Three Retirement Plan Head-Scratchers

And How to Think About Them

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RETIREMENT SERVICES

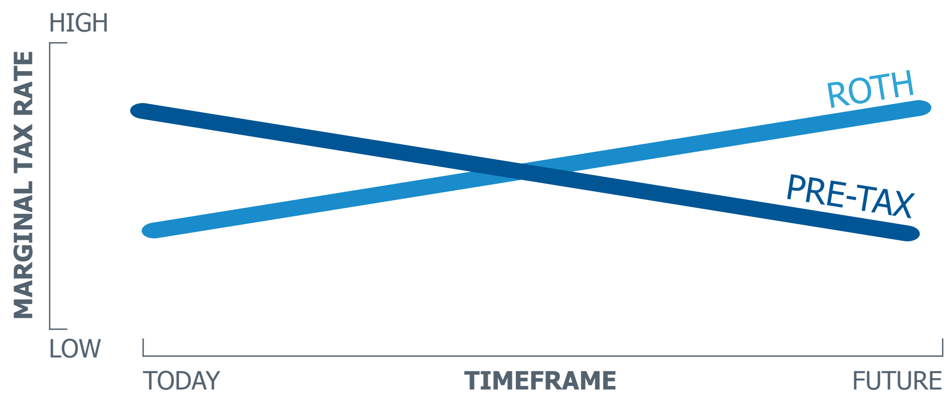
People often say that getting started is the hardest part. But, when it comes to saving for retirement, sometimes the decisions that come after enrolling in your employer's plan can be as difficult as making that initial choice to save. How do you know you are making the right decision from a tax perspective? What about other benefits options? And what if you need money? Is your retirement plan the best place to get it? The answers to these questions are unique to you and your personal situation, but a few rules of thumb can help. Here are three choices facing many retirement plan participants and ideas on how to think about them.

Head-Scratcher #1: Should I save pre-tax or through a Roth contribution?

For most of us, taxes are inevitable but, through your retirement plan, you at least decide when you pay. In a tax qualified savings program, like your employer's plan or an IRA, you can often make the choice to save either pre-tax or on a Roth basis. With pre-tax savings, your taxable income for the current year is reduced by the amount that you put away. With a Roth contribution, you pay taxes in the current year on the amount you save but, when you later withdraw that savings, you pay no taxes on that amount or on any amount your investment has earned.

Deciding which strategy makes sense for you depends on the direction you think your income is headed. If you are likely to make more money later and, by extension, to be in a higher tax bracket, you are better off with Roth contributions and paying the government now. A common example of this would be early career employees likely to advance and see promotions over time. On the other hand, later career employees, or those who plan to dial back their work in preparation for retirement, should consider pre-tax savings. This is because their incomes are likely to go down, so their tax brackets and the amount they owe will be lower in the future, too.

PAY YOUR TAXES WHEN YOUR RATES ARE LOWEST



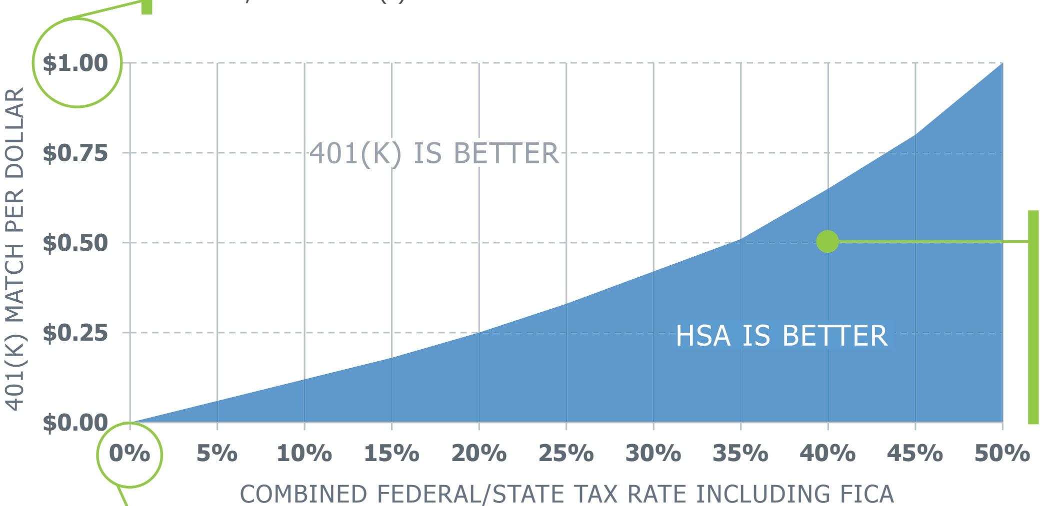
Head-Scratcher #2: My employer also offers a Health Savings Account. Is saving there better than saving in the retirement plan?

As many benefits programs shift to high-deductible healthcare options, more employers are offering health savings accounts (HSAs) that allow employees to save on a tax-deferred basis, similar to retirement plans. How do these plans compare?

	401(k) (2017)	HSA (2017)
Contributions	Pre-tax (normally) After-tax (Roth)	Pre-tax
Maximum Annual Contribution	$18,000	$6,750 (family) $3,350 (single)
Investment Opportunity	Yes	Yes, with a minimum account balance
Withdrawal Eligibility	Age 59 ½	Any time for qualified medical expenses
Distributions and Earnings	Taxed, if pre-tax contribution Not taxed, if Roth contribution	Not taxed when used for qualified medical expenses
Penalties	Early withdrawal	If used for nonqualified expenses before age 65
Required Distributions	Must begin at age 70 ½	None

While they share many similarities, the broader tax benefits of HSAs can make them more attractive in certain situations for long-term savings. The deciding factor often depends on the level of employer match (if any) in the retirement plan. The larger the match and the lower your tax rate, the better the 401(k) plan is:

If the 401(k) match is dollar for dollar, fund the 401(k) first.



If the 401(k) match is 50 cents on the dollar, the tax rate determines the best choice. **But remember: With an HSA not only are your contributions tax deductible, you also don't pay taxes on the distributions if you use them for qualified medical expenses.**

If there is no 401(k) match, fund the HSA first.

Note: Assumes all dollars in HSA go to qualified medical expenses and so aren't taxed.
Sources: Greg Geisler of University of Missouri-St. Louis and *The Wall Street Journal*

Head-Scratcher #3: Is my 401(k) a good place to go for a loan?

This one is a trick question. Generally speaking, debt is the enemy of financial success no matter where you get your loan and you want to avoid it, if you can. If, however, you must have cash, you need a relatively small amount and you can repay the loan quickly, then your 401k may be a smart choice:

- **It's fast.** There are no credit checks and taking a 401(k) loan doesn't affect your credit score.
- **It's flexible.** You can repay the loan early without penalties.
- **It's cheap.** Plan loan fees are usually minimal and the interest you pay goes back to your retirement plan.

For larger cash needs, loans that will be repaid over longer periods of time, there are good reasons NOT to tap into your 401(k):

- **There could be tax consequences.** If you leave your employer with an outstanding loan from your plan, you must pay it back immediately or face a 10% early withdrawal tax penalty on the outstanding balance and that balance becomes taxable income, so you'll pay even more.
- **You could miss out on tax benefits.** Though you can take a loan from your 401(k) to help with the purchase of a primary residence, the interest you pay would not be tax deductible as it is with a traditional mortgage.
- **The market may work against you.** Though you pay yourself back with the interest from your loan, that also means you are funding your account's growth with your own dollars rather than letting the market do it for you. Not only do you miss out on the investment potential of the money you've borrowed, you also miss out on the potential of the additional dollars you need to repay that money.

Whether it's deciding how to save, where to save, or if you should take your money out, you have a lot of options with your retirement plan dollars. Your current situation and what you anticipate for your future all play a role in the decisions you make. There are no hard and fast rules, but the guidelines presented here, and those you find on your service provider's website, can help you think through your options.

ON THE MARK:

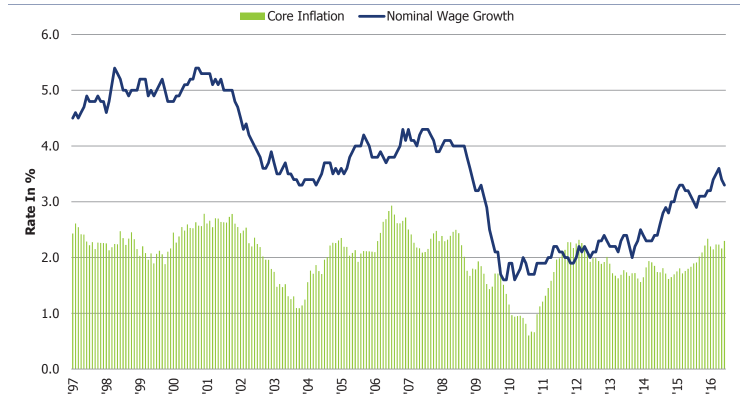
WHAT'S HAPPENING IN THE ECONOMY AND MARKETPLACE

Strengthening Labor Markets

Some areas of the US economy may appear stalled, but domestic employment is not one. Over the last year, the US economy created an average of 200,000 jobs per month and the unemployment rate steadily declined. This rate of job creation not only meets the needs of first-time workers, it also reduces the pool of those who have been underemployed and searching for full-time work. Job gains have been widespread, ranging from healthcare and professional services to construction, and the rising quit rate indicates worker confidence in the labor market.

While it is clear that a strong US dollar and weak energy prices have depressed certain parts of the US economy, job openings are at record highs and prospects for workers, it seems, will continue to improve. The spread between nominal wage growth and inflation has increased since 2013, which allows workers to consume more goods and services than in previous years. Rising wages, along with moderate inflation, will be a key driver of overall economic growth going forward.

WAGE GROWTH VS. INFLATION

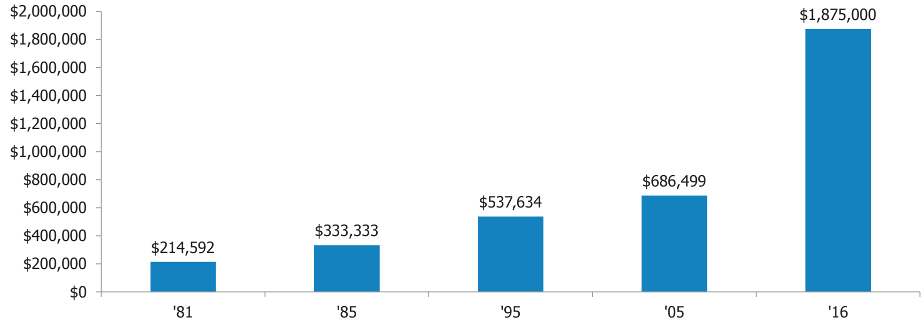


Source: Bureau of Labor Statistics, Federal Reserve.

Interest Rates Challenge Traditional Asset Allocation

In a core asset allocation strategy, the mixture of stocks, bonds, and cash, each component has a specific job: cash provides capital preservation and liquidity, bonds provide safe reliable income, and stocks provide the necessary growth potential to achieve long-term goals. Today's interest rate environment, though, challenges the effectiveness of traditional asset allocation. Short-term US interest rates have remained near zero since 2009 and longer-term interest rates sit near all-time historic lows. In today's environment, cash does not preserve capital on a real basis (after inflation), and bonds do not provide safe reliable income. In fact, government bonds may struggle to provide a positive return on a real basis in the years ahead. This leaves stocks (in their eighth year of a bull market) and a significant gap for safety and income.

ASSETS TO PRODUCE $30K INCOME—INVESTED IN 10-YEAR TREASURY



Source: The Federal Reserve.

The impact on savers and retirees is significant: The cost to produce $30,000 of income has increased from approximately $214,000 to $1.875 million. The low yields leave investors with an allocation gap that must be addressed by:

1. Accepting lower return.
2. Taking more risk.
3. Looking beyond traditional investments (stocks and bonds).

Marketplace Snapshot

Topic	Status
Economic Growth	Slow
Employment	Nearing Full Employment
Inflation	Low
Interest Rates	Historically Low Levels
Markets	Near All-Time Highs

ANNUALIZED RETURNS: BROAD MARKET EQUITY INDICES

	Q3 2016	YTD	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	2.78%	7.21%	15.46%	9.23%	13.77%	7.39%
S&P 500	3.85%	7.84%	15.43%	11.16%	16.37%	7.24%
NASDAQ	9.69%	6.08%	14.97%	12.09%	17.07%	8.93%
MSCI EAFE	6.43%	1.73%	6.52%	0.48%	7.39%	1.82%
MSCI ACWI	5.30%	6.60%	11.96%	5.17%	10.63%	4.34%
MSCI Emerging Markets	9.03%	16.02%	16.78%	-0.56%	3.03%	3.95%
MSCI US REIT	-1.45%	11.91%	19.83%	14.11%	15.79%	6.22%
Bloomberg Commodity	-3.86%	8.87%	-2.58%	-12.34%	-9.37%	-5.33%

Source: Dow Jones, Standard & Poor's, NASDAQ, & MSCI. Data as of: 09/30/2016.

ANNUALIZED RETURNS: FIXED-INCOME INDICES

	Q3 2016	YTD	1-Year	3-Year	5-Year	10-Year
2-Year Treasury	-0.13%	1.20%	0.72%	0.78%	0.59%	2.36%
5-Year Treasury	-0.38%	3.96%	2.52%	2.40%	1.82%	4.66%
10-Year Treasury	-0.75%	7.14%	5.60%	5.32%	3.08%	5.68%
BarCap US Aggregate	0.46%	5.80%	5.19%	4.03%	3.08%	4.79%
BarCap US Corp IG	1.41%	9.20%	8.56%	5.63%	5.14%	5.91%
BarCap US Corp HY	5.55%	15.11%	12.73%	5.28%	8.34%	7.71%
BarCap US TIPS	0.96%	7.27%	6.58%	2.40%	1.93%	4.48%
BarCap Global Aggregate	0.82%	9.85%	8.83%	2.13%	1.74%	4.26%

Source: Barclay's Capital. Data as of: 09/30/2016.

Given the low-yield environment across the globe, future return expectations will likely be lower for diversified portfolios. Fixed income categories historically providing returns modestly above inflation have mostly disappeared. Going forward, it will be important for investors to reevaluate their risk tolerance and return expectations and decide whether they will accept higher risk or lower return.

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