# Quarterly

BEACON HILL INVESTMENT ADVISORY

**Fall 2014**

*Thanks to our great clients, we're now in our 7th year of serving individuals and retirement plans. Our clients and partners could not have been more supportive of making this dream a reality! Time flies when you're having fun!!*

*Best Wishes – The Beacon Hill Team*

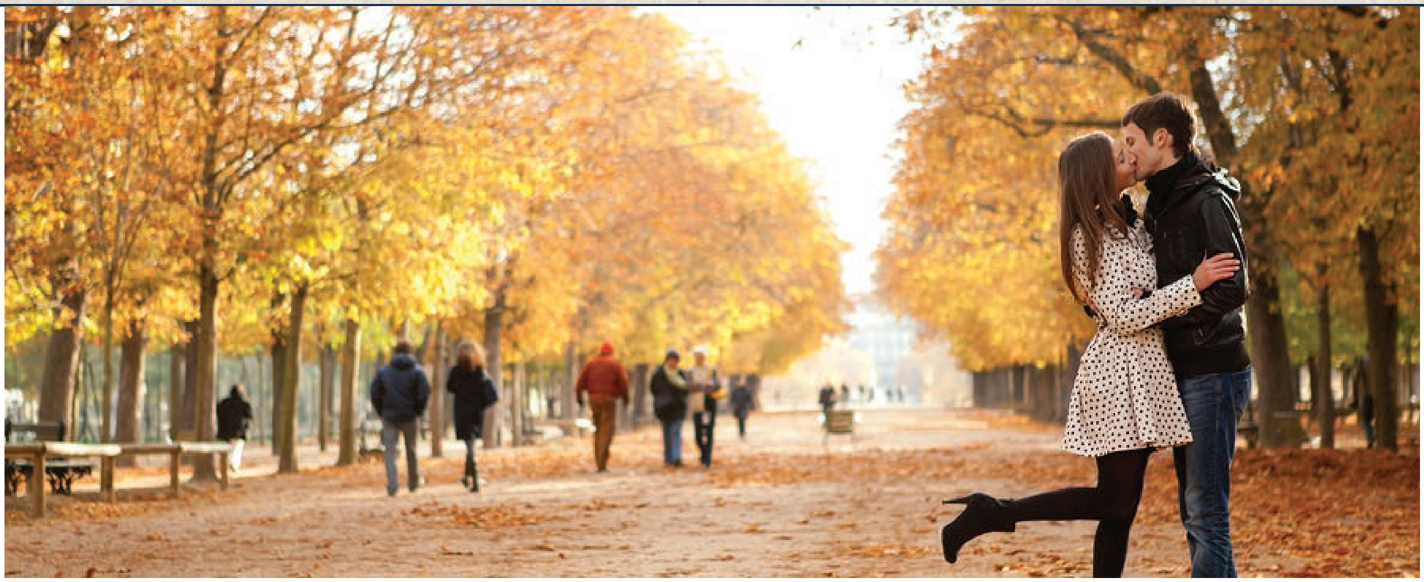
## Quarterly Market Review

Volatility returned to equities markets in Q3. A strong August was followed by losses in September, when any rallies began to focus around selected winners rather than benefiting stocks across the board. Investors exhibited a decided preference for large caps; the S&P 500 closed above 2,000 for the first time ever and the Dow industrials also set new all-time highs. The Nasdaq returned to a level it hadn't seen since March 2000 and regained the lead for 2014. However, the Russell 2000, which has struggled for most of the year, fell deeper into negative territory year-to-date, while the Global Dow suffered from political conflicts abroad and concerns about global growth.

Bond investors continued to demonstrate surprising resilience. In early September, the yield on the benchmark 10-year Treasury fell to 2.35%–a level it hadn't seen in more than a year–as prices rose. However, as the Federal Reserve continued to taper its economic support and ramped up discussion of how and when to increase rates, demand began to taper off (though geopolitical anxieties and a strengthening dollar kept the decline in check). Gold, which started the quarter at roughly $1,320, ended below $1,220. It was hurt in part by a stronger U.S. dollar, which by the end of the quarter had hit its highest level against the euro in almost two years. Dollar strength coupled with weaker global demand also meant lower oil prices; a barrel fell from $107 a barrel to roughly $93 during the quarter, a level it hasn't seen since January.

| Market/Index | 2013 Close | As of 9/30 | Month Change | Quarter Change | YTD Change* |
|---|---|---|---|---|---|
| **DJIA** | 16576.66 | 17042.90 | -.32% | 1.29% | 2.81% |
| **NASDAQ** | 4176.59 | 4493.39 | -1.90% | 1.93% | 7.59% |
| **S&P 500** | 1848.36 | 1972.29 | -1.55% | .62% | 6.70% |
| **Russell 2000** | 1163.64 | 1101.68 | -6.19% | -7.65% | -5.32% |
| **Global Dow** | 2484.10 | 2534.47 | -3.22% | -2.73% | 2.03% |
| **Fed. Funds** | .25% | .25% | .25% | 0 bps | 0 bps |
| **10-year Treasuries** | 3.04% | 2.53% | 17 bps | -1 bps | -52 bps |

**Chart reflects price changes, not total return. Because it does not include dividends or splits, it should not be used to benchmark performance of specific investments.*



# Quarterly Economic Perspective

- After contracting 2.1% in Q1, the U.S. economy grew at an annual rate of 4.6% during the second quarter. The Bureau of Economic Analysis said increases in consumer expenditures, exports, business spending on equipment, and spending by both state and local governments were major contributors to the growth. Meanwhile, after-tax corporate profits also rebounded from their Q1 slump, rising 8.6%.
- The Federal Reserve's monetary policy committee continued to unwind its economic support. Its September bond purchases were only $15 billion, and they are scheduled to end in October. The committee also reaffirmed that the key Fed funds interest rate won't increase for a "considerable time" after that. However, a survey of members showed that most now expect steeper increases than previously estimated, with rates hitting 1.4% by the end of 2015 and 2.9% by December 2016.
- Despite a slight improvement in August's unemployment rate (6.1%), the number of new jobs added in August was a disappointing 142,000, according to the Bureau of Labor Statistics. The continued slack in the labor market is one reason cited by the Federal Reserve for its caution about raising interest rates.
- The housing recovery showed signs of tapering off. New home sales fell in both July and August, and the National Association of Realtors® said a shortage of the cash buyers who had helped boost existing home resales in July cut resales the following month. Housing starts and building permits also slowed in August after a strong July, according to the Commerce Department, while the rate of home price increases in the S&P/Case-Shiller 20-City Composite Index began to taper off.
- After a strong July, manufacturing gains began to taper off. The Commerce Department said durable goods orders rose and fell based on orders for commercial aircraft, which hit a record high in July and plummeted a month later; aside from transportation, durable goods orders rose 0.7% in August. Auto production also saw a strong July and weaker August, and after six straight months of gains, the Fed's gauge of industrial production edged downward in August.
- By quarter's end, the Bureau of Labor Statistics said falling energy costs had helped cut consumer inflation by 0.2%. That left the annual inflation rate for the previous 12 months at 1.7%, down from Q1's 2.1%. The 1.8% annual inflation rate for final-state wholesale prices also was lower than Q1's 2%. The Bureau of Economic Analysis said both personal income and consumer spending saw gains throughout the quarter.
- Conflicts over Ukraine continued to raise concerns about how Russian retaliation for Western sanctions might affect the fragile European economy. A eurozone GDP that essentially flatlined in Q2 and weakness in both Germany and Italy led the European Central Bank to promise more aggressive stimulus measures.
- The Chinese economy continued to show signs of slowing in some key areas. By August, growth in industrial production was almost 7% instead of the previous month's 9%, housing sales were down nearly 11% from the beginning of 2014, and HSBC Corp.'s Purchasing Managers' Index remained at 50.2–barely above the level that would represent contraction.

*Source: Broadridge*

# Leaving Assets to your Heirs: Income Tax Considerations

**An inheritance is generally worth only what your heirs get to keep after taxes are paid. So when it comes to leaving a legacy, not all property is created equal–at least as far as federal income tax is concerned. When evaluating whom to leave property to and how much to leave to each person, you might want to consider how property will be taxed and the tax rates of your heirs.**

## Favorable Tax Treatment for Heirs

### Roth IRA's

Assets in a Roth IRA will accumulate income tax free and qualified distributions from a Roth IRA to your heirs after your death will be received income tax free. An heir will generally be required to take distributions from the Roth IRA over his or her remaining life expectancy. (Of course, your beneficiaries can always withdraw more than the required minimum amounts.) If your spouse is your beneficiary, your spouse can treat the Roth IRA as his or her own and delay distributions until after his or her death. So your heirs will be able to continue to grow the assets in the Roth IRA income tax free until after the assets are distributed; any growth occurring after funds are distributed may be taxed in the future.

*Note: The Supreme Court has ruled that inherited IRAs are not retirement funds and do not qualify for a federal exemption under bankruptcy. Some states may provide some protection for inherited IRAs under bankruptcy. You may be able to provide some bankruptcy protection to an inherited IRA by placing the IRA in a trust for your heirs. If this is a concern of yours, you may wish to consult a legal professional.*

### Appreciated Capital Assets

When you leave property to your heirs, they generally receive an initial income tax basis in the property equal to the property's fair market value (FMV) on the date of your death. This is often referred to as a "stepped-up basis," because basis is typically stepped up to FMV. However, basis can also be "stepped down" to FMV.

If your heirs sell the property with a stepped-up (or a stepped-down) basis immediately after your death for FMV, there should be no capital gain (or loss) to recognize since the sales price will equal the income tax basis. If they sell the property later for more than FMV, any appreciation after your death will generally be taxed at favorable long-term capital gain tax rates. If the appreciated assets are stocks, qualified dividends received by your heirs will also be taxed at favorable long-term capital gain tax rates.

*Note: If your heirs receive property from you that has depreciated in value, they will receive a basis stepped down to FMV and will not be able to claim any loss with respect to the depreciation before your death. You may want to consider selling depreciated property while you are alive so that you can claim the loss.*

## Not as Favorable Tax Treatment for Heirs

### Tax-Deferred Retirement Accounts

Assets in a tax-deferred retirement account (including a traditional IRA or 401(k) plan) will accumulate income tax deferred within the account. However, distributions from the account will be subject to income tax at ordinary income tax rates when distributed to your heirs (if there were nondeductible contributions made to the account, the nondeductible contributions can be received income tax free). An heir will generally be required to take distributions from the tax-deferred retirement account over his or her remaining life expectancy. (Of course, your beneficiaries can always withdraw more than the required minimum amounts.) If your spouse is the beneficiary of the account, the rules may be more favorable. So your heirs will be able to defer taxation of the retirement account until distribution, but distributions will generally be fully subject to income tax at ordinary income tax rates.

*Note: Your heirs do not receive a stepped-up (or stepped-down) basis in your retirement accounts at your death.*

Even though distributions are taxable, your heirs will nevertheless generally appreciate receiving tax-deferred retirement accounts from you. After all, they do get to keep the amounts remaining after taxes are paid.

### Toxic or Underwater Assets

Your heirs might not appreciate receiving property that is subject to a mortgage, lien, or other liability that exceeds the value of the property. In fact, an heir receiving such property may want to consider disclaiming the property.

## Always Nice to Receive

### Life Insurance and Cash

Life insurance proceeds received by your heirs will generally be received income tax free. Your heirs can generally invest life insurance proceeds and cash they receive in any way that they wish. When doing so, yours heirs can factor in how the property will be taxed to them in the future.

*Source: Broadridge*

# Wealth Management Process™

## Tax Efficiency

Tax Loss Harvesting

Muni vs. Corporate Bonds

Strategic Tax

Asset Location

Tax Deferred/Corporate Retirement Options

**This Quarter: Tax Efficiency**

This quarter's topic, *Planning for Tax Efficiency,* is both important and timely given a December 31st deadline to take action. In addition to the items listed, we are strategically reviewing our clients' portfolios in light of the new investment taxes. Of course, we always take this time of year to optimize portfolio gains and losses to decrease tax liabilities. We work best alongside your CPA or corporate finance professional.

**Next Quarter: Cash Flow Planning**

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