Is Dollar Cost Averaging A Winning Strategy?

The press often writes about the advantages of dollar cost averaging. The main idea is that people spread out investing over a period of weeks or months, instead of placing a large sum of money in the market at once. In other words, if the market goes down, people's next investment will be completed at lower prices.

Unfortunately, research suggests investing a large sum of money at once (as opposed to dollar cost averaging) actually produces better investment results. For example, a study by the Vanguard fund group, found that for the U.S., Australian, and U.K. markets a lump sum investment produced a higher total return than dollar cost average investing 67% of the time. This seems logical since markets deliver positive returns far more often than negative returns.

A different study from Seeking Alpha, found that during the past 27 years, the average lump-sum 12-month return in the S&P 500 was 8.77%, while the average dollar-cost averaging return would have been 4.77%. The returns of dollar-cost averaging strategy came a little closer to the lump sum strategy when bonds were substituted for cash.

Dollar cost averaging has shown some advantages – it reduces the risk of investing at the "wrong" time. For example, another study suggested the lump sum drawdown was 9.98%, but only 5.87% for the dollar-cost averaging strategy.

There is a calculator that allows you to compare results between lump sum vs. dollar cost averaging. You can select the year and month of the lump sum investment and compare the result to investing equal monthly amounts throughout the entire year. If you are interested, go to www.moneychimp.com/features/dollar_cost.htm

Capital Gains: How to Determine Your Tax Rate

A simple-sounding question that, in the world of tax planning, is harder to answer. The simplest calculation is that, in 2021, single taxpayers will pay 0% capital gains taxes if their adjusted gross income is below $40,400, while joint taxpayers will pay 0% capital gain taxes below $80,800 of adjusted gross income. After that, the 15% rate kicks in up to $445,850 (single) or $501,600 (joint). Above those income thresholds, taxpayers would pay at a 20% rate.

But, of course, it is never that simple. You may also be subject to the net investment income tax, or NIIT, which adds 3.8% to the tax on your overall investment income -- that is, the combination of all capital gains, plus interest, dividend, rental or royalty income. People are subject to this additional tax if their modified adjusted gross income exceeds $200,000 (single filers) or $250,000 (joint filers) or, alternatively, their net investment income surpasses these thresholds.

While these details are complicated, they only apply to "traditional" investments, like stocks, bonds, mutual funds and ETFs. Long-term gains on depreciable real estate investments is set at a maximum federal rate of 25% (plus the NIIT if applicable).

Not surprisingly, it's actually more complicated than that. Assume you sold a rental house for a $100,000 gain, after claiming $40,000 of depreciation deductions. The first $40,000 of the gain (the amount depreciated) would be taxed at a 25% capital gains rate, while the remaining $60,000 would be taxed at 20%. Add to that the NIIT if it applies.

There's more. If you are selling collectibles like artwork, coins or stamp collections, bullion or precious metal ETFs, the maximum federal rate on long-term gains is 28%.

What about short-term capital gains? Those are taxed at the (generally) higher ordinary income tax rates of 10%, 12%, 22%, 24%, 32%, 35% and 37% rates.

Trying to determine your capital gains tax rate could also be known as the full employment act for tax professionals.

Being Aware of Elder Abuse

When the media talks about elder abuse, people often think about domestic and physical violence. AARP suggests the most likely type of elder abuse is financial. For example, consider the elderly grandmother who is accompanied by her 20-year old grandson to the bank where, at the grandson's behest, she makes a $4,000 withdrawal. Debra Whitman of AARP estimates the average cost of elderly financial exploitation is $120,000 per victim at an aggregate U.S. cost of $2.9 billion per year.

The biggest clue to possible financial exploitation is constant and out-of-the-ordinary cash withdrawals. As a result, AARP has launched AARP BankSafe, an online training program available to bank and credit union employees who often interact with elderly customers.

Exploitation is defined as abusing one's relationships -- in this case a relationship with an older person -- as a way to persuade the elderly person into handing over some of their assets. There are a variety of ways exploitation can occur – misusing a power of attorney, blocking an elderly person from accessing their money, or withdrawing money from the victim's account without their permission. Most perpetrators are well-known to the victim and often include family members and caregivers.

Bank tellers should be asking customers a number of questions and, if they notice something unusual, request the help of a supervisor. There is at least initial evidence that the increased vigilance is somewhat effective. Nevertheless, AARP reports that, even with financial institutions increased efforts, reports of elder financial abuse quadrupled between 2013 and 2017. It is likely that reported incidents represent only a small fraction of actual cases.

Estate Planning Risks

There are many issues to consider as you organize your finances and decide what happens to your assets after your death. While there may be similarities between people, each person does have unique characteristics – and that is one reason why estate planning can be complex. Because of this complexity, there may be several unintentional mistakes made. Here are a few common things you should try to avoid.

Issue 1: Naming the Wrong Executor

The executor is the person who will be in charge of your assets after you pass away. They will collect the assets, pay debts and expenses, and file any necessary tax returns.

Unfortunately, the original named executor, years after the original documents were signed, may not be in a position to assist (death / elderly, etc.). If a professional was chosen, such as an attorney or accountant, they may be out of business and/or long retired. Children who may have been to young when the original documents were signed, may now be an appropriate choice.

Suggestion: Every few years, make sure to verify who has been named your executor and evaluate if they are still an appropriate choice.

Issue 2: Not Keeping Documents Up-to-Date to Reflect Maturity of Children

When children are young, it is common that a guardian and/or trust may be created if their parents die. Once the children reach maturity, the guardian provisions are likely not needed and leaving assets to a trust should, at a minimum, be re-evaluated. It may make sense, when the children are adults, to distribute assets directly to them – as opposed to a trust.

Your wishes may have changed as well. One of your children may be struggling financially while another has met with great financial success. Or maybe a grandchild has special needs.

Suggestion: Check to see that the provisions in your will/trust, as it relates to your children are appropriate and update if necessary.

<u>Issue 3: Inappropriate Health Care Directives</u>

Under the Health Insurance Portability and Accountability Act (HIPPA), people's medical records are confidential and cannot be shared with anyone without written permission. Not having this information could prevent any decision-making by others in case something happens to you.

Suggestion: Update and check your living wills, advanced health care directives and your health care powers of attorney.

<u>Issue 4: Inappropriate Estate Tax Provisions.</u>

In 2021, individuals are allowed to transfer assets valued up to $11.58 million ($23.16 million for married couples) free of gift taxes and estate taxes. However, outdated estate documents might include planning that was appropriate for much lower exemption values. For example, requiring the funding of a trust for heirs up to the applicable exclusion amount, might have the unintended consequences of impoverishing the surviving spouse.

Suggestion: Review the details in your estate documents with your attorney and/or tax professional.

<u>Issue 5: Estate Documents Created in a State You No Longer Reside</u>

Each state has its own income and estate laws. Some states use community property laws while others are common law states. As a result, there can be significant differences in how assets are transferred.

In addition, 17 states impose some form of estate / inheritance tax, with different exemption amounts. It is possible that an estate not subject to federal estate tax is subject to state estate taxes. If your estate planning documents were created in a state different than where you currently reside, they may be outdated and could be misapplied.

Suggestion: Review your estate plan to see if it is still appropriate, and make it reflects your current residency.

<u>Issue 6: Not Using Portability</u>

Portability is the ability of a surviving spouse to use any <u>unused portion</u> of their deceased spouse's exclusion amount. Portability is a relatively new tool in the estate planner's toolkit. Documents should be reviewed to ensure they properly allow the use of portability. In addition, portability only works if the first estate files a federal estate tax return within the allowed time frame. If they do not file a return at the first spouses death, this could be a costly mistake if the surviving spouse dies with more than $11.58 million.

Suggestion: Review your estate plan with your attorney to ensure portability.

Issue 7: Failing to Plan for Capital Gains Taxes.

Most estates will not pay a federal estate tax. As such, tax planning should generally be focused on income tax planning (as opposed to estate tax planning).

For example, planning for a step-up in basis for appreciated assets. This means that, for the heirs, the capital gains tax obligation on the amount of appreciation during the deceased's time of ownership will disappear. In the tax world, this is probably the closest thing one can get to a free lunch.

Suggestion: Working with your financial team, consider keeping low cost basis assets so heirs could receive the step up in basis.

Life Hacks That Will Save You Time

Many times, it's life's little annoyances and difficulties that get in our way and frustrate our plans and schedules. But over time, people have come up with ingenious ways to overcome at least a few of those small challenges.

A website called homehacks.com routinely collects these tips and ideas from its readers. Some of them are easy, like, when you find yourself trying to spread cold butter on a piece of bread, try rubbing the butter against a cheese grater to make it more spreadable. Or, if you are trying to tighten or remove a stripped screw try putting a rubber band between the screwdriver and the screw head – making the screw easier for the screwdriver to grip.

Want more? If you need to chill your wine that has warmed up, instead of dropping an ice cube in the wine glass, drop in a few frozen grapes. If you need to top off the oil in your car's engine but don't have a funnel, hold a screwdriver over the opening and pour the oil down the blade of the screwdriver and avoid spilling a drop.

Are your eggs fresh? How would you know just by looking at them? You can get a definitive answer by dropping the eggs in a container of water. The fresh ones will sink straight to the bottom. But if the eggs are going bad, they'll float at least halfway up the container.

Have you ever rented a car, and pulled into a gas station, and then suddenly found yourself wondering which side of the car the gas tank is on? You can tell by looking at the direction of a little arrow in the middle of your fuel gauge that you probably never noticed before.

Suppose you drop a piece of jewelry in the carpet. Wrap pantyhose around the opening of the vacuum attachment and run the vacuum over the carpet. Have you ever gone on the road and realized that you forgot the charging dock for your phone? Most hotel televisions have a USB port on the side.

Peeling boiled eggs can be a real hassle. But not if you drop the boiled eggs in ice water before peeling. The shells will slip right off. Trying to find and peel off the edge of a roll of packing tape? Every time you finish with the tape, mark the edge with a paper clip, which holds the end of the tape above the roll so you can get at it easily. Do you hit your finger with a hammer when driving a nail? Use a clothespin to hold the nail in place.

The site also suggests you polish your car's headlights with toothpaste, and that you color-code your many keys with different colored nail polish. You can also put all your charger cords and plugs into a glasses case when you travel, and use a lint remover roller to clean your window screens.

Who knew?