Investor Insights & Outlook

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Don’t Pay Tax Twice

Reinvestment can be a crucial component of the wealth accumulation process, as the reinvested amount compounds and grows over time. Yet if you are reinvesting dividends and capital gains (“distributions”) in funds you hold in your taxable account, it can be important to ensure that you're not paying more tax than necessary. You pay tax on those distributions in the year in which you receive them. But if you don’t keep good records, you could end up paying tax on those distributions again when you sell. For example, say you bought 1,000 shares of a fund for your taxable account at the end of 2011; you paid $18 per share for a total of $18,000. In 2012, with the share price still at $18, the fund made a dividend distribution of $0.50 per share, or $500 for your 1,000 shares. You'd owe tax on the $500 on your 2012 taxes, whether you reinvested the money or took the cash in hand. (The taxes would be deferred if you held the fund in a tax-sheltered account). If you reinvested the money in the fund, you’d now own 1,027.78 shares: your original 1,000 plus the nearly 28 additional shares that you were able to buy (at $18) with the $500 dividend distribution. If you sell now, with the fund's net asset value at $20, you’d think you’d owe taxes on your $2,555.56 profit ($20,555.56 minus $18,000), right? Wrong. You would only owe taxes on $2,055.56 ($20,555.56 minus $18,000 minus $500). Otherwise, the $500 dividends would be taxed twice.

Investments are subject to risk of principal and risk of loss. Dividends are not guaranteed. Retirement accounts are tax-deferred vehicles designed for retirement savings. Any withdrawals of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. This should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.

Advisor Corner

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Get Your Estate Plan in Gear

Estate planning laws have undergone swift changes over the past several years and may change again in the years ahead. If you're creating or updating an estate plan, it's essential that you seek the advice of an attorney who's well versed in this area. Before you hire an estate-planning attorney to draft or update your estate plan, it's important to understand your role in the estate-planning process.

Find a qualified attorney: Because your estate plan will likely need to be updated as the years go by and your personal circumstances change, it makes sense to find an attorney who practices in the community where you live. This can help you meet with him/her on an ongoing basis.

Take stock of your assets: Before you meet with your attorney, spend some time enumerating your assets and their value: your investment accounts, life insurance, personal assets such as your home, and your share of any businesses that you own. Also gather current information about any debts outstanding. Your estate-planning attorney is likely to provide you with a worksheet to document your assets and liabilities, but it's helpful to collect this information in advance.

Identify key individuals: Another important aspect of estate planning is identifying the individuals you trust to ensure that your wishes are carried out once you're gone.

Executor: A person who gathers all of your assets and makes sure that they are distributed as spelled out in your will.

Durable (Financial) Power of Attorney: A person you entrust with making financial decisions on your behalf if you should become disabled and unable to manage your own financial affairs.

Power of Attorney for Health Care: A person you entrust with making health-care decisions on your behalf if you are disabled and unable to make them on your own.

Guardian: A person who would look after your children if you and your spouse were to die when your children are minors.

Know the key documents you need: When you meet with your estate-planning attorney, he or she will make recommendations about your estate plan. At a minimum, you should ask your attorney to draft the following documents.

Last Will and Testament: A legal document that tells everyone, including your heirs, how you would like your assets distributed after you're gone.

Living Will: A document that tells your loved ones and your health-care providers how you would like to be cared for if you should become terminally ill; usually includes details about your views toward life-support equipment.

Durable (Financial) Power of Attorney: A document that gives an individual the power to make financial decisions and execute financial transactions on your behalf if you are unable to do so.

Medical Power of Attorney: A document that gives an individual the power to make health-care decisions on your behalf if you are unable to do so.

Manage your documents: Once your estate-planning documents are drafted, destroy any older versions of them. Notify your executor of the whereabouts of your estate-planning documents, and provide copies of the relevant documents to your executor, powers of attorney, and the guardian for your children.

Plan to keep your plan current: Last but not least, plan to keep your estate plan current. One of the biggest estate-planning pitfalls is drafting an estate plan but not keeping it up to date. Changes may include change in marital status, assets, financial status, death or ill health of your beneficiaries, executor, power of attorneys, or guardian.

A Beginner's Guide to Credit Cards

Credit cards are magic little pieces of plastic that allow you to use money without having it, right? Wrong. The reality is that credit cards are magic little pieces of plastic designed to make money for the credit-card companies. Not being aware of your full responsibilities as a credit card holder can bury you deep in debt and significantly limit your access to credit in the future. Therefore, it is crucial for you, the consumer, to be aware of all the little details of credit-card transactions.

A credit card is a valuable convenience, since it means you don't have to carry cash around anymore. But it definitely does not mean that you can make unlimited purchases and not pay for them, as some people may think. With a credit card, all the purchases you make during a certain period of time are allowed to accumulate, and you receive a bill (statement) for the total amount spent at the end of that time period (usually a month). Once you get the bill, you have a grace period—normally 20 to 25 days—until the due date.

When you receive the bill, you'll notice you can make a minimum payment, or you can pay the balance in full. In other words, you owe $3,000, but you can make only a minimum payment of $1,000 and keep the other $2,000 for yourself. This is great, right? Wrong again. If you do not pay your balance in full, your credit card company will make money by charging you fees.

Finance charges and late fees: If you have an outstanding balance (money that was not paid on time) on your credit card, you will pay interest on that balance. There are various methods for calculating your outstanding balance (adjusted balance, average daily balance, previous balance, ending balance), so try to understand which method your credit card issuer uses. Credit-card issuers have to disclose the interest rate they charge, so make sure you know what your APR (annual percentage rate) is. If you are billed monthly, the interest rate used to calculate your finance charges will generally be your APR divided by 12. Also, credit -card rates can be fixed or variable, so if yours is variable make sure you understand why it varies and how.

If you pay your balance in full every time, you will manage to avoid finance charges, but it is still important for you to know what they are, just in case. Before you sign up for the card (not after!), read the payment rules carefully (they differ from one issuer to another). If you pay by check, mail the payment early or, even better, pay online. Be aware that paying late may result in an increase of your interest rate in the future.

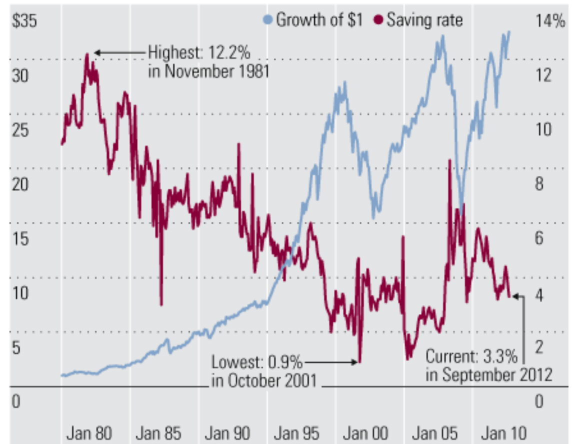
In addition to finance charges, every time you delay payment you will have to pay a late fee, which can be substantial. It is obviously in your best interest to pay your balance in full every time and as early as possible. Also, when deciding which credit card to choose, look for a card with a low APR. It may have fewer bells and whistles, but it will save you money in the long run. A useful source of information on credit card rates is the website www.bankrate.com.

Annual fees, credit limit fees, cash advance fees, and balance transfer fees: Some credit card issuers charge an annual fee per card, usually assessed on your first statement. Fortunately, avoiding this one is simple: Choose a card without an annual fee. You can also be charged if your outstanding balance exceeds your credit limit. You can probably avoid this fee by requesting a credit limit increase, but this is tricky because then you'll be tempted to spend more. Card companies generally charge a fee for cash advances, which can be calculated as a flat charge per transaction or as a percentage of the total. You can also be assessed a fee for balance transfers. The point should be clear by now: It is in the credit card company's best interest to charge you all these fees, and it is in your best interest to avoid them. Make sure you know all the rules, and make all your payments on time.

The Personal Saving Rate

Saving is an important part of any sound financial plan. In order to measure consumer spending and saving, the Bureau of Economic Analysis publishes personal income, expenditure and saving statistics, including the personal saving rate. This saving rate is calculated by taking disposable income (income after taxes), subtracting personal consumption expenditures, and dividing the result by personal disposable income. The saving rate has been generally trending downward for the past few decades. Recently, the saving rate was 3.3% in September 2012, extremely low when compared with previous levels. As the image illustrates, it would seem that when the market is in trouble, consumers get scared, spending less and saving more; the opposite happens when the market is doing well. However, even if the economy is now on the way to recovery, it's probably not a good idea to stop saving.

Personal Saving Rates and the Market
January 1980–September 2012



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Source: The market is represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Saving rate data from the U.S. Department of Commerce, Bureau of Economic Analysis, through the Federal Reserve Bank of St. Louis (FRED® database).

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