HAAS Fydroski Financial Services, Inc.
Investments - Planning - Education

IPE Insights

OCTOBER 2015

JIM'S JOURNAL

Look Back— 3rd Quarter 2015


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Due to investor worries about a China-led global slowdown and a possible rise in U.S. interest rates, the third quarter 2015 was the worst and most volatile quarter for the stock market in the last four years. All sectors of our domestic stock market as well as most world-wide markets slumped from about mid-August thru September.

In mid-August, China surprised the investing world by announcing that it would allow its currency to devalue relative to the U. S. dollar. Currency devaluation is a tactic used by countries to make their goods cheaper in foreign markets. Goods from a country with a devaluated currency are more attractive to import because they are less expensive. Devaluation also stimulates that economy. Think of it this way, all things being equal, most shoppers will choose the less expensive item if they have a choice between two items that are similar. The devaluation tactic works as long as the rest of the world does not devaluate their currencies as well – some of that is also happening. In today's world wide economic slowdown, every country would like their currency to be cheaper than the dollar in hopes of increasing their exports. From a stock market perspective, the Chinese devaluation ultimately led investors to question the overall strength of the Chinese economy.

The second event that caused stock markets to see negative returns in the third quarter was the Federal Reserve's decision not to raise interest rates following its September 16-17 policy meeting. While many Fed watchers thought a small interest rate increase would take place after the September meeting due to a generally positive outlook for the U.S. economy, it did not happen. The Fed opined that adverse "global economic and financial developments" influenced its decision not to raise interest rates. This decision further heightened concerns about a China slowdown. In addition to the China problems, the Fed also seemed to be concerned about undesirably low inflation in the U.S. economy. While it may seem counterintuitive, a certain lower level of inflation is considered to be a positive economic influence. If consumers feel that the price of goods will deflate i.e. go down in price instead of rising in price, they will delay purchasing items. Delaying purchases causes our consumer driven economy to slow down and not expand. Whether the Chinese devaluation and lack of an interest rate increase are, in fact, the real issues, investors perceived them to be so. Consequently, both U.S. and world markets suffered heavy losses in the 3rd quarter 2015.

That being said, the third quarter scorecard tallied the following returns: The Dow Jones Industrial Average lost -6.98% for the quarter and was down -6.95% year to date (YTD) at the end of the third quarter. The S&P 500 lost slightly less than the Dow at -6.44% and had a YTD return of -5.29%. And the tech heavy NASDAQ Composite won the biggest loser contest among the "big three" major indexes with a -7.35% third quarter downturn. However, the NASDAQ Composite was only down -2.45 YTD. Compared to the gains of the first two quarters and the last several years, the third quarter left investors a bit shell shocked. (Source: T. Rowe Price Third Quarter 2015 Market Wrap-Ups).

It should come as no surprise that most mutual funds also did very poorly during the third quarter. The average diversified U.S. stock mutual fund registered a negative -8.2% return in the three months ending in September and are off -5.9% YTD. It was only the second decline in the past 13 quarters for U.S. stock funds. Not to be outdone by U.S. mutual funds, International stock funds averaged a -10.1% decline in the third quarter. After years of persistent market leadership, the average health/biotechnology sector fund was down -14.5% in the third quarter. Other notable third quarter losers were: Natural Resources at -20.9, Latin America off -21.7% and Gold Oriented funds down -20.0%. In many years bond funds offer a safe haven when the stock market goes down, but not in the third quarter 2015. The Average Taxable bond fund was down -1.9% with only a few bond categories showing positive returns. (Source: Wall Street Journal 10-5-2015).

As mentioned in the opening paragraph, the third quarter 2015 was the worst and most volatile quarter for stocks in the last four years. With the Federal Reserve stimulus packages of the last several years to smooth out the bumps, we became very conditioned to only seeing positive returns. It is now somewhat difficult to imagine a negative quarter like the one we just had. Historically, however, markets have down quarters as well as down years. Volatility is also not an unusual phenomena of market behavior. Historical charts of the last 34 years show that the average intra-year decline in the stock market is about -14.2% in any given year. It has ranged from a low of -3.00 in 1995 to a high of -49.00 in 2008. If your goal is to score market returns, then both down years and volatility are part of the process you need to accept. If you are a pre-retiree or retiree, there is a warning from the research of the Financial Planning Association that should be heeded: projections on how long your money will last can be skewed if negative returns occur in the first three years of retirement. That is why I recommend both active management and risk management of your investments for both pre-retirees and retirees. Give me a call if you would like to discuss this concept further.

In closing, on another key subject, I would like to mention that there could be a hefty increase in Medicare Part B premiums for **some** recipients in 2016. The article on the reverse side outlines what these changes could be. I have included the most relevant parts of the article from a longer version that was directed toward financial advisors. I have also just read that Congress is working on a fix to address the problem. At this time, we do not know how it will ultimately turn out. Please read the article to see if you might be affected. Enjoy the rest of fall and take good care!!!

… A Medicare Surprise?

By - **Robin Brewton,** Vice President of Client Services at Social Security Solutions, Inc.

… there is a provision in the Social Security law that prohibits the net amount of a Social Security check from decreasing due to increases in Medicare premiums. Often referred to as the "hold harmless" provision, it's rarely an issue because there is a COLA (Cost of Living Adjustment) in more years than not, and the increase in gross Social Security benefits is greater than the increase in Medicare premiums. But there can be a problem in years when there will not be a COLA for Social Security but Medicare premiums need to increase due to expenditures.

Now let me clarify before we get too far into this discussion that the biggest sting will hit wealthy clients. But other clients may also be in danger of facing a stiff increase in their Medicare Part B premiums –as much as 52% --unless they fall into certain categories that will protect them.

Medicare Part B premiums are based on a 2-year "look back." That means that premiums for 2016 will be based on 2014 Medicare expenditures. The cost for Medicare is paid in this manner: 75% is paid from the general fund (primarily from Medicare taxes collected), and 25% is paid via premiums charged to beneficiaries. In 2015, the base premium is just under $105 for most beneficiaries. Medicare premiums also have a surcharge based on income, where income for determining Medicare premiums consists of Adjusted Gross Income plus tax-exempt interest.

Higher income seniors pay more for Medicare. Currently there are 5 income brackets for Medicare. In 2015, seniors who make more than $428,000 (couple) or $214,000 (single) –the highest bracket -pay about $336 per person per month vs the $105 per person most people pay. Since it's been projected there will be no COLA for 2016 but Medicare premiums need to increase substantially in 2016, there will likely be an issue.

In years prior to now when there has not been a COLA, Medicare premiums have not needed to rise as substantially as the projections for 2016. In 2015, Medicare premiums increased, but the 1.7% COLA covered the increase. For example, the average Social Security recipient saw a raise of about $22 monthly, but Medicare premiums went up only about $10 for a net Social Security benefit increase of about $12.

If there is no COLA for 2016 as has been projected, the hold harmless provision will be triggered. This means that a majority of Medicare beneficiaries will not see a premium increase in 2016 because they fall into the groups who will be "held harmless."

But someone still has to pay for the increased Medicare costs. Those people –25% to 30% of all Medicare beneficiaries—are ones who fall into these groups:

- New Medicare beneficiaries who enroll in Medicare in or after November of this year;
- Medicare beneficiaries who do not have premiums withheld from their Social Security checks --this includes those over age 65 who are on Medicare but are not receiving Social Security benefits;
- Those who exceed the first level of income thresholds –currently $170,000 for a couple and $85,000 for a single.

Who is not going to see an increase?

- Those who are receiving Social Security benefits in November and December of 2015, AND
- Have Medicare premiums for December deducted from their Social Security checks, AND
- Do not exceed the income threshold.

How much will the increase be? Estimates are as high as 52%, meaning a new enrollee in Medicare who earns under the income thresholds mentioned above will pay about $159 per person per month. The highest income bracket, those making over $428,000 for a couple and $214,000 if single could pay as much as $510 per month per person.

So what does this mean…clients who are aged 65 and receiving Medicare benefits who are paying premiums out of their pockets because they are not yet receiving Social Security benefits—or they've voluntarily suspended benefits in order to receive delayed retirement credits. This group, although already receiving Medicare, do not fall under the "hold harmless" provision. Because their premiums aren't deducted from their Social Security checks, the provision that their net Social Security check can't be reduced because of increased Medicare premiums doesn't apply. Consequently, they can be doled a large premium increase.

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