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Plan Now for a Year-End Investment Review

You might not enjoy sitting down to do year-end investment planning, but at least this fall you can make plans with greater certainty. For the last three years, investment planning has meant trying to anticipate possible changes in tax law; for tax year 2013 and beyond, you know for sure how income, capital gains, and qualifying dividends will be taxed. That gives you an opportunity to fine-tune your long-term planning, or to develop a plan if you've postponed doing so. Here are some factors to keep in mind as the year winds down.

Consider harvesting your losses

With tax rates settled, the question of whether to sell losing positions to generate capital losses that can potentially be used to offset capital gains or \$3,000 of your ordinary income becomes a much more straightforward decision. That process is known as harvesting tax losses, and it could prove especially worth considering this year. The first half of the year produced strong gains for U.S. equities; even a mediocre second half could still have the potential to leave you with a higher tax bill than you had anticipated.

To maximize your losses for tax purposes, you would sell shares that have lost the most, which would enable you to offset more gains. Unless you specify which shares of stock are to be sold, your broker will typically treat them as sold based on the FIFO (first in, first out) method, meaning that the first shares bought are considered to be the first shares sold. However, you can designate specific shares as the ones sold or direct your broker to use a different method, such as LIFO (last in, first out) or highest in, first out.

Interest rates: bane or blessing?

The Federal Reserve has said that if the economy continues to recover at its expected pace, it could raise its target Fed funds rate sometime in 2014. However, investors have been anticipating such an increase since early summer, when many bond mutual funds began seeing strong outflows from investors concerned that a rate increase could hurt the value of their holdings. As any consumer knows, lower demand for a product often

means lower prices. And since bond prices move in the opposite direction from bond yields, yields on a variety of fixed-income investments have begun to rise. However, there also could be a silver lining for some investors. Higher yields could provide welcome relief for individuals who rely on their investments for income and have suffered from rock-bottom yields.

The Fed has said any rate decisions will depend on future economic data. However, now might be a good time to assess the value of any fixed-income investments you hold, and make sure you understand how your portfolio might respond to a future that could include higher interest rates. Many investors' asset allocation strategies were likely developed when conditions generally favored bonds, as they have for much of the last 20 years. Though asset allocation alone can't guarantee a profit or prevent the possibility of loss, make sure your asset allocation is still appropriate for your circumstances as well as the current investing climate. And don't forget that other financial assets can be affected by potential future interest rate changes as well.

Calculating cost basis for fixed-income investments

The IRS had originally planned to require brokers to begin reporting the cost basis for any sales of bonds and options this year, as it already does for stocks and mutual funds. It has now postponed implementation of the requirements for bonds until January 1, 2014 to give financial institutions more time to test their reporting systems. However, don't throw away your old records yet, especially if you're considering selling any of your bond holdings. The cost basis reporting requirements will apply only to bond purchases and options granted or acquired on or after January 1, 2014, so you'll still be responsible for calculating your cost basis for any bonds or options acquired before that date.

October 2013

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Four Retirement Saving Myths

It's Time to Review Your Life Insurance Needs

Will interest rates rise this year?



Four Retirement Saving Myths



At every stage of your life, there will be competing financial needs. Don't make the mistake of thinking it will be easier to save for retirement in just a few years. It won't.



Before investing in a mutual fund, consider its investment objectives, risks, charges, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing.

No matter how many years you are from retirement, it's essential to have some kind of game plan in place for financing it. With today's longer life expectancies, retirement can last 25 years or more, and counting on Social Security or a company pension to cover all your retirement income needs isn't a strategy you really want to rely on. As you put a plan together, watch out for these common myths.

Myth No. 1: I can postpone saving now and make it up later

Reality: This is very hard to do. If you wait until--fill in the blank--you buy a new car, the kids are in college, you've paid off your own student loans, your business is off the ground, or you've remodeled your kitchen, you might never have the money to save for retirement. Bottom line--at every stage of your life, there will be competing financial needs. Don't make the mistake of thinking it will be easier to save for retirement in just a few years. It won't.

Consider this: A 25 year old who saves \$400 per month for retirement until age 65 in a tax-deferred account earning 4% a year would have \$472,785 by age 65. By comparison, a 35 year old would have \$277,620 by age 65, a 45 year old would have \$146,710, and a 55 year old would have \$58,900.

Note: This is a hypothetical example and is not intended to reflect the actual performance of any specific investment.

Why such a difference? Compounding. Compounding is the process by which earnings are reinvested back into a portfolio, and those earnings may themselves earn returns, then those returns may earn returns, and so on. The key is to allow enough time for compounding to go to work--thus the importance of starting to save early.

Now, is it likely that a 25 year old will be able to save for retirement month after month for 40 straight years? Probably not. There are times when saving for retirement will likely need to take a back seat--for example, if you're between jobs, at home caring for children, or amassing funds for a down payment on a home. However, by starting to save for retirement early, not only do you put yourself in the best possible position to take advantage of compounding, but you get into the retirement mindset, which hopefully makes you more likely to resume contributions as soon as you can.

Myth No. 2: A retirement target date fund puts me on investment autopilot

Reality: Not necessarily. Retirement target date mutual funds--funds that automatically adjust to

a more conservative asset mix as you approach retirement and the fund's target date--are appealing to retirement investors because the fund assumes the job of reallocating the asset mix over time. But these funds can vary quite a bit. Even funds with the same target date can vary in their exposure to stocks.

If you decide to invest in a retirement target date fund, make sure you understand the fund's "glide path," which refers to how the asset allocation will change over time, including when it turns the most conservative. You should also compare fees among similar target date funds.

Myth No. 3: I should invest primarily in bonds rather than stocks as I get older

Reality: Not necessarily. A common guideline is to subtract your age from 100 to determine the percentage of stocks you should have in your portfolio, with the remainder in bonds and cash alternatives. But this strategy may need some updating for two reasons. One, with more retirements lasting 25 years or longer, your savings could be threatened by years of inflation. Though inflation is relatively low right now, it's possible that it may get worse in coming years, and historically, stocks have had a better chance than bonds of beating inflation over the long term (though keep in mind that past performance is no guarantee of future results). And two, because interest rates are bound to rise eventually, bond prices could be threatened since they tend to move in the opposite direction from interest rates.

Myth No. 4: I will need much less income in retirement

Reality: Maybe, but it might be a mistake to count on it. In fact, in the early years of retirement, you may find that you spend just as much money, or maybe more, than when you were working, especially if you are still paying a mortgage and possibly other loans like auto or college-related loans.

Even if you pay off your mortgage and other loans, you'll still be on the hook for utilities, property maintenance and insurance, property taxes, federal (and maybe state) income taxes, and other insurance costs, along with food, transportation, and miscellaneous personal items. Wild card expenses during retirement--meaning they can vary dramatically from person to person--include travel/leisure costs, health-care costs, financial help for adult children, and expenses related to grandchildren. Because spending habits in retirement can vary widely, it's a good idea as you approach retirement to analyze what expenses you expect to have when you retire.



It's Time to Review Your Life Insurance Needs



Regularly reviewing your life insurance can help it keep pace with your changing needs, and your financial and family obligations.

Your life insurance needs may change without you even realizing it. You may have purchased life insurance years ago, and never gave it a second thought. Or, you may not have life insurance at all--and now you need it. When your life circumstances change, you have a fresh opportunity to make sure the people you love are protected.

You're tying the knot

When you were single, you may not have thought much about life insurance. But now that you're getting married, someone else may be depending on your income. If one of you should die, the other spouse may need to rely on life insurance benefits to meet expenses and pay off debts.

The amount of life insurance coverage you need depends on your income, your debts and assets, your financial goals, and other personal factors. Even if you have some low-cost life insurance through work, this may not be enough. To be adequately protected, you may each need to buy life insurance policies from a private insurer. The cost of an individual policy will be based on your age and health, the amount of coverage you buy, the type of policy (e.g., cash value or term insurance), and other variables.

You've become a parent

When you become a parent, it's time to take another look at your life insurance needs because your family's financial security is at stake. Married, single, and stay-at-home parents all need life insurance. Life insurance proceeds can help your family meet both their current expenses (such as a mortgage, child care, or car payments) and future expenses (such as a child's college education). Even if you already have life insurance, it's time to review your policy limits and beneficiary designations.

You're contemplating divorce

During a divorce, you'll have a number of pressing financial issues to address. Make sure that one of these is life insurance. You'll want to think about what protection you need, and what protection your children (if any) will need in the future. For example, if you'll be paying or receiving child support, you may want to use life insurance to ensure continuation of those payments. During a divorce, you may also need to negotiate ownership of life insurance policies. Life insurance ownership and obligations may be addressed in your divorce settlement, and state laws vary, so ask your attorney for advice and information. Finally, you'll want to evaluate your own life insurance

needs to make sure your family is protected in the event of your death.

Your children have left the nest

If having children was the reason you originally purchased life insurance, you may feel that you no longer need coverage once your children are living on their own. But this isn't necessarily the case. Before making any decision, take a look at the types and amounts of life insurance you have to make sure your spouse is protected (if you're married). And keep in mind that life insurance can still be an important tool to help you transfer wealth to the next generation--your children and any future grandchildren.

You're ready to retire

As you prepare to leave the workforce, you should revisit your need for life insurance. You may find that you can do without life insurance now if you've paid off all of your debts and achieved financial security.

But if you're like some retirees, your financial picture may not be so rosy. You may still be saddled with mortgage payments, tuition bills, and other obligations. You may also need protection if you haven't accumulated sufficient assets to provide for your family. Or maybe you're looking for a way to pay your estate tax bill or leave something to your family members or to charity. You may need to keep some of your life insurance in force or even buy a different type of coverage.

Your health has changed

If your health declines, how will it affect your life insurance? A common worry is that if your health changes, your life insurance coverage will end if your insurer finds out. But if you've been paying your premiums, changes to your health will not matter. In fact, you should take a closer look at your life insurance policy to find out if it offers any accelerated (living) benefits that you can access in the event of a serious or long-term illness.

It's also possible that you'll be able to buy additional life insurance if you need it, especially if you purchase group insurance through your employer during an open enrollment period. Purchasing an individual policy may be possible, but more difficult and more expensive.

Of course, it's also possible that your health has changed for the better. For example, perhaps you've stopped smoking or lost a significant amount of weight. If so, you may want to request a reevaluation of your life insurance premium--ask your insurer for more information.



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Will interest rates rise this year?

The Fed hasn't yet raised its target interest rate from less than 0.25%, and it has promised not to do so before unemployment reaches

roughly 6.5%, which it doesn't expect to happen until next year. However, some interest rates have already begun to go up. For example, according to Freddie Mac, the average interest rate on a 30-year fixed-rate mortgage shot above 4% last June for the first time since late 2011, hitting its highest level in almost 2 years. In the same month, the yield on the 10-year Treasury bond went above 2.5% for the first time since August 2011.

Why are interest rates rising even though the Fed's target rate hasn't? Because bond investors are concerned that higher interest rates in the future will hurt the value of bonds that pay today's lower rates. Immediately after the Fed's June announcement, investors began pulling money out of bond mutual funds in droves, reversing a multiyear trend. If there's less demand for bonds, yields have to rise to attract investors.

Aside from bonds, why are investors concerned about a possible Fed rate hike? Bonds aren't

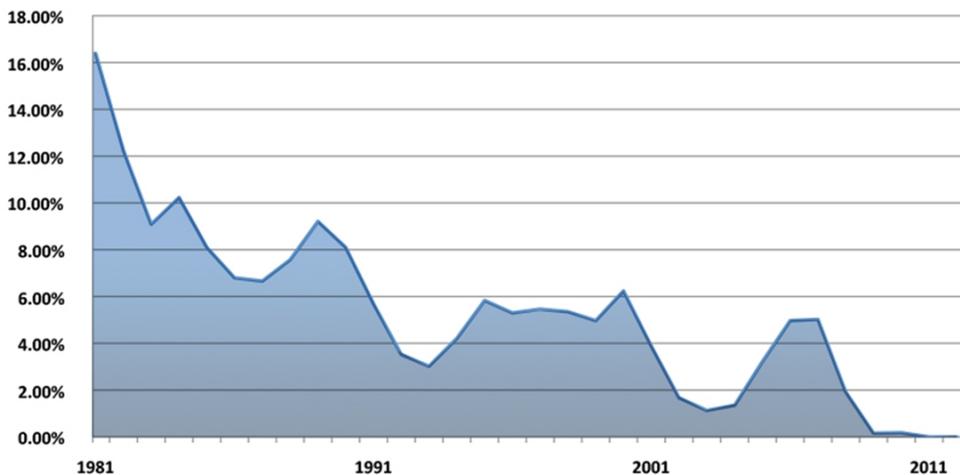
the only financial asset that can be affected by potential future interest rate changes. Dividend-paying stocks with hefty yields have benefitted in recent years; more competitive bond yields could start to reverse that dynamic. Shares of preferred stock typically behave much like those of bonds, since their dividend payments also are fixed; their values could be affected as well.

Also, higher mortgage rates could potentially slow the housing market recovery, though historically they remain at relatively low levels. And if a Fed rate increase were to bring on higher interest rates abroad, that could create even more problems in countries already struggling with sovereign debt--problems that have provoked global market volatility in the past.

The Fed has said any hikes in its target rate will occur only if the economy seems strong enough. If higher rates seem likely to halt the recovery, the Fed could postpone a rate hike even longer. It also will take other measures before raising rates. Even though the timing and size of any Fed action is uncertain, it's best to be aware of its potential impact.

Graph: Interest Rates 1981-2012

This graph represents the federal funds effective interest rate (the average rate at which banks lend to one another overnight), which has generally declined to historic lows over the 30-year period represented. Investment returns, as well as interest rates on bank loans and other fixed-income instruments, could potentially be affected when this rate rises.



Source: Board of Governors of the Federal Reserve System (www.federalreserve.gov), July 17, 2013

