Subject: Greenleaf Newsletter: Recession Predictions, Backdoor Roth IRAs, and Not-So-Safe Deposit Boxes
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Hello Greenleaf:

Welcome to the Greenleaf Guide

A Newsletter for Clients of Greenleaf Financial Group

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In Review

Market Update
For most of August, investors have grown concerned about a trade-war escalation, weak global economic data, and growth setbacks. Bonds, therefore, have been a solid investment over the past month with gains of a few percentage points.

Stocks have had some difficult days, but these have been tempered by occasional bouts of optimism. The prospect of further interest-rate cuts by the Federal Reserve and stimulus by China has kept stock declines to less than -5% overall. Small company and

August 2019

Spotlight On

Will a Trade War Push the U.S. Economy into Recession?

Last week's escalated trade and tariff disputes between the U.S. and China caused the U.S. stock market to drop by about -1.8% for the week. However, despite this step back, the markets are still showing significant gains for year-to-date 2019. Even with the past four weeks of volatile markets, the S&P 500 Index is up more than 14% for 2019.

Thus far, therefore, it's fair to say that things haven't been all that bad. But could they get a lot worse?

Potential Impact of Tariffs
With the economic expansion in a record 11th year for the U.S. and stocks hovering near all-time highs, it's true that sustaining growth is not an easy task. Higher tariffs result in higher prices for products made by manufacturers, retailers, farmers, and others. For export-dependent economies like China and Germany, the negative economic impact is fairly sudden. The U.S. economy is less dependent on exports, but uncertainty about trade and how to conduct business effectively could cause businesses to pull back from investment and capital spending.

In turn, if corporate earnings decline, then that would

Overall, small company and emerging markets stocks show slightly larger declines, as is typical.

Economic models are suggesting about a 32% chance of a recession in the next 12 months. Although this is not even a 50/50 chance, predictions of all kinds, while often right at a macro level, are rarely right in the details of timing and magnitude.

No investment expert has been able to time getting out and back into the stock markets at the ideal time. Instead, many careers -- and retirement assets -- have been undermined.

We see good reason to take an approach that leans strongly toward "better safe than sorry," but we don't think it's wise to get out of the stock market altogether. As shown by the severe decline last December and the double-digit gains since then, it's impossible to predict when gains can be made and losses avoided. Better to chart as steady a middle path as possible.

Financial Planning Calendar: What to Do in September

Next month, we encourage clients to do the following:

Your Task

If you rent a safe deposit box, check the contents. Many items are not

lead to decreased hiring (or layoffs) and a domino effect of less consumer spending and an overall economic contraction. There are a range of economic forecasts at this time. Some predict a mild recession in about a year; others see a few more years of growth first.

Still, the classic signs that precede a recession aren't readily apparent. Corporate profits are still robust, inflation is below target levels, and there aren't huge excesses to unwind, such as the dot-com craze in the late '90s. Recessions rarely start with a bang, which gives us time to prepare.

Trim Risky Assets

For starters, we have been analyzing our clients' holdings to make sure riskier investment segments are not disproportionately large. As stocks are riskier than bonds, this means adjusting each client's stock/bond mix when stocks exceed your target allocation.

Our analysis also makes sure you are not overexposed to emerging markets and growth stocks, which tend to suffer sharper declines in a market pullback because their prospects for growth are less strong in the near term.

Increase Stable Stocks

An emphasis on typically more stable, dividend-paying stocks is another way we are bolstering client portfolios for difficult times. We are adding defensively oriented stock funds, such as JPMorgan Equity Income, AQR Large Cap Defensive Style, and AQR International Defensive Style to accounts depending upon each client's target allocation, account size, and current holdings.

Overall, our investment approach favors fund managers who look closely at how much debt a company uses to run its business. It's been easy for companies to borrow at low interest rates over the past several years, but companies with too much debt may have to cut dividends or even borrow more to service their debt in tough times. Avoiding highly leveraged companies is a key investment consideration.

appropriate for a safe deposit box since no federal laws govern the boxes and banks are not required to compensate customers for stolen or damaged items.

Why?

A recent expose by the New York Times showed just how unsafe safe deposit boxes can be. Bank consolidation, theft (sometimes by family members), poor recordkeeping and errors of all kinds have resulted in customers losing the contents of their rented boxes.

Safe deposit boxes are simply storage spaces. The word safe refers to a box locked by a key, typically inside a vault, rather than a guarantee of protection. A box's contents are not FDIC insured, nor are they insured by the bank. If the contents are damaged or stolen, you have no legal recourse to recover their value.

We recommend that you keep cash in a savings account where it will earn interest and have FDIC protections. If you have valuables and collections, talk to your insurance agent about adding coverage for those items. Many safe deposit rental agreements exclude cash and valuable items, thereby limiting a bank's liability.

Emphasize High-Quality Bonds

Bonds are meant to be the stable portion of your accounts, but holding too many junk bonds or risky bonds can backfire for investors. As economic uncertainties grow, we are careful not to have too much exposure to high-yield/junk bonds, which can decline just as much as stocks during a recession due to the possibility of defaults. Instead, resilient, high-quality bonds are the core of our bond investment approach.

Better to Prepare than React

Recessions are an unpleasant, but inevitable, part of the normal economic cycle. Over a 30-year period, we can expect to have five or six recessions and, given historical averages, another 15 stock-market declines of at least -10%. However, our cautious approach to taking investment risks means your accounts are largely tilted toward defensive stocks and bonds. As has been the case in the past, these will help your investments ride out a recession and position you for a speedy recovery when the economy swings up again.

We're always happy to share additional details or discuss your concerns. Please contact us any time!

Question of the Month

Keep items that you may need to access quickly in water-safe containers in your home or a fireproof home safe. Powers of attorney, wills, passports, etc., do not belong in a safe deposit box. Your attorney should keep copies of legal documents, but providing copies to key people is also a good precaution.

A safe deposit box can be used for the following items, but make sure you don't miss a rental payment and consider removing the contents if your bank is acquired.

- *Originals of birth certificates*
- *Property deeds*
- *Pictures of your home's contents for insurance purposes*

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Question

What is a "backdoor Roth IRA" and when is it appropriate as a way to make Roth IRA contributions?

Answer

The "backdoor Roth IRA" refers to an *indirect* way to make Roth IRA contributions for those who earn too much to contribute directly to a Roth IRA.

Because this method essentially takes advantage of a loophole in the IRS' tax code, there have been risks to making backdoor Roth IRA contributions in the past. However, informal guidance from the IRS and Congress has recently clarified what was once a grey area and has alleviated our concerns about using this strategy.

If you make too much to contribute to a Roth IRA in 2019, then the backdoor method might work for you. For single taxpayers, your modified adjusted gross income (MAGI) must be under $122,000 to make a *direct* full Roth IRA contribution. For married, filing jointly taxpayers, the MAGI limit for *direct* full contributions is $193,000.

The backdoor approach is somewhat complex.
The backdoor approach requires a series of careful steps. In sum, you first make a nondeductible contribution to a Traditional IRA (and report that nondeductible contribution on your tax return). Then, you convert your full cash contribution to a Roth IRA, which returns the balance in your Traditional IRA to $0.

You'll want to allow some time between the contribution and the conversion. However, you don't want to invest the contribution until after the conversion or you'll owe taxes on any gains.

If you have a Traditional, Rollover, SEP or SIMPLE IRA with a balance, then the backdoor Roth IRA contribution is generally not a good idea. That's because of IRA aggregation rules which require you to include all of your pre-tax IRA savings in a proportionate conversion.

Without going too far into the details, suffice to say that you are not allowed to convert the nondeductible contribution dollars only. Other pre-tax IRA savings must be included proportionately in the conversion.

However, if **all** of your pre-tax retirement investments

are in a workplace plan, such as a 401k or 403b, then the backdoor method is an excellent option. Note that you must be under age 70 1/2 and have income from a job to start the process and make a nondeductible IRA contribution.

One other consideration is that backdoor, converted dollars must be kept in a Roth IRA for 5 years if you are under age 59 1/2 or withdrawals will incur a 10% penalty.

Is this complex method worth it?
If you plan to make contributions for many years to come, then the steps required in a backdoor Roth IRA contribution can be worth the effort. All gains in a Roth IRA are tax-free, so your contributions need time to grow, but there are no required minimum distributions during a Roth IRA original owner's lifetime.

Therefore, using tax-free Roth IRA monies later in your retirement or leaving your tax-free Roth IRA account for heirs are both highly beneficial.

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