RAA THE COMPASS

2018 tax lessons | qcds | cyber attacks | the summit | JULY 2019

LESSONS LEARNED FROM THE 2018 TAX SEASON

By Kristi Cherry, CPA®, Tax Services Manager

As we settle into summertime and continue to enjoy quality time with our loved ones, it's always beneficial to take a moment to reflect. How are you progressing toward your goals? What lessons have you learned this year?

I've personally learned a lot this year. The 2018 tax season was a whirlwind with all the new tax laws that were implemented. Many taxpayers, including myself, were surprised to see how these new laws affected returns.

Before summer ends and we all start preparing for the 2019 tax season, I would like to share some information with you that I learned this tax season.

TAX WITHHOLDING

The new tax laws lowered both tax brackets and withholding for most taxpayers, especially married couples who filed jointly. Though this was a positive change, many taxpayers still owed taxes and/or received less of a refund this year.

The reason this occurred is not because their tax liability increased. In fact, most taxpayers had a lower tax liability due to the new tax laws. The reason is that many taxpayers did not have enough withholding taken out of their paychecks to cover their taxes.

So, how can you be better prepared for the 2019 tax season regarding your withholding?

PREPARING FOR THE 2019 TAX SEASON

First, you should project your estimated tax and adjust your exemptions accordingly. Next, keep in mind your overall filing status. If your withholding exemption is married with zero exemptions and it is still not enough to cover your tax liability, then you can change it to single with zero exemptions. Remember, your withholding status can differ from your overall filing status. If filing single with zero exemptions is still not enough to cover your tax liability, you can choose to have an additional (set) amount withheld each paycheck or make quarterly estimated tax payments.

IRA TAX BASIS

If you have a non-deductible Individual Retirement Account (IRA), then your basis refers to the funds within it that have already been taxed. If you are 70 ½ or older, then you are required to withdraw a certain amount from your IRAs each year (Required Minimum Distributions). These distributions are reported on Form 1099-R and Box 2 shows the taxable amount.

Typically, tax preparers will report this amount as fully taxable on Form 1040. However, if you have made non-deductible IRA contributions in the past, a portion of the distribution is considered basis, making a percentage of the amount in Box 2 not taxable.

It's important that you keep track of your tax basis within your IRAs. It can be confusing if you switch custodians frequently. However, keeping track of your non-deductible contributions can help reduce your risk of a tax bill later.

MISCELLANEOUS ITEMIZED DEDUCTIONS

As you are probably already aware, the new tax laws widely eliminated the ability to claim miscellaneous itemized deductions. These deductions included non-reimbursed employee business expenses, investment advisory fees, tax return preparation fees, safe deposit fees, and more. However, several states still offer the ability to claim these deductions on your state return,

including California, Minnesota, Arkansas, and Pennsylvania. If you live in any of these states and didn't include applicable state deductions for 2018, you can amend your return to receive your additional refund.

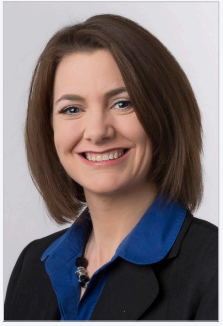
RAA TAX SERVICES

As we transition to the second half of the year, it's time to start planning for the next tax season. Remember, your tax strategy is a very important piece of your overall financial plan. When was the last time you reviewed your tax strategy? If it's been awhile, you might want to schedule a meeting with your CPA.

Working with a CPA is a great way to ensure you receive the maximum refund possible for your financial situation. If you are currently working with a CPA, we encourage you to introduce them to your Relationship Manager. Collaboration between advisors is always beneficial as it relates to your financial goals.

If you do not currently have a CPA, RAA Tax Services is an option you should consider. Visit **RAA.com/tax-services** to learn more about our tax planning and preparation services or contact your Relationship Manager for more information today.

QUALIFIED CHARITABLE DISTRIBUTIONS (QCDS) CAN SATISFY YOUR REQUIRED MINIMUM DISTRIBUTIONS (RMDS)



By Kat Schraeder, CFP®, Managing Director

A Qualified Charitable Distribution (QCD) is a tool specifically designed for taxpayers who are 70 ½ or older to give directly from their Individual Retirement Account (IRA) to a qualified charity, while satisfying the Required Minimum Distributions (RMDs) for the year.

The maximum annual amount that can qualify for a QCD is $100,000. This applies to the total of all QCDs made to one or more charities in a calendar year. If married, a husband and a wife could give up to a total of $200,000 as long as each spouse has his or her own IRA. Keep in mind that all QCDs must be distributed by your RMD deadline to count for that tax year.

QCD TAX BENEFITS

There are several tax benefits for using a QCD for one's charitable giving. For example, when a QCD is made, it counts toward a Required Minimum Distribution, but it is not included in taxable income. The lower adjusted gross income that occurs from making a QCD may lessen the effect of phaseouts and limitation on tax credits and other benefits, including lowering taxable Social Security amounts, lowering overall income that leads to lower Medicare Part B and prescription drug coverage premiums, and potentially eliminating Alternative Minimum Tax.

With the new tax law, the potential tax benefits of utilizing QCDs have been amplified. One part of the new tax law says that from 2018 to 2025, the standard deduction has nearly doubled compared to past years. In 2018, it increased to $24,000 for married couples filing jointly, $18,000 for heads of household, and $12,000 for all other individuals.

The ability to deduct state and local taxes has been capped at $10,000 annually. This means that many taxpayers who previously itemized deductions using Schedule A (Form 1040) will now find that the standard deduction is higher than their itemized deductions. Utilizing a QCD allows the taxpayer to still give to qualified charities with pre-tax dollars, while also using the standard deduction.

AN EXAMPLE

Bob and Sue, a 74 and 71-year-old couple, give $5,000 to their church every year. They are married, file a joint tax return, and have an Adjusted Gross Income (AGI) of $125,000, including $60,000 in RMDs from Bob's IRA.

In past years, they have utilized Schedule A so the charitable gift to the church has been a part of their itemized deductions. Their total itemized deductions, including the charitable distribution to their church, have been approximately $18,000.

Bob and Sue's Relationship Manager and CPA worked together to develop a tax strategy that is in alignment with their overall financial plan. Both advisors recommended that the couple utilize the QCD in 2018, so Bob sent a check for $5,000 directly from his IRA to the church.

- $125,000 AGI
- $24,000 STANDARD DEDUCTION
- $1,300 FOR BOB BEING OVER 65
- $1,300 FOR SUE BEING OVER 65
- $5,000 QCD/RMD

$93,400 TAXABLE INCOME

For the 2018 tax year, they reported federal taxable income of $93,400 ($125,000 AGI, minus the standard deduction of $24,000 and an additional $1,300 each for being over 65, minus $5,000 that counted toward the RMD but was excluded from taxable income as a QCD) with a federal tax of $12,427.

If Bob and Sue had simply taken their RMD and then written a check to the church, they would not have been able to remove the $5,000 from income. This means that the federal taxable income would have been $98,400 and the resulting tax would be $13,527. Because Bob and Sue used a QCD, they saved $1,100 in taxes and their church still received the full $5,000 gift.

QCD REPORTING

IRA custodians do not verify if a charity is qualified nor do they track charitable distributions. It is important for the taxpayer to keep track of all QCD amounts. A great way to do this is to keep the IRA statement for the month that the QCD occurred and the receipt from the charitable organization. At the end of the year, the custodian will send a 1099R with the total gross distribution from the IRA. On the 1040 tax form, you would report the gross amount of the 1099R on line 4a and then subtract out all QCDs and report the taxable part of the distribution on line 4b. The QCD is not reported on Schedule A.

DOES A QCD MAKE SENSE FOR YOUR FINANCIAL PLAN?

QCDs are a great way for taxpayers over age 70 ½ to give charitably and satisfy their RMD requirement. Although, some states with state income tax do not recognize QCDs, so it is important to consult with your Relationship Manager and tax advisor on the best philanthropic and tax saving strategies for you.

DON'T FALL FOR THESE 4 COMMON CYBER ATTACK METHODS

By John Sanborn, IT Director

Cyber security breaches happen every day and they can happen to anyone. You have probably seen the news headlines and understand that the stories are sensationalized to a degree to get your attention, but the threat of a possible cyber attack happening to you or someone you love is very real.

Protecting your information online is essential. Cyber criminals are smart, cunning, and know that the easiest way around your devices' defenses is to trick you into granting them access.

Within this article, we will look at common attack methods and how you can protect yourself and your information from scammers.

#1 MALWARE

Malware is a malicious software (in fact, that's where it gets its name) that can be used to spy on you through your computer's camera, steal your personal information, log your keystrokes, and even take over your computer. The worst type of malware is ransomware, which holds your information hostage until you pay the attacker.

#2 PHISHING

Phishing is the most common type of cyber attack and accounts for 95% of successful hackings. This method is referred to as "phishing" because the attacker is fishing for your personal information through a seemingly trustworthy and routine practice, such as a password reset.

For example, let's say you receive an email saying there is a problem with your email account and that you need to reset your password. The link in the email takes you to a password reset page that looks real enough, so you enter a new password. Unfortunately, this is exactly what the attacker wanted. They now have your password and can gain access to your email, and potentially other services if you have reused the same password.

#3 VISHING

Vishing is essentially the same as phishing, but it takes place offline. During a vishing attack, a hacker will call you and say there is a problem with one of your accounts and will ask that you call a fake customer support number to clear things up. Once you make the call, the "support representative" will ask for personal information such as your credit card number, pin, or the last 4 digits of your Social Security number. Once that information has been obtained, the attacker can use it to access your account(s) and steal your identity.

#4 SMISHING

Another common attack method is called smishing, which is when you receive a suspicious text message that asks you to call a phone number or to click on a link. It's just another way that hackers try to coax personal information from you. A good rule of thumb is to never click on a link that seems dubious.

YOUR BEST DEFENSE

Your best defense against any cyber attack is to remain aware of how you are storing and securing your information online. You should also be familiar with the common types of attack methods listed above so you can avoid any traps that are set for you by hackers.

Though these attacks can seem overwhelming, it is important to remember that these attempts all require you to take action to be successful. You should always question any email or text message that seems even slightly suspicious. Taking that extra moment to vet the correspondence will reduce more turmoil down the road if your identity is stolen.

Below are some other recommendations on how to protect yourself and your information from scammers:

1. SET UP MULTI-FACTOR AUTHENTICATION WHENEVER POSSIBLE FOR YOUR ONLINE ACCOUNTS

Multi-factor authentication requires another form of verification before you can gain access to an online account. Additional verification methods could include a code texted to your cell phone or a security question that you set up. If you increase the hoops the hacker must jump through to access your information, you have a better chance of deterring them altogether.

2. STAY UP TO DATE WITH THE LATEST UPDATES FOR YOUR ELECTRONIC DEVICES

Regardless of the platform or operating system, installing the latest updates on your devices can help protect you. It's important that you don't put off installing updates, as that delay can leave an opening for a hacker to initiate an attack.

3. BE VIGILANT

Remember to be vigilant. Hackers are smart but they need your cooperation to implement a successful attack. Don't cooperate. When in doubt, call whoever the hacker is pretending to be (your bank, etc.) to verify any suspicious emails, phone calls, or text messages.

As always, please reach out to your Relationship Manager for additional guidance. We are here to not only help you shape your financial plan, but to also ensure that no one tries to destroy the life you have worked hard to build.

SECURITY AND FRAUD EDUCATION (SAFE)

Cyber attacks can quickly jeopardize your financial security and disrupt your financial plan.

With this in mind, RAA has created Security and Fraud Education (SaFE), a resource on the RAA website to provide additional information on ways you can protect yourself against cybercrime and steps to take if you become a victim of a cyber attack.

Visit **RAA.com/safe** to start educating yourself today.

THE SUMMIT
IS NEVER THE GOAL

By Jeremy Merchant, CIMA®, Chief Investment Officer

Late one night in early June, I was scanning through news headlines and ended up reading an article about why mountain climbers pursue daunting summits such as Mount Everest. The article sparked my curiosity, so I began to seek out more information about Mount Everest and the hikers that attempt that difficult climb. Naturally, I stayed up late pouring over these fascinating stories.

Early the next morning, as I was driving to the office, I kept thinking about Alison Levine, a mountaineer who led an all-female Mount Everest expedition in 2002. During their trip up Mount Everest, Levine and her team had to make an early descent only 275 feet from the summit because of a dangerous turn in the weather.

During my drive, I kept thinking about something she said in her article: “What you have to remember in the decision-making process is that the summit is only the halfway point.” She goes on to say that “the summit is never the goal” and talks about the significant effort required to make the trip back down the mountain.

Levine’s words resonated with me, especially in terms of how we manage portfolios during times of volatility. While it may seem like a stretch to compare mountaineering to investments, the decision-making process within both concepts is very similar. Within both areas, you need to establish a long-term plan to ensure you either reach your financial goals or make it to the bottom of the mountain in one piece.

THIS QUARTER

During the second quarter of 2019, the market was somewhat volatile. We watched equities peak in April and decline dramatically in May, while fixed income was flat in April and climbed higher in May as bond yields declined. Ultimately, the movement of equities and fixed income and their relation to each other reduced volatility during this past quarter.

Remember, yields and prices have an inverse relationship within fixed income. This means if yields decline, bond prices rise on average. A side effect of lower bond yields is typically higher equity market multiples. The theory behind this relationship is that equity prices are a function of future cash flows discounted at appropriate interest rates.

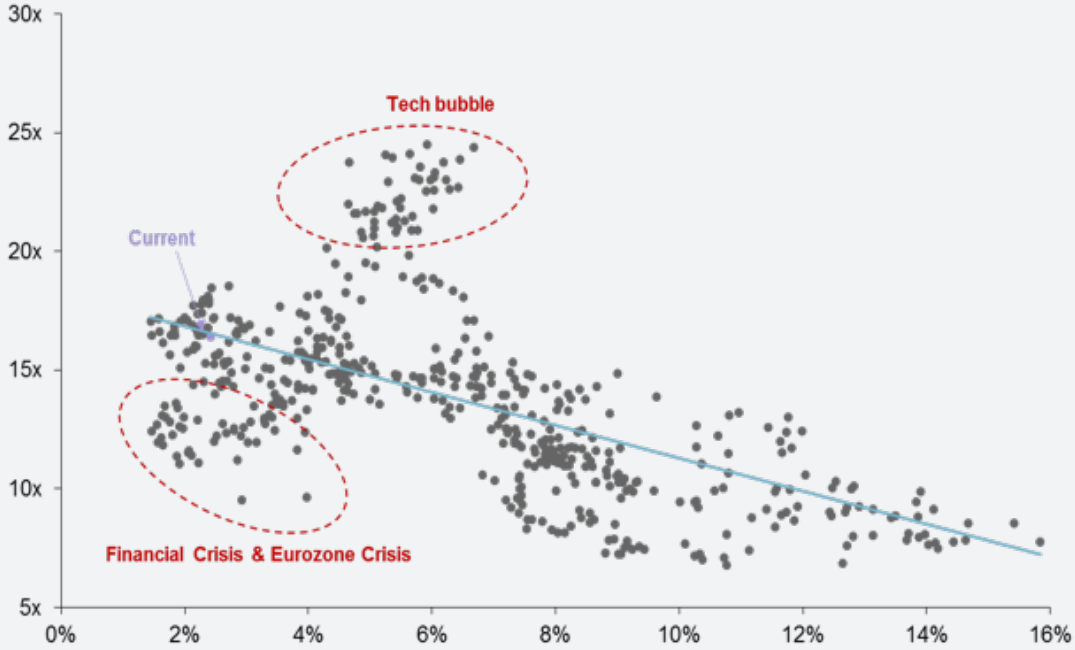
In today’s environment, yields are at historic lows. Low yields inflate the value of future cash flows and help to drive equity market multiples higher. Currently, it appears that yields will continue to remain where they are for a little while longer as inflation expectations are low and central banks are becoming more data dependent. Additionally, equity market multiples are likely to remain higher for longer.

Within the graphic to your right, we can see historical equity market multiples relative to yields. Note that at today's yield level (around 2%), equity market multiples tend to be higher.

LOOKING AHEAD

Even though equity market prices should remain elevated, we remain cautious regarding equities at this late stage in the economic cycle. Our focus will remain on larger cap positions, which pay above average dividends versus smaller size companies. Smaller size companies tend to be more volatile than larger companies, and at this stage in the cycle, we remain committed to managing volatility within the portfolios.

S&P 500 P/E Ratio Versus U.S. 10-Year Yields



Source: IBIS, Shiller, FactSet, J.P. Morgan Asset Management. IBIS NTM estimates are used until 1985. Between 1975 and 1985, CAPE-Shiller P/E ratios are used. Data are as of April 30, 2019.

For the time being, economic growth looks solid. However, if economic conditions deteriorate, equity valuations could impact portfolio performance as multiples decline. But currently, economic growth, jobs, corporate profits, inflation, and interest rates all remain in check. If that changes, we will be proactive in making portfolio adjustments on your behalf.

Regarding jobs, the unemployment rate is the lowest it has been since December of 1969. Within the labor markets, we are monitoring for signs of wage pressure, as this translates into inflationary pressures. However, at this time, we find little to be concerned about within this space.

Regarding growth, GDP growth was roughly 3.1% during the first quarter of 2019. Second quarter's GDP growth is expected to be softer than first quarter's, but still favorable. Although weaker data points to weaker growth, consumer spending remains solid and consumer confidence remains strong. We are monitoring trade tensions closely and will watch for any impact on growth going forward.

At this point, the biggest risk to the economy over the near term is related to trade tensions. Unresolved trade tensions may exacerbate a slowdown in global growth. However, we are still watching for empirical evidence of this to unfold in a material way. In the interim, we will continue to monitor policy bantering that occurs between countries.

ACTIVE ALLOCATION VIEWS

Themes	Category	Change	Negative	Neutral	Positive
Main Asset Classes	Equities	-	○○○	●	○○○
	Bonds	-	○○○	●	○○○
	Cash	-	○○○	●	○○○
Domestic Equities	Large Value	-	○○○	○	●●○
	Large Growth	-	○○○	○	●○○
	Mid Value	-	○○○	○	●○○
	Mid Growth	-	○○○	○	●○○
	Small Value	-	○○○	○	●○○
	Small Growth	-	○○○	●	○○○
	Tactical Equity	-	●●●	○	○○○
Foreign Equities	Developed	-	○○○	○	●○○
	Emerging	-	○○○	○	●●○
Fixed Income	Intermediate	-	○○○	●	○○○
	Short Term	-	○○○	●	○○○
	High Yield	-	○○●	○	○○○
	Cash	-	○○○	●	○○○

YOUR FINANCIAL JOURNEY

In many ways, your financial journey is like a mountain expedition. Both require research, planning, and flexibility. Regardless of where you are in your journey, remember, the summit is never the goal. It is only the halfway point to the success of your financial plan. Together, we will plan and strategize past the halfway point to help ensure your long-term goals are achieved.

KEY THEMES AND THEIR IMPLICATIONS

Themes	Category	Rationale
Equities	Economic Growth	Global growth and corporate earnings remain positive
	Business Cycle	Growth is moderating but remains slightly above 2%
	Inflation	Inflationary pressures are not a concern at this point
Bonds	Bond Yields	The Federal Reserve's policy remains in a neutral stance
	Duration	Interest rates should remain low for longer
	Quality	Higher quality credits are still preferred due to valuations

If you have any questions about the markets or our investment strategy, please contact your Relationship Manager.

RAA
15725 Dallas Parkway, Suite 220
Addison, TX 75001

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visit us at
raa.com
or call us at
800.321.9123