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Jana Shoulders and other financial advisors say tax planning is now essential to attracting and retaining high-net-worth clients.

By Charles Paikert

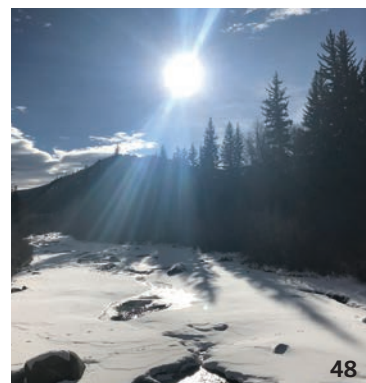
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SPOT ON OR WAY OFF?



Hollywood's Take on Financial Advisors

Hollywood typically has a certain way of portraying advisors: a little nerdy, finance-loving, great with numbers — and always looking to make money. But there's a lot more to planners and a lot more to how these characters are portrayed on the silver screen. Click through our slideshow to see what Hollywood gets right and wrong about the wealth management industry: <http://bit.ly/2rwksiW>



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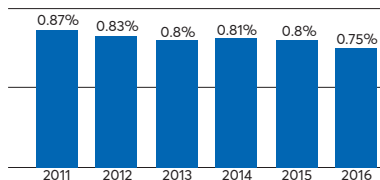
Broker-Dealers Outpace the Pack

While returns on assets declined industrywide again in 2017, asset growth at national and regional broker-dealers grew faster than any other advisor channel, according to research from Cerulli Associates. BD assets climbed 9.1% year-over-year, 1.9 percentage points quicker than the industry's overall rate of 7.2%. It's the first time in five years that independent RIAs failed to lead the pack. The gains came as wirehouses scale back recruiting deals, the research suggests. Read the story at: <http://bit.ly/2EI40Ed>

GUIDE TO GROWTH

Return on assets, industrywide

ROA has slid from 2011.



Source: Cerulli Associates, The Cerulli Report - U.S. Broker/Dealer Marketplace 2017. Segments of Strength; Most-recent data available.

EVENTS

APRIL		MAY		JUNE	
23-26 FPA Retreat Litchfield Park, Arizona http://bit.ly/2jSRVgo	25-27 Fi360 Conference San Diego http://bit.ly/2CFDhom	6-9 IWI Experience Conference Nashville, Tennessee http://bit.ly/2CVM8Cs	16-19 NAPFA Spring Conference Phoenix, Arizona http://bit.ly/2s29nFD	6-8 Pershing Insite Orlando, Florida http://bit.ly/2nCVxWG	

A silhouette of a person against a bright, hazy sky. The person is wearing a dark jacket and has their right arm raised with the hand open, reaching towards the sun. In their left hand, they are holding a white coffee cup with a dark lid. The sun is positioned to the right of the person's head, creating a strong backlight effect. The overall mood is one of aspiration and achievement.

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EDITOR'S VIEW

Attracting New Planners

Don't worry about technology replacing advisors. On the contrary, use it to help fix the advisor shortage.

HOLLIE FAGAN COULD HAVE CITED ANY NUMBER OF PROBLEMS WHEN I asked about the biggest worry for the planning industry. I didn't expect this to be at the top of her list: "We're not attracting talent."

Maybe I shouldn't have been surprised. There are now more CFPs over 70 than under 30, according to the CFP Board, and the percentage of women hasn't budged since 2007.

Fagan, head of BlackRock's dedicated RIA channel, said she sees young people turning their backs on careers in finance to seek jobs in the glamorous and potentially more lucrative tech sector. "It's a real issue," she told me during our conversation at TD Ameritrade's LINC conference in January. "A lot of the talent is going to technology companies. The average 22-year-old doesn't want to work on Wall Street."

The planning industry needs to do a better job of attracting those 22-year-olds, Fagan says.

Here's one solution: Make new advisor technology the selling point. Artificial intelligence and blockchain are just two exciting tools that will enhance planning services in the future, according to Alan Moore, a co-founder of XY Planning Network.

"As an industry, we've been stale and stagnant," Moore told me. "New advisors are going to have so much more and better technology – tech that current advisors don't have access to and have not been able to implement into their practice."

Firms that integrate or even design their own platforms and programs can attract talent who might otherwise have headed to the tech space. Here's another plus: This creativity allows both green and experienced advisors to set up shop anywhere in the country, such as Moore, who is based in Bozeman, Montana.

In his story, "Flourishing in Paradise," on p. 48, contributor James Thorne profiles planners who have built practices in exotic locales in Florida, Washington state and Colorado. When they are not scuba diving, fishing or skiing, they are using cloud-based management systems to work with clients. What's more, practices in desirable locations will have a leg up on their competitors when it comes to attracting and keeping talent.

Some veteran planners tell me they worry that the rush to integrate new artificial intelligence tools could undermine the valuable relationships they've built over years of face-to-face meetings. But TD Ameritrade CEO Tim Hockey said he's not worried. "AI will be quite helpful in face-to-face conversations," he told me in an interview. "I don't think it will be in any way unusual for an advisor, with a client in front of them, to ask a question of a digital advisor right there, because the world is a big place. Not everyone can know everything."

—Chelsea Emery



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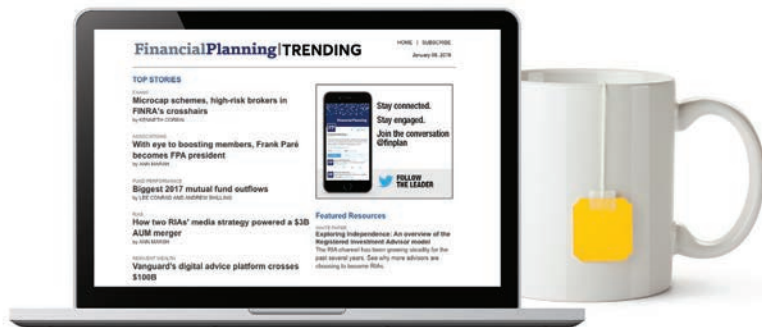
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RETIREMENT ADVISOR CONFIDENCE INDEX

Volatility Curbs Risk Tolerance

Risk tolerance growth slows as advisors urge clients to stick to the long view.

UNEASE THAT LOW VOLATILITY IN THE STOCK market would inevitably give way has helped curb gains in client risk tolerance, advisors say.

Risk appetite remains healthy overall, according to the latest Retirement Advisor Confidence Index – *Financial Planning's* monthly survey of wealth managers. But the component tracking client risk tolerance fell 4.9 points to 58. Readings above 50 show an increase, while readings below 50 indicate a decline.

“Folks are more nervous than last year,” one advisor says, backing others who say they believe that steady, consistent growth in equity values had worked to numb clients to the prospect of setbacks or worse.

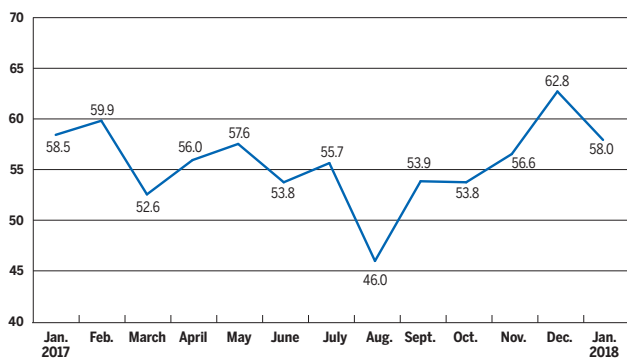
The chill is sharp among clients who will soon need to tap into savings, according to another advisor who says that “people near retirement age are more skeptical” and fearful of a “potential correction.”

Despite the widespread view that low productivity growth and incipient signs of inflation hurt the case for high stock multiples, advisors express confidence that the economy is still fundamentally on solid footing.

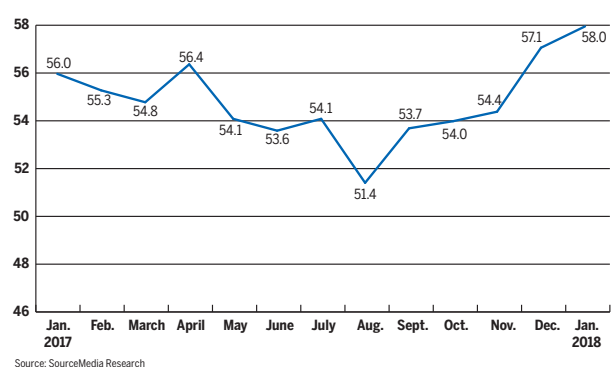
Advisors' perspectives on the tax cut legislation enacted in December are mixed. The package stands to boost corporate profits, add upward pressure to interest rates by stimulating an economy already operating near capacity and impact the personal finances of individual clients differently.

With the dip in the risk tolerance component, the composite RACI rose 0.9 points to 58. That reading is

CLIENT RISK TOLERANCE



RETIREMENT ADVISOR CONFIDENCE INDEX



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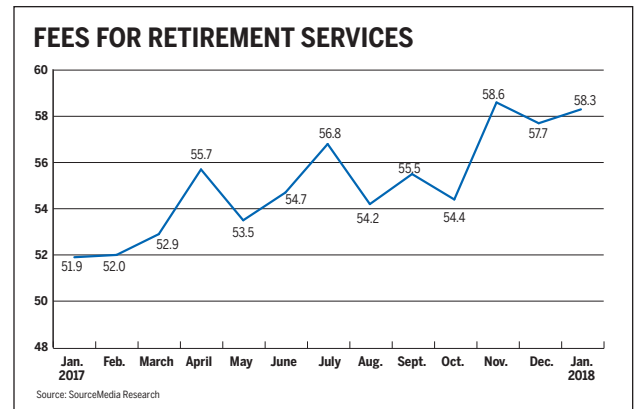
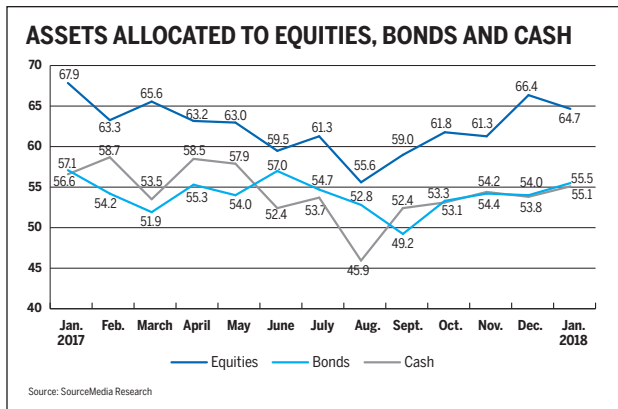
still well into expansion territory. The composite tracks asset allocation, investment product selection and sales, client risk tolerance and tax liability, new retirement plan enrollees and planning fees.

The cash allocation component increased 1.3 points to 55.1, suggesting clients are adding to their defenses against adverse moves in stock prices. One advisor says that “moving forward harvesting gains and protecting gains made over the last five

years will be the primary objective by the end of 2018.”

Above all, however, advisors say they are counseling clients to keep their portfolios balanced according to long-term plans. While the equity allocation component dipped 1.7 points, it still remained high, at 64.7.

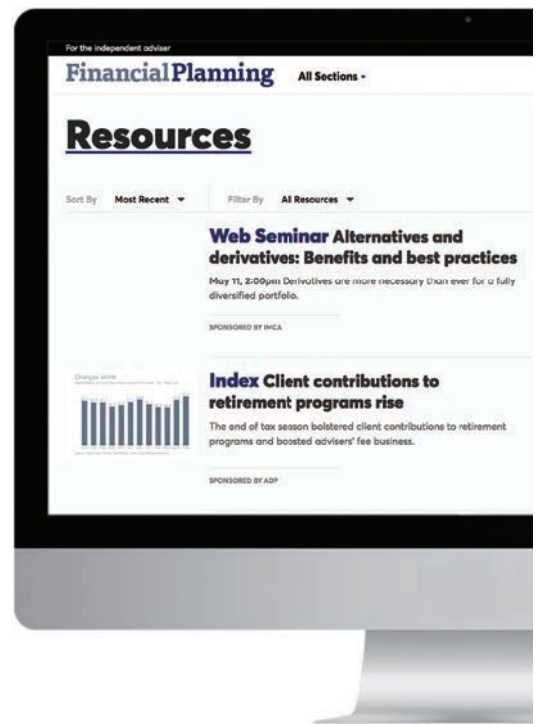
The index component tracking fees charged for retirement services continued to buoy the broad picture for wealth managers, gaining 0.7 points to 58.3. — *Harry Terris* **FP**




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INDUSTRY INSIGHT
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Bringing CPAs Into the Fold

What do they offer? Relationships with regulators, alternative fee structures and technical expertise are just part of the equation, Bob Veres says.

IN MY EARLY YEARS COVERING THE PLANNING industry, there was a common stereotype about accountants who also act as planners. It was thought that these CPAs were merely tax practitioners who had been badgered by their clients into learning a little bit more about investments.

That time has long since passed. It's about time planners start recognizing their close cousins in the CPA profession. Advisors would stand to gain much from bringing them into the fold.

In the CPA world today – and especially in the shadow of

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the new tax law – the key topics of discussion center on integrating technical expertise with sophisticated planning and tax-aware investment management. These are clearly top of mind for CFPs, too.

THE FORGOTTEN TRIBE

Why then do we hear so little about the CPA financial planning tribe in our profession? It's not because they lack numbers. The AICPA's Personal Financial Planning section now includes 11,500 members, up 12% over the past two years. While many of their members have a PFS credential – the accounting world's version of the CFP – many simultaneously hold the CFP designation, as well. And now, due to a recent outreach, the group has also accepted 350 non-CPA members to its ranks.

Rather, what seems to be holding back the PFP section is that even with those numbers, it remains a small subset of AICPA, which has over 400,000 members.

In addition, the AICPA community doesn't regard financial planning as a distinct profession. Instead, it is considered a specialty subset of CPA training, alongside tax planning, audit work, forensic and valuation services, information management consulting and nonprofit expertise. After all, to become a CPA/PFS, you first have to get the CPA, which usually means you've had at least one year of work experience involving accounting.

What would NAPFA, the Investments & Wealth Institute and FPA planners gain by including the CPAs in their discussions?

First, the AICPA has lobbying clout and significant relationships with regulators and members of Congress. The parent organization hasn't been asked to speak out on behalf of its PFP section members, but if it could be included in the grand coalition of planning professionals, lobbying efforts would be more effective.

Second, many CPAs are comfortable with

As the financial planning profession migrates toward a more professional fee structure, CPAs are the people most familiar with how that transition could look.

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what the mainstream calls alternative fee structures, which happen to be the fee structures that every other profession uses. You don't ask a doctor or lawyer what he charges, and get back the answer: "It depends on how much you have."

Yes, some CPAs charge via AUM, but to them it seems like a strange way to set your compensation, compared with the hourly or flat-fee models they're accustomed to for tax work and consulting services.

Overall, the CPA planning culture straddles the line between fee-only and dually registered. Although most CPA planners are compensated by fees, the community also includes a couple of very large broker-dealers that cater to CPAs: HD Vest Financial Services and 1st Global.

On the fee-only side, you run into advisors who charge hourly or by a retainer model, and many incorporate tax preparation and planning into their overall planning service offering.

As the financial planning profession migrates toward a more professional fee structure, CPAs are the people most familiar with how that transition could look. Also important: the fiduciary culture is already built into the CPA DNA, due to the ethical standards surrounding their audit work.

DEEPER LEVELS OF EDUCATION

Perhaps the most important argument for welcoming the CPA planning tribe into the mainstream is the technical expertise that it brings.

CPA planners are routinely exposed to deeper levels of technical education than you ever find in FPA or even NAPFA presentations, and IWI presentations tend to focus on the investment analytics, rather than how to set up a self-canceling installment note to freeze a wealthy client's estate, or how to recharacterize income under the new pass-through entity tax rules.

Sessions at the AICPA's annual Engage conference typically include presentations by tax and policy experts, including Bob Keebler, a CPA/PFS.

Keebler is famous in CPA circles for his simplifying flowcharts, his ability to recite entire tax code sections, explain loss limitations under various sections of the code and diagram the potential use of something called a NING Trust to reduce state taxes.

Advisors who believe that the planning profession has moved a bit too far in the direction of soft skills at the expense of professional expertise should sit in on a Keebler session. Or instead, they should listen to New York-based qualified plan expert Barry Picker discuss how to wring a few extra years of retirement income out of a client's portfolio using ultra sophisticated retirement distribution planning techniques.

NEW DANGERS

Of course, bringing more CPAs and CFPs together would create interesting new dangers to the existing professional organizations. Many advisors I talk with crave more technical updating and don't realize what resources the PFP section offers. Compared with the member benefits of some of the other organizations, the PFP section's menu seems rather generous.

The biggest danger seems to be to the CFP Board's hegemony over all things financial planning. But because you have to have tax training to get the CPA/PFS designation (rather than, say, a degree in English literature or journalism), you could make the case that the average PFS holder has a higher degree of educational training than is required to get the CFP.

Harmonizing the two designations would seem to be a logical solution, but the AICPA's insistence that financial planning is really a subset of the overall CPA profession, and the CFP Board's belief that its designation holds more mainstream credibility, have become sticking points in any negotiations.

My feeling is that the CFP Board can afford to give ground and accept PFS holders as CFPs, instantly raising its credibility (and numbers) without conceding what, exactly, financial planning is in relation to other professional groups.

FP

If the AICPA could be included in the grand coalition of planning professionals, our lobbying efforts would be more effective.



ELITE ADVISOR **BOWEN**

Becoming a Client's One and Only

Your clients should feel they couldn't live without you as their advisor. But that won't just happen — you need to make the case, John J. Bowen Jr. says.

WITH MORE THAN 400,000 ADVISORS seeking to work with affluent investors, it's become more important than ever to keep your clients happy so they always think about coming back to you — and never to the advisor down the road.

In short, you need to become indispensable. Your clients should feel that they couldn't live without you. But that won't just happen — you need to make the case.

The biggest benefits of being indispensable are that your client retention never dips much below 99%, and that you become hugely referable.

Think about making your 10 best clients so happy that they continually introduce you to new ideal prospects. Those referrals alone could supercharge your growth — and profits.

As I see it, there are two key factors to becoming indispensable among the affluent clients you most want to work with.

Relationship building: What steps are you taking to deepen the quality of the relationships with your best clients? Look at your current relationship-building model. Is it blueprinted? Can people on your team, other than you, deliver it to those clients? If not, you've got a big opportunity to improve.

Consider making someone in your prac-

tice a client relationship captain — a person who will take ownership of the responsibility to deepen client relationships and who will inspire your team to work together to truly "wow" your clients.

CHIEF RAINMAKER

The client relationship captain should be someone other than you so you can remain focused on building your business as the chief rainmaker.

Have your captain create a gap analysis and a 12-month project plan to address and

strengthen identified areas of weakness.

One great way to do that: Conduct an annual survey asking clients to rate your firm on investment satisfaction, service

satisfaction and overall satisfaction with the relationships they have with people at your firm. Your captain can use the survey information to create a gap analysis.

You can also leverage total client profiles across the firm. Make sure a profile of each client is easily accessible to everyone who interacts with clients so they pull up a client's information instantly whenever a call comes in.

The profile should include details about the client's personality and communication preferences — so that a client who is nervous

Think about making your 10 best clients so happy that they continually introduce you to new ideal prospects.

Video

Appoint someone in your practice to inspire your team to work together to truly "wow" your clients.
<http://bit.ly/2C1ZcBU>

about investing is not talked to in the same way as someone who enjoys taking risks and discussing the ups and downs of the market.

If you treat those two types of clients the same way, you are showing yourself to simply be a production machine – and not someone who is personalized, high-touch and indispensable.

One word of warning: A possible exception here is if you have clients who place extreme value on their privacy. Sharing their profile with your entire team could be seen as a breach of that trust.

Advanced planning: What are you doing to increase the value you bring to the table for your best clients? I have long stressed the idea that if your value proposition is based entirely on investment performance, you will take a severe hit at some point. It's not an "if," it's a "when." And it doesn't necessarily depend on a market correction. If another advisor is up 20% but your clients are up "only" 10%, you will hear from them.

You have to go beyond investments and offer something special that sets you apart. This is where the concepts of advanced planning and expert networks are so valuable.

It means offering services aimed at meeting clients' most important non-investment needs – from tax mitigation to wealth protection to estate transfer and charitable gifting – and doing so by using a network of outside experts, such as CPAs or private client attorneys, to help deliver those services.

KEY STRATEGIES

Managing those outside expert relationships is a crucial part of effective advanced planning, but it's an area where advisors often struggle. Just like with your clients, you want members of your professional network to essentially look at you in awe and say, "I can't live without him!" or "She's a vital part of our success!"

Here are two key advanced planning and expert relationship management strategies that have worked well with advisors that my firm, CEG Worldwide, has coached:

Share your client insights: When you

complete a client's total client profile, ask the client to sign a release allowing you to send a copy of it to his or her CPA or attorney. Let those professionals know that your goal is to help your mutual client address his or her financial life comprehensively.

This approach yields several benefits. For one, it shows the professionals that you have your clients' best interests in mind. And by sharing the client profile, you show yourself to be a team player – which helps alleviate a common fear among CPAs and attorneys that they will lose control of the client relationship if they share their clients with advisors.

Finally, this openness sets the stage for a stream of referrals as you develop closer relationships with these professionals.

Hold unique, nonfinancial client events: It's a win anytime you can demonstrate to another professional the amazing client experience you offer.

To really stand out, some top financial advisors have begun holding client events that focus on such issues as happiness in life and other nonfinancial matters, to which they invite their expert team members.

These advisors report that the outside experts walk away amazed at the extra mile that the advisors go to help their clients and bring unique value to their lives.

You have to capture the results of the advanced planning you do for your clients. It's easy for people to forget what you do for them, so make sure you have the tools needed to remind them.

Create a document that details the steps you will take to improve each client's financial life. Every time you complete a task, highlight it. At your regular client progress meetings, present the document so the client can see all of the action items you have taken since you last met.

This will not only deepen your clients' trust in you and increase their loyalty, it will motivate them to take even more action because of the value you bring to their lives, and they'll want more of it. At that point, you will truly have become indispensable. **FP**

Create a document that details the steps you will take to improve each client's financial life. Every time you complete a task, highlight it.

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AB National Portfolio (ALTVX)

Rated Against 258 Muni National Interm Funds



AB Income Fund (ACGYX)

Rated Against 847 Intermediate-Term Bond Funds



AB Global Bond Fund (ANAYX)

Rated Against 271 World Bond Funds



AB High Income Fund (AGDYX)

Rated Against 609 High Yield Bond Funds



AB Large Cap Growth Fund (APGYX)

Rated Against 1,216 Large Growth Funds



AB Sustainable Global Thematic Fund (ATEYX)

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For each fund with at least a three-year history, Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.) The Overall Morningstar Rating for a fund is derived from a weighted average of

the performance figures associated with its three-, five- and ten-year (if applicable) Morningstar Rating metrics.

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AB Intermediate Diversified Municipal Portfolio was rated 5 stars among 172, 152 and 94 funds in the category for the three-, five- and 10-year periods, respectively.

AB High Income Municipal Portfolio was rated 4 stars against 150 and 119 funds in the category, for the three- and five-year periods respectively.

AB National Portfolio was rated 5 stars against 258, 226 and 155 funds in the category for the three-, five- and 10-year periods, respectively.

AB Global Bond Fund was rated 4 stars against 271, 243 and 136 funds in the category for the three-, five- and 10-year periods, respectively.

AB High Income Fund was rated 4 stars against 609 and 501 funds in the category, for the three- and five-year periods, respectively.

AB Income Fund was rated 5 stars against 847, 778 and 554 funds in the category for the three-, five- and 10-year periods, respectively.

AB Large Cap Growth Fund was rated 5 stars against 1,216, 1,109 and 787 funds in the category for the three-, five- and 10-year periods, respectively.

AB Sustainable Global Thematic Fund was rated 5 and 4 stars against 720 and 589 funds in the category for the three- and five-year periods, respectively.

AB All Market Income Fund was rated 5 stars against 435 funds in the category for the three-year period.

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CLIENT MANAGEMENT **BOOMER**

Benefits of a Stock Plummet

The past nine years have been an easy time for financial planners. But with recent turbulence, some among us may feel exposed, Allan Boomer says.

FIFTEEN YEARS AGO, I WAS A FIRST- year associate at Goldman Sachs. Like most new advisors, I was preoccupied with searching for new clients. My manager, Josephine Linden, had a single requirement of every financial advisor in the office: Any day the Dow dropped more than 200 points, we were required to call every client in our book. There were a few trading days in early February when the markets were fluctuating wildly that certainly gave advisors plenty of opportunities to call our clients.

Before the days of managed accounts, advisors had to dial clients for every trade. This type of connection is now the horse-and- buggy of our industry. Moreover, a 200-point drop in those days constituted a much

bigger percentage decline, which made it less common. Still, there were benefits to these calls. A traditional brokerage relationship requires constant communication with your clients. In those days, it was not uncommon to reach out to certain clients daily with an update on the day's research reports.

Fast forward to today.

Many advisors have managed accounts and TAMPs where the trades are being handled by third-party managers. There are also discretionary accounts where there is no need to confirm trades constantly. While this business model is more efficient, it becomes easy to turn your back on some clients.

Not only has our business model become low-touch, we have also had extremely calm

and serene financial markets. U.S. equities delivered positive returns in every month of 2017, a feat which has not happened since 1958. We have not experienced material volatility since the "flash crash" of 2010.

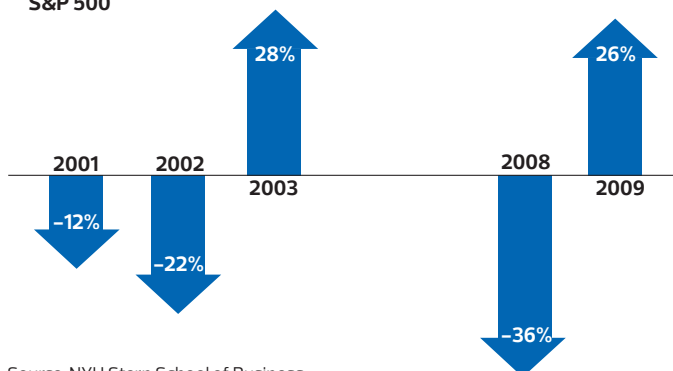
Had you relied on my Goldman manager's advice, you may not have called some of your clients in over a year. Until now. We

Clients know what they are supposed to do, but will they actually do it? Many admire Warren Buffett, but few have his stomach for risk.

Talking Points

Keep communication open during downturns.

S&P 500



Source: NYU Stern School of Business



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Jeff Kitchen, AAMS®
Financial Advisor
Philadelphia

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experienced a swift market correction just before press time when the Dow posted its largest one-day point decline in history. What a great time to call clients.

Robo advisors promote the fact that they take emotions out of investing. But are their clients devoid of emotions? I think not. Whether professional investor or layman, it is impossible to watch the 1,600-point intraday drop in the Dow and not feel something. Clients need reassurance. Some need hand holding. They know what they are supposed to do, but will they actually do it? Will they have the fortitude to stay the course? Many admire Warren Buffett, but few have his stomach for risk.

This is where competent and confident

client. The 200-point drop was no longer the focal point of the discussion; it was more like a reminder bell that prompted me to deepen my client relationships.

REASSURANCE AND COMFORT

Let's face it, no one wants to discuss gloom and doom all the time. Our clients care about much more than the daily fluctuations in the market, which in the long run will prove to be inconsequential. They want confirmation that they will be OK and their Social Security, pension or dividend check won't bounce.

There is one more benefit to a market correction that most seasoned advisors will appreciate: It's a great opportunity to land some new clients. Some advisors call it a

"wallet-share" opportunity, but I view it as a "mind-share" opportunity. Volatility creates uncertainty and fear in clients and prospects. This is a great time to reach out to the prospect who got away, especially someone who was satisfied with a current advisor simply because the performance was positive.

Let's not kid ourselves: In a stock market

that has gone straight up since March 9, 2009, it has been one of the easiest times in history to be a financial planner. However, with some financial turbulence, some of the less market savvy among us may find themselves exposed. And their clients will begin to ask around.

What will they be looking for? An advisor who communicates with their clients on a regular basis. Someone who is reassuring and calming on the 1,600-point down day or the inevitable 3,000-point down day. Someone who has a track record of building portfolios that can successfully weather the storm.

What won't they be looking for? I suspect it won't be a robot. **FP**

Not only has our business model become low touch, we've also had very calm markets (until recently). U.S. equities delivered positive returns in every month of 2017, which hadn't happened since 1958.



BLOOMBERG NEWS

advisors shine. We provide that needed gut check, that reassurance that comes from knowing the client's most intimate personal details. Clients look to us not just to be a steady hand on the portfolio, but also a therapist and voice of reason. Our job is to refocus them on the things that matter most — their families, their charities and their goals.

What did those early 200-point down-day phone calls sound like? At first, they were nervous recitations of facts and data points designed to calm myself as well as the client. After some practice — in 2008 I had plenty of opportunity to make these calls — the Dow became an afterthought. It became a routine opportunity to check in with the

Allan Boomer is the managing partner and chief investment officer of Momentum Advisors in New York City. He co-hosts a weekly radio show on SiriusXM Ch. 126 which focuses on wealth building and entrepreneurship. Follow him on Twitter @MomentumAdvice.

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Banned, but Still in the Game

Critics say FINRA's practice of allowing non-attorneys to represent aggrieved investors makes their problems worse.

BY ANN MARSH

FEW ADVISORS MAY BE AWARE THAT BROKERS WHO have been banned – even some with criminal convictions – may represent aggrieved investors in FINRA's arbitration forum. None of these representatives are licensed to practice law, yet FINRA says it will decide whether to allow so-called non-attorney representatives to continue in this role.

The fact that FINRA has long permitted this practice points to "one of the essential problems with arbitration," says Amanda Werner, who is leading a campaign to end mandatory arbitration with the nonprofit advocacy group Public Justice in Washington D.C. "You don't have the traditional protections of the legal system. I think it definitely shows FINRA is not doing a good enough job."

FINRA, a self-regulator run by the firms it oversees, says its mission is "to protect America's investors." It closed a two-month comment period in December about the role that non-attorneys and their firms should take in its dispute-resolution forum.

A FINRA spokesman declined to comment on questions about brokers who represent investors in arbitration even though they have criminal records or have been banned

from the securities industry. He said the regulator looks forward to reviewing the comments submitted by the public.

While attorneys are subject to stringent ethical requirements, non-attorney representatives can operate more freely – for example, by cold-calling clients, a practice forbidden for attorneys.

SECOND CAREERS

Some ex-brokers with long disciplinary histories have built second careers taking cases at lower rates than lawyers charge. Although FINRA prohibits brokers who have been banned from the industry from representing investors, at least one continues to handle high caseloads, and others offer their services through proxies, according to a study by the Public Investors Arbitration Bar Association.

Non-attorneys "are a real and growing menace to investors in the FINRA arbitration forum," says Andrew Stoltmann, president of PIABA. These investors can be twice victimized, he says: After losing money at the hands of their investment advisor, they might pay fees for poor representation in cases where awards cannot be collected.

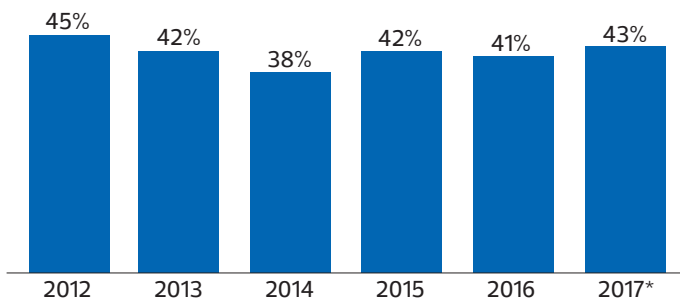
Non-attorney representatives should be banned from FINRA arbitration, the PIABA report contends. It was written by Stoltmann and an association board member, David Neuman, in response to FINRA's request for public input. Some critics contend PIABA is acting out of self-interest to widen the pool of clients for its own members.

"Anecdotal stories, emanating primarily from PIABA members about certain [non-attorney firms'] alleged misbehavior, [are] tiny compared to the extraordinary horror stories about attorneys taking people's money, making promises and then failing to perform," says Richard Sacks, founder of Investor's Recovery Service, a non-attorney firm in Novato, California, in comments published on FINRA's website.

Sacks was banned from the securities industry

Clients Usually Lose in Arbitration

They're awarded damages in only about 40% of FINRA cases that reach a decision.



Source: FINRA; data through Dec. 1

over 20 years ago, according to BrokerCheck, FINRA's tool for investors to check the backgrounds of brokers and advisors.

In at least half a dozen regulatory cases against him, Sacks was found to have overcharged clients, created a record of fictitious trades and breached client fiduciary duties.

After being fined thousands of dollars, Sacks wrote on one of the cases that the "sanctions [imposed on him] were exceptionally severe, unfair and totally inconsistent with other penalties."

When FINRA adopted a rule in 2007 preventing banned brokers from representing clients in arbitration, Sacks sued the SEC, which oversees FINRA, and prevailed in an appeal before the Ninth Circuit in San Francisco in 2011. This allowed him to continue representing investors in FINRA arbitration, partly because he had been doing so for years before the regulator adopted the ban.

In 1991 to 2014, Sacks filed more than 1,300 claims on behalf of investors with FINRA or its predecessor, the NASD, according to his letter published on FINRA's website. Sacks did not respond when asked for his firm's track record on those cases.

Sacks says the PIABA study is motivated by "attorneys looking to eliminate their competition, particularly in light of the extremely low number of customer complaints filed at FINRA over the past few years." In 2017, 3,137 arbitration cases were filed, compared with 3,681 cases for 2016, while 2009 had upward of 7,000, according to FINRA.

Stoltmann called Sacks' criticisms of the

PIABA study "nonsense."

Another founder of a non-attorney firm, Mitchell Markowitz of Stock Market Recovery Consultants, lost his insurance adjuster's license after pleading guilty in federal court in Newark, New Jersey, in a \$1 million insurance scam involving costume jewelry. He was sentenced to 180 days in jail followed by five years of probation, according to a 2004 report by New Jersey prosecutors.

The study found Markowitz's firm handled 61 FINRA arbitration cases from 2013 to 2016. That doesn't include settlements, which aren't entered into the public record. Some of the awards produced "disturbing" results in which arbitrators dismissed investors' claims, the study says. Markowitz didn't respond to requests for comment.

PROVIDING PROTECTION

The controversy about investor representation goes to the heart of ongoing questions about whether FINRA is truly protecting investors. Recently concerns have been raised about the deep industry ties of board members of FINRA, the regulator's practice of allowing brokers to wipe their public records clean of disciplinary histories and allegations that FINRA may have acted at the behest of JPMorgan Chase in retaliating against a whistleblower.

The fact that FINRA permits its firms to require that clients submit to private arbitration to resolve conflicts with brokers or their firms remains controversial. Binding arbitration prevents aggrieved investors from

taking their claims to court, where proceedings are open to public scrutiny and claimants are typically represented by attorneys.

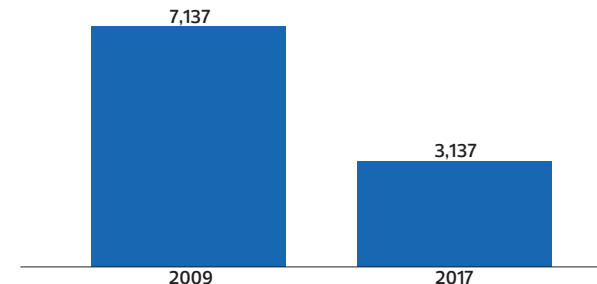
"There are no rules of professional conduct applicable to [these] firms' activities," FINRA's website says, noting that they are not subject to malpractice insurance requirements or licensing boards, and that no supervisory body polices their activities.

Clients for at least one non-

Non-attorney firms say they're being attacked because lawyers want to eliminate competition.

Drop in FINRA Arbitration Claims

Filings have declined by 56% since the Great Recession.



Source: FINRA

attorney firm went public in its defense. About 10 people identified as customers of Cold Spring Advisory Group in New York posted letters on FINRA's website.

Cold Spring is owned by Michelle Ottimo, the wife of a former broker, Louis Ottimo, who acts as a consultant to the firm even though FINRA barred him from the industry in 2015, the PIABA study says. Neither Michelle nor Louis Ottimo replied to requests for comment.

Donnie Pate, the 60-year-old founder of a used car and truck dealership in Tallahassee, Florida, wrote that Cold Spring did "a great job" on his case, even though he has yet to recover any money. Pate says he suffered losses of \$152,000 on an \$183,000 death benefit from his late wife's life insurance policy. He added that he paid his former broker \$91,000 in commissions and fees for managing the money.

"I was overjoyed when the award came down in our favor only to find out after 30 days [that his broker] filed for bankruptcy and we received nothing," Pate wrote in the letter.

'GOOD MONEY AFTER BAD'

"Mr. Pate's experience is not isolated," said Neuman, the PIABA board member.

"Cold Spring was involved in 27 arbitration awards, 19 of which were 'zero' awards for the client," Neuman said via email.

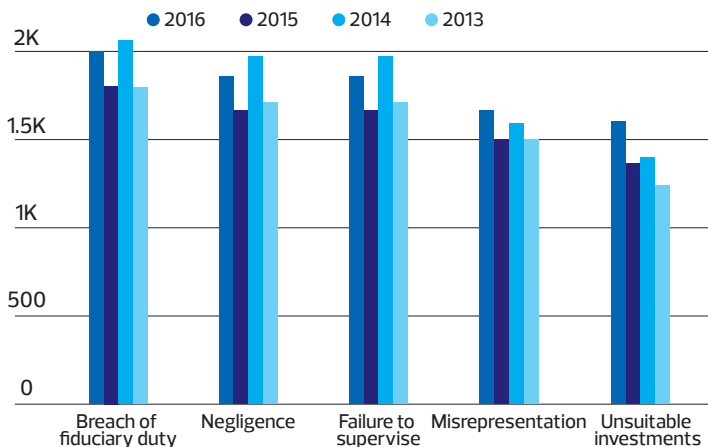
"In the eight cases in which Cold Spring 'won' something for the client, only one was successful against a brokerage firm that was still in business, and only one other award was against a broker who stayed in the securities industry," Neuman communicated. "Out of the other six awards, [they] were against brokers who left the industry or a defunct brokerage firm."

If Pate paid a large retainer upfront, "this is a big problem," he said. "For the investor, it's throwing good money after bad."

Pate did not respond to questions about his case. Jennifer Tarr, who handles arbitration cases for Cold Spring, did not disclose the amount of the retainer. She did say that

The Most Common Customer Claims

Breach of fiduciary duty remained the most frequent complaint in 2016.



Source: FINRA

"because of [Cold Spring's] continued support in the case, Mr. Pate is slated in the Chapter 13 to get back over \$65,000. If a broker files Chapter 13 bankruptcy, it is possible to recover for our clients."

Numerous commenters on FINRA's website noted that it's difficult to assess the role that non-attorney firms in FINRA play given that the regulator has not released statistics about their conduct.

One of the commenters, William A. Jacobson, director of the securities law clinic at Cornell University Law School, urged FINRA to do so, adding that attorney misconduct in arbitrations is also common.

"Without substantial evidence of the scope of inappropriate conduct by [non-attorney] firms, we believe that this policy ensuring that investors with small claims have representation warrants maintaining some use of [such] firms," he wrote.

If FINRA continues to allow them, Jacobson and others say, the regulator should consider adopting stricter rules, such as allowing people who are not attorneys to only take cases with less than \$100,000 in losses, to limit the magnitude of any harm. **FP**

Ann Marsh is a senior editor and the West Coast bureau chief of *Financial Planning*. Follow her on Twitter at @Ann_Marsh.

HIGH NET WORTH

Diving Deep for Exotic Data

UHNW clients may own unusual illiquid assets, and advisors without tools to provide accurate data risk losing those clients.

BY SULEMAN DIN

HOW DOES YOUR FIRM ACCOUNT FOR CLIENTS' submarines?

We're not talking here about assets that are figuratively underwater. Private Client Resources of Wilton, Connecticut, has a client who owns two actual submarines. The firm's challenge is to figure out how to value the vessels when reporting the client's total wealth.

And these aren't the only highly unusual, seemingly illiquid assets that the firm's platform is obligated to account for on behalf of its ultra-high-net-worth clients, says Robert Miller, CEO of Private Client Resources.

The firm was founded on 2000 by a group of private clients to deliver services to wealthy families. Since then, it has developed complex UHNW data aggregation and client reporting for wealthy families and their advisors.

Illiquid assets can make up 30% to 60% of an UHNW portfolio, according to Miller. "The pie chart looks very different compared to mass-affluent clients," he says.

AUTOMATED AGGREGATION

Such targeted, automated aggregation isn't easy to achieve, though. Through client authorizations, the platform stitches together information from over 2,000 managers, Miller says, and puts the data through a conversion, verification and reconciliation process.

This results in tens of thousands of mailed documents, PDFs and emails for Miller's firm, which is continually automating how it gathers information. Still, with the daily posting of transactions and changes in values in illiquid assets, the platform replicates and speeds up the work done in the past by costly, specialized research teams.

The platform's unique aggregation abilities have earned it a steady stream of clients. With over \$200 billion in assets for 2,000 families now being aggregated through the platform, Private Client Resources' clients span from the single ultra-high-net-worth family, to RIAs with sizable UHNW assets, to private banks.



Though a proliferation of wealth-technology tools exist, many advisors are still not equipped to handle the distinctive demands of clients who cross the UHNW threshold, Miller says. What follows are highlights of a lengthy interview, which have been edited for length and clarity.

Financial Planning: What are UHNW clients now asking for in terms of data insights?

Miller: Every morning, regardless of the asset class, transactionally they have 99.9% accurate data, whether it's tax planning, estate planning, how they are thinking about a business liquidity event, how they are thinking about risk and exposure.

These were all special projects before that we had to figure out how to gather and normalize.

Now that's served up every day, and they are free to more aggressively look at risk and investment opportunities. Remember, they are different than other investors in that they're not driven by returns like the rest of the world. They're driven by cash flow and balance sheets, their ability to be philanthropic and planning for what money they are going to leave for their children.

We have two submarines on our system. It matters to them. They care about this. Whatever the worth of the submarines is – that’s part of their total wealth. If they wanted to do something, they could sell one of their submarines. So having this information has freed them.

Maybe they have had someone doing their taxes, or a controller in their business monitoring some of their real estate investments. This tool gives them a hardened, institutionalized way to think about their data, and what tools can inform them and provide insight.

Financial Planning: Can technology help an advisor to attract and manage a UHNW client?

Miller: Many RIAs accidentally become UHNW advisors when a million-dollar client sells their business and makes \$50 million.

Most of them lose that client. They will not be the long-term advisor, because they are not specialized in the things that that client needs.

You won’t find many RIAs with a bunch of \$500,000 clients and one \$20 million client. Why? Because they’re not equipped to manage the requirements of that particular family and client. It’s not about returns, it’s not about balanced portfolios. It’s the whole strategy that has to be different.

Let’s say I’m a \$100 million guy, and I made all my money in real estate. My portfolio is probably 70% weighted in real estate. An advisor might say: that’s too heavily weighted in real estate; you need to have more of this; you need some of that. But the client’s exactly where he wants to be because that’s how he creates wealth. Traditional advisors don’t understand that; they’re using cookie-cutter management of portfolio construction rules.

Second, the family becomes the client; 30% of our clients are more than three gen-

erations. You’re going to have to adjust for the millennial shift – a whole generation getting access to wealth they didn’t earn. All the family angst about protecting that wealth, how to educate their children about how to sustain that wealth and sustain philanthropic activities – these are things that traditional advisors are not trained to do.

So doing UHNW advisory, you have to do it on purpose. The systems are different. You probably have more business services-type bill payments. Your advisory teams around attorneys and accountants are different because there’s so many more transactions involved. Organizationally, emotionally, and from the standpoint of the demands of a family, it’s all different.



Bob Miller, CEO of PCR

Financial Planning:

Embracing technology to serve that emerging client segment then – is it a smart strategy, or are too many advisors following the herd?

Miller: I think there’s some going with the herd frankly. The notion that the next generation is more self-initiated makes a lot of sense in the lower wealth segments, particularly in marketable securities and 401(k)s. It doesn’t make sense, though,

in managing real estate investments, or seven-year, 10-year private equity investments. It’s a different problem. It’s important to understand the total wealth picture.

If it’s a mobile experience that someone can easily understand what changed from yesterday, last month or last quarter, that’s valuable. But I don’t know any of the principals in my families who are going to use their phones to move \$100 million around. Teams of people decide to do that.

I think advisors have the opportunity to use technology internally to do a better job for their families. But the families are not the consumer of the technology, unlike the lower wealth segments, where robo advice is targeting the actual wealth holder. **FP**

“You won’t find many RIAs with a bunch of \$500,000 clients and one \$20 million client,” says Private Client Resources CEO Bob Miller.



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BIG

Jana Shoulders and other financial advisors say tax planning is now essential to attracting and retaining high-net-worth clients.

Mariner Wealth Advisors' Jana Shoulders says client inquiries about tax planning ramped up before the tax bill became law in December 2017.

RETURN

BY CHARLES PAIKERT

As buzz about the Republican tax bill ratcheted up in December, so did the calls to Jana Shoulders' office at Mariner Wealth Advisors in Tulsa, Oklahoma.

"We started getting a lot of inquiries before the bill became law," says Shoulders, who was a CPA for 18 years before starting a financial advisory firm in 1995. "Clients wanted to know what they needed to do before the end of the year."

Soon after President Trump signed the bill, her team swung into action. Some wealthy clients who owned businesses, for example, needed to know if they could save on taxes by buying manufacturing equipment in 2017. Others needed advice on whether to pay state income tax by Dec. 31 if they weren't subject to the alternative minimum tax.

"Time was limited," Shoulders says, "but the decision clients had to make wouldn't be easy. We knew they needed appropriate education about the new law."

There's little doubt that the new tax law has turbocharged wealthy clients' interest in tax planning, especially as they begin to face the reality of the need to prepare their 2018 taxes differently.

SPECIAL REPORT: TAX PLANNING

"The law has definitely upped the ante," says John Napolitano, CEO of U.S. Wealth Management, who is a CFP and CPA. "It's been front and center on people's minds and is making it easier for wealth managers to sell the story that they can coordinate everything."

To be sure, the appeal to wealthy clients of having advisors able to help them manage their tax liabilities and strategies has been building for years.

While still an accountant, Shoulders said she kept hearing from clients who wanted advice beyond preparing tax returns.

"They said they wanted guidance to get from where they were now to where they wanted to be in the future," she says.

By 2012, Shoulders' firm, Adams Hall Wealth Advisors, had reached close to \$1.5 billion in AUM and was acquired by Mariner Wealth Advisors. Shoulders now works closely with Mariner's tax division, Mariner Consulting, and says tax planning continues to be integral to her work with wealthy clients.

Demand from clients also pushed another CPA convert, Sheryl Rowling, to switch jobs. She had worked as an accountant for 10 years before starting her own financial advisory firm, Row-

ling & Associates, in San Diego in 1987.

"My clients wanted me to handle their investments instead of referring it out," she says. "And I was frustrated that, when you're preparing tax returns, you're always looking in the rearview mirror. I always wanted to put more emphasis on year-end tax planning and look at the client's entire situation before giving advice."

Rowling incorporated tax planning and tax minimization into a holistic approach to financial advice, and also developed software to help advisors make their clients' portfolios more tax efficient when rebalancing.

'A DIFFERENTIATOR'

"This approach has definitely been a differentiator," says Rowling, who is also head of rebalancing solutions for Morningstar. "People hate paying taxes, and if we're going to add value to a client's life, we have to do more than put their assets into an allocator and fall asleep."

Shoulders and Rowling aren't alone. Incorporating and leveraging sophisticated tax planning is increasingly being utilized as an effective – if not essential – way to attract and retain HNW and UHNW clients.

"Tax planning has become less of a differentiator and more of a required offering for those serving clients with

complex financial lives," says Mark Tibergien, CEO of Pershing Advisor Solutions. "Many firms now utilize tax harvesting, but those who operate more holistically also look at a client's entire balance sheet and income statement to know how to optimize their wealth."

That philosophy has certainly been a guiding principle for AdvicePeriod, the Los Angeles-based RIA founded by Steve Lockshin in 2014.

Lockshin, a key player in the financial advisory industry who founded Fortigent, was chairman of Convergent Wealth Advisors and an early investor in Betterment, believes the commoditization of investment advice has opened a clear path for prioritizing tax and estate planning for wealthy clients.

"There really is no alpha left in asset management," Lockshin contends. "The investment returns for clients of all the advisory firms within a three-mile radius of my office won't be that different. But for clients with \$100 million, an effective estate plan is a very big deal."

If an advisor can eliminate millions of dollars in taxes and help clients avoid transfer tax on the growth, Lockshin maintains, the savings can't be equaled with investment returns. "What makes this type of planning so valuable," he argues, "is that the results are measurable and don't increase portfolio risk at all."

He cites the example of an AdvicePeriod client who recently sold a chain of retail stores and netted almost \$300 million. "The client will pay zero dollars in transfer taxes when they die because we did good planning before the sale," Lockshin says. "Compound that amount by another 40 years of life expectancy and we are talking amounts north of \$1 billion."

The company was recapitalized to restrict the value of the shares, Lockshin explains, "thereby reducing the

New Tax Rates

There are still seven brackets, but tax rates dropped. The highest rate was 39.6% and is now 37%.

Bracket	Individual	Filing jointly
10%:	\$0 to \$9,525	\$0 to \$19,050
12%	\$9,525 to \$38,700	\$19,050 to \$77,400
22%	\$38,700 to \$82,500	\$77,400 to \$165,000
24%	\$82,500 to \$157,500	\$165,000 to \$315,000
32%	\$157,500 to \$200,000	\$315,000 to \$400,000
35%	\$200,000 to \$500,000	\$400,000 to \$600,000
37%	\$500,000 and above	\$600,000 and above

Source: Tax Cuts and Jobs Act of 2017

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amount that needed to be transferred. By utilizing the family's exemption and some intrafamily sales, we pushed all of the value into generation-skipping trusts and left the tax liability with the parents, thereby preserving the family legacy rather than losing much of it to taxes."

Sophisticated tax planning is also deeply embedded in the DNA of Wescott Financial Advisory Group, founded by Grant Rawdin in 1987 as an outgrowth of his tax law practice at the Philadelphia law firm of Duane Morris.

"People have had a recognition that tax planning can be proactive, while tax preparation is reactive," Rawdin says. "The value we provide is offering a different way for clients with complex wealth to arrange their affairs more effectively using a tax perspective."

To achieve that, Wescott has a so-called tax alpha group that provides clients with tax minimization strategies and their own annual tax scorecard. The group uses what Wescott advisor and CPA Bob Waskiewicz calls a "tax mining" approach to clients' documents to ferret out relevant information that can be used to reduce their taxes.

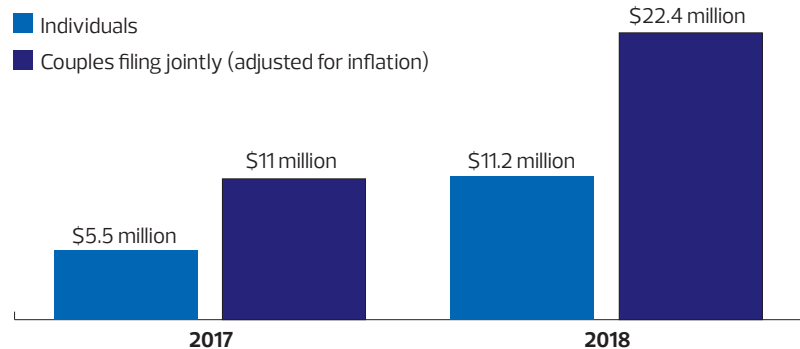
After the tax bill became law, the tax alpha group gave each Wescott client a checklist and flowchart detailing how provisions in the new law impacted them, for better and worse.

Indeed, high- and ultrahigh-net-worth clients across the country were anxious to find out "the impact the new law had on them and the next steps they should take," says Greg Sullivan, president and CEO of Sullivan Bruyette Seros & Blayney, a \$3.5 billion RIA based in McLean, Virginia.

Wealthy clients are particularly interested in the exclusion threshold for the estate tax exemption, which was raised to \$11.2 million per person and \$22.4 million per couple, Sullivan says. But, he notes, it's important to

Estate Tax Slashed

The federal tax exemption for estates, gifts and generation-skipping transfers doubled.



Source: Tax Cuts and Jobs Act of 2017

remind clients that the doubling provision expires in 2026.

The tax law has also drawn inquiries from owners of pass-through entities such as S corps and LLCs, Waskiewicz says. Changes in the corporate tax rate mean pass-through owners may not be able to deduct as much income as in the past, Waskiewicz says. As a result, they may want to re-examine their corporate structure.

AMT CHANGES

High-net-worth clients and business owners also kept a close eye on changes to the unpopular alternative minimum tax, which was rescinded for corporations and will apply to fewer individuals as a result of a raised threshold.

But the new law also brought bad news for HNW homeowners in high-tax states such as New York, New Jersey, California and Illinois who were accustomed to deducting five-figure property taxes.

Thanks to the new tax legislation, deductions for state and local taxes, including property, income and sales tax, are now limited to \$10,000.

Clients impacted by the change who were considering moving to a low-tax state may want to pull the trigger,

says Bill Morgan, a CPA who started a wealth management firm in Wyomissing, Pennsylvania, in 2005. The firm was acquired by Buckingham Strategic Wealth in 2016.

"Retirees in high-tax states may want to buy a place in a state like Florida for their primary residence," Morgan says, "and either rent or buy a smaller condo up north for a second residence."

And for HNW clients who had to pay the AMT, the loss of the state and local tax deductions "may not be quite as bad as first appears," Morgan says. Those clients weren't able to use the property tax deductions for the AMT anyway, he notes, and a higher AMT exemption and smaller SALT adjustment means they are less likely to be subject to the AMT in 2018.

"There's a lot of misinformation out there," Morgan says. "But, as a wealth advisor, you're not working on the clock, which can restrict the conversation. You can have a deeper relationship with the client than as an accountant. And it's way more enjoyable."

In order to make the tax planning part of their business work, advisors have taken a variety of practice management approaches.

Some, like Wescott, include tax

planning services in their core wealth management planning fee, which may be billed as a percentage of AUM or as a retainer, or both. Wescott does not prepare taxes for high-net-worth clients, but the firm works closely with its accountants and CPA firms.

Buckingham, one of the country's larger RIAs with nearly \$9 billion in assets, also includes comprehensive tax planning in its percentage of AUM fee. One Buckingham advisor with a master's degree in taxation says studying the subject appealed to him because it required more critical thinking than accounting.

"Strategic tax planning is more like a puzzle," says Elliot Dole, who works in Buckingham's St. Louis headquarters and is also a CFP. "It's endlessly complex and the law is always changing. You're looking at the client's

cial, tax and estate planning based on service provided and complexity, Lockshin says.

Clients with less than \$10 million in assets "who are in the accumulation phase" aren't required to pay a flat fee, Lockshin says. But for wealthier clients, including tax planning as part of a percentage of AUM fee is "a bit of a red herring," he contends.

"Charging for asset management is charging for a commodity and giving away a premium," Lockshin argues. "We want to charge for value and charge much less for a commodity."

As for Shoulders and Rowling, both advisors include tax planning in their inclusive percentage of AUM fee (Shoulders also has some clients on a flat fee retainer), and also have a separate division where clients can have their returns done for a fee.

informal relationship with."

Buckingham also works closely with outside accounting firms, and some of their branches even share office space with CPA firms.

"We try to make their lives as easy as possible and make them part of the team," Morgan says. "If a CPA is in a planning meeting, the client pays the CPA separately."

Buckingham doesn't ask an outside accounting firm for remuneration when it refers clients, Morgan says, but will pay a solicitor fee to registered CPAs who refer planning business to the firm.

TARGETING NICHE MARKETS

Sophisticated tax planning is also used to target niche HNW markets, such as professional athletes. Athletes with high incomes are extremely concerned about paying state taxes, says K. Sean Packard, tax director for OFS in McLean, Virginia. OFS works with athletes to determine if they are required to pay taxes to the state their team is based in, Packard says, even if they have residency somewhere else.

And the new tax law excludes a deduction for business earnings based on an owner's reputation — exactly the kind of income many active and retired professional athletes rely on.

"As a result, we're looking for opportunities to have business income for our clients that are not solely based on their reputation," he says, "but businesses where they can take advantage of the law."

He adds, "It's a good example of the different type of tax planning that advisors can provide, beyond what clients have to file with the IRS." **FP**

"TAX PLANNING HAS BECOME ... MORE OF A REQUIRED OFFERING FOR THOSE SERVING CLIENTS WITH COMPLEX FINANCIAL LIVES." — MARK TIBERGIEN, CEO, PERSHING ADVISOR SOLUTIONS

entire picture and trying to see where they will be in 30 years instead of just saving taxes this year."

Other firms, like Sullivan Bruyette, have a separate tax division that prepares tax returns for clients and charges for that service.

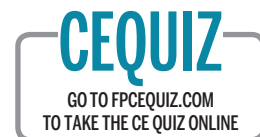
Sullivan's advisors who do tax planning — including estate planning, portfolio strategy and advice on charitable giving — work closely with the tax services division, says Sullivan, who is both a CFP and a CPA. Tax planning is included in the overall financial planning fee, he adds, which may be a percentage of AUM, hourly or flat.

AdvicePeriod charges around 80% of its HNW clients — and nearly all its UHNW clients — a fixed fee for finan-

"We encourage collaboration with Mariner Consulting," Shoulders says. "We found that a joint effort is a more enhanced experience for the client."

For advisory firms without an in-house tax prep division, deciding exactly how — or if — to collaborate with outside CPA firms is an ongoing issue. Some firms have revenue-sharing arrangements with accounting firms, but Napolitano thinks that's a bad idea.

"It sounds good in theory, but revenue sharing can result in tension over the question of 'Whose client is it?'" Napolitano says. "There's usually a fiefdom mentality. We want to be the head coach and assume fiduciary responsibility for the client. It took us three years to find CPA firms we could have a good



Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.

Tax Law's Impact on Roth IRAs

The new legislation will affect how advisors help clients manage conversions. Here are some pros and cons to consider.

BY ED SLOTT



BLOOMBERG NEWS

THE NEW TAX LAW MAY AFFECT THE WAY THAT YOU and your clients evaluate the pros and cons of Roth conversions. Among the biggest changes: Conversions cannot be undone this year. Lawmakers repealed Roth recharacterizations, which previously enabled conversions to be reversed.

The discussion around Roth conversions will immediately need to change. Clients will require more advice, and their advisors will need to conduct more careful analysis before making any recommendations.

Here's how some of the benefits and drawbacks of Roth conversions have changed under the new tax law.

THE UPFRONT TAX BILL IS LOWER

Roth conversions have long been seen as beneficial for clients, primarily because they create retirement accounts that are free from future income taxes.

That said, they're not entirely without costs. The tax bill

has to be paid upfront, after all, and that is the No. 1 stumbling block for most people. There's no such thing as a free tax ride with IRAs.

However, now that income tax rates are lower, Roth conversions are more attractive. This is because it may now cost less for clients to convert their funds.

The standard deduction has been doubled, and many other deductions were eliminated or rolled back.

As a result, many more clients will now be taking the standard deduction. The combination of the higher standard deduction and lower rates may make Roth conversions less taxing for clients.

Look specifically at clients who may not be using the full effect of the standard deduction. For example, a married couple can go up to \$165,000 of taxable income before they leave the 22% tax bracket in 2018. And the 12% bracket covers income up to \$77,400.

Clients who are still wary of the upfront tax bill could also consider beginning an annual series of smaller Roth conversions over the next 10 years or so, to lessen the tax impact each year.

Overall, I believe we have hit rock bottom for tax rates, making today's Roth conversions even more valuable for clients in retirement.

Here are some of the other tax-plan-related pros you can discuss with your clients:

FREE OF ESTATE TAXES

In addition to offering tax-free income in retirement, Roth IRAs will also be free of estate taxes for most clients now that the new law increased estate tax exemptions to \$11.2 million per person and \$22.4 million per couple.

This means clients will be able to pass more funds on to their beneficiaries tax-free.

But note: These increases may be temporary. After 2025, the law brings these amounts back to pre-2018 levels, which are half of the 2018 amounts.

CLIENTS CAN GIFT MORE, TOO

The annual gift exclusion for 2018 is \$15,000 per person, per year. This amount can be gifted to anyone without cutting into the lifetime exemption. But because the new tax law has

2018 Trust Tax Rates

These will now apply for the kiddie tax

10%	\$0 to \$2,550
24%	\$2,551 to \$9,150
35%	\$9,151 to \$12,500
37%	\$12,501+

Children affected:

Children under age 18 (or under age 24 for full-time students)

Beginning in 2018, a child's unearned income will be taxed at trust tax rates, rather than at the parents' tax rate.

Source: Tax Cuts and Jobs Act

are nowhere near those eye-popping eight-figure amounts.

For Roth conversions, this makes it easier to gift funds to family members to pay the tax on Roth conversions, or to make Roth IRA contributions without worrying about any gift limits. This can help younger family members to begin building Roth IRAs.

It can also help the other way. For example, a high-income client can gift money to her 75-year-old father to help him pay the taxes on converting his IRA to a Roth (after taking the RMD, which cannot be converted) and

GOOD FOR THE GRANDKIDS

Lawmakers not only raised the bar for estate taxes, they also raised it for generation-skipping transfer taxes, freeing the way for more Roth IRA funds to be passed tax-free to grandchildren. As with the estate tax, the GST tax exemption is now \$11.2 million for individuals and \$22.4 million for couples.

One word of caution here, however: Clients with large estates should be aware that the GST tax exemption is not portable, as the estate tax exemption is.

If the full GST exemption is not used, it could be lost. Look at conversions to leave Roth IRAs to grandchildren, and take advantage of the new increased GST exemption.

REDUCING KIDDIE TAXES

Roth conversions are now more valuable for clients who may be subject to the new so-called kiddie tax rules, which apply to children under age 18 and full-time college students under age 24.

Under the new tax law, children will now have their unearned income (such as interest and dividends – not wages) taxed at trust tax rates instead

CLIENTS SHOULD PROBABLY HOLD OFF ON CONVERSIONS UNTIL LATER IN THE YEAR WHEN THEY WILL HAVE A MORE PRECISE ESTIMATE OF THEIR 2018 INCOME AND THEIR TAX BURDEN.

increased the lifetime gift tax exemption to \$11.2 million (or \$22.4 million per couple), the limiting of gifts to only \$15,000 per person is irrelevant to most clients.

Gifts far in excess of the \$15,000 annual exclusion amount won't be an issue for clients with estates that

later leave the Roth IRA to her.

This way, RMDs are eliminated for the rest of Dad's life, allowing the Roth to grow uneroded by taxes. And Dad will be able to pass the Roth IRA on to your higher-bracket client, income-tax free, keeping that income off future years' tax returns.

of at the parents' rate.

The 2018 top trust rate of 37% applies when taxable income exceeds just \$12,500. There is no change if the parents are already at the top tax rate, but if the parents are not at the top rate, the child's unearned income can quickly become taxable at higher rates than the parents' own income.

This could affect, say, a grandchild who inherits a large IRA held by a trust. The RMDs are unearned income and could trigger the kiddie tax.

A Roth conversion now could eliminate the trust tax on those RMDs when the children inherit, because Roth IRA RMDs will be tax-free, even if they are held in the trust.

Also, excluding that RMD income could keep the child's other unearned income from reaching the top rates.

In addition to the new kiddie tax benefit, Roth conversions have always been a good strategy to eliminate trust taxes for any beneficiary when a trust is named as the IRA beneficiary.

Now let's take a look at some of the potential drawbacks for Roth conversions under the new tax plan.

CAN'T BE UNDONE

As mentioned earlier, federal lawmakers did away with a key provision that previously allowed Roth conversions to be reversed.

Given that new limitation, clients should probably hold off on conversions until later in the year, when they will have a more precise estimate of their 2018 income and their tax burden. This will involve coordination with the client's CPA or other tax advisors.

Unless the client is sure about having the funds to pay the conversion tax, I suggest not doing a Roth conversion until after Thanksgiving.

But conversions should be done before Dec. 15, because after that the

financial institutions that have to process these conversions will be swamped with end-of-year transactions. Last year some of the biggest custodians cut off year-end transactions as early as Dec. 21.

THE STOCK MARKET FACTOR

A strong stock market could complicate the timing of a Roth conversion in 2018. Some clients may be worried about converting their funds if values are high, without the ability to undo the conversion.

OVERALL, I BELIEVE WE HAVE HIT ROCK BOTTOM FOR TAX RATES, MAKING TODAY'S ROTH CONVERSIONS EVEN MORE VALUABLE FOR CLIENTS IN RETIREMENT.

This is something advisors must address with clients. Be sure to document those conversations.

Advisors also need to remind clients that retirement is a long-term plan, and the value of tax-free compounding also has to be factored into the equation.

INCOME INCREASE

Although tax rates are lower now, Roth IRA conversions nevertheless increase income in the year when they occur, possibly resulting in a one-time tax hit.

Roth conversions are not subject to the 3.8% net investment income tax, but adding the conversion to a client's income could trigger the tax on other income subject to the 3.8% tax, for the year of the conversion. Again, be sure to remind clients to look more at the long-term tax benefits.

TRUST IN GOVERNMENT?

The No. 1 question consumers ask me at every program I hold is, "Can I trust

the government?"

They want to know that, if they pay the tax upfront, the government will keep its promise and never tax these funds again.

Anything can happen when Congress gets hungry for revenue, but my answer now is, "Yes, the tax-free Roth IRA is here to stay."

Why am I so sure? It brings in money for Uncle Sam. Over the years, Congress has expanded the use of Roth IRAs as a revenue raiser to pay for other parts of the tax bills.

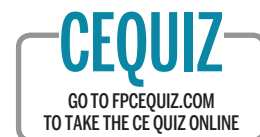
That's why, in 2010, Congress removed the income limitation and filing status restrictions for converting to Roths. This opened the floodgates for the largest Roth conversions, and it brought in a fortune of tax revenue.

In their latest negotiations, lawmakers tipped their hand by proposing to increase revenue by reducing maximum deductible contributions to 401(k)s while pushing savers toward nondeductible Roth 401(k)s.

So-called Rothification has yet to become reality, but it will probably be proposed again as Congress looks at any and all immediate revenue sources.

The big message is that the new tax law affects all your clients. You can be instrumental in providing the planning advice to help them maximize the benefits.

FP



Ed Slott, a CPA in Rockville Centre, New York, is a *Financial Planning* contributing writer and an IRA distribution expert, professional speaker and author of several books on IRAs. Follow him on Twitter at @theslottreport.



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PRACTICE

ALSO IN PRACTICE: P. 46: Meet the New Form ADV | P. 48: Flourishing in Paradise

A Slow-Footed Race to Texting

Compliance and technology hurdles have snarled firms' efforts to find a way to reach out to clients on their smartphones.

BY TOBIAS SALINGER

INDEPENDENT BROKER-DEALERS ARE SLOWLY BUT surely resolving a longtime gripe among financial advisors and their clients: sending text messages.

Firms largely ban texting, even for logistical purposes, amid guidance from FINRA that all business communications must be "retained, retrievable and supervised."

In mid-January, Securities America became the first of the top 10 largest IBDs to announce a program allowing its advisors to text clients.

The launch of the firm's app occurred shortly after Merrill Lynch unveiled its software allowing for texts. Morgan Stanley and Edward Jones have also added the capability.

More than 75% of Americans own smartphones and 97% of smartphone owners send texts, according to the Pew Research Center, so firms are playing catch-up.

Cambridge Investment Research and Commonwealth Financial Network are working on texting tools of their own, but vendors say the messages pose difficult compliance and technology issues.

BEING COMPLIANT

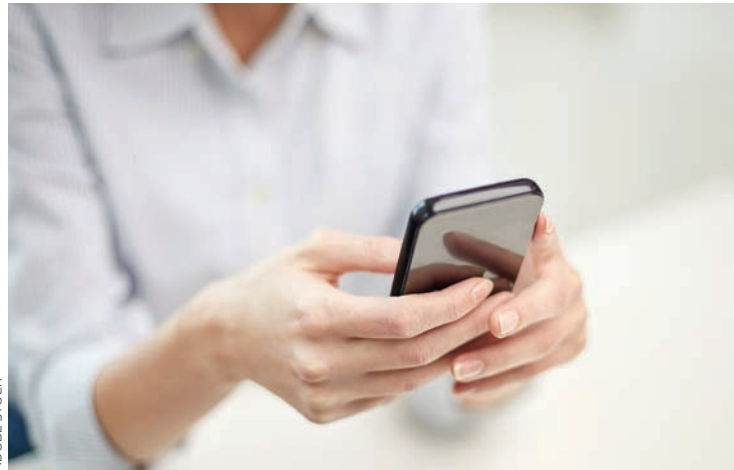
Securities America developed its texting app over the past two years with CellTrust, the same firm that Merrill Lynch worked with.

"The reason it took us a couple of years is just to be able to be compliant with those regulations," according to Greg Smith, Securities America's senior vice president for supervision. "There just wasn't a solution out there for the independent channel."

The firm has told its 2,200 advisors that they still can't discuss securities trades via text since "safety and security of data are paramount," Smith adds.

Advisors can download the app, CellTrust SL2, on any device and set up automated messages in addition to the everyday chatting and meeting arrangements.

Telling clients to "take it to email" when they try to send a simple text about the next visit to the office usually doesn't



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sit well with them, says Joe Heider, a Royal Alliance Associates advisor and the president of Cleveland-based Cirrus Wealth Management.

The difficulty displays "how far regulations are falling behind technology," he says, noting that phone calls involving such discussions aren't recorded and archived.

Allowing advisors to exchange texts with clients would make their jobs easier, adds Sarah Carlson, an LPL Financial advisor and the founder of Fulcrum Financial Group in Spokane, Washington.

"Texting is how moms talk to their kids and colleagues update each other," she said in a text message. "It's communication of convenience without any big login."

Firms have "increasingly raised new questions" with FINRA about text messages and social media, according to April 2017 guidance from the regulator. Earlier regulatory notices dating as far back as 2010 warned members that FINRA's record-keeping requirements apply to texts about "business as such."

Member firms must train advisors and other staff members about what constitutes business communication. As a

result of the complexity involved with the undertaking, Securities America found only four or five vendors that could even offer client texting software, Smith says.

CellTrust counts 78 financial services companies worldwide as its texting clients.

Another firm, Redtail Technology, launched a text program in its client relationship management system in October and has dozens of offices in the “early adoption phase,” according to David Mehlhorn, its director of sales.

Most IBDs appear to be way behind that stage, however. Out of the nine other top 10 IBDs in terms of revenue, only AXA Advisors, Cambridge and Commonwealth provided immediate responses to inquiries about whether the firms have client texting software in operation.

A Commonwealth spokeswoman, Jacquelyn Marchand, said in an email, “We have an advisor-client texting program in development that will be available from within the existing Commonwealth mobile app alongside our current WhatsApp-style secured messaging functionality.”

The software, she adds, will integrate into the firm’s CRM “so advisors can see all communications with a client in one location.”

CONSIDERING OPTIONS

Cambridge executives, alongside the firm’s New Century Council for advisors, are considering several options around text messages and other digital communication, says spokeswoman Cindy Schaus.

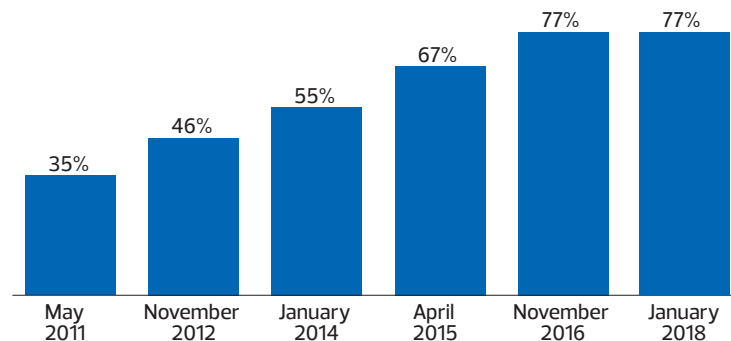
“We recognize the rapid pace of innovation and integration across digital communications and providers, and our intent over the short term is to be mindful of future needs while selecting the best solution and tools for independent advisors to use with their clients,” Schaus said in an email.

AXA is always looking at new tools to make connecting with clients easier, according to a spokeswoman.

Firms’ inability to put texting software in place stems from the technical difficulties of providing it, according to CellTrust’s chief

How Many U.S. Adults Own a Smartphone?

The percentage has more than doubled since 2011.



Source: Pew Research Center

executive, Sean Moshir.

“It requires a lot of telecommunication infrastructure,” he said in an email, noting “highly scalable enterprise back-end services,” regulatory expertise and archiving capabilities as among the necessary components. “Many organizations are not even aware such technology exists.”

Another difficulty involves advisors, “recognizing and accepting that, at this time, texting on the advisor end cannot be carried out from their native texting app,” says Mehlhorn at Redtail.

The firm therefore designed its texting software with an eye toward making it as easy as normal texting, he wrote in an email.

A NEW DIRECTION

Robo advisors who have begun offering text-only advisors present a potential new direction for IBDs, once they do set up client texting for their advisors.

The firms could use such technology to court less affluent and younger clients, Mehlhorn says, noting that Redtail’s product allows for text-only advice.

“The applications for texting clients and prospects are massive,” Mehlhorn says. “Text messaging is not only more effective in getting the quickest responses, but it is also far less disruptive than trying to get a client on the phone.”

FP

Telling clients to “take it to email” when they try to send a simple text about the next visit to the office usually doesn’t sit well with them, says Joe Heider, of Cirrus Wealth Management.

Tobias Salinger is an associate editor of *Financial Planning*. Follow him on Twitter at @TobySalFP.

Meet the New Form ADV

Some guidance is in order to ensure that handling the revised SEC document for the first time goes smoothly.

BY CHARLES PAIKERT

IF YOU HAVEN'T ENCOUNTERED THE NEW FORM ADV yet, be prepared to make its acquaintance soon. To assure the meeting doesn't become contentious, some guidance may be in order.

Two years in the making, the revised Part 1A of the SEC form, introduced last October, represents a "significant overhaul" of its predecessor, says Jamie Nash, partner for the New York law firm Kleinberg, Kaplan, Wolff & Cohen. Many RIAs whose fiscal year ended in December will be using the new form for the first time when they file, as required, before March 31 this year. Review priorities for advisors include:

Counting clients and assets: On Item 5.D of the revised SEC form, advisors must show the number of clients in each category, as well as the amount of AUM for each category, not percentages. Categories include high-net-worth individuals, banks, investment companies, business development companies and pooled investment vehicles.

"I think Item 5.D is going to provide a wealth of information to your competitors," says Arden Rodgers, founder of Arbus Capital Management. "We never had to disclose the actual number of clients in each category before."

Web and social media presence: Advisors must now disclose all websites and all publicly available social media platforms where the advisor controls the content, such as Twitter, Facebook and LinkedIn. They also need to update information related to social media content promptly.

Location and information about offices: RIAs now have to provide the SEC with their total number of offices and include more detailed information about their 25 largest offices based on number of personnel. This information is likely to help the SEC decide which offices to review, says Alyssa Briggs, senior principal consultant for ACA Compliance Group.

New disclosure categories for separately managed accounts: Separately managed account clients are defined



BLOOMBERG NEWS

by the SEC as advisory accounts other than those that are pooled investment vehicles. Individuals, banks and charitable organizations, for example, are considered SMA clients, while private funds, registered investment companies and business development companies are not.

RIAs must now report the approximate percentage of SMA assets invested in 12 broad categories, including ETFs, government, corporate and sovereign bonds, derivatives, cash and cash equivalents.

Advisors with less than \$10 billion in SMA regulatory assets under management must report the breakdown annually based on year-end SMA holdings. Advisors with over \$10 billion in SMA RAUM must include midyear SMA holdings in their annual report.

Advisors must now also provide detailed information for any custodian that accounts for at least 10% of their total registered SMA assets.

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Charles Paikert is a senior editor of *Financial Planning*. Follow him on Twitter at @paikert.



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BY JAMES THORNE

BILL MORRISSEY'S COMMUTE COMES WITH A VIEW

from several thousand feet up. Each week for the past 35 years (weather permitting), he has boarded the cockpit of his plane and taken off on a short flight from San Juan Island to Mount Vernon, Washington.

The trip between his two offices would take around two-and-a-half hours by car and ferry, but where's the fun in that? Morrissey, who runs Sound Financial Planning with his partner Tammy Prouty, counts whales among his neighbors and enjoys views of the Olympic Mountains.

Ask him if he has any plans to leave the region behind and he'll tell you: "I'm going to die here with my boots on."

Scattered among America's resort towns are financial advisory firms, mostly small shops, which have found a way to thrive in areas with small populations and a seasonal economy. Building a practice in these conditions is not easy, but those advisors who have put in the extra effort say it is well worth the sacrifice.

So where would you work, if you could work anywhere? And what would you be willing to give up to get there? If you're considering a move to the town of your dreams, here are some things you should know from advisors who have made it work.

The first lesson for advisors who want to start a practice in a resort town: either bring a book of business with you or practice patience. The good news is technology has made managing clients from afar an easier task.

While it's sometimes compared to Martha's Vineyard, San Juan Island lacks the population of an East Coast resort. Only around 7,000 people live on the island year-round. And while those residents tend to be wealthy, most of Morrissey's business still comes from his office in Mount Vernon, on the mainland. Luckily, Morrissey is finding that being physically isolated no longer has much effect on his ability to run a business. "What we're finding is it doesn't really matter where you're located anymore," he says.

Operating as a one-man band from his office in the



JAMES THORNE

Advisors who decide to open a practice in Colorado's Vail Valley can take in the view of the Eagle River.

town of Friday Harbor, Morrissey depends on cloud-based account management systems as well as physical support from his team in Mount Vernon.

If you're considering a move, take a realistic account of the kinds of resources you'll have available in the new locale. Look into opportunities to contract out or automate roles where possible.

YOU CAN'T RUSH TRUST

Stuart Green can trace his family's financial roots back to his great-grandfather, who started a stock brokerage in Kansas City. But when Green first came to Colorado's Vail Valley, he knew the young community wasn't ready for a financial advisory practice.

Instead, he started a commercial laundry business to support the hotel industry. Over the years, the ski town's population exploded, and Green decided to get his CFP. More than a decade later, he and his partner Tracy Tutag have built Aprisent Financial Group into a local institution based



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in Edwards, Colorado.

Since residents often don't trust outsiders who come into town to start a business, being a long-term local made things easier.

"When people come up here, they can come across as a carpetbagger," Green says. "I've seen people come into the area thinking that this would be a relatively easy place to establish a business, and they had trouble."

Green's reputation as a family man and his philanthropic efforts with Habitat for Humanity also helped to cement his reputation. "This is a business very much based on trust, and people want to believe that you are trustworthy," he says.

The smaller community also meant that Green didn't have the luxury of catering to specific segments. He has clients outside the valley, who tend to have more assets than locals. But the area also attracts a number of successful professionals.

"A lot of these people ran significant companies or were high level execs with big companies," he says. "It's a very sophisticated community for a small town."

Green cautions that advisors should make sure they're interested in sticking around for the long haul. In small towns, the key to success is often more about perseverance than rapid growth.

KNOW YOUR MARKET

Marlo DeMoss' circuitous path to financial advisor began under the sea. Her passion for diving in the Bahamas led her into insurance, which later morphed into financial advice. The ocean is still her passion, but now she runs DeMoss Financial out of Tavernier, Florida, and works with clients from Key Largo to Key West.

DeMoss is still a diver and an avid fisherwoman. When she wants a vacation from the seaside life, she goes skiing in Idaho.

DeMoss has never done traditional advertising, and grew her business slowly through word of mouth. Also, she rarely turns down a client. "If you say no to one person in a small town, it may hurt your business," she says. Instead, she does a lot of work that

isn't profitable, knowing that it will help her reputation. Her clientele range from people just starting out to those with multimillion-dollar stock portfolios.

"People say specialize, set account minimums. Neither of those would work in this kind of environment," DeMoss says.

Her region is driven by tourism, but it's still a small town. And success in a small town often means being a jack of all trades. "You want to be the financial quarterback for your client," DeMoss says.

Every town is different, so do your homework. The Census Business Builder, an online tool from the U.S. Census Bureau, is a helpful starting point for assessing the local market in towns throughout the country.

REALIZE THE RISKS

Different regions bring different risks. DeMoss knows that each year will bring, like clockwork, the threat of destructive hurricanes. And while nobody can predict the scale or timing of such events, DeMoss does what she can to prepare her clients financially. That means having standing ACH instructions on all nonqualified accounts. In the event of an emergency, clients can get money when they need it.

For Bill Morrissey, the advisor in the San Juan Islands, even remote threats deserve an appropriate plan. Wildfires from the mainland seem to be getting closer every year, bringing smoke and haze to the otherwise crystal-clear islands.

Less immediate, but much more concerning, is the looming danger of earthquakes from the Cascadia subduction zone. "We're long overdue for a quake," Morrissey says. "We emphasize to our clients the importance to prepare for it."

Despite the many quirks and obstacles to operating in a resort town, DeMoss and others claim they wouldn't live anywhere else. "I think the positives of where I live and the business far outweighs any negatives," says DeMoss, adding that a tightknit community is more important than one that's ideal for business. "All of my clients are friends." **FP**

More concerning is the looming danger of earthquakes from the Cascadia subduction zone. "We're long overdue for a quake," advisor Bill Morrissey says. "We emphasize to our clients the importance to prepare for it."

Dissecting Amazon's Expansion

Another blockbuster announcement from the online retail giant stirs more debate about its future plans for the financial industry.

BY SULEMAN DIN AND CHARLES PAIKERT

FOR A NUMBER OF WEALTH MANAGEMENT LEADERS, the joint announcement by Amazon, Berkshire Hathaway and JPMorgan Chase to team up on health care reinforced much of the tech-driven message they've promoted to advisors: digital efficiency will only create new opportunity.

But within that team up, the industry may be getting a glimpse of future competition in wealth management too, some speculate.

While the effort is first about finding a better health care offering for the employees of the three companies, says Will Trout, head of Celent's global wealth management practice, there is an underlying wealth management impact in how it could give Amazon even more access to customer data.

'CLASSIFY, PACKAGE AND DEPLOY'

More data will be essential to feeding Amazon's artificial intelligence capabilities, Trout notes, which are already being positioned for future use in investment insights, automated meeting preparation and even risk management for compliance.

"Amazon will embed itself in the fabric of the wealth management space unless the regulators intervene," Trout says. "Control of the data – and ability to classify, package and deploy it – will be the differentiator, including in the advised space. Think on-the-go analytics instead of going through the business intelligence team. That smart data, residing in the cloud, will remove the laborious and often manual data extraction process."

AI's future impact on industries including wealth management cannot be ignored, adds Lex Sokolin, global director of fintech strategy at Autonomous Research.

"We have entered a world where technology, capital and attention are massively concentrated in the hands of a few enterprises," Sokolin says.

"This concentration can only get more acute because of how technology functions and compounds," he says.

Sokolin views the move as an evolution of an ongoing



BLOOMBERG NEWS

discussion about broadening holistic care that the industry has grappled with. "Health care, income, retirement all fit together," he says. "I don't think it includes high-end wealth. There's no need to subsidize and socialize high-net-worth private wealth. But there's a need to solve for the retirement crisis among the retail customers who have no savings."

'RIPE FOR DISRUPTION'

Again, technology is a threat to the advisory that hasn't transitioned to more holistic, personalized advice, says Larry Swedroe, principal and the director of research for Buckingham Strategic Wealth.

"This whole area is ripe for disruption due to inefficiencies in chain of delivery," Swedroe says. "So no surprise [if] Amazon would go after it. As to RIAs, if you are a commodity, which is what Amazon specializes in, perhaps you might worry about them, but [you] already should be worried by robos."

The team up serves as a sound reminder to Carson Group CEO Ron Carson why he continually invests in technology, he says, and how there is competition outside wealth manage-

ment that his firm needs to focus on. “Moves like this have been a trickle but an avalanche is near,” Carson says. “A private enterprise solution for our health care crisis is going to be for the benefit of the consumer. Think of blockchain and peer-to-peer trends happening in every industry. This is how we cut out the middlemen that aren’t adding value.”

United Capital CEO Joe Duran, who regularly exhorts advisors to heed the disruption wrought by Amazon and Vanguard, acknowledges the three giant firms are tackling “one of the most complex and expensive sectors in the country. No one yet knows what they will end up accomplishing.”

As part of the announcement, JPMorgan



DAN NELKEN

Amazon, Berkshire Hathaway and JPMorgan Chase “could eventually commercialize their platform to expand beyond their initial group,” says United Capital CEO Joe Duran.

CEO Jamie Dimon stated “the three of our companies have extraordinary resources, and our goal is to create solutions that benefit our U.S. employees, their families and, potentially, all Americans.”

EXPANSION POSSIBILITIES

Duran said the three “could eventually commercialize their platform to expand beyond their initial group and welcome other firms to create a powerful collaborative platform, and perhaps even expand to small businesses and/or direct to consumers. Imagine Amazon health.”

But he had his doubts about how the three firms with such different cultures could agree on a singular solution.

Oppenheimer health care information technology and distribution analyst Mohan Naidu says that, as far as a deepening relationship between Amazon and JPMorgan, the relationship will be very focused for the near term.

“Amazon is a big player and they have also started doing Amazon Pay,” he says. “Reading between the lines, this is going to be pretty focused on health care, and anything that comes out of it is all gravy on top of that.”

Which is why advisors shouldn’t expect to see Amazon in wealth management directly anytime in the near future, says Wescott Financial CEO Grant Rawdin.

“Health care costs among these three behemoths are billions of dollars and they can’t seem to get an acceptable cost savings because of systemic issues in the health care system,” Rawdin says. “There is no such expense savings among them in the financial services sector.”

To some extent they compete in the financing, investment management and insurance areas, he acknowledges. “Of course, that begs the question whether it is these three who cooperate or another one or two of them that cooperate. But this motivation is about controlling the marketplace and creating some type of pricing power.”

REGULATORY HURDLES

The argument of regulatory hurdles barring tech giants from entering wealth management still stands for now, Rawdin adds.

“Can you imagine what Amazon’s ADV would look like?” he asks. “Affiliated businesses, conflicts of interest, fiduciary requirements, fee disclosures, custody issues since they have your credit card on file for purchases? Would they extend into this via their credit facilities providing other financing services, and then bring you in for investment management and insurance? Where would they custody? Who would they buy? Each transaction would present of potential regulatory issues. [But] nothing is insurmountable.”

FP

“A private enterprise solution for our health care crisis is going to be for the benefit of the consumer,” Ron Carson says.

Suleman Din is technology editor and Charles Paikert is senior editor of *Financial Planning*. Follow Din on Twitter at @sulemandin and Paikert on Twitter at @paikert.

Mastering Surcharge Planning

With income thresholds lower this year, strategies to manage the Medicare tax bite are a way for advisors to protect the cash of their retired clients.

BY MICHAEL KITCES

SINCE 2007, THE MEDICARE MODERNIZATION ACT OF 2003 has required high-income Medicare enrollees to pay an Income-Related Monthly Adjustment Amount surcharge on their Medicare Part B premiums. This IRMAA surcharge can mean that instead of paying just 25% of the projected average Part B costs for the aged, a Medicare enrollee may be required to pay as much as 80%; in 2017, this increased Part B premiums by as much as 219%.

This year, the IRMAA surcharges on Medicare premiums will apply more broadly, as changes under the Medicare Access and CHIP Reauthorization Act of 2015 reduce the top modified adjusted gross income threshold from \$214,000 per year down to \$160,000 for individuals, or \$320,000 for married couples. And an individual with a MAGI as low as \$133,500 or a married couple with a MAGI of \$267,000 a year will be forced into a higher IRMAA tier, resulting in an increase in IRMAA surcharges of nearly \$1,000 a year.

Granted, the surcharges still amount to a cost of only roughly 1% to 2% of the income the household must have to be subject to IRMAA in the first place. So while managing taxable income is important, it's equally crucial not to let the tax tail entirely wag the dog (unless, perhaps, you're very close to the next threshold).

Nonetheless, the new IRMAA rules will make Medicare-related tax planning more popular than ever. For advisors seeking another way to demonstrate value to clients, it pays to know the strategies available to them.

THE BACKGROUND

Health insurance is expensive, especially for retirees, who tend to have more frequent health complications. To help manage costs, in 1965 President Johnson

signed into law the legislation that established Medicare as the health insurance foundation for senior citizens over the age of 65.

Under Medicare, the federal government pays for 100% of Part A insurance, generally understood as hospital care, and generates the revenue for this through the 2.9% Medicare component of the 15.3% FICA tax on employee income.

In addition, the government covers about 75% of the cost of Part B insurance, relating to other medical services, from general revenue, with the other 25% of the cost paid by enrollees as a monthly premium. The Part B premium is set by the Centers for Medicare and Medicaid Services.

Under the Medicare Modernization Act, Medicare enrollees also have access to the Medicare Part D (prescription drug) coverage and pay ongoing monthly premiums as well.

For most individuals, Part B and Part D premiums are simply withheld from monthly Social Security checks, though those who delay Social Security benefits but have

IRMAA Medicare Surcharges in 2017

IRMAA Tier	Individual MAGI	Married Joint MAGI	Part B Premium (monthly)	Part D Premium (monthly)	Total Surcharge (monthly)	Part B Premium % Of Total Cost
Baseline	< \$85,000	< \$170,000	\$134.00	Plan Premium	N/A	25%
1	Up to \$107,000	Up to \$214,000	+ \$53.50	+ \$13.30	+ \$66.80	35%
2	Up to \$160,000	Up to \$320,000	+ \$133.90	+ \$34.20	+ \$168.10	50%
3	Up to \$214,000	Up to \$428,000	+ \$214.30	+ \$55.20	+ \$269.50	65%
4	> \$214,000	> \$428,000	+ \$294.60	+ \$76.20	+ \$370.80	80%

Source: Michael Kitces

already enrolled in Medicare must pay their premiums directly.

The Medicare Modernization Act of 2003, which introduced Medicare Part D prescription drug coverage, shifted how Medicare Parts B and D are funded by requiring high-income Medicare enrollees to pay a higher-than-25% portion of their Medicare premiums, beginning in 2007.

The rules require that Medicare enrollees whose MAGI exceeds \$85,000 as an individual, or \$170,000 as a married couple, must pay 35% of the total Part B premium. The share can reach 80% of the total Part B premium cost once income exceeds \$214,000 of modified AGI for individuals or \$428,000 for married couples.

Similarly, beginning in 2011 under the Affordable Care Act, higher-income individuals must pay a surcharge on their Medicare Part D prescription drug coverage. Unlike the Part B surcharge, the Part D surcharge is simply a flat dollar amount, starting at \$13.30 a month and rising to \$76.20 for those in the highest income tier.

CLIFF THRESHOLDS

The modified AGI that IRMAA surcharges are based is the AGI plus any tax-exempt bond interest that must be added back to determine if the thresholds are reached. And each of the four surcharge tiers are "cliff thresholds," meaning even \$1 of income past the threshold results in the entire higher surcharge amount being applied.

Because Medicare premiums are set for the coming year during the current year – for instance, 2018 premiums were set by October 2017 – a household's IRMAA tier for Medicare is determined by using prior-prior-year income. Thus, for 2018, a household's Part B and Part D surcharges are based on the 2016 tax year, using the tax return data filed in 2017.

The MAGI thresholds for IRMAA Medicare premium surcharges are adjusted annually for inflation, although under the Affordable Care Act, the inflation adjustments to the

MAGI thresholds were frozen in place from 2011 to 2019.

As a result, the impact of inflation on incomes will cause at least some people to creep into a higher IRMAA tier, although the IRMAA surcharges are still projected to impact fewer than 5% of Medicare enrollees.

Although they have been in place for barely a decade, IRMAA thresholds have already undergone several changes. And under Section 402 of the Medicare Access and CHIP Reauthorization Act of 2015, the IRMAA rules were changed again, substantially decreasing the MAGI threshold to reach the fifth tier, at which households must cover 80% of their Premium Part B premium costs and pay the maximum Medicare Part D surcharge of \$76.20 a month.

Specifically, the new rules shift the fourth income tier of IRMAA down from \$214,000 a year for individuals, or \$428,000 for married couples, to only \$160,000 a year for individuals, or \$320,000 for married couples. In turn, the prior third tier shifts down, and the prior second tier is further compressed.

As a result, it now takes far less income for a household to reach the top IRMAA tiers.

As an individual's income moves from \$85,000 to \$160,000 of MAGI, the taxpayer moves through all four tiers, shifting Medicare Part B premiums up an additional \$294.60 a month on top of adding another

With the changes in effect this year, it takes far less income for a household to reach the top IRMAA tiers. For some, this could mean a tax jump of nearly \$1,000 a year.

Changes in IRMAA Medicare Premium Surcharges

Income	Part B				Part D			
	2017	2018	2018 Increase		2017	2018	2018 Increase	
			\$	%			\$	%
Base Medicare Premium	134.00	\$134.00	\$0.00	0%	Varies By Plan		-	-
Less than \$85,000	+\$0.00	+\$0.00	\$0.00	0%	+\$0.00	+\$0.00	\$0.00	0%
\$85,001 to \$107,000	+\$53.50	+\$53.50	\$0.00	0%	+\$13.30	+\$13.00	-\$0.30	-2%
\$107,001 to \$133,500	+\$133.90	+\$133.90	\$0.00	0%	+\$34.20	+\$33.60	-\$0.60	-2%
\$133,501 to \$160,000	+\$133.90	+\$214.30	\$80.40	60%	+\$34.20	+\$54.20	\$20.00	58%
\$160,001 to \$214,000	+\$214.30	+\$294.60	\$80.30	37%	+\$55.20	+\$74.80	\$19.60	36%
\$214,001 or greater	+\$294.60	+\$294.60	\$0.00	0%	+\$76.20	+\$74.80	-\$1.40	-2%

Source: Michael Kitces

\$74.80 a month of Part D IRMAA surcharges – for a total of \$369.40 a month, or \$4,432.80 a year.

A married couple will experience these surcharges twice – as each member of the couple enrolls in Medicare – as household MAGI rises from \$170,000 to \$320,000 a year. These amounts come in addition to the baseline Medicare Part B premium itself, \$134 a month in 2018, plus the cost of the household’s chosen Medicare Part D premium, if applicable.

For those who were in the second or third IRMAA tiers, the impact is even more substantial, as they will be shifted up an entire tier, lifting the IRMAA surcharge from \$133.90 a month in 2017 to \$214.30 in 2018, or from \$214.30 a month in 2017 to \$294.60 in 2018. This means an increase of nearly \$1,000 a year.

NO ‘HOLD HARMLESS’

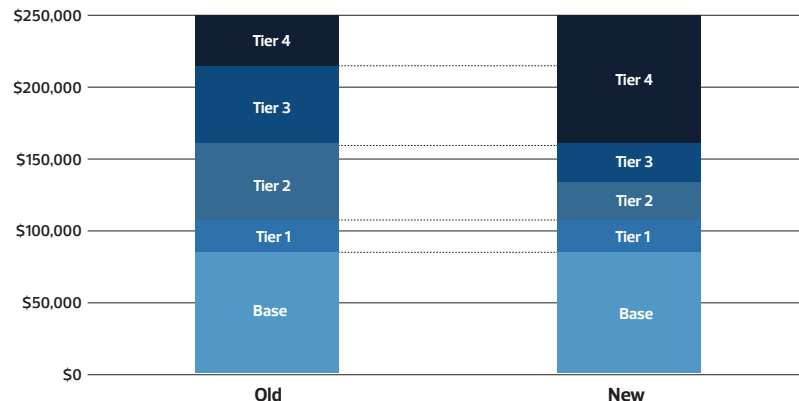
It’s also notable that those who are subject to IRMAA Medicare surcharges are not eligible for the “hold harmless” rules that cap the annual increase in Medicare premiums at the dollar amount of Social Security’s COLA increase – which, as occurred in 2016, can cause Medicare Part B premiums to spike for those impacted by IRMAA.

However, for better or worse, given that the first IRMAA surcharge tier – the threshold where the first surcharge applies – is still the same \$85,000 for individuals and \$170,000 for married couples, the new IRMAA thresholds won’t impact high-income Medicare recipients any more now than they have in the past.

While many higher-income individuals will find themselves perpetually subject to IRMAA based on ongoing income that exceeds the MAGI thresholds, others may find that IRMAA impacts them only in occasional years when the first – or higher – IRMAA tiers are reached.

Accordingly, it’s important to recognize that even if a household has been subject to IRMAA in the past, it will not automatically

Change in Medicare IRMAA Surcharge Tiers From 2017 to 2018



MAGI thresholds for married couples are two times the amounts listed above.
Source: Michael Kitces

be subject to the surcharges in the future. The determination is on the individual’s reported income each year.

One major caveat is that because of the prior-prior-year income calculation, a household could have a reduction in income in the current year and still be subject to IRMAA. For instance, a married couple who had an income jump in 2016 and 2017 because of substantial Roth conversions in retirement that put their household income over \$170,000 would be subject to IRMAA surcharges on their Part B and Part D premiums in 2018 (and 2019). This would happen even if their income is well below the specified threshold in 2018, when they’re no longer doing Roth conversions.

Because the 2018 premiums and surcharges were calculated based on the couple’s 2016 income, IRMAA will apply. Granted, the couple’s lower income in 2018 will eventually shield them from IRMAA, but the lower Medicare Part B and Part D premiums, without IRMAA surcharges, won’t apply until 2020, when income from the 2018 tax year is used.

Still, sometimes a household’s income declines because of “life-changing” circumstances beyond its immediate control, so that using prior-prior-year income is no lon-

ger an accurate reflection of the household's current financial status. In such situations, those impacted by IRMAA may submit Form SSA-44 to request a surcharge reduction.

To have IRMAA surcharges reduced, the life-changing event must be one of those listed on Form SSA-44, which includes:

- Marriage.
- Divorce or annulment.
- Death of a spouse.
- Work stoppage.
- Material reduction in work hours.
- Loss of income-producing property because of a disaster or similar circumstance.
- Loss of pension income (due to a pension default, for instance).
- Income stemming from a settlement with an employer for the employer's bankruptcy or reorganization.

NEW RETIREES

Newly minted retirees over age 65 who start Medicare immediately after retirement will usually need to file Form SSA-44 to report their work stoppage and avoid having pre-retirement wages treated as part of their MAGI when determining IRMAA surcharges in the first full year of retirement.

In subsequent years, this is typically a moot point, as a lower income often reduces MAGI below the first IRMAA threshold.

For those who have experienced a life-changing event that does not fit the specific list of choices on Form SSA-44, it's possible to file a formal appeal on Form SSA-561-U2. Officially dubbed a "Request for Reconsideration," this form is used to appeal a number of Social Security retirement or disability scenarios – including the application of Medicare IRMAA surcharges – that are technically determined by the SSA.

It's important to recognize, though, that mere substantial changes in portfolio and investment income – including various types of retirement withdrawals – are not treated as life-changing events eligible for an IRMAA surcharge exception.

Thus, it would not be unusual for a

household to have a single-year or even multiyear big income event, from liquidating substantial portfolio capital gains to selling a primary residence – where the value was above the up-to-\$500,000 capital gains exclusion under IRC Section 121 – taking sizable IRA withdrawals or engaging in substantial partial Roth conversions. In such cases, the household will have to pay IRMAA surcharges on Medicare premiums. If the income event lasts only a year or two, so too does the IRMAA premium surcharge.

While it's fortunate that enrollees who experience income-reducing life-changing events may be able to file Form SSA-44 to avoid IRMAA surcharges on Medicare premiums, it's preferable to simply manage income to stay below those thresholds.

At the same time, though, it's crucial to recognize that relative to the income levels it takes to hit IRMAA thresholds in the first place, IRMAA is really just the equivalent of a modest income surtax.

The optimal IRMAA planning strategies will typically manage those clients already close to the threshold, where a relatively small shift in the timing of recognizing capital gains or harvesting capital losses can get a household below it.

This makes it essential for advisors to know which clients have household incomes approaching an IRMAA threshold – as, again, a mere \$1 over the line can instantly result in a \$600 to \$1,000 Medicare premium surcharge.

Advisors must also be aware of clients whose income levels exceed the IRMAA threshold but who may be able to claim a life-changing-event exception via Form SSA-44 – especially recent retirees, whose retirement itself will render them eligible.

Nonetheless, with the 2018 changes to the IRMAA thresholds, the upper IRMAA tiers now impact retirees more quickly as their income rises. This in turn increases the value of IRMAA planning. Ultimately, this increases the value of the advisor who has good planning strategies.

Because surcharge calculations are based on prior-prior-year income, a household could have a substantial reduction of income and still be subject to IRMAA.

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FP

Michael Kitces, CFP, a *Financial Planning* contributing writer, is a partner and director of wealth management at Pinnacle Advisory Group in Columbia, Maryland; co-founder of the XY Planning Network; and publisher of the planning blog Nerd's Eye View. Follow him on Twitter at @MichaelKitces.

Adding Health to the Equation

A data firm and a hospital network are betting that advisors can use precise cost forecasts for clients' health needs.

BY TOBIAS SALINGER

FINANCIAL ADVISOR ERIC AANES REFERS CLIENTS

to yoga, water aerobics and his practice's health insurance, but he says he struggles to show them exactly how much they could save if they make healthy choices.

"It would be tremendously useful. It would be part of every appointment. I just don't know where to get that data," says Aanes, the founder of Titus Wealth Management in Northern California.

A joint venture between HealthView Services, a data provider for financial firms, and Mercy, a major hospital network, might fill that void. The firms recently launched HealthyCapital, and the new firm released a report tracking savings from behavior such as exercise, treatment compliance and nutrition.

Experts like Carolyn McClanahan, a CFP and physician, point out the need to include health care in clients' financial plans, but that's easier said than done. According to the Centers for Medicare & Medicaid Services, health spending is on pace to grow at an average rate of 5.6% per year.

ADOPTING HEALTHY PRACTICES

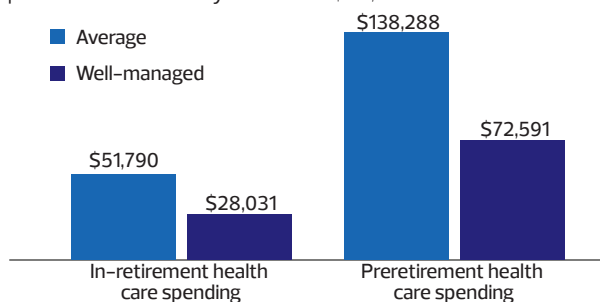
HealthyCapital's data comes from HealthView's database of 70 million patient cases and other sources, says CEO Ron Mastrogiovanni. The new firm will work with individual advisors of all kinds, 401(k) managers and broker-dealers.

Advisors who buy the tool will gain access to health care spending projections for any of their clients by entering the specific health profile into HealthyCapital's website.

Advisors can then show clients how much they're on pace to spend before and after their retirement, along with the potential savings. Clients can cut tens of thousands of dollars in costs and invest them for the long haul if they live up to what HealthyCapital refers to as "well-managed care." The practices include quitting smoking, taking prescribed medication and exercising for a half-hour, five days a week.

How much do clients save by living healthy?

An average 45-year-old male with high blood pressure can cut preretirement costs by more than \$65,000.



Source: HealthyCapital study, January 2018

If a 45-year-old man who has had high blood pressure for five years adopts such behavior, he'll save \$1,192 per year that year and \$6,592 per year by the time he's 64, according to HealthyCapital. Between preretirement and in-retirement, he could amass total savings of more than \$89,000, the firm says.

Taking the U.S. diabetes rate of roughly 9%, HealthyCapital predicts that a company with 10,000 workers could see annual savings of \$1.9 million. Such forecasts, however, often fail to take into account a dysfunctional system, along with geography, individual conditions and prices, McClanahan says.

"Providing information on how people can be better patients and take better care of themselves is useful," says McClanahan, a *Financial Planning* contributing writer and the director of planning for Life Planning Partners in Jacksonville, Florida. "To me, the whole financial planning industry is doing it wrong in that they're trying to predict a future that can't be predicted."

FP

Tobias Salinger is an associate editor of *Financial Planning*. Follow him on Twitter at @TobySalFP.

All About the Salsa

What's more important: measuring overall portfolio performance or analyzing separate asset classes?

BY CRAIG L. ISRAELSEN

CHEFS AND ADVISORS HAVE MORE IN COMMON THAN they might realize. They both bring expertise, creativity and a deep knowledge of ingredients to their creation, whether it be salsa or portfolios.

This analogy is apt when scrutinizing the returns of asset classes. While it may be tempting to focus on analyzing the individual returns, the more important measurement is the performance of an overall diversified portfolio. Consider this in culinary terms: It's important to evaluate the taste of all the separate ingredients of salsa – the tomatoes, the onions, the peppers, the cilantro – but it's far more crucial to make a final judgment based on the taste of the finished product.

The well-known Callan chart (Periodic Table of Investment Returns, by Callan Associates) visually depicts the year-to-year performance of various asset classes, and has been an incredibly valuable contribution to the literature of finance – particularly because it reminds us to focus on the entire portfolio recipe rather than chasing the performance of individual asset classes. It provides an easy-to-understand snapshot of key points successful investors should heed, including: (1) past performers seldom repeat in a logical pattern, and (2) there is no discernible pattern that would allow anyone to pick next year's winning asset class.

There is one aspect of comparative performance analysis, however, that's missing in the Callan chart – there's no visual representation of how different the best- or worst-performing asset classes are from year to year, because the returns of the various asset classes are contiguously stacked on top of each other, from high to low. In short, there is no spatial separation between the returns of the various asset classes.

It's time to take another look at an expansion of the Callan chart. I first introduced this updated chart in *Financial Planning* in January 2014. I call this the "7Twelve Index Chart." It represents 12 major asset classes over the 20-year period from 1998 to 2017. This chart also adds another dimension missing in the standard Callan chart—it shows the performance of a multi-asset portfolio from year to year.



BLOOMBERG NEWS

The 12 asset classes are represented by the following indexes: the S&P 500 (large-cap stocks), S&P Mid Cap 400, S&P Small Cap 600, MSCI EAFE (developed non-U.S. stocks), MSCI EM (emerging-market stocks), S&P Global REIT (real estate), S&P North American Natural Resources Sector (natural resources), Deutsche Bank Optimum Yield Diversified Commodity Index Total Return (commodities), Barclays U.S. Aggregate Bond (U.S. bonds), Barclays U.S. TIPS, Barclays Global Treasury (international bonds) and the U.S. Treasury 90-day T-bill (cash).

To help you parse the chart, I've used a separate color to represent each of the 12 asset classes. The chart also includes the performance of the 12-asset 7Twelve portfolio.

READING THE QUILT

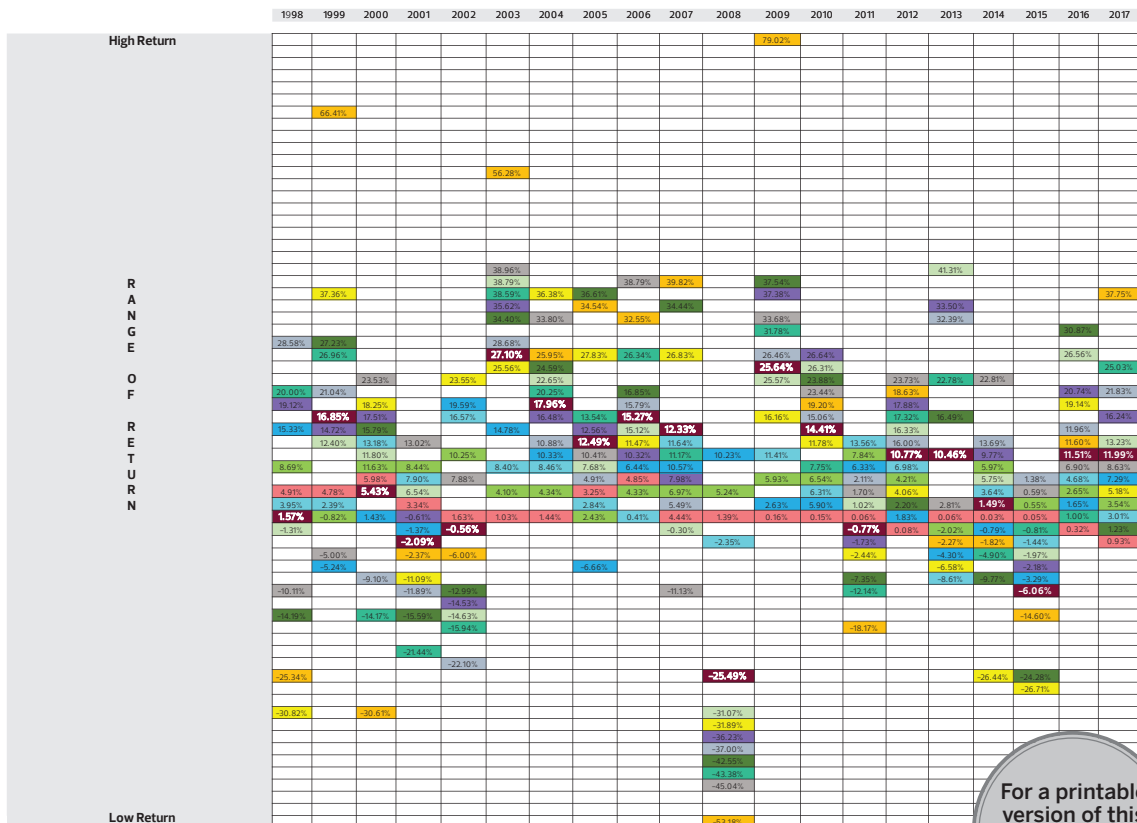
In seven of the 20 years illustrated in the chart, the worst-performing asset class was cash. However, in the midst of the financial crisis of 2008, cash was the third-best performer.

Commodities are often perceived as a chronically underperforming asset class, but in four years commodities were the best or second-best performer. In fairness, commodi-

Visualizing Multi-asset Portfolio Performance

Consider the performance of a diversified portfolio, not just that of the separate asset classes.

77twelve Asset Category (yearly returns)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	20-Year Avg. Annualized Return	20-Year Standard Deviation
U.S. Large-Cap Equity	28.58%	21.64%	-9.10%	-11.89%	-22.10%	28.68%	10.88%	4.91%	15.79%	5.49%	-37.00%	26.46%	15.06%	2.1%	16.00%	32.39%	13.69%	1.38%	11.96%	21.83%	7.20%	17.89%
U.S. Mid-Cap Equity	19.32%	14.72%	17.37%	-9.63%	-14.33%	35.67%	16.46%	15.36%	10.32%	7.98%	-36.23%	27.38%	26.44%	-1.23%	19.96%	33.32%	9.77%	-2.19%	20.76%	16.24%	10.58%	17.35%
U.S. Small-Cap Equity	-1.31%	12.40%	11.80%	6.54%	-14.63%	38.79%	22.65%	7.69%	15.12%	-0.30%	-31.07%	25.57%	26.31%	1.02%	16.33%	41.31%	5.75%	-1.97%	26.56%	13.23%	9.73%	17.17%
Developed Non-U.S. Equity	20.00%	26.56%	-14.17%	-21.44%	-15.54%	38.59%	20.25%	13.54%	26.34%	11.7%	-43.38%	31.78%	7.75%	-12.14%	17.32%	22.78%	-4.90%	-0.81%	1.00%	25.03%	5.25%	21.02%
Emerging Equity	-25.34%	66.41%	-30.61%	-2.37%	-6.00%	56.28%	25.95%	34.54%	32.59%	39.82%	-53.18%	79.02%	19.20%	-18.17%	18.63%	-2.27%	-1.82%	-14.60%	11.60%	37.75%	8.10%	34.06%
Real Estate	-10.11%	-5.00%	23.53%	13.02%	7.88%	38.95%	33.80%	10.41%	38.79%	-11.15%	-45.04%	33.68%	23.44%	1.70%	23.77%	2.81%	22.87%	0.59%	6.90%	6.63%	8.88%	20.30%
Natural Resources	-11.1%	22.03%	3.7%	16.39%	-23.99%	34.65%	24.99%	36.81%	10.33%	34.44%	-42.15%	27.74%	23.89%	-7.4%	2.2%	16.89%	-9.7%	-24.2%	39.37%	1.83%	6.09%	23.42%
Commodities	-30.82%	37.36%	18.25%	-11.09%	23.55%	25.56%	36.38%	27.83%	11.47%	26.83%	-31.89%	16.16%	11.78%	-2.44%	4.06%	-6.98%	-26.44%	-26.71%	19.14%	5.18%	3.94%	22.28%
U.S. Aggregate Bonds	8.69%	-0.82%	11.63%	8.44%	10.25%	4.10%	4.34%	2.43%	4.33%	6.97%	5.24%	5.93%	6.54%	4.21%	-2.02%	5.97%	0.55%	2.65%	3.54%	4.98%	3.50%	4.98%
Inflation-Protected Bonds	3.95%	2.39%	13.18%	7.90%	16.57%	8.40%	8.46%	2.84%	0.41%	11.64%	-2.35%	11.41%	6.31%	13.56%	6.98%	-8.67%	3.64%	-1.44%	4.68%	3.01%	5.48%	6.11%
International Bonds	13.38%	-4.24%	1.4%	-1.37%	16.39%	14.19%	10.33%	-4.66%	6.44%	15.7%	10.23%	2.63%	5.90%	4.39%	1.83%	-4.30%	-23.9%	-2.29%	14.5%	2.9%	4.39%	7.22%
Cash	4.91%	4.78%	5.96%	3.34%	1.63%	1.10%	1.44%	3.25%	4.85%	4.44%	1.99%	0.16%	0.15%	0.06%	0.08%	0.06%	0.03%	0.05%	0.32%	0.93%	1.92%	2.06%
77twelve Portfolio Index	1.57%	16.85%	5.43%	-2.09%	-0.56%	27.10%	17.96%	12.49%	15.27%	12.33%	-25.49%	25.64%	14.41%	-0.77%	10.77%	10.46%	1.49%	-6.06%	11.51%	11.99%	7.34%	11.90%



For a printable version of this chart: please go to: <http://bit.ly/2H2xqJh>

Data source: Steele Mutual Fund software, author calculations

ties also represented the worst performer in three of the 20 years.

In eight out of 20 years, including last year, emerging-markets equities had the highest or second-highest return. But in three years (2000, 2008 and 2011), this class was significantly at the bottom. It's feast or famine for EM, which suggests these investments need portfolio companions to smooth out the ride.

During some years, the returns of the 12 asset classes have been more compressed (that is, more tightly bunched together, as can be seen in 2010), whereas in other years

the dispersion of returns among these 12 core asset classes can be very wide, as in 2009.

This is significant because, after a year in which a particular asset class has had dramatically higher performance than the other asset classes, you will need to be on guard for clients who want to chase that outlier performer by investing a disproportionate amount of their portfolio in last year's winner.

Only once did an asset class repeat as the winner (real estate in 2000 and 2001). In short, this type of performance chart is clearly signaling us not to chase last year's winner.

PORTFOLIO

As with the traditional Callan chart, the 7Twelve Index Chart reveals a patchwork of performance – hence it’s often referred to as a performance quilt. One of the purposes of this type of visual representation is to remind us that performance across a wide variety of asset classes is highly variable.

Here are other lessons: (1) past winners are not necessarily winners the next year, (2) past losers are not necessarily next year’s losers and (3) the variation of return from high to low can be remarkably large.

CONSIDERING THE CHALLENGES

The fact that a broadly diversified portfolio produces a middle-of-the-road return is more than just a mathematical reality; it also represents great challenges.

1. A broadly diversified portfolio will never be the best performer in any given year when compared with all of its constituent ingredients. Of course, the upside is that it will never be the worst performer either.

2. The performance of a broadly diversified portfolio will be benchmarked against some standard of performance, typically the S&P 500. But does this index represent the correct performance benchmark for a client who has a diversified portfolio?

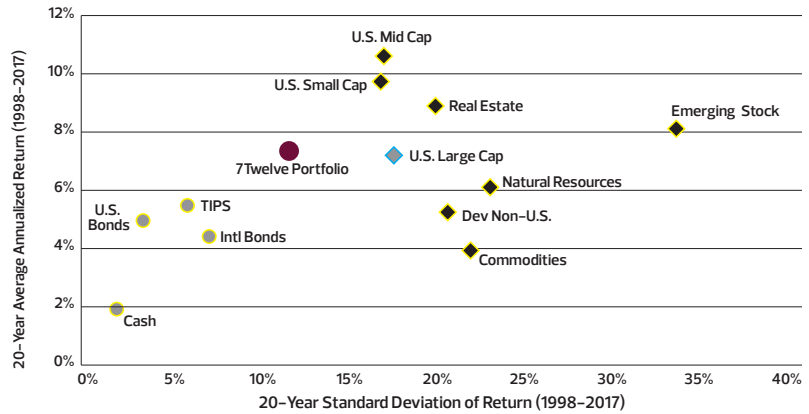
The answer is no. A multi-asset portfolio should behave differently than the S&P 500, because it contains many ingredients absent from the index. To return to our gastronomic analogy: Would you be critical of salsa for tasting different from tomatoes?

So is middle-of-the-road performance good enough? Interestingly, the S&P 500 finished the 20-year period from 1998 to 2017 with an average annualized return of 7.20%, while the 12-asset 7Twelve Portfolio had a 20-year annualized return of 7.34%.

Raw performance is clearly important to clients, but so is volatility. Remember 2008? As shown in the “Ideal Location” chart, the risk/return location of the 7Twelve Portfolio is more attractive than the location of U.S. large-

Ideal Location

A 20-year risk/return map of all 12 asset classes and a multi-asset portfolio.



Date source: Steele Mutual Fund software, author calculations

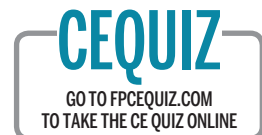
cap stock, due to the fact that the 7Twelve Portfolio is much closer to the coveted north-west (or upper-left) quadrant of the graph.

The risk/return coordinates of the other asset classes are also provided. The location of the maroon dot is arguably one of the ideal combinations of risk and return. As we might expect, the four fixed-income asset classes have a lower standard deviation of return, but lower returns as well. As a result they are below and to the left of the 7Twelve portfolio, indicating lower return and lower volatility.

Of the remaining eight asset classes (equity and diversifier indexes shown by diamonds), only four had a higher return than the 7Twelve Portfolio, but each of them had higher volatility.

The other four indexes (U.S. large cap, natural resources, developed non-U.S. stock and commodities) had lower returns and higher risk than the 7Twelve Portfolio – indicating they produced an inferior risk/return trade-off over the past 20 years.

What’s the final lesson here? It’s all about the salsa, baby. The performance of an entire portfolio, while taking risk into account, is far more important than the separate measurement of the asset classes that make up the portfolio.



Craig L. Israelsen, Ph.D., a *Financial Planning* contributing writer in Springville, Utah, is an executive in residence in the personal financial planning program at the Woodbury School of Business at Utah Valley University. He is also the developer of the 7Twelve portfolio.

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CE QUIZ

MARCH 2018

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FROM: BIG RETURN

1. If a client is single and has an annual income of \$165,000, which tax bracket will they be in under the new tax plan?

1. 27%
2. 32%
3. 22%
4. 35%

2. What would the minimum annual income be for a couple filing jointly to be in the top tax bracket under the new tax law?

1. \$500,000
2. \$450,000
3. \$600,000
4. \$700,000

FROM: TAX LAW'S IMPACT ON ROTH IRAS

3. Which one of these is NOT a benefit for Roth IRA conversions under the new tax law?

1. The upfront tax bill is lower
2. Roth IRAs will be free of estate taxes for most clients
3. Clients can leave more tax-free funds to grandkids
4. Conversions can be undone

4. Under the new tax law, what is the minimum a child's unearned income (interest, dividends, etc.) must be in order to be taxed at the top rate?

1. \$12,501
2. \$25,502
3. \$9,151
4. \$8,601

FROM: ALL ABOUT THE SALSA

5. From 1998 to 2017, what was the average annualized return of a 12-asset portfolio that included large-cap, mid-cap and small-cap stocks; developed stocks; emerging market stocks; REITs; natural resources; commodities; U.S. bonds; international bonds; TIPS and cash?

1. 7.20%
2. 7.34%
3. 6.52%
4. 8.25%

6. What was the highest-returning asset class in 2017?

1. Emerging equity
2. Developed equity
3. Real estate
4. U.S. large-cap equity

FROM: MEET THE NEW FORM ADV

7. On the revised Form ADV, advisors must provide detailed information for any custodian that accounts for what percentage of their total registered SMA assets?

1. 5%
2. 10%
3. 15%
4. 20%

FROM: MASTERING SURCHARGE PLANNING

8. If a client's annual income is \$135,000, by what percentage will their Part B Medicare premium surcharge increase this year?

1. 37%
2. 40%
3. 60%
4. 0%

9. By what percentage will the same client's Part D surcharge increase?

1. 36%
2. 58%
3. 45%
4. 0%

FROM: AM I RESPONSIBLE FOR CLIENTS' POSTS ON MY FACEBOOK PAGE? (Online only)

10. Under which rule in the Securities Exchange Act of 1934 must a broker-dealer retain records of digital communications relating to "business as such"?

1. Rule 14a-6
2. Rule 10b-18
3. Rule 13e-4
4. Rule 17a-4

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SELFIE

Time to Pass the Torch

I have been telling my clients that they need a succession plan. Turns out, I needed one, too.

BY PAT HINDS



I'VE ALWAYS FELT MOST REWARDED WHEN I'VE set a goal, mapped out a plan and seen that plan through to success. That's why my 26-year career as an advisor has been so fulfilling.

For a long time, though, I shirked away from one of the most critical plans an advisor needs to make: my own succession plan. It was difficult to face the reality that one day I would have to step away from Granite Financial, the practice I'd built from the ground up.

Most successful entrepreneurs find it's easier to focus on the present. But as advisors, that mindset runs contrary to the advice we give every day.

When it came to planning for the future, I had two advantages over many of my colleagues. First, my broker-dealer, Securities America, makes continuity and succession planning a high priority and offers helpful resources. Also, my daughter, Laurie Humphrey, had shown an interest in financial planning from an early age.

While I never pushed her down that path, I hoped Laurie would eventually take over the practice. She was introduced to the business during college when she worked in my office. After graduation, she went her own way and specialized in long-term care insurance before rejoining me at Granite Financial in 2006.

At that time, we'd completed a professional business analysis, but I still lacked a succession plan specifying when, whether or how Laurie would take my place. I'd even hired another advisor who could take over the business if she chose not to.

If Laurie had opted not to buy the practice and I looked outside the firm, I would have still used the business valua-

tion, but the terms would have been substantially different. Furthermore, there would have been no way to gauge the buyer's commitment to a seamless transition for the clients and employees.

FILLING MY SHOES

The future of the practice came into focus rather suddenly when I suffered a major medical incident just after Laurie joined me.

Fortunately, she chose to purchase the business. I know advisors who planned for a family succession only to have those plans fail because the son or daughter was not fully invested in running the business. So I knew the risks.

In my case, it was a relief to know Laurie would step into my shoes and take care of my clients. She had participated in client meetings, so they felt comfortable working with her. Even before she was licensed, some said they hoped she would eventually manage their accounts.

It took a long time for me to overcome a persistent desire to remain involved, but gradually, I gave up control of day-to-day operations. Eventually, clients no longer turned to me during the meetings. They focused on Laurie. That's when I knew we'd made a smooth transition.

Laurie and I still talk almost every day. Occasionally, she asks for advice. But most of the time, I'm just a sympathetic ear or sounding board for ideas.

I've learned a lot over the course of this journey from startup to retirement. But the most important lesson was one I'd shared with clients for years: No matter where you are in your career – just starting out, looking ahead to the future or nearing the finish line – you need a plan. **FP**

Pat Hinds is the founder of Granite Financial in St. Cloud, Minnesota.

To submit a Selfie commentary, email fpeditor@sourcemedia.com. Post your comments online at financial-planning.com.

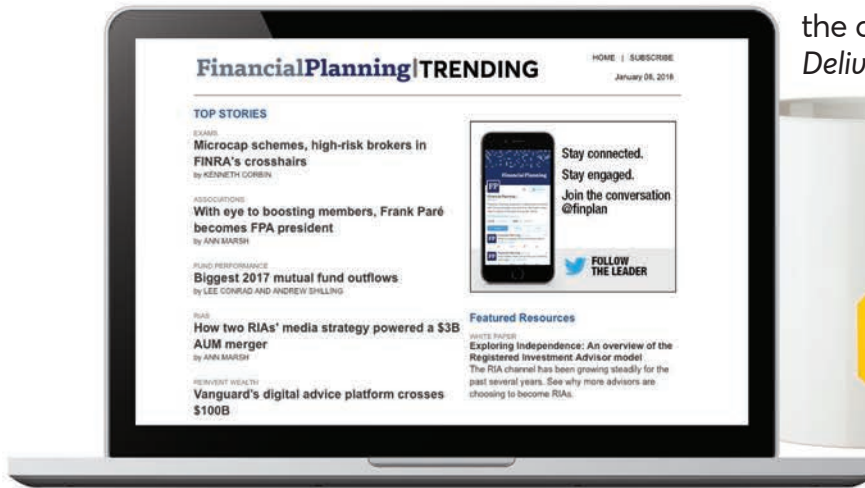
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