Family Wealth Management, Inc.

FINANCIALLY Speaking

PRACTICAL FINANCIAL PLANNING IDEAS & INSIGHTS

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Giving Up Some Luxuries Buys Some Peace Of Mind

Michael and Susan Walker thought they had it made in the shade. After years of ups and downs, Michael's business had finally turned the corner and he was able to give himself annual compensation of $250,000. After staying at home raising their two kids, Susan had reentered the workforce and had worked her way up to making $100,000 a year. The couple had managed to pay off their home mortgage and to fund their children's college costs without taking any drastic measures. It looked like a worry-free retirement was in the cards.

But that was before the stock market went into free-fall at the end of 2008. The stocks and other retirement plan assets that the Walkers were counting on to help pay for luxuries when they retired—a seaside cottage, a new top-of-the-line Mercedes, and lavish weddings for their children—lost about a third of their value. The recession hit Michael's business, too, forcing him to cut back his salary to $200,000. Now, with Michael at age 60 and Susan 58, they are left with stocks worth $1 million, a combined $700,000 in their 401(k) plans, and $500,000 in Michael's IRA. Their home, which had been worth $900,000, now would sell for $750,000.

In this hypothetical example, analyzed with a professional software package, it turns out that the Walkers will do well to live comfortably during retirement, let alone be able to afford all of those nice extras they'd been anticipating. By giving up the second home and the fancy new car, they can increase their probability of success to 82%, based on the software package. But they'll likely have to watch what they spend, and another downturn could leave them in perilous circumstances.

In today's post-recession world, there are millions of people forced to come to grips with new financial realities. Yet there are still ways to improve the odds of success and reduce anxiety over what's ahead. If your situation is similar to the Walkers, here are several ways to improve your future outlook.

Tighten the monthly budget. Take a long, hard look at how you're spending your money. Do you really need to dine out at pricey restaurants each week or keep season tickets for the local sports teams? By making a few sacrifices now that won't dramatically alter your lifestyle, you may be able to preserve more cash for the future. Furthermore, whatever you save can be invested, generating even more income. This reduction in standard of living has the most dramatic impact on your retirement because you get used to spending less which continues for your 20-30 years in retirement.

Ramp up retirement plan contributions. In our example, both Walkers were deferring just 5% of their salaries to their retirement plans. But that's considerably less than the maximum they could give to their tax-

(Continued on page 4)

Avoid Overpaying For Smartphone Service Contracts

Many smartphone users are paying more than necessary, according to a study of mobile phone usage.

Among all mobile phone users, 76% are overpaying for the service, according to a study of United Kingdom users by Billmonitor. In most cases these users fail to match their contract to their usage patterns.

When users move from mobile phones to smartphones such as the Android and the iPhone the situation can worsen. Some smartphone users fail to take advantage of the new capabilities while remaining at high price levels. Others opt for low-cost contracts and then pay extra each month when they exceed the usage terms.

The majority of cases involve paying for more voice minutes than are used, or going over the monthly limit for data services such as Internet usage. The latter problem is bound to increase as smartphone users become more dependent on their devices and download more apps.

The global mobile phone market soared by 19.8% in the first quarter of 2011, according to research firm IDC, which said demand for smartphones fueled the increase.

If you are a smartphone user, check your monthly statement to make sure your usage matches your contract parameters. And remember that your usage levels may change over time as your needs evolve, so you may need to adjust your contract periodically.

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Helping Grandchildren Pay For College

If you paid for most or all of your children's higher education, congratulations. You've given them a gift that will benefit them throughout their lives. But as high as college costs were when your kids were in school, they're stratospheric now, with one year at a top private university running well over $50,000. If you're in a position to help out your grandchildren, too, consider these savings options.

Section 529 plans. This is the fastest-growing vehicle for funding a college education. It lets you contribute generous amounts to a state-sponsored plan established on behalf of your grandkids. Plan investment growth and withdrawals to pay qualifying college expenses aren't taxed, you or a parent can control the account, and it can be transferred to another beneficiary if the original one doesn't need all of the money for education. There's also an estate planning benefit. Though gifts to 529s are potentially taxable as gifts, you and your spouse can each contribute $13,000 a year without gift-tax liability, or you could make five years' gifts all at once, putting in $65,000 (or $130,000 with your spouse) to jump-start a plan. Every state has a plan and you don't have to be a resident or have your grandchild go to school there.

Custodial accounts. Before there were 529 plans there were custodial accounts, set up in a child's or grandchild's name but not accessible to the child until the age of maturity—18 or 21, depending on your state. In some cases, custodial accounts still make sense, but a recent change in the "kiddie tax" adds to tax costs that could undercut the value of your gift. Now, children up to age 24 are taxed on account earnings above an annual exempt amount—$1,900 in 2011—at their parents' top income rate.

Minor's trust. If you establish a Section 2503(c) trust (a "minor's trust") for a grandchild, all of the trust's income will be taxed directly to the trust, thus avoiding kiddie tax complications. And you can keep control of a trust past the state age of majority, as long the child doesn't exercise a limited right to withdraw the funds. However, downsides of a trust include marginal tax rates that climb quickly and costs of setting up and maintaining, including annual income tax preparation fees.

Coverdell ESAs. The Coverdell Education Savings Account is basically an IRA for higher education instead of retirement. (It used to be called the "Education IRA.") But in 2011, annual tax-advantaged contributions to Coverdells are capped at $2,500, and there are income limits on eligibility.

Outright gifts. You and your spouse could also use the annual gift-tax exclusion to give up to $26,000 a year directly to a grandchild to help pay for college. Or, if you pay tuition directly to the student's college, your contribution doesn't count as a taxable gift at all. ●

Creating A Comfortable Financial Independence Plan

Everyone needs a financial blueprint for life after work. Operating without one is a little like closing your eyes as you barrel down the freeway. It's essential to know where you're going and how you expect to get there. But a financial independence plan will help you achieve your goals only if you incorporate it into your financial life, and that won't happen unless the plan feels comfortable. And that comes from understanding its component parts and how they're connected. Consider these elements:

Cash flow analysis. Your plan needs to project where your money will come from and where it will go during the rest of your life (and your spouse's life, too, if you're married). What will come in during retirement, from Social Security, a company pension, annuities, and from drawing down your savings? And how will that match the needs of the lifestyle you want? Several unpredictable variables complicate these calculations. Inflation affects how far your money goes, and investment returns, based in turn on economic and market cycles and your choices, determine how much you have to spend. Taxes will also play a role.

Investment choices. Three factors affect what should be in your investment portfolio. Your goals: What kind of return do you need, both while you're working and during retirement, to support your lifestyle? Your risk tolerance: How much volatility in portfolio returns are you willing to accept to meet your goals? Taking greater risks may provide higher potential long-term returns, but not if you panic and sell when the market takes a turn for the worse. And your time horizon: How long do you have to save for retirement,

Choose Social Security Payout Wisely

Social Security may make up only a small part of your expected retirement income, but it can be a crucial part, perhaps covering a significant portion of your basic expenses. Figuring out what you'll actually receive, however, can be complicated, and you'll have to choose from among many variables that could make a big difference in the amount of monthly income for you and your spouse. Understanding Social Security's complex rules needs to be an essential part of your retirement planning.

Social Security retirement benefits are generally based on your lifetime earnings and your age when you request the benefits. If you opt to start getting a monthly check at age 62, the earliest possibility, you'll receive less than you would if you started receiving benefits at your full retirement age— between ages 65 to 67, depending on the year you were born. Full retirement age for baby boomers born from 1943 through 1955 is 66.

How much you'll lose by beginning benefits at age 62 ranges between 20% and 30%, again depending on when you were born. For example, the reduction for someone born in 1950 is 25%. So if you would be entitled to a $2,500 monthly benefit at age 66, you would receive only $1,875 if you retired at age 62. The later you were born, the steeper the reduction, which peaks at 30% for those born after 1959.

There's an additional incentive for postponing benefits even longer. If you wait until age 70 to begin taking Social Security, you'll receive a significantly higher monthly amount—an extra 8% for each year you delay benefits—than if you had started at full retirement age. For someone born in 1953, for example, waiting those four extra years, from age 66 to age 70, could add more than 34% to the monthly benefit.

Things get really tricky when you try to figure out Social Security retirement benefits for a married couple. Each spouse is entitled to a benefit based on his or her own earning history and the age at which benefits begin. But if a wife, for example, has earned considerably less than her husband has, her benefit at full retirement age will be the greater of her own benefit or a spousal benefit that could be as much as half of her husband's benefit.

Other complications may arise if one spouse continues to work. If the low-earning spouse works past full retirement age while the other spouse has retired, also at full retirement age, the working spouse can begin receiving the 50% spousal benefit. Then, when the working spouse reaches age 70, he or she can claim increased benefits in lieu of the spousal benefit.

Though the Social Security Administration sends you an updated estimate each year of what your future benefits may be, that's unlikely to answer all of your questions. Here are two hypothetical examples illustrating strategies that might maximize a couple's total benefits. The first involves something known as the 62/70 split. Suppose that a husband's full retirement benefit is $2,150 a month and the full benefit for his wife, who's the same age, is $1,080. If she begins taking benefits at age 62, she'll receive a reduced amount—$720 a month. But if her husband delays his claim until age 70, he'll collect $3,300. If he dies at 82, his monthly benefit will have grown to $4,600, and that becomes the wife's survivor benefit—almost 90% more than she would receive if her husband had also begun taking benefits at age 62.

But could this couple do even better? Suppose that the husband applied at age 66 for a spousal benefit based on his wife's earnings record, letting his own benefit continue to grow. Because he has reached his full retirement age, the husband qualifies for the maximum spousal benefit of $540 a month—half of the wife's $1,080 benefit. When he reaches age 70, he can drop the spousal benefit and begin collecting his own much larger benefit.

Beyond studying your annual benefits statement from the government, you can visit www.ssa.gov for a wealth of additional information as well as online calculators that can help you estimate your benefits under different scenarios. But as you weigh your choices, you may also want to factor in other factors, including your health, your life expectancy, your need for cash during retirement, and the retirement lifestyle you're planning. We can help you consider the role Social Security may play for you and work with you to make informed decisions about your government benefits. ●

what is your tax bracket, and how many years do you need your savings to last?

Contingency plans. Job losses, expensive illnesses, or the unexpected death of you or your spouse could put your plan off track. There could also be unforeseen expenses involving your children or parents, and the need for nursing home care during retirement could quickly drain your savings. Having a cash cushion along with life, disability, and long-term care insurance can prepare you to handle potential setbacks. Not planning for lifestyle changes is a major mistake and will put your financial future in jeopardy.

Estate planning. This is crucial even if estate taxes aren't likely to be an issue. You need a will, periodically updated, and a letter of instruction that tells heirs where to find information about financial accounts, life insurance, safe deposit boxes, and the like. It's also important to designate beneficiaries for 401(k)s, IRAs, and other financial accounts that reflect your wishes and take into account potential tax liability.

It can be complicated to weave together all of these elements. But we have the tools, expertise, and experience to help you create a financial plan that feels comfortable. ●

Children In College Need A Health Proxy

Have you just sent your child off to college for the first time? For your offspring, this marks a new, exciting chapter in life. But your child will also face new challenges and perils, and it makes sense to take precautions, such as obtaining a "health care proxy" (also known as a "health care power of attorney") for your son or daughter. This document will give you access to your child's medical history and enable you to make health care decisions in the case of a serious illness or injury.

Although health care proxies are frequently used for elderly relatives, the same basic premise applies to a child in college. Once your child turns age 18, he or she is treated as an adult for legal purposes. Under the Health Insurance Portability and Accountability Act of 1996 (HIPAA), your child is entitled to full confidentiality unless you have a health care proxy. Without a proxy, you might not even learn of a child's health problem at school or receive information about the child's health status.

The health care proxy is a legally binding document appointing someone—usually another family member such as a parent—to make health care decisions for an individual if he or she is temporarily or permanently incapable of making those decisions. It's a narrow power of attorney that gives authority to the designated party and allows you to take action on behalf of your child.

Of course, you can't execute a health care proxy unilaterally. Your son or daughter will need to sign the document, thus giving up his or her right to complete medical privacy. But you can reassure children that you'll have access to information about them only under very specific circumstances. A health care provider may discuss only the immediate medical condition, and only when prompt attention is needed for someone who is incapacitated. Very likely your kids will see the wisdom of having a health care proxy and may even be surprised to learn that otherwise you would have no say about their care even in life-threatening situations.

Once the proxy has been signed and notarized, you'll need to make sure that everyone who might be involved in a child's care knows that it exists. Give a copy to your child's college health service as well as to physicians and hospitals in your town from whom your son or daughter might receive care. If your child has a car, you could put a copy of the proxy in the glove compartment, and you might want to give copies to close friends or roommates.

To get a form for the proxy, check online or with your physician or attorney. You can also file a HIPAA release form that gives you additional access to information about your child's health. ●

Peace Of Mind

(Continued from page 1)

deferred accounts. The current ceiling for annual 401(k) contributions is $16,500—or $22,000 for those, like the Walkers, who are over age 50. In addition, as a business owner, Michael could consider switching the company to another kind of retirement plan that permits much larger tax-deductible contributions.

Postpone retirement. In this example, Michael and Susan will both retire at age 66, the normal age at which they can collect full Social Security benefits. Yet if each one delays retirement by a single year, together they'll earn an additional $300,000 from their jobs, or more if Michael's business rebounds. That will also knock a year off the length of their retirement, and if they delay taking Social Security, they'll be able to draw larger monthly amounts. Putting off retirement longer would help that much more.

Get off the sidelines. The recent bear market hurt the Walkers, and after most of the damage had been done, they moved all of their 401(k) assets out of stock mutual funds and into cash. But that means they'll have trouble keeping up with inflation and gives them no chance to make up lost ground. Over extended periods, stocks have outperformed other assets, and with a few years left until retirement—and perhaps decades of life after they stop working—they need to consider moving part of their money back into equities.

How much or little you'll need to adjust your post-recession retirement savings depends in part on how long you have until you leave the work force. The closer you are to your retirement date, the more you may have to skimp now in order to be comfortable later. If you'd like us to review your plan and see what changes may be needed, please call our office for an appointment. ●

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