Investor Insights & Outlook

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The New Tax Package and Your Portfolio

On Dec. 16, 2010, Congress approved $801 billion in tax cuts and $57 billion for extended unemployment insurance. It includes other tax breaks, such as college tuition credit for some families, an expanded child tax credit, and the earned income tax credit. Here is how some of these changes may impact your portfolio.

Social Security Tax: The one-year payroll tax cut would reduce the Social Security tax to 4.2% from 6.2%. Although this was intended to increase consumer spending levels and stimulate the economy, a better option would be to increase your contribution to your 401k plan to match your employer's contribution, at a minimum, if you do not need extra cash in the near future. The contribution limit for 401k plans remains at $16,500 for those under 50, and $22,000 for those age 50 or older.

Dividends/Capital Gains Tax Rates: Dividend and long-term capital gains taxes will remain at 15% for the next two years. Many had suggested selling securities in your portfolios that were projected to have huge capital gains before the end of 2010, since the capital gains tax rate was projected to increase to 20%. Now, you can sell your securities if your investment strategy dictates.

Estate Taxes: The new tax package sets new estate tax parameters with an exemption of $5 million per person, or $10 million per couple, and a maximum rate of 35% for the next two years. You should speak to your financial advisor about creating an estate plan that will detail how you would like your assets distributed after you are gone, and who should act on your behalf should you become disabled.

Dividends are not guaranteed and are paid solely at a company's discretion. Please consult with your tax professional for specific tax advice.

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Advisor Corner

Thank you for the opportunity to serve as your advisor.

Compound and Compare

Approaching retirement with too little money is unfortunate. Furthermore, getting sucked into the daily hype that has people jumping in and out of the stock market can be disastrous. The market will inevitably go down once in a while, but history proves that despite this, the long-term trend for the market is up. Taking that into account, the earlier an individual begins to invest, the better.

Data from the Bureau of Economic Analysis indicates that the U.S. overall savings rate has been drastically falling since the early 1980s, and only recently started to recover a little (since 2005). Even so, most people simply aren't saving enough for retirement, in an era when even more responsibility for retirement savings has been shifted from corporations to individuals.

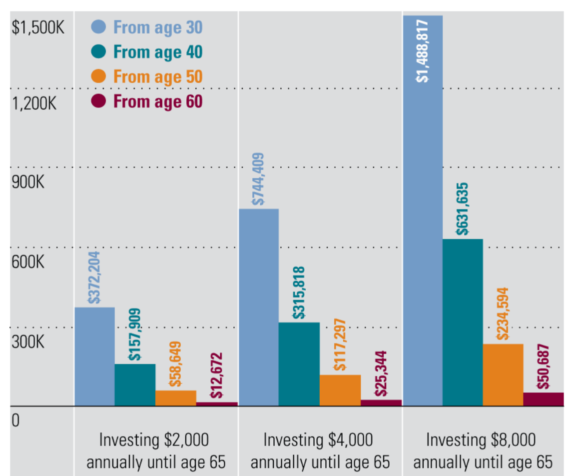
This long-term lack of savings is partly a cultural phenomenon. Baby boomers have a stronger sense of optimism than the World War II generation, and have not placed the same priority on saving. Worse yet, they have relatively easy access to credit and a habit of spending beyond their means, regardless of how much money they make. This trend continued in subsequent generations. The problem is that nowadays people should be saving more, considering the declining availability in pensions provided by employers and the level of confidence in receiving Social Security benefits. The good news is that people have started to realize this recently.

By contributing early and often to an investment plan, an investor's money compounds over time. Compounding, otherwise known as the ability of an asset to generate earnings from previous earnings, accelerates the growth of your assets over time. How does compounding work, exactly? Let's say you begin in year 1 by investing $1,000. Year 1 proves to be a very good year for the market, and your investment returns 12%. You now have $1,000 + $120 = $1,120. Year 2, however, is not so great, and your return for year 2 is now only 7%. The power of compounding is that you have now gained not 7% of your principal value (7% of $1,000 = $70), but 7% of your total investment value at the beginning of year 2: 7% of $1,120 = $78.4. Now imagine what continuous compounding over a longer period or time can do.

The image below illustrates the growth of an account based on an investor's age and the amount contributed annually until age 65. The 30-year-old investor contributing $8,000 per year will have nearly $1.5 million at the age of 65. This is more than double the ending wealth value of an investor who saved the same amount per year but waited until age 40 to begin saving. It is quite clear that the earlier you start and the more you invest, the easier it is to achieve your retirement savings goal, thanks to the power of compounding investment returns.

But all is not lost for investors who do not start to aggressively save for retirement until they reach their 40s or 50s. The good news for these investors is that they still have enough time to change their savings behavior and achieve their goals, but they will need to act quickly and be extremely disciplined about their savings. Time waits for no one, so don't procrastinate-get started now.

The Power of Compounding



The image is for illustrative purposes only and does not represent an investment in any specific security. The calculations assume an 8% annual rate of return, compounded annually. The values represented do not account for inflation or taxes. Savings rate information from the Bureau of Economic Analysis.

The Labyrinth of Financial Statements: The Balance Sheet

Public companies in the United States are required by law to disclose relevant business figures and other information. They do this in the form of financial statements: documents whose purpose is to offer detailed information on the company's financial situation: what the company owns (assets), what it borrowed and therefore has to pay back (liabilities), its stock, profit, cash going in and out, and other figures. All financial statements must follow official accounting rules and must be publicly available. There are three major financial statements: the balance sheet, the income statement, and the cash-flow statement. This article will focus on the balance sheet.

The balance sheet basically lists, in detail, what a company has and what it owes. It is organized into three sections: assets, liabilities, and shareholders' equity. Think of it as an individual sitting down at the end of the year and making a list: 1) Items owned (assets): house, furniture, car, books, and so on.; 2) Items owed (liabilities): mortgage, college loan, etc.; 3) Shareholders' equity can be thought of as total value—an individual's net worth.

1. Assets: Assets refer to resources the company owns. They include cash and cash equivalents, accounts receivable (payments the company is waiting for after the sale of products or services), inventories (supply of materials used in operations), and PP&E (property, plant, and equipment). Assets can be current or non-current. Current assets are defined as cash and other items that will be converted to cash within one year. Cash, accounts receivable, and inventories are considered current assets. Property, plant and equipment are considered non-current assets. An important term you may see in this section is depreciation or accumulated depreciation. This represents the decrease in the value of physical resources caused by wear and tear over time. For example, a piece of factory equipment is originally purchased for $50,000, but after being used for a year, its value decreases to $40,000. The $10,000 difference is depreciation.

2. Liabilities: Just like an individual, when a corporation does not possess the resources necessary for its operations, it has to borrow (from investors or other corporations). When the company borrows, it owes money and is therefore in debt. Debts owed are called liabilities on financial statements. Liabilities include short-term (current) and long-term debt (obligations lasting longer than one year), accounts payable (what the firm has to pay its suppliers, for example), taxes payable (what the firm has to pay in taxes) and interest payable (interest the company owes to its lenders). Who does the company borrow from? A company usually borrows by issuing bonds, which are bought by investors (either individuals or institutions). When you include a bond in your portfolio, you are, in reality, lending money to the company and receiving interest on that money.

3. Shareholders' equity: The third item on the balance sheet is called shareholders' equity (or owners' equity). This represents the total sum of money stockholders have invested in the firm. The shareholders' equity portion of the balance sheet will list the dollar value and the number of shares for the company's common and preferred stock. Total shareholders' equity is composed of paid-in capital and retained earnings. Paid-in capital is the amount the company has raised in the past by issuing stock. Retained earnings represent the sum of past earnings (profit) that have been retained in the business.

A very important point about the balance sheet is what is generally known as the balance-sheet equation: Assets = Liabilities + Shareholders' Equity. Also, it is important to remember that the balance sheet shows the company's financial situation at a specific point in time; for example, Dell's balance sheet as of Dec. 31, 2010.

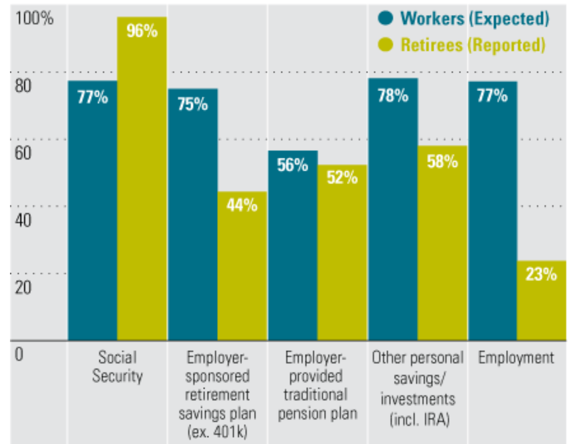
Retirement Income Sources

Concerns about shortfalls in traditional retirement income sources like Social Security and pension plans have caused people to expect to rely more heavily on personal savings to fund their retirement.

The graph illustrates that while only 58% of current retirees utilize their personal savings for retirement income, 78% of current workers anticipate personal savings to play a role during retirement. Further, 75% of workers expect to receive retirement income from an employer-sponsored retirement savings plan, while only 44% of those already retired actually receive income from such a source.

It may be a good idea to plan for a diminished reliance on Social Security or a pension plan. Whatever extra funds you save by taking this more conservative view will make retirement all the more enjoyable.

Times are Changing:
Sources of Retirement Income are Shifting



Source: Employee Benefit Research Institute, 2010 Retirement Confidence Survey.

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