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Exchange-Traded-Funds: ETF Strategies Can Be Trendy or Tried and True

As of January 2019, there were 2,007 exchange-traded funds (ETFs) listed in the United States, with about $3.6 trillion in total assets. Assets held in ETFs have more than tripled since 2010,while the number of ETFs has more than doubled.[1]

An ETF is a portfolio of securities assembled by an investment company, similar to a mutual fund. An ETF's underlying investments are often selected to passively track a particular market index, but some may be actively managed.

The proliferation of ETF choices means they can now be used to create a broad portfolio of core investments, to target narrower sectors, or to gain market exposure that might otherwise be too difficult or costly to access. They are also being used to implement more sophisticated investment themes and strategies.

TRADING FLEXIBILITY

Mutual funds are typically purchased from and sold back to the investment company and priced at the end of the trading day, with the price determined by the net asset value (NAV) of the underlying securities. By contrast, ETFs can be traded throughout the day on stock exchanges, like individual stocks, and the price may be higher or lower than the NAV because of supply and demand.

In relatively calm markets, ETF prices and NAVs are generally close. However, when financial markets become more volatile, ETFs may quickly reflect changes in market sentiment, while NAVs — adjusted once a day — may take longer to react, resulting in ETFs trading at a premium or a discount.

EXPENSES AND TAXES

ETFs typically have lower expense ratios than mutual funds. However, you must pay a brokerage commission whenever you buy or sell an ETF, so your overall costs may be higher if you trade frequently, or they may be lower if you hold shares over a long period of time.

The way ETFs are structured also makes them relatively tax-efficient. Normally, ETFs don't distribute capital gains, so investors are not hit with capital gains taxes unless shares are sold for a profit. For this reason, high-income investors may favor ETFs over mutual funds for assets held in taxable accounts. (Some ETFs may occasionally distribute capital gains if there is a shift in the composition of the underlying assets.)

ETF TRENDS

One fixed-income strategy involves laddering exchange-traded bond funds that have defined maturity dates. Such ETFs typically hold many bonds that mature in the same year the ETF will liquidate and return assets to shareholders. ETFs may enhance liquidity, but unlike individual bonds, the income payments and final distribution rate are not fully predictable.

Smart beta ETFs use clearly defined factors (other than market capitalization) to select and weight investments in order to track an existing factor-based

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index or create a new index. Some of these factors are momentum, risk, volatility, growth potential, dividend growth or yield, earnings, cash flow, and equal weighting of all securities, among others.

The principal value of ETFs and mutual funds fluctuates with market conditions. Shares, when sold, may be worth more or less than their original cost. Bond ETFs are subject to the same inflation, interest rate, and credit risks associated with their underlying bonds.

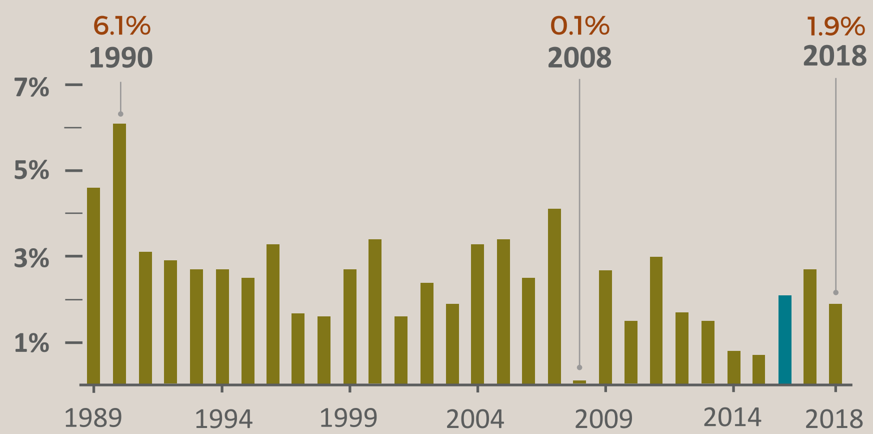
Exchange-traded funds and mutual funds are sold by prospectus. Because sector funds are typically concentrated in a particular industry or market sector, they carry a significant level of volatility and risk. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

[1] Investment Company Institute, 2019

Inflation Variation, Eroding Purchasing Power

Inflation averaged 2.5% for the 30-year period from 1989 to 2018. Although the recent trend is below the long-term average, even moderate inflation can reduce purchasing power and cut into the real return on your investments.

Annual rate of inflation, based on change in the Consumer Price Index



Source: U.S. Bureau of Labor Statistics, 2019 (December year-over-year change in CPI-U)

What is a College Income-Share Agreement?

A college income-share agreement, or ISA, is a contract between a student and a college where a student receives education funding from the college today in exchange for agreeing to pay a percentage of future earnings to the college for a specified period of time after graduation. The idea behind ISAs is to minimize the need for private student loans, to give colleges a stake in their students' outcomes, and to give students the flexibility to pursue careers in lower-paying fields.

Purdue University was the first college to introduce such a program in 2016. Under Purdue's ISA program, students who exhaust federal loans can fund their education by paying back a share of their future income, typically between 3% to 4% for up to 10 years after graduation, with repayment capped at 2.5 times the initial funding amount.[1]

A handful of other colleges also offer ISAs; terms and eligibility requirements vary among schools.

ISAs are considered friendlier than private student loans because they don't charge interest, and monthly payments are based on a student's income. Typically, ISAs have a minimum income threshold, which means that no payment is due if a student's income falls below a certain salary level, and a payment cap, which is the maximum amount a student must pay back relative to the initial funding amount. For example, a payment cap of 1.5 means that a student will pay back only 1.5 times the initial funding amount. Even with a payment cap, a student's payment obligation ends after the stated fixed period of time, regardless of whether he or she has fully paid back the initial loan.

[1] U.S. News & World Report, September 26, 2018

Charitable Giving After Tax Reform

Tax reform changes to the standard deduction and itemized deductions may affect your ability to obtain an income tax benefit from charitable giving. Projecting how you'll be affected by these changes while there's still time to take action is important.

Income tax benefit of charitable giving

If you itemize deductions on your federal income tax return, you can generally deduct your gifts to qualified charities. However, many itemized deductions have been eliminated or restricted, and the standard deduction has substantially increased. You can generally choose to take the standard deduction or to itemize deductions. As a result of the changes, far fewer taxpayers will be able to reduce their taxes by itemizing deductions.

Taxpayers whose total itemized deductions other than charitable contributions would be less than the standard deduction (including adjustments for being blind or age 65 or older) effectively have less of a tax savings incentive to make charitable gifts. For example, assume that a married couple, both age 65, have total itemized deductions (other than charitable contributions) of $15,000. They would have a standard deduction of $27,000 in 2019. The couple would effectively receive no tax savings for the first $12,000 of charitable contributions they make. Even with a $12,000 charitable deduction, total itemized deductions of $27,000 would not exceed their standard deduction.

Taxpayers whose total itemized deductions other than charitable contributions equal or exceed the standard deduction (including adjustments for being blind or age 65 or older) generally receive a tax benefit from charitable contributions equal to the income taxes saved. For example, assume that a married couple, both age 65, have total itemized deductions (other than charitable contributions) of $30,000. They would be entitled to a standard deduction of $27,000 in 2019. If they are in the 24% income tax bracket and make a charitable contribution of $10,000, they would reduce their income taxes by $2,400 ($10,000 charitable deduction x 24% tax rate).

However, the amount of your income tax charitable deduction may be limited to certain percentages of your adjusted gross income (AGI). For example, your deduction for gifts of cash to public charities is generally limited to 60% of your AGI for the year, and other gifts to charity are typically limited to 30% or 20% of your AGI. Charitable deductions that exceed the AGI limits may generally be carried over and deducted over the next five years, subject to the income percentage limits in those years.

Year-end tax planning

When making charitable gifts during the year, you should consider them as part of your year-end tax planning. Typically, you have a certain amount of control over the timing of income and expenses. You generally want to time your recognition of income so that it will be taxed at the lowest rate possible, and to time your deductible expenses so they can be claimed in years when you are in a higher tax bracket.

For example, if you expect that you will be in a higher tax bracket next year, it may make sense to wait and make the charitable contribution in January so you can take the deduction next year when the deduction results in a greater tax benefit. Or you might shift the charitable contribution, along with other itemized deductions, into a year when your itemized deductions would be greater than the standard deduction amount. And if the income percentage limits above are a concern in one year, you might consider ways to shift income into that year or shift deductions out of that year, so that a larger charitable deduction is available for that year. A tax professional can help you evaluate your individual tax situation.

Qualified charitable distribution (QCD)

If you are age 70½ or older, you can make tax-free charitable donations directly from your IRAs (other than SEP and SIMPLE IRAs) to a qualified charity. The distribution must be one that would otherwise be taxable to you. You can exclude up to $100,000 of these QCDs from your gross income each year. And if you file a joint return, your spouse (if 70½ or older) can exclude an additional $100,000 of QCDs.

You cannot deduct QCDs as a charitable contribution because the QCD is excluded from your gross income. In order to get a tax benefit from your charitable contribution without this special rule, you would have to itemize deductions, and your charitable deduction could be limited by the percentage of AGI limitations. QCDs may allow you to claim the standard deduction and exclude the QCD from income.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to receive from your IRA, just as if you had received an actual distribution from the plan.

***Caution:** Your QCD cannot be made to a private foundation, donor-advised fund, or supporting organization. Further, the gift cannot be made in exchange for a charitable gift annuity or to a charitable remainder trust.*

How to Recover From a Mid-Life Financial Crisis

A financial crisis can be scary at any age, but this is especially true when you're in your 40s or 50s. Perhaps you're way behind on saving for retirement or have too much debt from unnecessary spending. Or maybe an unexpected challenge, such as a job loss, illness, or break from the workforce for caregiving responsibilities, took a direct hit on your finances.

Regardless of how you got to this point, it's important to develop a strategy that will help you re-establish financial stability.

REGAIN CONTROL

Start by accepting the reality of your situation. This may be easier said than done when you'd rather avoid the anxiety, stress, and guilt that you may feel when you have money issues. It's okay to feel these negative emotions as part of the recovery process. They are likely to pass with time as you come up with a plan to regain control.

REVIEW YOUR SPENDING

Another step is to create a budget to help establish a positive cash flow. If you're spending more money than you earn, you'll need to cut back on your discretionary spending immediately. If you've made cuts and your monthly income still isn't enough, you'll need to figure out a way to cut your fixed expenses or increase your income.

REDUCE YOUR DEBT

It's likely that debt is one of the reasons why you're facing a financial crisis. One survey found that people between the ages of 45 and 54 reported the highest amounts of debt overall, totaling $134,600.[1] To reduce your overall debt, identify the amount and interest rate for each obligation you have. Then tackle it by paying off the debt with the highest interest rate first, then the next highest, and so on.

You might also consider restructuring your debt. This involves negotiating new repayment terms with creditors so you can meet your monthly expenses and pay off your debts within a reasonable amount of time.

If you can't afford to hire a professional credit counselor to help you manage or restructure your debt, check with your local Consumer Credit Counseling Service (CCCS) office or another nonprofit credit counseling service to receive assistance at low or no cost.

You should also consider other options, such as seeking part-time work for extra income or liquidating assets, that can help you pay off debt more quickly.

REBUILD YOUR FUNDS

Chances are you've drained your emergency savings fund. If so, you'll need to build it back up. Otherwise, you'll risk racking up credit card debt or dipping into your retirement savings when the next crisis hits.

It's okay to start small. Set aside a percentage of your paycheck each pay period to go into your cash reserve. Continue adding money after reaching your goal.

REVISIT YOUR FINANCIAL RELATIONSHIPS

In order to prevent another financial crisis, what changes will you need to make to your current financial relationships? Consider the following.

- Career. Do you need to increase your income with a second or a part-time job? Is there room for growth in your current career, or should you consider additional education or training to help boost your earnings?
- Home. Do you currently live in an expensive location? Does it make sense to downsize your home or move to a lower-cost area?
- Family. If you're financially supporting adult children, can you reduce or discontinue it? Similarly, if you support your elderly parents, can your adult sibling(s) share the financial burden of care?
- Habits. Do you overspend to reward yourself? Are you an emotional shopper? Do you buy things you actually want, or are you just trying to keep up with the Joneses?
- Health. Can you make a lifestyle change to improve your health to help avoid future issues and potentially reduce medical costs? Some of these changes will require careful research (e.g., moving or changing careers), whereas others can be easier to implement (e.g., avoiding shopping sprees or reducing aid to adult children).

REASSESS YOUR FINANCES PERIODICALLY

As you get back on the right financial track, it's critical to monitor your progress. Failure to do so in the past might have contributed to your crisis, so make it a habit to periodically review your finances. You might benefit from working with a financial professional who can help you stay on track with your financial goals as your situation changes.

[1] 2016 Survey of Consumer Finances, Federal Reserve Board (most recent data available)

Only 48% of workers ages 45 to 54 are confident that they will have enough money to last throughout their retirement.

Source: 2018 Retirement Confidence Survey, Employee Benefit Research Institute

How Much Money Should a Family Borrow for College?

There is no magic formula to determine how much you or your child should borrow for college. But there is such a thing as borrowing too much. How much is too much? One guideline is for students to borrow no more than their expected first-year starting salary after college, which, in turn, depends on a student's particular major and/or job prospects.

But this guideline is simply that — a guideline. Just as many homeowners got burned in the housing crisis by taking out larger mortgages than they could afford, families can get burned by borrowing amounts for college that seemed reasonable at the time but now, in hindsight, are not.

Keep in mind that student loans will need to be paid back over a term of 10 years (possibly longer). A lot can happen during that time. What if a student's assumptions about future earnings don't pan out? Will student loans still be manageable when other expenses like rent, utilities, and/or car expenses come into play? What if a borrower steps out of the workforce for an extended period of time to care for children and isn't earning an income? There are many variables, and every student's situation is different. A loan deferment is available in certain situations, but postponing loan payments only kicks the can down the road.

To build in room for the unexpected, a smarter strategy may be for undergraduate students to borrow no more than the federal student loan limit, which is currently $27,000 for four years of college. Over a 10-year term with a 5.05% interest rate (the current 2018-2019 rate on federal Direct Loans), this equals a monthly payment of $287. If a student borrows more by adding in co-signed private loans, the monthly payment will jump, for example, to $425 for $40,000 in loans (at

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MERGERS & ACQUISITIONS: WHAT'S IN THE DEAL FOR INVESTORS?

Merger and acquisition (M&A) activity in North America and Europe reached its second highest level on record in 2018. There were 19,501 deals worth $3.6 trillion — a 6.3% increase in deal volume over 2017. There was also a rise in mega deals exceeding $10 billion.[1]

Collectively, U.S. corporations had plenty of cash to spend after a long string of solid profits and a significant tax cut.[2] High stock prices also provided plenty of equity for deals involving the exchange of stock, while relatively-low borrowing costs made it possible to finance acquisitions.

The primary goal of a merger or an acquisition is to boost earnings growth by expanding operations, gaining market share, or becoming more efficient. Here's a closer look at these important transactions and some possible implications for investors.

Deal-making terms

An acquisition is the purchase of one company by another that is paid for with stock, cash, or both. The target firm is absorbed by the buyer, and the buyer's stock continues to trade. The target firm's shareholders may receive stock in the buying company and/or have the option to sell their shares at a set price.

A true merger occurs when two companies of roughly equal size combine into one and issue new stock. In this case, stockholders of both companies generally receive shares in the new company. Some transactions that are technically acquisitions are announced as mergers when the deals are friendly, with both sides agreeing to fair terms. When one company purchases a controlling interest in another against the wishes of the target, it's known as a hostile takeover; these transactions are typically announced as acquisitions.

Benefits and opportunities

Synergy is the financial benefit that is expected from the joining of two companies. This might be achieved by increasing revenue, gaining access to talent or technology, or cutting costs. Bigger corporations typically benefit from economies of scale, which enables them to negotiate lower prices for larger orders with suppliers. In addition, combining two workforces into one often results in headcount reductions. Some mergers result in industry consolidation, but government regulators may scrutinize deals and/or block mergers that threaten competition. In other cases, companies may join forces across industries for strategic reasons or to diversify their lines of business. Disruptive competition from technology giants is one reason companies have been pursuing large mergers and novel cross-sector acquisitions.[3]

For better or worse

A successful merger should create shareholder value greater than the combined value of the separate companies. To accomplish this, the buyer must have an accurate assessment of how much the target company is worth. When a deal is first announced, the share prices of both companies are likely to move up or down based solely on investor expectations. Of course, even a well-received merger could eventually be viewed as a disappointment if the merger fails to create enough value.

When a company pays more than the value of the other company's assets, the difference is recorded as "goodwill" so that assets match up with liabilities. Sooner or later, under performing companies may have to take a write-down in that goodwill value, causing the company's share price to be discounted. Thus, only time will tell whether any particular deal will pay off in the form of future earnings growth or investor returns.

The return and principal value of stocks fluctuate with changes in market conditions. Shares, when sold, may be worth more or less than their original cost. Investments offering the potential for higher rates of return also involve higher risk.

[1] PitchBook Data, 2019

[2] U.S. Bureau of Economic Analysis, 2018

[3] The New York Times, May 3, 2018

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the same interest rate) and to $638 for $60,000 in loans. Before borrowing any amount, students should know exactly what their monthly payment will be. And remember: Only federal student loans offer income-based repayment (IBR) options.

As for parents, there is no one-size-fits-all rule on how much to borrow. Many factors come into play, including the number of children in the family, total household income and assets, and current and projected retirement savings. The overall goal, though, is to borrow as little as

Crown House Memorial Day Celebration Recap

The Crown House (SICounsel's main location at 297 King Street, In Chappaqua, NY) honored fallen heroes this past Memorial Day. A great time was had by all who attended. Great music from *School of Rock* energized the crowd who had fun enjoying face painting, music, refreshments and a great parade.

See you again next year!

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