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MARKET MATTERS: Keeping more of what you earn; Or, location, location, location

Joseph Matthews

Well, here we are again — spring is upon us and April 18, Tax Day, is right around the corner. It's that wonderful time of year when our yards start to turn green again and,

perhaps, that should serve as a reminder to consider what's happening to our "folding green."

For those investors who give thought to the location of our greenbacks, that is, how our investment assets are allocated, it's the time of year when tax filings serve as a reminder of how meaningful the benefits of using well-thought out strategies to reduce taxes can be.

Morgan Stanley research shows that even small reductions in taxes can lead to significant changes in wealth accumulation. As an example, one scenario shows that improving after-tax returns by 0.6 percent annually can lead to a remaining wealth difference of 75 percent after 30 years of distributions!

Most investors are aware of the benefits of a well-diversified portfolio. Because asset allocation is the predominant factor in determining why a portfolio's value will fluctuate, we can use diversification to help mitigate risk to a level consistent with personal risk tolerance.

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Many investors, though, do not take full advantage of efficiently locating their assets. By doing so, we can significantly increase the probability of success in reaching long-term financial goals.

It makes sense for investors to consider ways to tilt the odds of achieving our financial goals in our favor. Some more common ways to do this are: saving more, modifying our goals (e.g., delaying retirement) and attempting to increase portfolio returns. Methods that help us better control the way we are taxed complement these other strategies by helping us to keep more of what we earn.

So, how is it done?

At the simplest level, it's taking advantage of IRAs or individual retirement accounts. Morgan Stanley's research shows that the opportunity to defer taxes (traditional IRA) or create an exemption from taxes (Roth IRA) can add over 2 percent of incremental added return per year! Although this is based on an investor in the highest marginal federal tax rate holding a 50 percent equity and 50 percent bond portfolio for 40 years, all investors can ultimately realize tax benefits from making annual contributions to a retirement account.

Of course, there are numerous more complex strategies — best to consult with a trusted tax accountant or tax attorney to evaluate what is best for your financial situation.

And, while we are considering the location of our assets, it would be a good idea to remember that too many eggs in one basket is generally not a good idea either. Many corporate executives, for example, receive equity in the employer company as part of a compensation package. As a result, it becomes far too easy to have a portfolio significantly over-weighted in that one company.

It's all about location. Being mindful of the location of our investment assets — like we've heard every real estate agent tell us about home buying — and using our tax-advantaged investments to allow for greater compounding for wealth accumulation, can

significantly increase the probability of not running out of money ... as well as leaving a legacy to our kids or favorite charity.

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