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Not So Bad for a *Low-Return World*

In case you missed the memo, we're supposed to be in a *low-return* world. And if one focuses only on money market, CD, and short-term Treasury yields, the description fits. But across a broader landscape, investors have had a more rewarding run than the general mood was signaling just 12 months ago.

Stocks of large U.S. corporations still call the tune for most diversified portfolios. As shown in the accompanying table on page 2, mutual funds populated by these stocks averaged double-digit returns this past year, with comparable results for mid- and small-cap stocks. Even the trailing *five-year* numbers for U.S. equity funds are at rather lofty levels for a period of such low inflation and interest rates.

For a change, the U.S. was not the only place to be this past year. Emerging markets provided some sail after being an anchor much of the past decade. For all the fretting over China's economy, markets in the Asia-Pacific region (other than Japan) actually performed a little

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Updating the College Financing Challenge

Five years ago, we wondered whether a bubble was forming in college costs, fueled by big increases in grant aid and student loans. Today, student debt tops $1.3 trillion, more than auto loans ($1.08 trillion) and credit card debt ($700 billion). Student loans have been growing about twice as fast as household debt, and they comprise the only category of consumer-related debt with a higher current delinquency rate than during the financial crisis.

Writing recently in the *Wall Street Journal*, former chair of the FDIC, Sheila Bair, decried that growing burden and the perverse incentives that have helped inflate it. However, Ms. Bair is now president of Washington College in Maryland, so it's not surprising that she focused more on financing issues rather than questioning the cost of college itself.

Tuition increases actually have slowed in recent years. The College Board reports that published tuition and fees for public four-year schools rose just 2.8%, 2.9%, and 2.9% the past three years – the smallest *relative* increases since the mid-1970s. But that capped a 35-year period of sustained escalation; note that the costs shown below are in 2015 dollars, meaning those increases are *in addition to general inflation*.

Tuition and Fees *in 2015 Dollars* **(4-Year Schools)**

	Private Nonprofit	5-Yr. % Change	Public Colleges	5-Yr. % Change
1985-86	$13,551	30%	$2,918	26%
1990-91	$17,094	26%	$3,492	20%
1995-96	$19,117	12%	$4,399	26%
2000-01	$22,197	16%	$4,845	10%
2005-06	$25,624	15%	$6,708	38%
2010-11	$29,300	14%	$8,351	24%
2015-16	$32,405	11%	$9,410	13%

Source: The College Board Annual Survey

Grants appear to have helped with college affordability, but they also help prop up prices. *Net* of grant aid, students at public universities pay an average of about 42% of published tuition and fees, compared to 52% back in the mid-1990s. The equation is roughly comparable at private universities where, on average, a student's net outlay on tuition and fees is 46% of the sticker price compared to 59% in the mid '90s.

In their 10th annual College Savings Indicator Study, Fidelity Investments reports an unprecedented rise in the use of tax-advantaged college savings and investment accounts, especially 529 plans. Among the families surveyed, 72% are actively setting money aside for higher education, up 24% from 2007. Still, nearly half the respondents feel they're not quite on track to reach their targeted goal.

This election season, candidates seem focused on the familiar refrain of having taxpayers provide debt relief and pick up a larger share of those inflated costs. Parents and grandparents just keep saving. ■

The VIX Has Been a Little Vexing

No, we're not talking about cough drops or that old standby cold remedy, VapoRub™. The VIX is an *index* designed to gauge expected stock market volatility. It was developed in the early 1990s by finance professor Robert Whaley at the behest of the Chicago Board Options Exchange.

The CBOE has an exclusive on options activity related to the Standard & Poor's 500 Index (SPX) and the S&P 100 (OEX). It sought an actual measure of *expected* volatility in the form of an index on which futures and options contracts could be written. Today, the CBOE is believed to get about 40% of its revenue from contracts on the VIX.

Reviewing reams of market data, Dr. Whaley observed a marked difference in how individual and in-

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Remember *Brexit*? It was in all the papers.

Three months ago, we previewed the main issues just ahead of the United Kingdom's vote to exit the European Union. At that point, popular wisdom had the Brits voting to *stay* in the EU. That proved wrong, and financial markets were royally roiled by the surprise.

In the aftermath, the *new* popular wisdom predicted decidedly dire effects for the U.K. economy. The pound sterling and major stock indexes took a hit. U.K. voters were widely believed to have shot themselves in the foot based on misguided nationalism and misperceptions of EU rules and immigration policy.

Since then, Britain's real economic data has held up rather well. The jobless rate remains below 5%, reinforcing the economy's relative strength compared to most of its EU brethren. Consumers appear to be unfazed as July's retail sales numbers were the strongest in 14 years. Warm weather and a weaker pound have boosted tourism. London's commercial property is still down somewhat, albeit from rather robust pre-Brexit-vote levels.

Given the above, one might also question the widely held view that next April is a likely time for the U.K. to trigger Article 50 of the Lisbon Treaty, launching official and probably prolonged withdrawal negotiations. Three months ago we suggested that however the vote went, "effects will be multi-faceted, ambiguous, and spread over time," and that "soon enough, those Brexit headlines in the financial news will be replaced by other preoccupations." And so it goes. ■

Investment Performance Review	**TOTAL RETURN *** (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	**--- Annualized through Sept. 6, 2016 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Blend)	12.3 %	9.7 %	14.1 %	6.7 %
Mid-cap Stocks (Blend)	8.8	8.0	13.3	7.1
Small-cap Stocks (Blend) †	10.6	7.1	13.3	6.9
Foreign Stocks (Large Blend) †	7.1	2.3	6.3	2.0
Diversified Emerging Markets †	18.3	1.6	1.4	3.8
Specialty Natural Resources †	12.7	− 4.1	− 1.2	0.6
Specialty Real Estate †	26.1	15.0	13.6	6.0
Cons. Allocation (30-50% Equity)	7.8	4.9	6.2	4.7
Long-term Bond	14.7	10.3	6.7	7.9
World Bond †	7.7	3.0	1.9	4.4
High-Yield Taxable Bond †	− 2.2	4.0	6.4	6.2
Long-term Municipal Bond	7.2	7.1	5.1	4.3

* Source: Morningstar. **Past performance is NOT indicative of future results.**

† Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

New Money Fund Regime In Place

Last spring we previewed changes to money market funds in response to new regulations from the Securities and Exchange Commission. The changes are designed to ward off any run on money funds under the kind of market stress we saw eight years ago. The rules take effect in October, and most of the changes are already in place.

For most brokerage account and mutual fund holders, the default "parking place" for reserves is now either a government money market fund or FDIC-insured deposit program. These can still maintain that $1.00 stable net asset value (NAV) without being required to impose the redemption fees or liquidity "gates" that other retail money funds may be required to exercise.

Government money funds *must* hold at least 99.5% of their assets in cash, government securities, and/or repurchase agreements collateralized by cash or government securities. Bank deposit programs also tend to boost the demand for government securities, since banks do not have to hold capital against potential losses on such holdings.

Some see this as part of a global effort to steer savings to governments rather than the private sector, reversing the financial liberalization launched in the late 1970s. The new money fund rules alone may be shifting some $500 billion from commercial to government paper.

On the other hand, one person's financial repression is another's prudent protection for taxpayers. At today's skinny yields, it may not make much difference. Whether that holds true for a stronger economy, or whether these measures actually reduce the *likelihood* of a stronger economy, remains to be seen. ■

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better than their U.S. counterparts.

Energy and resources were quite out of favor a year ago, as the big decline in oil prices sparked fears of recession. That bird never sang, and while oil stayed relatively low, natural resources *funds* bounced back with double-digit returns. Real estate securities also benefited from a reasonably healthy economy and investors' appetite for income.

With continued downward pressure on rates, quality bonds fared well. And for tax-sensitive investors, diversified municipal bonds proved quite rewarding. Apparently, even a low-return world will cut us a break from time to time. ■

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A Trend Reversal in the Retirement Age

From 1900 to 2010, the average retirement age in the U.S. fell dramatically, from 76 to just 64. Most developed countries saw similar trends, especially in the post-World War II era. But a recent report from Bank of America Merrill Lynch Global Research notes that 18 of the 34 countries of the Organization for Economic Cooperation and Development (OECD) are phasing in *higher* retirement ages.

The U.S. may be ahead of the curve as our average rose from 63 to 64 between 2010 and 2014. The financial crisis almost certainly contributed to that trend reversal, as the market sell-off dented retirement savings, and the recession crimped personal income. Working longer is an imperative for some, a choice for others, and a broadening trend either way. The Merrill report estimates that delaying retirement by up to five years can boost total retirement income by as much as 25%.

Rising longevity and low interest rates are also key factors. U.S. life expectancy at birth has risen more than 30 years since 1900 and eight years just since 1970. The prospect of sustaining one's standard of living for up to three decades of retirement is daunting, especially given the meager yields from traditional "safe" investment vehicles such as CDs, high quality bonds, and basic income annuities. As an aside, a recent study by researchers at Oregon State University found a correlation between working longer and better health, even among relatively unhealthy workers and retirees.

Whatever one's reason for continuing to work, it pays to make the most of those extra years of earned income. If you are part of that vibrant cohort continuing to earn into your late 60s and 70s, you might want to check out the accompanying article on post-70½ contributions to retirement accounts. As the work goes on, so does the planning. ■

Contributing to Retirement Plans *Past* 70½

Reaching your 70s is generally associated with enjoying the fruits of your savings, including required minimum distributions (RMDs) from various retirement accounts. But what if you are still working and want keep *contributing* to those accounts? Regular (direct) contributions to a *traditional* IRA are not permitted after age 70½, but you can roll in funds from other types of retirement account. And there are contribution opportunities as well.

For example, *Roth* IRA contributions are allowed up to the current limit of $5,500 plus the $1,000 "catch up" for taxpayers over 50. You must have earned income at least equal to the amount of a direct Roth IRA contribution. And your eligibility to contribute is phased *out* above adjusted gross income of $117,000 for single taxpayers, or $184,000 for joint filers.

SEP-IRA or 401(k) accounts offer an avenue for tax-deferral if you are still generating meaningful earned income. Deductible SEP-IRA contributions can be for as much as 25% of compensation up to a dollar limit of $53,000 (in 2016). RMD rules still apply, so you could find yourself both contributing and withdrawing from that SEP-IRA.

An employer-sponsored 401(k) plan must make contributions for older employees on the same basis as for younger staff. Staying in a 401(k) avoids the RMD obligation on those assets as long as you work for that same employer and do not own 5% or more of the company.

With the onset of RMDs plus the taxation of Social Security benefits, taxpayers in their 70s *can* face a relatively high marginal tax rate. Check with your tax and investment professionals on strategies for reducing that burden through tax-deferred retirement accounts. ■

IRS Loosens Up a Little on Rollovers

A couple years back we reported on a tightened interpretation of the one-IRA-rollover-per-year limit. The Tax Court had surprised IRA experts as well as the Internal Revenue Service by ruling that a taxpayer is entitled to only one rollover within a twelve-month period, regardless of how many Individual Retirement Accounts the taxpayer maintains.

More recently, the IRS popped out a surprise of its own by *loosening* the rules around the standard 60-day deadline to complete an IRA rollover. That deadline applies if you withdraw funds from an IRA or qualified retirement plan *intending to redeposit* to an IRA to avoid having the withdrawal taxed as a distribution. Before 2002 the IRS was not empowered to consider taxpayer excuses for failing to meet the deadline. And even after it became possible to apply for forgiveness, the process was protracted and costly.

Now, savers who fail to return the funds within 60 days may be eligible for a waiver of the deadline. Affected taxpayers will "self-certify" by filing a form stating that they deserve a waiver based on extenuating circumstances. There are 11 such circumstances specified in the revenue procedure, including misplaced distribution checks, severe home damage, taxpayer illness, or a death in the family. And with the IRS, honesty is the best policy.

Another good policy is to check with your advisor before embarking on this type of rollover. If you're just moving assets to a different retirement plan or IRA, it's usually better to arrange a *direct trustee-to-trustee transfer or rollover*. That does *not* involve your taking receipt of the funds, so neither the 60-day deadline nor the one-rollover-per-year limit applies. If you *do* have a short-term need for the money, there might be better alternatives than a time-pressured IRA rollover. ■

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stitutional investors use stock and index options. Individuals tend to buy *call* options, which confer the right to *buy* a security at a given price, reflecting a *bullish* view of the underlying company. Institutions more commonly buy *put* options (the right to sell) on the index to hedge against a broad market decline.

The VIX formula places the most weight on those puts, so the index tends to rise with the demand-driven price for the widely used SPX put options. This reflects the degree of nervousness among institutional portfolio managers.

Research shows the VIX to be a good indicator of rising or falling volatility, but it tends to overestimate the *degree* of those fluctuations. And Dr. Whaley recently noted the lack of evidence for the VIX as a predictive tool for portfolio allocation.

Over the past year, the VIX has spiked on a few occasions into the 25-30 range, including the short but nasty sell-off in the third quarter of 2015, the market's rough start to 2016, and the Brexit surprise earlier this summer. More recently, the VIX has hovered near its *lowest* levels (11-15) of the past five years.

There are exchange traded funds (ETFs) designed to track the VIX, including some that use leverage to magnify the movement of the index. Like most portfolio tools, their effectiveness will depend on the skills and discipline of the user. ■

Elections *Have* Moved Markets, Briefly

Speaking of volatility (above), the weeks leading up to presidential elections have often seen their share. This year's quadrennial quack-up features unpopular candidates spouting policies that can discomfit financial and corporate interests. Yet, recent stock volatility has been low compared to the average for the same period ahead of the last six elections.

Volatility may well pick up in the campaign's closing weeks, depending on the state of the race and implications for control of the Senate and House. In the last four elections, investors tended to pull back from equity funds in the last month of the campaign. Volatility usually tails off when the over-arching uncertainty as to the next chief executive has been resolved.

Then there's the interregnum, a time to speculate on which of the winner's campaign promises might be achievable with a new Congress, and which will be conveniently forgotten. Global investors may be especially sensitive to signs of follow-through on the anti-trade rhetoric that has emanated from both campaigns. As we noted before the Brexit vote in June, the market's attention span tends to be short and fickle... not to mention short. ■

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