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Retirement Distribution Pitfalls: Tax Consequences

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement, which can be even more complicated.

Pitfall: One of the big mistakes of retirement distribution can be neglecting to consider tax consequences of some distributions. Distributions from traditional IRAs and 401(k)s are fully taxable at your ordinary income tax rate, so if you're not paying taxes at the time you're pulling money out, remember that the distribution is smaller than it looks because you'll be paying taxes on it at a later time.

Workaround: It may be a good idea for retirees to pay quarterly estimated taxes to avoid a penalty from the Internal Revenue Service. Also, retirees should consider the tax effects associated with IRA and 401(k) distributions when assessing their portfolio's long-term viability. Spreading assets among various account types can help lessen the tax shock, as can carefully sequencing withdrawals to lessen the drag of taxes and preserve the tax-saving features of IRAs and 401(k)s for as long as possible.

401(k) plans and IRAs are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. This is for informational purposes only and should not be considered tax or financial planning advice. Please consult with a financial or tax professional for advice specific to your situation. This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

Mitchell McLeod Pugh & Williams, Inc. - New Shareholder

Bragg Van Antwerp

251-471-2027
mmpw.com

We are excited and pleased to welcome Bragg Van Antwerp as the newest shareholder and director of Mitchell McLeod Pugh & Williams, Inc. Bragg joined our firm in February of 2013 as an Investment Counselor. Since that time, Bragg has proven to be an outstanding addition not only to MMPW, but to the Mobile community as well. He serves as a board member for Distinguished Young Women and is a member of the board of advisors for the Mobile Area Chamber of Commerce. He and his wife Hayley, have three sons, Thomas, Emory and Charles. Bragg is a native of Mobile and a graduate of the University of Virginia. Prior to returning to Mobile, he spent 13 years on Wall Street - first with Deutsche Bank and later with Sanford C. Bernstein & Company where he was made director in 2011. Please join us in congratulating Bragg, we are proud that he is now one of our directors and an owner of MMPW.

Monthly Market Commentary

In recent economic data, payroll numbers correct sharply, manufacturing continues to slow down fueled by the strong dollar and low oil prices, and the pace of home price growth increases as inventory levels remain low.

Employment: The U.S. economy added a disappointing 126,000 jobs in March. Certainly the over 300,000 jobs added late last year looked downright out of place. Job growth accelerated in a period when economic growth was slowing. Now with the much slower reported job growth in March and the substantial revisions to prior months, the employment data looks much more in line. However, the 126,000 jobs added in March is not the new normal, it was just an adjustment month.

The strong job openings data (from the end of February versus the jobs report, which is from the second week of March) confirms that the job market is not falling apart. In fact, the huge number of openings suggests that employers will need to pay more or be more willing to train workers before the pace of hiring will increase. Besides the job openings report, other metrics that point to a benign if not robust jobs market include initial unemployment claims, the labor sections of the small-business sentiment report, and various purchasing manager reports, as well as the ADP report.

Manufacturing: The ISM purchasing manager report continued to show a slowing—not panicky—manufacturing sector. The pace of deceleration has continued unabated since October and peaked way back in August. That weakness is now clearly visible in the month-to-month industrial production data that is now down three months in a row. The year-over-year data is at its early stages of deterioration, with more bad news likely with the softer March ISM report this week and a weak durable goods report last week.

The weakness in the ISM data was rather broad-based with just current production levels and prices paid subcomponents showing increases. Employment data was particularly weak, with that index dropping to 51.4, marking a second straight month of sharp declines. ADP payroll data suggested that March manufacturing employment was basically unchanged from February. Order backlogs also dropped sharply in March, although that may be because the port strike settlement in late February enabled manufacturers to clear backlogs. In some more clearly bad news, export orders remained well below the 50 level that separates growth from contraction, falling from 48.5 in February to 47.5 in March. It will probably take either a pop in auto manufacturing or a restart of the housing industry to get the manufacturing data humming again. That's a real possibility by late summer, but probably not enough to help in the next month or two.

Housing: Recent pricing data suggests that home prices are on the rise again. According to CoreLogic, home prices increased 1.1% between January and February and were up 5.6% February over February. Year-over-year prices have been up for 36 consecutive months, or three years. The rate of home price growth has been slowing since fall 2013 when growth was as high as 11.9% compared with the current single-month reading of 5.6%. Still, it appears that the decline in the rate of home price appreciation has been stopped, with prices moving back up since a low reading of 4.7% in December. The three-month averaged, year-over-year data shows a similar pattern. We have also included CoreLogic-estimated results for March in the table below. We had estimated home price growth in 2015 at 4%–6%. Recent inventory data and price trends suggest that the high end of this range is now more likely.

Auto sales: On a more positive note, auto sales for March showed 17.1 million units sold (on a seasonally adjusted annual run-rate basis), the highest March number going back to 2000. Auto sales are one of the best indicators of consumer confidence, so this may be a sign that consumers are emerging from their malaise and could show some strength as we move into the spring.

Financial Aid Not Just for Low-Income Families, Part 1

A key part of the college-planning equation often is whether admission includes an offer of financial aid and the amount awarded. For upper-income families, financial aid may be an afterthought. They may not even bother applying, assuming they make too much to qualify. But financial aid comes in many forms, and even higher-income families get aid in certain circumstances. Whether your child is headed to college in the fall or will just be starting preschool, understanding how financial aid works and the role your family income plays can help you better prepare a college financial plan.

Aid Helps Reduce Some—But Not All—of the Burden: About two-thirds of undergraduate students receive some form of financial aid. However, about 38% of this aid comes in the form of federal loans, which must be repaid. (The federal government considers loans—both subsidized and non-subsidized—to be a form of student aid in that they help students who might otherwise not be able to afford college.) About half of all undergraduate students received grants (which do not need to be repaid and thus amount to free money to attend college) during the 2007–08 academic year, the most recent available from the U.S. Department of Education. Many students receive both federally subsidized loans and grants.

However, even with loans and grants widely available, the amount provided is rarely enough to cover all college costs. In fact, during the 2011–12 academic year, college undergraduate students received an average of $13,218 in financial aid per full-time equivalent student (a calculation that incorporates part-time students into the mix), including an average of $6,932 in grants and $5,056 in the form of federal loans, according to the College Board. (Private student loans were not included in the study.) By comparison, average published college costs—including tuition, fees, and room and board—at four-year public colleges averaged $17,136 (in-state) and $29,703 (out-of-state) that year, while the same costs at not-for-profit private colleges averaged $37,971.

Grant Availability Varies by Source: Grants and scholarships can be need-based or merit-based, and come from four primary sources: the federal government, state governments, private sources, and the colleges themselves. Because each source uses its own criteria for providing aid, it's difficult to say which students will qualify.

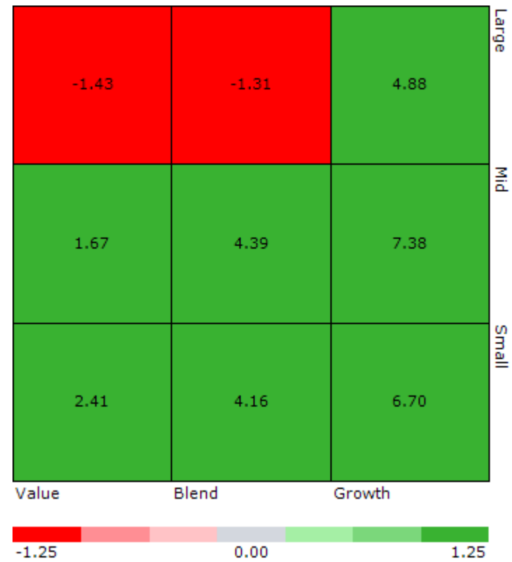
Federal grants targeted at lower-income families: Federal grants tend to be aimed at low- to moderate-income families (Pell Grant recipients come from households whose median income is just $16,300, for example). For families making less than $40,000 per year, odds of receiving federal grant money are good, but for those making more than $60,000, such awards tend to be rare. Federal loans, on the other hand, are more widely available even at higher income levels, with nearly one-third of students from households making $100,000 or more using them (according to data from the National Center for Education Statistics).

Nonfederal grants more available to higher-income families: Nonfederal grant sources include state governments, private entities, and colleges themselves. The likelihood of receiving a nonfederal grant is much greater than it is for a federal grant at incomes of $40,000 and above. More than half of all grant money comes from nonfederal sources, according to the College Board. In 2011–12, 44% of all grant aid for undergraduate and graduate students came from the federal government, with colleges the second-largest source at 37%, 10% from private sources, and 9% from state governments. In recent years, states have been allocating more student aid on the basis of merit, although most still award the majority of their grant aid based at least partially on economic need. On average, states allocated 71% of grants on the basis of need during the 2010-11 academic year.

Quarterly Market Barometer

3 Months, ending March 31, 2015. The U.S. Market returned 1.77% (YTD 1.77%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.



MMPW
Mitchell McLeod Pugh & Williams
Investment Adviser

Bragg Van Antwerp
2610 Dauphin Street
Mobile, Alabama 36606
mmpw.com
Tel:251-471-2027
Fax:251-471-2302