

The Loop

An Insight Financial Advisor Newsletter

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Capital Gain Tax Shrinkage

Written by: Wanda L Delgado, CFP® (238616)

If you own mutual funds in a taxable account, you may get a big tax surprise for 2018: large capital gain distributions. A lot of the profits generated in the last few years are making their way to your 2018 tax return and this could mean an unexpected income tax liability. Tim Miller of BlackRock, Inc. tells us, “This will be a big year: 60% - 70% of stock mutual funds will be making capital gain distributions.”

The rise in U.S. and international stock markets means that the prices of stocks worldwide have resulted in rising portfolio values. Hopefully, you have seen your investment portfolio participate in these profits. If you have not sold the shares where you have a profit, you have not paid tax on that profit because the gain is “unrealized”. The profit in mutual fund shares becomes a taxable “realized” gain in one of two ways:

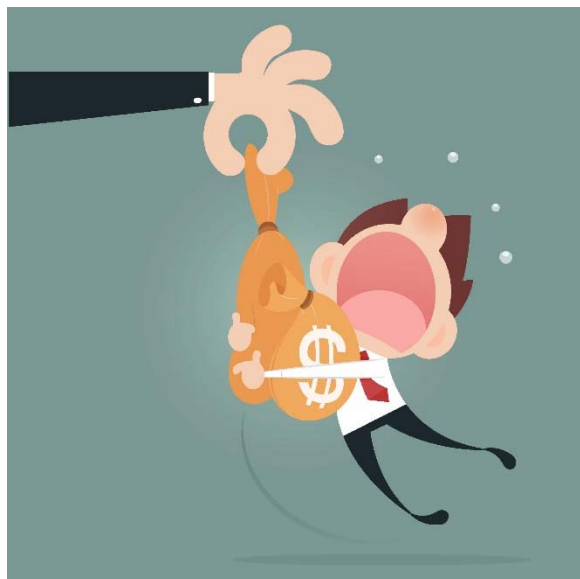
- 1) You sell the mutual fund shares and you pay tax on the profit: the difference between the sales proceeds and what you paid for the shares (cost basis).
- 2) The mutual fund manager sells stock inside the fund and a profit is generated between the sales proceeds and what the fund paid for the shares. That profit is allocated amongst all the mutual fund shareholders pro-rata and distributed to them in a capital gain distribution.

Mutual fund shareholders have holdings set up to re-invest the distributions or pay them in cash. Don't worry if you do not know how yours is set-up, most mutual fund investors don't. The important thing to know is that you will owe tax on the capital gain distribution either way. Logic may tell you, “I re-invested the capital gain distribution and did not receive cash, so I should not owe any tax!” The IRS sees it differently. You see, you could have taken the cash (this is called constructive receipt) and so you owe the tax.



Most often people are pleased to pay taxes when they make money. Now, what if your portfolio of mutual funds shows a modest profit for 2018, but you owe tax on capital gain distributions that are larger than your profit? Ouch! This happened to a lot of mutual fund investors in 2008. Portfolio profits were negative for 2008, but capital gain distributions were paid on profits from

stocks sold early in the year after a robust 2007. That was like salt in the wound! The investors' portfolio showed no profits and a drop in value, but they owed a capital gain tax! Yes, it can happen.



Is there anything that can be done? Well, maybe. Let's look at these 2 strategies to minimize income tax pain:

Capital Gain Canceling

We analyze clients' accounts to sift out any holdings that may be valued under what our client paid for them. If there are holdings that were sold during the year that generated a taxable gain, we may sell the under-water shares to trigger the loss which offset the gain. This technique cancels the effect of the taxable gain. We used this strategy effectively in 2008 and fairly often

actually, as clients' situations may trigger a need to do this.

Capital Gain Sidestep

We monitor the capital gain announcements from the mutual funds held by our clients' taxable accounts. We also review our clients' holdings and analyze the unrealized profit/capital gain in their accounts. If a mutual fund announces a capital gain of 30% (and one did – last year!), and our client(s) holding has an unrealized profit of 10%; we will sell the holding before the record date. Paying capital gain tax on 10% is less painful than paying tax on the 30%. If an investor owns those shares on the record date, they receive the 30% capital gain and the income tax liability, so we want to time this carefully. We use this strategy to minimize capital gains taxes. This is what we think will be useful for 2018.

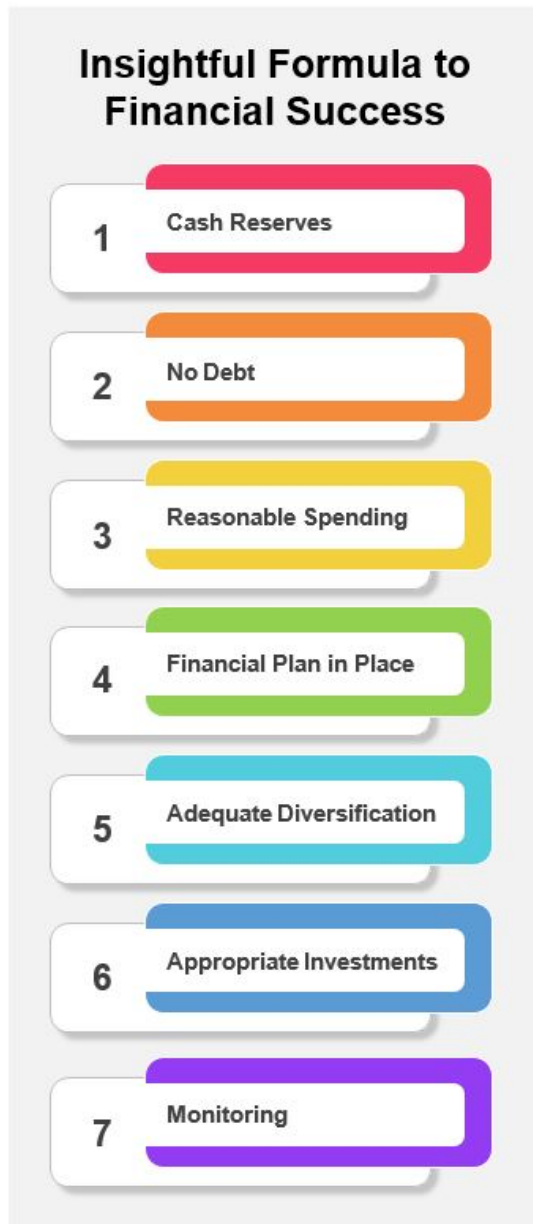
These strategies are tailored processes and one method will not fit all. There is no button that we push or a computer program that we run. We have some neat tools that we use, but this management requires a bit of old fashioned work. We cannot control the markets, but we can control our efforts.

This article was written by
Wanda L Delgado, CFP®
Registered Principal



Insightful Formula to Financial Success

Written by: Wanda Delgado, CFP® (238895)



There is a fairly simple formula for financial success that I have been using during my 30+ years in this industry and I'm going to give it to you. In fact, we've put together a graphic (pictured on the left) to show you the secret sauce...

Yep! It's the same few things I talk about at every client meeting, in practically every newsletter, and inevitably at just about every social gathering. Although you may have heard or seen me discuss these topics before, it is always important to have a reminder. We've already covered Cash Reserves and No Debt in previous issues of The Loop, so let's move on to Part 3 – Reasonable Spending ...

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This article was written by
Wanda L Delgado, CFP®
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Reasonable Spending

Insightful Formula to Financial Success, Part 3

Written by: Wanda Delgado, CFP® (238895)

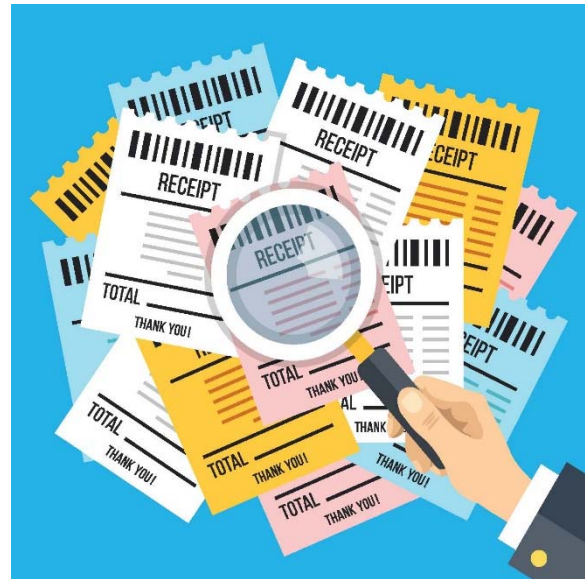
Spend less than you earn – that’s all you need to know, isn’t it? Not so fast. “Reasonable spending” can be sabotaged by a number of sneaky things. Most of them are sneaky things people do to themselves. The sneaky things are only outdone by the outrageous things people do. If this topic seems a bit too tame for you, read on for a bit of bemusement, if not shock value.

Sneaky lack of awareness

A lovely 25 year old asks her parents for money because she needs to buy a washer and dryer to do her laundry. Her parent wisely responds that what she really needs to do is gather a fistful of quarters, pack up her clothes, gather laptop and cellphone and take herself (term actually used: “happy behind”) to the laundromat. This young person had not sorted out the fact that she had more time than money. She could only see the inconvenience of having to visit the laundromat.

Outrageous lack of discernment

A young (trim and fit) friend relates how he had to purchase a \$400 shirt as the shirts of “brands with lower price points” did not fit well. As he said this, one thinks, “How about an \$80 shirt and a \$25 tailor treatment?!” This individual had not thought through reasonable options and overpaid 4 times as much for the desired outcome.



Famous and bordering self-destruction

Johnny Depp shows that taking in an outrageously massive income can be undone by outrageously massive spending. The talented actor has managed to evaporate almost all of his \$650 million net worth on mansions, old guitars, Andy Warhol artworks, designer clothes, luxury cars, private jets, a few islands in the Bahamas and vintage wine. After receiving \$48 million in 2016, paying the taxes and agents, Depp spent \$200,000 per month for the private jet and the famous \$30,000 monthly wine bill (and few other things). Add some sloppy business management and late fees to the IRS, and the fortune is almost all gone.

Full disclosure: the examples above are true, and not my family or clients.

How do you know if you are UN-Reasonable?

You will have outstanding credit card balances and they grow. Or, you will take on other types of loans. This means your net worth is being cannibalized by the growing debt to fund the spending. You just keep getting poorer.

How do you get to be Reasonable?

First, make an accurate list. Note the word “accurate”; it means being honest with yourself. A good start is to look at the last 3

months of credit card statements and the checking account statement (banks provide copies of checks written with the monthly statement). You start to see where all that money goes. Even if you don’t spend all you make, spend some quality time with your list. If the word “Budget” makes you shudder, do this: Prioritize the most important things you spend money on. See if you can’t dump the less desirable things that eat up your money.

These categories can get folks into a tight spot



Shelter: This is fixed overhead and hard to reduce. Rent, mortgage principal, utilities, insurance and HOA fees are after-tax costs. You must earn enough to cover any payroll taxes (7.65%), federal (22% - maybe higher) and state (8%) income taxes. This usually means 30% or more! \$2,500 per month means you must earn \$3,571 to pay for shelter.



Food and beverages: Dining out costs at least \$26 per person for dinner with an entrée, a few veggies and an iced tea. More with wine/beer, salad and dessert. This means \$1,578 a month per couple (Or \$2,254 after tax!). Breakfast and lunch are not in the math at this point. If you can cook and can limit the gourmet items, dining at home is a lot less expensive than dining out.



Transportation: Auto payment (auto leases are often the best way to overpay for a car), insurance, fuel, repairs, parking and toll roads. By the way, parking tickets are taxes on folks who can probably least afford it.



Communication: Telephone/cell phone and internet access. You must keep working smarter to have competitively priced plans.

We have a comprehensive expense list named “Cash Flow Worksheet” on our website. You can find it here: www.insightfa.com/client-tools/. It’s free, and private. No one will know you looked at it, or downloaded it. Good luck.

“Too many people spend money they haven't earned, to buy things they don't want, to impress people that they don't like.”

— Will Rogers

What Happens to Your Retirement Accounts After You're Gone?

Written by: Heather N Calmes (239269)

Working with Wanda for 10 years now, I've noticed there's one thing nobody ever wants to think or talk about – what happens after they pass? As a result, many people blow right through the beneficiary designation in their account set-up paperwork and never think about it again... but that is a big mistake.

There are some important things you need to know about what happens to your money after you're gone. And since we don't want you – well, rolling over in your grave – we better address them now!

Your Trust Does Not Apply to Retirement Accounts

A Trust document is important to have as it instructs how property held in the name of the Trust will be dealt with after you pass away... but only the property held in the Trust. Many people believe having a Trust will direct the inheritance of all bank accounts, property and investment accounts; however, this is not accurate. Any property outside your Trust, including

retirement accounts, is not subject to the instructions in your Trust document. Without proper instructions, those accounts will go through probate, and the fat cat attorneys and state government will get to enjoy a large chunk of the money instead of your heirs.



Even if your Will directs property to your Trust, it may still be subject to probate.

Retirement Account Beneficiary Designations

For retirement accounts you should be sure to carefully fill out a beneficiary designation for each account. The inheritance

instructions for each of your retirement accounts is dictated by its own beneficiary designation form. If you have more than one retirement account, you should have more than one beneficiary designation. Retirement accounts include IRA, ROTH IRA, Simple IRA, 401(K), etc.

Other accounts, such as Individual and Joint accounts, may include a TOD (Transfer on Death) clause. This allows you to designate beneficiaries just like on a retirement account. If these accounts are not already titled in the name of your Trust, it may be a

good idea to add TOD to Individual and Joint investment and bank accounts to avoid probate. You should ask your estate planning attorney or financial advisor for their recommendation.

Per Stripes

While designating your beneficiaries you have the option to add a *per stripes* designation. This is a way to ensure that all children/grandchildren will be included in the inheritance by passing it to the surviving heirs of a beneficiary. It's easier to explain with examples ...

Example 1:

Don opens an IRA account and names his wife, Debbie as primary beneficiary and his good friend, Greg as contingent beneficiary. Throughout the years Don and Debbie have two children. Unfortunately, Don and Debbie pass away in a tragic basket weaving accident. As Don and his primary beneficiary, Debbie, have passed away the inheritance then goes to the contingent beneficiary, Greg. Don and Debbie's children will inherit nothing...probably not what Don and Debbie intended.

However, if Don indicates in his Beneficiary Designation that Debbie is to be the primary beneficiary with per stripes we get a different outcome. After the tragic basket weaving accident, Debbie's inheritance is passed to her surviving heirs – their two children. Greg will only receive the inheritance if basket weaving takes out the whole family at the same time. (Unlikely, but you never know!)

Example 2:

Now, say Don was diligent and updated his contingent beneficiaries to name his children, but still did not indicate per stripes. Unfortunately, their oldest son (and the father of their grandkids) was with them and suffered the same fate. (Darn those baskets... darn them to heck!) Since there is no per stripes designation, his kids (the grandchildren) get nothing and his brother (youngest son) gets 100% of the account. This may be the desired outcome, but they may have intended the grandchildren to share the oldest son's inheritance.



As someone who personally inherited money thanks to a per stripes designation, I give my own personal unprofessional seal of approval for this method: 5 out of 5 stars, two thumbs up... but I may be biased.

Better Review That Sucker

In addition to ensuring you have a Beneficiary Designation for each retirement account and ensuring you include a per stirpes designation where appropriate, you had better be sure to review those suckers regularly. Again each retirement account has its own beneficiary designation, so you must review the beneficiary designation for ALL retirement accounts.

We find the most common updates include adding new children/grandchildren (the per stirpes designation may help to safeguard here) and the removal of estranged or deceased spouses/beneficiaries. That's right, even a divorce does not automatically change your designation, you must keep it up to date or you (well, really, your heirs) may be faced with unintended consequences.

Example:

Bill and Sally have a messy divorce. Bill remarries a lovely woman named Grace and has a happy life. Years later Bill passes away and Grace begins administering his estate and collecting her inheritance. What does she discover? His ex-wife, Sally, is still the primary beneficiary on his 401(k) account! Bill never thought to review and update his beneficiary designation. The money Bill thought would go to Grace is actually going to Sally. You think Sally is going to give Grace the money? (She's not.)

It's Your Job to Keep Track

You know how sometimes you see how something works and you think, "What genius came up with this idea?" This is one of those times. It will be your (or your heirs) job to tell your retirement account administrators what to do with your money after you're dead. Surprisingly, financial institutions do not always keep accurate/up-to-date copies of your beneficiary designations. Additionally, many 401(k) providers do not collect or keep copies of your designation. So all you need to do is come on back from the grave, pull out your beneficiary designations and everything will go just as you wish.



As an alternative, we suggest keeping a copy of all beneficiary designations with your estate planning documents so your heirs will have easy access. Remember, each retirement account has its own beneficiary designation, so you should have one beneficiary designation for each account stored with your estate planning documents.

Here at Insight Financial Advisors we are making sure to review all beneficiary designations as part of our Cc Update System; looking over and updating the designations for each account we manage

during our Update Meetings. If you have not talked to your IFA advisor, you should ask your financial advisor or review your beneficiary designations at home.

Now is as good a time as any to review your beneficiary designations. Don't wait until it's too late!

This article was written by
Heather N Calmes
Marketing Director



Investment Committee Meeting

Written by: John R Calmes, CFP®

IFA held their quarterly Investment Committee meeting on September 21st. The committee evaluated their recommended fund list, reviewed current allocation recommendations, and reviewed their investment policy for advisory accounts. Changes to most portfolios were done earlier this year, no further changes are

recommended at this time. We noted that capital gain distributions may be larger this year and we will be reviewing taxable accounts as year-end distributions near to identify any opportunities to harvest unrealized losses or other tax saving opportunities.

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