Modera Perspectives – Third Quarter 2017

Investment Commentary

Equity markets across the world had a very strong third quarter, continuing to build on gains from earlier in the year. International equities led the way, most notably emerging markets which were up 8% in the quarter. U.S. market increases were in the 4.5%-5.7% range. In the U.S. growth stocks continued to outperform value stocks, although the gap tightened a bit, and small cap stocks regained their edge over large caps. Thus far in 2017, global stock market performance has been aided by strong earnings, lower volatility and steady (albeit slow) economic improvement.

Within the fixed income sector, the Federal Reserve Bank indicated that it will begin to slowly unwind the quantitative easing program that has been in place since the 2008 recession. The Fed is signaling that it may raise rates at least once more before the end of the year. The market interest rate for the 10-year Treasury note has increased from about 1.6% twelve months ago to the current 2.33%, while during that same time the 3-month Treasury bill has moved up from 0.9% to 1.06%.

High yield and corporate bonds led the way again in the third quarter and are significantly outperforming treasuries, foreign bonds and municipals over the past twelve months. Within fixed income our focus continues to be on broadly diversifying across the spectrum of fixed income asset classes and maintaining shorter durations as a defense against interest rate increases. Real estate has rebounded so far this year after declining at the end of 2016 when the Fed raised rates.

Data ending 9/30/2017 (not annualized if less than 1 year)

Indices	Q3 2017	YTD	1 year	3 years	5 years	10 years
Equities						
MSCI ACWI (All Country World)	5.3%	17.8%	19.3%	8.0%	10.8%	4.5%
S&P 500 (U.S. Large Cap)	4.5%	14.2%	18.6%	10.8%	14.2%	7.4%
Russell 2000 (U.S. Small Cap)	5.7%	10.9%	20.7%	12.2%	13.8%	7.9%
MSCI EAFE (International Developed)	5.5%	20.5%	19.7%	5.5%	8.9%	1.8%
MSCI EM Emerging Markets (International Emerging)	8.0%	28.1%	22.9%	5.3%	4.4%	1.7%
Fixed Income						
Citigroup World Government Bond (Global Bonds)	1.8%	6.4%	-2.7%	0.9%	-0.4%	3.0%
Barclays U.S. Aggregate (U.S. Investment Grade Bonds)	0.9%	3.1%	0.1%	2.7%	2.1%	4.3%
Barclays Municipal Bond 5Y (4 - 6) (Municipal Bonds)	0.7%	3.9%	1.1%	2.0%	1.9%	3.8%
Barclays U.S. Corporate High Yield (U.S. High Yield)	2.0%	7.0%	8.9%	5.8%	6.4%	7.8%
Other Indices						
S&P Developed REIT (Global Real Estate)	1.5%	5.0%	-0.0%	7.8%	8.5%	3.7%
HFRI FOF: Conservative Index (Diversifiers)	0.9%	2.5%	4.2%	1.7%	3.4%	0.9%

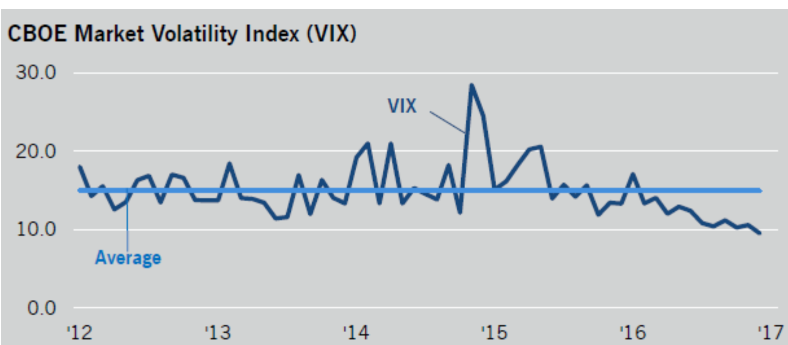
At Modera, our allocations of domestic and international equities are tilted with a bias toward small cap and value. Historically, both of these biases have generally proven to be beneficial for long-term investors. The trend over the past three years, however, has been mixed, as shown below (using U.S. stocks as a guide). Recently the so-called "value premium" has not been obvious, although the growth advantage lessens as company size decreases. On the other hand, smaller company stocks have performed well in relation to their larger company peers over the time period shown.

3 year Historical Performance:

	Value	Core	Growth
Large Cap	8.50%	10.60%	12.70%
Mid Cap	9.20%	9.50%	10.00%
Small Cap	12.10%	12.20%	12.20%

Large: Russell 1000, Value & Growth
Mid: Russell Midcap index, Value & Growth
Small: Russell 2000, Value & Growth

With recent performance so strong, many investors have become complacent regarding market risk. However, just because we don't directly observe risk doesn't mean that it is not there or has gone away. Stock market gains and relative interest rate stability belie this continuing reality. The graph below illustrates the changing trends in historical volatility over the last several years.



Source: FactSet and Ned Davis Research as of 9/30/17

Currently, the VIX index is below its historical average. Yet we can see how quickly this can change. Risk remains an inherent part of any investment portfolio. It is important to take no more risk than needed to achieve one's goals. Success is best achieved by having a plan and sticking to it through all types of market conditions. We will never be able to anticipate every risk, but we work to be able to reduce volatility as much as possible in all market conditions.

MODERA
WEALTH MANAGEMENT

Financial Planning Perspectives

Social Security: How does it fit into your financial plan?
By Kelly Henning, CFP®, Financial Planning Committee

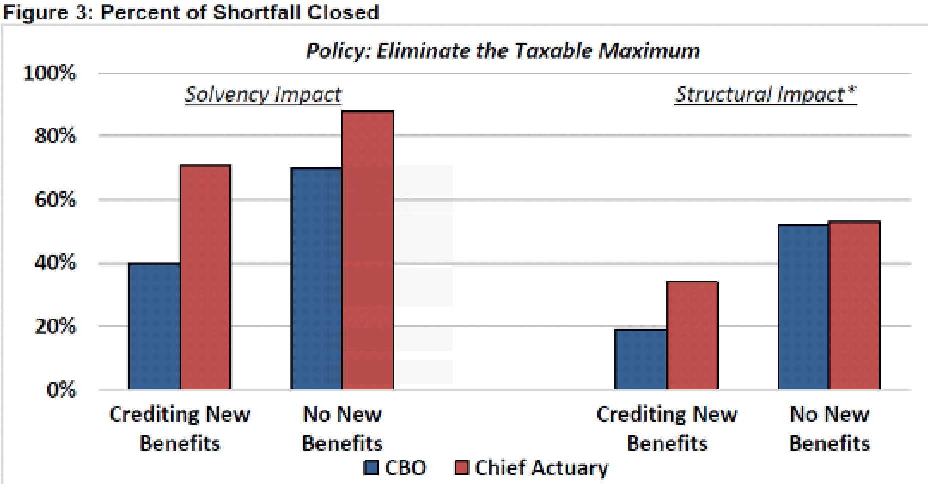
An investment portfolio is not an end in itself but rather a tool that is part of the overall financial plan. Starting this quarter, our Financial Planning Committee will provide insights on a myriad of financial planning-related topics.

We have heard it before: the Social Security trust fund is in trouble. People are living longer, and there are not enough workers to cover future retiree benefits known as OASI (Old-Age and Survivors Insurance) and disability insurance benefits. Social Security and Medicare outlays comprised 42 percent of federal program expenditures in fiscal year 2016.[1] The Social Security commissioner wrote last year that the Social Security reserves (both OASI and disability coverages) will be depleted in 2034.

Despite these statistics, after 2034 payroll taxes will still cover about 75% of scheduled retiree benefits. How to cover the 25% gap is the ongoing debate, and there are a number of ways to address this shortfall over the next 17 years.

One option is to subject all wages to payroll tax, not just those under $127,000. According to the Chief Actuary of the Social Security Administration, this would close 71% of the program's 75-year gap and extend the life of the trust fund by 32 years. The Congressional Budget Office states that the actual impact would be less, as illustrated below.

Figure 3: Percent of Shortfall Closed



Source: Congressional Budget Office, Social Security Administration
* Represents percent of 75th year shortfall closed

Another option is to increase the payroll tax. The current payroll tax is 12.4% (employers and employees) and has not increased since 1990. Increasing the payroll tax now by 2.8 points would help to ensure 75 year solvency.[2] If no action is taken until 2034, the payroll tax would need to increase by 4 points to address the gap.

[1] (https://www.ssa.gov/oact/trsum/)
[2] https://www.ssa.gov/oact/solvency/provisions_tr2016/summary.pdf

Other options include increasing the current highest Full Retirement Age to 68 over a period of time to help close the funding gap by 13%. Reducing the cost of living adjustment (COLA) by 1 percentage point could reduce up to 66% of the gap.

We at Modera endeavor to stay up-to-date on the most recent research pertaining to Social Security, Medicare and other government benefits. For current retirees and retirees in the near future, many experts believe it is unlikely that benefits will be cut in 2035 by the 25% number previously mentioned. The impact on the U.S. economy would be too large for Congress to sit on the sidelines and not legislate a change to fund these benefits. As a result, we continue to utilize the amounts detailed on clients' benefits statements for financial planning purposes. Clients have the option to request financial plan modeling without Social Security benefits. We have seen this request from a number of younger clients who do not expect to receive the same level of benefits when they reach their Full Retirement Age in 20 or more years.

Social Security benefits statements, which are available on the Social Security website (and for certain individuals by mail), include projected benefits at various ages, most notably age 62, Full Retirement Age (which varies based on the recipient's birthday) and age 70. As you can see below, the impact of delaying Social Security from age 62 to age 67 and then further to age 70 can have a profound impact on a retiree's annual income. If an individual at Full Retirement Age delays Social Security benefits from age 66 to age 67, there is an 8% increase in benefits. This increase occurs annually until age 70 when the maximum benefit is achieved. Lastly, COLA also impact the increase in benefits between age 62 and 70.

Your Estimated Benefits

***Retirement** You have earned enough credits to qualify for benefits. At your current earnings rate, if you continue working until…

your full retirement age (67 years), your payment would be about..$ 1,827 a month
age 70, your payment would be about ....$ 2,266 a month
age 62, your payment would be about ....$ 1,271 a month

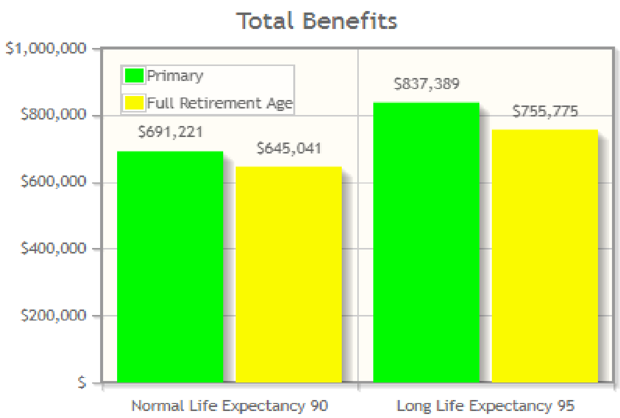
The decision to delay Social Security benefits is complex and specific to each individual and couple. As we explore the question of delaying benefits, we take the following factors into consideration:

- **Sources of Income in Retirement:** If an individual plans to meet his/her living expenses with a combination of a pension, cash and taxable investment funds in early retirement, the decision to delay Social Security claiming is more compelling than an individual who is relying fully on pre-tax IRA funds. This is because the federal and state income tax implications of withdrawing from an IRA can negate the increased Social Security benefits.

- **Ratio of Cash and Taxable Investments to Pre-Tax Investments:** Continuing on the prior point, if an individual has sufficient taxable funds and cash, this help can delay withdrawals from pre-tax accounts, such as IRAs. At the same time, fully depleting cash reserves and taxable investment accounts reduces an individual's account withdrawal strategies later in life. A balanced proportion of accounts with different tax treatments is key to delaying Social Security.

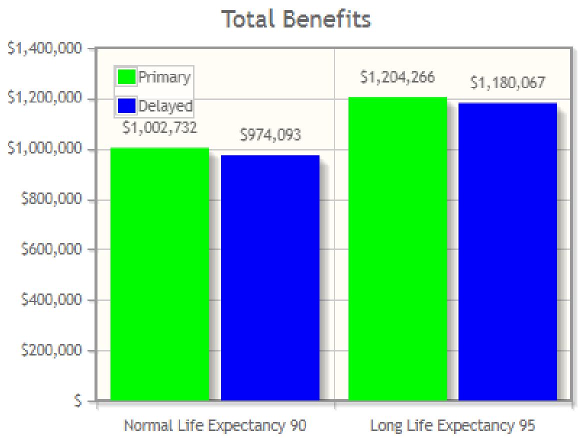
- **Retirement Date:** Social Security is taxed at 85% of the benefit if an individual's combined income is more than $34,000 (combined income definition: https://www.ssa.gov/planners/taxes.html). For a married couple, the combined income amount is $44,000 or more. Given the federal and state income tax for individuals during their working years, 85% of one's Social Security could be taxed at 39.6% for the highest income earners. Allowing the benefit to grow at 8% (plus any COLA) will not only increase an individual's benefits, but also increase one's after-tax Social Security amount (assuming one's tax bracket is lower in retirement).

- **Life expectancy:** In financial planning projections and modeling Social Security claiming strategies, we often assume a life expectancy of 90 years. If an individual has current health issues or a family history of health issues, the decision to delay claiming benefits becomes less appealing. For the individual below, it only makes sense to delay benefits until age 70 if they live past the breakeven age of 84. Thus, if an individual has reason to believe they will have a shorter life expectancy, claiming at Full Retirement Age or earlier should maximize benefits.

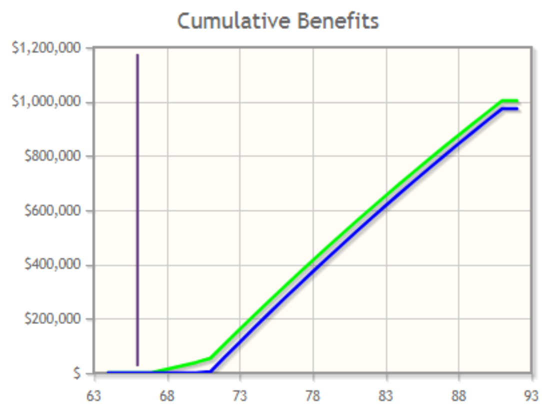


In the example above, this individual's monthly benefit at their Full Retirement Age is $2,825 in 2020. If the individual waits until age 70, the benefit increases to $3,988. This increase includes 8% per year in benefits plus an additional COLA of 1.69%.

- **Spousal Benefits:** Planning strategies for couples were reduced last year with the abolishment of the "File and Suspend" strategy which allowed the lower-earning spouse to claim benefits on the higher-earning spouse's open record. This would allow the lower-earning spouse's benefits to grow in the meantime, which could be claimed later. Delaying benefits for a couple is based on all of the aforementioned factors plus additional ones such as differing ages of spouses and varying benefits based on earnings record. The example below illustrates two spouses of the same age, but one spouse has a lower Primary Insurance Amount ($2,687 vs $1,100). In this case, the optimal claiming strategy is for the lower income earner to claim at age 66 and the higher income earner to claim at age 70. In this case, delaying both benefits to age 70 does not maximize total lifetime benefits.



Primary Strategy becomes better than Delayed Strategy at ages 66 yrs and 66 yrs.



The decision on when to claim Social Security grows in complexity when viewed in light of an individual's and couple's unique financial and health circumstances. Ultimately, though, the decision lies with the individual, and many decide that with Social Security, a bird in the hand is worth more than two in the bush.

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Thank you for your continued confidence and trust in our services. We welcome your questions and comments.

Modera Wealth Management, LLC

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