Insights & Outlook

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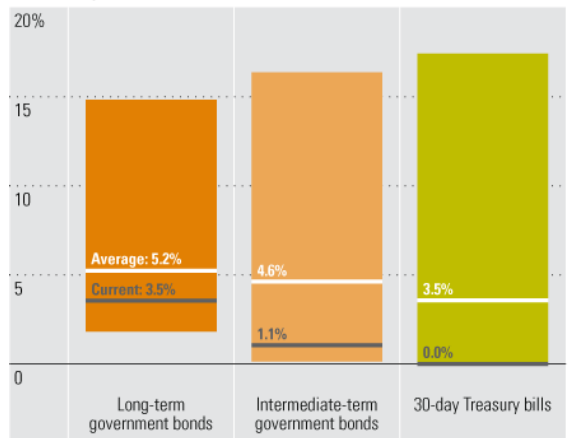
History of Interest Rates

It is commonly known that interest rates have been at historically low levels for a few years now. But how low are they? The image illustrates the characteristics of interest rates of various maturities. On average, long-term government bonds delivered the highest yield of 5.2%, while intermediate-term government bonds and 30-day Treasury bills provided an average yield of 4.6% and 3.5%, respectively. Current interest rates are positioned relatively close to the all-time lows, especially on the lower end of the maturity curve.

A rising interest rate environment seems to be the generally accepted forecast for the future. While rates can't drop much lower from their current level, the timing and magnitude of the rise still remains highly uncertain.

History of Interest Rates
January 1926–November 2013



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Indexes are unmanaged and not available for direct investment. Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. U.S. government bonds may be exempt from state taxes and income is taxed as ordinary income in the year received. With government bonds, the investor is a creditor of the government. In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest-rate changes.

Data: The long-term government-bond yield is represented by the monthly Ibbotson SBBI U.S. Long-Term Government-Bond Yield Index. The intermediate-term government-bond yield is represented by the monthly Ibbotson SBBI U.S. Intermediate-Term Government-Bond Yield Index. The 30-day Treasury bill yield series uses annualized monthly Ibbotson SBBI U.S. 30-Day Treasury Bill Total Return Index.

Mezzasalma Advisors

Advisor Biography

JOHN MEZZASALMA
CPA, CFP®

JOHN@MEZZCPA.COM
732-842-1120
mezzadvisors.com

John has been in the tax and financial services industry since 1976 and is a member of The Institute of Certified Financial Planners, The NJ CPA Society and his local chapter of Lions Club International, where he currently serves as their treasurer.

He has been a Certified Public Accountant (CPA) since 1978 and a Certified Financial Planner (CFP®) since 1990.

John specializes in developing financial strategies for physicians, business owners and high net worth individuals. He is also an expert on Income Tax savings strategies for physicians.

John has received numerous awards such as: Five Star Wealth manager (multi year recipient); The National Quality Award; The Oppenheimer President's Council.

Community Service: He currently serves as treasurer of his church and the local chapter of the Lions club where he earned the "Lion of the Year" award for his service.

Personal: He has 3 children and 8 grandchildren. Both his sons are CPAs and one, Anthony, is now part of the firm.

529 Plan Participants Deserve Better Disclosure

College savers need to be aware of many details when choosing a 529 plan, yet often the information either isn't provided or takes too much digging to find. A recent Morningstar study of 529 plans' disclosure found that the typical 529 plan website and plan document provide only high-level descriptions of the investment options. Basic information, including the name and tenure of the portfolio managers running the 529 investment options and details about the most recent portfolios, isn't required disclosure for 529 plans.

What Investors Need to Know for Static Options: Static 529 plans are plans whose investment allocation does not change over time. Unlike the age-based options (discussed below), they do not move to a more conservative allocation mix as the beneficiary approaches college age.

For static options, crucial information includes how much the option costs, who manages the portfolio and how experienced they are, what the investment strategy is, what the portfolio owns, and what the performance record is.

For stock fund portfolios, it's good to know whether an investment is primarily exposed to big or small companies, or firms in a specific sector of the economy, like health care, technology, or energy. This information may help investors and advisors anticipate how an investment will perform and identify potential risks. With bond portfolios, it is important to look at credit quality and interest-rate exposure to broadly understand how the plan will perform in different market environments. For example, a portfolio with low credit quality may outperform in bull markets, when investors are less risk-averse, but it could post steep losses in a downturn.

What Investors Need to Know for Age-Based Options: Age-based options hold the majority of 529 assets and have a similar structure to the popular target -date mutual funds found in retirement savings plans. Age-based options' asset allocation becomes more cautious over time, moving college savers' assets from primarily stocks when the beneficiary is young to primarily bonds and cash as college enrollment nears.

For an age-based option, necessary disclosure should include how much it costs and who's managing the portfolio, but also a description of the asset allocation strategy, the strategies of the underlying holdings, and the performance record.

Morningstar's study showed that few 529 plans provide this valuable information. Professional investment researchers can dig it up by cross-referencing 529 investments with data on the plan's ultimate mutual fund holdings, but college savers would be much better served if this portfolio and manager information were easily accessible.

Transparency Matters: Better informed investors can make better investment decisions, but most 529 plans aren't providing the basics that college savers and their financial advisors need to make informed choices. Just as mutual fund investors can get access to the appropriate data to monitor and evaluate a fund, college savers deserve an equally high standard of transparency. Importantly, the data should be timely and easily accessible. Examples of good disclosure exist in both the 529 plan and mutual fund industry, so plans with poor transparency should emulate the disclosures of their peers.

529 plans are tax-deferred college savings vehicles. Any unqualified distribution of earnings will be subject to ordinary income tax and subject to a 10% federal penalty tax. Tax law is ever-changing and can be quite complex. It is highly recommended that you consult with a financial or tax professional with any tax-related questions or concerns. An investor should consider the investment objectives, risks, and charges and expenses associated with municipal fund securities before investing. More information about municipal fund securities is available in the issuer's official statement, and the official statement should be read carefully before investing.

529 Plans: State Benefits

Among the most attractive benefits of a 529 college-savings plan are the tax breaks savers receive while building a nest egg to pay for a child's education expenses. 529 plan participants can avoid paying federal taxes on their 529 savings' gains, but many states offer local benefits on the initial 529 contributions, as well.

Morningstar recently tallied the states' benefits to determine which states offered the most generous local tax breaks. By quantifying these benefits, college savers are better able to determine whether their home state's 529 plan is a good choice. Generous tax benefits and fee waivers may offset other shortcomings in a plan, like higher expense ratios or mediocre investments options. Likewise, if a state's tax benefits are little to none, college savers have little reason to stay with their state's plan and may instead seek a better one elsewhere.

Morningstar found a wide range of benefits. Eight states (California, Delaware, Hawaii, Kentucky, Massachusetts, Minnesota, New Hampshire, and New Jersey) tax their residents' income and offer no state tax benefits. Residents in these states often invest elsewhere and are actively targeted by other states' 529 plans. On the flip side are states that offer portable tax benefits. Residents of states such as Maine, Kansas, Missouri, Pennsylvania, and Arizona receive benefits on their contributions to any 529 plan, not just the ones offered by their home state. For most 529 savers, however, their state's tax benefits are not portable, so if they choose another state's plan, they give up the local tax breaks.

Topping Morningstar's list of the states with the most generous 529 benefits is Indiana. While most states with tax benefits allow their residents to subtract their 529 contributions from their taxable income, residents of Indiana get something far better: a tax credit. This credit of 20% of the first $5,000 of 529 contributions allows them to subtract $1,000 from their annual state tax bill. When you also include two $20 account-fee waivers, Indiana residents can save $1,040 on $5,000 in annual 529 contributions by staying in-state. (Vermont and Utah also offer tax credits on 529 savings, but they're not as generous as Indiana's.)

Maine is another state with solid benefits, but much of them expire after the child's first birthday. Maine residents get a $500 grant from their state if they open a 529 account before their child's first birthday. From there, however, the Maine benefits are less generous. Residents may deduct from their taxable income just $250 per child in annual 529 contributions.

Beyond Indiana and Maine, six states offer benefits in the $400 to $500 range, and more than a half dozen are $300 to $400. The states with greater benefits, like Iowa and Oregon, often also have higher tax rates.

A handful of states offer smaller benefits. Some states, including Arizona, hold benefits in check by limiting the amount of 529 contributions that qualify for deductions. These smaller benefits, when expressed as a percentage of the overall 529 investment, can add up, but 529 savers may choose to give up smaller benefits in favor of a better plan elsewhere.

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Year-End Portfolio Review: Rebalancing

Finding the right frequency for rebalancing is a personal decision that rests on a number of factors. Here's an overview of what to bear in mind.

Tax Status of Investments: Rebalancing involves peeling back on winners, which in turn could result in taxable capital gains if the sales occur within taxable accounts. Investors whose assets are mostly in taxable accounts may want to err on the side of less-frequent rebalancing. On the flip side, the tax costs of rebalancing aren't a concern for investors who hold assets mostly in tax-sheltered accounts.

Other Costs of Trading: Commissions, for example. Investors who use a commission-based broker or buy or sell by themselves on a commission-based platform may consider rebalancing less frequently. Those who do not use a broker can view transaction costs as less of an impediment to rebalancing.

Time Commitment: A more frequent monitoring and rebalancing approach requires a greater amount of time than a laissez-faire tack. For example, retirees who have the time to commit to more frequent oversight (and won't incur tax and transaction costs to rebalance) can take a more hands-on approach. For busy investors, it’s fine to check up annually.

Time Horizon/Risk Tolerance: The key benefit of rebalancing is in the realm of risk management, not potential return enhancement. By extension, investors with shorter time horizons and more limited risk tolerance may want to tightly police their asset allocations versus their targets. Longer-term investors, meanwhile, can employ a more hands-off approach.

This information is provided for informational purposes only and should not be construed as tax advice. Consult your tax advisor for advice regarding your personal situation.

Mezzasalma Advisors

JOHN MEZZASALMA
CPA, CFP®

106 APPLE ST
STE 107
TINTON FALLS, New Jersey 07724

JOHN@MEZZCPA.COM
mezzadvisors.com

Tel:732-842-1120
Fax:732-676-7639