The Phillips Curve, was wrong.

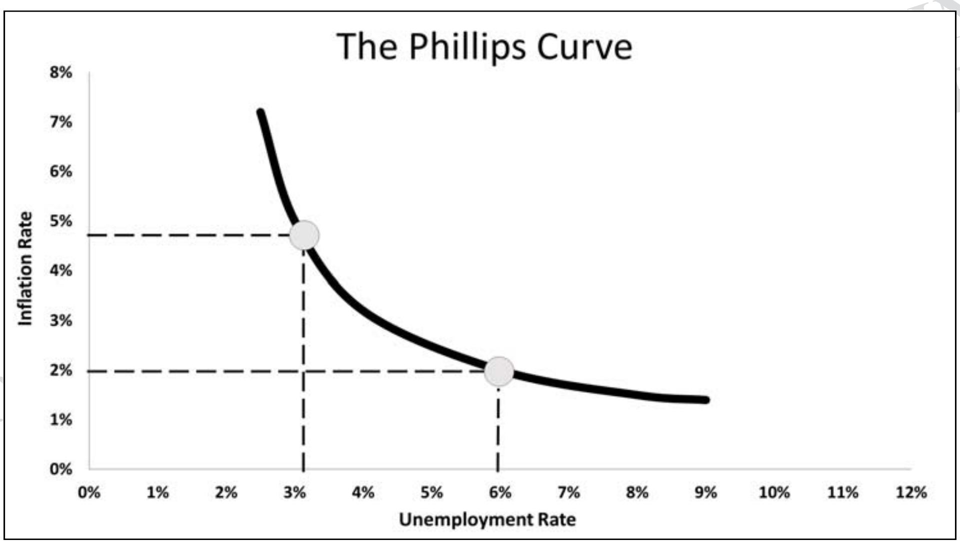
While civilization generally progresses at glacial speed, this is a breakthrough in the world's understanding of economics and it has modern-world consequences.

William Phillips, a professor of economics at the London School of Economics in the 1950s, explained the inverse relationship between unemployment and wages in 1958. When the economy grows the unemployment rate declines, driving wages and spurring higher inflation.

By the late 1960s, the Phillips Curve was the primary framework for forecasting inflation among central banks across the world. Now, however, in a departure from conventional economic wisdom, the Phillips Curve is being rethought by the U.S. Federal Reserve.

Jerome Powell, the chairman of the U.S. central bank, does not expect a sharp rise in inflation, even though unemployment has hit a record-low and wages are on the rise. He believes the inverse correlation between employment and wage inflation isn't as strong as it used to be, and he sets U.S. interest-rate policy.

If the Fed relied on the Phillips Curve, Mr. Powell would likely be trying to head off inflation right now by raising rates more aggressively to slow down the economy.



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Life Is Fragile, So, Please, Value Each Day As Priceless

If you spend your professional life giving financial advice, you learn to appreciate every day.

As financial advisors, the fragility of life unfolds before us every day. At any moment, a client might call amid a family crisis or death.

This is not the kind of thing to bring up at a cocktail party, but this is part of the day-to-day work of a financial professional: a 17-year-old killed in a car crash; a 65-year-old mother of two grown children succumbing to cancer in her husband's arms; and a litany of unspeakable family tragedies happening in slow motion. This is the most important work in the practice of a financial professional.

The specialized knowledge about financial planning that we bring is often thought of only amid a family crisis, and that is what we're here for. It is a privilege not taken lightly.

Your trust motivates the relentless pursuit of your best interest and that is the way we operate. But the main point here, in these 190 words, is not about business; it's that we all should be thankful for every moment of every day and value it pricelessly.

Mary Jane Callaghan & Mitch Glickman

Your Alma Mater Or Your Family?

The new tax law doubles what you can leave loved ones' tax free when you die and that's really bad for your alma mater. Tax breaks for donations to your alma mater may no longer make the grade with you. Here's why:

Estate Tax Exemption Rises. The Tax Cuts And Jobs Act (TCJA) doubles a married couple's estate's tax-exemption to $22 million. Alums now want to maximize their exemptions by leaving $22 million to their children, nieces, nephews and other loved ones before even thinking about a donation to favorite old schools.

Larger Standard Deduction. The TCJA upped the standard deduction from $13,000 to $24,000 for married couples and most Americans no longer will itemize deductions. But that also means you no longer may deduct college donations. Younger alumni will never get into the habit of contributing to their alma mater, disrupting the finance of U.S. educational institutions.

Athletic Deduction Nixed. Before the TCJA, many colleges targeted contributions from alumni who might qualify for good seats at games. The old law allowed donors to deduct 80% of such gifts. Now, the deduction is zero.

Taxing Endowments. Under the new tax code, schools with endowments of $500,000 per student or more and 500 students or more face a 1.4% levy on income. Only a small number of schools are subject to this new tax, but it is a consideration in making college donations.

The Plus Side. The TCJA is not entirely bad for all education-minded donors. Some plusses:

- If you itemize, you may now deduct up to 60% of your adjusted gross income on donations to qualified charities, including your old school. That's up from 50%.
- You can "bunch" donations you pledge to give over several years. The deduction can exceed the write off under the standard deduction.
- You can contribute via a donor-advised fund, which entitles you to a large immediate deduction on annual donations you pledge to make over a period of years. If you suddenly strike it rich, this is a great way to go.

Old Ivy has been around since before the income tax and has managed to flourish, but the new economics of supporting education is disrupting the finances of major educational institutions and the effects are yet to be felt. If you have questions about donating money to a school or your priorities in planning your estate, please contact us. ●

Qualifying For The New Business Owner Tax Break

Under the new tax law, business owners are entitled to deduct 20% of "qualified business income." The test for qualifying a tax break on 20% of business income is defined in the Tax Cuts and Jobs Act (TCJA) and summarized here along with a simple illustration.

If you formed your BUSINESS as a sole proprietorship, S corporation, partnership, LLC or similar pass-through entity, you are entitled to the deduction. C corporations don't qualify for the 20% deduction. Only businesses generating income not taxed at the company level, but directly to the owner.

Qualified business income is the business' day-to-day, non-investment income. It's revenue the business generates minus expenses.

QBI doesn't include interest, dividend income or capital gains on a property sale. Nor does QBI include salary or wages paid either as W-2 wages from an S corporation or guaranteed payments from a partnership.

However, the 20% deduction is limited to the lesser of:

- 20% of qualified business income, or
- 50% of the total W-2 wages paid by the business.

A separate limit based on the unadjusted basis of certain business assets could also apply, a rare situation.

More important: The 50% W-2 wage cap kicks in when a couple filing jointly has a total taxable income of more than $315,000 ($157,500 for singles).

Here's an illustration of a couple who owns a business with $200,000 in qualified business income, with no real assets, such as vehicles or real estate, and with one employee who was paid $50,000 in 2018. The couple would be entitled to QBI deduction of $40,000. That's 20% of $200,000.

Because the couple's taxable

Five Documents At The Core Of An Estate Plan

Every estate plan is unique because of a particular family's circumstances. Still, most people share many primary objectives that may be reflected in five documents often found at the core of a plan.

If your current estate plan doesn't include these five items, you might need to fill the gaps. And if you don't yet have a comprehensive estate plan in place, it's probably time to make that a priority. Mortality can sneak up on anyone.

1. Financial power of attorney: A power of attorney is a legal document that authorizes another person to act on your behalf. A financial power of attorney enables the "attorney-in-fact"—the person specified to act for you—to conduct your financial affairs. Many states have a standard form for financial power of attorney.

Usually, the power of attorney is "durable," meaning that it remains in effect in the event you are incapacitated. But you might use a non-durable power of attorney for specific purposes, such as to have someone manage your portfolio temporarily. Keep in mind that a power of attorney is enforceable only when it has been established before its creator becomes incompetent.

2. Health care power of attorney: Like a financial power of attorney, this authorizes a designated person to act on your behalf in the event you're unable to make your own decisions—in this case, about your medical care. This goes further than a living will, which generally applies only if you're terminally ill or on life support, based on the prevailing state law.

Your attorney-in-fact for a health care power of attorney needs to be someone you can trust to act in your best interests. Typically, that would be a spouse, a child, or another close family member. But you'll also need to name contingent and successor agents.

3. Health care directives: Although there are several other kinds of health care directives that you might include in your estate plan, the most common version is a living will. Without it, family members may be left in a quandary about end-of-life decisions involving your care. This can lead to turmoil and questions could even end up being decided in court.

Often a health care power of attorney is coordinated with a living will, or the two may be combined in a single document. Some states have forms combining these elements and reflecting other personal choices such as whether to donate your organs.

4. Will: No matter how sophisticated your estate plan is, you'll likely circle back to the need for a will to tie everything together. A will can be used for a wide range of purposes, including (but not limited to):

- Dividing your assets and allocating them to your beneficiaries;
- Naming guardians for your children;
- Achieving estate tax benefits;
- Arranging gifts to charity;
- Creating trusts for your beneficiaries;
- Excluding certain family members from inheriting your assets;
- Avoiding a lengthy probate process; and
- Thwarting potential legal challenges.

A will may refer to other documents in your estate plan. If you don't have a legally valid will and you die "intestate," your estate will be governed by the laws of the applicable state.

5. Revocable trusts: Finally, your estate plan may include more revocable trusts, which let you change terms based on future events or preferences. Such trusts are commonly called living trusts—or, more technically—inter vivos trusts—because you create them while you are alive.

With a revocable living trust, you can transfer assets to the trust to be managed by a party you designate. The transferred assets aren't subject to probate.

Other kinds of trusts can also be created to complement the rest of your estate plan. These trusts might be designed to minimize potential state or federal estate taxes, as well as to protect assets from creditors or in the event of a divorce.

This list of estate planning basics can be a good starting place for many families. You'll need the help of an experienced attorney and other advisors to create a plan that fits your family's needs. ●

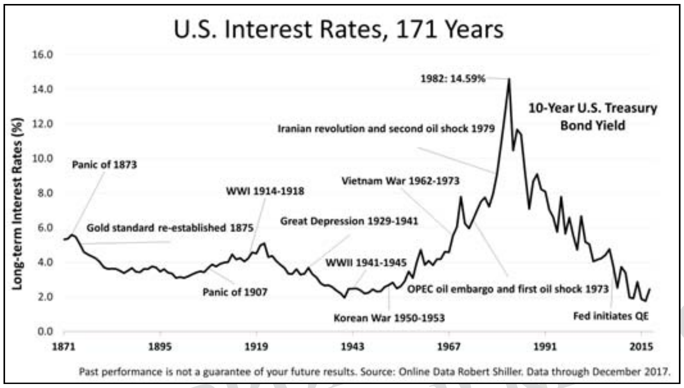
income is less than $315,000, the wage limitation — 50% of wages paid to their employee — is equal to $25,000 and would not apply.

Some business owners with more than $315,000 in QBI may want to consider reducing their W-2 wages or guaranteed payments to qualify for the deduction, but this requires careful planning and personal consulting beyond this simple illustration. The rules are new and technical, and before changing how your business pays you to qualify for the 20% QBI deduction, it's prudent to contact us and plan properly. ●

This Is Not Your Parents' Interest Rate Cycle

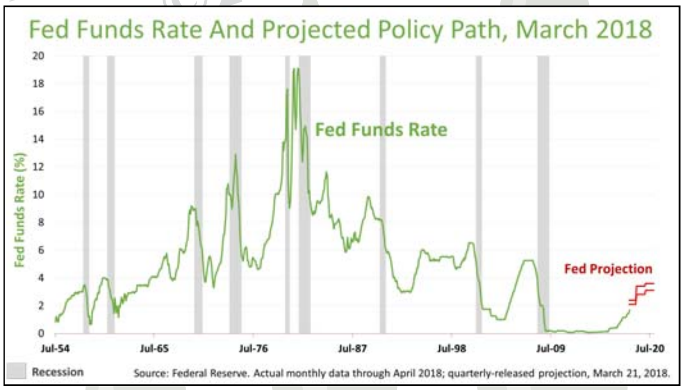
If you're a pre-retiree, your returns on fixed income investments may be much lower than your parents' portfolio.

If you're over 70, you were invested during four decades marked by strong fixed income returns. From the astronomical highs of the late 1980s, rates climbed down before finally bottoming in 2017, and two generations of retirement investors enjoyed bull market returns in bonds annually for years. The next generation of retirees face an entirely different fixed income investing environment.



The last 50 years were an aberration when viewed from the perspective of the past 171 years. The rise in rates of the 1970s and 80s and the unwinding of that anomaly is behind us now, and history indicates the next decades could be characterized by 10-year U.S. Treasury bond rates of about 4%. That may be the new normal.

Past performance is not a guarantee of your future results, but we are nonetheless grateful to Robert Shiller, an economics professor at Yale University and Nobel Laurate in Economics, for sharing this historical data online. It shows that, over in the long arc of U.S. financial history, nothing like the last 50 years ever happened before the 1970s. If interest rates revert to their long-term mean, a 4% 10-year U.S. Treasury bond is a likely path in the decades ahead.



The yield on a 10-year U.S. Treasury bond, in the grand sweep of history, averaged about 4% annually. That's normal. Mortgage rates of the 70s, 80s, or 90s were abnormal. The new normal may be a 2% inflation rate and a 10-year bond yield of 4%. That's what the Federal Reserve Board of Governors expected in the second quarter of 2018.

The point is, this is not your parents' retirement savings environment. Economic fundamentals are different. If you learned about investing from your parents or invest based on what's worked in the past, the future may not be much like the recent past but instead like the distant past. This is the kind of fundamental analysis you get from a real financial professional. This is the kind of analysis you can expect from us. ●

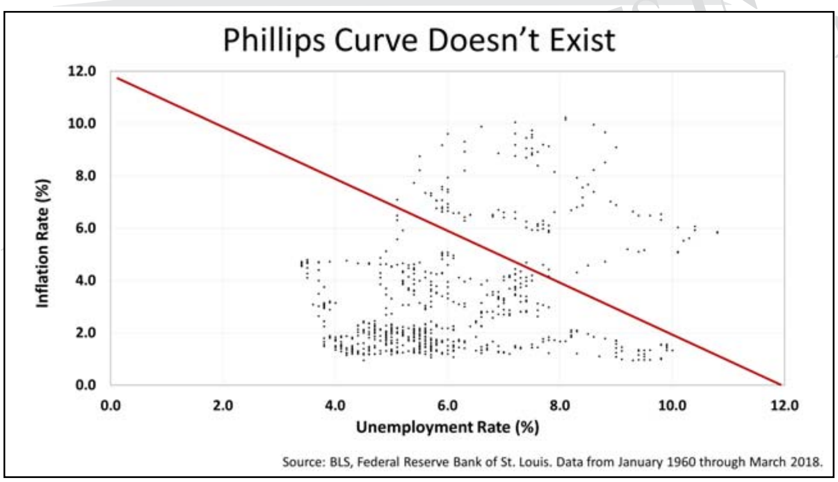
Fed Shatters Economic Wisdom

(Continued from page 1)

Inflation recently surged to the Fed's target rate of 2% and the unemployment rate dropped to a record low of 3.9%. In addition, the Index of Leading Economic Indicators, a forward looking composite measuring growth literally 10 ways monthly, rose again in April continuing an uptrend and suggesting solid growth continuing through the second half of 2018.

Mr. Powell, who became Fed chair in February 2018, has moved decisively in defiance of conventional wisdom, highlighting humanity's improved understanding of financial economics.

This chart from independent economist Fritz Meyer, whose research we license to share with you regularly, shows the inverse relationship of inflation and unemployment since 1960.



If the Phillips Curve were an accurate forecasting tool, each of the black dots would line up on top of the red line. When Professor Phillips came up with his theory in 1958 it was prophetic, but a half-century later we know so much more.

We're here to help you plan your future based on facts, analysis, and humanity's growing understanding of financial economics. ●

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