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Trust UPDATE

Stillman BANK

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What you need to know about IRA rollovers

According to the Investment Company Institute 2019 Fact Book, IRAs are now the largest pot of retirement money, with some $8.8 trillion. Defined contribution plans such as 401(k) plans rank second, at $7.5 trillion. Private sector pension plans now hold only $2.9 trillion, but they also have promised $600 billion in benefits that are unfunded.

How did accumulation of funds in IRAs grow so large? It wasn't from annual contributions or investment earnings, it was through IRA rollovers from employers' qualified retirement plans.

If you expect to retire soon and will be receiving a lump sum distribution of your retirement benefits, you need to review your strategies. A lump sum distribution can be rolled over into an IRA, to preserve beneficial tax treatment for your retirement money. However, you will have many important decisions to make during this process. The consequences of your choices will last for the rest of your life, so make them carefully.

How do I arrange for an IRA rollover?

Most people will opt to roll their lump sums into an IRA to avoid current income taxation. There is a wrong way and a right way to handle this.

The wrong way is to accept a check for the amount of the lump sum. If you take this approach, your employer will be required to withhold 20% in income taxes on the distribution. You'll either have to be satisfied with an 80% rollover, or you'll have to come up with the difference from other savings sources.

The right way is to arrange a direct transfer from the qualified plan trustee to the trustee of your IRA rollover—there is no withholding requirement with this approach.

How should IRA assets be invested?

During the accumulation years, most people saving for retirement have a significant amount invested in the stock market. That exposure typically falls as one approaches retirement, and it falls still further in retirement. Retirees need the steady stream of income that bonds can provide.

However, in our current environment of persistently low interest rates, getting sufficient income from a bond portfolio can

be difficult. One also needs to keep in mind the probability of eroding purchasing power due to inflation that can occur over the course of a long retirement. Although inflation has been quite mild in recent years, that trend is not likely to last consistently for the next 20 or 30 years. Some amount of stock investing is often needed to hedge against inflation.

If you have significant savings in taxable accounts, you don't want to evaluate your investment strategy for your IRA rollover in isolation. You'll need to decide whether your stock investments belong in the IRA rollover or on the taxable side of the ledger. All the distributions from the IRA will be taxed as ordinary income, whether they are of interest, dividends, capital appreciation, or return of principal. For the sake of tax efficiency, many advisors suggest focusing the IRA on providing steady income and doing the growth investing outside of the IRA.

Who should be the surviving beneficiary?

You'll want to designate a surviving beneficiary for your IRA rollover. Usually a surviving spouse is named, but another beneficiary may be appropriate, depending upon the composition of family wealth and other family circumstances. The decision can be changed at any time.

Will death taxes apply to my IRA?

The federal estate tax will apply in full to the assets remaining in your IRA rollover at your death. State inheritance or estate taxes may apply as well. Although the federal estate tax is targeted to the wealthiest families ($10 million and up, plus inflation adjustments), estate planning for your IRA rollover remains important. The exemption is scheduled to fall in 2026, and there is considerable political support for accelerating that date. What's more, unlike most inheritances, heirs must pay income taxes on distributions from the inherited IRAs.

If your spouse will inherit the IRA rollover, the estate tax may be deferred with the marital deduction. With careful drafting it is possible to coordinate an IRA rollover with a Qualified Terminable Interest Property Trust (affectionately known as the "QTIP trust") for the surviving spouse. The QTIP trust is often a core element of marital estate plans, especially when one or both spouses have been married more than once.

Where can I get more information for planning my IRA rollover?

Are you expecting a lump sum payout from a retirement plan in the next year or so? Or do you have questions about your retirement readiness? It's not too soon to start rehearsing your tax strategy and reviewing your investment options. We'll be pleased to offer you our assistance with these important financial planning issues.

We look forward to meeting with you to discuss your needs. ☐

Our services for retirees

You don't have to be retired to benefit from these financial services, but if you have started your retirement (or plan to soon), you should give them some careful consideration. At your request, we'd be happy to tell you more.

• **IRA rollovers.** When you receive a plan payout, you may preserve tax advantages for your retirement capital by arranging for an IRA rollover. Do you already have such an account with another firm, but feel lost in the shuffle? We'd be happy to help you move your IRA so that you can begin to benefit from our personalized investment management.

• **Personal investment accounts.** After careful study of your goals and circumstances, resources and risk tolerances, we recommend, implement, and monitor a personalized investment program for you. We charge annual fees linked to market value.

• **Living trusts.** The same personalized investment guidance is available to clients who wish to set up their investment programs as revocable living trusts. A trust-based financial plan doesn't impair the client's control of his or her investments, but it does offer such added benefits as probate avoidance, integration with the estate plan, and financial management in the event of prolonged illness or incapacity.

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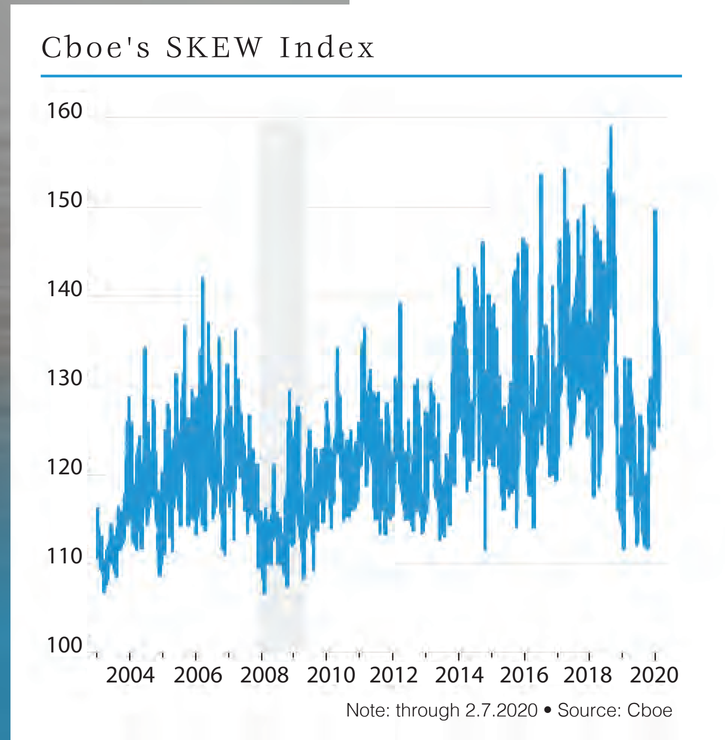

What is the SKEW?

For centuries Europeans knew to a certainty that all swans were white. The scientific truth came from simple observation—thousands of swans had been sighted; there had never been an exception to the rule; there was no reason to think that there ever would be an exception.

Until 1697. That's the year that the Dutch explorer, Willem de Vlamingh, recorded seeing a black swan on the west coast of Australia. In a moment, centuries of experience were swept away, and the idea that all swans were white evaporated.

This phenomenon has been adopted by market theorists as a metaphor for the fundamental unpredictability of financial markets.

Monday, October 19, 1987, was probably a black swan. That was the day that the Dow Jones Industrial Average lost nearly 25% of its value. Roughly $1 trillion evaporated from the total value of U.S. stocks. The stock returns of the prior 201 trading days were wiped out that day, and it took 320 trading days to recover fully.

An index is born

In response to that sudden market drop, the Chicago Board Options Exchange (now called "Cboe") created the SKEW index, which is sometimes referred to as the "black swan" index. The index, which is derived from options prices, is thought to be an indicator of the market's fear of an unexpected negative event and the prices investors are willing to pay as a hedge against it.

For example, the index peaked at 146.22 on October 16, 1998, as the internet stock bubble was inflating. The normal range of the index is 100 to 150, and the long-term average is 119.6. The 140 mark was breached in 2006, before the 2007-09 financial crisis. See the graph above of the index movements.

The contrarian interpretation

Recently SKEW has been well above its long-term averages. In fact, on December 19, 2019, it was 150.14, which was in the top 0.02% of all readings since 1990. Is another black swan on the way?

Investment columnist Mark Hulbert wrote in *The Wall Street Journal* in February that SKEW might actually be a contrarian indicator; it does *not* tell us that financial disaster is on the way. Rather than showing bearish sentiment, the SKEW may be illustrating the distance between "superbears" and the mainstream consensus. If the consensus is getting more bullish while the superbears don't change, the SKEW would be pushed higher. The work of finance professor Jessica Wachter at Wharton supports this view. During the actual 2007-09 downturn, when everyone was bearish, the SKEW averaged 114.5, which was below its long-term average.

In February SKEW was in the 130s, suggesting to Mr. Hulbert that bullishness has declined from earlier peaks but is still above the long-term average. For the contrarian investor, excess bullishness is usually taken as a bad sign.

Investing for the long term

SKEW may be a useful tool for short-term traders or for investors who are trying to time the market. In general, we do not believe that market timing is as important as time in the market. Daily volatility is so unpredictable, and studies have shown that the opportunity cost of being out of the market on an up day is very high.

Are you confident that your investment strategies are taking advantage of today's opportunities? We offer tailored investment advice and investment management services for a fee. We would be pleased to share our capabilities in this regard with you, at your request. ☐

IRS is knocking

The IRS does not make telephone calls to taxpayers. Anyone who receives a call purporting to be from the IRS demanding immediate tax payment should hang up the phone; it's an imposter running a scam. Three Pennsylvania residents were recently indicted for wire fraud for impersonating IRS agents, for example. Another tip-off is a demand that the tax be paid in gift cards—that is not how the IRS works.

However, the IRS may make in-person contact. In February the Service announced that it is stepping up a program of agents making unannounced face-to-face visits to high-income taxpayers who have not filed their tax returns for 2018 and earlier years. "High income" is defined as $100,000 and up. The announcement did not specify whether the calls would be at the taxpayer's home or place of business.

In general, these taxpayers will have been contacted earlier by mail, and so already should be aware that they are in tax trouble. Real IRS revenue officers will always provide two forms of official credentials, and both include a serial number and photo of the IRS employee. Taxpayers have the right to see each of these credentials.

Fortnite currency not reportable

This year the IRS has added a question to the 2019 Form 1040, Schedule 1, "Additional Income and Adjustments to Income," that requires taxpayers to answer yes or no: "At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency?" What is "any virtual currency"? In a December announcement the Service explained that "Bitcoin, Ether, Roblox, and V-bucks are a few examples of a convertible virtual currency."

Most people have heard of Bitcoin, but the other "currencies" are created within video games. V-bucks are the currency of Fortnite, which last year reportedly had 250,000,000 players worldwide. The total value of these currencies is unknown but could be substantial.

In February the IRS changed course, removing video game currency from the examples. IRS Chief Counsel Michael Desmond admitted that their inclusion had been a mistake. So long as game currency is used only within the game, there are no tax consequences to earning it or using it.

Parents of videogamers won't have to audit their children's game progress to be able to accurately file their 2019 tax returns, thank goodness. ☐

Do you have a receding heir line?

Then it's a good time for trust planning.
Call on us to learn more.

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