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U C C E S S

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What Happens If You Become Disabled?

For many people, a long-term disability would be financially devastating. Although no one likes to think about this possibility, you should consider your options now so you can obtain disability income insurance if needed.

Many individuals can find the funds, even though it might be difficult, to get through a short-term disability of six months or less. Find out what benefits you would be entitled to under sick leave policies, short-term disability policies provided by your employer, and workers' compensation. Another source of funds might be your emergency fund of three to six months of living expenses.

When considering a long-term disability, assess your income needs until age 65, when presumably retirement benefits would begin. During this analysis, consider the following items:



✓ Estimate your monthly expenses following a disability.

Typically, some of your disability benefits would be free of income taxes (if you paid the premiums) and you won't incur work-related expenses. However, don't underestimate your expenses, since your medical and rehabilitation expenses might be much higher after a disability. Find out if you would continue to be covered under your employer's health insurance plan. If not, you'll need to make provisions for that expense.

✓ Review your annual Social Security Statement for an estimate of disability benefits.

However, keep in mind that the eligibility requirements are quite stringent — you must be totally disabled, have little or no chance of recovery, and wait six months or longer for your first check. Even if you do qualify, benefits tend to be modest.

✓ **Decide what personal resources you would want to use.** You can access funds from individual retirement accounts, annuities, or 401(k) plans without penalty if you are disabled. But first consider whether you want to risk depleting your retirement fund or children's college fund due to a

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Regaining Investing Confidence

The recent market declines have caused many investors to lose their confidence in their ability to devise an appropriate strategy for investing. No one seems to know what will work in this environment.

An important part of your methodology is to develop realistic return expectations for your portfolio. Be conservative with your expected returns. Historical long-term average returns might not even be realistic for the near future. If your investment methodology incorporates modest return expectations, you are more likely to stick with the plan and to achieve your financial goals.

The recent market declines will take time to overcome. Don't try to figure out when you'll get back to previous values. Instead, start with where your portfolio is now. Reexamine your financial goals, realizing you're likely to have to revise those goals. Maybe you won't be able to retire until a later age. Or you might not be able to travel as much. You might have to consider working at least part-time after retirement. Determine how much you need to save annually to reach those goals, based on modest return expectations. ○○○

Taxes and Your Investments

One of your portfolio's largest expenses is probably taxes. Ordinary income taxes on short-term capital gains and interest income can go as high as 35%, while long-term capital gains and qualified dividend income are taxed at rates not exceeding 15% (0% if you are in the 10% or 15% tax bracket). One way to help maintain your portfolio's growth potential is to invest in a tax-efficient manner. Some suggestions include:

✓ **Contribute to your 401(k) plan.** Contributions are made on a pretax basis, so you don't pay income taxes currently (Social Security and Medicare taxes are paid) and earnings grow on a tax-deferred basis until withdrawn. In 2009, you can contribute a maximum of \$16,500 to a 401(k) plan, although plans typically limit your contributions to a certain percentage of your pay to ensure the plan complies with nondiscrimination rules. Individuals over age 50 may be able to make an additional catch-up contribution of \$5,500 in 2009. Many employers also match your contribution, so you get additional funds at no cost to you.

✓ **Make contributions to an individual retirement account (IRA).** In 2009, you can contribute a maximum of \$5,000, plus those over age 50 can make an additional \$1,000 catch-up contribution. Investigate whether you're eligible to contribute to a traditional deductible IRA or a Roth IRA and then decide which option is best for you. While you can't deduct your contributions to a Roth IRA, your

earnings grow tax free as long as you make qualified distributions from the IRA. With a traditional deductible IRA, your contribution is deductible on your current-year income tax return, and earnings grow tax deferred until withdrawn.

✓ **Carefully decide which investments to hold in tax-advantaged and taxable accounts.** Gains from investments held in retirement accounts, such as 401(k) plans and traditional IRAs, are taxed at ordinary income tax rates when withdrawn, rather than the lower capital gains tax rates. While it may make sense to hold investments that produce ordinary income or that you want to trade frequently in retirement accounts and investments that generate capital gains in taxable accounts, factors such as your investment period should also be considered.

✓ **Analyze the tax consequences before rebalancing your portfolio.** Portfolio rebalancing is a taxable event that may result in a taxable gain or loss. In general, avoid selling investments from your taxable portfolio for reasons other than poor performance. Bring your asset allocation in line through other methods. For instance, when purchasing new investments, select ones from underweighted categories. Or, rebalance through your tax-deferred accounts, which generally won't result in a current tax liability.

✓ **Consider municipal bonds or stocks generating dividend income if you are in a high tax bracket.** Since municipal bond interest is exempt from federal, and sometimes state and local, income taxes, your marginal tax bracket is a major factor when deciding whether to include municipal bonds in your portfolio. Thus, you should determine how a muni bond's yield compares to the after-tax yield of a comparable taxable bond. Since qualified dividend income is taxed

at rates not exceeding 15%, stocks that generate significant dividend income may be a good choice.

✓ **Look into tax-advantaged ways to save for college.** If you are saving for college, look at education savings accounts (ESAs) and Section 529 plans. The annual contribution limit to ESAs is \$2,000. While you can't deduct the contribution on your tax return, earnings grow tax free as long as funds are used for qualified education expenses. With Section 529 plans, you can contribute up to \$65,000 to a qualified plan (\$130,000 if the gift is split with your spouse) in one year and count it as your annual \$13,000 tax-free gift for five years. However, if you die within the five-year period, a pro-rata share of the \$65,000 returns to your estate. Distributions from 529 plans to pay qualified higher-education expenses are excluded from income.

✓ **Consider owning a home.** Despite declining home values over the past couple of years, owning a home has significant tax advantages. Mortgage interest and property taxes can be deducted on your tax return, reducing the cost of owning a home. Mortgage interest is deductible on up to \$1,000,000 of original debt incurred to purchase a principal residence. Additionally, interest paid on up to \$100,000 of home-equity debt is deductible on your tax return. When you sell your home, significant capital gains can be excluded from income. You can exclude up to \$250,000 of gain if you are a single taxpayer and up to \$500,000 of gain if you are married filing jointly, provided the home was your primary residence for at least two of the preceding five years.


These are only a few suggestions for investing in a tax-efficient manner. If you'd like to review other options, please call. ○○○




What Happens?


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long-term disability.


 **Investigate any long-term disability benefits provided by your employer.** Long-term group disability plans are less common and typically less common than short-term plans. The policies frequently have strict definitions of disability, pay up to 60% of your base salary (bonuses and commissions generally aren't included), pay two to five years of benefits, and don't provide cost-of-living increases. Also factor in income taxes that must be paid on any benefits your employer paid for. Check to see if your employer-sponsored retirement plan offers an option for early retirement in case of disability.


 **Consider purchasing disability income insurance to fill any gaps.** However, you might not be able to replace more than 60% to 80% of your income through insurance, since insurers want you to have an incentive to return to work. Any benefits from policies you paid the premiums for are received income tax free. Coordinate your employer-provided insurance and your own policy so that the maximum benefits do not exceed the amount the insurance companies will pay. Otherwise, you may pay for coverage you won't receive.


If you decide to purchase disability income insurance, make sure to consider these things:


 **Pay special attention to the definition of disability.** There are three basic types of coverage: own occupation, any occupation, and income replacement. Own occupation pays benefits when you can't work at your specific occupation. Many professionals, such as doctors and lawyers, opt for this coverage. However, due to substantial claims, this coverage is now more difficult to obtain. You may be able to find own occupation coverage for a specified period, with the policy then converting to any

occupation coverage. Any occupation means you must be unable to work at any occupation that your training and education would be suited for. Income replacement policies pay the difference between what you were earning before the disability and what you are earning now. For most individuals, income replacement policies will provide the best balance between cost and benefits.

 **Opt for a long waiting period before benefits start.** This is a good way to reduce premiums, provided you have other resources to rely on for the short term, such as sick leave, personal savings and investments, and short-term disability coverage. Waiting periods can range from one week to two years, but the most common option is a 90-day delay in benefits.

 **Consider coverage that pays benefits until age 65.** Disability insurance is designed to protect your financial situation from a serious disability, so you should obtain coverage for the long term. Policies for lifetime benefits are rare and expensive. It's probably not needed, however, since you will probably be eligible for Social Security and other retirement benefits once you turn 65.


 **Look for a policy that provides residual benefits.** This allows you to return to work on a part-time basis and still receive partial benefits.


 **Make sure the policy is either noncancelable or guaranteed renewable.** Noncancelable means you can renew the policy every year at the same premium. Guaranteed renewable means you can renew the policy every year, but the premium can increase as long as it is not done so in a discriminatory manner. Either provision will ensure that the policy can't be canceled due to medical problems.


Please call if you'd like to discuss your need for disability income insurance in more detail. ○○○


Stretching Your Salary


In the current economic climate, many employers are cautious about increasing expenditures. That means your best bet for the near term is to make your current salary stretch farther. Some tips to consider include:

 **Deposit your paycheck directly into your bank account.** That way, you'll be less tempted to cash part of your paycheck and spend it.

 **Contribute to your 401(k) plan.** Not only will this help with your retirement goals, it can help with your current financial situation. Any contributions you make are deducted before income taxes (unless contributing to a Roth 401(k) plan), so you don't pay any current federal income taxes on your contributions. In addition, many employers match some portion of your contribution.

 **Check out your 401(k) investments.** Make sure you are familiar with all options in your plan and review those options at least annually. Even if you only increase your rate of return by a percent or so, that can make a significant difference.

 **Review your health insurance coverage.** If your employer offers more than one option, review those choices carefully to select the most appropriate insurance for the least cost.

 **Take a look at other fringe benefits offered by your company.** Many employers provide a variety of fringe benefits. Usually, you do not have to pay any income taxes on these benefits. Thus, carefully assess your company's fringe benefit package to ensure you are utilizing all appropriate ones. ○○○

How Much Do You Need in Retirement?

If that retirement date is years or decades away, it may be difficult to come up with a reasonable estimate of your income needs in retirement. Most people will want a standard of living similar to the one they're living before retirement; so simple rules of thumb, like 70% of preretirement income, may not give you an accurate estimate. Follow these tips to make an estimate:

✓ **Add up your current expenses.** Make sure the list is as complete as possible, including regular monthly expenses as well as irregular, periodic expenses, such as insurance premiums, tuition, and gifts. If you've prepared a detailed budget, much of the work will already be done. If you don't have a budget, most of the information can be found by examining cancelled checks, credit card bills, and tax returns.

✓ **Estimate which expenses won't be incurred in retirement.** Once you retire, you won't need to save for retirement anymore. Other expenses that are likely to go away include commuting

costs, some clothing expenditures, and meals while working.

✓ **Determine what additional expenses to expect after retirement.** This will depend in large part on how you plan to spend your retirement years and will typically include items like travel and entertainment. At this point, you want to plan for your ideal retirement lifestyle.

✓ **Decide which expenses you can cut back.** This analysis will become critical if you can't afford your ideal retirement. Break down your expenses between essential and discretionary. Cutting back on discretionary items is not your only alternative. Perhaps you can move to a smaller home or pay off your mortgage, both of which could dramatically lower your expenses. Or, you might only need one car instead of two after retirement.

Once you decide how much retirement income you need, you can calculate how large a nest egg you'll need at retirement. If you'd like help with this analysis, please call. ○○○

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Use Catch-Up Contributions



In an era where the amount of your retirement income is increasingly dependent on how much you save, you should take advantage of all tax-advantaged ways to save for retirement. In addition to normal contributions, individuals age 50 and older can make catch-up contributions to individual retirement accounts (IRAs) and 401(k) plans. In 2009, the maximum contribution to a 401(k) plan is \$16,500 plus an additional \$5,500 catch-up contribution for individuals age 50 and older, if permitted by the plan. For IRAs, the maximum contribution in 2009 is \$5,000 plus an additional \$1,000 for individuals age 50 and over.

If your 401(k) plan limits your contribution to less than the maximum amount of \$16,500, you can make catch-up contributions, if permitted by the plan, once you reach the plan's maximum contribution.

Thus, once you reach age 50, make sure to take advantage of catch-up contributions. Please call if you'd like to discuss the potential impact of these additional contributions on your retirement portfolio. ○○○

Financial Thoughts

A 50-year-old white male college graduate can expect to live an additional 10 years of healthy life compared to a white male with less than a high school education (Source: Center for Retirement Research, 2008).

Approximately 45% of small business owners do not offer any type of retirement savings plan (Source: *Journal of Financial Planning*, December 2008).

In a recent poll, nearly half

of all colleges report having students who have dropped out or changed to part-time status after being denied access to private loans (Source: National Association of Independent Colleges and Universities, 2008).

Approximately 42% of Americans postponed or skipped medical tests or care, didn't fill a prescription or reduced doses, or didn't get mental health care during the past year due to costs (Source: *Journal of Financial Planning*,

September 2008).

Approximately 17 million individuals had out-of-pocket medical expenses in 2007 that equaled 10% or more of their family income (Source: *Journal of Financial Planning*, September 2008).

There is a 23% chance that at least one member of a 65-year-old couple will live to age 95 (Source: *InvestmentNews*, October 20, 2008). ○○○