The Meridian Memo

Meridian Financial Advisory **7/27/2018** [Edition 1, Volume 2]

Mitigating Interest Rate Risk

Target Date Bond ETFs

In our inaugural newsletter we discussed how we create and position client portfolios. In this follow up newsletter there are many things we want to discuss including our adoption of Money Guide Pro software and various tools that come with it including Monte Carlo Analysis and how they assist us as advisers to develop robust integrated financial plans. In future newsletters we hope to cover these topics.

However, as we have indicated to some clients, we will spend some time on Target Maturity Bond ETFs which are a relatively new product that can help clients protect against interest rate risk. This is a primary concern both because of the composition of many our clients' portfolios and because of the present nature of the risk of rising interest rates with the consequent impact on portfolios. As we mentioned in our first newsletter, when interest rates increase the price of bonds decrease. This risk is simply called "interest rate risk." *For the vast majority of investors who hold mutual bond funds or ETFs which generally maintain a fairly constant average maturity, they can lose principal due to rising interest rates. This is a risk we often want to avoid. A large motivation to hold fixed income instruments is to reduce risk.* Now for investors who purchase actual bonds and hold them to maturity, even though the price of those bonds in the secondary markets may decrease, they will not lose any principal (if the issuer does not default). The worst that happens is that investors are left holding bonds that are paying less income than newer bond issues. Well, there are these relatively new products that allow individual investors to have the same opportunity that more affluent

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Company Communique

We are also happy to note that Meridian's Managing Principal Joshua Henry did pass the Certified Financial Planner exam on July 17 which is a major step towards achieving the CFP® certification. We advertise this achievement because we want clients to have confidence in our firm and to know Joshua is motivated to better serve clients.

"CFP® certification is generally recognized as the highest standard in personal financial planning, qualifying financial planning professionals to provide their clients with comprehensive financial advice."

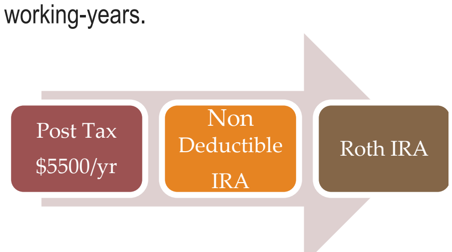
The CFP Board says it well: "Although many professionals may call themselves "financial planners," CFP® professionals have completed extensive training and experience requirements and are held to rigorous ethical standards. They understand the complexities of the changing financial climate and know how to make recommendations in your best interest."

investors have access to, who have the means to purchase a diversified set of actual bonds (not funds) and hold them to maturity. These newer products are called Target Date Bond ETFs. At Meridian, we have studied these products and would like to begin integrating them in certain client portfolios, particularly to those closer to, in, or later into their retirement. Clients with more conservative outlooks who are not in or near retirement may still find Target Date Bond ETFs attractive.

Non-Deductible IRA and Back Door Roths

IRA Strategies

Many people know the basics of Traditional IRAs and know a thing or two about Roth IRAs. However, much less is known about what are called non-deductible IRAs and a related maneuver known as a backdoor Roth. For people who have earned income, but are not participants in employer sponsored retirement plans, there are no adjusted gross income limits on making contributions to a Traditional IRA which is $5,500 for those under 50 and $6,500 for those over 50 but under 70.5. Also, anyone with an AGI under $101,000 (phased out at $121,000) who files married filing jointly (MFJ) or less than $63,000 (phased out at $73,000) who files as single who has earned income, even if they are participants in an employer sponsored plan, can contribute to a deductible IRA. If you are the spouse of an active participant, you can contribute to a deductible IRA if your combined adjusted gross income is less than $189,000 (phased out at $199,000). In each of these situations, even if you exceed the earnings threshold, both the high wage earning active participant and the spouse can contribute to non-deductible IRAs. Also, anybody who has earned income, even if they are active participants, can contribute to a Roth IRA, provided they make less then $189,000 (phased out at $199,000) if you file MFJ or make less than $120,000 (phased out at $135,000) if you file as single. However, there are many people that make over the above limits and thus cannot contribute to a Roth and are in employer sponsored plans and are not sure whether they can contribute to an IRA or not. That answer is they can, but they cannot deduct the contribution. These are known as non-deductible IRAs. Upon retirement, taxes are paid on all distributions including the contributions and the earnings just as any other Traditional IRA. The benefit is they can grow tax free and when they are withdrawn may be taxed at a rate that is lower than they experienced during their working-years.



Even better, however, is a maneuver known as a backdoor Roth. Clients can immediately convert the money contributed to a non-deductible IRA to a Roth IRA without paying any additional tax provided they do not have any existing Traditional IRA balances. (Conversions are allowed for those with existing Traditional IRA balances. It is just a little more complicated.) This backdoor way allows people with incomes greater than $189,000 to make full contributions to a Roth of $5,500. The wonderful thing about a Roth IRA is that balances can be withdrawn completely tax free and that includes the contributions, conversions, and earnings as long as they are held onto for 5 years and until 59.5 years old. There are a few more complexities regarding rules governing taxes on distributions. Holding requirements to avoid taxes and premature distribution penalties are different for contributions, conversions, and earnings.

For those with high earnings who are participants in an employer sponsored plan, we believe contributions to a non-deductible IRA alone are beneficial and pursuing the backdoor Roth is a no brainer and a clear winner. If you have any questions about pursuing these strategies, please reach out to us.

"If you start drinking, smoking and eating fatty food, you'll have enough retirement money to last the rest of your life."

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