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A Tale of Two CBs (i.e., Central Banks)

The labors of the Federal Reserve and the European Central Bank (ECB) may not carry the drama of Charles Dickens' classic, *A Tale of Two Cities*, set in the maelstrom of the French Revolution's Reign of Terror. But both central banks are expected to wind down their respective quantitative easing (QE) programs over the next few years. Markets hope the process can be managed adroitly and that investors don't *lose their heads*, so to speak.

A Preview from the Fed

The Federal Reserve is a bit farther down this road, but then it started buying bonds as part of economic stimulus efforts initiated way back in December, 2008. This past June the Fed's Open Market Committee (FOMC) outlined plans to normalize a balance sheet that has ballooned to $4.5 trillion.

That outline didn't pinpoint a start date, but it did say that "relatively soon" the Fed will cut its *monthly* reinvestment of interest by $10 billion for three months, with further quarterly cuts of that size until the *monthly* reduction reaches $50 billion. That's a cumulative reduction of $300 billion over the first 12 months and $600 billion annually in subsequent years.

Those reductions are to comprise about 60% U.S. Treasury bonds and 40% mortgage-backed securities (MBS). The process had been expected to launch as early as October, but the impact of Hurricane Harvey may give FOMC members pause.

For context, recent auctions of the benchmark 10-year Treasury have averaged $21 billion per month, while the seven- and five-year auctions have averaged $28 billion and $34 billion, respectively. The Fed's waning buy-side presence in the secondary market could help push five- to ten-year Treasury yields higher, other factors being equal. It may also tend to steepen the *yield curve* (the extent to which longer maturities deliver higher yields).

The mortgage market could see greater impact. New MBS issuance averaged $134 billion per month in 2016. The planned reduction in Fed purchases represents about 15% of that new supply which could drive a more meaningful uptick in mortgage rates than the housing sector has seen in at least a decade.

Meanwhile Across the Pond

The ECB is still getting used to more positive economic news across its constituent countries. Most market watchers do not expect it to start trimming its QE regime before 2018. Recent strength in the euro may complicate those considerations as it tends to dampen Eurozone inflation, currently running below the ECB's target of just under 2%.

By several measures the ECB's QE program does appear to have helped. The U.S. and the Eurozone are similar in size and have converged somewhat in terms of economic growth and inflation rates. Europe's unemployment has come down, although it continues to run higher than in the U.S., a familiar pattern that has persisted for decades. The ECB's attenuation of QE will likely trail the Fed's by at least six to nine months.

These actions may be measured and gradual, but probably not trivial. Higher yields on the types of securities held by these central banks are apt to ripple across a wide range of fixed income instruments. Thoughtful diversification by maturity, market sector, and underlying issuer will be key to helping portfolios contend with this potential shift in the secular trend of interest rates. ■

Can Russia Evolve Into a Stronger Investment Story?

In the volatile push-pull of U.S. politics, Russia finds itself recast as a sinister force and an imposing strategic competitor. Despite its renewed assertiveness on the geopolitical stage, the world's largest country by land mass continues to face acute challenges at home. While President Vladimir Putin appears to command the heights of domestic power and popularity, he has not been able to reorder the realities of a commodities based, corruption-plagued economy with a crying need for international investment.

Russia's heavy dependence on oil, gas, and other mineral resources gave it a lift in the commodities upturn that prevailed in the early 2000s. But reliance on commodities has proven to be a two-edged sword for nations that failed to pursue the kind of economic diversification that could help cushion against downturns in commodities.

The latest big decline in oil and gas prices dovetailed with the imposition of international sanctions punishing Russia's actions in Crimea and eastern Ukraine. This prompted a precipitous decline in Russia's balance of payments, steep inflation, a nasty recession, and a big hit to its currency. The ruble lost 39% of its real, trade-weighted value in the second half of 2014 and is still well below its mid-2014 peak.

The crash in oil prices coupled with the impact of international sanctions led to a big push for "import substitution" in such key sectors as pharmaceuticals and electronics, as well as a meaningful cutback in agricultural imports. Reuters re-

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One for the *Ages*: What's the *Right* Posture Toward the Market?

Have you noticed how hard it is to please experts? By their lights, investors always seem to be doing the wrong thing, or at least failing to do the right thing.

For example, a recent study by the Dreyfus investment organization reported that 49% of respondents with more than $50,000 in investable assets report that they have *not* reevaluated their investment approach in the face of a (presumably) shifting investment landscape. But isn't the investment landscape always shifting to some extent?

Older investors in particular appear to be sticking with their portfolio allocations. Among respondents over 55, more than 60% said they had not reevaluated their investment approach or didn't plan to do so. Many market watchers cite stretched equity valuations, potential Fed tightening, the aging recovery, and political uncertainty as reasons to consider a more defensive posture. But experienced investors may simply be more dubious of those experts' ability to call major market turns with any real consistency.

Meanwhile, a different survey from Bankrate found that only 13% of Millennials are inclined to invest in the stock market. Those young adults were markedly more inclined toward such assets as real estate, cash, and even gold. Most experts would probably suggest that those in their 20s and 30s will need the long-term inflation-topping returns stocks have traditionally delivered to accumulate real wealth over the course of their working lives.

Younger investors' attitudes are often attributed to their formative experiences of the market, particularly the 2000-01 Tech Wreck and the 2008-09 Financial Crisis. In contrast, their Boomer grandparents seem to be pretty sanguine about stock investing, having weathered well over four decades of major market cycles that generated some pretty heady long-term returns.

A little role reversal probably wouldn't hurt. Young investors have time to build stock exposure through dollar-cost averaging to help temper the inherent volatility. Boomers, on the other hand, might be a little more circumspect about the impact of near-term volatility on portfolios that support their immediate retirement plans and standard of living. But generalizations are rarely that instructive. Better to sit down from time to time with an experienced advisor for a candid discussion of your own situation and objectives. ■

Investment Performance Review	**TOTAL RETURN *** (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	**--- Annualized through Sept. 5, 2017 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Blend)	13.6 %	7.2 %	12.8 %	6.7 %
Mid-Cap Stocks (Blend)	10.4	5.0	12.3	6.7
Small-Cap Stocks (Blend) †	10.9	5.7	11.8	6.7
Foreign Stocks (Large Blend) †	15.1	2.8	8.0	1.6
Diversified Emerging Markets †	20.5	1.3	5.2	2.2
Specialty Natural Resources †	10.9	− 3.8	2.0	0.7
Specialty Real Estate †	− 0.3	6.5	8.4	5.7
Cons. Allocation (30-50% Equity)	6.0	3.1	5.4	4.5
Long-Term Bond	1.7	5.5	4.7	6.9
World Bond †	2.9	1.2	1.7	4.1
High Yield Taxable Bond †	7.6	3.3	5.2	6.4
Long-Term Municipal Bond	0.3	3.5	3.1	4.3

* Source: Morningstar. **Past performance is NOT indicative of future results.**

† Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

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Can Russia Evolve Into a Stronger Story?

ports that by September of 2015 the Russian government was supporting 2,500 import substitution projects to the tune of $2.5 trillion rubles (U.S. $38 billion). Many economists worry that import substitution, a throwback to the Great Depression, can lead to a less than optimal allocation of resources.

Evaluating potential risk and reward for Russia-based investments is a tall order. On one hand, global portfolio managers see a relatively attractive yield play, a central bank focused on containing inflation to avoid another run on the ruble, and a recovering economy forced to focus on building up its domestic agriculture, technology, and services sectors. On the other hand, many managers continue to avoid the country given its checkered history with capitalism, geopolitical pot-stirring, pervasive corruption, and the risk of investments running afoul of U.S. and EU sanctions.

The International Monetary Fund recently proffered a laundry list of recommendations for Russia to improve its investment climate. These include stronger property and contract rights, more streamlined regulation, larger and more evenly distributed infrastructure investment, better trade facilitation, and more support for research and development, especially in science and technology. It points up the impediments to Russia soon taking its place as a solidly constructive contributor to global growth. ■

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It's Harvest Time for Tax Losses Too

There's been a lot of talk about tax reform this year, but no real action. Year-end looms with many portfolios having garnered gains. For high earners, investment income (interest, dividends, and capital gains) continues to incur significantly higher tax rates than was the case several years ago.

Managing taxes on investment results can enhance long-term growth. A cornerstone of such management is the process of tax-loss harvesting – offsetting gains taken on some portfolio holdings by selling other securities that are in a loss position. A portfolio manager may then purchase comparable securities (stocks, funds, etc.) to maintain the desired asset allocation profile.

Tax-loss harvesters must remember the "wash sale" rule which holds that if a security is sold for a loss, but the same or a substantially identical security is repurchased within 30 days, the tax loss can't be claimed on a current basis. That loss gets added instead to the cost basis of the replacement holding which (eventually) reduces the gain or increases the loss when that position is liquidated.

Managers may maintain lists of similar but not identical securities to use in tax-loss swaps. This can be challenging with individual stocks, as the performance of similar companies in the same industry or market sector may still be quite different. With exchange traded funds (ETFs), the relative ease of the task depends on the fund's scope or sector focus.

For most mainstream mutual funds, it isn't hard to identify alternatives with comparable investment objectives and market sector exposure. But mutual funds add another dimension; they have to distribute to shareholders the net capital gains (or losses) realized in selling securities over the course of the year. As year-end approaches, advisors watch for announcements of impending gain distributions and determine the current-year tax effects of a timely exchange into a similar (but *not* identical) mutual fund.

Technically, the maneuvers described above are largely a matter of delaying rather than eliminating taxes on gains. But one key tenet of wealth building is to *keep as much capital working as long as possible*. Unnecessarily paying current taxes on gains in your portfolio does tend to run counter to that principle. ■

Your Life Insurance Policy, Your Asset

Have you seen the news? September is National Life Insurance Awareness Month. Although it may be kind of late to plan a big celebration, it's always timely to reassess one's life insurance needs and any in-force coverage.

Surveys frequently suggest that a significant percentage of households headed by young and middle-aged adults are under-insured against the loss of a key income earner. This can jeopardize such future goals as their children's education and a surviving spouse's retirement.

On the other hand, many retirees carry coverage that's no longer really needed and may not merit further investment of premium dollars. Some types of policies such as whole life are often described as "permanent insurance," but that doesn't mean they must be held forever.

Evaluating whether to retain or dispose of a policy calls for a thorough, practical assessment of its investment performance, premium requirements, tax implications, and estate planning objectives – all in the context of the policy owner's financial wherewithal and the availability of other coverage if needed.

If that assessment makes a good case for letting the policy go, the basic choices are to surrender it to the carrier or sell it to an individual or group of investors. Selling the policy may offer more upside along with a considerably more involved "underwriting" process imposed by a prospective buyer.

A starting point is to understand the basic tax issues in retaining, surrendering, or selling a policy. In

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Despite the Government's Best Intentions, *myRA* Falls Flat

Three-and-a-half years ago President Obama announced the establishment of *myRA*, a retirement savings program targeted at workers without access to an employer's plan. Initial availability was by payroll deduction, with eligibility to be expanded to anyone with direct paycheck deposit and income below $129,000 (or $191,000 joint).

The U.S. Treasury recently said it will wind down the program which has *cost* more than $70 million while attracting a mere $34 million of retirement savings from just 20,000 participants. Treasury noted that savers have "options in the private sector that offer no account fees, no minimum balance, and safe investment opportunities," an observation no more obvious today than it was when the program was created.

As noted then, *myRA* resembles a Roth IRA but with an implicit subsidy. It credits the interest rate paid by the Government Securities Fund in the Thrift Savings Plan for federal employees. Even that sweetener didn't attract meaningful participation, so Treasury will be helping *myRA* participants make "a smooth transition to other investment opportunities," most notably Roth IRAs.

Many of those for whom *myRA* was designed might check out the Saver's Credit. That long-standing benefit offers modest-income earners a tax credit of up to 50% of elective contributions to an IRA or other retirement plan. To read all about it go to *www.irs.gov* and enter "saver's credit" in the Search box. ■

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Here's a shocker: A lot of us wish we had saved more.

Regrets, I've had a few,
But then again,
Too few to mention...

When Frank Sinatra sang those lines from his mega hit, "My Way," he probably wasn't thinking about his IRA balance. For the rest of us, failing to save *earlier* for retirement appears to be one our most widely shared financial regrets.

In a recent poll conducted by *Bankrate.com*, three of four respondents expressed some financial regrets which also included credit card and student loan debt as well as insufficient college savings and emergency reserves. These are threads of the same fabric, as near-term needs and desires always crimp our efforts to save for life's major hurdles.

A separate study by United Income found that older Americans have become steadily more pessimistic about their economic prospects. Meanwhile, the Millennial generation (age 27-36) are said to be in the throes of deep regret over their outstanding student loans.

While 39% of Baby Boomers (age 53-71) regret not having saved more earlier, only 23% of those 72 and older cite such a regret. Then again, those older seniors comprise the "Silent Generation." They may just be more inclined to keep their regrets to themselves. ■

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Your Policy, Your Asset

general, death benefits and loans from a life insurance policy are received income tax free, but the sale or surrender of a policy may not receive such favorable tax treatment.

First you determine your basis or net investment in the policy. In most cases that's the amount of premiums paid in minus the policy's internal cost of insurance. The insurance company typically can provide that figure. Basis is further reduced by the amount of any outstanding, untaxed loans from the policy.

Gain on a policy is the difference between that basis and the cash value received at surrender. That gain typically is taxable as ordinary income, as it represents previously untaxed investment earnings inside the contract, net of insurance and administrative costs. If a policy is sold (often referred to as a "life settlement"), any proceeds in excess of the cash value are also taxable, but as long-term capital gain.

As noted above, letting go of a life insurance policy is a decision not to be taken lightly. Individual situations are sure to involve factors not detailed above. If you have questions about a policy you own, don't hesitate to call on the expertise and counsel of your insurance, tax, and investment professionals. ■

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