The Insurance Depot, Inc.
Life Insurance and Annuity Specialists

PO Box 1344 ▪ Sparta, NJ 07871
Phone: 973-726-6015 ▪ Fax: 973-726-6017
www.lifeandannuityexchange.com

financial $UCCESS

QUARTER 4, 2011

Investing Before and During Retirement

There are two phases in the life cycle of a retirement portfolio: the time when you're contributing to it and the time when you're using it, to cover your living expenses. During each phase, the basic challenge is deciding how to invest your nest egg, and for that there are three common approaches:

✔ **Going with your comfort level.** Most people have some idea as to what investments appeal to them, either because of the rate of return they associate with them or how much safety they seem to offer. Whichever it is, people tend to pile their retirement funds in one place, which can cause problems if there is a significant decrease in that investment.

✔ **Using a "one-size-fits-all" formula.** There are at least several of these "formulas" floating around. On the theory that the closer you get to retiring the more conservative you should become, one says you should subtract your age from 100, treat the result as a percentage, and put that portion of your portfolio in stocks and the rest in bonds. Another follows the same method but suggests you subtract your age from 120. The appeal of this approach is that it's simple and unambiguous. The downside is that the results don't take into account the details of your circumstances, the state of the economy and inflation, or the cyclical nature of market returns.

✔ **Using a financial plan.** A plan includes all the details that the other two methods leave out. It's by far your best bet for achieving your retirement goals, since it takes your circumstances and the state of the economy into account. The plan should be split into before-retirement and during-retirement strategies.

Before You Retire

The key factor is to determine

Continued on page 2

A Tax-Planning Mentality

Take time early in the year, perhaps as part of the tax preparation process, to assess your tax situation, looking for ways to reduce your tax bill. Consider a host of items, such as the types of debt you owe, how you're saving for retirement and college, which investments you own, and what tax-deductible expenses you incur.

During the year, consider the tax consequences before making important financial decisions. This will prevent you from finding out later that there was a better way to handle the transaction for tax purposes.

Look at your tax situation again in the fall, which gives you plenty of time before year-end to implement any additional tax-planning strategies. At that point, you'll also have a better idea of your expected income and expenses for the year.

There are basically three strategies that can help reduce your income tax bill — reduce or eliminate taxes, postpone the payment of income taxes until sometime in the future, and shift the tax burden to another individual. ❍❍❍

FR2011-0421-0001

Investing

Continued from page 1

what rate of growth you need to achieve in your portfolio to retire with a nest egg capable of supporting you for the rest of your life once you no longer earn a paycheck. It's a balancing act between how much you can afford to put aside every year, how much growth will maximize your nest egg, and how much risk you feel comfortable taking.

By analyzing these factors, a good financial plan produces a recommended asset allocation strategy that specifies how much of your portfolio should be invested in stocks, bonds, cash, commodities, and real estate. The mix you invest in aims at a target rate of return and risk level that both meets your goals and makes you comfortable with the year-to-year results.

In general, the younger you are, the more risk you can afford to take since you will have many market and economic cycles to smooth out your returns. It's not unheard of for someone in his/her 30s or 40s to invest up to 70% or 80% of his/her assets in stocks. Conversely, younger people who are risk averse may be able to take less risk and put more of their assets in CDs and bonds, as long as they have more modest retirement goals.

It's generally true that the closer you are to retiring, the more conservative your portfolio should be. But this doesn't suggest the precise proportions that you should put into each asset class, nor does it take into account the opportunities or challenges that current market conditions present. Those answers will come only when you get into the details of your current situation and your future goals.

After You Retire

Before you retire, your asset allocation strategy is driven largely by the goal of creating the largest possible retirement portfolio within the limits of your tolerance for risk. After you retire, the goal shifts to keeping your retirement portfolio large enough to continue generating the supplemental income you need for the rest of your life.

While this shift means your strategy aims for less growth and risk than in the accumulation stage, it's usually a mistake to revert to the most conservative strategy possible. That's because your portfolio gets eroded over time by:

- ✔ Inflation, which means the real value of your portfolio (as well as the buying power of the income it throws off) gets smaller every year.
- ✔ Taxes on income and capital gains in taxable accounts and withdrawals from non-Roth IRAs.
- ✔ Withdrawals that you make to support your lifestyle.

Because of this constant shrinkage, some portion of your portfolio needs to be invested in stocks, which is a riskier asset class but the only one that typically stays ahead of inflation, taxes, and reasonable rates of withdrawals. Please call if you'd like to discuss your situation. ❍❍❍

Managing Withdrawals in Retirement

Once you've retired, you begin a balancing act between two imperatives: withdrawing enough from your retirement portfolio to cover your expenses and not taking out so much that you run out of money. So how do you get the rate of withdrawal that is just right?

Over the years, there's been a general rule of thumb: keep your withdrawals to between 4% and 6% of your total portfolio a year. While you will still want to consider your circumstances, these general rules of thumb point out that the appropriate rate at which you should take money out of your accounts is much smaller than many people imagine. Just as with every other issue related to retirement planning, the withdrawal rate that's right for you can only be determined by a financial plan.

But right off the bat, it's safe to say that whatever that rate is, ideally it should be less than the annual rate of growth your portfolio achieves, minus the rate of inflation.

However, on a year-to-year basis, market returns and inflation fluctuate. Sometimes, as we've seen recently, market returns are negative. If you want to avoid shrinking the real value of your portfolio in these circumstances, you should adjust how much you take out of your portfolio for spending purposes.

But does that mean when your accounts lose money in a bad stock market year you shouldn't withdraw any money from them? Strictly speaking, the answer is yes, but that's not always realistic. If it means forgoing some luxuries or putting off some discretionary expenses, holding off on withdrawals when market returns are below average might make good sense.

If it means that you're forced to cut back on necessities, you may have no choice but to take out the money you need. But then ask yourself: does that mean that your lifestyle is more expensive than you can really afford? Or that you need to alter your asset allocation in favor of higher-growth investments?

Whatever the case, it's to your advantage to have a financial plan for retirement — and revisit it at least once a year. Please call if you would like to discuss this in more detail. ❍❍❍

Thinking Strategically about Risk

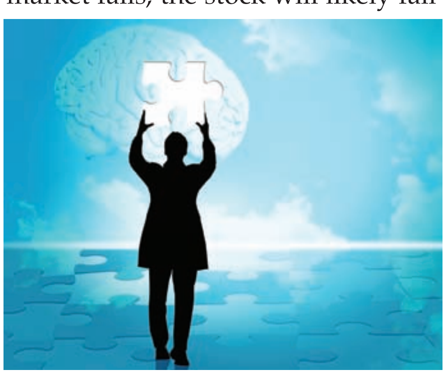
York University business school professor Moshe Milevsky recently wrote an article on risk that was featured in *The Wall Street Journal*. In it, he states that investors often don't look at risk as strategically as they should and don't consider the most important asset of all: themselves.

Milevsky believes investors should consider how a high or low day in the stock market directly impacts their take-home pay. The answer varies greatly by industry and job profession: a middle school librarian may have a zero impact, while an investment banker or portfolio manager may be highly impacted by the stock market's highs and lows.

After considering this relationship, investors should consider how this relates to their investment portfolio. Instead of assuming a position in one of the risk camps (averse or tolerant), look at how much risk your "personal balance sheet" can tolerate.

Consider your number-one asset as *you*. Look at your future earnings and consider the amount of income that you will generate before retirement.

And after looking at your income and how it is tied to the stock market, actually assign a number to it. Milevsky explains it this way, "If a stock has a beta of 1, it means that it's likely to move in tandem with the overall market. A beta above that means that if the market falls, the stock will likely fall



by even more; a beta below 1 means the stock won't move as much as the market" (Source: *The Wall Street Journal*, 2010).

Most traditional professions have a beta of zero. This doesn't mean the incomes don't fluctuate, but that the volatility of the stock market has no impact on the income.

A question of balance. Once you know your personal beta, apply it to how your portfolio is allocated. If you have a high personal beta, if the returns on your human capital tend to fluctuate with the market, then your financial capital — your 401(k), IRA, brokerage account, etc. — should be invested more conservatively. It doesn't matter if you *feel* the market is due to rise. Even your emotional tolerance for risk becomes less important. You should instead be considering that if markets decline over a prolonged period of time, there is a greater chance you might lose your job, be unemployed for a long time, own less valuable stock options, and so on.

Rethink your insurance. Human capital isn't influenced only by the stock market. It is vulnerable to plenty of other factors, such as death, disability, and extended illness. One way to reduce the risk level on your balance sheet is to ensure that you are properly insured. Insurance allows your family to treat your human capital a bit more like a bond — and perhaps take more risk in the family's financial portfolio.

Start early. This advice is given frequently when it comes to investing, and the same is true for risk. Earlier starts of assessing your personal beta, understanding your income and human capital worth, and allocating the right assets to your portfolio will go a long way.

Please call to discuss this concept in more detail. ❍❍❍

How Much Disability Insurance?

You should consider your options now so that 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. When considering a long-term disability, assess your income needs until age 65, when presumably retirement benefits would begin. During this analysis, consider these items:

✔ Estimate your monthly expenses following a disability. Typically, some of your disability benefits would be free of income taxes 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.

✔ Review your annual Social Security Statement for an estimate of disability benefits. However, keep in mind that the eligibility requirements are quite stringent.

✔ 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.

✔ Investigate any long-term disability benefits provided by your employer. Long-term group disability plans are less common and typically less generous than short-term plans.

✔ 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. ❍❍❍

Reducing Your Debt

If you find that you have accumulated too much debt, there are various ways to tackle it. Here are a few suggestions to get you started.

Understand your expenses — The first step in reducing debt is to get a handle on it all. Produce a list of all your expenditures. Then categorize them into fixed expenditures (i.e., mortgage and car loans); items that are necessary but not fixed (home phone bill, fuel, etc.); and items that are highly variable (clothes, dining out, etc.).

Create a budget — Include all of the expenditures you just calculated. Then make a list of all your debt obligations and the interest you're charged for each. Create a line item in your monthly budget for debt payoff. This number needs to be above the minimum payments on your credit card statements. Once you determine the maximum amount you can pay off each month, pay down the debt with the highest interest rate first.

If you have debt besides your home, don't be overly ambitious in paying off your mortgage. Mortgages tend to have lower interest rates than other debt, and you can deduct the interest you pay on the first $1 million of a primary-home mortgage loan.

Lower your expenses — Think about how you can dedicate more money to debt payoff. Cut down on the extra items in your variable spending category and put the extra money toward your debt payments.

Increase your income — Consider whether there's any way to boost your take-home pay. Even though the job market is still struggling, it can't hurt to ask for that well-deserved raise or to post for an open position within (or outside of) your company. If you get a big tax refund every year, that means you're having too much withheld from your paycheck. If that's the case, you can reduce your withholding by changing your W-4 at work.

What not to do — It may be convenient to borrow against your home equity or your 401(k) to pay off debt, but that can be dangerous. It puts your home at risk and means that you may fall short of your retirement goals. Even if you can't manage your monthly debt payments, lenders are often willing to work with you to create a repayment plan that you can manage.

Finally, the best debt-reduction move is to ask for help. Please call if you'd like to discuss this topic in more detail. ❍❍❍

Are You Subject to the AMT?

The problem is that most people don't know if they are subject to the alternative minimum tax (AMT) until they prepare their income tax returns, when there's not much that can be done.

The AMT raises your tax exposure by adding back into taxable income amounts that were removed on form 1040, where you claim certain exemptions, deductions, and tax credits. These income-reducing provisions are called "preferences," and include the standard deduction; personal exemptions; state, local, and property taxes; medical expenses, in part or in total; miscellaneous itemized deductions; certain tax-exempt bond income; interest on home-equity loans and lines of credit used for purposes not directly related to your home; certain business-related items, large capital gains, particularly those from the exercise of incentive stock options; and some tax shelters.

It's difficult to determine which combination of factors will make you subject to the AMT. It's best to make that estimate before the end of the tax year, when there are still some steps you can take to minimize the AMT pain. ❍❍❍

The Insurance Depot, Inc.
Life Insurance and Annuity Specialists
PO Box 1344
Sparta, NJ 07871

FR2011-0421-0001