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TILIA NEWS

INVESTMENT MANAGEMENT | FIDUCIARY ADVICE | RETIREMENT PLANNING

The Return of "TINA" and Navigating the Trade War

Following the change in the Federal Reserve's interest rate outlook in late 2018, the interest rate for 10 year US Treasury Bonds has declined from 3.23% in late November to 2.38% today. This is extremely important, as 10 year Treasury rates serve as a proxy for the returns that investors can expect to get from a variety of different conservative bond or bond-like investments.

After a brief period where investors could lock in 4 - 5% on intermediate term bonds without taking a lot of risk, the market has descended back into what some have termed the "TINA" market. TINA means that for investors seeking to earn a respectable return, **T**here **I**s **N**o **A**lternative to stocks, or other investments that are high on the risk/reward spectrum.

Bond investors are now faced with a market where returns are universally low, and there is woefully insufficient reward offered for buying longer-term bonds. With money that shouldn't be invested in stocks, short-term US treasury bonds or corporate bonds ranging from 1-5 years are the best option now for avoiding market volatility and preserving capital for near-term needs.

Making Sense of College Funding Options

Parents seeking to set aside funds for their children's education face a large array of investment vehicles and account types. To make matters more complex, these accounts vary in tax treatment at the state and federal level, impact financial aid differently, and are governed by separate distribution rules (Table 1). Three common means of saving include the 529 Education Savings Plan, custodial account (also known as a UTMA or UGMA account) and a brokerage account retained by the parents. These accounts will be briefly explored through the lens of their taxation, impact on financial aid and distribution flexibility.

Select College Funding Options			
	529 Account	UGMA/UTMA "Custodial" Account	Brokerage Account
Contributions State Tax Deductible?	Varies by State	N	N
Growth Tax-free?	Y	N	N
Distributions Federal Tax-free?	Y	N	N
Low Impact on financial aid for higher education?	Y	N	Y
Funds can be used for purpose other than education?	N	Y	Y
Parents keep Control of Assets?	Limited	N	Y

The 529 Education Savings Plan is a state-specific account which provides federal tax-free growth and distributions, provided they are used for qualifying education expenses. Some states also offer a tax deduction for contributions (though North Carolina does not). A 529 Plan held by a parent with a child beneficiary is viewed favorably for financial aid purposes, per the formula set by law in the "Expected Family Contribution" formula. However, the 529 funds must be distributed for qualified education expenses, which include K-12 & higher education books, tuition, computers and supplies, or face income taxes and a 10% penalty.

A custodial account, also known as a Uniform Transfer to Minors Act (UTMA) or Uniform Gift to Minors Act (UGMA) account, is an

While the decline in interest rates is a headache for bond investors, it has been a welcomed sight for risk-taking investors. Renewed optimism spurred in part by lower forecasted borrowing costs has propelled stocks back near all-time highs and quickened demand for new mortgage loans. Stocks, particularly recession-resistant dividend-payers like utility companies and consumer staples, have also benefitted from being on the receiving end of investment dollars that might otherwise be attracted to bonds.

There are plenty of downsides to the TINA market. Unsatisfied by bond returns, many conservative investors find themselves owning far more stocks in their portfolio than they can handle when the tide turns against them. This is particularly dangerous with the current trade war going on between the U.S. & China. We believe the likelihood of some sort of agreement in the next few months is relatively high. However, the continuation of tariffs & retaliatory acts will make goods more expensive for American consumers, & pressure earnings for corporations that export U.S.-made goods to China or that rely on inexpensive Chinese imports for their business. Chinese imports cover a staggering wide array of consumer products and inputs.

While most corporations that meet our investment criteria will ultimately adapt & thrive whether a deal is made or not, the near-term impact of a no-deal situation could lead to a slow-down and possibly a recession by late 2020. For this reason, we are counseling clients against racheting up stock exposures in lieu of owning bonds. We believe the certainty of short-term capital preservation outweighs the potential return of adding additional stock holdings.

Sources: Ned Davis Research

irrevocable trust set up by a parent or guardian for the sole benefit of a minor. Funds deposited become the child's property, which means income generated by investments held within the account is taxed at the child's (generally favorable) rate. For 2019, the first $1,050 of unearned income is tax-free, and the next $1,050 is taxed at the child's rate of 10%. Unearned income beyond $2,100 is then taxed at (generally unfavorable) trust tax rates. It should be noted that investments can be utilized that focus on long-term capital gains rather than current income, which can help keep taxable income below the threshold. The UTMA/UGMA account is viewed less favorably by colleges than a 529 Plan for financial aid purposes. However, fund distributions are broadly allowed for the benefit of the minor, which is more flexible than the 529 Plan's qualified education expense requirement.

Another option for most people to consider is a regular brokerage account owned by the parents but earmarked for education expenses. Funds deposited receive no special tax treatment, though growth and distributions are taxed at favorable capital gains (versus income) rates. Funds may be used as the parent desires, whether for unforeseen expenses or a child's education, without penalty. Because the parental brokerage account is not considered part of the child's assets, it is viewed favorably (much like a 529 Plan) for financial aid purposes. Distribution rules are the most flexible of the UTMA/UGMA and 529 Plan options, as funds can be used for any purpose.

There are many nuances to the options above. A distribution from a 529 Plan owned by grandparents or non-custody parent following a divorce can negatively impact a child's financial aid. The Expected Family Contribution formula also considers household income and demographic factors, among other factors, not just student and parent assets. Some private colleges may calculate EFC differently than the federal government, which can impact financial aid. A final consideration is prioritizing your own retirement savings ahead of saving for a child's education. While scholarships, grants and loans are available for college, none of those options exist for retirement!

Developing a focused college savings plan while children are still young is an important first step. Your team at Tilia Fiduciary Partners can help you navigate these decisions while ensuring the financial well-being of loved ones.

Sources: SEC.gov, IRS.gov & vanguard.com https://investor.vanguard.com/college-savings-plans/which-account