

Key Personal Finance Issues for 2010-2011

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Today's 5 Key Issues

- **Managing IRAs**
- **The Current Investment Regime**
- **Changing Income Taxes**
- **Financing Retiree Medical Care**
- **Estate Taxes in Limbo**

Benefits of Roth IRAs

- **Qualified distributions are tax free**
- **Returns of principal are tax free**
- **No required minimum distributions**
- **Heirs can continue tax-free lifetime distributions**
- **Excellent estate planning vehicle**
- **Conversion can be reversed**

Conversion Basics

- **Any traditional IRA, many employer plans can be converted**
- **Pay tax on conversion**
- **Can defer taxes on 2010 conversions**

Basic Factors to Consider

- Rate of return
- Effective tax rates before and after conversion
- Source of money to pay the conversion taxes
- Compounding period/Other sources of income
- State income taxes
- Current value versus past and future values

Less-Known/Overlooked Factors

- **Income taxes on Social Security benefits**
- **Medicare premium surtax**
- **Phaseout of income tax breaks**
- **Alternative minimum tax**
- **Earlier in the year is best**
- **Will the law change?/Tax diversification**
- **Convert in stages**
- **Convert each investment in own Roth**
- **After-tax contributions**

Converting Employer Plans

- **Most types of employer plans can be directly converted to Roths; same basic terms**
- **Most likely:**
 - **Left 401(k) at former employer**
 - **Allowed an “in-service distribution”**
- **Major difference is after-tax contributions**
- **Might be able to convert only after-tax contributions**
- **Don't convert employer stock**

Should You Defer Conversion Taxes?

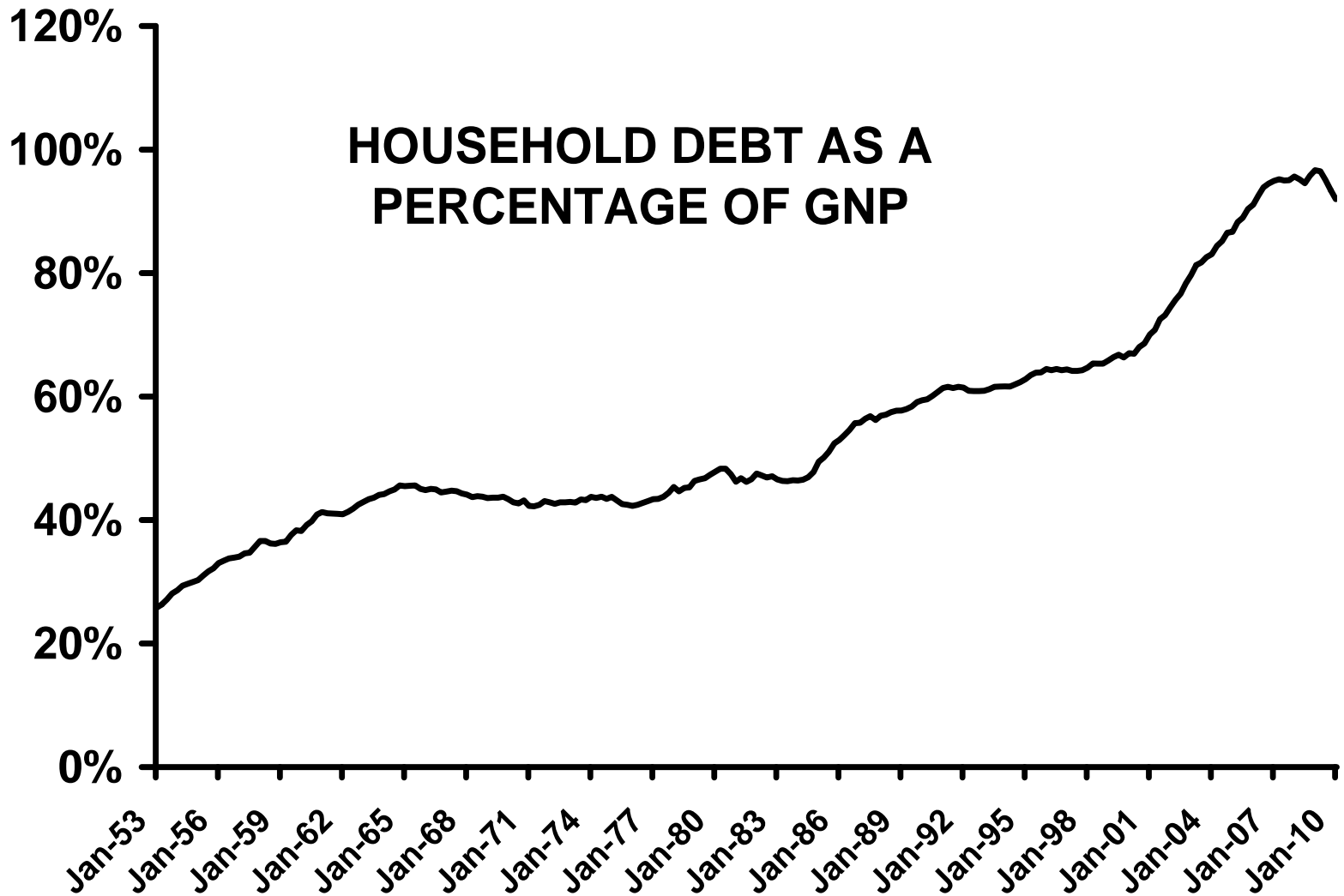
- **Spouses can decide separately**
- **Individual can't decide separately for each account**
- **Will pay at 2011 and 2012 tax rates**
- **Tax deferral does not change reversal deadline**

Changing Your Mind

- **Recharacterizations are allowed**
- **Deadline: due date for return, including extensions**
- **Main Reasons:**
 - **IRA's value declines**
 - **Your situation changes/aware of new facts**
- **Reconvert: Later of 30 days and next calendar year**

Understanding the Investment Climate

- **Not the typical post-WWII decline/recovery**
- **Deleveraging/deflation or Balance Sheet Recession Or New Normal**
- **Public stimulus vs. private contraction**
- **Developed vs. Developing World**



Characteristics of the Climate

- **Little private sector credit growth**
- **Slow economic growth in developed world**
- **Low inflation or deflation**
- **Low interest rates, investment returns**
- **Will continue until debt reduced**

Investing as Risk Management

- **Risk management most important**
- **Risk of the portfolio more important than risk of assets**
- **Forecasting essential to risk reduction**
- **Reduce correlations with major indexes**

4 Strategies that Work

- **True diversification in portfolio**
- **Active management, tactical allocation**
- **Add a “tail risk” hedge**
- **Retirement “buckets” strategy**
- **TIPS-plus strategy**

True Diversification

- **Investments with low correlations**
- **Low correlations with major indexes**
- **Add more asset classes**
- **Add different strategies**
- **Change asset allocation based on prospects — forecasting**

TIPS-Plus Strategy

- **Money for expenses invested for safety**
- **10% or so in growth**
- **Can use leverage for growth**
- **Means need to save more**
- **At retirement, inflation-indexed annuities**

Retirement “Buckets” Strategy

- **Also known as liability-driven investing**
- **Safe fund for 2-5 years of expenses**
- **Longer-term, diversified fund**
- **Can break down further**
- **Much like saving for college**

To Boost Retirement Income

- **Maximize Social Security**
 - **Delay receiving benefits**
 - **Use benefits strategies**
- **Immediate Annuities**
- **Annuities with inflation indexing**
- **Higher yield = higher volatility**

Why Disasters Don't Happen

- **Diverse, service-oriented economy**
- **Regulators, investors aware of problem**
- **Globalization, with weak linkages**
- **Sectors not as correlated**
- **Wealth effects are lagged**

The End of Tax Deferral?

- **Classic advice: Don't pay taxes until have to. Reasons:**
- **Pay in cheaper dollars**
- **Earn a return while holding dollars**
- **Look for opportunities to reduce future taxes**

What's Different

- **Tax increases already enacted**
- **Income tax increases scheduled**
- **More tax increases likely**
- **Fewer tax brackets**
- **Hard to figure current and future tax rates**

Advantages of Not Deferring

- **Capital gains not converted to ordinary income**
- **Control timing of tax bills**
- **Possibly lowest tax rates of the rest of your life**

Tax Strategies for Today

- **Take capital gains before 2011?**
- **Conversions to Roth IRAs**
- **Investing in taxable accounts**
- **Tax diversification**
- **Continue re-evaluating annually**

Financing Retirement Medical Expenses

- **Medicare Advantage likely to shrink**
- **Traditional Medicare expands**
- **Still need coverage for Medicare gaps**
- **Prescription drug coverage**
- **Long-term care a private expense**
- **New CLASS program**

Key Elements of Reform

- Expanded Part D drug coverage
- Reduced subsidy for higher income Part D members
- More people pay premium surtax
- Various pilot programs attempt to improve care, cut costs
- More preventive care
- Higher taxes, fewer tax breaks

Uncertainty & Estate Taxes

- **Estate planning is more than taxes**
- **Flexibility in estate plan**
- **Educate heirs on IRAs, other choices**
- **Use of trusts is increasing**
- **Focus on protection, probate, management**