ROCKBRIDGE
INVESTMENT MANAGEMENT

FINANCIAL COMMON SENSE July 2019

<u>**THE ROCKBRIDGE TEAM:**</u>

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Patrick Rohe, CFP®
Edward Barno, CPWA
David Carroll, CFP®
Claire Kobylanski
Kevin Sullivan, CFP®
Ethan Gilbert, CFA, CFP®
Mike Antonacci, J.D.
Nicholas Stancato
Zach DeBottis
Patricia Edwards
Julie Murfitt
Julia Conlan
Robert Ryan, Ph.D.
Edward Petronio, Ph.D.
Richard Schlote

Rockbridge Investment Management is a group of like-minded professionals working with a select group of clients with whom we can have a significant impact. Everything we do is focused on building and preserving wealth for our clients. We help remove complexity so clients can focus on the simple but difficult process of successful investing.

New Faces at Rockbridge

We'd like to welcome to the firm our newest investment advisor, **Zach DeBottis**, as well as our two summer interns, **Joel Farella** and **Hari Nanthakumar**.

Zach joined Rockbridge in a new capacity this past June, having worked for Rockbridge as an intern intermittently throughout his senior year of college at SUNY Geneseo. While working as an intern, Zach found a real appreciation for the approach that Rockbridge takes to improve the financial well-being of their clients. Upon nearing graduation, Zach received several job offers from other Syracuse-area firms within the industry, but he realized very quickly that the values instilled within the framework of Rockbridge resonated with his own values the most.

You can learn more about Zach on our website www.rockbridgeinvest.com.

Joel joins us having just completed his first year at St. Lawrence University, where he intends to major in business and environmental studies. His connection to the firm is through his father, Anthony Farella, one of the founding partners. Joel believes this internship is an appropriate fit for him because he has had an interest in finance for a number of years. Aside from his interest in finance, he also believes that the dynamic of working in the Rockbridge office will provide him with valuable skills and experience for all of his future endeavors.

Hari, like Joel, has also just completed his first year at Columbia University as an economics and philosophy major. He heard about Rockbridge through Ed Barno, one of the advisors of our firm. Hari is hoping to take a deep dive into the world of investment management and explore the complex and sometimes difficult financial issues faced by individuals and institutions. Additionally, Hari is excited to learn about how Rockbridge in particular goes about making decisions to better the financial well-being of their clients.

Welcome Zach, Joel, and Hari!◆

Tax Diversification of Accounts in Retirement

by Kevin Sullivan

For nearly all investors, the importance of asset allocation and security diversification cannot be overlooked. *Diversification* can mean different things to investors, but the concept is pretty well understood – hold several different types of investments and you will be better served than those who are concentrated in one stock or in one narrow investment strategy.

I would like to introduce the topic of "tax diversification" here – since it's not a phrase that is generally understood or discussed among a large percentage of investors and retirees. The type of account you are eligible to open and maintain will determine how and when the funds are taxed.

Tax Diversification of Accounts in Retirement *Continued*

For example, whether a withdrawal from your account will affect your taxable income, and ultimately how much you pay in federal and state income taxes depends on the type of account.

Account types generally fall in one of three categories: Tax-Deferred, Tax-Free and Taxable.

(1) **Tax-Deferred:** Funds held in Traditional IRAs, a 401k, 403b, pensions or profit-sharing plans are tax-deferred. Contributions to an employer's sponsored plan are made on a *pre-tax* basis before wages are taxed (such as with a 401k or 403b or 457 plan). Most insurance annuities are tax-deferred – gains are taxable when you or a beneficiary receives a withdrawal. In the case of a Traditional IRA, contributions are normally made on a pre-tax basis. Contributions are allowed but complicate the future reporting that is required to avoid paying tax again.

(2) **Tax-Free:** Funds held in Roth IRA's are tax-free. Contributions to the account are after-tax, but there is no tax charged on earnings or normal distributions. Additionally, certain types of municipal bonds produce tax-free income and may not have to be reported as income on either your state or federal return - or both.

(3) **Taxable:** A typical Brokerage account is taxable. The dividends, interest, capital gains or capital losses are reported to the taxpayer at the end of each year and you will have to pay tax on any income or realized gains. A withdrawal from this type of account is not a taxable event, because tax is paid on the income each year.

When in retirement, there may be compelling reasons to accelerate or delay tax-deferred distributions or rely on those that are deemed tax-free. Rather than simply withdrawing from only one account type, it may make sense to rely on two or even three of those category-types in later years, depending on personal circumstances. We generally advise our clients, when appropriate and advantageous, to have and maintain a combination of accounts that are "tax-diversified" to maximize the efficiency of distributions, and the favorable tax treatment given to long-term capital gains, dividends and capital losses. Certain account types are better suited for gifting to individuals or charities during life, while others can more effectively meet philanthropic goals upon death and avoid income tax.

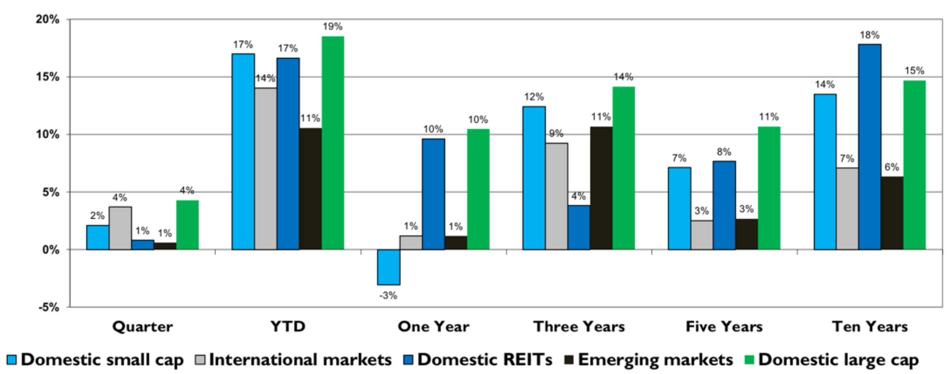
As with many facets of financial planning, there is rarely an absolute right or wrong method, but rather, a *better* method for distributions, gifts and asset classes held in certain account types. If you believe you stand to benefit from being more "tax-diversified" with your account types, please contact your Rockbridge advisor for a more detailed discussion of this topic. ◆

Market Commentary *by Bob Ryan*

Stock Markets

Stocks for this quarter maintained the above-average trend in the year-to-date numbers. The primary market drivers are the Fed activities and the status of tariff discussions with China and Mexico. As the prospects for reduced interest rates and resolution of the tariff negotiations wax and wane, stocks move up and down.

Stock Market Returns over Periods Ending June 30, 2019 (Returns greater than a year are annualized)

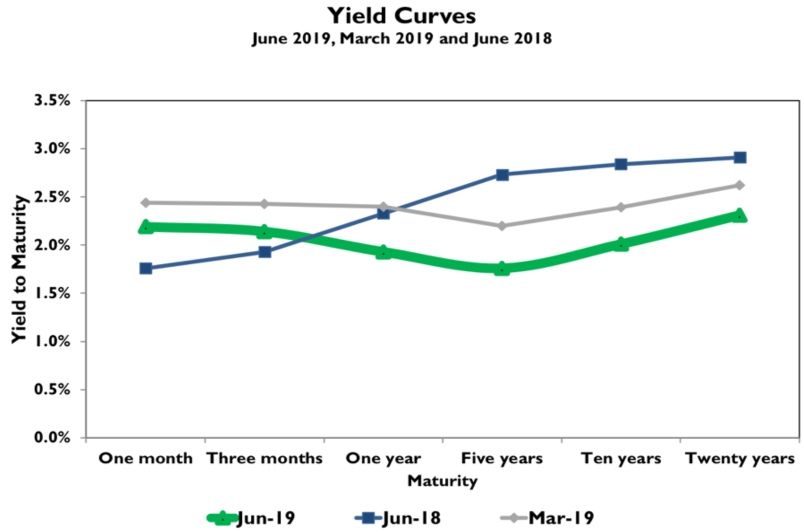


The graph at right shows returns in several equity markets for various periods ending in June. A few things stand out: (1) domestic markets have done better than non-domestic markets; (2) there are significant differences among the various markets and; (3) while volatile, it was a reasonably good period for stocks. Keep in mind that ten years is a short period and that markets have no short-term memory – what we see here may not be indicative of what the next ten years hold. Consequently, the need for diversification.

Market Commentary *Continued*

Bond Markets

The yield curves at right show what's earned over several periods from holding U.S. Treasury securities to maturity. These curves are sometimes indicative of the future direction of interest rates – upward sloping is consistent with a reward for taking interest rate risk and increasing rates; flat and downward sloping for decreasing rates. Note the parallel shift downward over the past quarter – positive for bond returns. The typical yield curve slopes upward – greater return for longer maturities. Note the June and March yield curves do not follow this pattern. Look at the uptick in short-term yields and decline in yields for longer maturities over the past year - positive for long-term bonds, negative for short-term.



Diversification

Diversification can bring short-term uncertainty, but unless you can predict the future consistently, it is still the best strategy for the long run. Holding a diversified portfolio means in most periods, there will be at least one market we wished we avoided. Recently, value stock returns are well under those in other markets. Yet, to realize the long-run benefits of diversification, we must deal with this short-term regret and uncertainty. There is evidence that over the long run, markets tend to move towards averages – periods of above-average returns are followed by periods of below-average returns.

International Trade

Markets move as the prospects for tariff negotiations wax and wane. International trade ties world economies together – it's fundamental to the workings of today's global economy. Through time the world changes and comparative advantages shift. International trade continuously affects various industries differently. Recent volatility in stocks is consistent with ongoing trade negotiations with China and now Mexico. As the specter of increasing tariffs becomes an issue, markets tend to fall when first introduced, and then rise with anticipated resolution. These ups and downs are something we must live with today.

Capital Markets and the Fed

All eyes are on the Fed and the prospect for reduced interest rates. While this noise is apt to be positive for stocks in the short run, it is hard to put together a compelling story for the longer term. First, the Fed can only directly affect short-term rates. Second, there is not much room for rates to fall from today's historically low levels. Third, Fed actions only impact long-term rates and borrowing costs to the extent they change market expectations. Finally, the reason for a rate cut is an economic slowdown – generally not positive for stocks.

Stock prices are the present value of expected future cash flows, and so move in sync with an increase's or decreases in expected cash flows and move inversely with interest rates. For reduced interest rates due to an economic slowdown, the positive impact of falling interest rates would offset the negative effect on expected cash flows. It appears the market is making that tradeoff today.

The impact the Fed has on the bond market is mostly perception. It can only affect short-term rates. A bond's yield (the amount it will earn if held to maturity) depends to an important extent on expected inflation. Changes in these yields, which affect periodic returns, follow changes in expected inflation. This is where the Fed and bond returns come full circle – the Fed watches expected inflation and signals its views by adjusting short-term rates. While it is comforting to have explanations for short-term market behavior, often it is random noise. This time around the explanation seems to be an anticipated reduction in interest rates by the Fed. ◆

Check out our Blog!

Ethan Gilbert, an advisor here at Rockbridge, wrote an informative article on the Securities and Exchange Commission Ruling on the Broker-Dealer Standard of Conduct. In June of 2019, the SEC's ruling focused on brokers and their interaction with retail investors. Previously, brokers were required to use products that were "suitable"; now, brokers must adhere to a "Best Interest" standard. The SEC ruling notes there are "key differences between Regulation Best Interest and the Advisers Act fiduciary standard." To learn more about the SEC ruling and the fiduciary standards that Rockbridge abides by, be sure to read the full article on our website blog at www.rockbridgeinvest.com. ◆

Returns from Various Markets

The following table shows the returns from various markets over periods ending June 30, 2019:

Market/Asset Class	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
FIXED INCOME							
3-Month US Treasury Bills	0.63%	1.24%	2.31%	1.38%	0.87%	0.49%	1.85%
Bloomberg Barclays US Agg Bond	3.08%	6.11%	7.87%	2.32%	2.95%	3.90%	4.93%
Bloomberg Barclays 1-5 Yr Credit	2.06%	4.50%	6.13%	2.47%	2.36%	3.44%	4.43%
DOMESTIC STOCKS							
S&P 500	4.30%	18.54%	10.42%	14.20%	10.71%	14.70%	5.90%
S&P 500 Value	4.02%	16.70%	8.67%	10.65%	7.93%	13.10%	5.63%
S&P 500 Growth	4.56%	20.19%	12.02%	17.27%	13.09%	16.10%	5.68%
Russell 2500	2.96%	19.25%	1.77%	12.35%	7.66%	14.44%	8.92%
Russell 2500 Value	1.89%	15.26%	-1.92%	8.98%	5.55%	13.28%	9.05%
Russell 2500 Growth	4.14%	23.92%	6.13%	16.15%	9.98%	15.67%	7.90%
MSCI US REIT	1.29%	17.77%	11.06%	4.14%	7.81%	15.55%	10.30%
INTERNATIONAL STOCKS							
MSCI EAFE	3.68%	14.03%	1.08%	9.11%	2.25%	6.90%	4.00%
MSCI Emerging Markets	0.61%	10.59%	1.21%	10.67%	2.49%	5.81%	7.82%
U.S. Consumer Price Index	0.74%	1.93%	1.63%	2.04%	1.45%	1.73%	2.19%

Note: These results were developed by simulating past returns in the various markets included in each benchmark, assuming the reinvestment of dividends and other earnings. The BofA Merrill Lynch 3-Month U.S. Treasury Bill Index represents money market/cash; the Bloomberg Barclays US Aggregate Bond Index represents the total U.S. bond market; the Bloomberg Barclays 1-5 Yr Credit Index represents the U.S. corporate bond market; the S&P 500, S&P 500 Value Index and S&P 500 Growth Index represent the domestic large-cap market; the Russell 2500, Russell 2500 Value Index and Russell 2500 Growth Index represent the domestic small-cap market; the MSCI U.S. REIT Index represents the U.S. real estate market; the MSCI EAFE Index represents the developed international equity market; the MSCI Emerging Markets Index represents international emerging markets. Benchmark Portfolio returns include Real Estate and Emerging Markets allocations beginning in July 2011. Benchmark Portfolio returns do not include allocations to these asset classes prior to June 30, 2011. Benchmark portfolio returns include Corporate Bond Market as of January 1, 2019 and do not include an allocation to this asset class prior to this. This data is presented to show the long-term relationship between returns at various levels of investment risk. It is not intended to present performance results experienced by clients of Rockbridge Investment Management, but is intended to provide a benchmark against which actual performance might be judged. Also, readers should recognize that future investments would be made under different economic conditions. It should not be assumed that future investors would experience returns, if any, comparable to those shown above. The information given is historic and should not be taken as any indication of future investment results.