THE H GROUP, INC. | SALEM

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Financial Perspective

Interest Rates and the Bull Market Everyone Loves to Hate

Who would have ever thought that interest rates would be this low? Today's mortgage interest rates would have been a fantasy for home purchasers in the double-digit rate era of the 1980s. On the other hand, the 7%+ interest one could earn on a one-year CD 30 years ago is nothing but a fond memory for savers. Now, according to Bankrate.com, the interest rate as of August 18, 2016 is 0.3%.

At least the rates are positive for individuals in the United States. After inflation, they may as well be negative. In Japan and most of Europe, the central banks charge their member banks (not individual savers) for excess reserves in the hopes that the banks will loan the money to businesses and consumers, and thereby stimulate the economy. A companion objective is to help devalue the currency to make a country's exports cheaper.

With these historic lows,* early signs are that they may be having the opposite effect of what policy makers intended, at least in some countries. According to the Wall Street Journal (Aug 8, 2016), savings rates in some negative interest rate countries are at their highest levels since the OCED started tracking them in 1995. Companies in Europe, the Middle East, Africa and Japan also are holding on to more cash.

Perhaps this is because low inflation has left consumers with more money to sock away or aging populations are naturally more inclined to save. But some economists wonder if the problem is negative rates themselves because they communicate fear about the economic outlook.

Low or negative interest rates are a mixed blessing. First, lower interest rates in other countries drive up the value of the US dollar and US bonds. This makes our exports more expensive. Low rates hurt traditional savers, particularly risk adverse retirees with small asset levels. They are affecting the health of pension plans and insurance companies that are required to invest their reserves heavily in bonds. Lower rates force savers to venture into riskier investments.

On the other hand, low rates are good for borrowers. Homeowners and businesses can refinance and save money; so can local and state governments. The Federal government

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The Mixed Blessings of Low Interest Rates and a Strong US Dollar

Winners	Losers
Home Buyers & Builders	Savers
Borrowers	Insurance Companies
Stocks	Pension Funds
Local Governments	Exporters
Consumers of Imports	Bond Buyers
Travelers Abroad	Foreign Tourist
Federal Government	Destinations in US

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Larry Hanslits, CFP® • Mary Way, CPA, CFP®
Brenna Baucum, CFP®

INSIDE

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INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

Providing Fee-Only Wealth Management and Creative Planning for Your Family, Business and Estate

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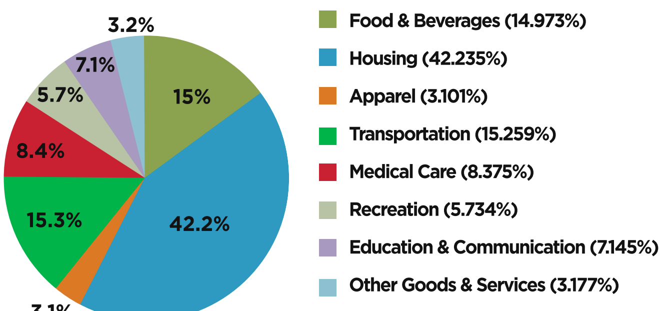
Is There a COLA and an Extra Medicare Premium in Your Future?

As we discussed, low interest rates hurt savers on fixed incomes, particularly retirees. But low rates hurt retirees in another way. One of the reasons why interest rates are so low is because inflation is low. When inflation is low, annual Social Security cost of living increases (COLAs) are also low or non-existent.

That shouldn't be a problem if inflation was even for all items and COLAs matched the reality of what people purchase in different stages of their lives. That certainly has been the case for retirees with higher medical and prescription drug costs, which have increased 75% over the past 16 years. COLAs, meanwhile, have increased benefits by just 36%. According to a 2016 survey of senior costs conducted by the Senior Citizens League (TSCL), Social Security beneficiaries have lost 23% of their buying power since 2000, based on 38 key items in a typical retiree's budget. Put another way, for every $100 worth of expenses seniors could afford in 2000, they can afford just $77 today.

Consumer Price Index Components*

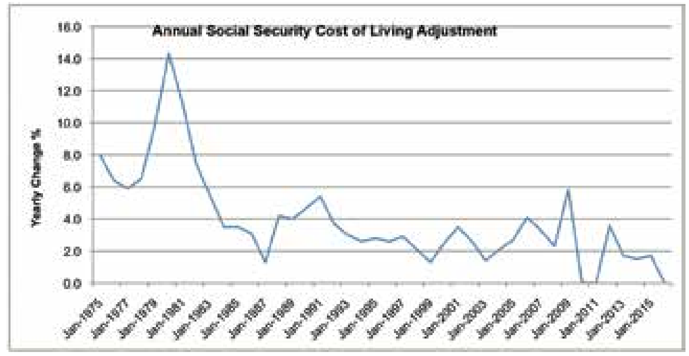


**Note: Official weights are to 3 decimal places*

Source: BLS; The most recent reweighting was in December 2015

Automatic adjustments based on the Consumer Price Index (CPI) started in 1975. Prior to that, it literally took an act of Congress to give beneficiaries a COLA. The COLA is based on the CPI for Urban Wage Earners (CPI-W). An increase kicks in when inflation as measured by the CPI for Urban Wage Earners (CPI-W) increases over the prior 12 months from third quarter of the previous year. The COLA for 2017 — if any — would be based on the increase in the third-quarter average CPI-W for 2016 over the third quarter of 2014, the last year in which a COLA became effective.

Right now, it is likely that there will be no COLA in 2017. If that happens, it would mark the second year in a row — and the fourth time since 2010 — that there will be no cost-of-living adjustment (COLA) in Social Security benefits.



Data Source: Socialsecurity.gov

Enter Medicare into the Equation

The good news is that, due to a hold harmless provision in the law, if there is no COLA for Social Security, there is no Medicare premium hike. However, not everyone escapes the Medicare premium increase.

If you are subject to Medicare premium tax—called the Income-Related Monthly Adjustment Amount (or IRMAA), you are ***not*** protected. You will pay an additional amount for your monthly Medicare Part D prescription drug plan premiums and your monthly Medicare Part B (out-patient or doctor visit coverage) premiums. The additional premium amounts kick in for individuals with a Modified Adjusted Gross Income (MAGI) of $85,000 and $170,000 for couples, and goes up from there.

Also, if you are newly entitled to Medicare in 2017 or if you are enrolled in Medicare but have not yet started to collect Social Security benefits, such as if you continue to work beyond age 65 or you elected to file and suspend your Social Security benefits before the April 29, 2016, deadline, you will also pay the higher Medicare premiums.

Planning Implications–How We Can Help

If small COLA adjustments are going to be the norm, perhaps they should be modeled into your planning and investing. We can model different Social Security, health care expense, inflation rates, and investment assumptions into your retirement projections. You may need to give yourself a raise each year from a well-designed investment portfolio, taking on a little more risk in exchange.

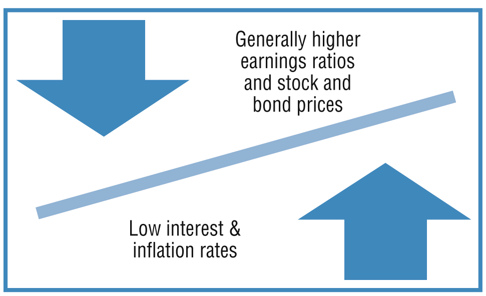
The IRMAA issue might require a sharpened pencil or one of our advanced Social Security planning spreadsheets. Quite often it is a temporary situation, unlike a lifetime of inflation-adjusted Social Security benefits. ***If you are planning a Roth IRA conversion or if you think you may be in a higher income situation for an extended number of years, we would be happy to analyze your unique situation for you.***

Interest Rates and the Bull Market Everyone Loves to Hate...*Continued from page 1*

can finance its deficit at much lower costs. Foreign imports and travel are cheaper. Generally speaking, lower rates are good for the stock market. ***When rates are low, corporate earnings are more attractive, and that, in part, is why the current bull market has lasted so long.***

In an era of low interest rates, what we are willing to pay for trailing and future earnings should be a lot higher than "normal." If interest rates were "normal," they'd be more like 5% on a 10-year Treasury bond, rather than 1.5%. If interest rates were 5%, then paying 18 or 19 times earnings would be ridiculous.

The "Normal" Relationship between Inflation, Interest Rates and Stock Prices*



**Not an absolute historic relationship, as other factors can affect security prices.*

But, interest rates are not 5% so we are willing to pay more than normal for our stocks, especially if they pay dividends or have good growth prospects.

What happens when interest rates go up or get to "normal?"

When interest rates get more "normal" then valuation ratios for the stock market should also become more "normal." When they do, this long-running bull market that doesn't get much respect will taper off. This won't happen overnight, and it will take more than just minor rate increases by the Fed. However, if corporate earnings and profits continue to grow, they can overcome the negative effects of higher interest rates on the stock market.

**According to Andy Haldane, Chief of Economist of the Bank of England, these are the lowest interest rates in 5,000 years! For more the interesting details and a chart, see our August 16 blog post at thehgroup.com (under the "Our Blogs" tab).*

The Survey Monkey Has Spoken

Our sincere thanks to those of you who took our June communications survey, which focused mostly on this newsletter. We had an excellent response rate, well above industry standards for surveys of this type. You gave us an overall rating of "very good," and overwhelmingly said that the frequency of our written communications was "just about right." You told us you liked topics about the economy, financial markets, and our team updates the most, but variety was also important.

Most respondents didn't know we had a blog or a Facebook page. Actually, we have two blogs—one for the Salem team and one for the H Group, Inc. in general. ***The easiest way to access them is to go near the bottom of the main page of www.thehgroup.com.*** There, you'll see links to both blogs. We have weekly market and economic commentary on Mondays, and usually something else later in the week. We're on Facebook at The H Group, Inc.

The survey was completely anonymous. Therefore, if you indicated that you would rather have an electronic copy of our newsletter, we don't know who you are. ***Please call Michelle or email her at salem@thehgroup.com to update your preferences. Thanks again!***

The Team Advantage™

Larry Hanslits, Brenna Baucum, Katherine Suchan, Mary Way, and Ron Kelemen are independent CERTIFIED FINANCIAL PLANNER™ certificants. They jointly serve their clients as a team with over 100 years of combined experience. They work on a fee-only basis and do not accept any third party compensation or finder's fees. Their practice focuses on wealth planning and investment management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., an independent fee-only registered investment advisory firm with 11 professionals in five offices with over $700 million under active management. For more information about us go to the Who We Are tab at TheHGroup-Salem.com.

About Larry Hanslits, CFP®

In practice since 1985, Larry merged his practice with Ron's and Mary's in 2011. He sits on the investment policy committee of The H Group, Inc., provides advanced estate planning case writing services to attorneys nationwide, and is an adjunct professor of financial planning at Oregon State University.

About Brenna Baucum, CFP®

Brenna joined the practice in 2013 and focuses her attention on Social Security and the grey areas of retirement planning. She is a member of the Rotary Club of Salem, the Women's Leadership Group, Salem Young Professionals, the FPA Mid-Winter Conference Committee, and a board member of the Chemeketa Community College Foundation.

About Katherine Suchan, CLU, CFP®

Katherine joined the practice in 2016, following 20 years of experience in Eugene and five in Portland. With the Chartered Life Underwriter (CLU) designation, she has additional expertise in life insurance planning for individuals and businesses.

About Mary Way, CPA, CFP®

Mary joined the practice in 1995. She is also a non-practicing CPA with 16 years' experience in banking, business, and finance. She is the Immediate Past-President of the 185-member Rotary Club of Salem, and like Ron, a past president of the Willamette Valley Estate Planning Council.

About Ron Kelemen, CFP®

In practice since 1981, Ron is the author of *The Confident Retirement Journey*. He is active in Rotary, and serves as a board member for Capital Manor and the Capital Manor Foundation.

The opinions expressed in this newsletter are those of Ron Kelemen, CFP®, Larry Hanslits, CFP®, Mary Way, CPA, CFP®, Brenna Baucum, CFP®, and Katherine Suchan, CFP®, CLU. The opinions expressed here do not necessarily reflect those of The H Group, Inc. Opinions and information presented are general comments that may not be appropriate for every individual. This information should not be construed as investment, legal or tax advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. All economic information is historical and not indicative of future results.

Page 1 photo courtesy of Caren Ann Jackson

Team Update

Ahh, summer! We love the warm weather, flowers, barbecues, festivals, fairs, and vacations. In spite of the seemingly relaxed pace, it's been one of our busiest summers in recent memory—lots of client update meetings, responding to concerns about the Brexit vote, financial plans prepared, client service, and some new clients in the door. Thanks for the referrals!

Michelle moved closer to downtown Salem and is enjoying checking out all that it has to offer. She visited friends and relatives Colorado, house/pet sat in Lake Oswego for 2.5 weeks, and traveled to the coast often.

Debbie and husband, Bob, did some travel in the NW and they are eagerly awaiting the birth of their first grandchild in October.

Katherine and husband, Duane, moved into their south Salem home after a brief search and a quick and frantic offer process. In addition to "playing house," they managed to squeeze in some camping with their tent trailer and explore more of Salem, their newly adopted home town.

Brenna made a surprise visit for her grandmother's birthday in San Diego. She and husband, Ben, undertook some remodeling projects at home before camping with her parents at the coast. She is working as the Chair of the FPA's Mid-Winter Conference committee and is heading up Salem Rotary's Good Works Committee that awards grants and decides on the club's major annual project.

Larry and Laurie have been enjoying the summer with multiple golfing trips to various Oregon destinations. Laurie participated in a Pro-Am at The Resort at The Mountain where her team tied for 2nd net low score. They have been enjoying fresh produce from their garden and Larry reports their roses are looking better than ever.

Mary hosted a fun party for all of us in early June. She finished her year as President of the Rotary Club of Salem with accolades and a standing ovation. Immediately afterward she visited her sister and niece in Minnesota, then later in the summer spent a week at the coast with the grandkids.

Ron was quoted in *Financial Planning Magazine* in an article about timeshares. He and Kathy took a 40 day, 6,500 mile road trip to the East Coast and back with their Airstream trailer, and biked parts of the Erie Canal and Hudson Valley. The highlight was spending time with their daughters, their dogs and boyfriends. You can see photos and read about it in their blog: Ron & Kathy's Mid-Life Adventures.

Financial Perspective

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SMALL BUSINESS OF THE YEAR
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Do you have a Durable Power of Attorney for your IRA?

Our team appreciates simple solutions for complex issues. A favorite simple solution of ours is the Durable Power of Attorney. To quote the Oregon Bar Association, "A power of attorney gives someone else, called an agent, the right to make financial decisions about the things you specify in the document."

There are four main varieties of powers of attorney – limited, general, durable, and springing, but the focus of this article is on the "durable" variety. ***The beauty of Durable Power of Attorney (DPOA) is that it remains in effect even if you become incapacitated and it can cover assets not in your trust, like IRAs.*** During a meeting we had with a married couple, we brought up the subject of their DPOAs. They responded with, "Isn't that why we have a trust?" They had a revocable trust and have done an excellent job of funding it. What they did not realize is that the trust cannot own their IRAs—a very significant part of their estate. "That's okay," they said, the IRAs have beneficiaries and we recently reviewed them with you." Correct again! We then explained that beneficiaries only come into play at the death of the IRA owner.

Enter the "Grey Zone" Discussion

We described to them a potentially grey time in life, a time when an individual might become fully or partially incapacitated. This can happen at any time—early in life, late in life, on a surfboard, playing shuffleboard. It may last a short time or many years. It can happen in an instant or slowly creep up. ***It is during this grey time that a DPOA can be most valuable. Without it, even a spouse will have to petition the court for conservatorship of his or her spouse's IRA.***

This story ended on a happy note. The couple went home, looked through their estate planning documents, and brought us back a copy of their DPOAs. It turned out that when they engaged the services of an attorney who specializes in estate planning, the attorney prepared their living trust and created DPOAs for each spouse.

We encourage you to have a DPOA as part of your overall estate planning. They aren't perfect for all situations and they aren't as comprehensive as a well-drafted living trust. However, for retirement plans they are the best tool available. Hopefully you or your loved one will never enter the "grey zone" and need one.