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MONTHLY ECONOMIC UPDATE

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THIS MONTH'S HIGHLIGHT IS SOCIAL SECURITY

Social Security benefits can be a critical part of your retirement income. It's important to understand how it works and consider carefully when to claim your benefits. The following articles are designed to help you start thinking about Social Security

THE MONTH IN BRIEF

Financially speaking, the last month of 2017 was also the year's most newsworthy. Congress reformed federal tax law to a degree unseen since the 1980s, the Federal Reserve raised the benchmark interest rate, and bitcoin took its investors for a wild ride. Hiring, retail sales, and personal spending numbers were all impressive, as more momentum. Oil closed above $60 again. Emerging stock markets rallied; European equity benchmarks struggled. As all this transpired, the S&P 500 gained nearly 1%.

DOMESTIC ECONOMIC HEALTH

On December 22, President Trump signed the Tax Cuts & Jobs Act into law. The new legislation amounted to a dramatic rewrite of key federal tax code provisions; it doubled the individual estate tax exemption to $11.2 million, raised the standard income tax deduction to $12,000, and eliminated the personal exemption as well as corporate tax rate to 21% and permitted most pass-through businesses to take a 20% deduction on earnings. Most of these changes are scheduled to expire after 2025, unless Congress preserves them.

The Federal Open Market Committee voted 7-2 to lift the benchmark interest rate another quarter of a point. That put the target range for the federal funds rate at 1.25%-1.5%. The FOMC maintained its forecast for three rate hikes in 2018, with a consensus projection of the federal funds rate at 2.1% at the end of this year.

As the fourth quarter ended, the third estimate of Q3 growth came in from the Bureau of Economic Analysis: a strong 3.2%, down from the prior 3.3%. In a good sign for Q4 GDP, personal spending rose 0.6% in November, with personal incomes up 0.3%. Looking ahead, the Federal Reserve's median forecast sees the economy growing 2.5% in 2018.

Speaking of growth, the factory and service sectors of the economy continued to expand nicely. The Institute for Supply Management's manufacturing purchasing manager index came in at 58.2 for November; ISM's non-manufacturing PMI showed a November reading of 57.4. (In October, the readings had been even higher. The factory PMI was up at 58.7; the services PMI, at 60.1.) Complementing this data, the federal government noted a 1.3% gain in hard goods orders in November.

The country's most-watched consumer confidence gauges were in good shape, though both declined in December. Economists polled by MarketWatch expected a reading of 127.5 for the Conference Board's barometer and 97.1 for the University of Michigan's index of consumer sentiment. The CB index fell 6.5 points to 122.1; the UMich index, 0.9 points from its preliminary December reading to 95.9.

Confident consumers tend to spend freely, and that was the case during the holidays. The Department of Commerce found retail sales up 0.8% for November, and Adobe Digital Insights reported a 14.7% year-over-year rise in e-commerce sales in December.

How about hiring? The latest Department of Labor employment snapshot showed a net gain of 228,000 jobs during November, with yearly wage growth of 2.5%. With hurricanes and floods no longer impeding payroll gains, October-November 2017 was the best two-month hiring period since mid-2016 (companies added a net 244,000 workers in the year's tenth month). Headline unemployment remained at 4.1%, and the U-6 rate (unemployed + underemployed) was 0.1% higher at 8.0%. Headline and core inflation diverged in November: the main Consumer Price Index climbed 0.4%, yet the core CPI (minus energy and food prices) gained but 0.1%. For the year ending in November, the core CPI advanced only 1.7%; the headline CPI, 2.2%.

GLOBAL ECONOMIC HEALTH

As 2017 ended, the European Union's economy appeared to be stronger than it had been in some time. Its annual GDP was running at 2.5% through the third quarter, its jobless rate had fallen to 7.4% as of October, and annual inflation was at 1.8% in November. Recent developments affirm that the sovereign debt crisis is in the rearview mirror. Burdened Greece finally had its credit rating upgraded by Fitch and Moody's. Standard & Poor's lifted Portugal's credit rating from "junk" back to first time since the 1980s. Even with the Brexit hanging over the Eurozone's collective head, journalists and other observers took to calling 2017 the year of the "euroboom."

While November reports on China's factory production, business investment, and housing fell short of analyst expectations, its official manufacturing PMI did match the decent 51.6 forecast of economists surveyed by Reuters. China's official Q3 GDP reading was released: 6.9%, topping government projections. In India, a rough economic year ended: a lingering cash shortage and a stumbling application of tax reforms helped drive the nation's annualized GDP down below 6% at one juncture. (Economic growth had nearly reached 8% in 2016.) The International Monetary Fund has downgraded India's 2018 growth forecasts to 7.4% from 7.7%.

WORLD MARKETS

Good news exceeded bad news in December. The MSCI Emerging Markets index climbed 3.36%, leaving its 2017 return at a striking 34.35%. The MSCI World advanced nicely as well – its 1.26% gain capped off a 20.11% annual rise. The Americas and the Asia-Pacific region saw many positive moves: a 3.05% gain for Brazil's Bovespa, a 3.64% rise for Mexico's Bolsa, and an 11.38% jump for Argentina's MERVAL. India's Nifty 50 added 1.63%; Canada's TSX Composite, 1.51%; India's Sensex, 1.35%. Australia's All-Ordinaries gained 1.17%, while Hong Kong's Hang Seng benchmark rose 1.00%. In Japan, the Nikkei 225 improved 0.74%. In Europe, contrary to all this, the United Kingdom's FTSE 100 soared 3.98%.

The month's notable declines were mainly in Europe – dips of 1.10% for the German DAX, 1.58% for the CAC 40 in France, and 2.18% for Spain's IBEX 35. China's Shanghai Composite lost 0.90%; Taiwan's TSE 50, 1.58%, South Korea's Kospi, 1.86%.

MSCI's Emerging Markets benchmark was not the only standout of 2017. The Hang Send and the MERVAL, respectively, returned 37.30% and 81.57% year-over-year.

COMMODITIES MARKETS

Bitcoin left cyber currency investors queasy in December. The Commodity Futures Trading Commission approved bitcoin futures trading on the CBOE Global Markets and CME exchanges on December 1, and this new legitimacy helped the price almost double to nearly $20,000 by December 18. Then bitcoin dropped precipitously, partially recovering to $14,610 by the end of 2017's final trading day. Turning to a different and far more stable kind of currency, the U.S. Dollar Index weakened 0.81% during December 50 92.30.

WTI crude ended 2017 at $60.10 a barrel, up 4.67% for December. Heating oil futures advanced 8.77% last month, and unleaded gasoline gained 3.42%; natural gas, on the other hand, slipped 2.25%. Cotton ruled ag futures with an 8.23% December improvement. Wheat gained 4.40%; corn, 2.71%. Other crops took minor or major falls: coffee lost 0.24%; sugar, 0.53%; soybeans, 3.37%; cocoa, 7.90%. What was gold worth at the end of 2017? An ounce was valued at $1,305.10 on the COMEX, thanks to a 2.42% December advance. Silver rose 3.79% on the month to wrap up 2017 at $16.98. Copper posted a 7.72% December gain; platinum, a 1.26% December loss.

REAL ESTATE

Prices were high; inventory was thinner than it had been – and still, buyers found the homes they wanted. The annualized pace of existing home purchases rose 5.6% in November, and the rate of new home purchases accelerated 17.5%. The National Association of Realtors stated that resales were up 3.8% year-to-date; the median sale price was at $248,000, up 5.9% for the year. New home buying was up 22.8% year-over-year, according to the Census Bureau, with the annual increase at 31.1% in the west.

If you found a home to buy, you probably found a cheap mortgage, historically speaking. Freddie Mac's final Primary Mortgage Market Survey of 2018 did show rates climbing, however. In the December 28 PMMS, the average interest rate on a conventional home loan was 3.99%, up from 3.90% on November 30. In the same time frame, the average interest rate on the 15-year fixed went from 3.30% to 3.44%, and the mean interest on the 5/1-year ARM jumped from 3.32% to 3.47%.

Now to the latest statistics on home construction. The Census Bureau reported a 3.3% gain for groundbreaking in November, with building permits down 1.4% (but there was a 1.4% rise for single-family permits).

LOOKING BACK…LOOKING FORWARD

Blue chips led the way in December: the Dow Jones Industrial Average added 1.84% last month, far outpacing the S&P 500 (+0.98%), the Nasdaq Composite (+0.43%), and the Russell 2000 (-0.53%).

As the table below notes, the Dow also recorded the best 2017 gain of the big three. (The Russell 2000 rose 13.14% on the year.) At the closing bell on December 29, the settlements were: Dow, 24,719.22; S&P, 2,673.61; Nasdaq, 6,903.39; Russell, 1,535.51.

The CBOE VIX, which gauges volatility in the markets, had a poor year: it fell 21.37% to 11.04. The NYSE Arca Biotech index had a phenomenal 2017, climbing 37.31%.

% CHANGE	2017	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	+25.08	+24.72	+18.21	+8.49
NASDAQ	+28.24	+27.09	+26.64	+15.81
S&P 500	+19.42	+18.87	+18.13	+8.08
REAL YIELD	12/29 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	0.44%	0.55%	-0.73%	1.78%

Sources: finance.google.com, wsj.com, bigcharts.com, treasury.gov – 12/29/17[21,22,23,24]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

In hindsight, we look back at 2017 and see a year that surpassed expectations. You could say the stars aligned for Wall Street: no news events truly disrupted the markets, inflation remained tame, the dollar weakened, and the economic recovery gained further momentum. Will 2018 be as great as 2017 was? Probably not, in the view of analysts. Many are predicting just a single-digit advance for the S&P 500 (*Kiplinger's Personal Finance,* to cite but one forecast, projects a 2018 total return of just 8% for the benchmark). While fundamental economic indicators are strong, Fed policymakers could tighten faster if wage growth and inflation accelerate. The Fed is continuing to thin its balance sheet, and the European Central Bank seems poised to end its long-running stimulus. The last S&P 500 correction, a 14% drop, occurred in early 2016; the index is long overdue for another. If the bull market lasts into September, it will be the longest ever witnessed. Some strong headwinds could arise in 2018; prepare for some turbulence, which will arrive at some point, and be glad for the sizable stock gains of 2017.

The Many Benefits of a Roth IRA

Why do so many people choose it rather than a traditional IRA?

The Roth IRA changed the whole retirement savings perspective. Since its introduction, it has become a fixture in many retirement planning strategies. Here is a closer look at the trade-off you make when you open and contribute to a Roth IRA – a trade-off many savers are happy to make.

You contribute after-tax dollars. You have already paid income tax on the dollars going into the account, but in exchange for paying taxes on your retirement savings contributions today, you could potentially realize greater benefits tomorrow.

You position the money for tax-deferred growth. Roth IRA earnings aren't taxed as they grow and compound. If, say, your account grows 6% a year, that growth will be even greater when you factor in compounding. The earlier in life that you open a Roth IRA, the greater compounding potential you have.

You can arrange tax-free retirement income. Roth IRA earnings can be withdrawn tax-free as long as you are age 59½ or older and have owned the IRA for at least five tax years. The IRS calls such tax-free withdrawals *qualified distributions*. They may be made to you during your lifetime or to a beneficiary after you die. (If you happen to die before your Roth IRA meets the 5-year rule, your beneficiary will see the Roth IRA earnings taxed until it is met.)

If you withdraw money from a Roth IRA before you reach age 59½ or have owned the IRA for five tax years that is a *nonqualified distribution*. In this circumstance, you can still withdraw an amount equivalent to your total IRA contributions to that point, tax-free and penalty-free. If you withdraw more than that amount, though, the rest of the withdrawal may be fully taxable and subject to a 10% IRS early withdrawal penalty as well.

Withdrawals don't affect taxation of Social Security benefits. If your total taxable income exceeds a certain threshold - $25,000 for single filers, $32,000 for joint filers – then your Social Security benefits may be taxed. An RMD from a traditional IRA represents taxable income, and may push retirees over the threshold – but a qualified distribution from a Roth IRA isn't taxable income and doesn't count toward it.

You can direct Roth IRA assets into many different kinds of investments. Invest them as aggressively or as conservatively as you wish – but remember to practice diversification.

Inheriting a Roth IRA means you don't pay taxes on distributions. While you will need to take distributions from an inherited Roth IRA within 5 years of the original owner's passing, those distributions won't be taxed as long as the IRA is at least five years old (five tax years, that is).

You have nearly 16 months to make a Roth IRA contribution for a given tax year. Roth and traditional IRA contributions for a tax year that has passed may be made up until the federal tax deadline of the succeeding year. The deadline for a 2017 Roth IRA contribution is April 17, 2018. Making your Roth IRA contribution as soon as a tax year begins, however, gives that money more time to potentially grow and compound with tax deferral.

How much can you contribute to a Roth IRA annually? The 2018 contribution limit is $5,500, with an additional $1,000 "catch-up" contribution allowed for those 50 and older. (That $5,500 limit applies across all your IRAs, incidentally, should you happen to own more than one.)

You can keep making annual Roth IRA contributions all your life. You can't make annual contributions to a traditional IRA once you reach age 70½.

Does a Roth IRA have any drawbacks? Actually, yes. One, you will generally be hit with a 10% penalty by the IRS if you withdraw Roth IRA funds before age 59½ or you haven't owned the IRA for at least five years. (This is in addition to the regular income tax you will pay on any Roth IRA earnings withdrawn prior to age 59½, of course.) Two, you can't deduct Roth IRA contributions on your 1040 form as you can do with contributions to a traditional IRA or the typical workplace retirement plan. Three, you might not be able to contribute to a Roth IRA as a consequence of your filing status and income; if you earn a great deal of money, you may be able to make only a partial contribution or none at all.

These asterisks aside, a Roth IRA has remarkable potential as a retirement savings vehicle. Now that you have read about all of a Roth IRA's possible advantages, you may want to open up a Roth IRA or create one from existing traditional IRA assets. A chat with the financial professional you know and trust will help you evaluate whether a Roth IRA is right for you, given your particular tax situation and retirement horizon.

Things to Consider if You Plan to Retire Before 60

Financially speaking, what moves might you want to make?

By choice or by chance, some people wrap up their careers before turning 60. If you sense this will prove true for you, what could you do to potentially make your retirement transition easier? As a start, you may need to withdraw your retirement funds strategically.

The I.R.S. wants you to leave your retirement accounts alone until your sixties. To encourage this, it assesses a 10% early withdrawal penalty for most savers who take money out of traditional retirement accounts prior to certain ages. For a traditional IRA, the penalty applies if you withdraw funds prior to age 59½; for a workplace retirement plan, the penalty may apply as early as age 55.

You may be able to avoid that 10% penalty by planning 72(t) distributions. Under a provision in the Internal Revenue Code, you can withdraw funds from a traditional IRA prior to age 59½ in the form of substantially equal periodic payments (SEPPs) over the course of your lifetime. The schedule of payments must last for at least five years or until you reach age 59½, whichever period is longer. Once the schedule of periodic payments is established, it cannot be revised – if the payments are not taken according to schedule, you will be hit with the 10% early withdrawal penalty. All 72(t) distributions represent taxable income.

You can also take 72(t) distributions, in the form of SEPPs, from many employee retirement plans. To do this, you must “separate from service” with your employer, i.e., leave or lose your job. Should that happen in the year you turn 55 (or in subsequent years), you can take a lump sum out of the plan without any early withdrawal penalty. If you quit or leave before age 55, you may arrange SEPPs over your lifetime or prior to age 59½, as per the above paragraph.

If you have a Roth IRA or Roth employer-sponsored retirement account, things get easier. You can withdraw you contributions to these accounts at any time without incurring taxes or tax penalties. At age 59½ or older, both account contributions and account earnings can be distributed tax free and penalty free if you have held the account for at least five years.

In addition to your retirement funds, you will need health coverage. A decade may pass before you are eligible for Medicare, so what are your options past 18 months of COBRA?

The health insurance exchanges may be your best resource to find coverage at a decent cost. In fact, you may qualify for health insurance subsidies because your income will drop when you leave work. Retirement (and the loss of employer health coverage) counts as a “qualifying life event,” giving you a special 60-day enrollment window outside the usual November-December enrollment period.

In the best-case scenario, your employer keeps you on its group plan for a few years after your retirement. (If you have paid for your own health insurance for years, you can keep doing so.)

You may appreciate having a health savings account. Contributions to HSAs are tax deductible, and the assets within them grow tax-free. HSAs are sometimes called “backdoor IRAs” because you can use the money within them for any reason without penalty once you turn 65, not just for qualified health care expenses. (All HSA withdrawals are taxable.)

Think about a conservative retirement income withdrawal rate. The standard 4% baseline may be too optimistic; 3% or 3.5% may be more realistic if you feel you will be retired for 30 years or longer.

Should you claim Social Security at 62? You can, as long as you are prepared for the trade-off: the probability of proportionately smaller monthly benefits over the rest of your life compared with larger monthly benefits you could receive by claiming later.

Any early retirement decision should prompt a consultation with a qualified financial or tax professional. This is a critical financial juncture in your life, and whether you find yourself at it by choice or by change, your decisions could have lifelong impact.

The Major Retirement Planning Mistakes

Why are they made again and again?

Much has been written about the classic financial mistakes that plague start-ups, family businesses, corporations, and charities. Aside from these blunders, there are also some classic financial missteps that plague retirees.

Calling them "mistakes" may be a bit harsh, as not all of them represent errors in judgements. Yet whether they result from ignorance or fate, we need to be aware of them as we plan for and enter retirement.

Leaving work too early. As Social Security benefits rise about 8% for every year you delay receiving them, waiting a few years to apply for benefits can position you for greater retirement income. Filing for your monthly benefits before you reach Social Security's Full Retirement Age (FRA) can mean comparatively smaller monthly payments. The FRA varies from 66-67 for people born between 1943-59. For those born in 1960 and later, the FRA is 67.

Some of us are forced to make this "mistake." The Center for Retirement Research at Boston College says 56% of men and 64% of women apply for Social Security before full retirement age. Still, if you can delay claiming Social Security, that positions you for greater monthly benefits.

Underestimating medical bills. In its latest estimate of retiree health care costs, Fidelity Investments says that a couple retiring at 65 will need $275,000 to pay for future health care costs. That estimate may be conservative, as Fidelity's calculation does not include eye care, dental care, or long-term care expenses.

Taking the potential for longevity too lightly. Actuaries at the Social Security Administration project that around a fourth of today's 65-year-olds will live to age 90, with about one in ten living 95 years or longer. The prospect of a 20- or 30-year retirement is not unreasonable, yet there is still a lingering cultural assumption that our retirements might duplicate the relatively brief ones of our parents. The American College New York Life Center for Retirement Income recently polled people about longevity, and 47% of respondents over age 60 underestimated the remaining life expectancy for an average 65-year-old male.

Withdrawing too much each year. You may have heard of the "4% rule," a popular guideline stating that you should withdraw only about 4% of your retirement savings annually. Many cautious retirees try to abide by it.

So, why do others withdraw 7% or 8% a year? In the first phase of retirement, people tend to live it up; more free time naturally promotes new ventures and adventures and an inclination to live a bit more lavishly.

Ignoring tax efficiency & fees. It can be a good idea to have both taxable and tax-advantaged accounts in retirement. Assuming your retirement will be long, you may want to assign this or that investment to its "preferred domain" – that is, the taxable or tax-advantaged account that may be most appropriate for it as you pursue a better after-tax return for the whole portfolio.

Many younger investors chase the return. Some retirees, however, find a shortfall when they try to live on portfolio income. In response, they move money into stocks offering significant dividends or high-yield bonds – which may be bad moves in the long run. Taking retirement income off both the principal and interest of a portfolio may give you a way to reduce ordinary income and income taxes.

Fees have an impact. The Department of Labor notes that a 401(k) plan with a 1.5% annual fee will eventually leave a participant with 28% less money than one with a 0.5% annual fee.

Avoiding market risk. Equity investment does invite risk, but the reward may be worth it. In contrast, many fixed-rate investments offer comparatively small yields these days.

Retiring with big debts. It is hard to preserve (or accumulate) wealth when you are handing portions of it to creditors.

Putting college costs before retirement costs. There is no "financial aid" program for retirement. There are no "retirement loans." Your children have their whole financial lives ahead of them. Try to refrain from touching your home equity or your IRA to pay for their education expenses.

Retiring with no plan or investment strategy. An unplanned retirement may bring terrible financial surprises; the absence of a strategy can leave people prone to market timing and day trading.

These are some of the classic retirement planning mistakes. Why not plan to avoid them? Take a little time to review and refine your retirement strategy in the company of the financial professional you know and trust.

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