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The weather is changing, and the financial markets are trying to figure out what last week's elections mean for the economy. I've included an article on the "ficscal cliff" and noticed this morning that Washington is crambling to craft a compromise that would lessen the potential pain felt by most taxpayers.

In the middle of political headwinds and economic uncertainty, the markets have been relatively resilient. (The S&P 500 is up over 11% YTD.) As always, it's the wise investor who keeps a broad perspective, a diversified portfolio, and a long-term approach.

Thank you for your business!

-John

November 2012

On the Precipice: the "Fiscal Cliff"

The phrase "fiscal cliff" has been used to describe the unique combination of financial realities scheduled to take effect in 2013: expiring tax breaks; the imposition of new taxes on high-income individuals; and automatic deficit-reduction spending cuts.

Expiring tax breaks

Lower federal income tax rates, part of the tax landscape for more than ten years, expire at the end of 2012. We'll go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). The maximum rate that applies to long-term capital gains will generally increase from 15% to 20%. And while the current lower long-term capital gain rates now apply to qualifying dividends, starting in 2013, dividends will be taxed as ordinary income. The temporary 2% reduction in the Social Security portion of the Federal Insurance Contributions Act (FICA) payroll tax, in place for the last two years, also expires at the end of 2012, as do temporary breaks relating to the federal estate and gift tax.

Several other significant breaks go away in 2013 as well. Itemized deductions and dependency exemptions will once again be phased out for individuals with high adjusted gross incomes (AGIs); the earned income tax credit, the child tax credit, and the American Opportunity (Hope) tax credit all revert to old, lower limits and less generous rules; and individuals will no longer be able to deduct student loan interest after the first 60 months of repayment. Lower alternative minimum tax (AMT) exemption amounts (the AMT-related provisions actually expired at the end of 2011) mean that there will be a dramatic increase in the number of individuals subject to AMT when they file their 2012 federal income tax returns in 2013.

New taxes

Beginning in 2013, the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--increases by 0.9% for individuals with wages exceeding $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately).

Also beginning in 2013, a new 3.8% Medicare contribution tax is imposed on the unearned income of high-income individuals. This 3.8% contribution tax applies to some or all of the net investment income of individuals with modified adjusted gross income that exceeds $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately).

Mandatory spending cuts

The failure of the deficit reduction supercommittee to reach agreement in November 2011 automatically triggered $1.2 trillion in broad-based spending cuts over a multiyear period beginning in 2013 (the official term for this is "automatic sequestration"). The automatic cuts are to be split evenly between defense spending and non-defense spending. Although Social Security, Medicaid, and Medicare benefits are exempt, and cuts to Medicare provider payments cannot be more than 2%, most discretionary programs including education, transportation, and energy programs will be subject to the automatic cuts.

Understanding the "cliff"

Many fear that the combination of tax increases and spending cuts will have severe negative economic consequences. According to a report issued by the nonpartisan Congressional Budget Office *(Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013, May 2012),* taken as a whole, the tax increases and spending reductions will reduce the federal budget deficit by 5.1% of gross domestic product (GDP) between calendar years 2012 and 2013. The Congressional Budget Office projects that under these fiscal conditions, the economy would contract during the first half of 2013 (i.e., we would likely experience a recession).

Four Retirement Planning Mistakes to Avoid

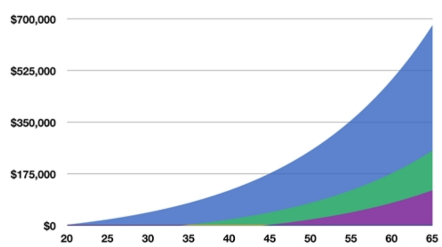
Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

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.

Dave Ramsey's Endorsed Local Providers

Withdrawals from Traditional IRAs

In these challenging economic times, you may be considering taking a withdrawal from your traditional IRA. While you're allowed to withdraw funds from your IRAs at any time, for any reason, the question is, should you?

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Why you should think twice

Financial professionals generally recommend using your retirement funds for one purpose only--retirement. Why? Because frequent dips into your retirement funds will reduce your ultimate nest egg. Plus, there will be less money available to take advantage of the twin benefits of tax deferral and any compound earnings. Depleting your retirement funds too soon can create a dire situation in your later years.

And then there are taxes. If you've made only deductible contributions to your traditional IRA, then all the funds in your account are subject to federal income tax when you withdraw them. They may also be subject to state income tax. If you've made any nondeductible (after-tax) contributions to your IRA, then each withdrawal you make will consist of a pro-rata mix of taxable (your deductible contributions and any earnings in your account) and nontaxable (your nondeductible contributions) dollars.

All your traditional IRAs (including SEPs and SIMPLE IRAs) are treated as a single IRA when you calculate the taxable portion of a withdrawal. So you can't just transfer all your nondeductible contributions into a separate IRA, and then withdraw those funds tax free. And, if you're not yet age 59½, the taxable portion of your withdrawal may be subject to a 10% federal early distribution tax (your state may also apply a penalty tax).

10% early distribution penalty

To discourage early withdrawals from IRAs, federal law imposes a 10% tax on taxable distributions from IRAs prior to age 59½. Not all distributions before age 59½ are subject to this penalty, however. Here are the most important exceptions:

- Distributions due to a qualifying disability
- Distributions to your beneficiary after your death
- Distributions up to the amount of your tax-deductible medical expenses
- Qualified reservist distributions
- Distributions to pay first-time homebuyer expenses (up to $10,000 lifetime)
- Distributions to pay qualified higher education expenses
- Certain distributions while you're unemployed, up to the amount you paid for health insurance premiums
- Amounts levied by the IRS
- Distributions that qualify as a series of substantially equal periodic payments (SEPPs)

The SEPP exception to the early distribution penalty

The SEPP exception allows you to withdraw funds from your IRA for any reason, while avoiding the 10% penalty tax. But the rules are complex, and this option is not for everyone. SEPPs are amounts you withdraw from your IRA over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. You can take advantage of the SEPP exception at any age.

To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually. If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

Even though SEPPs are initially determined based on lifetime payments, you can change--or even stop--the payments after five years, or after you reach age 59½, whichever is later. For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce the payments (or stop them altogether) once you reach age 59½.

Short-term loan

If you only need funds for a short period of time you may be able to give yourself a short-term loan by withdrawing funds from your IRA, and then rolling those dollars back into the same or a different IRA within 60 days. However, watch the deadline carefully, because if you miss it, your short-term loan will instead be treated as a taxable distribution. And keep in mind that you can only make one rollover from a particular IRA to any other IRA in any 12-month period. A violation of this rule can also have serious adverse tax consequences.

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Do I need to file a gift tax return?

If you transfer money or property to anyone during any year without receiving something of at least equal value in return, you may need to file a federal gift tax return (Form 709) by April 15 of the next year. If you live in one of the few states that have a gift tax, you may also need to file a gift tax return with your state.

Some gifts aren't taxable and generally don't require a gift tax return. These exceptions include:

- Gifts to your spouse that qualify for the marital deduction.
- Gifts to charities that qualify for the charitable deduction. (Filing is not required as long as you transfer your entire interest in the property to qualifying charities. However, if you are required to file a return to report gifts to noncharitable beneficiaries, all charitable gifts must be reported.)
- Qualified transfers exclusion amounts paid on behalf of anyone, either directly to an educational institution for tuition or directly to a provider for medical care.
- Annual exclusion gifts totaling $13,000 or less for the year to any one individual. (However, you must file a return to split gifts with your spouse. But, if your spouse is not a U.S. citizen, the annual exclusion is increased to $139,000 in 2012 for gifts to your spouse.)

If your gift isn't exempt from taxation, you'll need to file a gift tax return. But that doesn't mean that you have to pay gift tax. Generally, each taxpayer is allowed to make taxable gifts totaling $5,120,000 (scheduled to drop to $1 million in 2013) over his or her lifetime before paying gift tax. Filing the gift tax return helps the IRS keep a running tab on that $5,120,000 basic exclusion amount (sometimes referred to as an exemption).

If you made a gift of property that's hard to value (e.g., real estate), you may want to report the gift, even if you're not required to do so, in order to establish the gift's taxable value. If you do, the IRS generally has only three years to challenge the gift's value. If you don't report the gift, the IRS can dispute the value of your gift at any time in the future.

What happens to my property if I die without a will?

If you do not have a will, your property will generally pass by state law under the rules for intestate succession. Under intestate succession, the state essentially makes a will for you. The state laws for intestate succession specify how your property will pass, generally in certain proportions to various persons related to you. These laws vary from state to state.

The intestate succession laws generally favor spouses and children first. For example, a typical state law might specify that your property pass one-half or one-third to your surviving spouse, with the remainder passing equally to all your children. If you don't have children, your spouse might take all in many states; in other states, your spouse might have to share the estate with your brothers and sisters or parents.

But not all property passes by will or intestate succession. Whether or not you have a will, some property passes automatically to a joint owner or to a designated beneficiary. For example, you can transfer property such as IRAs, retirement plan benefits, and life insurance by naming a beneficiary. Property that you own jointly with right of survivorship will automatically pass to the surviving owners at your death. Property held in trust will pass to your beneficiaries according to the terms you set out in the trust.

So, only property that does not pass by beneficiary designation, joint ownership, will, or trust passes according to state intestacy laws. You should generally use beneficiary designations, joint ownership, and wills and trusts to control the disposition of your property, so that you, rather than the state, determine who receives the benefit of your property.

Even if it seems like all your property will be transferred by beneficiary designation, joint ownership, or trust, you should generally have a will. You can designate in the will who will receive any property that slips through the cracks.

And, of course, you can do other things in a will as well, such as name the executor of your estate to carry out your wishes as specified in the will or name a guardian for your minor children.