DOW THEORY FORECASTS®

Product placement

Successful investing doesn't end with picking securities. *Placing* investments in the most appropriate accounts can affect long-term results, especially after-tax returns.

Asset Placement

Taxable accounts
- Index equity funds
- Exchange-traded funds
- Low-turnover stocks
- Tax-managed funds
- Municipal bonds
- Low-interest-bearing investments

Traditional/Roth IRA
- Most bond funds, especially high yield
- High-turnover stocks
- Actively managed U.S. funds
- Actively managed international funds
- Real estate investment trusts (REITs)

Roth IRA
- Highest expected return investments

Consider these five factors when deciding where to place your investments:

• **Taxes**. Investors pay ordinary-income rates, which can be as high as 39.6%, on short-term capital gains (realized gains on investments held less than 12 months), interest on many fixed-income investments, and nonqualified dividends, such as income paid by real estate investment trusts. On the other hand, long-term capital gains and qualified dividend income are taxed at a top rate of 20%. Interest on certain bonds, such as municipals and Treasury securities, can escape taxation at the federal and/or state levels. Investors may prefer to hold such higher-taxed investments as REITs, most bonds, and other income-producing assets in traditional and Roth IRAs while keeping stocks in taxable accounts.

• **Traditional IRA versus Roth IRA**. Investors must begin withdrawing funds from a traditional IRA at age 70½. The Internal Revenue Service taxes those funds at ordinary-income rates. Withdraw money from a traditional IRA prior to age 59½, and in most cases you will incur an additional 10% penalty. In contrast, investors can usually withdraw from Roth IRAs tax-free. And as long as the owner lives, he need not take any minimum distribution. During your wealth-building years, put your investments with the highest expected return in a Roth IRA. You may wish to alter that approach once your cash-flow needs change. But, in general, if you have a choice between a traditional or Roth IRA to hold growth investments, choose the Roth.

• **Trading versus buy and hold**. Since stocks won't trigger a capital-gains tax bill until sold, buy-and-hold investors can put off capital-gains taxes indefinitely. In fact, by holding stocks in a taxable account, you may be able to erase any capital-gains tax liability if you leave the stocks to your heirs, because they inherit the stock at a stepped-up cost basis. Holding stocks in a taxable account also allows you to use realized losses to offset realized gains and ordinary income. However, if you actively trade, you may do better with an IRA, which lets you avoid taxes on realized capital gains, particularly short-term gains. Of course, in an IRA you cannot use realized losses to offset gains and income.

• **Individual stocks versus actively managed mutual funds versus index funds versus exchange-traded funds (ETFs)**. Consider the structure of an investment when determining account placement. Individual stocks offer the most flexibility in terms of capital-gains taxes, since you decide when to realize gains, thus making them suitable for taxable accounts. Actively managed mutual funds, where you have little control over taxable distributions, may work better in IRAs than in taxable accounts. Conversely, index mutual funds and most exchange-traded funds tend to be more tax-friendly than actively managed funds and fit well in taxable accounts.

• **Access**. You will probably have different needs from your investments at age 70 than at age 40. While building wealth, you likely won't require access to the funds. However, once you start taking distributions from investment accounts, you may need to switch the type of investments in your accounts. For example, because you can withdraw money from taxable accounts and Roth IRAs without incurring taxes or penalties, investors who need regular cash flows may want to preference income-producing investments in those accounts.

Of course, all of these choices for product placement assume investors own both taxable and nontaxable accounts. That is not always the case. Furthermore, you should consider the strategies presented above as recommendations rather than rules. Indeed, some investors will argue — perhaps rightly so — that in today's low-interest-rate environment, it makes little sense to shield fixed-income investments in nontaxable accounts. An investor might be better off placing stocks in an IRA to shield total returns, and instead pay taxes on the modest interest generated by bonds in a taxable account. In addition, some investors who require lots of income from their investments to pay bills may prefer keeping income-producing investments in taxable accounts, where they can more easily access the funds.