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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Hello readers of The Financial Formula! Please enjoy this month's articles (very timely) and please let us know if you have any questions - thank you!

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In This Issue

Three Strategies to Help You Manage Volatility

Equity investors looking to limit volatility may want to consider dividend-paying stocks.

Managing an investment portfolio is a challenge. Recent market cycles have tested many investors' commitment to their long-term investment plans.

Understand that while volatility cannot be eliminated, it can potentially be reduced. The following three strategies can be used to help you reduce the amount of volatility in your portfolio.

Strategy 1: Seek Investments With Low Correlation

Longer term, the market risk associated with an individual asset class, such as stocks, may be reduced by allocating a portion of a portfolio's assets to other types of investments that historically have reacted differently to market and economic events.[1] This is known as "correlation," which measures the tendency of two investments to move together. A correlation close to zero indicates that two investments are largely independent of each other. The closer a correlation is to 1.00, the greater the tendency two investments have had to move in tandem. The table below lists four assets that have had relatively low correlations with U.S. stocks during the past decade.[2] Past performance does not guarantee future results.

	Commodities	Cash	Investment-Grade Bonds	Home Prices
Large-Cap Stocks	0.48	-0.12	0.05	0.17

Strategy 2: Diversify Your Investments[1]

Modern portfolio theory is founded on the assumption that investment markets do not reward investors for taking on risks that could be eliminated though diversification. There are many strategies available for diversifying a stock portfolio. Investors can allocate portions of a portfolio to domestic and international stocks, which may take turns outperforming depending on circumstances in various global economies.[3] An allocation to small-cap, midcap, and large-cap stocks also provides exposure to companies of various sizes. Although there are no guarantees, smaller companies may be nimble enough to exploit untapped market niches and capitalize on growth potential.[4]

Strategy 3: Consider Dividend-Paying Stocks

In addition, equity investors looking to limit volatility may want to consider dividend-paying stocks. Although a company can potentially eliminate or reduce dividends at any time, a dividend may provide something in the way of a return even when stock prices are volatile. When evaluating dividend-paying stocks, it may be worthwhile to review how long a company has paid a dividend and whether the dividend has increased over time. According to a study by S&P Dow Jones Indices, firms that had increased their dividends for the past 25 years outperformed the S&P 500 and also were less volatile during the 5-year, 10-year, and 15-year periods ending June 30, 2015.[5] Past performance does not guarantee future results.

For investors interested in managing volatility, low-correlation investments, diversification, and dividend-paying stocks may be worth considering.

[1]*Asset allocation and diversification do not ensure a profit or protect against a loss.*

[2]*Source: Wealth Management Systems Inc. Large-cap stocks are represented by the S&P 500 Index, commodities by the Standard & Poor's GSCI®, cash by the Barclays 3-Month Treasury Bill Index, investment-grade bonds by the Barclays Aggregate Bond Index, home prices by the S&P/Case-Shiller 20-City Composite Home Price Index. You cannot invest directly in an index. Past performance is not a guarantee of future results. Data is based on the 10-year period ending December 31, 2014.*

[3]*Foreign stocks involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.*

[4]*Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments.*

[5]*Source: S&P Dow Jones Indices. Returns are based on the S&P 500 Dividends Aristocrats. Volatility is measured by a statistic known as standard deviation. Past performance does not guarantee future results.*

529 plans have altered education planning in much the same way that the 401(k) altered retirement planning.

Making the Grade: Test Your Knowledge of Key College Planning Facts

The latest report on college costs published by the College Board brought some good news: The increases in tuition and fees for the 2014-2015 academic year were lower than the average annual increases in the past 30 years across all sectors included in the study.

Yet even though college price increases are not accelerating, the report's authors affirmed that, in real terms, college costs have been rising for decades. For instance, the report, "Trends in College Pricing 2014," revealed that the inflation-adjusted average published price for in-state students at public four-year universities is 42% higher than it was 10 years ago and more than twice as high as it was 20 years ago. In the private nonprofit four-year sector, the increases were 24% over 10 years and 66% over 20 years.

Given this reality, it is easy to see why devising a plan to pay for college is a major stressor for many American families. Underlying that anxiety are numerous misconceptions about the financial aid process and how a family's savings might affect a student's eligibility to receive aid.

Further, there also seems to be a general lack of knowledge about college savings vehicles, specifically 529 college savings plans -- how they work, and the many benefits they have to offer families struggling to juggle multiple financial goals.[1]

529 plans have altered education planning in much the same way that the 401(k) altered retirement planning. A unique combination of features -- high contribution limits, professional asset management, account holder control of assets, flexibility in transferring the money, and perhaps most important, generous tax advantages -- have solidified the 529 plan's position as a leader in the education planning world.

Test Your Knowledge

Here's your chance to test your knowledge about college planning and 529 plans. We hope that the information shared here will shed new light on some of the details of the process.

1. What form do all colleges require of students applying for financial aid?

_____ CSS Financial Aid PROFILE

_____ FAFSA

_____ EFC

Answer: **FAFSA.** Any college or university that awards federal student aid requires the Free Application for Federal Student Aid (FAFSA). For the majority of colleges this is the only aid application required. The CSS Financial Aid PROFILE is required by some private colleges for assessing eligibility for the specific college's institutional aid dollars. The Expected Family Contribution (EFC) is a number calculated by the financial aid forms.

1. Saving for college in a 529 college savings plan negatively impacts eligibility for financial aid.

_____ True

_____ Maybe, but often the effect is minimal in the financial needs-analysis process

_____ False

Answer: **Maybe, but often not enough to worry about.** The value of a 529 savings plan account set up by a parent or legal guardian is reported as a parental asset on the FAFSA and only increases the EFC by a maximum of 5.64% of the total account value. 529 plans and Coverdell Education Savings Accounts tend to be two of the better options for saving for college without jeopardizing financial aid. Income is generally more of a determinant of need-based financial aid eligibility or lack thereof.

1. Assets held in a 529 college savings plan can be used to pay for what type of school?

_____ Four-year college or university

_____ Two-year community college

_____ Qualified trade school

_____ All of the above

Answer: **All of the above.** With a 529 savings program, you can use your account at any accredited college or university in the country (and some outside of the country).

1. What happens to the 529 college savings funds if the student does not go to college?

_____ The money can be used by another family member to pay for qualified expenses

_____ The federal government will seize the account

_____ Nothing

_____ The plan will be declared void, and the money returned to the plan owner

Answer: **You may generally change the beneficiary.** That money can be used by a sibling, cousin, or other family member for qualified higher education expenses, without penalty.

1. 529 *assets* held in the grandparent's name are shielded from the needs-analysis process.

_____ True

_____ False

Answer: **True.** Assets saved in the name of a grandparent are not reported on the FAFSA and do not typically count toward the EFC.

Caution: *Distributions* from a grandparent-owned 529 plan used to pay for a student's college expenses generally weigh heavily in the federal needs-analysis process and are typically counted as student income on the following year's FAFSA form, with an assessment rate of 50%.[2]

1. 529 plan *distributions* from a parent-owned 529 account do not increase the family's EFC.

_____ True

_____ False

Answer**: True.** Unlike distributions from a grandparent-owned account, *distributions* from a parent-owned 529 plan that are used to pay for a dependent student's college expenses are not reported on the FAFSA and do not typically count as income in the federal needs-analysis process.[2]

1. What is assessed most heavily in the federal financial aid formula for dependent students?

_____ Student's income

_____ Parent's income

_____ Student's assets

_____ Parent's assets

Answer: **Student's income is generally assessed at the highest rate.** The federal formula considers up to 50% of a dependent student's income as being available to pay for college. Here are the approximate rates for the primary financial resource categories that are assessed in computing an EFC:

- Student's income Up to 50%
- Parent's income 22% to 47%
- Student's assets 20%
- Parent's assets 2.6% to 5.64%

1. Federal loans tend to be the most common type of financial aid used for the education of dependent undergraduates.

_____ True

_____ False

Answer: **True.** For many families, the lion's share of financial aid is in the form of federal loans often supplemented by private loans, particularly when incomes are above a certain level and many need-based grants have been ruled out.

Important caveat: If you combine all grant/scholarship aid dollars from all sources for all undergraduates, the amount would exceed the total federal loan dollars. Federal loans constituted 34% of total undergraduate student aid in 2013-14, according to the College Board.

How did you do? Hopefully this information has helped you to better understand the financial aspects of college planning -- in particular the powerful but somewhat complex 529 college savings plan. To learn more about 529 plans and selecting the right plan for your situation, contact a qualified financial advisor.

For more on the financial aid process, the following organizations offer ample, free information:

- The College Board: Call your regional office or visit collegeboard.org.
- FinAid: Visit http://www.finaid.org.
- U.S. Department of Education, Federal Student Aid Information Center: Call (800) 433-3243 or visit www.fafsa.ed.gov.

[1]*Investing in 529 plans involves risk, including loss of principal. Before you invest in a 529 plan, request the plan's official statement and read it carefully. The official statement contains more complete information, including investment objectives, charges, expenses, and the risks of investing in a 529 plan, which you should carefully consider before investing. You should also consider whether your home state or your beneficiary's home state offers any state tax or other benefits that are only available for investments in such state's 529 plan. Section 529 plans are not guaranteed by any state or federal agency. By investing in a 529 plan outside of the state in which you pay taxes, you may lose the tax benefits offered by that state's plan. Withdrawals used for qualified expenses are federally tax free. Tax treatment at the state level may vary.*

[2]*Note that some private colleges may treat the needs-analysis process a little differently from what is reported here, and generally the comments in this document apply to the federal needs-analysis process. Individual situations will vary.*

Sources:

The College Board, "Trends in College Pricing 2014," November 13, 2014.

Wealth Management Systems Inc., "Increasing 529 Sales & Savings Rates: The Role of Personalized Planning Tools and Education: Part 2," June 2015.

The College Board, "Trends in Student Aid 2014," November 13, 2014.

Forbes, "How Much Do You Know About a 529 Savings Plan? [Quiz]," June 23, 2015.

Brush Up on Your IRA Facts

If you are opening an IRA for the first time or need a refresher course on the specifics of IRA ownership, here are some facts for your consideration.

IRAs continue to play a prominent role in the retirement saving strategies of Americans.

IRAs in America

IRAs continue to play an increasingly prominent role in the retirement saving strategies of Americans. According to the Investment Company Institute (ICI), the U.S. retirement market had $24.7 trillion in assets at the end of 2014, with $7.3 trillion of that sum attributable to IRAs.[1] Today, some 41 million -- or 34% -- of U.S. households report owning IRAs.[2]

Traditional IRAs, the most common variety, are held by about 25% of U.S. households, followed by Roth IRAs, which are held by 15.6% of households, and employer-sponsored IRAs (including SEP IRAs, SAR-SEP IRAs, and SIMPLE IRAs), which are held by 6% of households.[2]

Contributions and Deductibility

Contribution limits. In general, the most you can contribute to an IRA for 2015 is $5,500. If you are age 50 or older, you can make an additional "catch-up" contribution of $1,000, which brings the maximum annual contribution to $6,500.

Eligibility. One potential area of confusion around IRAs concerns an individual's eligibility to make contributions. In general, Internal Revenue Service guidelines state that you must have taxable compensation to contribute to an IRA. This includes income from wages and salaries and net self-employment income. If you are married and file a joint tax return, only one spouse needs to have compensation in most cases.

With regard to Roth IRAs, income may affect your ability to contribute. For tax year 2015, individuals with an adjusted gross income (AGI) of $116,000 or less may make a full contribution to a Roth IRA. Married couples filing jointly with an AGI of $183,000 or less may also contribute fully, up to $11,000 for the year. Contribution limits begin to decline, or "phase out," for individuals with AGIs between $116,000 and $131,000 and for married couples with AGIs between $183,000 and $193,000. If your income exceeds these upper thresholds, you may not contribute to a Roth IRA.[3]

Deductibility. Whether you can deduct your traditional IRA contribution depends on your income level, marital status, and coverage by an employer-sponsored retirement plan. For instance:[3]

- If you are single and covered by an employer-sponsored retirement plan, your traditional IRA contribution for 2015 will be fully deductible if your AGI was $61,000 or less. The amount you can deduct begins to decline if your AGI was between $61,000 and $71,000. Your IRA contribution is not deductible if your income is equal to or more than $71,000.
- If you are married, filing jointly, and you both are covered by an employer-sponsored retirement plan, your 2015 IRA contribution will be fully deductible if your combined AGI is $98,000 or less. The amount you can deduct begins to phase out if your combined AGI is between $98,000 and $118,000. Neither of you can claim an IRA deduction if your combined income is equal to or more than $118,000.
- If you are married, filing jointly, and your spouse is covered by an employer-sponsored plan (but you are not), you may qualify for a full IRA deduction if your combined AGI is $183,000 or less. The amount you can deduct begins to phase out for combined incomes of between $183,000 and $193,000. Your deduction is eliminated if your AGI on a joint return is $193,000 or more.
- If neither you nor your spouse is covered by an employer-sponsored retirement plan, your contribution is generally fully deductible up to the annual contribution limit or 100% of your compensation, whichever is less.

Keep in mind that contributions to a Roth IRA are *not* tax deductible under any circumstances.

Distributions

You can begin withdrawing money from a traditional IRA without penalty at age 59½. Generally, deductible contributions and earnings are taxable at the then-current rate. Nondeductible contributions are not taxable because those amounts have already been taxed.

You must begin receiving minimum annual distributions from your traditional IRA no later than April 1 of the year following the year you reach age 70½ and then annually thereafter.If your distributions in any year after you reach 70½ are less than the required minimum, you will be subject to an additional federal tax equal to 50% of the difference.

Unlike traditional IRAs, Roth IRAs do not require the account holder to take distributions during his or her lifetime. This feature can prove very attractive to those individuals who would like to use the Roth IRA as an estate planning tool.

What's New for 2015?

Application of one-rollover-per-year limitation. Beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA in any 12-month period regardless of the number of IRAs you own. However, you can continue to make unlimited trustee-to-trustee transfers between IRAs because these transfers are not considered to be rollovers. Furthermore, you can also make as many rollovers from a traditional IRA to a Roth IRA (also known as "conversions"). To learn more, see Publication 590-A.[4]

This communication is not intended as investment and/or tax advice and should not be treated as such. Each individual's situation is different. You should contact your financial professional to discuss your personal situation.

[1] *The Wall Street Journal, "Battle Continues Over Fiduciary Rule for Retirement Investments," June 14, 2015.*

[2] Investment Company Institute, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," January 2015.

[3] Internal Revenue Service, "Retirement Topics-IRA Contribution Limits," January 22, 2015.

[4] Internal Revenue Service, "IRS Publication 590-B, Distributions From Individual Retirement Arrangements (IRAs).