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Year-End Investment Planning and the Fiscal Cliffhanger

Investment planning at the end of 2012 revisits issues that have complicated the planning process for the last two years--tax cut extensions and spending cuts designed to reduce the U.S. budget deficit. Uncertainty about both and whether they will lead to what's been called a "fiscal cliff" in 2013 is likely to affect year-end investment planning yet again.

Despite the uncertainties--or perhaps because of them--it might be worth starting early to look at various "what-if" scenarios in case you need to make last-minute changes to your portfolio. Even though you may not be sure of exactly what will happen in 2013, here are some factors to keep in mind as you plot your year-end strategy.

Review timing of your investment sales

As of January 1, tax brackets are scheduled to return to their pre-2001 levels. That means the current six tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) are scheduled to become five (15%, 28%, 31%, 36%, and 39.6%). Also, absent further changes, the maximum tax rate on long-term capital gains, currently at 15%, will increase to 20% (10% for those in the 15% tax bracket); those in the 10% or 15% marginal income tax bracket, who now pay a 0% rate on capital gains, will lose that special rate. Finally, qualified dividends, now taxed at a maximum of 15%, will once again be taxed at ordinary income tax rates.

Another factor for high-income individuals in 2013 is a new 3.8% Medicare contribution tax on some or all of the net investment income of individuals with a modified adjusted gross income over $200,000 ($250,000 for married couples filing jointly, and $125,000 for couples filing separately).

Ordinarily, higher rates in 2013 might suggest taking profits in an investment before those higher rates go into effect. However, the November election could affect the scheduled expiration date of those tax cuts, or even whether they expire at all. As a result, it's especially important this year not to let tax considerations be the sole factor in any investment decision. If you're uncertain about a sale, remember that another way to minimize capital gains taxes is to harvest investment losses that may offset gains.

Consider the potential economic impact of 2013

The nonpartisan Congressional Budget Office has warned that the tax increases and the roughly $109 billion in spending cuts could hamper an already sluggish economic recovery. Also, a 2% reduction in the Social Security portion of the payroll tax is scheduled to expire in January, leaving consumers with less to spend. Though there has already been talk about revisiting the spending cuts and tax cut expirations, you might want to consider how your portfolio might be affected.

Some companies are highly sensitive to economic cycles; others offer products and services that people need regardless of how the economy is doing and generally suffer less from a downturn (though any industry or company can have its own challenges). Also, the spending cuts could disproportionately affect some specific industries, such as defense, and companies that rely heavily on government contracts.

Interest rates and European instability

Partly because of the Federal Reserve's monetary policy and partly because of the European debt situation, interest rates have been at historic lows in recent months. This has meant higher prices for U.S. Treasury bonds, because bond yields move in the opposite direction from bond prices. However, investors who have relied on Treasuries for income and now want to roll over the proceeds of maturing bonds might be disappointed with available rates, which the Federal Reserve expects to remain low well into 2014. If that's the case for you, you may need to explore supplemental sources of investment income, or reexamine your Treasury holdings to see whether they now represent too much of your portfolio.

Even if you decide to wait and see what happens at year-end, planning for multiple scenarios now could help improve any last-minute decisions.

See disclaimer on final page

Organizing Your Finances After Your Spouse Has Died

Duplicate copies of marriage and birth certificates are available at the county clerk's office where the marriage and births occurred. To get a duplicate copy of a military discharge, contact the National Personnel Record Center, 9700 Page Avenue, St. Louis, MO 63132.

If your spouse was a veteran, you may be eligible for burial and memorial benefits. Call 1-800-827-1000 to find the nearest VA regional office.

Do not be hasty when settling your spouse's estate. Important decisions need to be made regarding distributions, which must be made in compliance with the will and applicable laws. Seek an experienced estate planning attorney for advice.

Losing a spouse or partner is a stressful event. Yet, during this time, you must complete a variety of tasks and make important financial decisions. You may need to make final arrangements, notify various businesses and government agencies, settle your spouse's estate, and provide for your own financial security. Fortunately, there are steps you can take to make dealing with these matters less difficult.

Notify others and get advice

Dealing with both the death of your spouse and money matters at the same time can be overwhelming, especially if the death was unexpected. But there are resources available to help. First, call on close family members, friends, and clergy--you'll need their emotional support. Notify your employer and your spouse's employer. Then contact the professionals who will help you cope with the paperwork and financial matters. These may include your funeral director, attorney, insurance professional, financial advisor, and accountant. Keep their phone numbers handy.

Get organized and keep your finances current

You will need a number of documents to finalize your spouse's financial affairs. First, obtain certified copies of the death certificate. Your family doctor or the medical examiner should provide you with the death certificate within 24 hours of the death. The funeral home should complete the form and file it with the state. Get several certified copies (photocopies may not be accepted). Then, gather any estate planning documents, such as a will and trusts, and other relevant documents, such as deeds and titles. Also locate any marriage certificate, birth or adoption certificates of children, and military discharge papers, which you may need to apply for benefits. If you don't know where these documents are, they may be found in a safe-deposit box, or your attorney may have copies. You may want to set up folders so you can keep track of everything. And, although it may be difficult under the circumstances, pay your bills and keep your finances current, especially mortgage and insurance payments.

Settle your spouse's estate

Settling your spouse's estate is the duty of the executor, who is named in the will. Spouses generally name each other as executor of the other's estate. If this is so, your attorney can help you to wind up your spouse's financial affairs. If that is not the case, contact the executor and assist him or her when you can.

Here is a rundown of some of the most important tasks that must be completed.

- Report the death to Social Security by calling 1-800-772-1213. If your spouse was receiving benefits via direct deposit, request that the bank return funds received for the month of death and thereafter to Social Security. Do not cash any Social Security checks received by mail. Return all checks to Social Security as soon as possible. Surviving spouses and other family members may be eligible for a $255 lump-sum death benefit and survivor's benefits. Go to www.ssa.gov for more information.
- Contact all insurance companies to file claims. The policies could include individual and group life, mortgage insurance, auto credit life insurance, accidental death and dismemberment insurance, credit card insurance, and annuities.
- Arrange to retrieve your spouse's belongings from his or her workplace. Collect any salary, vacation, or sick pay owed to your spouse, and be sure to ask about continuing health insurance coverage and potential survivor's benefits for a spouse or children.
- Contact past employers regarding pension plans, and contact any IRA custodians or trustees. Review designated beneficiaries and post-death distribution options.
- Contact all credit card companies and let them know of the death. Cancel all cards unless you're named on the account and wish to retain the card.
- File the will with the appropriate probate court. If real estate was owned out of state, file ancillary probate in that state also. If there is no will, contact the probate court for instructions, or contact a probate attorney for assistance.
- Retitle jointly held assets, such as bank accounts, automobiles, stocks and bonds, and real estate.
- A federal estate tax return may need to be filed within nine months of death. State laws vary, but state estate tax and/or inheritance tax returns may also need to be filed, and may have a different filing date. Federal and state income taxes are due for the year of death on the normal filing date, unless an extension is requested. If there are trusts, separate income tax returns may need to be filed.
- Reevaluate your budget, short-term and long-term finances, insurance needs, and investment options. Update insurance policies, and your own estate and investment plans as needed.

Four Retirement Planning Mistakes to Avoid

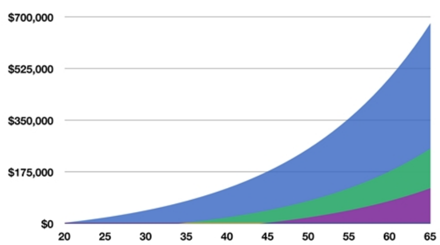
Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

We all recognize the importance of planning and saving for retirement, but too many of us fall victim to one or more common mistakes. Here are four easily avoidable mistakes that could prevent you from reaching your retirement goals.

1. Putting off planning and saving

Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

The chart below shows how much you could save by age 65 if you contribute $3,000 annually, starting at ages 20 ($679,500), 35 ($254,400), and 45 ($120,000). As you can see, a few years can make a big difference in how much you'll accumulate.



Note: *Assumes 6% annual growth, no tax, and reinvestment of all earnings. This is a hypothetical example and is not intended to reflect the actual performance of any investment.*

Don't make the mistake of promising yourself that you'll start saving for retirement as soon as you've bought a house or that new car, or after you've fully financed your child's education--it's important that you start saving as much as you can, as soon as you can.

2. Underestimating how much retirement income you'll need

One of the biggest retirement planning mistakes you can make is to underestimate the amount you'll need to accumulate by the time you retire. It's often repeated that you'll need 70% to 80% of your preretirement income after you retire. However, depending on your lifestyle and individual circumstances, it's not inconceivable that you may need to replace 100% or more of your preretirement income.

With the future of Social Security uncertain, and fewer and fewer people covered by traditional pension plans these days, your individual savings are more important than ever. Keep in mind that because people are living longer, healthier lives, your retirement dollars may need to last a long time. The average 65-year-old American can currently expect to live another 19.2 years (Source: National Vital Statistics Report, Volume 60, Number 4, January 2012). However, that's the average--many can expect to live longer, some much longer, lives.

In order to estimate how much you'll need to accumulate, you'll need to estimate the expenses you're likely to incur in retirement. Do you intend to travel? Will your mortgage be paid off? Might you have significant health-care expenses not covered by insurance or Medicare? Try thinking about your current expenses, and how they might change between now and the time you retire.

3. Ignoring tax-favored retirement plans

Probably the best way to accumulate funds for retirement is to take advantage of IRAs and employer retirement plans like 401(k)s, 403(b)s, and 457(b)s. The reason these plans are so important is that they combine the power of compounding with the benefit of tax deferred (and in some cases, tax free) growth. For most people, it makes sense to maximize contributions to these plans, whether it's on a pre-tax or after-tax (Roth) basis.

If your employer's plan has matching contributions, make sure you contribute at least enough to get the full company match. It's essentially free money. (Some plans may require that you work a certain number of years before you're vested in (i.e., before you own) employer matching contributions. Check with your plan administrator.)

4. Investing too conservatively

When you retire, you'll have to rely on your accumulated assets for income. To ensure a consistent and reliable flow of income for the rest of your lifetime, you must provide some safety for your principal. It's common for individuals approaching retirement to shift a portion of their investment portfolio to more secure income-producing investments, like bonds.

Unfortunately, safety comes at the price of reduced growth potential and the risk of erosion of value due to inflation. Safety at the expense of growth can be a critical mistake for those trying to build an adequate retirement nest egg. On the other hand, if you invest too heavily in growth investments, your risk is heightened. A financial professional can help you strike a reasonable balance between safety and growth.

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Do I have the right type of life insurance?

Your need for life insurance changes as your life changes. You may need less life insurance when you're younger, but as you take on more responsibilities and as your family grows, the amount and type of life insurance that fits your circumstances changes.

There are many different types of life insurance. But generally, life insurance policies fall into one of two categories, temporary or term insurance, and permanent or cash value insurance.

Term insurance

Term insurance provides coverage for a specified period ranging from 1 to 30 years. Premiums are typically lower compared to permanent life insurance. If you die during the coverage period, your beneficiary receives a specified death benefit. If you live to the end of the specified period, coverage ends and the policy has no cash value.

Permanent insurance

Unlike term insurance, permanent insurance continues throughout your life as long as you pay the premiums. As with term insurance, permanent insurance pays a death benefit to your beneficiary at your death, but it also contains a cash value account funded by your premium dollars. The cash value portion of the policy grows, tax deferred, as long as the coverage remains in force. With permanent insurance, you can tap the dollars in the policy even while you're alive. You can borrow against the policy, and in some cases, withdraw part of the cash value. Keep in mind, though, that unpaid loans and withdrawals will decrease the death benefit available to your beneficiaries, and reduce the cash value, which may cause the policy to lapse.

What's right for you?

Think about what protection you need and what you can afford before you purchase any type of life insurance. If you really need insurance but don't have the discretionary income, term insurance may be your best choice. On the other hand, if you want lifetime coverage and you're interested in accumulating cash value, then permanent insurance may make more sense.

Should I buy my life insurance through my employer or on my own?

Many companies offer their workers employer-sponsored life insurance coverage as part of their employee benefits package. If you're offered this opportunity, it may be in your best interest to accept. Buying life insurance through your employer can be a relatively inexpensive and hassle-free way to get some of the life insurance coverage you need.

With a group life insurance plan, your employer purchases a single policy that covers all employees. This policy is subject to a single group premium payment. Some employers may pay the entire cost of the group policy (which is tax deductible to the employer). But if the plan requires you to pay a portion of the group premium, that amount will probably be lower than what you would pay for the same type and amount of individual insurance coverage. And you generally don't need to pass a medical exam when applying for group life insurance.

A disadvantage of employer-sponsored life insurance is that it may not be portable. If you leave your job, your group life insurance coverage may end--potentially leaving you underprotected, especially if you can't purchase an individual policy at a reasonable cost because of your age or changes in your health. However, you may be allowed to convert your group insurance to an individual policy, which would allow you to keep your insurance coverage, regardless of your age or health, but you'd have to pay the entire premium out-of-pocket.

Another disadvantage of group life insurance is that the policy may not be tailored to your individual needs. For example, the amount of coverage may be less than what you require to be fully protected. If so, the group policy may give you the option of purchasing more coverage for an additional cost and for which you may be asked to answer medical questions. But even if you end up buying supplemental insurance through a separate company, your employer-sponsored plan gives you a head start in meeting your life insurance needs.

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