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FROM JOHN CARROLL

As we welcome in the fall season of 2016, I encourage you to reflect on the resiliency that our nation has shown since "Y2K". Through drastic economic challenges, recession, market swings, etc. we remain a well-blessed people. All of us at Smith Capital are deeply grateful to you for allowing us to serve you in an advisory capacity. We consider that to be a tremendous blessing in itself.

DIRECTIONS FOR LIFE

The prospect of the righteous is joy, but the hopes of the wicked come to nothing.

Proverbs 10:28

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Quiz: Test Your Interest Rate Knowledge
Five Things to Know About Inherited IRAs
Debt Optimization Strategies
Should I accept my employer's early-retirement offer?



SMITH CAPITAL

DIRECTIONS

The Investor's Guide to Financial Management

Quiz: Test Your Interest Rate Knowledge



In December 2015, the Federal Reserve raised the federal funds target rate to a range of 0.25% to 0.50%, the first rate increase from the near-zero range where it had lingered for seven years.

Many economists viewed this action as a positive sign that the Fed had finally deemed the U.S. economy healthy enough to withstand slightly higher interest rates. It remains to be seen how rate increases will play out for the remainder of 2016. In the meantime, try taking this short quiz to test your interest rate knowledge.

Quiz

1. Bond prices tend to rise when interest rates rise.

- a. True
- b. False

2. Which of the following interest rates is directly controlled by the Federal Reserve Open Market Committee?

- a. Prime rate
- b. Mortgage rates
- c. Federal funds rate
- d. All of the above
- e. None of the above

3. The Federal Reserve typically raises interest rates to control inflation and lowers rates to help accelerate economic growth.

- a. True
- b. False

4. Rising interest rates could result in lower yields for investors who have money in cash alternatives.

- a. True
- b. False

5. Stock market investors tend to look unfavorably on increases in interest rates.

- a. True
- b. False

Answers

1. b. False. Bond prices tend to *fall* when interest rates rise. However, longer-term bonds may feel a greater impact than those with shorter maturities. That's because when interest rates are rising, bond investors may be reluctant to tie up their money for longer periods if they anticipate higher yields in the future; and the longer a bond's term, the greater the risk that its yield may eventually be superceded by that of newer bonds. (The principal value of bonds may fluctuate with market conditions. Bonds redeemed prior to maturity may be worth more or less than their original cost.)

2. c. Federal funds rate. This is the interest rate at which banks lend funds to each other (typically overnight) within the Federal Reserve System. Though the federal funds rate affects other interest rates, the Fed does not have direct control of consumer interest rates such as mortgage rates.

3. a. True. Raising rates theoretically slows economic activity. As a result, the Federal Reserve has historically raised interest rates to help dampen inflation. Conversely, the Federal Reserve has lowered interest rates to help stimulate a sluggish economy.

4. b. False. Rising interest rates could actually benefit investors who have money in cash alternatives. Savings accounts, CDs, and money market vehicles are all likely to provide somewhat higher income when interest rates increase. The downside, though, is that if higher interest rates are accompanied by inflation, cash alternatives may not be able to keep pace with rising prices.

5. a. True. Higher borrowing costs can reduce corporate profits and reduce the amount of income that consumers have available for spending. However, even with higher rates, an improving economy can be good for investors over the long term.



You are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. Spousal beneficiaries, however, may be able to assume actual ownership of an inherited IRA.

****If the traditional IRA owner died after age 70-1/2 and did not take an RMD for the year of his or her death, you must also withdraw any remaining RMD amount for that year.***

Five Things to Know About Inherited IRAs

When an IRA owner dies, the IRA proceeds are payable to the named beneficiary--or to the owner's estate if no beneficiary is named. If you've been designated as the beneficiary of a traditional or Roth IRA, it's important that you understand the special rules that apply to "inherited IRAs."

It's not really "your" IRA

As an initial matter, while you do have certain rights, you are generally not the "owner" of an inherited IRA. The practical result of this fact is that you can't mix inherited IRA funds with your own IRA funds, and you can't make 60-day rollovers to and from the inherited IRA. You also need to calculate the taxable portion of any payment from the inherited IRA separately from your own IRAs, and you need to determine the amount of any required minimum distributions (RMDs) from the inherited IRA separately from your own IRAs.

But if you inherited the IRA from your spouse, you have special options. You can take ownership of the IRA funds by rolling them into your own IRA or into an eligible retirement plan account. If you're the sole beneficiary, you can also leave the funds in the inherited IRA and treat it as your own IRA. In either case, the IRA will be yours and no longer treated as an inherited IRA. As the new IRA owner (as opposed to *beneficiary*), you won't need to begin taking RMDs from a traditional IRA until you reach age 70½, and you won't need to take RMDs from a Roth IRA during your lifetime at all. And as IRA owner, you can also name new beneficiaries of your choice.

Required minimum distributions

As beneficiary of an inherited IRA--traditional or Roth--you must begin taking RMDs after the owner's death.* In general, you must take payments from the IRA annually, over your life expectancy, starting no later than December 31 of the year following the year the IRA owner died. But if you're a spousal beneficiary, you may be able to delay payments until the year the IRA owner would have reached age 70½.

In some cases you may be able to satisfy the RMD rules by withdrawing the entire balance of the inherited IRA (in one or more payments) by the fifth anniversary of the owner's death. In almost every situation, though, it makes sense to use the life expectancy method instead--to stretch payments out as long as possible and take maximum advantage of the IRA's tax-deferral benefit.

You can always elect to receive more than the required amount in any given year, but if you receive less than the required amount you'll be

subject to a federal penalty tax equal to 50% of the difference between the required distribution and the amount actually distributed.

More stretching...

What happens if you elect to take distributions over your life expectancy but you die with funds still in the inherited IRA? This is where your IRA custodial/trustee agreement becomes crucial. If, as is sometimes the case, your IRA language doesn't address what happens when you die, then the IRA balance is typically paid to your estate--ending the IRA tax deferral.

Many IRA providers, though, allow you to name a successor beneficiary. In this case, when you die, your successor beneficiary "steps into your shoes" and can continue to take RMDs over your remaining distribution schedule.

Federal income taxes

Distributions from inherited IRAs are subject to federal income taxes, except for any Roth or nondeductible contributions the owner made. But distributions are never subject to the 10% early distribution penalty, even if you haven't yet reached age 59½. (This is one reason why a surviving spouse may decide to remain as beneficiary rather than taking ownership of an inherited IRA.)

When you take a distribution from an inherited Roth IRA, the owner's nontaxable Roth contributions are deemed to come out first, followed by any earnings. Earnings are also tax-free if made after a five-calendar-year holding period, starting with the year the IRA owner first contributed to any Roth IRA. For example, if the IRA owner first contributed to a Roth IRA in 2014 and died in 2016, any earnings distributed from the IRA after 2018 will be tax-free.

Creditor protection

Traditional and Roth IRAs are protected under federal law if you declare bankruptcy. The IRA bankruptcy exemption was originally an inflation-adjusted \$1 million, which has since grown to \$1,283,025. Unfortunately, the U.S. Supreme Court has ruled that inherited IRAs are not covered by this exemption. (If you inherit an IRA from your spouse and treat that IRA as your own, it's possible that the IRA won't be considered an inherited IRA for bankruptcy purposes, but this was not specifically addressed by the Court.) This means that your inherited IRA won't receive any protection under federal law if you declare bankruptcy. However, the laws of your particular state may still protect those assets, in full or in part, and may provide protection from creditors outside of bankruptcy as well.





You may be able to improve your financial situation by implementing certain debt payoff strategies that can reduce the time you make payments and the total interest you pay. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any prepayment penalties.

Note: All examples are hypothetical and used for illustrative purposes only. Fixed interest rates and payment terms are shown, but actual interest rates and payment terms may change over time.

Debt Optimization Strategies

As part of improving your financial situation, you might consider reducing your debt load. A number of strategies can be used to pay off debt. However, before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including interest rates, terms of payment, and any prepayment or other penalties.

Understand minimum payments (a starting point)

You are generally required to make minimum payments on your debts, based on factors set by the lender. Failure to make the minimum payments can result in penalties, increased interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you may have to pay large amounts of interest over the life of the loan. This is especially true of credit card debt.

Your credit card statement will indicate the amount of your current monthly minimum payment. To find the factors used in calculating the minimum payment amount each month, you need to review terms in your credit card contract. These terms can change over time.

For credit cards, the minimum payment is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or a base minimum amount (such as \$15). For example, assume you have a credit card with a current balance of \$2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a base minimum amount of \$15. The initial minimum payment required would be \$70 [greater of $(\$2,000 \times 2\%) + (\$2,000 \times (18\% / 12))$ or \$15]. If you made only the minimum payments (as recalculated each month), it would take you 114 months (almost 10 years) to pay off the debt, and you would pay total interest of \$1,314.

For other types of loans, the minimum payment is generally the same as the regular monthly payment.

Make additional payments

Making payments in addition to your regular or minimum payments can reduce the time it takes to pay off your debt and the total interest paid. The additional payments could be made periodically, such as monthly, quarterly, or annually.

For example, if you made monthly payments of \$100 on the credit card debt in the previous example (the initial minimum payment was \$70), it would take you only 24 months to pay

off the debt, and you would pay total interest of just \$396.

As another example, let's assume you have a current mortgage balance of \$100,000. The interest rate is 5%, the monthly payment is \$791, and you have a remaining term of 15 years. If you make regular payments, you will pay total interest of \$42,343. However, if you pay an additional \$200 each month, it will take you only 11 years to pay off the debt, and you will pay total interest of just \$30,022.

Another strategy is to pay one-half of your regular monthly mortgage payment every two weeks. By the end of the year, you will have made 26 payments of one-half the monthly amount, or essentially 13 monthly payments. In other words, you will have made an extra monthly payment for the year. As a result, you will reduce the time payments must be made and the total interest paid.

Pay off highest interest rate debts first

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt, and then allocate any remaining dollars to the debts with the highest interest rates.

For example, let's assume you have two debts, you owe \$10,000 on each, and each has a monthly payment of \$200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments, it will take 94 months until both debts are paid off, and you will pay total interest of \$10,827. However, if you make monthly payments of \$600, with the extra \$200 paying off the debt with an 18% interest rate first, it will take only 41 months to pay off the debts, and you will pay total interest of just \$4,457.

Use a debt consolidation loan

If you have multiple debts with high interest rates, it may be possible to pay off those debts with a debt consolidation loan. Typically, this will be a home equity loan with a much lower interest rate than the rates on the debts being consolidated. Furthermore, if you itemize deductions, interest paid on home equity debt of up to \$100,000 is generally deductible for income tax purposes, thus reducing the effective interest rate on the debt consolidation loan even further. However, a home equity loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.



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Should I accept my employer's early-retirement offer?

The right answer for you will depend on your situation. First of all, don't underestimate the psychological impact of early retirement. The adjustment

from full-time work to a more leisurely pace may be difficult. So consider whether you're ready to retire yet. Next, look at what you're being offered. Most early-retirement offers share certain basic features that need to be evaluated. To determine whether your employer's offer is worth taking, you'll want to break it down.

Does the offer include a severance package? If so, how does the package compare with your projected job earnings (including future salary increases and bonuses) if you remain employed? Can you live on that amount (and for how long) without tapping into your retirement savings? If not, is your retirement fund large enough that you can start drawing it down early? Will you be penalized for withdrawing from your retirement savings?

Does the offer include post-retirement medical insurance? If so, make sure it's affordable and provides adequate coverage. Also, since Medicare doesn't start until you're 65, make

sure your employer's coverage lasts until you reach that age. If your employer's offer doesn't include medical insurance, you may have to look into COBRA or a private individual policy.

How will accepting the offer affect your retirement plan benefits? If your employer has a traditional pension plan, leaving the company before normal retirement age (usually 65) may greatly reduce the final payout you receive from the plan. If you participate in a 401(k) plan, what price will you pay for retiring early? You could end up forfeiting employer contributions if you're not fully vested. You'll also be missing out on the opportunity to make additional contributions to the plan.

Finally, will you need to start Social Security benefits early if you accept the offer? For example, at age 62 each monthly benefit check will be 25% to 30% less than it would be at full retirement age (66 to 67, depending on your year of birth). Conversely, you receive a higher payout by delaying the start of benefits past your full retirement age--your benefit would increase by about 8% for each year you delay benefits, up to age 70.