GREENLEAF TRUST

Perspectives

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Chairman, Greenleaf Trust

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Economic Commentary

I enjoy the interaction that I get with readers of our Greenleaf Trust newsletter each month. The reactions are usually positive and occasionally challenging, especially when we approach the silly season of political campaigns. I changed the title of my monthly article a few years ago from "Economic Update" to "Economic Commentary" because I felt commentary was more accurate. My articles usually involve economic data and, as you have observed, almost always involve opinion and commentary surrounding the data points articulated. Last month's topic of the impeachment process seems to have landed squarely in the commentary category given the number of responses received.

Interestingly, those who responded to the article seemed to reflect exactly the current polarization afflicting our country. Half of those who engaged with me felt I was a Republican making excuses for immoral, unethical and illegal activities of the President, while the other half expressed belief that I was endorsing the political process of impeachment, and therefore, the Democrats' push for impeaching the President. I either hit the right or balanced chord with my article as witnessed by the equally polar opposite reaction, or the reaction is yet additional evidence of the political divide that exists. For me, the reaction is reinforcement that how we view any public policy decision or economic result will be determined by what party is in office and generally not by the quality of the decision nor the direction of the data. If it is our party and our candidate, we will make excuses for supporting the policies and results, and if it is not our party and candidate then we do not need fact to support our discontent. In any case, there will be more opportunity for the exchange of ideas, and it is an exchange I enjoy. Speaking of ideas and data, let us examine some.

Federal Reserve

For the third time this year, Fed Chairman Powell announced the lowering of federal funds rate. The rate cut was expected and had been telegraphed by various Fed governors during the weeks leading to the FOMC meeting. As always, it is not the action that is most important, but the verbiage and the nuance of that verbiage in the announcement

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Commentary, continued

itself as well as the notes that accompany each FOMC meeting. Powell clearly suggested that the Fed did not expect any further rate cuts this year and spent a good deal of time speaking of employment slack and its relationship to inflation as well as the Fed's inflation target of 2%.

Specifically Powell said, "Since monetary policy operates with a lag, the full effects of these adjustments on economic growth, the job market and inflation will be realized over time." Further, he stated, "We see the current stance of monetary policy as likely to remain appropriate as long as information about the economy remains broadly consistent with our outlook of moderate economic growth, a strong labor market and inflation near our symmetric 2% target."

Market analysts left feeling that the Fed was comfortable with where we are with respect to the Fed Funds Rate, yet will continue to monitor the data for further directional change.

"Every recovery cycle enjoys consistent trends in employment. Initially in every post-recession environment, job growth is gained first by the highest educated and technically skilled workforce..."

Employment

Every recovery cycle enjoys consistent trends in employment. In every post-recession environment, job growth is gained first by the highest educated and technically skilled workforce, commonly referred to as U-3 employment data. This job growth is regional at first and often reflects very low wage growth. As employment grows, the supply of labor diminishes and wage growth begins a slow but steady accent. Initially, monthly job gains need to be robust in order to move the rate of unemployment down. In the deepest part of our 2008 recession with U-3 unemployment in excess of 10%, monthly job gains of 250,000 were necessary to keep the employment rate steady. At today's 3.6% unemployment rate, we need add only 100,000 jobs to stabilize employment. This month's announcement of job gains of 133,000 were certainly enough to hold the unemployment rate at 3.6% and improve the labor participation rate by .001%, which implies a precision that probably doesn't exist. Most notable in the data was the continued improvement in U-6 employment. You will recall that U-6 employment comprises those first fired and last hired and are in a pool of labor in larger supply. The lag between an improving economy and U-6 employment is significant and is especially true for wage rate growth among that sector of employed. The most recent data reveals U-6 unemployment at 6.3%, a reduction of twelve points from the high experienced in 2008 at 18.6% and well below the last twenty-year average of 10.4%.

As you might expect, wage rate growth among the lowest wage earners has also begun to advance, as has the transfer of people from minimum wage to higher wage rate employment. This data is certainly great for those who suffer the longest duration of unemployment

and lowest wage rates during recovery cycles. The data also reflects a further inflection point in labor supply. U-3 employment categories have experienced consistent wage growth for 2018 and 2019. That wage growth has now found its way to U-6 employment. We are adding jobs at a monthly rate consistent with the number needed to stabilize the current unemployment rate and labor participation rates have been incrementally increasing especially between the ages of 23 - 54, a category that has lagged for several years. For those who see the glass half full, this data is welcome and amplifies the notion that the economy is strong. For those who might have their glass half empty, this data cannot be sustained for much longer and they feel that it is further evidence that the economic cycle of expansion is near its end.

From the Fed's point of view, it is evidence that the current monetary policy is appropriate. Employment is full, wage growth is occurring and inflation is benign though positive.

> "The thing that concerns most economic analysts is the lack of inflation given the length of our economic expansion and historically low unemployment rate."

Inflation

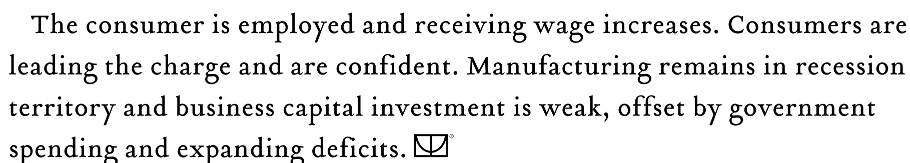
The current inflation rate is 1.7%, slightly below the Fed target rate of 2%. Yes that is correct the Fed actually wants some inflation of prices to assure economic activity remains positive. Deflation of prices is not good for economic expansion, as it does not reward capital investment, and therefore growth of production of goods and services. The thing that concerns most economic analysts is the lack of inflation given the length of our economic expansion and historically low unemployment rate. Further troubling is the lack of business capital investment necessary to improve productivity, and therefore sustain GDP growth.

GDP

Real GDP (adjusted for inflation) rose at an annual rate of 1.9%, which the Fed now characterizes as moderate and the President characterizes as the best economy ever. As a reminder, the opposition party during the last administration labeled 2% GDP growth as weak.

In Balance

The consumer is employed and receiving wage increases. Consumers are leading the charge and are confident. Manufacturing remains in recession territory and business capital investment is weak, offset by government spending and expanding deficits.



Michael F. Odar, CFA®
President

The Advance

We believe diverse, critical thoughts and candid discussions are necessary components of the decision making process. Decisions at Greenleaf Trust are made with these components, especially when it comes to strategic decisions. And since the focal point of our strategic planning process is our Advance, diverse critical thoughts and candid discussions are required.

Our Advance is an annual three-day off-site meeting in October involving our entire Executive Leadership Team. This year we held our Advance in Bay Harbor, Michigan. The purpose is to share and discuss divisional strategic plans for the upcoming year. Divisional plans are scrutinized and challenged by each leader's peers in an effort to create a cohesive organizational plan. Once an organizational plan is constructed, we build our budget around it. We view strategic planning as a long-term endeavor. However, each year we want to take one step forward towards achievement of our longer term Top of Mind strategic plan. Our Advance helps us do this. And, if you are wondering why we do not call it an executive retreat, it's because we are not going backwards. We call it an Advance because we are moving forward.

"Our Advance is an annual three day off-site meeting... involving our entire Executive Leadership Team."

We will roll out the finished organizational strategic plan for 2020 to the entire company in a couple of weeks, so I cannot get into details, but I can provide a sense of our focus next year. Diverse critical thoughts and candid discussions were focused on four key themes that came out of our companywide strategic planning survey — Workplace Culture, Purposeful Growth, Near Term Projects, and Longer Term Initiatives. Talent development, diversity and inclusion, and connectivity were universal topics of discussion around Workplace Culture. Our culture is what differentiates us in the marketplace and multiplies the talent within it. As we grow, how do we continue to nurture it? When it came to Purposeful Growth, we spoke in depth about what our organic growth and inorganic growth looks like. What new Michigan markets are appropriate? Are there new lines of service that our clients desire? Does an opportunistic purchase of an adjacent business make sense? Finally, we have many projects that we are currently working on and just as many initiatives to start working on. All are focused on serving our clients more efficiently and effectively.

All of the improvements we have made to Greenleaf Trust can trace their roots back to our strategic planning process and Advance. We have a long list of desired accomplishments in 2020 and cannot wait to get started.

Capital Gains Distributions A Seasonal Affair

Jacob A. Barker
Associate Manager Selection Analyst

As the last vestiges of summer quickly fade, people throughout the region begin turning their attention to winter activities and the impending holiday season. Accompanying every change in seasons is a unique set of to-do items, and one such activity that Greenleaf Trust advisors actively anticipate this time of year is the emergence of annual capital gains distributions. These distributions, traditionally made in late November to mid-December, can create a tax liability for investors regardless of whether they have recently sold shares. For us at Greenleaf, advisors begin preparing for this annual event well in advance, with the goal of ensuring the best tax outcomes for each client through the management of capital gains distributions. Given the financial implications of these distributions, we believe a robust and strategic plan that is cognizant of each client's unique circumstances can prove remarkably additive to an investor's long-term capital appreciation. To explain capital gains distributions and how Greenleaf approaches taxes in fund portfolios it is our pleasure to once again share with you this article on the topic.

Most investors are familiar with basic tax principals for individual shares of stock. Mr. Smith buys shares of ABC Company for $100 and sells them for $110 realizing a $10 profit, or gain, on which he is expected to pay taxes. If Mr. Smith holds the shares for more than one year, the gains are considered long-term and subject to a federal tax rate of up to 23.8% (in 2019). If Mr. Smith holds the shares less than a year, the gains are short-term and taxed as ordinary income. The key here though, is that Mr. Smith has to sell the shares to realize the gains. He controls the timing, and has the ability to delay realization of gains and the resulting tax liability for as long as he holds the shares. The same concept is only partially true when it comes to mutual funds.

A share in a mutual fund represents a share in a portfolio of stocks (or other investments), and the price of that share (the net asset value or NAV) fluctuates with the prices of the underlying securities. The mechanics here are really no different than in the individual stock example above. Mr. Smith buys shares of the ABC Fund for $100, the underlying securities in that fund collectively appreciate by 10%, and Mr. Smith sells them for $110, realizing a $10 gain and the associated tax liability. Pretty straight forward right? Here's where it gets a little more complicated...

If a mutual fund sells a holding in which it has a gain, it has to distribute that gain to the fund's shareholders in the year it was realized.

"If a mutual fund sells a holding in which it has a gain, it has to distribute that gain to the fund's shareholders in the year it was realized."

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Capital Gains Distributions, continued

If the mutual fund buys shares of ABC Company for $100 and sells them for $110, it has to distribute the $10 gain (short or long-term) to shareholders who are responsible for the tax liability. Instead of distributing gains after every transaction, funds typically make a single distribution at year-end which incorporates all gains netted against any offsetting losses or applicable loss carry forwards.

So there are two ways a fund investor can realize gains: 1) by receiving a capital gain distribution from the fund; and 2) by selling a fund share for more than the purchase price. Mechanically, capital gains distributions are processed similarly to dividends. There is a record date (holders of record on this date will receive the distribution), and an ex-date (the first day you can buy the fund without receiving the distribution). This means that a fund could set a record date of December 15 and if our friend Mr. Smith bought shares on December 14, he would receive the distribution and a tax bill. Likewise Mr. Smith could have bought shares earlier in the year and sold them on December 14th and he would avoid the distribution altogether.

“Current estimates show that funds with significant foreign equity exposure expect to make higher distributions than funds with other types of holdings.”

Perhaps this seems unfair. The fund accumulates gains all year and then distributes them to whoever happens to be holding the shares on the record date. Fortunately, there is a mechanism in place that prevents fund investors from being taxed twice – specifically, the distribution results in a corresponding reduction to the NAV or price of the fund share, which effectively reduces any gain in the shares themselves.

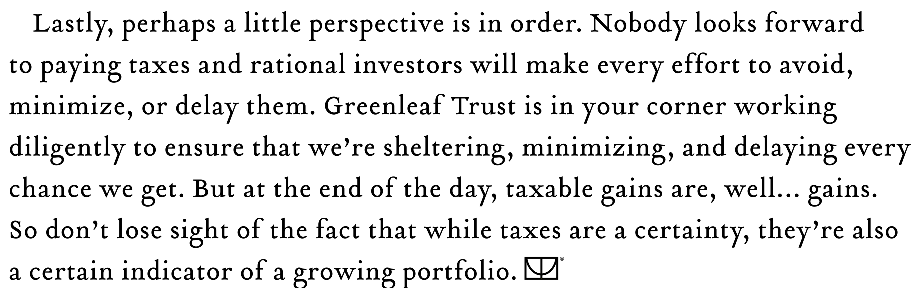
To illustrate, let’s say Mr. Smith buys one share of ABC fund for $100 on December 14 and the fund distributes $10 in capital gains on December 15. Mr. Smith receives the $10 and will pay taxes on that amount (clearly unpleasant), and his share immediately re-prices to $90. Sounds like a lose-lose, but it means Mr. Smith’s share could appreciate as much as $10 (from $90 back to $100) before he would realize gains on a sale.

For each of the past several years, the average distribution across our client holdings was between three and five percent. This year, our estimate of the average distribution across our client holdings is somewhere between three and four percent. Current estimates show that funds with significant domestic growth equity or global real estate exposures expect to make higher distributions than funds with other types of holdings.

Fortunately, our hands are not completely tied when it comes to taxes. In fact, several steps in our process are inherently geared toward managing tax liabilities generally and specifically as they apply to externally-managed funds. First of all, this discussion does not apply to 401(k)s, IRAs, or other qualified accounts and we ensure clients are maximizing these vehicles in the context of a broader wealth

management plan. For non-qualified accounts, our portfolio construction and fund selection processes carefully consider the assumed tax impacts of the strategy or fashion in which our clients are investing. We carefully consider turnover rates, as it is usually the case that higher turnover (more trading) means more realized gains while lower turnover means the opposite. We also evaluate the tax characteristics of different investment vehicles for our clients. This emphasis on tax efficiency is part of what led us recently to increase the use of index-tracking exchange-traded funds (ETFs), which usually experience less turnover and are generally more tax efficient than the average actively-managed mutual fund. We also monitor funds closely for manager or prospectus changes which may drive higher turnover if the portfolio is repositioned. Additionally, we analyze capital gains estimates to inform decision-making around year end — under unique circumstances, there may be benefits to strategic repositioning during the distribution season based on a host of account-specific factors. You can rest assured that we are thoroughly examining every account for opportunities.

> "Nobody looks forward to paying taxes and rational investors will make every effort to avoid, minimize, or delay them."



Lastly, perhaps a little perspective is in order. Nobody looks forward to paying taxes and rational investors will make every effort to avoid, minimize, or delay them. Greenleaf Trust is in your corner working diligently to ensure that we're sheltering, minimizing, and delaying every chance we get. But at the end of the day, taxable gains are, well... gains. So don't lose sight of the fact that while taxes are a certainty, they're also a certain indicator of a growing portfolio.

Avoiding Probate with Proper Asset Titling

Kristen M. Tidd, CTFA
Senior Trust Relationship Associate

A common question I get asked by clients and prospects is, "How do I avoid probate?" Probate is the process that a state uses to settle the estate of a deceased person, referred to as the decedent. One of the main objections many people have with the probate process is that it often violates their desire to keep their estate distribution details private because the proceedings are made a matter of public record. In addition, there can often be unnecessary costs incurred, as well as requiring time-consuming efforts on behalf of the executor settling the estate, resulting in a delay in beneficiaries receiving their share of the estate's assets. For these reasons, and to streamline the estate settlement process for their inheritors, many people prefer to structure the ownership of their assets in such a way that avoids probate. The ownership structure is determined by the asset's titling. Forms of ownership are governed by state law, can vary significantly and have wide-ranging consequences, including potentially negative estate planning results. We recommend that you review the ownership structure of your assets to ensure that they are in line with your current and future goals.

> "Even for those forms of ownership that pass by law to the surviving spouse, the property [may] become subject to probate upon the death of the surviving spouse…"

You should consider any ownership interests in business entities such as Limited Liability Companies (LLC), Limited Partnerships (LP), Subchapter S Corporations (S-Corp) and Subchapter C Corporations (C-Corp) as those may also be subject to probate depending on who or what holds the ownership interest. For instance, an advantage of being an individual member of an LLC may provide you creditor protection, but that ownership interest is still subject to probate. If, however, your revocable trust was the member of the LLC instead of you individually, this would allow the ownership interest to pass according to the provisions of your trust, outside of probate.

Even for those forms of ownership that pass by law to the surviving spouse, the property will become subject to probate upon the death of the surviving spouse unless appropriate planning is in place. In most states, one option is to have a payable on death (POD) designation naming a specific beneficiary added to bank accounts and transfer on death (TOD) designations added to securities or brokerage accounts. While currently allowed by fewer states, filing a beneficiary deed may accomplish this same end for real estate. With these designations listed, the assets will transfer immediately to the named beneficiaries upon your passing. While certainly not the only option and not optimal in all

situations, it is important to be aware of these strategies as they may have a place in your estate plan.

Retirement accounts such as 401(k)s, IRAs, and pension plans have named beneficiaries to whom the assets will pass directly, outside of probate. The same holds true for life insurance policies and annuities. It is important to remember that specific beneficiary designations, on a bank account, brokerage account, retirement plan, or insurance contract, will override any provisions set forth in your will or trust. For this reason, it is important that you review the named beneficiary designations to ensure that the assets will pass according to your wishes.

A recurring challenge to avoiding probate is related to vehicle and boat titles. The question often arises if the title to a vehicle or watercraft should be retitled in the name of your revocable trust, if you have established one. While title to a motor vehicle can be held in a revocable trust, and thus avoid probate upon your passing, it is often better to retain the vehicle's title in your individual name, unless the vehicle is an antique or collectible of intrinsic value. Joint ownership of the vehicle also will avoid probate when one joint owners dies. Michigan has a statute [MCL 257.236] that enables the transfer of title to a vehicle or watercraft without having to process that title through probate. Instead, title to the decedent's vehicle or watercraft in his or her name alone can be 'processed' directly at a local Secretary of State office by producing the decedent's certified death certificate, the certificate of title to the vehicle, and filing a Secretary of State form TR-29 entitled Certification From the Heir to a Vehicle. The vehicle's title will be furnished by the Secretary of State according to the following priority: (i) surviving spouse first; and (ii) heirs, next. The primary limitation to this informal process to change title to a vehicle at the Secretary of State's office is that (i) the decedent's solely owned vehicles cannot exceed $60,000 and (ii) there is no other property for which a probate court administration is required, which would be the case if all of the decedent's other assets were titled in the name of his or her revocable trust. This informal process thus enables the title to be changed either to a surviving spouse or to an heir who can then formally take ownership in order to use the vehicle, gift it to a grandchild, or instead sell the decedent's vehicle and retain the sales proceeds.

"A recurring challenge to avoiding probate is related to vehicle and boat titles."

A commonly overlooked asset is a safe deposit box. If you have a safe deposit box, it is recommended to title it in the name of your revocable trust, if you have one established. Upon your passing, the successor trustee will automatically have access to the box and its contents. Some

Avoiding Probate with Proper Asset Titling, continued

people have had issues with their banks allowing them to retitle their safe deposit box in the name of a trust. If you come across this issue, you can shop for a bank that is happy to comply with your request. Leaving the safe deposit box in your individual name will be problematic for the executor of your estate to gain access to the box at your passing.

With numerous types of assets and various forms of potential ownership, it is easy to lose track of asset titling and not be fully aware of the estate planning results of the titling you currently have in place. Call your client centric team to assist in reviewing your current asset titling and beneficiary designations to see if any changes are needed to achieve your estate planning goals.

Year-End Tax Planning Strategies

Steve P. Phillips, CFP®
Wealth Management Advisor

It's hard to believe, but the end of 2019 is quickly approaching. For most Americans, the season is filled with time with family and friends, last minute online orders with the hope Amazon's two day delivery doesn't fail you now, and for those lucky enough to call Michigan home, dusting off the snow blower for our first winter storm. Here at Greenleaf Trust, the end of the year also brings focus to year-end tax planning on behalf of our clients. This includes ensuring applicable Required Minimum Distributions (RMDs) are made to avoid steep IRS penalties, as well as the frenzy of year-end charitable giving that occurs for many of our clients. As mentioned in previous articles, Greenleaf Trust is active in recommending and facilitating tax-efficient methods of giving, such as making Qualified Charitable Distributions (QCDs) from IRAs, gifting appreciated stock, or bunching gifts into one tax year.

In addition to the above items, special attention is paid to reducing taxes for clients from a capital gain perspective. This is not to say that no attention has been paid to capital gains throughout the year. We are intentionally focused on optimizing after-tax, after-fee returns on behalf of our clients. This starts from the very outset with our portfolio construction. Every client portfolio is uniquely tailored and constructed based on that client's goals and objectives: which goes to say no two client portfolios are exactly alike. In general, though, our aim is to place tax-efficient assets, such as exchange-traded funds (ETFs), within taxable accounts while placing tax-inefficient assets, such as actively managed portfolios with some degree of turnover, in qualified accounts not subject to capital gains. When evaluating mutual funds for inclusion within client portfolios, avoiding funds with a track record of significant turnover is a key consideration.

> "...taxable accounts, however, turnover and resulting capital gains will always be a reality for most clients."

For taxable accounts, however, turnover and resulting capital gains will always be a reality for most clients. Whether the turnover comes from regular rebalancing, accommodating client distributions, or repositioning the portfolio to enhance returns, by the end of the year most client portfolios have some level of realized capital gains. Two specific strategies are employed to help mitigate these capital gains for our clients: 1) actively harvesting losses within client portfolios to offset realized gains and 2) thoughtfully selling mutual funds prior to capital gain distributions, when appropriate. The first strategy is by far the most common and straight forward: selling a position at a loss directly offsets any realized gains for the year, reducing the associated tax

Year-End Tax Planning Strategies, continued

liability of those gains. Often the proceeds from these sales are reinvested immediately in the market, or are invested back into the same security after 30 days to avoid wash sales.

The second strategy listed above is slightly more complex and requires significant attention to detail by our wealth management team. As discussed in previous *Perspectives* articles, mutual funds accumulate capital gains that have been realized throughout the year and make distributions of those capital gains in one final distribution, typically made in November or December for most fund companies. Any holder of record as of the "ex-dividend" date will be forced to receive any applicable capital gain payout from the mutual fund. In certain circumstances, it may be appropriate to sell the underlying mutual fund prior to the ex-dividend date in an effort to avoid the year-end capital gain distribution. This may be particularly advantageous in a year when the mutual fund has an unusually high level of turnover. It should be noted that by selling the mutual fund any unrealized capital gains from price appreciation become realized, so the embedded gain must be less than the year-end distribution for this strategy to make sense. Special attention also needs to be paid to the holding period for the fund and wash sale rules when reinvesting proceeds.

"The second [tax] strategy listed above is slightly more complex and requires significant attention to detail by our wealth management team."

Whether it is ensuring compliance with IRS RMD rules, facilitating tax-efficient charitable gifting, following a tax-loss harvesting strategy, or selling mutual funds prior to capital gain distributions, you can be sure Greenleaf Trust is actively involved in deferring and/or reducing our client's tax liability and improving after-tax returns on an annual basis. So with that peace of mind, we hope you enjoy your upcoming holiday season and all that it entails.

High Earners: To Roth 401(k) or Not?

Rosalice C. Hall, MBA, CRPS®
Relationship Service Specialist

How can I get more money into my retirement plan? As a relationship manager for numerous retirement plans, I regularly receive this question from business owners and other highly compensated employees (HCEs). These same individuals are often surprised to learn there are no income restrictions on Roth 401(k) or Roth 403(b) dollars, unlike the income restrictions placed on Roth IRAs. A major advantage being that Roth 401(k)/403(b) contributions begin immediately compounding earnings tax-free. The October 2019, issue of *Perspectives* contains an article by Jeff Pauza titled "Super-Size Your Roth IRA." The article provides a comprehensive analysis of the process to fund Roth IRA accounts through after-tax contributions to 401(k) accounts. Unfortunately, not all plans allow for after-tax contributions and those plans that do may be restricted in their use because of unfavorable plan demographics.

In the text that follows, I will attempt to demonstrate why contributing on a Roth basis makes eminent sense, especially for those individuals facing contribution restrictions. In the simplest terms, contributions made by HCEs cannot be excessive when compared to non-HCEs. The IRS requires testing to ensure that the contributions made for lower paid employees are "proportional" to those made for owners and others deemed HCE. These annual non-discrimination tests frequently result in returns of excess contributions to HCE participants, which effectively limits their personal contributions to the plan.

"... Roth 401(k)/403(b) contributions begin immediately compounding earnings tax-free."

The most important distinguishing factor between Roth and traditional 401(k)/403(b) is when the money is taxed. Traditional 401(k)/403(b) contributions are pre-tax, meaning you can deduct your contributions from your current income, and you will be taxed when the money is withdrawn. Roth 401(k)/403(b) contributions are after-tax, so your deductions will not favorably affect your current tax returns, but the contributions and earnings will be tax-free at retirement, as long as the Roth account has been funded for 5 years.

Weighing now versus later

For many, it comes down to deciding when it is better for you to pay the taxes—now or later. If you are a HCE who is limited on the qualified dollars you are able to set aside within a retirement account, why not opt to pay the taxes now, so that the money within the plan can grow tax-free into retirement?

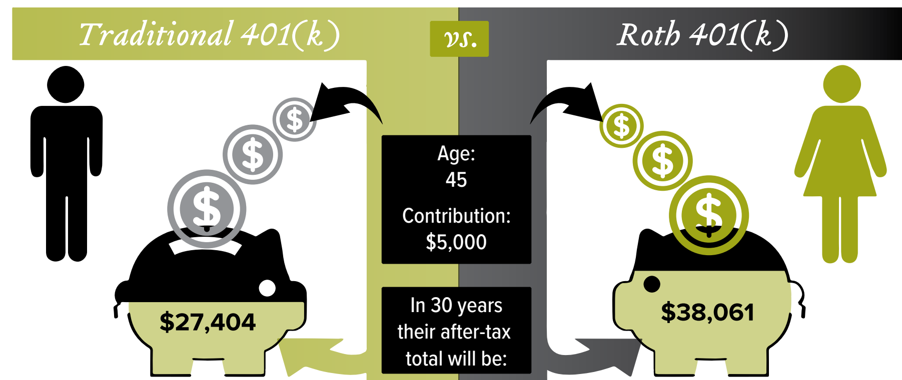
A tax deduction today can be appealing, but you have to think ahead.

To Roth 401(k) or Not?, continued

Roth contributions have traditionally been recommended for individuals who believe their current marginal income tax rate is lower than it will be when the amounts are withdrawn in retirement years. Roth has also been recommended as a way to diversify the tax treatment of retirement income sources and to provide retirees with tax flexibility. Even if you end up in a lower income tax bracket when you retire, withdrawals from your traditional retirement accounts could potentially place you into a higher tax bracket. Higher taxable income could also increase the cost of your Medicare B premiums in retirement. So, giving up the tax deduction now may be well worth having tax-free withdrawals later on.

"Even if you end up in a lower income tax bracket when you retire, withdrawals from your traditional retirement accounts could potentially place you into a higher tax bracket."

The graphic below illustrates the long-term tax savings that can result from making elective deferrals to a Roth source vs. a traditional 401(k)/403(b). I encourage individuals who are restricted in their contributions because of unfavorable non-discrimination test results to view the graphic in terms of the contribution you are permitted to make to the plan. Hypothetically, if you can only defer $5,000 into the qualified retirement plan, it seems reasonable to assume that the best long-term success comes from electing Roth and paying the taxes now vs. waiting. Retirees are commonly disappointed to learn that their retirement savings accounts do not have quite the purchasing power they expected. A Roth account helps to manage those expectations through its predicable tax treatment.



This hypothetical example for is illustrative purposes only. It assumes a 30-year investing time horizon and compounds investments annually at a rate of 7% in the Roth and Traditional 401(k) accounts. Marginal tax rates are assumed to be 28% in the contribution year and in the year of withdrawal.

Diversify your retirement account with both traditional and Roth dollars

The good news is that when it comes to a traditional vs. a Roth 401(k)/403(b), you don't necessarily have to make an all-or-nothing choice. Most plans allow you to split your contributions between the two types of accounts, and decide year-by-year where you want to make your contributions.

It is important to note that employer contributions are always made with pre-tax dollars, so taxes will be due on this portion of the money—and its earnings—once you start taking distributions.

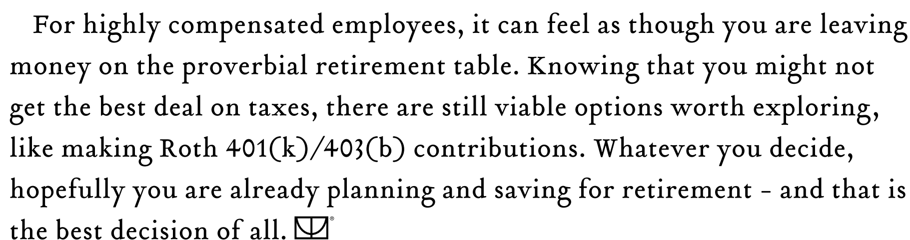
A few added thoughts

With federal income tax rates at historic lows due to the 2017 Tax Act, especially for married couples, now might be the ideal time to defer into a Roth 401(k)/403(b) source. It is unknown if you will pay lower or higher taxes in retirement, but it pays to know that tax-free withdrawals from a Roth will have a much greater after-tax value than a conventional 401(k)/403(b) withdrawal.

Additionally, similar to a traditional 401(k)/403(b)—and unlike a Roth IRA—you do have to take a required minimum distribution (RMD) at age 70½ from a 401(k)/403(b). However, you can easily avoid RMDs by rolling the funds to a Roth IRA. With a Roth IRA, you can leave the money in the account as long as you like, so it is a useful early or "deep" retirement fund.

"If you are thinking even farther ahead to estate planning, inherited Roth IRAs are beneficial for your heirs..."

If you are thinking even farther ahead to estate planning, inherited Roth IRAs are beneficial for your heirs because of the tax-free account status. In addition, with the current discussion in Washington about the SECURE Act's proposed maximum 10-year distribution of Inherited IRAs, it is a strategically sound decision to elect deferrals into a Roth 401(k)/403(b) source now.



For highly compensated employees, it can feel as though you are leaving money on the proverbial retirement table. Knowing that you might not get the best deal on taxes, there are still viable options worth exploring, like making Roth 401(k)/403(b) contributions. Whatever you decide, hopefully you are already planning and saving for retirement - and that is the best decision of all.

Stock Market Pulse

Index	10/31/19	Total Return Since 12/31/2018
S&P 1500	696.85	22.70%
Dow Jones Industrials	27,046.23	18.19%
NASDAQ	8,292.36	26.07%
S&P 500	3,037.56	23.16%
S&P 400	1,955.37	19.19%
S&P 600	965.35	15.65%
NYSE Composite	13,171.81	18.44%
Dow Jones Utilities	867.52	24.70%
Barclays Aggregate Bond	113.15	8.54%

P/E Multiples	10/31/19
S&P 1500	20.3x
Dow Jones Industrials	18.6x
NASDAQ	31.8x
S&P 500	20.2x
S&P 400	21.2x
S&P 600	23.2x

Key Rates

Rate	
Fed Funds Rate	1.50% to 1.75%
Tbill 90 Days	1.48%
T Bond 30 Yr	2.18%
Prime Rate	4.75%

Current Valuations

Index	Aggregate	P/E	Div. Yield
S&P 1500	696.85	20.3x	1.88%
S&P 500	3,037.56	20.2x	1.90%
Dow Jones Industrials	27,046.23	18.6x	2.28%
Dow Jones Utilities	867.52	22.5x	2.91%

Spread Between 30 Year Government Yields and Market Dividend Yields: 0.30%

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