

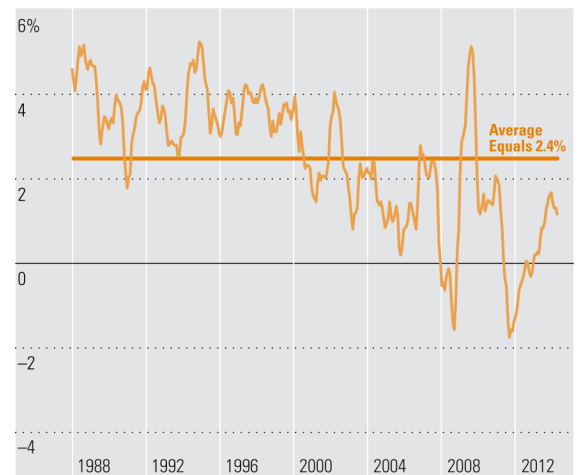
Investor Insights & Outlook

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Inflation Rate and Typical Spread Suggest Higher Interest Rates Ahead

Given that the U.S. Federal Reserve is stepping back some of its maneuvers to keep interest rates low, interest rates are expected to increase to more normal levels. Normal means that interest rates are generally dictated by the rate of inflation plus a spread. In the case of the U.S. 10-year Treasury bond, the spread has averaged about 2.4%, though that level has been quite volatile. If one puts that 2.4% spread on top of the current inflation rate of 1.5% (as of Apr. 2014), one could expect an interest rate of 3.9% (compared with 1.8% at the end of 2012 and 2.9% at the end of 2013). Yet, it might take some time to get there. Higher rates are generally bad news for the economy as they tend to slow both housing and auto activity.

10-Year Treasury and CPI Inflation Spread



Source: St. Louis Federal Reserve, updated June 2, 2014. Last data point is for April 2014.



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Advisor Corner

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What You Need to Know about Health Savings Accounts

Health Savings Accounts (HSAs) are growing in popularity, and more companies are offering them to their employees. Many people, however, are confused about what these plans are and when it is appropriate to take advantage of them.

What Is an HSA? Health Savings Accounts were created by a provision in the Medicare Prescription Drug Improvement and Modernization Act of 2003 and signed into law in December of that year. The purpose of creating the accounts was to provide a way for Americans to prepare for future medical costs and lower their health insurance premiums by switching to higher-deductible medical plans. Employers can establish plans for employees, and HSAs are also offered by banks, credit unions, insurance companies, and other approved companies.

In 2013, an individual can contribute up to \$3,250 to an HSA, while families can contribute \$6,450. People over 55 can also make a catch-up contribution of \$1,000.

What Type of Tax Benefits Does an HSA Offer? Personal contributions offer participants an “above-the-line” deduction, which allows them to reduce their taxable income by the amount they contribute to their HSA. Participants aren't required to itemize their deductions to realize this benefit.

If your employer offers a “salary reduction” plan (also known as a “Section 125 plan” or “cafeteria plan”), you can make contributions to your HSA on a pre-tax basis. However, the “above-the-line” deduction is off limits for those who elect to contribute on a pre-tax basis.

If you are self employed, you cannot contribute to an HSA on a pre-tax basis. However, you can contribute with after-tax dollars and take the above-the-line deduction.

Who's Eligible? In order to be eligible to contribute to an HSA you have to be covered by a high-deductible health insurance plan. “High-deductible” is defined as a deductible (where you pay the first dollars for

medical service out of your own pocket) of \$1,250 or higher for singles and \$2,500 or higher for families.

In order to be eligible to contribute to an HSA, you cannot be 65 years of age or older. People 65 and older can maintain an HSA established prior to age 65, but they can no longer make contributions into it.

An HSA cannot be established for those eligible to be claimed as a dependent on another person's tax return. Also, if you are covered by another health insurance plan (such as a spouse's), you are not eligible for an HSA.

If you die and have money in an HSA, your spouse can use the account as if it were his or her own. If you are not married, the account can pass to a beneficiary but will no longer be considered an HSA and will be taxable to the beneficiary. If your estate is the beneficiary, the value of the HSA will be included on your final income tax return.

Making Withdrawals from Your HSA: Withdrawals made from your HSA are tax-free if used for qualified medical expenses. The same things you can deduct on Schedule A are considered medical expenses for HSAs. For more information on exactly what qualifies, see IRS Publication 502: Medical and Dental Expenses.

If you don't need to withdraw the funds from your HSA, you can let your contributions grow over time tax-free (similar to IRA accounts). HSA contributions grow on a tax-deferred basis. Moreover, unlike flexible spending accounts you may have used in the past, HSA contributions are not “use it or lose it.”

Property and Casualty Insurance

Just as in driving, when planning your finances you have to learn to be defensive. While the word "insurance" makes some people cringe, it might not seem so bad if you can find ways to protect your family and save money at the same time. Let's investigate homeowners, auto, and umbrella insurance coverage.

Homeowners Insurance: As scary as it might be to even think of, homeowners are at the risk of losing their property to a fire. Those who live in certain parts of the country are also prone to floods, tornadoes, hurricanes, you name it. Unfortunately, none of us is immune. Homeowners insurance protects what is most likely your biggest investment (your house) and all of its contents. It also provides much-needed liability coverage in case you are ever sued. Because disasters happen when we least expect them, proper preparation is a must. It is recommended that homeowners take an inventory of the contents of their houses, preferably on videotape if possible. Then put the video record in a safe deposit box or a flame-resistant home safe. Next, take a closer look at your insurance policy. Does it provide for 100% guaranteed replacement value for your house and possessions? Is there an inflation clause? Is there "loss of use" coverage that pays for expenses while you can't live in your house? What are the limits on items such as computers, cameras, jewelry, furs, or other valuables? If you've accumulated more "stuff" over the past few years, have you included it in your inventory of assets? Most people should update that at least every two years. Also, it never hurts to comparison shop. You can obtain free insurance quotes from a number of companies on the Internet. Be sure to get the best bang for your buck. For renters, you should be covered by renters insurance. The building owner's property coverage will not pay to replace your apartment's contents. You never can predict if an upstairs neighbor will leave a candle lit or trip over one of your kids' roller skates.

Auto Insurance: Most importantly, your auto insurance policy needs to cover liability. It is not unusual for people to end up in multimillion-dollar lawsuits if they were at fault in an auto accident. You might also need medical coverage, but check your health policy to make sure you are not duplicating coverage. Furthermore, be sure you have protection

from uninsured or underinsured drivers—not everyone is as responsible as you are. Physical damage is another important aspect of car insurance. There are two basic types of coverage: collision and comprehensive. As the value of your car goes down, it may not make sense to continue collision coverage. You can check out the value of your car according to Kelly Blue Book. If you know you'll replace your car if you have an accident, you probably don't need the collision protection. Comprehensive covers all risks other than collision (fire, theft, storm damage, etc.).

Umbrella Insurance: Umbrella coverage gets its name because it sits on top of your homeowners and auto insurance. It extends the liability coverage of those policies. You must have the underlying coverage (assuming you own the asset) in place. Be careful to read the underlying coverage liability limits. You don't want to have a gap between what the homeowners coverage pays for and what the umbrella policy pays for. If you do, you will be responsible for the gap. Be sure to check into discounts if you purchase all of these policies from the same insurance company. Umbrella insurance may be worth considering especially if you have a swimming pool, a big dog, teenage drivers, or if you employ babysitters or cleaning people. Here's the good news: this coverage is cheap. It will cover accidents at your home, in your car, slander, defamation of character, invasion of privacy, libel, and plagiarism. The more assets you have, the more you need this coverage.

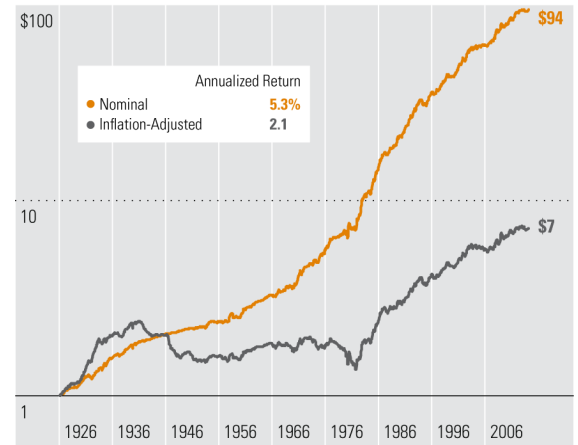
So remember to protect those assets that you've worked so hard to accumulate. You never know when something unexpected can ruin not just your day but your financial plans for the future.

Inflation, not Rising Rates, Biggest Bond Threat in the Long Term

Since the beginning of 2013 when rates started to rise, investors have been concerned about a potential decline in bond performance. In general, bonds tend to perform poorly in times of rising interest rates, but by worrying about rates investors may lose sight of an even bigger long-term threat: inflation.

Over the long term (since 1926) investors have lost 3.2% (the difference between 5.3% nominal and 2.1% inflation-adjusted) in return every year to inflation. Compounded over almost 89 years, the difference in ending wealth values is astounding: A \$94 nominal value becomes only \$7 when adjusted for inflation. Investors may be well advised not to neglect inflation risk while focusing on interest-rate risk.

Intermediate-Term Government Bonds January 1926–March 2014



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Government bonds are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest.

Data: Nominal performance of intermediate-term government bonds—Ibbotson SBBI U.S. Intermediate-Term Government-Bond Index, total return. Inflation-adjusted performance of intermediate-term government bonds—Ibbotson SBBI U.S. Intermediate-Term Government-Bond Index, inflation-adjusted return. Inflation—Consumer Price Index. The data assumes reinvestment of all income and does not account for taxes or transaction costs.

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