Investor Insights and Outlook

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The Bridge Between Your Goals and Accomplishments

I stumbled across a motivational poster recently showing a bridge spanning a lake in the middle of a forest. The tagline at the bottom read, "Discipline is the bridge between goals and accomplishments." This should be every investor's motto, since in my experience discipline can be the bridge between the investment goals you set and the investment goals you accomplish. Here are some tips to help you stay disciplined.

Don't lose sight of the forest for the trees

2013 returns for Domestic U.S. stock markets were 25.3%, International stock markets were 20.1%, and Emerging Markets stocks were 0.3%. Does this mean Emerging Markets (and maybe even International stocks) were poor investments?

What about the three-year returns of 16.6%, 8.4%, and 0.3% for U.S., International and Emerging Markets respectively... does this mean International and Emerging Markets are not worth investing in?

If you take a broader perspective, everything changes: 10-year returns have been 7.5% for the U.S., 7.7% for International and 12.4% for Emerging Markets!

Not only have Emerging Markets and International stocks outperformed U.S. stock markets over the long term, they also provide diversification and helped contribute to greater wealth creation than an exclusively U.S. stock portfolio. Disciplined investors aren't sidetracked by short-term performance and remain focused on their long term goals.

There is an emotional rollercoaster ride many investors suffer when markets oscillate (see the chart on the last page). As the market moves up, investors tend to move from optimism to elation, but when the market wanes, elation turns to concern and nervousness, and some frightened investors end up deviating from their well-thought-out investment plans. These deviations are investment mistakes which may be very difficult to recover from.

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Advisor Corner

Thank you for the opportunity to serve as your advisor.

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Using a HSA or FSA to Help You Manage Your Health Care Costs

Health care costs continue to mount. But you could utilize one of two types of savings plans that allow you to save money—on a tax-free basis—to help cover your out-of-pocket expenses.

Unlike IRAs and certain other tax-deferred investment vehicles, no income limits apply to HSAs.

Even with the Affordable Care Act taking effect this year, health care costs continue to mount. According to a recent study, the average health care premium rate rose 3.3% from 2012 to 2013, while out-of-pocket costs – including co-payments, coinsurance, and deductibles – jumped an alarming 12.8%.[1]

Depending on the types of plans offered by your employer, you could have access to two types of savings accounts that allow you to make tax-free contributions to help you pay your medical expenses: a health savings account (HSA) and a flexible spending account (FSA).

Health Savings Accounts

A health savings account is a tax-advantaged savings account set up in conjunction with a high-deductible health plan (HDHP). You are eligible for an HSA if you are enrolled in a qualified HDHP, are not covered by another health plan, are not eligible for Medicare benefits, and are not a dependent of another person for tax purposes.

The maximum contribution to an HSA for 2014 is $3,300 for single coverage or $6,550 for family coverage. If you are over age 55, you can contribute an additional $1,000 regardless of whether you have single or family coverage.

Contributions are made via payroll deduction on a before-tax basis, meaning they reduce your taxable income. Note that unlike IRAs and certain other tax-deferred investment vehicles, no income limits apply to HSAs. Any funds not used one year can be saved and used in future years. Earnings on HSAs are not subject to income taxes.

Eligible expenses include most of the out-of-pocket costs not fully covered by your health plan, including co-payments, deductibles, vision care, prescriptions, over-the-counter medicines, dental care, tests, and medical supplies, among others. See IRS Publication 502 for a more detailed list of qualifying expenses. If funds are withdrawn for any purposes other than qualifying health care expenses, you will be required to pay taxes on amounts withdrawn plus a 10% penalty.

Flexible Spending Accounts

A flexible spending account (FSA), offered as an elective benefit by many employers, permits you to contribute to an account that is designated for out-of-pocket costs not covered under the plan. All amounts contributed are pretax, and funds are not taxed when spent on qualifying health care costs.

Before contributing to an FSA, you must first designate how much you want to contribute for the year, based on an estimate of your expected out-of-pocket costs. The maximum amount you can contribute to your FSA is $2,500 per year. You do not pay federal income tax or employment taxes on the salary you contribute or on any amounts your employer may contribute to the FSA.

Typically, amounts contributed that are not spent by the end of the plan year are forfeited. However, the IRS recently changed this regulation. If your employer elects to change the restrictions in its plan, you could be allowed to keep up to $500 of your balance to use in the following year. Regardless, it is important not to significantly overestimate the qualifying expenses you expect to incur during the year.

As with an HSA, the eligible expenses for an FSA include most of the out-of-pocket costs not fully covered by your health plan. See IRS Publication 502 for a more detailed list of qualifying expenses.

Which One Is Right for You?

Whether an HSA or FSA will suit your needs depends largely on the out-of-pocket costs you expect to incur and how accurately you can predict them. Ultimately, the decision boils down to your particular circumstances and needs.

Source/Disclaimer:

[1]Source: AON Hewitt, AON Hewitt Health Value Initiative Database, October 2013.

Could You Be Subject to the Alternative Minimum Tax?

The alternative minimum tax (AMT) was originally created as a fallback tax for wealthy taxpayers who avoided regular taxes by claiming many exemptions and deductibles. Now, however, more individuals are finding themselves subject to the AMT. The mechanics of the AMT are complex. But a general understanding of how the tax works can help you avoid it and even use it to your advantage.

What Triggers the AMT?

The AMT truly functions as an "alternative" tax system. It has its own set of rates and rules for deductions, which are more restrictive than the regular rules. It operates in parallel with the regular income tax system in that if you're already paying at least as much under the "regular" income tax as you would under AMT, you don't have to pay it. But if your regular tax falls below this minimum, you have to make up the difference by paying the alternative minimum tax.

The AMT can be triggered by a number of different variables. Certain circumstances and tax items are likely to trigger the AMT, including the following:

- Your gross income is $100,000 or higher.
- You have large numbers of personal exemptions.
- You have significant itemized deductions for state and local taxes, home equity loan interest, deductible medical expenses, or other miscellaneous deductions.
- You exercised incentive stock options (ISOs) during the year.
- You had a large capital gain.
- You own a business, rental properties, partnership interests, or S corporation stock.

To find out if you are subject to the AMT, fill out the worksheets provided with the instructions to Form 1040 or complete Form 6251, Alternative Minimum Tax – Individuals.

AMT rates start at 26%, rising to 28% at higher income levels. This compares with regular federal tax rates, which start at 10% and step up to 39.6%. Although the AMT rates may appear to cap out at a lower rate than regular taxes, the AMT calculation allows significantly fewer deductions, making for a potentially bigger bottom-line tax bite.

Unlike regular taxes, you cannot claim exemptions for yourself or other dependents, nor may you claim the standard deduction. You also cannot deduct state and local tax, property tax, and a number of other itemized deductions, including your home-equity loan interest, if the loan proceeds are not used for home improvements. Accordingly, the more exemptions and deductions you normally claim, the more likely it is that you'll have an AMT liability.

Avoiding the AMT

Because large one-time gains and big deductions that trigger the AMT are sometimes controllable, you may be able to avoid or minimize the impact of the AMT by planning ahead. Here are some practical suggestions.

- **Time your capital gains.** You may be able to delay an asset sale until after the end of the year, or spread a gain over a number of years by using an installment sale. If you're looking to liquidate an investment with a long-term gain, you should review your AMT consequences and determine what impact such a sale might have.
- **Time your deductible expenses.** When possible, time payments of state and local taxes, home-equity loan interest (if the loan proceeds are not used for home improvements), and other miscellaneous itemized deductions to fall in years when you won't face the AMT. Since they are not AMT deductible, they will go unused in a year when you pay the AMT. The same holds true for medical deductions, which face stricter deduction rules for the AMT.
- **Look before you exercise.** Exercising ISOs is a red flag for triggering the AMT. The AMT on ISO proceeds can be significant. Because ISO tax issues are complex, you should consult with your tax professional before exercising ISOs.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

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Develop a plan and put it in writing

Investment mistakes often stem from focusing on short-term performance, emotional decision making and the lack of a written Investment Policy Statement (IPS).

Your IPS is something we write together to guide how your portfolio will be managed. It documents important guidelines, such as the length of time you plan to invest, your risk tolerance, portfolio allocation and rebalancing schedule. As your goals and circumstances evolve, we regularly meet to review and update your IPS.

Don’t Ride the Emotional Rollercoaster

Diversification neither assures a profit nor guarantees against a loss in a declining market. Past performance does not guarantee future returns and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

International and Emerging markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign wars, and different methods of accounting and financial reporting. As a result, they may not be suitable investment options for everyone.

Thanks in part to Sheldon McFarland, VP Portfolio Strategy & Research at Loring Ward

2013 Tax Reporting Note

As we all look for our 2013 Tax Documents please remember to allow time for custodians to consolidate accurate information from investment companies. Your tax documents may not arrive until mid-March.

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