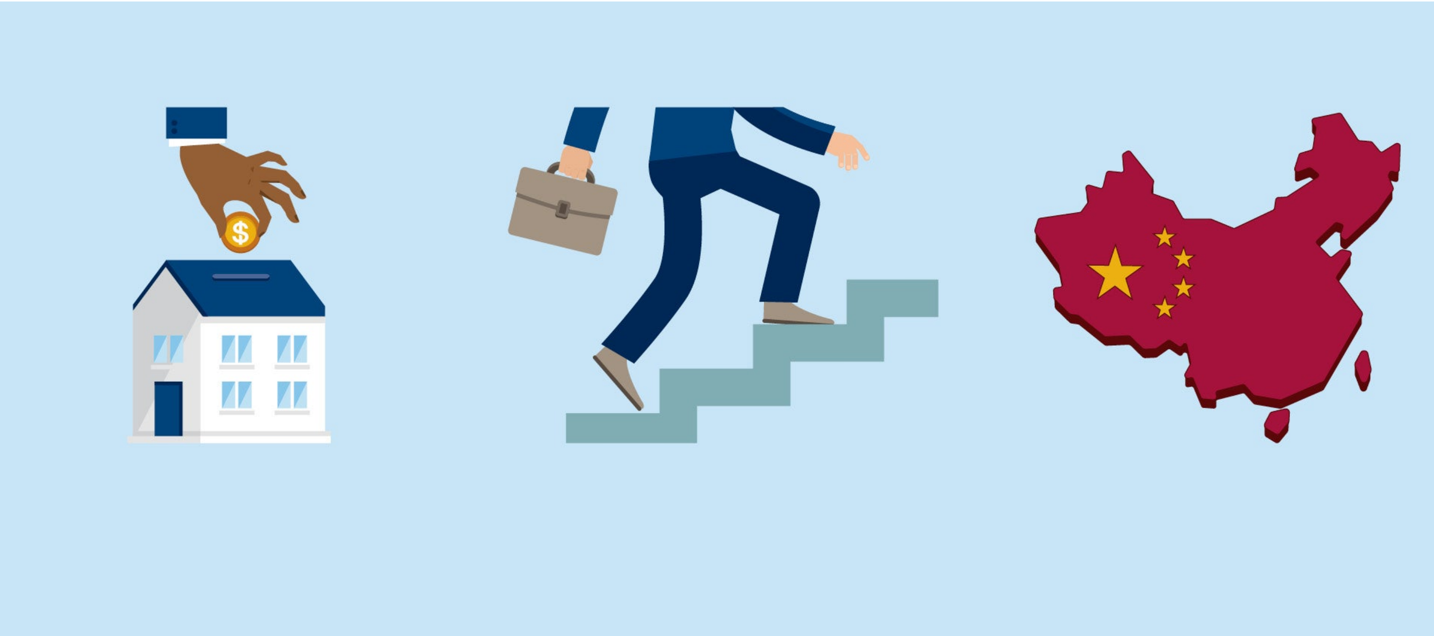

Ask the Experts: Financial FAQs (Fall 2015)

In this issue, we address reader questions about why (or why not) to pay off your mortgage before retirement, tax treatment of annuities for beneficiaries, and the long-term effects of recent economic weakness in China.

Q. I am planning to retire in the next few years. Should I pay off my mortgage prior to retiring?

A: Financially speaking, there is no one-size-fits-all answer to this question. With mortgage rates near historic lows and the ability to deduct mortgage interest on your taxes, the economic case for paying off a mortgage before retirement is less clear cut than in the past.

The decision is dependent on a number of factors, including:

- **Retirement and emergency savings.** You shouldn't pay off your mortgage if doing so would substantially deplete the emergency fund you have created for unexpected expenses (like medical costs) or force you to take a large withdrawal from a retirement account.
- **Taxes.** If you are in a high income tax bracket, have a low-interest mortgage (below 5 percent), and benefit from the mortgage interest tax deduction, it may make sense to keep making monthly mortgage payments.
- **Cost of capital.** If you have the funds to pay off your mortgage, it may make sense to do so, particularly if those funds are in a low-yielding account. Meanwhile, if you are willing to accept more investment risk, you may be better off to keep your mortgage; you may be able to generate higher returns elsewhere.

- **Timeframe.** If you're planning to stay in your home for the long haul, a plan to pay off your mortgage early may make sense. If, instead, you're considering downsizing or moving to a new locale, you'll likely want to hold on to your cash.

A final emotional factor should not be overlooked—the sense of financial freedom and security that comes from paying off a mortgage and owning a home outright. Retirees and those a few years away from retirement should examine their unique personal circumstances to help them make the right choice.

Q. Do annuities receive a step-up in tax basis at death?

A: The simple answer is no. While annuities can be an effective way to save on a tax-deferred basis above and beyond the limits imposed on qualified retirement accounts like 401(k)s, 403(b)s, and IRAs, they don't benefit from a step-up in basis that most other securities offer.

A step-up is an increase in the cost basis of inherited property to reflect its market value as of the date of the owner's death. For example, an investor invested a total of $100,000 in a mutual fund during her life. Assume her investment is worth $200,000 when she dies. If you inherit the mutual fund, your cost basis becomes $200,000, which means you could immediately sell it tax free.

If she had instead invested in an annuity, your cost basis on inheriting it as a death benefit would be $100,000. You would owe taxes on the remaining $100,000 at ordinary income tax rates.

Keep in mind that many annuities allow a spousal beneficiary to keep the annuity policy intact after the death of the owner under a provision called spousal continuation. Unlike a non-spouse beneficiary, a spouse could use spousal continuation to defer taking any distribution and allow the annuity to continue its tax-deferred growth.

Annuities are complex and their features, benefits, and expenses are specific to the issuing insurance company, so it is difficult to generalize. Please explore the specifics of the annuity contract in light of your personal circumstances before making any decisions.

Q. What long-term effects will China's recent economic weakness and currency devaluation have on the U.S. economy?

A: Our view is that China's economic weakness is more impactful to the U.S. economy than the mild currency devaluation introduced in August. China's linkage with the U.S. and global economy is significant. According to the International Monetary Fund, China is the world's second largest economy, generating 15 percent of global gross domestic product. According to official Chinese statistics, the country's economy has grown by over 9 percent annually since 2005.
Recent reports show that China's growth has slowed to 7 percent, which is still high, but well below recent levels (even if reported growth levels are somewhat inflated).

China's economy is transitioning away from a historical dependence on exported goods and domestic infrastructure spending toward a more consumer-driven model. Making that transition under any system, let alone within a centrally planned economy, would likely result in some choppiness. To smooth its transition, China has engaged, at times, in reactive policy responses, including its recent decision to devalue or lower the value of its currency relative to the U.S. dollar. Economic theory suggests that a lower currency stimulates exports, which in turn helps economic growth, ostensibly at another country's expense.

Based on Goldman Sachs research, China directly accounts for $168 billion of S&P 500 index companies' revenues and indirectly accounts for significantly more. U.S. investors should be aware of recent dollar strength relative to China's and other countries' currencies. While that dynamic could, in fact, impact U.S. export growth, most economic forecasts anticipate a stronger dollar. A healthy—or at least stable—China will cure lots of ills, but again, we do not expect China to follow a straight linear path toward a more modern and sustainable economy.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948, or schedule an appointment with a retirement counselor today.
