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financial $UCCESS

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Getting the Money Out

Traditional deductible and Roth IRAs have significantly different tax rules. With a traditional deductible IRA, current contributions are not taxed in the year the contributions are made, but you must pay income taxes on withdrawals. In contrast, with a Roth IRA, you do not get a tax deduction for contributions, but withdrawals are taken income-tax free.

The tax laws regarding withdrawals from individual retirement accounts (IRAs) are complex. To avoid unnecessary penalties and to ensure you withdraw the funds efficiently, here are the basics:

Before Age 59 1/2

In addition to any income taxes that may be due, withdrawals before the age of 59 1/2 are subject to a 10% federal tax penalty. (Withdrawals of contributions from a Roth IRA are never subject to a 10% penalty tax. Contributions are deemed to be withdrawn first.) For traditional IRAs, all of these distributions are exempt from the 10% federal tax penalty, but the entire distribution amount is subject to ordinary income taxes:

- ✔ Distributions are made to beneficiaries after the IRA owner's death.**
- ✔ Distributions are made to the IRA owner due to the owner's disability.**
- ✔ Distributions equal medical expenses paid in excess of 7.5% of adjusted gross income.*
- ✔ Distributions are made to certain unemployed IRA owners to pay health insurance premiums.*
- ✔ Distributions are made for up to the $10,000 lifetime limit for qualifying first-time homebuyer expenses.**
- ✔ Distributions are made to pay qualified higher-education expenses for the IRA owner, his/her spouse, children, or grandchildren.*
- ✔ Distributions are made as a series of annual withdrawals in substantially equal amounts over the owner's life expectancy or the joint life expectancy of the owner and beneficiary.*

** These types of Roth IRA withdrawals are subject to ordinary income taxes on any earnings, but distributions are exempt from the 10% federal income tax penalty.*
*** These Roth IRA withdrawals are penalty free and income-tax free.*

Between Ages 59 1/2 and 70 1/2

Between these ages, you can

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Your Bond Allocation

What you are saving for is an important consideration for your bond allocation. If you're 35 years old and saving for retirement, your bond allocation will be very different than if you're 55 years old. If you're saving for your daughter's wedding and she's already engaged, your allocation will be very different than if you are saving for your five-year-old's college education.

For instance, if you're saving to buy a sailboat or a second home in the near future, you probably want to invest in bonds with maturities that match your time horizon. For very near-term expenditures, short-term bonds or cash equivalents are typically your best alternative.

One of the most significant risks long-term investors face is that their investment portfolio won't keep pace with inflation. Before even considering withdrawals, you need a rate of return at least equal to inflation for your funds to maintain their value in real terms over time. If you expect your portfolio to grow in value in real terms, you need returns that are higher than inflation.

Please call if you'd like help determining what mix of each asset class makes sense for your investment goals. ❍❍❍

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A 3-Step Asset Allocation Process

The most important move you can make for your investments is to properly diversify your portfolio. Although asset allocatino and diversification do not assure a profit or protect against loss, investing in a mix of stocks, bonds, and cash helps reduce the risk of a significant loss.

How you combine your diverse mix of investments is called your asset allocation. It is a highly individual determination that's based on your risk tolerance, financial goals, and age. Asset allocation will spread out your investments among a mix of three types:

- ✔ **Stocks** — Stocks tend to be the riskiest investment. However, while they have the highest potential for loss, they generally offer the greatest potential for gain.
- ✔ **Bonds** — Bonds tend to be less risky than stocks but more risky than cash equivalents.
- ✔ **Cash** — Cash equivalents, such as savings accounts, certificates of deposit, and money market accounts, typically offer the lowest risk and the lowest potential returns.

The benefits of allocating your assets across the three types of investments include:

- ✔ Proper asset allocation diversifies your portfolio among the three types of investments, helping to reduce your risk.
- ✔ Allocating your assets among the three types allows you to tailor your portfolio to your specific goals.
- ✔ You can help manage the level of risk and volatility of your returns.

To properly allocate your investments across stocks, bonds, and cash, consider this three-step approach to asset allocation:

Step 1: Be honest about your level of risk tolerance.

If you don't mind the more dramatic ups and downs associated with higher-risk investments, you may see higher return potential. But if you can't stand the thought of putting your hard-earned money in an untested company, you're probably better off sticking with relatively low-risk allocations, even though you may see more modest returns.

Step 2: Write down your financial goals.

What are the purposes of your investments? Are you saving to buy your first home? Planning to send your children to college? Whatever your financial goals are, knowing them will help you determine how to allocate your assets to help you meet them.

Step 3: Consider your time horizon for meeting those goals.

How much time do you have before you need the money for your goals? Is retirement a long-term goal, with 30 years to go? Or is it a short-term goal, with only five years to go? There's no consensus on exactly how much of your portfolio should be in any of the three investment categories at any time. However, broadly speaking, the farther away in time you are from your financial goals, the more aggressively you can invest.

Asset allocation cannot eliminate the risk of fluctuating prices and uncertain returns. Please call if you would like help allocating your assets given your unique situation. ❍❍❍

Spousal IRAs: Contributing Together

Perhaps you are a stay-at-home parent, or maybe your spouse decides to take time off to write a book. Even though you are not working, you still need to consider retirement plans. A spousal individual retirement account (IRA) allows a nonworking spouse to contribute to an IRA, even though the spouse has little or no earned income. Here are the basics:

- ✔ To be eligible to contribute, the couple must be legally married at tax year-end and file taxes jointly. The couple's combined earned income must equal or exceed the combined IRA contribution.
- ✔ Contributions can be made to traditional IRAs as long as the owner is under age 70 1/2, while there is no age limit for Roth IRAs.
- ✔ In 2008, the maximum contribution to an IRA is $5,000 with an additional $1,000 catch-up contribution for individuals age 50 and over.
- ✔ For traditional IRAs, if the working spouse is covered by a qualified retirement plan but the nonworking spouse is not, the contribution for the nonworking spouse is phased out once adjusted gross income (AGI) is between $159,000 and $169,000 in 2008 and totally phased out once income exceeds $169,000. If you both have earned income equal to at least the maximum IRA contribution amount and are both covered by a qualified retirement plan, your contribution is phased out at joint AGI between $85,000 and $105,000 in 2008. If neither of you is covered by a qualified plan, both of you can make a deductible contribution regardless of your AGI.
- ✔ For Roth IRAs, eligibility is phased out for AGI levels between $159,000 and $169,000 in 2008. It doesn't matter whether your spouse is covered by a qualified retirement plan at work.

Contributing to a spouse's IRA may be as beneficial to the working spouse as to the nonworking spouse, since the assets are likely to be shared during retirement. Please call if you'd like to review whether you or your spouse are eligible to contribute to a spousal IRA. ❍❍❍

Getting the Money

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withdraw as much or as little as you like from traditional and Roth IRAs. Both contributions and earnings withdrawn from a traditional deductible IRA and earnings from a nondeductible IRA will be subject to ordinary income taxes. As long as the first contribution was made at least five years previously, Roth IRA distributions will not be subject to federal income taxes. Generally, you should postpone withdrawals as long as possible to continue tax-advantaged growth. However, in years when income is low, you may want to take distributions from a traditional IRA to take advantage of lower income tax rates. You may also want to convert all or part of a traditional IRA to a Roth IRA during low-income years. While you will have to pay income taxes on the conversion, future earnings will accumulate tax free as long as you make qualified distributions.

After Age 70 1/2

You are not required to take distributions from a Roth IRA after age 70 1/2. You must, however, take required minimum distributions (RMDs) from your traditional IRAs every year, or you will be assessed a 50% penalty on amounts that should have been withdrawn. You can always take out more than the RMD. Your RMD is calculated by taking the account balance as of the preceding year divided by the life expectancy factor from a uniform table. The table is based on joint life expectancies and assumes your beneficiary is 10 years younger than you. If your spouse is your sole beneficiary and is more than 10 years younger, you can use either the uniform table or a table based on the actual joint life expectancy of you and your spouse.

Your first RMD must be made by the required beginning date (RBD), which is April 1 of the year after you turn 70 1/2. However, if you take the distribution in the following year, you will then take both your first and second distributions in the same year. Evaluate your tax situation before doing that. Two distributions may increase your income so you are in a higher tax bracket, lose tax deductions or credits, or Social Security benefits become taxable. In those situations, you may be better off taking your first RMD in the year you turn 70 1/2.

After Death

Heirs must generally start taking distributions by December 31 of the year after your death. Distributions by heirs are based on who your beneficiary is and whether you died before or after the RBD:

✔ If the account has a designated beneficiary, which includes individuals and certain trusts, the account balance can be withdrawn over the beneficiary's life expectancy, based on a single life expectancy table. This calculation is used whether you die before or after your RBD. Spouses who inherit traditional IRAs can delay distributions until attaining age 70 1/2, while spouses who inherit a Roth IRA do not have to make withdrawals during their lifetime.

✔ A spouse can treat an inherited IRA as his/her own, but the surviving spouse has to be the sole beneficiary. However, if a spouse and other beneficiaries inherit an IRA, the account can be split so the spouse solely owns his/her portion.

✔ If the account does not have a designated beneficiary, which includes your estate, charitable organizations, and certain trusts, and you die after your RBD, the balance is paid out over your remaining life expectancy. If you die before your RBD, then the balance must be paid out within five years of your death.

The decisions you make regarding IRA withdrawals have important consequences for your retirement and for your beneficiaries. Please call if you'd like help making these decisions. ❍❍❍

How Can Retirees Protect Their Nest Eggs?

While stock market fluctuations are painful for all investors, they are even more so for those nearing or in retirement. Investors who won't be retiring for many years have plenty of time for their investments to grow. Current and prospective retirees, however, may be concerned about how market fluctuations will affect their retirement plans. If you're looking for ways to help protect your retirement nest egg, consider the following:

✔ **Try to withdraw as little as possible from your investments.** If your investments have declined in value, reevaluate your current withdrawal amounts. Withdrawing the same amount from a substantially smaller portfolio means that you will deplete the balance much sooner. If you must make the same withdrawals, at least calculate what impact that will have on your current portfolio.

✔ **Build up a reserve of investments not tied to the stock market, totaling three or four years of retirement expenses.** With this reserve, you won't have to sell your stock investments during market declines.

✔ **Withdraw funds in a tax-efficient manner so they last longer.** In general, you should withdraw taxable investments first so that your tax-deferred investments can continue their tax-deferred growth. In most cases, however, you will need to start taking minimum required distributions from your tax-deferred investments by age 70 1/2.

✔ **Reassess your asset allocation.** The recent stock market fluctuations may have made you realize that your portfolio contains too much risk. While you may not want to make major asset allocation changes immediately, you can take steps to gradually add diversification to your portfolio.

✔ **Decide whether you want a professional to manage your investments.** In volatile markets, you may feel more comfortable allowing an investment professional to make investment decisions for you. ❍❍❍

Managing Your Money by Mastering Your Financial Habits

In my studies of people and their habits about personal finances, I have made some really interesting discoveries, but none of them is more important than getting to the "why" behind their financial habits. Simply put, to kick a habit, one to has first understand what they are doing to create the problem and why they are doing it.

Getting to Why

If you're having a hard time changing money habits even though you've identified the problem, then it is key to figure out **why** you are doing what you are doing. And it is time to figure out what you believe that keeps you on your current course. It may be that you believe you have earned it. You work hard each day in your job, studies, or both; and you need to reward yourself. Perhaps you just dislike dealing with your finances. In your mind, the pain of dealing with your finances is greater than the pleasure of controlling your money or getting out of debt. Or maybe — you feel the pressure of "keeping up with the Jones," where you need to compete to keep up with your family, friends, and colleagues. Whatever the cause, what you believe about the situation is the reason or "why" it is happening.

Kicking Old Spending Habits

Now that we have dug into possible motivations for your money habits, the next thing we have to do is empower you to change your beliefs. One thing is for sure. If you believe you can't change, you won't change. It's just that simple. If you believe you can't change your financial picture because budgeting and finances are too difficult, you won't. You have to change that belief. Get emotional about mastering your money. Emotion is power, positive or negative. It drives us. Channel this emotion toward your desired outcome and take daily steps, however small, to take control over your money.

If your desire for change is not prompting you to change, consider the old "carrot or stick" approach to get yourself to the point of change. If you are motivated by pleasure (the carrot), you need to see your accomplishments as your reward. **You know you are better than the way you have been acting.** If the carrot approach only makes you see vegetables and not results, consider the stick approach of focusing on your need to change, **because you are letting yourself down and — by not changing — you are setting yourself up to fail financially for the rest of your life**. You know the type of person that you are. Give yourself the right motivation for success.

Finding Your Healthy Habits

In addition to creating a new belief about your financial picture, you can also help yourself by creating new healthy habits to manage your finances. Both success and failure leave clues. Discovering the right habits that work for you will help you create lasting change. I have seen the following at work to reinforce change and reinforce new behavior in my clients.

✔ Consider finding a mentor you trust and respect to share your financial goals and help keep you accountable. Write down your financial goals, share them with your mentor, and meet with your mentor regularly to hold you accountable.

✔ Follow your money trail. You need to get on a monthly budget and figure out two things: where is your money going each month and what specific expenses (and habits) do you need to change or eliminate to get ahead.

✔ Avoid trouble spots. If going to the shopping mall or hanging out with certain friends always results in you spending more money than you should, avoid these temptations outright or leave your cash at home.

Managing your money is possible by mastering the right habits. Once you understand why your financial picture is not where it needs to be, leverage yourself to create a new belief system and kick your old money habits to the curb. And remember — creating lasting financial change is not a two-day goal or a one-month plan…it is a lifetime of healthy money habits.

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Financial Thoughts

A recent study of U.S. households with college-bound children revealed a pronounced lack of awareness of college savings options, including section 529 plans. Of households that intend to begin saving for college, just 9% reported being familiar with 529 plans, and 56% were completely unaware of any college saving instruments (Source: *Investment News*, 2008).

Early baby boomers (those born between 1948 and 1954) face a 50% risk of failure to maintain their income in retirement. For late baby boomers (those born between 1955 and 1964), that average jumps to 61%, and for Generation Xers (those born between 1965 and 1974), it climbs to 68% (Source: Center for Retirement Research at Boston College, 2008).

Only 26% of parents with children age five and older feel well prepared to teach their children basic personal finances (Source: Lenox Advisors, 2008).

According to a recent poll, 22% of Americans have received a "large gift of money" from relatives who were still alive. Forty-eight percent used the gift for a home down payment, 14% to buy a car, and 11% put it toward college education (Source: *Journal of Financial Planning*, February 2008). ❍❍❍