



Arboretum Wealth & Trust Management

801 Warrenville Road
Suite 500
Lisle, IL 60532
630-810-4535
arboretum@awtm.com
www.awtm.com

Our economy entered 2018 with a tailwind. Lower corporate tax rates and higher labor force participation may help deliver strong economic growth. The American consumer is still a driver of worldwide consumption, and a revitalized workforce should send ripples globally. After years of strong markets, it would be easy to get excited for what may happen in 2018.

Investors often refer to balancing risk and reward. If you accept more risk, your expected returns should be higher. This antiseptic saying doesn't dig into the real emotional drivers of behavior; the balance is really between the concepts of fear and greed. Bull markets tend to dull the fear of loss and encourage riskier portfolios. Extending risk and reacting emotionally to volatility is a recipe for deleterious market-timing.

Our approach to risk is designed to help you avoid the emotional turmoil of fear and greed. If you would like to learn more, please contact me at drichter@awtm.com.

Thank you,

David M. Richter, CFA

Winter 2018

Managing Debt While Saving for Retirement

Examining the Taxpaying Population: Where Do You Fit In?

What can I do to crack down on robocalls?

How can I protect myself from digital deception?



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How Much Risk Can You Take?



Many market shocks are short-lived once investors conclude the event is unlikely to cause lasting economic damage. Still, major market downturns such as the 2000 dot-com bust and the 2008-09 credit

crisis are powerful reminders that we cannot control or predict exactly how, where, or when precarious situations will arise.

Market risk refers to the possibility that an investment will lose value because of a broad decline in the financial markets, which can be the result of economic or sociopolitical factors. Investors who are willing to accept more investment risk may benefit from higher returns in the good times, but they also get hit harder during the bad times. A more conservative portfolio generally means there are fewer highs, but also fewer lows.

Your portfolio's risk profile should reflect your ability to endure periods of market volatility, both financially and emotionally. Here are some questions that may help you evaluate your personal relationship with risk.

How much risk can you afford?

Your capacity for risk generally depends on your current financial position (income, assets, and expenses) as well as your age, health, future earning potential, and time horizon. Your time horizon is the length of time before you expect to tap your investment assets for specific financial goals. The more time you have to keep the money invested, the more likely it is that you can ride out the volatility associated with riskier investments. An aggressive risk profile may be appropriate if you're investing for a retirement that is many years away. However, investing for a teenager's upcoming college education may call for a conservative approach.

How much risk may be needed to meet your goals?

If you know how much money you have to invest and can estimate how much you will need in the future, then it's possible to calculate

a "required return" (and a corresponding level of risk) for your investments. Older retirees who have sufficient income and assets to cover expenses for the rest of their lives may not need to expose their savings to risk. On the other hand, some risk-averse individuals may need to invest more aggressively to accumulate enough money for retirement and offset another risk: that inflation could erode the purchasing power of their assets over the long term.

How much risk are you comfortable taking?

Some people seem to be born risk-takers, whereas others are cautious by nature, but an investor's true psychological risk tolerance can be difficult to assess. Some people who describe their personality a certain way on a questionnaire may act differently when they are tested by real events.

Moreover, an investor's attitude toward risk can change over time, with experience and age. New investors may be more fearful of potential losses. Investors who have experienced the cyclical and ever-changing nature of the economy and investment performance may be more comfortable with short-term market swings.

Brace yourself

Market declines are an inevitable part of investing, but abandoning a sound investment strategy in the heat of the moment could be detrimental to your portfolio's long-term performance. One thing you can do to strengthen your mindset is to anticipate scenarios in which the value of your investments were to fall by 20% to 40%. If you become overly anxious about the possibility of such a loss, it might be helpful to reduce the level of risk in your portfolio. Otherwise, having a plan in place could help you manage your emotions when turbulent times arrive.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

Managing Debt While Saving for Retirement



¹ Employee Benefit Research Institute, 2017 Retirement Confidence Survey

² Employee Benefit Research Institute, 2016 Retirement Confidence Survey

³ Distributions from pre-tax accounts will be taxed at ordinary income tax rates. Early distributions from pre-tax accounts and nonqualified distributions of earnings from Roth accounts will be subject to ordinary income taxes and a 10% penalty tax, unless an exception applies. Employer contributions will always be placed in a pre-tax account, regardless of whether they match pre-tax or Roth employee contributions.

It's a catch-22: You feel that you should focus on paying down debt, but you also want to save for retirement. It may be comforting to know you're not alone.

According to an Employee Benefit Research Institute survey, 18% of today's workers describe their debt level as a major problem, while 41% say it's a minor problem. And workers who say that debt is a problem are also more likely to feel stressed about their retirement savings prospects.¹ Perhaps it's no surprise, then, that the largest proportion (21%) of those who have taken a loan from their employer-sponsored retirement plans have done so to pay off debt.² Borrowing from your plan can have negative consequences on your retirement preparedness down the road. Loan limits and other restrictions generally apply as well.

The key in managing both debt repayment and retirement savings is to understand a few basic financial concepts that will help you develop a strategy to tackle both.

Compare potential rate of return with interest rate on debt

Probably the most common way to decide whether to pay off debt or to make investments is to consider whether you could earn a higher rate of return (after accounting for taxes) on your investments than the interest rate you pay on the debt. For example, say you have a credit card with a \$10,000 balance that carries an interest rate of 18%. By paying off that balance, you're effectively getting an 18% return on your money. That means your investments would generally need to earn a consistent, after-tax return greater than 18% to make saving for retirement preferable to paying off that debt. That's a tall order for even the most savvy professional investors.

And bear in mind that all investing involves risk; investment returns are anything but guaranteed. In general, the higher the rate of return, the greater the risk. If you make investments rather than pay off debt and your investments incur losses, you may still have debts to pay, but you won't have had the benefit of any gains. By contrast, the return that comes from eliminating high-interest-rate debt is a sure thing.

Are you eligible for an employer match?

If you have the opportunity to save for retirement via an employer-sponsored plan that matches a portion of your contributions, the debt-versus-savings decision can become even more complicated.

Let's say your company matches 50% of your contributions up to 6% of your salary. This means you're essentially earning a 50% return on that portion of your retirement account contributions. That's why it may make sense to save at least enough to get any employer match before focusing on debt.

And don't forget the potential tax benefits of retirement plan contributions. If you contribute pre-tax dollars to your plan account, you're immediately deferring anywhere from 10% to 39.6% in taxes, depending on your federal tax rate. If you're making after-tax Roth contributions, you're creating a source of tax-free retirement income.³

Consider the types of debt

Your decision can also be influenced by the type of debt you have. For example, if you itemize deductions on your federal tax return, the interest you pay on a mortgage is generally deductible — so even if you could pay off your mortgage, you may not want to. Let's say you're paying 6% on your mortgage and 18% on your credit card debt, and your employer matches 50% of your retirement account contributions. You might consider directing some of your available resources to paying off the credit card debt and some toward your retirement account in order to get the full company match, while continuing to pay the mortgage to receive the tax deduction for the interest.

Other considerations

There's another good reason to explore ways to address both debt repayment and retirement savings at once. Time is your best ally when saving for retirement. If you say to yourself, "I'll wait to start saving until my debts are completely paid off," you run the risk that you'll never get to that point, because your good intentions about paying off your debt may falter. Postponing saving also reduces the number of years you have left to save for retirement.

It might also be easier to address both goals if you can cut your interest payments by refinancing debt. For example, you might be able to consolidate multiple credit card payments by rolling them over to a new credit card or a debt consolidation loan that has a lower interest rate.

Bear in mind that even if you decide to focus on retirement savings, you should make sure that you're able to make at least the minimum monthly payments on your debt. Failure to do so can result in penalties and increased interest rates, which would defeat the overall purpose of your debt repayment/retirement savings strategy.



Examining the Taxpaying Population: Where Do You Fit In?



Sources for data: IRS Statistics of Income Bulletins, Spring 2017 and Summer 2017, Washington, D.C., irs.gov/statistics

What is adjusted gross income (AGI)?

Adjusted gross income, or AGI, is basically total income less adjustments for certain items, such as deductible contributions made to an IRA, alimony paid, and qualified student loan interest paid.

Every quarter, the Statistics of Income Division of the Internal Revenue Service (IRS) publishes financial statistics obtained from tax and information returns that have been filed with the federal government. Recently published reports reflect data gleaned from 2014 individual federal income tax returns. These reports offer a snapshot of how the U.S. population breaks down as taxpayers.

The big picture

For tax year 2014, U.S. taxpayers filed roughly 139.6 million individual income tax returns.¹ Total adjusted gross income reported on these tax returns was \$9.71 trillion, resulting in a total income tax of \$1.37 trillion. That works out to an overall average tax rate of 14.16% for all returns filed — the highest total average rate in the 10-year period represented by the statistical report.

If your 2014 AGI was \$38,173 or more, you were in the top 50% of all federal income tax filers based on AGI. This group accounted for 88.7% of all AGI reported and paid 97.3% of total federal income tax for the year.

A look at the top

How much AGI did it take to make the top 10% of all individual filers? Probably not as much as you might think. If your AGI was \$133,445 or greater, you would have been one of the almost 14 million filers making up the top 10%. This group reported about \$4.58 trillion in AGI (more than 47% of all AGI reported) and accounted for about 70.9% of total individual income tax for the year.

To make the top 5%, you would have needed \$188,996 or more in AGI. You would have been among approximately 7 million filers who reported almost \$3.5 trillion in total AGI and accounted for about 60% of total income taxes paid.

It's also worth noting that the top 3% of all 2014 individual income tax returns based on AGI accounted for 52.9% of total income tax paid for the year.

The very, very top

For the 2014 tax year, 1.4 million returns had an AGI of \$465,626 or more. These taxpayers make up the top 1% of filers, reporting almost \$2 trillion in total AGI and responsible for just under a 40% share of the total tax haul.

The 1,396 income tax returns that showed \$56,981,718 or more in AGI make up the top 0.001% (that's the top one-thousandth of 1%) of 2014 filers. These filers together reported over \$207 billion in AGI and paid over 3.6% of taxes.

Not all high-income returns showed tax

Of the 6.2 million income tax returns filed for 2014 with an AGI of \$200,000 or more, 10,905 showed no U.S. income tax liability (the number drops to 3,927 if you eliminate returns filed by individuals who were responsible for income taxes to foreign governments and had no U.S. income tax because of a credit for such taxes paid).

Why did these high-income returns show no U.S. tax liability? The IRS report noted that these returns show no tax for a variety of reasons, including tax credits and deductions, most notably miscellaneous deductions and deductions for charitable contributions, medical and dental expenses, and investment interest expenses. A significant secondary factor was the deduction for taxes paid.

Average tax rates

Dividing total tax paid by total AGI yields the following average federal income tax rates for the 2014 tax year:

Top Filers (by Percentile)	AGI Threshold	Average Tax Rate
0.001%	\$56,981,718	24.01%
0.01%	\$11,407,987	25.92%
0.1%	\$2,136,762	27.67%
1%	\$465,626	27.16%
5%	\$188,996	23.61%
10%	\$133,445	21.25%
20%	\$90,606	18.64%
30%	\$66,868	17.19%
40%	\$50,083	16.24%
50%	\$38,173	15.52%

¹ Excludes returns filed by dependents; based on final estimates for tax year 2014 reported in Spring 2017 Statistics of Income Bulletin

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801 Warrenville Road
Suite 500
Lisle, IL 60532
630-810-4535
arboretum@awtm.com
www.awtm.com

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What can I do to crack down on robocalls?

You may not mind if a legitimate robocall provides a helpful announcement from your child's school or an appointment reminder from a doctor's office. But sadly, criminals often use robocalls to collect consumers' personal information and/or conduct various scams. Newer "spoofing" technology displays fake numbers to make it look as though calls are local, rather than coming from overseas, which could trick more people into answering the phone.

Robocalls have been illegal since 2009 (unless the telemarketer has the consumer's prior consent). In mid-2017, federal agencies announced they are ramping up enforcement by fining violators and encouraging blocking technologies. What should you do if you want to help put an end to this nuisance?

1. Don't answer calls when you don't recognize the phone number. If you pick up an unwanted robocall, just hang up. Don't answer "yes" or "no" questions, provide personal information, or press a number to

"opt out." Responding to the call in any way verifies that it has reached a real number and could prompt additional calls.

2. Look into robocall blocking solutions that may be offered by your phone service provider. If they're available, you may need to follow specific instructions to "opt in." Otherwise, consider a mobile app or cloud-based service designed to block robocalls; some of them are free or cost just a few dollars.
3. Consider registering your phone number on the National Do Not Call Registry. While taking this step can help mitigate the amount of robocalls you receive, it's only a partial solution to the problem. The Federal Trade Commission advises consumers whose numbers are on the registry but still receive unwanted calls to report robocall violations at complaints.donotcall.gov. The phone numbers provided by consumers will be released each day to companies that are working on call-blocking technologies, which largely depend on "blacklists" with numbers associated with multiple complaints.



How can I protect myself from digital deception?

Imagine that you receive an email with an urgent message asking you to verify your banking information by clicking on a link. Or maybe you get an enticing text message claiming that you've won a free vacation to the destination of your choice — all you have to do is click on the link you were sent. In both scenarios, clicking on the link causes you to play right into the hands of a cybercriminal seeking your sensitive information. Just like that, you're at risk for identity theft because you were tricked by a social engineering scam.

Social engineering attacks are a form of digital deception in which cybercriminals psychologically manipulate victims into divulging sensitive information. Cybercriminals "engineer" believable scenarios designed to evoke an emotional response (curiosity, fear, empathy, or excitement) from their targets. As a result, people often react without thinking first due to curiosity or concern over the message that was sent. Since social engineering attacks appear in many forms and appeal to a variety of emotions, they can be especially difficult to identify.

Take steps to protect yourself from a social engineering scam. If you receive a message conveying a sense of urgency, slow down and read it carefully before reacting. Don't click on suspicious or unfamiliar links in emails, text messages, and instant messaging services. Hover your cursor over a link before clicking on it to see if it will bring you to a real URL. Don't forget to check the spelling of URLs — any mistakes indicate a scam website. Also be sure to look for the secure lock symbol and the letters *https*: in the address bar of your Internet browser. These are signs that you're navigating to a legitimate website.

Never download email attachments unless you can verify that the sender is legitimate. Similarly, don't send money to charities or organizations that request help unless you can follow up directly with the charitable group.

Be wary of unsolicited messages. If you get an email or a text that asks you for financial information or passwords, do not reply — delete it. Remember that social engineering scams can also be used over the phone. Use healthy skepticism when you receive calls that demand money or request sensitive information. Always be vigilant and think before acting.

