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FEBRUARY 2018

Focus on the Basics

How do you choose the right combination of investments to help you work toward a goal that may be decades away? The answer is to focus on the basics. Make sure you are getting these fundamentals right:

✔ **Don't wait — invest now.** To put the power of compounding to work for you, start investing now. It's easy to put off investing, thinking you'll have more money or time at some point in the future. Typically, however, you'll be better off saving less now than waiting and saving more later.

✔ **Live below your means so you can invest more.** Most people have trouble coming to grips with the fact that the amount of money you have left over for investing is a direct result of your lifestyle. Don't have any money left over for investing? Ruthlessly cut your living expenses. Redirect all those reductions to investments. This should help significantly with your retirement. First, you'll be saving significant sums for that goal. Second, you'll be living on significantly less than you're earning, so you'll need less for retirement.

✔ **Maintain reasonable return expectations.** When developing your financial goals, you'll typically decide how much you need, when you'll need the money, and how much you'll earn on those savings. Those factors will determine how much you'll need to save on an annual basis to reach your goals. The higher the expected return on your investments, the less you'll need to save every year. However, if your assumed rate of return is significantly higher than your actual rate of return, you won't reach your goals. Thus, it's important to come up with reasonable return expectations. While past returns aren't a guarantee of future returns, you'll want to start by reviewing historical rates of return for investments you're interested in. You can then

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The Need for IRAs

✔ **You'll probably need the additional funds for retirement.** Even with Social Security, pension, or 401(k) benefits, you'll probably need other savings to fund your retirement.

✔ **You'll lower your taxes.** You can lower your taxes currently by contributing to a traditional deductible IRA or in the future by contributing to a Roth IRA.

✔ **You're more likely to use the funds for retirement.** If you save in a taxable account, it's easy to use the funds for other purposes. However, the government discourages the use of IRA funds for other purposes by assessing a 10% federal income-tax penalty when funds are withdrawn before age 59½ (except in certain limited circumstances). That makes it more difficult to withdraw the funds and more likely they'll stay in the IRA.

✔ **You have a wide variety of investing options.** With a 401(k) plan, you typically have a limited number of investment options. However, with an IRA, there are a wide variety of investments to choose from.

Please call if you'd like to discuss IRAs in more detail. ❍❍❍

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Focus on the Basics

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adjust those returns based on your expectations for the future. Assessing your progress every year will allow you to make adjustments along the way.

✔ **Understand that risk can't be totally avoided.** All investments are subject to different types of risk, which can affect an investment's return. Cash is primarily affected by purchasing-power risk, or the risk that its purchasing power will decrease due to inflation. Bonds are subject to interest-rate risk, or the risk that interest rates will rise and cause the bond's value to decrease; and default risk, or the risk that the issuer will not repay the bond. Stocks are primarily subject to nonmarket risk, or the risk that events specific to a company or its industry will adversely affect a stock's price; and market risk, or the risk that a stock will be affected by overall stock market movements. These risks make some investments more suitable for longer investment periods and others for shorter investment periods.

✔ **Diversify your portfolio.** When stocks have above-average returns for an extended period, diversification acts as a drag on total return. By definition, allocating anything other than all of your portfolio to the best-performing asset lowers your return. But when stocks decline substantially, the disadvantage of investing in only one asset class becomes apparent. Typically, you do not know which asset class will perform best on a year-to-year basis. Diversification is a defensive strategy — it helps protect your portfolio during market downturns and reduces volatility. Diversify your investment portfolio among a variety of investment categories, such as stocks, bonds, cash, real estate, and other alternatives. Also diversify within investment categories.

✔ **Only invest in the stock market for the long term.** Stocks should only be considered by investors with an investment time frame of at least five years. Remaining in the market over the long term reduces the risk of receiving a lower return than expected.

✔ **Don't try to time the market.** Timing the market is a difficult strategy to accomplish successfully since so many factors affect the market. Remember that most people, including professionals, have difficulty timing the market with any degree of accuracy. Significant market gains can occur in a matter of days, making it risky to be out of the market for any length of time. Instead of timing the market, concentrate on setting an investment program that works in all market environments and you can stick with in good and bad times.

✔ **Pay attention to taxes.** Taxes are probably your portfolio's largest expense. Using strategies that defer income for as long as possible can make a substantial difference in the ultimate size of your portfolio. Some strategies to consider include utilizing tax-deferred investment vehicles (such as 401(k) plans and individual retirement accounts), minimizing portfolio turnover, selling investments with losses to offset gains, and placing assets generating ordinary income or that you want to trade frequently into your tax-deferred accounts.

If you need help with investing, please call. ❍❍❍

Are You Making Progress?

One of the most rewarding parts of a financial plan is watching the progress you make toward your financial goals. Following are some simple steps you can take to ensure you are on track:

Review Your Goals — All of your goals should have a time frame and an attached dollar value, so that you know how much money you need to achieve that goal within a particular period of time. For example, if one of your goals is to pay off all your credit card debt within one year, you will then be able to determine how much money you need to pay on a monthly basis to realize that goal. By reviewing your progress at regular intervals, you will be able to identify any gaps and work to fill them.

How's Your Cash Flow? — Another way to measure progress toward your goals is your monthly cash flow. By keeping a close watch, you will be able to see if you need to increase your income or lower your expenses to put you on track to meet your goals. If cash flow is a constant struggle, make sure you develop a budget and automate your savings to help manage variable income.

Track Your Net Worth — Add up all your assets, including property, investments, and cash, and subtract all your debt, including mortgages, credit cards, and personal loans, to come up with your net worth. Hopefully, you will be seeing it rise or at least staying steady during volatile markets. If you are not seeing progress, you need to take a step back and review your financial plan.

Peace of Mind — The most important thing a good financial plan can give you is peace of mind. If you feel confident you have good cash flow, emergency savings, life insurance coverage, diversified investments, and a retirement plan, then the progress you are making is on track. If you are stressed and worried about your progress, this is a significant sign you need to review and rework your financial plan. ❍❍❍

Assessing Your Risk Tolerance

While investors want the highest returns possible, returns compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns. However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments decrease significantly in value. What you are trying to assess is your emotional tolerance for risk, or how much price volatility you are comfortable with. Some questions that can help you gauge your risk tolerance include:

✔ **What long-term annual rate of return do you expect to earn on your investments?** Your answer will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as variations in those returns over a long time period to see if your estimates are reasonable. Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be tempted to sell frequently. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.

✔ **What length of time are you investing for?** Some investments such as stocks should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.

✔ **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.

✔ **What types of investments do you own now and how comfortable are you with those investments?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as your understanding of how risk impacts different investments increases.

✔ **Have you reassessed your financial goals recently?** Due to the significant market volatility of the past few years, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.

✔ **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk-reduction strategies you should consider for your portfolio. These strategies include:

Diversify your portfolio. You should diversify among several different investment categories, including cash, bonds, and stocks, as well as within investment categories, such as owning several types of stocks. A properly diversified portfolio should contain a mix of asset types whose values have historically moved in different directions or in the same direction with different magnitudes.

Stay in the market through different cycles. Remaining in the market over the long term helps reduce the risk of receiving a lower return than expected, especially for more volatile investments, such as stocks.

Use dollar cost averaging to invest. Rather than accumulating cash so you have a large sum to invest, invest small amounts regularly. Dollar cost averaging is a method of investing a certain sum of money in set amounts at regular intervals. This spreads your purchases over a period of time, keeping you from making one major purchase at high prices. Since you are investing a set amount, you purchase more shares when prices are lower and fewer shares when prices are higher. While a valuable investment strategy, dollar cost averaging does not ensure a profit or protect against losses in declining markets. Before starting a program, consider your ability to continue purchases during periods of low price levels. This strategy requires the discipline to invest consistently regardless of market prices and can help develop a habit of regular investing.

Please call if you'd like help assessing your risk tolerance. ❍❍❍

What Does the New Tax Law Mean to You?

We are a little surprised by the reaction many of our clients have had to the new tax law. Many believe they are going to pay a lot more in taxes. In general, the reaction has not been good. While it is true that large corporations are getting the largest tax cut — which, by the way, brings their tax rates in line with international averages — those tax breaks help us as individual investors. There are also breaks for small pass-through companies, with the exception of professional service corporations (like Burke Financial Strategies), and for personal filers, unless those filers have significant itemized deductions (more on this later).

We believe that many are influenced by recent headlines stating that tax reform benefits the rich. Let's clear something up here. The rich pay most of the taxes, so any tax breaks will likely benefit them the most. According to the IRS (figures from 2015), the top 1% of earners pay over 39% of personal federal income taxes. The top 20% (which includes nearly all of you) pay 95% of personal federal income taxes! The bottom 50% pay less than 3%.

We don't like taxes. At one time, the Federal government made do without a personal income tax. While that goes too far, taxes are too high. According to the Tax Foundation, the highest earners in New York face a top marginal income tax bracket of 50.3% (federal plus state). New Jersey is only one percentage point less. Add to that Social Security, Medicare, property and sales taxes, and you have a whole lot of money being paid to governments. We are not only happy to see taxes decline, we will also do everything in our power to help you save taxes, at least when it comes to your investments. In fact, we spent a very busy month of December focused on last-minute strategies to help clients reduce their taxes.

The bulk of tax savings in this new law, however, is for large corporations. As investors in large corporations, we are happy to see this; and we are studying companies that might get outsized savings, hoping to identify investment opportunities.

As to the direct impact on you, the individual taxpayer, we will share some details here. But we also suggest you speak to your accountant to see how you specifically will be impacted, and discuss any recommendations your accountant may have for you. Owners of small businesses should certainly consult with their accountants. If you own a "pass-through" company and are not a professional services corporation, you could be getting a nice tax break. Again, your accountant may have recommendations to best position you and your business under the new tax law.

Specific Tax Implications

✔ **Tax brackets** have been expanded with lower percentages in most brackets. This will result in a lesser tax bill, given a fixed taxable income. For example, if you have taxable income of $150,000, you will save more than $4,000 in taxes, according to our estimate.

✔ **SALT deductions –** SALT is a new acronym that is derived from "State And Local Taxes." These deductions have been limited to $10,000 for married payers and $5,000 for single payers.

✔ **Standard deduction and personal exemptions –** The standard deduction has been raised to $12,000 for single payers and $24,000 for joint payers. Because of this larger deduction combined with the limit on SALT deductions, far fewer taxpayers will itemize. Without itemizing, taxpayers are unable to offset (deduct) mortgage interest and charitable contributions. Personal exemptions have been eliminated.

✔ **Mortgage Interest Deduction –** For those who still itemize, interest on a mortgage incurred after December 14, 2017, will only be deductible up to a $750,000 loan amount (for married couples). Existing mortgages continue to be subject to the current $1,000,000 limitation. Interest on home-equity loans will no longer be deductible.

✔ **Alternative Minimum Tax (AMT) –** The AMT exemption amounts have been increased by about 30% and will now be indexed to inflation. In addition, the income thresholds at which exemption amounts begin to phase out are significantly increased. This, combined with the limited SALT deductions, will significantly reduce the number of taxpayers subject to the AMT.

✔ **Sunset Provisions –** Because of complicated Congressional budgetary rules, the vast majority of changes will "sunset" on 12/31/2025. This means that barring subsequent action by Congress, changes will revert back in 2026 to rules that are in place today. The two main exceptions are the reduced corporate tax rate and the 20% deduction for small, "pass-through" businesses.

✔ **Expanded Child Tax Credit –** This credit is increased from $1,000 to $2,000, with an increase in the "refundable" portion to $1,400. This is a break for people who pay no income tax because they can get money from the government up to the $1,400 limit. Higher-income taxpayers can also benefit from a significantly increased income limit — $200,000 for individual returns and $400,000 for joint returns.

✔ **Section 529 Education Plans –** No longer limited to funding college costs, 529 Plan proceeds can now be used to cover private K – 12 schooling costs. This is especially interesting for states that offer a deduction for 529 contributions, such as New York.

✔ **Loss of deductions –** All expenses that were subject to the old "2% floor," like unreimbursed employee business expenses, are no longer deductible. For some people, like performers for example, this can result in a significant tax increase.

Generally speaking, those of you with low itemized deductions who are not business owners will see only a modest impact. We believe you can wait to discuss your specific situation with your accountant when you work on your 2017 tax return. Those of you with high itemized deductions may want to speak with your accountant to see if there are tax strategies that will help mitigate, what is for you, a potential tax increase. Owners of a small business should consult with your accountant to see if there are tax strategies that will lower your taxes.

This information has been obtained from sources deemed to be reliable, but its accuracy and completeness cannot be guaranteed. Neither Raymond James Financial Services nor any Raymond James Financial Advisor renders advice on tax issues; these matters should be discussed with the appropriate professional.

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