YOUR FINANCIAL FUTURE

Your Guide to Life Planning

December 2017

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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The IRS Clarifies Rules on Rollovers of Retirement Plan Monies

After years of ambiguity, the IRS has ruled definitively that plan participants can roll after-tax contributions into a Roth IRA tax free.

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As Americans, we can take pride in the many things we do well. But there's one thing that we could all do better -- and that's saving for the future.

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In anticipation of a large tax reform deal that has powered equity markets higher, the Treasury market has been oddly quiet.

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The bull market continues to march higher.

For those participants who are not currently making after-tax contributions, advisors may want to encourage them to do so, if their employer plan allows.

The IRS Clarifies Rules on Rollovers of Retirement Plan Monies

After years of ambiguity around what is and is not allowed regarding the disbursement of after-tax contributions to an employer-sponsored retirement plan, the IRS announced in September of 2014 that plan participants can roll those dollars into a Roth IRA tax free.

IRS Notice 2014-54, "Guidance on Allocation of After-Tax Amounts to Rollovers," provides rules for allocating pretax and after-tax amounts among disbursements that are made to multiple destinations from a qualified plan.[1] Importantly, the Notice provides that all disbursements from a retirement plan made at the same time will be treated as a single distribution even if they are sent to multiple new accounts. Prior to this ruling, the IRS treated distributions from a retirement plan that were rolled over to multiple new accounts as separate distributions, each requiring that a proportional share of pretax and after-tax monies be disbursed.[2]

A Simplified Process

Now individuals holding both pretax and after-tax amounts in their plan can transfer -- through direct, trustee-to-trustee rollovers -- the pretax portion of the distribution (including earnings on after-tax amounts) to a traditional IRA and the after-tax portion of the distribution to a Roth IRA. In the past, this could only be accomplished through indirect 60-day rollovers, not through simplified direct rollovers.[2]

More Clarification, Please

As with many IRS rulings, Notice 2014-54 raised many questions with taxpayers. In response, the IRS recently issued some answers to those commonly asked.

Q: If I have both pretax and after-tax monies in my retirement account, can I roll over just the after-tax monies to a Roth IRA, leaving all of the pretax monies intact?

A: No, the rule does not change the requirement that each distribution from a plan -- including partial distributions -- must include a "proportional share" of the pretax and after-tax amounts.

Example: If your account balance is $100,000 and consists of $80,000 in pretax amounts and $20,000 in after-tax amounts, and you request a distribution of $50,000, your distribution would consist of $40,000 of pretax amounts and $10,000 of after-tax amounts.[2]

In order to roll over all of your after-tax contributions to a Roth IRA, you could take a full distribution (all pretax and after-tax amounts), roll over all the pretax amounts directly to a traditional IRA or another eligible retirement plan, and roll over all the after-tax amounts directly to a Roth IRA.

Q: Can I roll over my after-tax contributions to a Roth IRA and the earnings on my after-tax contributions to a traditional IRA?

Yes, since earnings on after-tax contributions are considered pretax monies, after-tax contributions can be rolled over to a Roth IRA while the earnings on those contributions can be directed to a separate traditional IRA and avoid being taxed until they are distributed.

Plan Sponsors: A New Opportunity

The guidelines present an opportunity for plan sponsors to reach out to participants to determine which individuals have after-tax money in their plans and explain the new rules -- and the new opportunity -- to them. Further, for those participants who are not currently making after-tax contributions, advisors may want to encourage them to do so, if their employer plan allows.

With the current annual pretax contribution limit of $18,500 -- or $25,000 for individuals age 50 or older (for 2018) -- high-earning employees who are not making after-tax contributions are missing out on the chance to sock away significantly more (the annual total contribution cap on defined contribution plans is $55,000 in 2018) while benefitting from tax deferral of potential investment growth.

[1]*The Internal Revenue Service, Notice 2014-54, Guidance on Allocation of After-Tax Amounts to Rollovers, September 18, 2014.*

[2]The Internal Revenue Service, *Employee Plans News*, December 23, 2014.

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Start Today! Three Ways to Boost Your Retirement Savings

Given the uncertainty surrounding the Social Security system, maybe it's time to rethink your own saving habits.

As Americans, we can take pride in the many things we do well. We work hard. We have excellent hospitals and universities, and we entertain the world with the movies we make. But there's one thing that we could all do better -- and that's saving for the future.

Of course, if you are already saving for your retirement through your employer-sponsored savings plan, each contribution you make brings you closer to your retirement goal. But are you saving as much as you can?

If you need a reason to get serious about saving more, consider this: Today the average Social Security retirement benefit was just $1,404 a month at the beginning of 2018.[1] Given the uncertainty surrounding the Social Security system, maybe it's time to rethink your own saving habits.

Here are three quick ideas for giving your retirement plan a boost.

1. Apply a raise or bonus to retirement savings. Consider boosting your contribution rate with each increase in pay you receive. Making voluntary increases a habit year in and year out could bring you that much closer to the maximum contribution allowed by your employer. In 2018, workers may contribute up to $18,500 to a 401(k) plan, and workers age 50 and older may add an additional $6,000 in catch-up contributions (subject to plan limits).
2. Cut back household expenses. You may be surprised by how quickly small savings can add up. Things as simple as brown-bagging lunch, switching from brand name to store brand items, and doing away with premium cable channels can make a noticeable difference in your monthly cash flow. Setting up a monthly budget of income and expenses may help you find ways to cut back more.
3. Forgo a tax refund. In 2015, the IRS estimated the average tax refund check to be a little over $3,000.[2] If you typically get a tax refund, consider revising your W-4 form to reduce your withholding. Your paycheck will grow, which means you may be able to increase the amount you save in your employer's retirement plan.

You can probably think of other ways to save, such as paying off credit card debt. It really doesn't matter how you save, the important thing is to build your retirement account in ways that work for you.

[1] *Social Security Administration, "Fact Sheet--2018 Social Security Changes"*

[2] *Internal Revenue Service, "Tax Refunds Reach Almost $125 Billion Mark; IRS.gov Available for Tax Help," IR-2015-34, Feb. 26, 2015*

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Bond Market Perspectives | Week of December 18, 2017

Key Takeaways

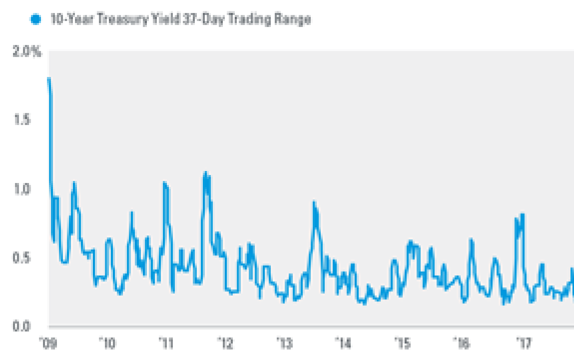
- As Congress moves toward passing tax reform, long-term Treasury yields have been stagnant, out of sync with equity markets that are moving higher on this progress.
- Treasury futures markets are showing indecision and Treasury market volatility is near historically low levels.
- One segment of the market reacting to legislative progress is short-term yields, which have continued to move higher in response to more aggressive rate hike expectations for 2018.

Nothing Ado About Much

In anticipation of a large tax reform deal that has powered equity markets higher, the Treasury market has been oddly quiet. Tax cuts for both corporations and individuals have many investors anticipating a pickup in economic growth and inflation. Yet longer-term Treasury yields, largely reflective of growth and inflation expectations, have barely budged in over a month and a half. Most of the action in interest rates has been concentrated in short-term yields, which have steadily marched higher since early September.

TRADING RANGE

The complacency in longer-term yields has been historic. Over the 37 trading days from October 27 through December 18, 2017, the 10-year Treasury yield has closed in a range of just 9.6 basis points (0.096%). This is the tightest trading range of that length since February 1974 [Figure 1]. Other volatility measures corroborate this. The Merrill Lynch Option Volatility Estimate (MOVE) Index, a measure of Treasury market volatility and the fixed income market's equivalent of the equity market's CBOE Volatility (VIX) Index, is just above all-time lows. The top 10 lowest readings in the history of the indicator all occurred during either November or December of this year.

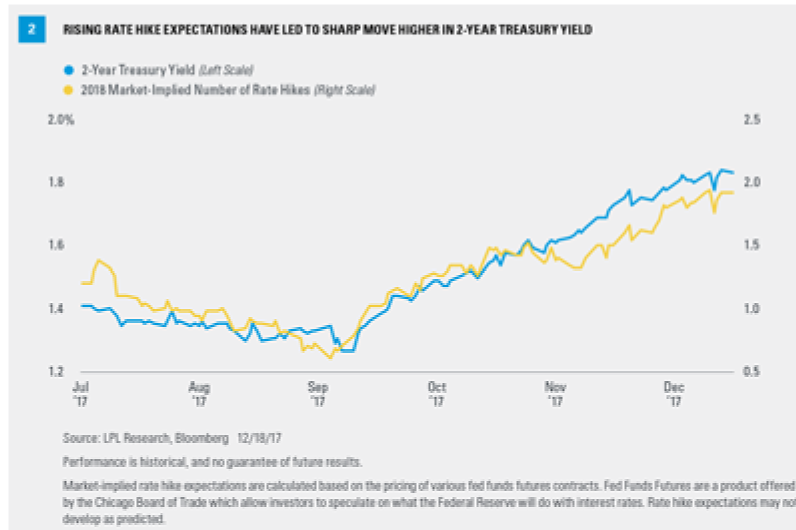


Futures markets are also showing very little certainty. Net short positions in the futures market for the 10-year Treasury reached extremes in early 2017. This can be a good contrarian indicator, as generally when sentiment is that negative, positive news (for Treasuries) can lead to demand outweighing supply, which can drive Treasury yields lower. As we expected, this led to a decrease in yields. The market then moved to an extreme net long futures position near midyear. We warned this could lead to an increase in yields, which is how that scenario also played out. That same market is now virtually flat, evenly split between longs and shorts in the futures market. This is yet another sign of a market in search of direction.

THE FED'S INFLUENCE

One area where there has been action recently is in shorter-term yields. Although longer-term yields have been stagnant, the 2-year Treasury yield has marched higher by 57 basis points (0.57%) since September 8, 2017. Although that rise over a 70-day trading period is not that historically impressive on an absolute basis, it is impressive on a percentage basis. On September 8, 2017, the 2-year Treasury yield was just 1.26%, so the 0.57% increase from there represents a 45% increase in yield. Although this has happened before, it has only occurred in roughly 2% of all 70 trading day rolling periods going back to 1977.

This increase in shorter-term yields has been driven by increasing expectations for future Federal Reserve (Fed) interest rate hikes [Figure 2]. Although the Fed just raised rates in December, markets are anticipating a more aggressive Fed in 2018 than just months ago. Improving economic data is helping that push, with tax reform clearly being a stimulative measure that could make the Fed more aggressive with rate hikes in 2018, in an effort to stay ahead of a potential pickup in inflation beyond their 2% target. Fixed income markets are still digesting the long-term growth and inflation implications of tax reform, evidenced by sideways long-term yields, but are aggressively pricing in faster rate hikes as the cycle continues.



FLATTENING CURVE

The net result of rising short-term yields and stagnant long-term yields has been a flattening yield curve. One factor that may be helping flatten the yield curve is global demand. Interest in high-quality developed market sovereign debt remains strong, and the United States boasts longer-term yields far above those of Germany, Japan, and almost all other highly rated developed nations. As we have seen throughout 2017, a material rise in Treasury yields has inexorably been met with a pickup in foreign demand, limiting further upward moves in long-term rates, and thus leading to a flatter curve. For more information on the flattening yield curve and what it may mean, please see our recent *Bond Market Perspectives*, "Further Flattening."

CONCLUSION

Despite the excitement in equity markets surrounding the tax plan and potential resulting economic growth boost, Treasury markets remain seemingly unconvinced. The tight trading range in long-term Treasury yields, the indecision in the Treasury futures market, and low trading volatility all point to a market searching for direction. As tax plan details are cemented and finally enacted, we may get a better sense of Treasury yields' direction. As outlined in our *Outlook 2018* publication, we expect yields to move higher throughout 2018, with more volatility than current levels, as growth and inflation notch higher and central bank support gradually wanes globally. However, we may have to wait until 2018 for rates to wake up from their late year lull.

IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

International debt securities involves special additional risks. These risks include, but are not limited to, currency risk, geopolitical and regulatory risk, and risk associated with varying settlement standards.

Futures and forward trading is speculative, includes a high degree of risk, and may not be suitable for all investors. A futures contract is a legal agreement, generally made on the trading floor of a futures exchange, to buy or sell a particular commodity or financial instrument at a predetermined price at a specified time in the future.

Yield curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

INDEX DESCRIPTIONS

The Bloomberg Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).

The Merrill Lynch Option Volatility Estimate (MOVE) Index is a yield curve weighted index of the normalized implied volatility on 1-month Treasury options which are weighted on the 2, 5, 10, and 30 year contracts.

The VIX is a measure of the volatility implied in the prices of options contracts for the S&P 500. It is a market-based estimate of future volatility. When sentiment reaches one extreme or the other, the market typically reverses course. While this is not necessarily predictive, it does measure the current degree of fear present in the stock market.

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KEY TAKEAWAYS

- The S&P 500 is historically overbought after a very persistent bid the past year.
- Fortunately, history suggests longer-term gains are quite strong after being overbought.
- Market sentiment is flashing some near-term concerns.

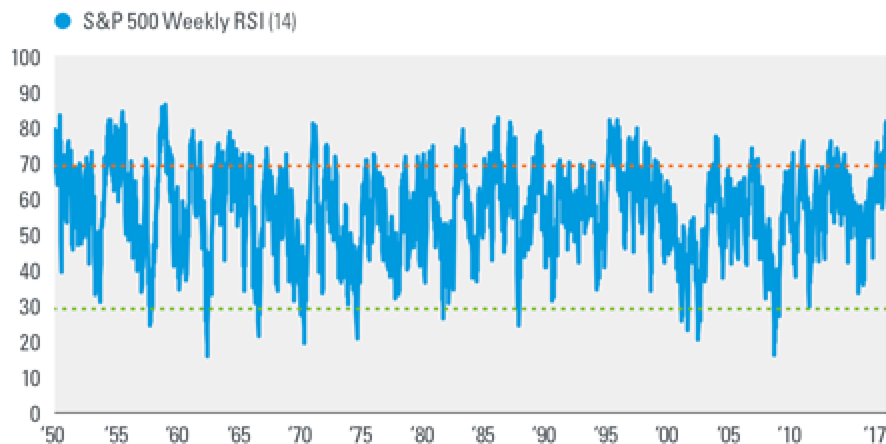
WHEN OVERBOUGHT IS BULLISH

The bull market continues to march higher. The S&P 500 Index is near one of the most overbought levels in history and this has many wondering how much longer the rally can continue. The longer-term technical indicators continue to look strong, but sentiment is flashing some warning signs suggesting market volatility could finally be heating up.

MOST OVERBOUGHT IN 22 YEARS

How can we sum up the events of 2017? Although our favorite story might be that the world's largest snowball fight was canceled because of too much snow, this year will be remembered for being one of the least volatile years in history. In other words, this is another reminder that nearly anything is possible when it comes to markets. Put simply, we are currently in the midst of the longest streak ever without a 3% correction for the S&P 500, and potentially the first year in the history of the S&P 500 to have a total return monthly gain all 12 months. Add it all up and equities are the most overbought they've been in 22 years.

The Relative Strength Index (RSI) is a popular momentum indicator and as **Figure 1** shows, it is the most overbought it has been since 1995. This has many market participants suggesting equity markets are ripe for a substantial pullback at any time.



Source: LPL Research, Bloomberg 12/11/17

The S&P 500 is unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

RSI—Relative Strength Index (RSI) is a technical momentum indicator that compares the magnitude of recent gains to recent losses in an attempt to determine overbought and oversold conditions of an asset.

Here's where things get interesting. There's an old technical analysis saying that "the most bullish thing a market can do is get overbought and stay that way." Sure enough, when the S&P 500 weekly RSI has gotten over the historically super overbought level of 80 (like recently), the returns have been better over the longer term.

THE RELATIVE STRENGTH INDEX

The RSI is a very popular momentum indicator that was developed by J. Welles Wilder. It measures the speed and change of price movements and oscillates between 0 and 100. It is widely accepted that a measurement above 70 is overbought, while a measurement below 30 is oversold. The calculation is based on 14 periods, as suggested by Wilder.

We'll be the first to admit that a normal correction of 5-10% could happen at any time given how long it has been since the last pullback. But it is important to note that any pullbacks could be a nice opportunity to add to positions. As seen in **Figure 2**, the S&P 500 has reached this overbought level only 13 other times dating back to 1950.* Somewhat surprisingly, the future returns are actually stronger after such periods of overbought natures. For instance, a year after being overbought, the S&P 500 is up 12.8% on average versus the average gain of 8.8% and higher 12 out of 13 times, which suggests there may be a good chance for solid market returns next year.

2 BEING OVERBOUGHT ISN'T A BAD THING

S&P 500 RETURNS AFTER WEEKLY RSI (14) IS OVER 80

Date	3-Month Return	6-Month Return	12-Month Return
06/09/50	-2.6%	0.7%	11.6%
05/14/54	6.7%	16.5%	30.0%
07/01/55	6.0%	10.4%	14.0%
09/23/55	-0.3%	7.0%	2.1%
09/19/58	9.5%	14.1%	13.5%
01/02/59	1.8%	6.9%	8.0%
02/12/71	3.8%	-2.8%	6.8%
04/23/71	-4.9%	-8.2%	4.7%
12/20/85	10.6%	17.4%	18.4%
02/28/86	9.0%	11.5%	25.2%
03/20/87	3.0%	5.6%	-9.1%
06/23/95	5.8%	11.3%	21.3%
12/08/95	2.6%	9.0%	19.8%
12/01/17	?	?	?
Average Return	3.9%	7.7%	12.8%
Median Return	3.8%	9.0%	13.5%
Max Return	10.6%	17.4%	30.0%
Minimum Return	-4.9%	-8.2%	-9.1%
Count	13	13	13
% Positive	76.9%	84.6%	92.3%

At-Any-Time Returns Since 1950			
Average Return	2.1%	4.3%	8.8%
Median Return	2.4%	4.8%	9.9%
% Positive	65.9%	69.9%	73.3%

Source: LPL Research, Bloomberg 12/13/17

RSI—Relative Strength Index (RSI) is a technical momentum indicator that compares the magnitude of recent gains to recent losses in an attempt to determine overbought and oversold conditions of an asset.

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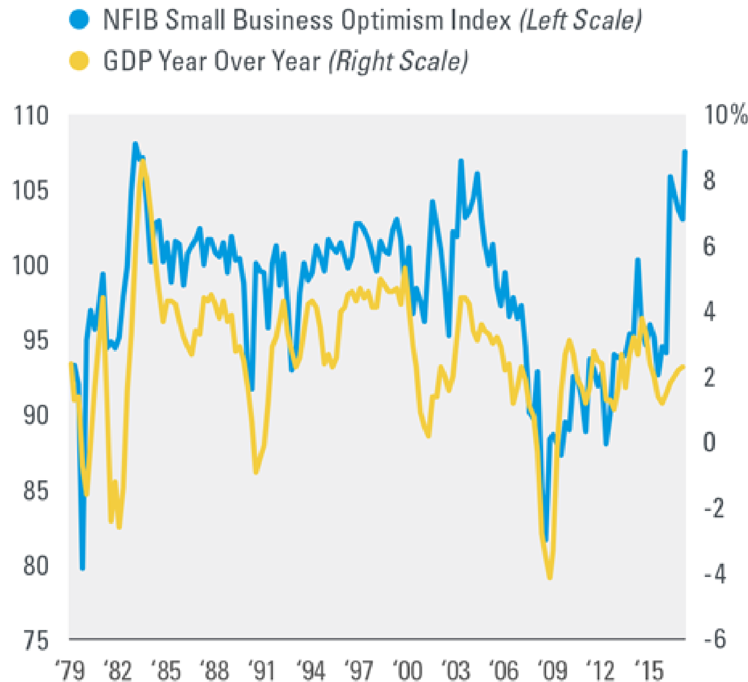
INVESTOR SENTIMENT

As we laid out in our ***Outlook 2018: Return of the Business Cycle*** publication, the global economy is on firm footing and is being led by a resurgence in earnings. The overall technical backdrop continues to look strong as well, but one near-term worry we have is that sentiment is getting quite frothy here.

History has shown us that the crowd can be right during trends, but it also tends to be wrong at extremes. This is why sentiment can be an important contrarian indicator, because if everyone who might become bearish has already sold, only buyers are left. The reverse also applies.

In the near term, we see the potential for some concern, as confidence is high and worries are few, which could potentially be a contrarian warning signal.

- The popular Bank of America/Merrill Lynch Global Fund Manager Survey found that a record number of investors say they are taking above-normal levels of risk in their investments. Additionally, a record number are also expecting a 'Goldilocks' scenario of above-trend growth and below-trend inflation.
- Derivatives are suggesting a good deal of complacency, according to the Chicago Board of Options Exchange (CBOE). The 20-day moving average of bullish versus bearish derivatives on equities is at its lowest level this year, suggesting many traders are quite comfortable and optimistic.
  Sentiment polls are showing a good deal of excitement. For instance, the 10-week moving average of bulls in the Investors Intelligence U.S. Advisors' Sentiment survey of newsletter writers is at its highest level going back 25 years.
- According to data from the Federal Reserve Bank Z.1 report, during the third quarter of 2017, household and nonprofit's stock holdings jumped to 36.3% of all total financial assets. This is the highest level since 2000-the tech bubble is the only other time households owned more stocks. The Conference Board's Consumer Confidence Survey shows confidence is at the highest level since late 2000, and a recent National Federation of Independent Business (NFIB) survey found that small business optimism is at its highest level in 34 years. Although high optimism might sound like a contrarian indicator, as **Figure 3** shows, in this case it could actually be a sign of stronger gross domestic product (GDP) growth over the coming quarters.
- Last, it is important to note that we still aren't seeing huge flows into equities, as Investment Company Institute (ICI) data showed seven of the past eight months experienced outflows from domestic equity mutual funds and exchange-traded funds.



Source: LPL Research, Bloomberg 12/13/17

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GDP—Gross Domestic Product

CONCLUSION

This has been a historic year for the bulls and one that many didn't expect would be this tranquil. Because of the consistent move higher with no pullbacks, the S&P 500 is the most overbought it has been in 22 years. Although some volatility appears likely in the near term, history suggests being this overbought is a bullish event. We will continue to watch certain factors, however, that could suggest a contrarian warning.

Thanks to Dave Tonaszuck for his contributions to the publication this week.

Please note, this will be our last *Weekly Market Commentary* of the year, as we will take next week off to be with our families. See you in 2018!

IMPORTANT DISCLOSURES

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All investing involves risk including loss of principal.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The small business optimism index is compiled from a survey that is conducted each month by the National Federation of Independent Business (NFIB) of its members. The index is a composite of ten seasonally adjusted components based on questions on the following: plans to increase employment, plans to make capital outlays, plans to increase inventories, expect economy to improve, expect real sales higher, current inventory, current job openings, expected credit conditions, now a good time to expand, and earnings trend.

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