Stocks and Commodities 201904

TECHNICAL ANALYSIS OF STOCKS & COMMODITIES
The Traders' Magazine™

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Subscriptions: USA: one year (13 issues) $89.99; Magazines shipped outside the US require additional postage as follows: Canada, US$15 per year; Europe, US$25.50 per year; all other countries US$39 per year. Single copies of most past issues from the current year are available prepaid at $8 per copy. Prior years are available in book format (without ads) or digitally from www.traders.com. USA funds only. Washington state residents add sales tax for their locale. VISA, MasterCard, AmEx, and Discover accepted. Subscription orders: 1 800 832-4642 or 1 206 938-0570.

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Planning Ahead

401(k): Set It And Forget It

Worried about a shortfall in your retirement income? Don't overlook using your retirement accounts to prepare for your days ahead.

by Peter Smolens



common for people in the middle of their working life to think they'll never be able to retire—that they'll have to keep on working until they drop. The reality is that may not be so easy to do, as many baby boomers are now finding out. The grind of getting up each morning and going to work gets rougher the older you become.

It is on those mornings that you might find yourself wondering if you'll ever retire. Then you receive your quarterly Social Security statement in the mail, which includes a chart showing how much money you will get each month when you start collecting your Social Security.

At first, you get depressed and wonder how you will live off of that amount of Social Security alone. But maybe, just maybe, there's a savior lurking out there that you didn't know about or had forgotten about. Lacking any long-lost uncle who would leave you a surprise inheritance, what about your retirement accounts? If you had regularly been contributing to your company's 401(k) plan, you might find, as I did, that you have saved more for retirement than you thought.

For the millennials reading this or younger, many of you fear Social Security and Medicare might be gone or radically changed by the time you are ready to retire. That is a valid concern, given the way some in government are talking. But there are things you can do to prepare yourself for retirement apart from counting on Social Security. One of the most important is to set up and contribute regularly to an IRA, and also to a 401(k) plan if the company you work for offers that. IRAs and 401(k)s are among the most common defined-contribution plans, and both offer tax-advantaged retirement savings. However, there are a few key differences between these types of plans.

Of course, you've heard it before: It is important to start saving when you're young. One of the challenges young people have is if they have money in their pocket (or e-wallet), they want to spend it. This is nothing new; it's been the same for generation after generation.

WHAT IS A 401(K) PLAN?

In fact, people are generally so bad at saving that years ago, the US government stepped in and passed the Revenue Act of 1978. A provision within this law allows employees to receive deferred compensation on a portion of pre-tax income rather than direct pay, thus creating an "automatic savings plan" that benefited both the employee and employer. Commonly known as a 401(k) plan, it's one of the best ways you can start saving for retirement.

According to the IRS definition, "The 401(k) plan is a defined contribution plan where an employee can make contributions from his or her paycheck either before or after tax, depending on the options offered in the plan. The contributions go into a 401(k) account, with the employee often choosing the investments based on options provided under the plan."

Most employers offer an option for pre-tax savings as an employee benefit. The idea behind the plan is to have your employer take the money out before you see it. Then that money is invested in a portfolio of stocks and bonds, usually within

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mutual funds, bond funds, and money funds. The money is generally unavailable until you're about ready to retire (that is, until you reach age 59.5). When you retire and start taking the money out of the plan, your income is usually lower by that point in your life (since you are no longer receiving a paycheck), so the income taxes on the money withdrawn from your 401(k) plan should be lower.

To encourage you to save, some employers will even offer a "matching" amount to your own contribution (although a "match" can and usually does mean that only a certain percentage of your own contribution is matched). After a period of time (often three to five years) known as the vesting period, the company's part of the contribution becomes yours. If you leave the company before your vesting period is up, you are only eligible to keep the amount that you yourself invested from your paycheck deductions, and the company retains its matching portion.

If your employer does not offer a 401(k) or other sponsored plan, you should probably begin saving in either a Roth IRA or a traditional IRA.

IRAs

While the opportunity to contribute to a 401(k) plan is for the most part limited to people employed by companies that offer such plans, almost anyone can contribute to a traditional IRA, as long as they are under the age of 70½. In 1974, the US government passed the Employee Retirement Income Security Act of 1974, which gave birth to the traditional IRA, or *individual retirement arrangement*.

As with a 401(k) account, a traditional IRA offers the potential for tax-deferred growth on your investments. These assets are tax-deductible and a great way to lower your annual taxable income for people who don't participate in an employer-sponsored plan. The limit for annual contributions to an IRA for 2018 is $5,500, or $6,500 for people over 50. (For tax year 2019, it will go up to $6,000/$7,000.) Those limits are the same for both traditional and Roth IRAs.

Roth IRAs

A Roth IRA offers tax advantages in an opposite way than a traditional IRA: While you pay tax on income *before* you make contributions to the Roth IRA, you'll pay no tax on the earnings when you make withdrawals in retirement. However, not everyone qualifies for a Roth IRA. To qualify, you must have an adjusted gross income that is less than $120,000, or $189,000 for married couples filing jointly.

Invest and Forget

If you set up a 401(k) paycheck deduction for yourself and then put it out of your mind, you may find that with these regular contributions plus market value appreciation on the assets in your 401(k) account, the money will add up. While you have been working and contributing money to your 401(k) plan from each paycheck, in most economies, your money will grow.

Later, when you're ready to retire, you might be in for a pleasant surprise. The money that you have been putting away should have grown. When I was ready to retire, I consolidated all of my 401(k) accounts from different company plans I had over the years, and I realized I had more than I thought.

Commonly known as a 401(k) plan, it's one of the best ways you can start saving for retirement.



Because your money in a 401(k) is in funds with a long-term horizon, it's even possible that the return on the investment could be greater than from funds that aren't in a plan (although that certainly isn't always the case). Many 401(k) plans have mutual funds that are less volatile than some of your average mutual funds. The financial managers are investing for the long term, believing the money will be available for them to manage for a long time.

Resist Early Withdrawal!

However, if you do take money out early from any of your plans, you will have to pay a penalty in addition to paying taxes on the withdrawn amount. Unfortunately, many people do just that. Sometimes, families who are facing rising costs, including housing, college tuition for the kids, and so on, resort to borrowing money from their retirement account. It's very tempting to take money out early and borrow from your 401(k) plan. But you should resist! Explore other possible alternatives first.



Keep Track of Your 401(k) Plans

Some financial experts suggest that when you leave an employer, you should roll over your 401(k) to your primary financial service provider. In many cases it makes sense to do that, because then you'll have all your accounts in one place. Just make sure that your financial service company is on solid footing. After all, keep in mind the old saying, "Putting all your eggs in one basket is risky if the basket breaks." By keeping your 401(k) accounts and/or IRA accounts in different financial institutions, if something went wrong with that financial services provider, the amount lost would be limited to the money kept with that company. You can always merge everything later.

Upon leaving an employer with whom you have a 401(k), you have the option to roll it over into an IRA or Roth IRA (rather than leaving the money in that employer's plan or moving it to a new employer's 401(k) plan). If you opt to go that route, consider any tax implications, particularly when rolling over into a Roth. In addition, rolling over the funds

electronically to your financial service provider means you won't have to worry about the time limit you'd need to keep to if you withdrew the funds and then redeposited them with your financial service provider.

THE TAKEAWAY

If the company you work for offers a 401(k) plan, sign up for it even if they don't match any of your contribution. Put in as much as you can afford. Set up an IRA and add something to it every month. Then, later, when it's time to retire, you might find that those 401(k) and IRA accounts added together can become a meaningful component of your retirement funds.

Peter Smolens is a writer/photographer/digital artist who recently retired from the working world as a programmer and technical writer. His website is www.pbsstudios.com.



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FUTURES FOR YOU

GARNER

Continued from page 20

CMEGroup.com). While these papers offer great information, they aren't for rookies. The tendency of these white papers is toward high levels of complexity and sophistication.

Keep in mind, simply having access to fundamental data doesn't necessarily mean it will aid a trader in speculation. We must remember that for that data to be available, it must first be collected, compiled, and published. Each of these steps, particularly via government resources, takes time (days, weeks, or even months in some cases). All the while, the markets are already reacting to changes in data that hasn't been released yet.

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TRADERS' GLOSSARY



Artificial intelligence—The field of computer science dedicated to producing programs that attempt to mimic the processes of the human brain.

Backtesting—A strategy is tested or optimized on historical data and then the strategy is applied to new data to see if the results are consistent.

Bandpass filter—An oscillator that accentuates only the frequencies in an intermediate range and rejects high and low frequencies. Implemented by first applying a low-pass filter to the data and then a high-pass filter to the resulting data (for example, a two-SMA crossover system).

Basis—The difference between spot (cash) prices and the futures contract price.

Bayesian statistics—A method of statistical inference based on the work of Thomas Bayes, who developed a mathematical basis for using the number of times an event has not occurred to calculate the probability of its future occurrence.

Coefficient—A constant used to multiply another quantity or series; in $3x$ and ax, 3 and a are *coefficients* of x.

Confidence level—The degree of assurance that a specified failure rate is not exceeded.

Fast Fourier transform—A method by which to decompose data into a sum of sinusoids of varying cycle length, with each cycle being a fraction of a common fundamental cycle length.

Frequency—The number of complete cycles observed per time period (i.e., cycles per year).

High-pass frequency filter—A detrending filter that lets pass the high-frequency noise and rejects low-frequency trend. Implemented by first applying a low-pass filter to the data, then subtracting the filtered data from the original data.

Market maker—A broker or bank continually prepared to make a two-way price to purchase or sell for a security or currency.

Mean—When the sum of the values is divided by the number of observations.

Moving average—Used to smooth or eliminate fluctuations in data to emphasize the direction of a trend. Calculated by summing a value and a selected number of previous values, divided by the total number of values.

Noise—Price and volume fluctuations that can confuse interpretation of market direction.

Parabolic indicator—Developed by J. Welles Wilder; based on stop-and-reverse strategies that help locate good exit and entry points.

Pip (price interest point—The smallest price increment of change in a currency. The value of a pip is based on the type of account and the exchange rate of the cross currency. Often referred to as "ticks" or "points" in the futures markets, pips are used to measure gain/loss. The last digit after the decimal point of the exchange rate is a pip: for example, in EUR/USD, a move from 0.9015 to 0.9016 is one pip.

Regression analysis—A method of comparing two investment variables to determine an independent variable's impact on a dependent variable, with the end result providing a prediction on future performance.

R-squared—The percentage of variation in the dependent variable that is explained by the regression equation. A relative measure of fit.

Spot prices—Same as cash price, the price at which a commodity is selling at a particular time and place.

Stochastics oscillator—An overbought/oversold indicator that compares today's price to a preset window of high and low prices. These data are then transformed into a range between zero and 100 and then smoothed.

For more terms, visit the glossary at www.traders.com.