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Will End Of Fed Easing Kill The Bull Market In Stocks?

The yield on a 10-year Treasury Note leaped a full percentage point over the one-year period that ended on June 30, 2013, and the stock market reacted. The S&P 500 stock index dropped, which during the quarter had hit a new all-time high, lost 3.8% of its value by the end of the quarter. What happened?

Ben Bernanke, Federal Reserve Chairman, reiterated his intention to end the central bank's easing program, which has kept interest rates low to fuel economic growth. If the economy continues to improve, Bernanke said on June 19, the Fed would start to slow its "quantitative easing" program for keeping interest rates low.

The big question for investors is whether the end of quantitative easing (QE) will abruptly end the stock market's long advance. How will stocks perform in 2014? In truth, no one can predict the future with certainty. But examining some likely scenarios is prudent.

The grey bands in this chart show when the Federal Reserve began and ended the different stages of its monetary easing program, known as Quantitative Easing One, QE 2 and Operation Twist. The easing program, which helped maintain lower interest rates, coincided with a strong rise in stock prices in the five years ended June 30, 2013.

You might conclude from this chart that the end of the easing program would bring higher interest rates and halt the bull market. But that may not necessarily be what happens.

The small green arrows point to four bull runs since 1994, and interest rates were rising during those bull markets.

Of course, that's not guaranteed to happen again now. Still, it is undeniable that rising bond prices have not derailed recent bull markets.

The End Of Quantitative Easing: What's It Mean For Stocks?

Source: Standard and Poor's through July 1, 2013.

Despite the fact that rising interest rates have not spelled an end to bull markets in the past, you can expect to see some of Wall Street's "best minds" on TV over saying that rising rates will be bad for stocks in 2014.

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Our Perspective on the Quarter

The third quarter ended with a surprising twist after a much-anticipated shift in monetary policy failed to materialize at the Federal Open Market Committee's September meeting. After signaling at its June meeting that it might begin tapering its monthly bond-buying program if economic data pointed to a sufficiently strengthening economy, the Fed ultimately opted to stay the course. Shortly thereafter, the spotlight shifted from the Fed's monetary policy to the nation's fiscal policy. The inability of Congress to reach consensus on a budget led to a partial government shutdown.

Despite these obstacles, stocks managed a healthy gain for the quarter, with large-caps up 5% (and 20% year-to-date). International stock markets gained in the third quarter as well, with developed international markets outperforming U.S. stocks by a wide margin. After a rocky start to the year, emerging-markets stocks also rallied, as the region's dominant player, China, showed signs of improved growth.

Core bonds were modestly positive for the quarter, thanks in large part to the rally that occurred after the Fed announced its decision to delay tapering.

While we do not put much weight on short-term market moves, both the Fed's actions in the third quarter and the market's subsequent reactions reinforce our view that we are investing in a time of material uncertainty. Working with us to develop, monitor and rebalance a long term diversified investment portfolio as needed remains the best defense against this uncertainty.

Thank you for your confidence and trust. If you have any questions, please don't hesitate to contact us.

Managing Your Tax Bracket Now Crucial

Four tax law changes that took effect in 2013 are driving high-income earners to manage their tax brackets more carefully.

1. A new top income tax rate for ordinary income of 39.6% (previously 35%) has been added for single filers with taxable income above $400,000 and joint filers above $450,000.

2. For investors who exceed those same thresholds, the maximum tax rate on long-term capital gain has increased from 15% to 20%.

3. A new 3.8% surtax applies to the lesser of "net investment income" (NII) or the amount by which modified adjusted gross income exceeds $200,000 for single filers and $250,000 for joint filers. The definition of NII includes capital gains and dividends, but not payouts from retirement plans and IRAs.

4. The tax benefits available for itemized deductions and personal exemptions are phased out for taxpayers above certain income limits.

Faced with this changing tax landscape, you need to be especially vigilant to keep "bracket creep" in check. At the same time, it could make sense to realize year-end income up to the next bracket threshold. Here are several tax strategies to consider in this environment:

• Make the most of your capital gains and losses. If you've taken losses during the year, it could make sense to realize capital gains now, using those losses to offset extra income that could put you in a higher bracket or subject you to the 3.8% surtax. Or, if you have existing gains, taking capital losses could offset them and up to $3,000 of ordinary income.

• Convert a traditional IRA to a Roth IRA—but stagger the amount you convert each year to avoid rising into a higher tax bracket. The converted amount is taxable as ordinary income, but it may pay off in the form of future tax-free distributions.

• Stay in a lower bracket by shifting taxable income to the younger generation. For instance, you might give dividend-paying stock to a child in a low tax bracket. Just keep in mind that under the "kiddie tax," unearned income above $2,000 received by a dependent child in 2013 generally will be taxed at your top rate.

• Reduce your taxable income by making charitable gifts. The tax law generally allows you to deduct the fair market value of donated property that you've held for more than a year. However, deductions for charitable gifts are among those that may be reduced for upper-income taxpayers. ●

Avoid Squabbling Over Your Estate

Don't assume that you're immune from the sort of dire consequences that can tear apart a family after you're gone. What often starts as a minor beef over a few prized possessions can turn into a full-fledged war. Things can get even worse if distant relatives show up out of the blue, staking their claim. But you might be able to avoid future family squabbles by addressing these issues now. Start by listing your assets and deciding who will get what and when.

Here are several areas that may require some extra attention:

Business ownership. This can be complex if you run a company and have to decide who will be named as your successor. Figure out the best person (or persons) to take the helm. If that arrangement disproportionately benefits one or more heirs, you might designate other assets to go to the others to keep things fair. One possibility is to use a buy-sell agreement facilitating the sale of business interests. Note that it may be crucial to start by establishing the value of any business you own.

Vacation homes. Transferring rights to a principal residence is often straightforward, but what about that cabin in the woods or your seaside cottage? If you have several children, splitting ownership may be a problem if one child's family expects to get more use out of the place. If you can't work out an equitable solution, consider selling the vacation home and dividing the proceeds.

Second marriages. Suppose you've remarried (perhaps more than once) and you or your spouse—or both of you—have children from a prior marriage. Depending on how your will is worded, all of the children from both sides of the family may share evenly in the estate. As an alternative, you could use a trust as a vehicle for passing assets to particular beneficiaries you've chosen.

Internet Killing Papers; Is TV News Next?

The digital age not only is killing newspapers in America, it also is reducing the audience for TV news. Internet websites are sucking up newspapers and magazines like a giant funnel cloud, and television newscasts appear to be directly in the storm's path. Yet as dire as the situation seems in the United States, print media are holding their own in many parts of the world, complicating a seemingly simple story of technology rendering traditional news sources obsolete.

Since 2008, more than 166 newspapers in the United States have closed or stopped publishing a print edition, according to *Paper Cuts,* a website dedicated to tracking the U.S. press industry downturn, and that count is not up to date. Newspaper circulation has declined more than 15% since 1984, the Nieman Foundation for Journalism at Harvard University reported in its *Nieman Reports* in 2005. During the same period, viewership for television network evening news fell 37.8%, Nieman said, and the audience for local TV evening news slipped from 76% in 1993 to 59% in 2005. And as circulation and viewership go, so goes advertising revenue, the lifeblood of all news media.

Nieman reasoned, however, that not all is doom and gloom. "In fact, there is a great deal of information suggesting that most news consumers prefer to use new media as a complement to print and television rather than as a substitute," it reported.

Yet despite that somewhat rosy outlook, the tumult surrounding print media has continued—and part of the fault may lie with journalists themselves, according to media watcher David Ryfe, author of *Can Journalism Survive?* "Journalists have failed to respond adequately to the challenge of the Internet, with far-reaching consequences for the future of journalism and democracy," he says. Ryfe argues that journalists "are unable or unwilling to innovate for a variety of reasons: in part because habits are sticky and difficult to dislodge; in part because of their strategic calculation that the cost of change far exceeds its benefit. . . ."

The dominance of newspapers as a source of news began to give way in the 1950s and '60s with the advent of television network newscasts. Cable television news later came on the scene, and then the Internet arrived in the 1990s. Today, the majority of Americans under age 30 get most of their information from the Internet, which reportedly passed newspapers in 2010 as the leading source of news.

Still, *The Economist,* a respected weekly news magazine published in London, says reports of the death of newspapers may be premature. "There is no doubt that newspapers in many parts of the world are having a hard time," *The Economist* reported in July 2011, adding that newspapers "are in the deepest trouble" in America. "But it would be wrong to conclude from the woes of American newspapers that newspapers and news are in crisis everywhere."

The London publication, which also has a worldwide digital news presence, quoted Larry Kilman, deputy head of the World Association of Newspapers, a trade group: "The United States is the worst case that we see worldwide," but "the U.S. experience is not being replicated elsewhere."

Newspapers in Western Europe, especially in Germany, seem to be holding up fairly well so far, but this doesn't mean the industry is immune to long-term changes, *The Economist* said, noting that many European newspapers are family-owned, which helps to protect them in difficult times.

"In Japan, home to the world's three biggest-selling daily newspapers (the *Yomiuri Shimbun* alone has a circulation of more than 10 million), circulation has held up well, in part because over 94% of newspapers are sold by subscription. But there is trouble on the horizon. Young Japanese do not share their elders' enthusiasm for newsprint, and advertising revenues are dropping as the population ages."

The number of newspapers in Russia, meanwhile, increased 9% during 2009, but the Kremlin controls 60% of them. According to *The Economist,* India, China, and Brazil could represent the great new hopes for print journalism. Of course, there's no guarantee that developing countries won't eventually follow the trends now being seen in the United States. But it does appear that the final chapters of the decline and fall of traditional news media have yet to be written. ●

Jewelry and other valuables. When it comes to handing down your assets, don't leave any stone unturned, especially if it's a rare diamond. Catalog all valuables and family heirlooms and make sure you've accounted for the major pieces in your will.

Of course, it's your business, house, and valuables, and you can do whatever you want with them. But it probably won't hurt—and it most likely will help—to open a dialogue with other family members. You may be able to head off potential problems by clearing the air instead of letting things fester.

One of the best things you can do is spell out your wishes clearly in your will and attach a letter of instructions for clarification. In some cases, it also makes sense to film a video showing that you were of a "sound mind" at the time that you made these decisions. ●

'Tis The Season To Receive RMDs

When you're putting together this year's holiday shopping list, don't forget to add one gift that you may need to give to yourself: a required minimum distribution (RMD). If you've reached age 70½, you'll have to take an RMD from your 401(k), traditional IRA, or any other retirement plan that lets you shield your contributions from taxes. And the penalty for missing this obligation is a lot worse than getting a lump of coal in your stocking.

The funds that remain in your employer-sponsored retirement plans and IRAs can continue to grow without current investment or income taxes, but you must begin taking RMDs by April 1 in the year after the year in which you turn 70½. Thereafter, you must make the required withdrawal by December 31 of each and every succeeding year. So if you turned 70½ in 2012, you had to take the RMD for the 2012 tax year by April 1, 2013—and now you must withdraw another RMD for the 2013 tax year by December 31, 2013. You'll pay federal income tax on these distributions, plus you may owe state income tax, too.

There's an exception for employer-sponsored plans that may apply if you're still working full-time and you don't own 5% or more of the company. In that case, you can postpone withdrawals until your retirement. But you'll still have to take RMDs from your IRAs.

How much do you have to withdraw? First, look up your life expectancy in the special IRS tables. If your spouse is the sole beneficiary for an account, his or her age also may enter into the equation. Distributions are based on the value of all of your accounts on the last day of the previous tax year. For example, suppose you're age 75 and the value of all of your IRAs on December 31 of last year was $500,000. If your spouse is the sole beneficiary and is less than 10 years younger than you are, the withdrawal factor under the appropriate table is 22.9 Using an online calculator, you can determine that the RMD for the 2013 tax year is $21,834.

Though the IRS requires you to take these withdrawals, if you have multiple 401(k)s or IRAs, it doesn't care which account the money comes from. You can take the entire amount from one plan or divide up the RMD between or among other accounts.

What happens if you fail to take an RMD? The IRS can impose a harsh penalty equal to 50% of the amount that should have been withdrawn (or the difference between the required amount and any lesser amount that was distributed). For instance, if you failed to take the RMD in the example above, the penalty would be $10,917. That penalty is in addition to the regular income tax you owe on the RMD.

To be on the safe side, arrange to receive your RMD well before the December 31 deadline. You don't want to be hit with a hefty penalty if there are any glitches. ●

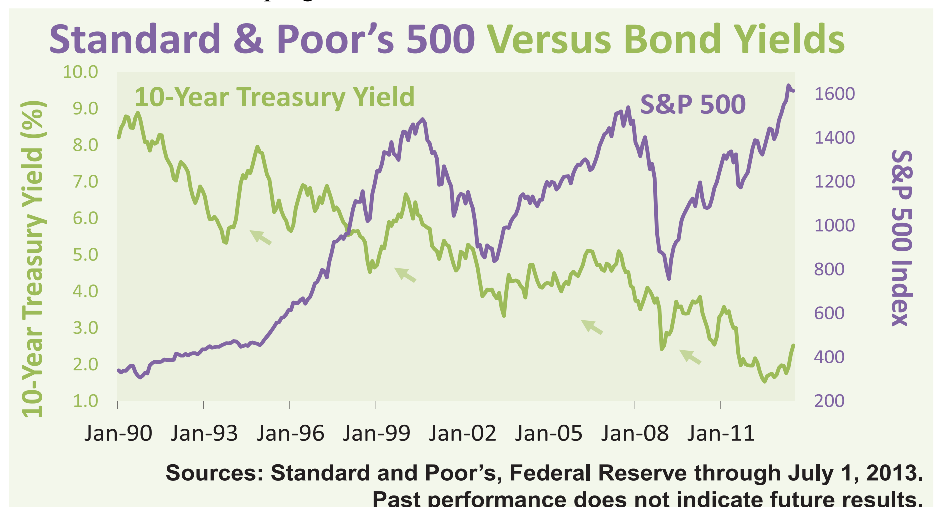
The Bull Market In Stocks

(Continued from page 1)

In the months ahead, it seems likely that the chatter will grow louder on financial TV stations and across the Web about how terrible higher bond yields are going to be for stocks. This has happened in previous periods of rising rates. Prognosticators are probably going to make three arguments:

One, that higher bond yields provide competition to dividend yields, which will make stocks less attractive. Secondly, that higher bond yields drive down the market's price-to-earnings ratio. And, lastly, that higher bond yields will choke economic growth, sending stocks lower.

Wall Street's talking heads have already been out in force in the media, warning that rising interest rates will hurt stocks. When you hear these forecasts, remember that many-- if not most--of Wall Street's prognosticators have a bad track record for predicting the market's next move. So when bond yields start to rise and you hear the refrain: "rising bond yields are bad for stocks," don't believe it. ●



Sources: Standard and Poor's, Federal Reserve through July 1, 2013.
Past performance does not indicate future results.

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