Family Wealth Management, Inc.

FINANCIALLY Speaking

PRACTICAL FINANCIAL PLANNING IDEAS & INSIGHTS

Fourth Quarter 2010 (413) 313-0030 www.fwmgt.com

Need To Save More For Retirement? Find The Solution

Paying that last tuition bill for your children is reason for celebration. But after you go out on the town, take a sober look at your other looming financial responsibility—your own retirement. Getting there in good shape could mean making adjustments that go beyond salting away what you had been spending on your children's college expenses. Financial planning software can help you assess your situation and determine where to go from here. But software is only as good as the data you feed into it, and we can work with you to find solutions that make sense for you.

Consider the Smiths. John, age 55, and his wife, Jane, 52, have two children who recently graduated from college. John currently makes $200,000 a year as an executive and Jane earns $50,000 as a guidance counselor.

The assets in John's 401(k) plan are worth $500,000. He defers 10% of his salary to the plan and his employer provides a matching contribution equal to 3% of compensation. John has allocated 50% of his retirement assets to stocks, 30% to bonds, and 20% to cash. In addition, John owns an IRA valued at $500,000 that he built with tax-deductible contributions and earnings.

Jane participates in a 403(b) plan. Her account is worth $250,000. She funds it with contributions equal to 5% of compensation and follows the same asset allocation model as John. John anticipates working until age 65, while Jane plans to retire at age 62.

John is insured under a whole life policy with a death benefit of $500,000, while Jane is covered by a term life policy with a death benefit of $250,000. Each policy provides that 50% of the proceeds will go to the surviving spouse and the other half will be split between the children. John also has stock holdings in a taxable account valued at $300,000. A summary of the Smiths' assets and liabilities shows they have a net worth of $1.45 million (not counting their home).

All of that data is crucial for planning their financial future. But making projections is a tricky proposition, because so many variables can affect the outcome. What kind of return on their investments should the Smiths count on? Will inflation reduce their spending power during retirement? How will fluctuating interest rates enter in? And how will rising taxes affect the distributions from their retirement plans, which represent 80% of their savings? To evaluate their prospects, the Smiths' financial advisor uses professional financial planning software that can factor in all of the uncertainties about the future. The software projects thousands of possible scenarios that take into account a wide range of investment returns, inflation rates, and other variables and then calculates the odds of success. For the

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Goodwill Will Take Your Old Electronics

Remember when every neighborhood had an electronics repair shop where you could trade in your old stuff or get it fixed? Nowadays, American homes and businesses dump a staggering 41 million computers, 27 million televisions, and 140 million cell phones every year, largely because we have no idea what to do with all those devices when they break down or just get old.

Most of the hardware ends up in landfills or incinerators, which turns the waste of perfectly good components into an ecological nightmare, with dangerous metals escaping into the air or seeping into groundwater. But even if your old computer is in good shape, a lot of charities and schools won't take it because they're already flooded with everyone else's hand-me-down machines.

The good news is that Goodwill will now accept your electronic devices even if they're broken. Just take a look at reconnectpartnership.com and see if any of the1,900 locations that currently support this program are convenient to you. (Some will even pick up computers, TVs, or other equipment for a small added fee.)

They'll refurbish, resell, or break down your gear for recycling. You'll get a tax receipt; in general, working computers are worth a $100 to $500 deduction, printers and scanners $25 to $100, and even those clunky old monitors will get you at least a $10 tax write-off.

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Do A Direct 401(k) To Roth Rollover

In the not-so-distant past, it wasn't particularly easy to roll over funds from a 401(k) plan to a Roth IRA, which can provide tax-free income during retirement or for your heirs. Now, it's a relative snap. What's more, the IRS has provided new guidance on how to complete this maneuver.

Prior to the Pension Protection Act of 2006 (PPA), it took two steps to complete a 401(k) to Roth rollover, and it was possible only if your income didn't exceed a specified limit. First, you transferred funds from your 401(k) to a traditional IRA. Next, you converted the traditional IRA to a Roth, paying income taxes on the amount of the conversion. But you could do this only in a year in which your modified adjusted gross income (MAGI) didn't exceed $100,000.

The PPA fixed part of the problem. Beginning in 2007, you were allowed to roll over funds directly from a 401(k) plan to a Roth, bypassing the traditional IRA. But you still might have been blocked by the $100,000 limit.

That impediment no longer exists. Based on a tax law change that took effect in 2010, you may now convert to a Roth regardless of your annual MAGI. And, for conversions completed in 2010, you can split taxable conversion income between 2011 and 2012. That lets you postpone the tax hit of converting to a Roth, and you may pay less overall if the smaller taxable amount keeps you out of a higher tax bracket.

The IRS recently issued rulings clarifying aspects of a direct rollover. The guidance included these points:

- You can convert to a Roth IRA from retirement plans including 401(k)s, 403(b)s, and 457(b)s.
- A direct rollover to a Roth isn't subject to automatic 20% withholding. But you can agree to voluntary withholding.
- Beneficiaries may make rollover contributions to Roth IRAs. Also, surviving spouses who complete a rollover to a Roth IRA may treat the Roth IRA as their own.
- If funds in a designated Roth 401(k) account are rolled over to a Roth IRA, the rollover isn't taxable, whether or not the transfer is a "qualified distribution."
- Other transfers, except for amounts representing after-tax contributions to your plan, are taxable.
- If you own company stock in a 401(k), you will not be taxed on the "net unrealized appreciation" (NUA) of the stock when it's distributed. But you can't avoid tax on the NUA by rolling over assets directly to a Roth.
- If you're married, you no longer need to file a joint return to benefit from the rollover provisions.

This is just an overview. We can work with you to weigh the merits of a Roth conversion and help you follow the rules governing such transfers. ●

Yield vs. Risk In Emerging Market Bonds

Stock markets around the world improved in 2009, but the spectacular growth came in emerging markets, which gained more than 75%, according to Barron's. Foreign stocks and bonds swept up a record $64 billion of American investor assets, with just more than half going into emerging market equities, $2.7 billion into emerging bonds, and the rest into developed market bonds. Meanwhile, U.S. equity mutual funds lost $40.3 billion in assets in 2009.

While the money flowing into emerging market bonds represented a small proportion of foreign investment, it was nevertheless a remarkable development. U.S. investors had paid little attention to those fixed-income securities until the global financial crisis reduced yields on U.S. government bonds to next to nothing. Because bonds of developing countries are considered riskier than U.S. Treasuries, they pay more—and recently, a lot more. Some emerging market debt now pays more than U.S. corporate high-yield bonds.

Emerging market bonds provide a good example of the trade-off between risk and return. U.S. Treasuries have historically been considered "risk-less" and pay little. Emerging bonds, which pay plenty, may bring considerable risks. The Dubai scare, when Dubai World announced in December 2009 that it had to renegotiate at least some of its $59 billion in debt, reminded investors of the 1998 crisis, when Russia defaulted on its bonds. Back then, some emerging market bond funds sported yields well into the double digits, as they did again in 2008, according to The Wall Street Journal.

Yet despite their volatility, emerging market bonds can serve as an effective tool for managing risk. They can squeeze a little extra yield out of the income portion of a portfolio while also decreasing risk, thanks to their

Asset Protection For Desperate Times

Even in the best of times, people with significant assets may find themselves on the wrong end of a lawsuit. Most physicians, for example, will be sued for malpractice at least once during their careers, and they pay high premiums for liability insurance, which may not cover the entire exposure. Other professionals and business owners also are frequently dragged into court, and adverse judgments may put family assets at risk.

But if the wealthy are targets of lawsuits even when the economy is strong, they're all the more vulnerable these days, when financial desperation may motivate people to take a legal shot at anyone for any reason. And if a judge or jury sides with the plaintiff, a defendant could lose business interests, investments, or other property.

In some states, the simple act of purchasing life insurance and annuities can help to protect assets. But whatever strategy you follow, you need to act before there's a problem. If you're already being pursued by creditors or embroiled in a lawsuit, the courts may disregard moves to shield your property.

Consider these possible asset-protection strategies and vehicles.

Transferring property. One simple way to protect assets is to give them away. You can transfer as much property as you like to your spouse (if a U.S. citizen) free of estate or gift tax, and under the annual gift tax exclusion, you can also make gifts of up to $13,000 a year to anyone else. Moreover, you're entitled to a lifetime, cumulative gift tax exemption of $1 million. But making property gifts means relinquishing control, and spousal transfers may create estate tax complications.

Forming a corporation. If your fortune is tied to business interests, a traditional method for avoiding personal liability is to establish a C corporation. In the absence of fraud, you normally won't be liable for corporate debts, but you also aren't necessarily protected against professional liability if you are a professional. The personal liability protection of a C corporation is not impregnable, however, as the courts have increasingly allowed persistent plaintiffs to "pierce the corporate veil" and reach a defendant's personal assets.

Other corporate variations, such as S corporations and limited liability companies (LLCs), offer protections similar to those of a C corporation, and those alternative business structures may give you tax advantages. Generally, a C corporation is taxed twice—the business pays income tax, and then you're taxed on the dividend you receive—whereas S corporation shareholders and LLC members get only a single tax bill. The LLC format, compared with the older S corporation, has fewer restrictions, but may have higher taxes in some states.

Owning assets jointly. Another long-standing asset protection strategy is to title property as joint tenants with your spouse or another family member. If assets are owned by "joint tenants with rights of survivorship" (JTWROS), they automatically pass to the survivor upon the other owner's death. A special type of co-ownership only between a husband and wife, known as "tenancy by the entirety" (TBE), may protect assets from creditors. More than half the states now recognize TBE protections.

In the nine community property states, on the other hand, property acquired during a marriage is generally treated as being owned by both spouses, regardless of how it is titled, and could be accessible to creditors of either spouse.

Domestic trusts. Various kinds of trusts created within the United States can help shield assets from creditors. For example, you could establish a "spendthrift trust" for a child. Normally, that involves transferring control of trust assets to a designated trustee, who will manage the trust. Creditors can't touch the assets before the beneficiary actually receives a distribution. The maximum protection is obtained with a discretionary trust which does not require distributions to be made at any particular time.

Self-settled trusts. A self-settled trust is one you form for your own benefit—you're the beneficiary as well as the grantor. Currently, 11 states allow you to establish self-settled trusts to protect assets from future creditors. To qualify, the trust must generally adhere to the laws of the state, have a trustee resident in such state, and be irrevocable.

Foreign trusts. A foreign or "offshore" trust can be a legitimate means for protecting assets by subjecting the property to the more lenient laws of a foreign jurisdiction. But foreign trusts also have disadvantages, including tax reporting requirements, lack of tax benefits, and concerns about trustees.

Devising an effective asset-protection plan is often complex and subject to crucial missteps. We can work with you and your attorney to create a plan that provides effective legal protections. ●

diversification value, and may provide a hedge against the fluctuating value of the U.S. dollar, as long as the currency of the country issuing the bonds isn't pegged to the dollar.

The governments of many developing countries have received high marks for their handling of the global financial crisis, and if they can follow up with sensible policies as economic growth returns, investors may be more willing to hold their bonds. At the end of 2009, the "risk premium"—the additional return investors receive for putting money into less stable holdings—on developing world bonds, as measured by JPMorgan's Emerging Markets Bond Index Global, had fallen to just under 3 percentage points above Treasuries.

Many investment experts believe U.S. holdings should account for a smaller proportion of investors' assets than they have in the past, and increasing exposure to international markets could include buying debt in developing countries. ●

Should Retirees Carry A Mortgage?

Your home mortgage is likely to be the biggest debt you ever take on. And if you've moved or refinanced a few times since your first home loan, you may be years or even decades away from owning your house free and clear. But that begs the question: What about retirement? If you're getting ready to retire or already have stopped working, does it make financial sense to keep making monthly payments? Or should you use some of your savings to retire that debt?

Traditionally, paying off the mortgage was a pre-retirement objective, but the recent trend has been to carry the debt longer. A study by the Center for Retirement Research at Boston College found that in 2007, 41% of households with people in their 60s still had a mortgage, even though more than half owned sufficient assets to repay the loan.

Why would you hold a mortgage in retirement? Depending on your situation, you may value the tax benefits and liquidity. Consider these four critical factors.

1. Investment returns. Recently, the average 30-year fixed rate for mortgages has been between 4% and 5%. You might keep your mortgage if you think you can do better investing the money you would spend to retire it. But retirees who invest heavily in low-risk vehicles such as bank certificates of deposit (CDs) and Treasury securities are likely to come up short. And though stocks and mutual funds may provide higher rates of return, they carry greater risks, and if your portfolio plummets, you could have trouble making mortgage payments.

2. Tax breaks. You can generally write off mortgage interest if you itemize deductions. But people who claim the standard deduction—and that's almost two out of every three taxpayers—receive no tax benefit from mortgage interest payments. So if you're not an itemizer, it may make sense to pay off the mortgage. Also keep in mind that the tax benefit of itemized deductions will be reduced if your income is high.

3. Retirement accounts. It's generally not a good idea to pay off your mortgage if you have to invade your retirement accounts to do it. The money you pull out of a 401(k) plan or an IRA will be reduced by taxes—at ordinary income rates of as high as 35%—plus you'll be hit with an additional 10% penalty if you're under age 59½. And you'll be left with fewer funds to draw upon during retirement.

4. Refinancing. One alternative to paying off the mortgage may be to refinance it at a lower interest rate. That can reduce your payments, or you could use the opportunity to pull out equity you've built. But the deep decline in real estate values has underscored the risks of financial strategies built around home loans.

Choosing what to do about your mortgage is a major financial decision. We can help you choose the best approach for your situation. ●

Find The Solution

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Smiths, the initial projection gives them less than a 40% chance of meeting their goals.

While that's not a comfortable result, it's also not unusual, particularly coming after an economic crisis and bear market that diminished almost everyone's investment portfolios. The Smiths' advisor asks them to consider tweaking their plans to improve their likelihood of funding the retirement they want. One relatively minor change is to have John work an extra two years. That increases their savings, and reduces the amount of time they need to live off their savings. Combined with a few other possible alterations, that improves their chance of success to between 70% and 90%.

There are other possibilities, too. Rather than work longer, the Smiths might decide they could live on a little less during retirement, or they could consider increasing the proportion of their portfolios that they invest in stocks, which bring higher risks but also the potential of higher returns. Saving more in their tax-deferred retirement accounts would also help, and they could look at how converting John's traditional IRA to a Roth IRA would affect their retirement income and taxes.

The Smiths' financial advisor plugs these different options into the software and explains the different outcomes. Just as important, though, is his role in helping the couple talk through their plans and consider their priorities. After the Great Recession, many people find themselves up against what may seem like insurmountable financial obstacles. In fact, even the stiffest challenges usually have solutions, and the sooner you begin to address yours, the more likely you'll have the outcome you like. We have the planning tools, expertise, and experience to help you assess your current situation, and we can work with you to map out a desirable financial future. ●

This newsletter is intended to provide general information and is not intended to provide investment, tax or legal advice.

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