JOHNSON
INVESTMENT COUNSEL

Quarterly Insight

HSAs: THE UNDER-THE-RADAR RETIREMENT SAVINGS ACCOUNT

2019: FIRST QUARTER

Now that tax season has come and gone, most taxpayers are aware (in some cases, painfully) of the impact of the changes brought about by the Tax Cuts and Jobs Act. Each tax return has its own unique wrinkles, and few situations are the same. Still, one broad conclusion that has been made about the new law is the sharp reduction in the percentage of taxpayers who itemized deductions. It is estimated that more than 80% of filers will now use the standard deduction, which was nearly doubled from its prior amount ($24,000 for married couples, $12,000 for single filers). A direct result of this change is the benefit of deducting certain expenses has been reduced or eliminated for many people.

As less people itemize deductions, it's as important as ever to take advantage of reductions to income still available. One common example of a reduction to income is traditional IRAs and/or 401(k) contributions. The merits of maximizing contributions to these retirement accounts are well known. But there is another under-the-radar and very effective tax-saving strategy that is often overlooked: the Health Savings Account (HSA).

Why is the HSA so valuable, especially for higher-income people? In short, it is a rare "triple-advantaged" savings vehicle. By "triple-advantaged" we mean 1) contributions are tax deductible; 2) the account grows with no tax on capital gains, dividends, and interest; and 3) withdrawals are not taxed (subject to limitations described below). In addition, and of critical importance, it's one of the few tax-advantaged accounts available, even to those with higher income.

So let's start with what HSAs are, the restrictions, and why we think they should be considered an additional means to boost retirement savings.

HSAs DEFINED

HSAs are individually-owned accounts that hold funds used to pay qualified medical expenses for the account owner. Contributions to these accounts are tax-deferred, which means all contributions reduce taxable income. If funds are withdrawn for anything other than medical expenses before age 65, the funds are taxed as ordinary income and may be subject to an additional penalty. When the account owner leaves their current job, they keep the account and all the funds in it. This is not a "use-it-or-lose-it" account.

HSA ELIGIBILITY

To be eligible to contribute to an HSA you must participate in a "high-deductible" health care plan with your employer. If you're self-employed or self-insured you are subject to the same stipulation. For 2019, the health care plan must have an annual deductible of $1,350 for self-only coverage or an annual deductible of $2,700 for family coverage. There are also maximum out-of-pocket limits with the high-deductible plans: $6,750 for self-only coverage or $13,500 for family coverage.

FEATURING

TOTAL RETURNS

	2019
S&P 500	13.7%
Dow Jones Industrial Average	11.8%
NASDAQ	16.8%
Russell 2000	14.6%
MSCI EAFE (International)	10.2%
Barclays Aggregate Bond Index	2.9%

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HSA CONTRIBUTIONS & USAGE RESTRICTIONS

Account holders for self-only coverage can contribute and deduct $3,500 per year while family-coverage account holders can contribute $7,000 per year. If you're 55 or older, you can add $1,000 to those amounts ($4,500 and $8,000, respectively). **There are a few caveats:**

1) Any contributions from the employer reduce the taxpayer's eligible contributions dollar-for-dollar. So if you are 55 years old with family coverage and your employer kicks in $2,000 to your HSA, you can only contribute $6,000 ($8,000 - $2,000).

2) Account holders can coordinate contributions to other accounts such as an FSA (flexible spending account) with the key being the FSA must be limited purpose (dental and vision expenses) and cannot overlap. It is highly important to confirm with your benefits department before opening and contributing to multiple health savings vehicles, as these rules can get complicated.

3) In general, you can use the funds any time for qualified medical expenses before and after retirement. Qualified expenses are unreimbursed medical expenses for the taxpayer, spouse, and dependents, including prescriptions. Health insurance premiums are not qualified unless the premiums are for COBRA, Long Term Care insurance, or if you're unemployed.

THE MATH BEHIND THE ADVANTAGES OF HSAs:

After sorting through the red tape, we believe there are two substantial advantages to HSAs – both before retirement and during retirement.

1) Before Retirement: As mentioned above, during the working years you can contribute funds to the accounts and save on your income taxes. For example, if you contribute $7,000 per year and you are married with over $200,000 of taxable income, you would save about $1,680 in taxes every year. Remember, under the new tax code a family at this income level has very few deductions available. At that level of income IRA contributions are not deductible. But the deductions for HSAs are not limited by income! And the fact that all of us will have at least some medical expenses somewhere along the line means it is highly likely tax-free withdrawals will be possible.

2) During Retirement: One of the little-known provisions of the HSA is that when the account holder is eligible for Medicare (usually at age 65) they cannot contribute to an HSA, but they can withdraw the money and use it for any reason without the penalty. Withdrawals for non-qualified expenses are still taxable as ordinary income (like a traditional IRA distribution) but the ability to avoid the penalty means the HSA can act just like a tax-deductible IRA after age 65.

BOTTOM LINE

With fewer deductions available than before, and some only available to those with lower income, any remaining deductions to income are worth consideration. If you have access to an HSA, and currently or will someday have medical expenses (won't we all?), you should strongly consider making contributions to an HSA. Not only will you save on income taxes while working, but you'll have another pool of money from which to draw in your retirement years.

MARKET UPDATE

STOCKS RALLY SHARPLY ON TRADE PROGRESS, CENTRAL BANK POLICY DEVELOPMENTS

Stocks shot higher in January and February on their way to the best quarterly return in 10 years. The rally came directly on the heels of the worst quarter since 2011. The S&P 500 Index lost 13.5% in the fourth quarter of last year, but gained 13.7% in the first quarter of 2019. The gains were fueled by several factors, including the severity of the selloff in late 2018. The main drivers were market-friendly developments on two fronts: U.S./China trade negotiations and global central bank policy.

Falling interest rates also supported stocks, particularly for bond proxies like utilities and real estate. Technology stocks were the market leader yet again. Financial stocks lagged mainly as a result of falling interest rates. Commodities also enjoyed a robust rally, as crude oil had its best quarter in three years. WTI crude oil rose 32% after a brutal loss of 38% in the fourth quarter of 2018. Global demand was steady while the outlook for supply looked bleaker.

CORPORATE EARNINGS IN FOCUS

Weakening corporate earnings served to slow the market's rally in March. According to FactSet, S&P 500 companies are expected to report a drop in first-quarter earnings of about 4%, S&P 500 Index: Sep. 20, 2018 - March 31, 2019

Source: FactSet

the first time since the second quarter of 2016. At the beginning of January analysts were expecting year-over-year earnings growth of 2.9%, but estimates were cut consistently throughout the quarter. Projections for the second quarter are barely positive at 0.1%. Expectations for third and fourth quarter earnings are brighter, but investors will be combing through the details in the coming weeks to understand the sources of the weakness.

The fact that stocks still gained as earnings estimates fell can be at least partially attributed to two elements: lower initial valuations and stronger revenue numbers. The fourth quarter selloff made stock valuations much more attractive, setting the stage for a valuation rebound independent of earnings growth. The 12-month forward P/E for the S&P 500 Index was below 15 in late 2018, and by the end of the first quarter was back above 17. Despite decreased earnings growth, valuations are still below levels of September 2018 when the market peaked. And though earnings were weakening throughout the quarter, revenue numbers were projected to grow by about 4%. Investors are more willing to put up with declining profit margins than declining revenues.

U.S. AND CHINA NEGOTIATIONS SEEMINGLY ADVANCE, BUT NOT A SURE THING

Chinese and American officials continued to discuss various aspects of trade relations. The world's two most important economies have much to gain from a positive resolution to these negotiations, especially China. As a result, observers are relatively optimistic about the outcome. China has reportedly agreed to increase purchases of American goods and services and better respect intellectual property rights in exchange for reduced U.S. tariffs.

However, both sides appear willing to dig in on certain issues that could prevent a market-positive result, or if nothing else would prolong the ordeal. There is some optimism President Trump will hold another summit with Chinese President Xi, which could increase the urgency to strike a deal. Either way this will remain a closely-watched situation that will have significant impact on markets in 2019.

BONDS POST GAINS AS INTEREST RATES FALL; YIELD CURVE IN THE HEADLINES

U.S. investment-grade bonds enjoyed a strong quarter thanks to falling interest rates. By late March the 10-year Treasury yield had reached a 15-month low at 2.34%. Rates reacted to slowing economic growth abroad and dovish central bank policy announcements. As yields on longer-term bonds fell, shorter-term bond yields were steadier. This led to the first yield curve inversion of the current economic cycle. Late in the quarter the 3-month Treasury bill yield was higher than that of the 10-year Treasury note for the first time since 2007. An inversion is often cited as a sign of imminent recession, but it's not always that simple (more on that below). The 3-month/10-year inversion was very shallow and did not last long.

RECESSION WORRIES GROW, BUT KNOWING WHEN IS EXTREMELY DIFFICULT

A temporary, shallow inversion of one portion of the yield curve is by no means a sure sign of recession. In fact, there are several historical examples where this has occurred and the economy and stock market have continued to advance for months, even years afterward. The most effective yield curve signal is a sustained, significant inversion of the 10-year Treasury below the Fed Funds rate. It's also worth noting the yield curve is a less reliable signal when the overall level of interest rates is low, as it is today.

Economic risk is rising, especially overseas, but in the U.S. it is still low. Many common recession indicators are still not flashing any signals. The labor market is still solid. The consumer is also still healthy, and housing market indicators have started to pick back up as well.

Still, global central banks, including the Fed, have become more dovish. Policymakers in China, Europe, and the U.S. have either pushed pause on tightening measures or have gone back to implementing stimulus measures. The Fed announced it would end its balance sheet reduction by September, and market expectations for further rate hikes are currently zero. Instead, markets are pricing in an approximately 65% probability the Fed would cut rates by the end of 2019. Fed officials have denied this so far, but clearly there is more caution about the outlook.

Predicting recessions is inherently difficult, and attempts to time the market by cutting back exposure to stocks too early can be costly. Significant gains often come in the final months leading up to a turn in the economic cycle. This is yet another reason that a disciplined, long-term focus is a crucial element of prudent investing.

If you are a client of Johnson Investment Counsel, you should receive account statements on at least a quarterly basis directly from the qualified custodian that holds and maintains your assets. You are urged to carefully review all custodial statements for accuracy. If you are not receiving custodial statements, please contact our Chief Compliance Officer, Scott Bischoff at (513) 661-3100.

PROMOTIONS

We are pleased to announce that these individuals have been promoted to new positions:

- **Evette N. Maddox, SHRM-CP®**
  Human Resources Generalist
- **Jamie L. Ritter**
  Director of Marketing
- **R. Maria Seda**
  Senior Corporate Finance Associate


Maddox


Ritter


Seda

NEW DESIGNATIONS

Johnson Investment Counsel is committed to continuing education to provide personal development for our employees and better service to our clients.

Trinity Garrett and Diane Spitznagel have recently earned the Certified Trust and Financial Advisor (CTFA) designation. The CTFA is widely recognized in the trust industry for advanced competence in fiduciary and trust activities, financial planning, and tax law. Trinity is a Senior Trust Associate and Diane is a Trust Officer within Johnson Trust Company. Diane also has her Juris Doctorate.


Garrett

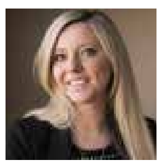

Spitznagel

Evette Maddox (pictured above) has completed her SHRM-CP (Society for Human Resource Management – Certified Professional) certification. The SHRM-CP is a competency-based designation for HR professionals.

NEW ADDITIONS TO THE TEAM

We are pleased to announce that the following individuals have recently joined the firm:

- **Danielle R. DePew**
  Human Resources Assistant
- **Jennifer L. Junk**
  Receptionist
- **M. Deneé Kochersperger**
  Portfolio Manager Assistant
- **Elyse D. Luecke**
  Operations Associate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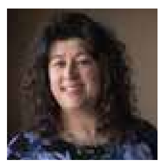
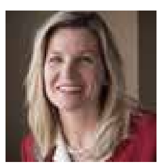

Junk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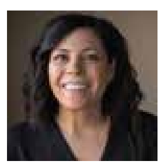
Luecke

JIC SPONSORS LWiB EMPOWERMENT DAY

Johnson Investment Counsel was a sponsor for the 3rd annual University of Cincinnati Lindner Women in Business (LWiB) Empowerment Day on Saturday, March 2nd. JIC's Chief Operating Officer, Holli Alexander, introduced the LWiB President, Emily McDonough, to kick off the event, and shared our passion for women's initiatives in the community and at JIC. Portfolio Manager Assistants Priya Sivagnanam (left) and Gabrielle Calderone (right) led a session entitled "Financial Empowerment through Saving and Investing." Their session detailed the value of budgeting, saving, and investing early and provided clear steps for how the young women in attendance can take control of their financial health and future.

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ABOUT US

Johnson Investment Counsel, Inc. is one of Ohio's largest independent wealth management firms, managing over $10 billion in assets. Johnson Investment Counsel is an employee-owned firm, offering a full range of fee-based, integrated wealth management services, including: investment portfolios, education and retirement planning, cash management, estate planning, trust services, charitable giving, mutual funds, 401(k) plans, IRAs, and more. Johnson Investment Counsel has built strong, long-term relationships with individuals, families, charitable organizations, foundations, and corporations through four integrated divisions.

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