HELPING YOU UNDERSTAND THE COMPLEXITIES OF WEALTH MANAGEMENT AND PROVIDING SOLUTIONS AS UNIQUE AS YOUR GOALS

WEALTH MANAGEMENT NEWSLETTER

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UNDERSTANDING STOCK MARKET INDEXES

No doubt you've seen headlines reporting that a particular stock index is up or down. But do you know what an index is, and how understanding the nuts and bolts of a specific index may be helpful to you?

An index is simply a way to measure and report the fluctuations of a pool of securities or a representative segment of a market. An index is developed by a company that sets specific criteria to determine which securities are included in the index based on factors such as a company's size or location or the liquidity of its stock. For example, the Standard and Poor's 500 index (S&P 500) is an index made up of mostly large-cap, U.S.-based companies that Standard & Poor's considers to be leading representatives of a cross-section of industries.

The company that develops the index tracks the performance of its components and aggregates the data to produce a single figure that represents the index as a whole. Virtually every asset class is tracked by at least one index, but because of the size and variety of the stock market, there are more stock indexes than any other type. It's important to note that the performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in an index.

Comparing apples to oranges

Since indexes encompass a wide range of securities, it's important to know what segment of the market a particular index covers. For instance, a composite index follows a specific stock exchange. The Nasdaq composite index includes all the stocks listed on the Nasdaq market. Conversely, sector indexes track securities in a specific industry.

Even indexes that include the same securities may not operate in precisely the same way. Generally, indexes tend to be either price-weighted or market capitalization-weighted. If an index is price-weighted, such as the Dow Jones industrial average, the impact of each stock on the overall average is proportional to its price compared to other stocks in the index. With a price-weighted index, the highest-priced stocks would have the most impact on the average. For example, a 1 percentage-point drop in the price of a stock selling for $80 per share would have more impact on the overall index's performance than a 1 percentage-point drop in the price of a stock that had been selling for $40 a share.

If an index is market capitalization-weighted or market value-weighted, such as the Nasdaq composite index or the S&P 500 composite index, the average of the index is adjusted to take into account the relative size of each company (its market cap) to reflect its importance to the index. Stocks with a larger market capitalization have a greater influence on how the index performs than stocks with a smaller market capitalization. For example, if the stock of a $10 billion market-cap company drops by 1 percentage point, it will drag down the index's performance more than a 1 percentage-point drop in the share price of a $1 billion market-cap company.

Though an index adheres to a set of guidelines for selection of the securities it includes, the company that oversees the index generally reviews the security selection periodically and may make occasional changes. For example, some indexes may rebalance if an individual security grows so large that it dominates the index. Others have a limit on how much of the index can be devoted to a particular sector or industry and may rebalance if the proportion gets skewed.

Indexes are worth watching

Stock indexes can provide valuable information for the individual investor. If checked regularly, an index can provide information that may help you stay abreast of how the stock market in general, or a particular segment of it, is faring. However, understanding the differences between indexes and how each one works will help you make better use of the information they provide. All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

STEP-UP GRATs AND QPRTs

A traditional grantor retained annuity trust (GRAT) or a traditional qualified personal residence trust (QPRT) can be used to obtain a valuation discount for federal gift tax purposes, while removing the trust property from your estate for federal estate tax purposes (if you survive the trust term). By modifying a few trust provisions, a step-up GRAT or QPRT can be used instead to obtain a stepped-up income tax basis for appreciated property, regardless of whether you or your spouse dies first. If you are considering a GRAT or a QPRT, you should consult an estate planning attorney.

What is income tax basis?

Income tax basis is the base figure used to determine whether capital gain or loss is recognized on the sale of property for income tax purposes. Initially, basis is typically equal to the amount you paid for property, but adjustments may be made. If the property is sold for more than its adjusted basis, there is a gain. If the property is sold for less than its adjusted basis, there is a loss.

What is a stepped-up basis for inherited property?

When your heirs receive property from you at your death, they generally receive an initial basis in property equal to its fair market value (FMV). The FMV is established on the date of your death, or sometimes, on an alternate valuation date six months after your death. This is often referred to as a "stepped-up basis," because basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

There is no step-up (or step-down) in basis for income in respect of a decedent (IRD). IRD is certain income that was not properly includable in taxable income for the year of the decedent's death or in a prior year. In other words, it is income that has not yet been taxed. Examples of IRD include installment payments and retirement accounts.

A step-up in basis is not available if you give appreciated property to anyone within one year of that person's death, and the property then passes to you (or your spouse).

Both spouses' shares of community property qualify for a step-up (or step-down) in basis upon the death of the first spouse to die.

So how can you and your spouse be fairly certain of a step-up in basis for appreciated property (excluding IRD, which cannot be stepped up), regardless of who dies first? Except for community property, whether there is a step-up in basis when the first spouse dies generally depends on that spouse owning the appreciated property at death. A couple of step-up trusts may help provide for a step-up in basis for appreciated property, no matter which of you dies first.

What is a traditional GRAT or QPRT?

In a traditional GRAT, you transfer property to the trust and retain a right to a stream of payments from the trust for a term of years. After the trust term ends, the remaining trust property passes to your beneficiaries (such as your children). The gift of the remainder interest is discounted (possibly to zero) because it will be received in the future.

With a traditional QPRT, you transfer your personal residence (it can be a vacation home or a second residence) to the trust, while retaining the right to live in the residence for a term of years. After the trust term ends, the personal residence passes to your beneficiaries (such as your children). The gift of the remainder interest is discounted because it will be received in the future. If you wish to live in the residence after the trust term ends, you need to pay rent at fair market value.

How do you turn a traditional GRAT or QPRT into a step-up GRAT or QPRT?

In order to turn a traditional GRAT or QPRT into a step-up GRAT or QPRT, a few trust provisions must be changed when the trust is created. First, the trust should terminate upon the earlier of the death of you or your spouse (rather than at the end of a term of years). Second, the trust should provide that when that death occurs, the trust property would pass to your spouse, or to your spouse's estate if your spouse predeceases you (rather than to other beneficiaries). Your spouse provides in a will that the property in his or her estate passes back to you if your spouse predeceases you.

The initial transfer of a remainder interest in the trust to your spouse generally qualifies for the marital deduction for gift tax purposes.

If you die first, all or a substantial portion of the property in the step-up GRAT or QPRT will generally be included in your estate and receive a step-up in basis. If your spouse dies first, all of the property in the step-up GRAT or QPRT will be included in your spouse's estate and will generally receive a step-up in basis. In either case, the property passes to the surviving spouse and should generally qualify for the marital deduction and avoid estate tax.

Caution: *If your spouse dies first and within one year of your transfer to the trust, a step-up in basis is not available because the property passes back to you.*

FOUR LESSONS GRANDPARENTS AND GRANDCHILDREN CAN LEARN TOGETHER

If you're a grandparent, maintaining a strong connection with your grandchildren is important, but that may become harder over the years, as they leave for college or become busier, building their careers and families. While they're just starting out financially, you have a lifetime of experience. Although you're at opposite ends of the spectrum, you have more in common than you think. Focusing on what you can learn together and what you can teach each other about financial matters may help you see that you're not that different after all.

1. Saving toward a financial goal

When your grandchildren were young, you may have encouraged them to save by giving them spare change for their piggy banks or slipping a check into their birthday cards. Now that they're older, they may have trouble saving for the future when they're focused on paying bills. They may want and need advice, but may not be comfortable asking for it. You're in a good position to share what experience has taught you about balancing priorities, which may include saving for short-term goals, such as a home down payment, and long-term goals, such as retirement. You'll also learn something about what's important to them in the process.

You may even be willing and able to give money to your grandchildren to help them target their goals. While you can generally give up to $14,000 per person per year without being subject to gift tax rules, you may want to explore the idea of offering matching funds instead of making an outright gift. For example, for every dollar your grandchild is able to save toward a specific goal, you match it, up to whatever limit you decide to set. But avoid giving too much. No matter how generous you want to be, you should prioritize your own retirement.

2. Weathering market ups and downs

Your grandchildren are just starting out as investors, while you have likely been in the market for many years and lived through more than one challenging economic climate. When you're constantly barraged by market news, it's easy to become too focused on short-term results; however, the longer-term picture is also important. As the market goes up, novice investors may become overly enthusiastic, but when the market goes down, they may become overly discouraged, which can lead to poor decisions about buying and selling. Sharing your perspective on the historical performance of the market and your own portfolio may help them learn to avoid making decisions based on emotion. Focusing on fundamentals, such as asset allocation, diversification and tolerance for risk, can remind you both of the wisdom of having a plan in place to help you weather stormy market conditions.

Note: *Asset allocation and diversification do not guarantee a profit or protect against investment loss. Past performance is no guarantee of future results.*

3. Using technology wisely

Some people avoid the newest technology because they think the learning curve will be steep. That's where your grandchildren can help. With their intuitive understanding of technology, they can introduce you to the latest and greatest financial apps and opportunities, including those that may help you manage your financial accounts online, pay your bills, track investments and stay in touch with professionals.

Unfortunately, as the use of technology has grown, so have scams that target individuals young and old. Your grandchildren might know a lot about using technology, but you have the experience to know that even financially savvy individuals are vulnerable. Consider making a pact with your grandchildren if you are: asked for financial information over the phone, via email or online (including account or Social Security numbers); asked to invest in something that promises fast profits; or contacted by a person or business asking for money. If so, you will discuss it with each other and with a trusted professional before taking action.

4. Giving back

Another thing you and your grandchildren might have in common is that you want to make the world a better place.

Perhaps you are even passionate about the same special causes. If you live in the same area, you might be able to volunteer together in your community, using your time and talents to improve the lives of others. But if not, there are plenty of ways you can give back together. For example, you might donate to a favorite charity, or even find the time to take a "volunteer vacation." Traveling together can be an enjoyable way for you and your grandchildren to bond, while you meet other people across the country or globe who share your enthusiasm. Many vacations don't require experience, just a willingness to help—and learn—something you and your grandchildren can do together.

WHAT ARE SOME TIPS FOR ORGANIZING FINANCIAL RECORDS?

Organizing your financial records is a cyclical process, rather than a one-time event. You'll need to set up a system that helps you organize incoming documents and maintain existing files, so that you can easily find what you need. Here are a few tips.

Create your system: Where you should keep your records and documents depends on how quickly you want to be able to access them, how long you plan to keep them and the number and type of records you have. A simple set of labeled folders in a file cabinet may be fine, but electronic storage is another option for certain records if space is tight or if you generally choose to receive and view records online. No matter which storage option(s) you choose, try to keep your records in a central location.

File away: If you receive financial statements through the mail, set up a collection point, such as a folder or a basket. Open and read what you receive, and decide whether you can file it or discard it. If you receive statements electronically, pay attention to any notifications you receive. Once you get in a routine, you may find that keeping your records organized takes only a few minutes each week.

Purge routinely: Keeping your financial records in order can be even more challenging than organizing them in the first place. Let the phrase "out with the old, in with the new" be your guide. For example, when you get this year's auto policy, discard last year's. When you receive an annual investment statement, discard the monthly or quarterly statements you've been keeping. It's a good idea to do a sweep of your files at least once a year to keep your filing system on track (doing this at the same time each year may be helpful).

Think safety: Don't just throw hard copies of financial paperwork in the trash. To protect sensitive information, invest in a good quality shredder and destroy any document that contains account numbers, Social Security numbers or other personal information. If you're storing your records online, make sure your data is encrypted. Use strong passwords, and back up any records that you store on your computer.

HOW LONG SHOULD I KEEP FINANCIAL RECORDS?

There's a fine line between keeping financial records for a reasonable period of time and becoming a pack rat. A general rule of thumb is to keep financial records only as long as necessary. For example, you may want to keep ATM receipts only temporarily, until you've reconciled them with your bank statement. But if a document provides legal support or is hard to replace, you'll want to keep it for a longer period or even indefinitely. It's ultimately up to you to determine which records you should keep on hand and for how long, but here's a suggested timetable for some common documents.

One year or less	More than one year	Indefinitely
Bank or credit union statements	Tax returns and documentation*	Birth, death and marriage certificates
Credit card statements	Mortgage contracts and documentation	Adoption papers
Utility bills	Property appraisals	Citizenship papers
Annual insurance policies	Annual retirement and investment statements	Military discharge papers
Paycheck stubs	Receipts for major purchases and home improvements	Social Security card

*The IRS requires taxpayers to keep records that support income, deductions and credits shown on their income tax returns until the period of limitations for that return runs out — generally three to seven years, depending on the circumstances. Visit irs.gov or consult your tax professional for information related to your specific situation.