LEGG MASON
GLOBAL ASSET MANAGEMENT

Investor Education

TAX-WISE

Long-term investors have long valued the impact tax deferral can have on their portfolios. For high earners (with greater than $470,700 in annual income),[1] these benefits can be substantial. Taking advantage of the full range of tax-deferred investment options available can be critical, and sometimes it's the simplest strategy that has the most impact.

If saving for retirement is at the top of your investment priorities, consider the Rule of 72 — and the power of tax-deferred investing.

The Rule of 72 is a time-honored maxim that speaks to the power that compound interest can have on a long-term investment. Simply stated, divide 72 by an investment's growth rate to help estimate when the initial investment could double in value, not taking into account portfolio fees and expenses or federal and state taxes. Applying this same principle to tax deferral helps illustrate how a tax-deferred investment may help benefit a portfolio over the long term.

Conversely, consider how long it could take money in a taxable account to double. Generally speaking, dividing 96 or 120 by the growth rate can estimate how long it would take an investment to double using different tax rates, not taking into account portfolio fees and expenses or state taxes.

How long could it take your investment to double? (measured in years)

Growth rate (%)	**Rule of 72:** Tax-deferred account	**Rule of 96:** Taxable account (25% annual tax rate)	**Rule of 120:** Taxable account (39.6% annual tax rate)
2	36	48	60
3	24	32	40
4	18	25	30
5	14	19	24
6	12	16	20
7	10	14	17
8	9	12	15
9	8	11	13
10	7	10	12

Using a 6% annual growth rate in a taxable account...

Rule of 96
With a 25% tax rate it would take **16 years** or 33% longer for an investment to double

Rule of 120
With the top 39.6% tax rate it would take **20 years** or 66% longer for an investment to double

Source: Legg Mason. For illustrative purposes only. This table serves as a demonstration of how the Rules of 72, 96 and 120 concepts work from a mathematical standpoint. It is not intended to represent an investment. The chart uses constant rates of return, unlike actual investments which will fluctuate in value, and is not guaranteed. It does not include fees, taxes or portfolio expenses, which would lower performance. It assumes no distributions are made during these periods. However, lower maximum tax rates on capital gains and dividends would make the investment return for the taxable investment more favorable. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. Actual returns will vary.
Withdrawals of earnings from a tax-deferred account may be subject to ordinary income tax, and early withdrawals can be subject to a 10% IRS penalty charge and/or surrender charges. If an investor would withdraw their entire account balance at the point of time in which the portfolio value doubled, the redemption amount would be significantly lower. Taxes are assessed annually on taxable accounts. Investors should consider their own personal goals, time horizon and tax bracket when making investment decisions. Past performance does not guarantee future results.

[1] On January 1, 2017, the income threshold for the highest tax bracket (39.6%) was raised to $470,700 (joint filers) and $418,400 (single filers). Source: IRS.

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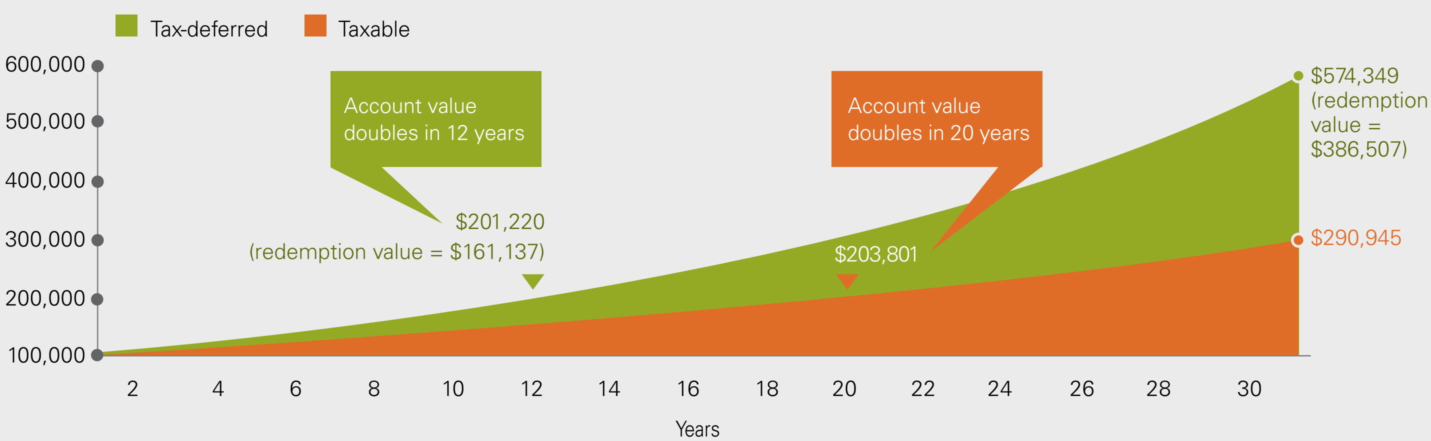
TAX DEFERRAL MAY HELP YOUR PORTFOLIO GROW FASTER

In the example below, $100,000 grows at 6%. Thanks to the Rule of 72, we know that it might take 12 years to double the money in a tax-deferred account, while a fully taxed (at 39.6%) account would take approximately 20 years to double. And after 30 years, a tax-deferred account would be worth $574,349 (or $386,507 after taxes), compared with $290,945 for a taxable account. Investors in lower tax brackets (those with income below $470,700 or $418,400)[2] are unlikely to see as dramatic a difference between tax-deferred and taxable accounts.

Tax deferral can have a substantial impact on portfolio value ($)
Growth of $100,000



Sources: Legg Mason, Thomson. Chart shows hypothetical 6% growth over 30 years, with and without taxes. Taxes assumed at a 39.6% rate. This is a hypothetical example only and does not represent any specific investment product. Actual investments may include fees, charges and other expenses that would affect an investment's return. It assumes no distributions are made during these periods. However, lower maximum tax rates on capital gains and dividends would make the investment return for the taxable investment more favorable. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. Actual returns will vary.

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Past performance does not guarantee future results.

Don't forget the impact of state taxes

State-level taxes can also act as a drag on your portfolio, unless you live in, for example, Florida or Nevada, which don't have state income taxes. But if you reside in California, New York or other high-tax state, this is an especially important consideration. You should, of course, speak with your financial and/or tax professional for more information on how the nuances of taxation will impact your personal situation.

[2] On January 1, 2017, the income threshold for the top tax bracket changed to $470,700 and $418,400, respectively. Source: IRS.

INCORPORATE TIME-HONORED INVESTMENT CONCEPTS

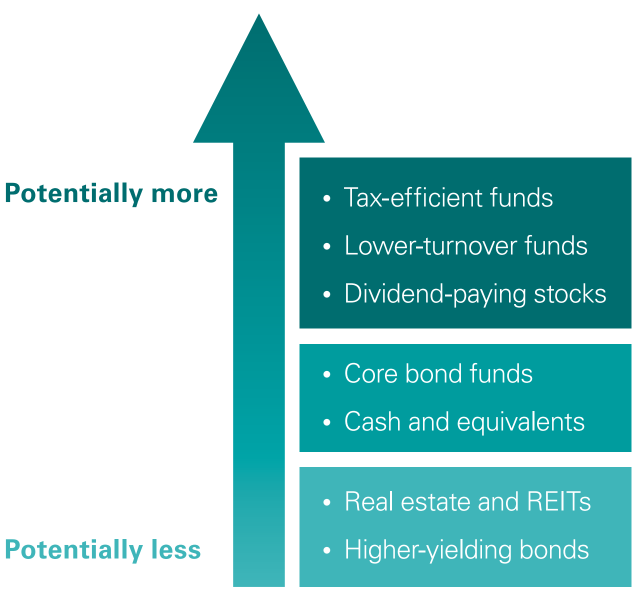
Choosing a tax-deferred vehicle for your investment can be an important part of meeting your long-term goals. The investments within the portfolio and how those investments are managed are also key factors.

Seek out more potential tax benefits

Certain asset classes can provide greater benefits within a tax-deferred vehicle. For example, bond income is taxed as ordinary income. By including bonds in an annuity, IRA or other tax-deferred account, investors can wait to pay taxes on income later, when they may be in retirement and are potentially being taxed at lower levels.

Asset classes that generate a high level of short-term capital gains, such as high-turnover stocks, can also provide additional advantages within a tax-deferred account, since short-term gains are subject to ordinary income tax, not the lower 15% or 20% rate.

Tax-efficiency scale



Active management: The final piece

The final piece to building a long-term portfolio is to consider professional, active management. This can complement the benefits of tax deferral by potentially providing diversification, enhancing performance and reducing volatility.

Adding overall portfolio diversification

Passive, index-based strategies can provide limited diversification. This is particularly concerning with bonds, where some indexes tend to be concentrated in low-yielding government securities, which may be more vulnerable to falling prices when interest rates eventually rise. Remember, **diversification does not ensure a profit or protect against loss.**

Enhancing total return

Some indexes (particularly in fixed income) have intrinsic biases that inadvertently de-emphasize sectors that managers might be well-advised to include. Also, active managers have the flexibility to respond to changing market conditions, often avoiding overpaying for high-priced securities and searching for values among securities that may offer greater opportunities.

Active sector rotation

Because they are not tied to a particular index, active managers may be able to defensively position their portfolio by proactively moving out of sectors in order to protect profits, or by employing other specialized strategies designed to mitigate risk.

Talk to your financial professional about how the powerful combination of tax deferral, diversification and active management can help you get the most out of your investments.

Source: Legg Mason. Does not represent a specific Legg Mason investment or product.
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* As of December 31, 2016.

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