POLARIS ADVISORS, LLC.

THE Retirement Report

Retirement Transition Planning

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How Portfolio Theory Worked In Real-World 2017

For investors, 2017 was a mirror image of 2016. The top performing types of American companies in 2016 were the biggest laggards in 2017. Meanwhile, the worst performing types of U.S. stocks in 2016 were the biggest winners in 2017.

The orderly rotation of the leaders and laggards vividly illustrates how Modern Portfolio Theory worked in the real world last year. Modern Portfolio Theory is a large body of knowledge based on 70 years of research by investment academics. It's a framework for how investing is now taught in the world's best business schools and long embraced by institutional investors. Basically, classifying investments based on their statistical characteristics imposes a discipline for managing assets based on history and fundamental facts about the economy.

Of course, human judgment based on a good sense of history is critical in applying the theory to people in the real world. And all this doesn't guarantee success. It's a theory. But it is the best solution spawned of the research by several generations of the world's best minds for increasing the likelihood of investment success, and it is the framework for investing that this firm believes in.

Applying portfolio theory at the end of 2016 meant lightening up proportionately on the most-appreciated types of assets — small-cap value stocks — and buying more of the types of assets that lagged, the S&P 500 large-cap growth stocks. The exact amount of each type of asset is set based on your personal preferences and appetite for risk.

Usually, when you look at the returns of asset classes from one calendar year to the next, the performance seems random - there is no order to what occurred. The orderly reversal of leaders and laggards from 2016 to 2017 vividly illustrates a key concept in managing wealth prudently. In real-world 2017, then, the theory

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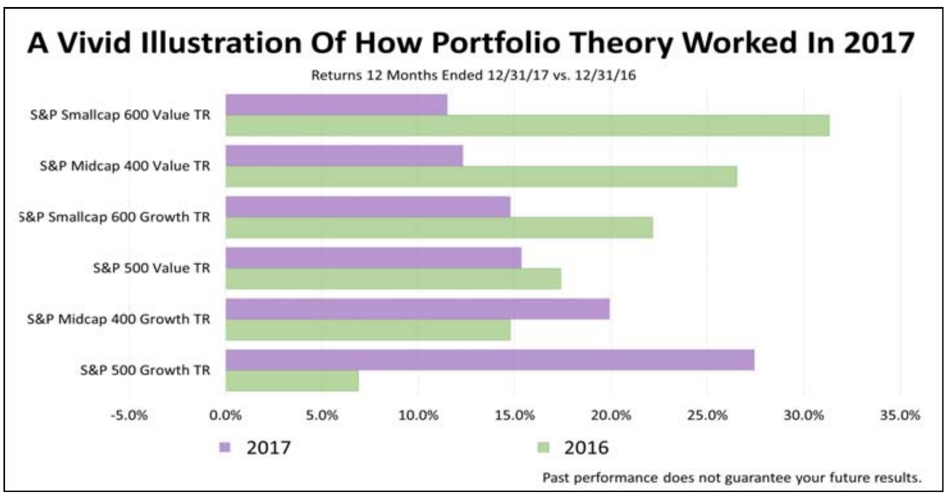


Gambling Or Investing: Which Way To Retirement?

A recent article in *The Wall Street Journal* highlights the sorry predicament many Americans find themselves in regarding retirement. To summarize, most have way too little saved. Sometimes it was too much spending, sometimes it was mistakes of investing. Often it was both. Their future looks bleak.

We promote the idea that investing is a lifetime commitment, like owning a house. Homeowners don't think of themselves as traders. No one thinks of selling and buying based on changing home values. We know we need a home to live in, so we keep it all our lives.

Why are retirement assets different? Why do pre-retirees repeatedly question the value of their holdings every time the markets decline? Do they see their 401k plans as one giant casino, ruled by luck and feeling? A place to make bets, win big, and possibly suffer huge losses when markets retrench?

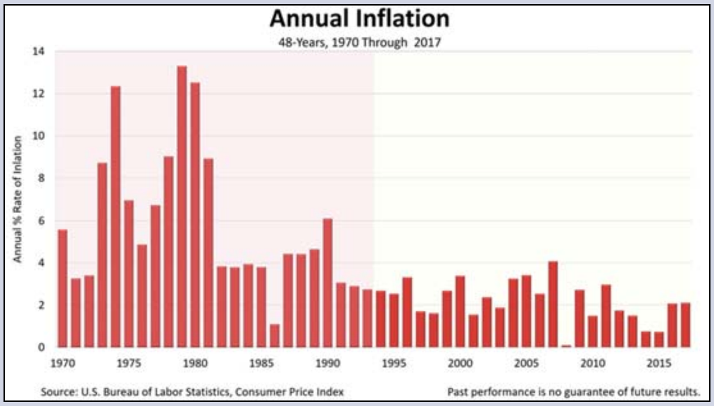
Investing is not gambling, it's about accumulating. Gathering and keeping quality income-producing assets. Amassing enough so we don't have to work when we grow old.

Our lead article this quarter describes one of the skills used to achieve that. We wish we could go back in time and teach it to those who now find themselves in dire straits. They could have used the help to save and invest wisely.

Be Well,

Ric and Trang

Inflation: A Portfolio Risk That Never Dies



The threat of inflation is nothing like the double-digit affair of the 1970s, but it's still there. Dormant for years, inflation may seem irrelevant, but it remains a risk. Here's a short lesson for managing this risk.

In the 48 years after it raged in 1970, inflation was a tale of two times, distinctly different but equal in length. The first 24 years was a high-inflation period and low inflation marked the last 24 years.

The median Consumer Price Index, a widely-watched inflation barometer, was 3.8% for the 48-year span. However, the CPI topped 3.8% just once in the past 24 years, while hitting 3.8% or higher in 18 of the previous 24 years.

The table below shows the average yearly returns for seven distinct types of investments over the two 24-year periods. Some important observations:

Inflation And Performance Annually, 1970 - 2017

		Large US Stock	Small US Stock	Non-US Stock	US Bonds	US Cash	Real Estate	Commodities
Low Inflation Years 24 Years with Below-Median CPI	Average Nominal Return	13.08	13.76	10.91	6.39	2.45	12.58	(1.97)
	Average Real Return	10.80	11.44	8.67	4.27	0.41	10.30	(4.03)
High Inflation Years 24 Years with Above-Median CPI	Average Nominal Return	10.82	12.61	11.33	9.03	7.39	14.26	21.98
	Average Real Return	4.70	6.26	5.21	3.00	1.33	7.86	15.13

Source: US Bureau of Labor Statistics, Consumer Price Index; Standard & Poor's Corp.
Past performance is not a guarantee of your future results.

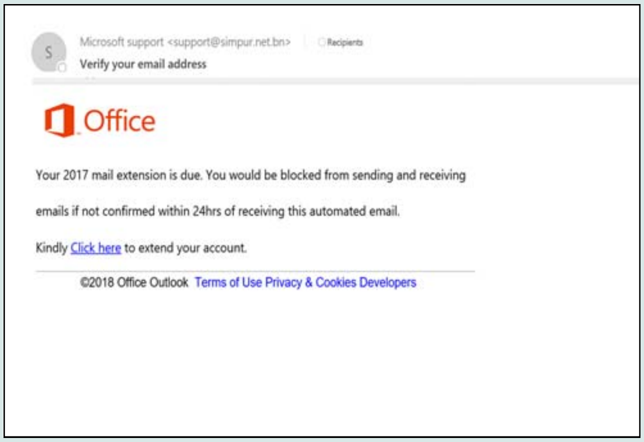
- Large U.S. stocks' nominal return in the low-inflation era was 13.08% and, after subtracting the small CPI increase, 10.8%. In the high-inflation years, a 10.8% nominal return shrunk to 4.7% after inflation. High CPI slashed real returns after inflation in half, a frightening risk to a retiree on fixed income.
- Stocks held up well in low-inflation times, because bonds — their chief competitor for investor capital — were yielding less income. Stocks performed okay in high-inflation periods, too. An escalating CPI eroded the value of bonds' interest income. Longer-maturity bonds suffered.
- Money market instruments are never big interest payers. But shorter-term income investments go up with inflation. They've been good for times of rising inflation.
- Real estate performed well in low-inflation years, which foster lower mortgage payments that encourage home buying. Yet real estate also performed in the high inflation era.
- A real wild card for investors in securities over the last 48 years was commodities. Oil companies dominate commodities in this class of securities, but it also reflects prices of gold, food and raw materials. Historically, prosperity increased demand for goods and boosted commodities prices. Low inflation meant the opposite happened.
- It's easy to think commodities are irrelevant, but long-term financial history indicates otherwise. The fact that they were losers after years of good stock returns demonstrate why they remain important in a diversified portfolio. If you did not have some investments underperforming, you're not properly diversified. ●

Six Tips To Avoid Phishing Scams

"Fake news" has exacted a high cost to American culture and political discourse, but the internet fakery that costs you time and money is phishing, emails diabolically aimed to trick you into opening your personal data to crooks and miscreants.

Phishing is the practice of emailing people purporting to be a reputable company to fool people into revealing passwords, credit card numbers, contacts, emails, internet accounts, and your most personal digital data. It's rampant. Whether you're using a smartphone, tablet, or computer, here are some tips for protecting yourself:

Mistakes. Phishing emails often are generated by teens or crooks with weak skills in English punctuation, grammar, and spelling. The phishing email from Office uses an improper style in "24hrs" and the capitalization of the phrase, "Kindly Click here" should arouse suspicion. When you look at this email's bottom line, the copyright is "Office Outlook." The logo is off. The product name is Office 365 and there is no mention of Microsoft in the copyright notice. Does the sentence Terms of Use Privacy & Cookies Developers make sense? It's a hint that this is a fake.



Reply email address. In this

Seven Steps To Get Ready For Your Retirement

Are you among the millions of Baby Boomers counting down the days to retirement? Before you move into the next stage of life, it's important to get all of your financial ducks in line. To prepare yourself, consider these seven practical suggestions.

1. Rebuild the budget. You've probably been living on a monthly budget that takes into account your usual expenditures and income. But that's about to change in a big way. For example, once you stop working, your expenses for a business wardrobe and commuting will also end, but so will the regular paychecks you've been living on.

Come up with a new plan. Identify what you expect to have coming in and going out. Remember that you won't be able to rely on 401(k) deferrals to reduce your taxable income after retirement, but you should still keep saving.

2. Zone in on a homestead. You could be planning to pull up stakes and move to a smaller home, perhaps downsizing from the place where your kids grew up and you might hope to end up in a warmer climate or in a less expensive area (or both). Or perhaps you're contemplating a move to a retirement community. But this kind of upheaval isn't for everyone, and you just might decide to stay put. In any event, your choice will affect numerous other aspects of retirement.

Also, don't assume that you and your spouse share the same vision. If you haven't talked about it yet, bring up the subject before you call it quits.

3. Review your investments. As you head into the home stretch before retirement, compile a list all of the investment assets you own, including amounts parked in taxable accounts, bank savings or checking accounts, and tax-favored retirement accounts such as 401(k)s and IRAs. Consider whether you will want to keep retirement plan assets where they are when you retire or consolidate them into other accounts. Similarly, consider the best use of life insurance policies.

One thing to think about is whether to convert your traditional IRAs to a Roth IRA. Although the conversion is taxable, your future withdrawals from the account will normally be tax-free. Check with a professional to crunch the numbers.

4. Settle on Social Security. If you retire before full retirement age (FRA)—age 66 for most Baby Boomers—you'll receive less in monthly Social Security benefits. You can apply for benefits as early as age 62. Waiting until after you reach FRA, on the other hand, can result in bigger monthly benefits. The longer you wait, until you turn 70, the larger your benefit checks will be.

But if you and your spouse will both receive Social Security payments, there will be other factors to consider. For instance, a higher-earning spouse might wait longer to claim benefits to provide greater protection for a surviving spouse if the higher-earning spouse dies first.

5. Learn all about Medicare. Usually, retirees opt to be covered by Medicare once they become eligible at age 65. But you will have a number of options to consider, so it's best to familiarize yourself with the key elements of Medicare before then. Estimating your future out-of-pocket costs, including premiums, deductibles, and prescription drug costs will help you decide which Medicare benefits to opt for and whether you'll need to supplement Medicare with coverage from a private insurance plan. Try to investigate all of the possibilities before the time comes to make your decisions.

6. Develop a draw-down strategy. Control the distribution of funds in your retirement by deciding which accounts you want to tap first. Although everyone's circumstances are different, often the best plan is to withdraw funds from your taxable accounts first (because you'll owe only capital gains taxes, which are usually much lower than taxes on distributions from 401(k)s and traditional IRAs), then from those other tax-deferred accounts, and finally from your Roth IRAs. This sequence enables you to benefit from tax-free compounding of investment income within a Roth for as long as possible.

But taxes aren't the only consideration. You may have other reasons for withdrawing funds from some accounts and holding onto others.

7. Meet with your financial advisor. As you can see, you'll be facing some difficult decisions during your countdown to retirement, and the financial consequences can be significant. But you don't have to do it all by yourself.

Schedule a meeting with your advisor to assess and review your situation well before your expected retirement. The countdown to retirement won't be as nerve-wracking if you're well prepared. ●

phishing email, the reply address at the top left says "Microsoft support," but if you look closer, the reply email address is "support@simpur.net.bn" and that is not a Microsoft address. The "bn" suffix is the internet country code for Brunei, and that's another telltale sign of fraud. Clever phishing emails often fake reply addresses in other ways. The easiest way to verify a reply email address is to double click on it and look at its properties. If the email purports to be from Microsoft or Google, will hitting reply send an email to a Microsoft or Google email account? If not, it's fake.

Links. Don't click on links in a suspicious email without being deliberate. The link could be a malicious website. Right click on the link and check its properties and see if the link goes to the company.

Slow down. The grammar, misspelling, bad links, and other telltale signs are easily overlooked when you're in a rush, and that's perhaps the reason why people become ensnared by phishing emails.

Verify before you trust. Trust but verify works for some things but not with internet security. First verify and then you can trust.

Secure Software. Microsoft and Apple release updates to computer operating systems continually and those are essential to staying secure. Anti-virus and anti-malware programs are also essential and they need to be kept updated with the latest fixes. ●

Giving More To Loved Ones – Tax-Free

While it may be better to give than to receive, as the adage contends, both givers and receivers should be happy with the new tax law. The annual amount you can give someone tax-free has been raised to $15,000, from $14,000 in 2017.

Exempting $15,000 annually from gift tax, over time, transfers a lot of wealth to those you care about during your lifetime, while avoiding the tender mercies of the tax man, and married couples can have double the fun.

Take the example of a husband and wife with three married children and six grandchildren. The husband can give $15,000 each to his married children and the same amount to their spouses, and also $15,000 to the half-dozen grandchildren — totaling $180,000 — and his wife can do the same for the same 12 beneficiaries. The grand total is $360,000 per year. No federal tax will be levied on these transfers of your wealth to family as well as friends.

In addition, you can give more than the annual exemption caps for college savings. The Tax Cuts and Jobs Act (TCJA) permits bunching five years of $15,000 annual gifts into one year, by plugging it into a 529 college savings plan for a child or grandchild. That's $75,000 in total. Assets in 529 savings plans grow tax-free, if used to pay qualified education expenses.

Gifts made during your lifetime reduce your exemption from tax on your estate. The TCJA more than doubled the estate tax exemption in 2018 from $5.5 million to $11.2 million for individuals, and from $11 million to $22.4 million for couples. All of these new levels will increase with inflation, though the formula annually adjusting inflation is less generous than before.

Lifetime gifts can be made directly or through trusts. With a trust, you place the gift of cash, securities, or other assets in an entity set up to make the transfer of wealth after you die. The assets in the trust avoid probate court, and makes the transfer faster, less costly, less likely to be contested, and generally more sure-footed. Trusts can influence the values of your progeny by requiring the money you leave to be spent for religious, philosophical, or any variety of educational activities.

A trust also shields assets left to your heirs from lawsuits and business creditors. Should your grandchild get divorced, the trust money is shielded.

The friendlier tax treatment of transfers under the TCJA affects your estate plan and how your assets will be spent after you are gone, but it also may change your plan for gifting during your lifetime. Giving assets during your lifetime can be satisfying because you can witness your impact and influence on the future of your family. ●

How Portfolio Theory Worked

(Continued from page 1)

worked exactly the way it's supposed to — it was uncanny.

Global stock market returns in 2017 versus 2016 reflected a similar mirror image. Although the seven types of U.S. and foreign stocks did not prove the theory quite as perfectly, the biggest winners of 2016, small-cap U.S. stocks, were the biggest laggards of 2017, and the biggest laggards of 2016 were the biggest leaders of 2017.

The real world of investing in 2018 is filled with uncertainty. Tax reform could accelerate economic growth and prompt the Federal Reserve to make a policy mistake by squelching growth or allowing the economy to overheat and inflation to surge.

The political scandal in Washington could devolve into a constitutional crisis or the nuclear standoff with North Korea could erupt with terrifying consequences. A 10% or 15% drop could occur at any time on bad news and the chance of a bear market decline of 20% or more increases as the eight-and-a-half-year bull market grows older.

On the other hand, the bull market could continue in 2018 and beyond, and prices could head much higher. The economy shows no sign of slipping into a recession; leading indicators signal a strong start to 2018; the world economy is growing in synchronicity with the U.S. - the first time that's happened in many years; and the new tax law is expected to boost earnings sharply and that's what drives stock prices.

You can't be sure what the future holds, but seeing how well portfolio theory worked in the real world in 2017 may give you comfort and boost your confidence to stay committed to a program of long-term wealth management and financial planning. ●

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