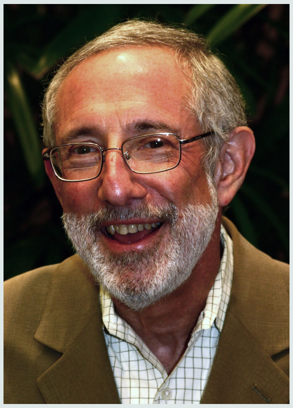

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August 31, 1976 John C. Bogle, the founder of The Vanguard Group, established the first index fund. The fund was renamed the Vanguard 500 Index Fund, and today is the largest mutual fund. Most index funds and Exchange Traded Funds have lower expenses than actively managed funds. Among the expenses that would be reduced are: advisory fees, operating expenses, and portfolio expenses. Index funds also tend to be more tax efficient. With lower costs, index funds should produce superior results. James Zweig in his October 10th Wall Street Journal article, "The Age of 'Macro' Investing", stated "Because so many mutual-fund managers failed to protect their shareholders against calamities of the past decade, index funds-which passively replicate the performance of entire markets-have come to dominate the scene."
The use of indexed mutual funds and exchange funds continues to grow.
Your referrals are appreciated.

Joe

September 2011

Current Financial Topics

Food for Thought

Year-End Investment Planning: The Clock Is Ticking

Investment planning at the end of 2010 was complicated by uncertainty over whether existing tax rates would be extended. This year, it's the congressional "supercommittee" charged with tackling the country's deficit financing problem that's the source of uncertainty. Even though you may not be sure how the committee's work might ultimately affect you, here are some factors to keep in mind as you plot your year-end strategy.

Harvest tax losses if appropriate

If you plan to harvest losses to offset capital gains, you may want to think about the cost basis of those shares. To maximize your losses for tax purposes, you would sell shares that have lost the most, which would enable you to offset more gains. Unless you specify which shares of stock are to be sold, your broker will typically treat them as sold based on the FIFO (first in, first out) method, meaning that the first shares bought are considered to be the first shares sold. However, you can designate specific shares as the ones sold or direct the broker to use a different method, such as LIFO (last in, first out) or highest in, first out. You can also use a standing order or instruction to specify that a particular method is to be used.

As of this year, brokers must report to the Internal Revenue Service your cost basis for the sale of any shares of stock bought after January 1, 2011. That will make it even more important to make sure when preparing your tax returns that your cost basis records for such sales are accurate and agree with those of your broker. If you decide to specify stock shares in order to determine your cost basis, you must do so by the settlement date (typically, three days after execution of the trade) in order for your broker's records for the stock sale to be accurate.

Mutual funds, dividend reinvestment plans, bonds, and other securities eventually also will be subject to the same mandatory cost basis reporting requirement.

Don't procrastinate on tax break for small business stock

If you plan to invest in a qualifying small business, you may want to do so by December 31. That's because 100% of any capital gains on the sale of qualified small business stock issued after September 27, 2010, and before January 1, 2012, can be excluded from your taxable income. (The exclusion is scheduled to revert to 50% next year.)

To claim the 100% exclusion, you must have acquired the stock at original issue (with some exceptions for stock acquired as an inheritance or gift). Also, the business must satisfy certain requirements, and you must hold the stock for at least five years. There are limits on the total amount of gain that is eligible for the exclusion. There also may be special considerations if you roll over the gain from the sale of your stock to another qualified small business stock, or if you receive qualified stock as part of your deferred compensation plan. Don't hesitate to get expert help with your specific situation.

Consider the potential impact of higher interest rates

Interest rates have been at historic lows in recent years, but as the economy continues to heal, that won't always be the case. The Federal Reserve Board has said that raising interest rates won't be its first step in reducing the support it has given the monetary system. However, at some point, interest rates are likely to begin moving up again. When that happens--and there's no way to know for sure when that might be--bond prices will begin to feel the impact. As bond yields begin to rise, bond prices will begin to tumble, since prices move in the opposite direction from bond yields.

Don't let payroll tax increase derail long-term plans

If you've benefitted from the 2% reduction in workers' Social Security taxes in 2011, congratulations! However, be aware that the provision is scheduled to expire at the end of this year. If you've been saving or investing that money, your long-term plans will benefit if you can figure out how to replace that source of funding for your investment efforts.

See disclaimer on final page

Making Benefit Decisions during Open Enrollment

The decisions you make during open enrollment season are important, because you generally must stick with the options you've chosen until the next open enrollment season. The exception to this is if you experience a "qualifying event" such as getting married or divorced, or having a child, in which case you'll be able to make changes outside of the open enrollment period.

The end of the year is traditionally open enrollment season, your annual opportunity to review your employer-provided benefit options and make elections for the upcoming plan year. Even if you're busy, take a look at the enrollment packets or information you receive from your employer. You generally only have a few weeks (or less) to make important decisions about your benefits, and with health-care costs rising, it's more important than ever to choose your benefits wisely.

Are you happy with your health plan?

During open enrollment season, many employers roll out new health plan options. Even if you're satisfied with your current health plan, it's a good idea to check out the plans your employer is offering for next year and compare these to your existing health coverage. If you decide to stick with the same health plan you have now, look for differences between this year's plan and next year's. Premiums, out-of-pocket costs, and coverage offered often change from one year to the next.

Some tips for reviewing your health plan:

- Start by reading any plan materials you've received in your open enrollment packet and find out as much as you can about your options. Look for a "What's New" section that spells out plan changes.
- List your expenses. These will vary from year to year, but what you've spent over the course of the last 12 months may be a good predictor of what you'll spend next year. Don't forget to include co-payments and deductibles, as well as dental, vision, and prescription drug expenses.
- Reevaluate your coverage to account for life changes. For example, getting married, having a baby, or retiring are events that should trigger a thorough review of your health coverage.
- Consider all out-of-pocket costs, not just the premium you'll pay. For example, if you frequently fill prescriptions, you may save money with a plan that offers the broadest prescription drug coverage with the lowest co-payments, even if it charges a higher premium than other plans.
- Compare your coverage to your spouse's if he or she is eligible for employer-sponsored health insurance. Will you come out ahead if you switch to your spouse's plan? If you have children, which plan best suits their needs?
- Take advantage of technology. Some employers offer calculators or tables that allow you to do a side-by-side comparison of health plans to help select the best option.

Should you contribute to a flexible spending account?

You can help offset your health-care costs by contributing pretax dollars to a health flexible spending account (FSA) or reduce your child-care expenses by contributing to a dependent care FSA. The money you contribute is not subject to federal income and Social Security taxes (nor generally to state and local income taxes) and you can use these tax-free dollars to pay for health-care costs not covered by insurance or for dependent care expenses.

If your employer offers you the chance to participate in one or both types of FSAs, you'll need to estimate your expenses for the upcoming year in order to decide how much to contribute (subject to limits). Your contributions will be deducted, pretax, from your paycheck. If you're currently participating in an FSA, it's also an ideal time to find out how much money you have in this year's account. Unused contributions are lost if you don't spend them by the end of your benefit period. And remember, you must enroll each year--you won't automatically be reenrolled in a health or dependent care FSA.

What other benefits or incentives are available?

Health insurance coverage is a valuable benefit, especially if your employer pays a large percentage of the cost, but many employers offer other voluntary benefits such as dental care, vision coverage, disability insurance, life insurance, and long-term care insurance. Even if your employer doesn't contribute toward the premium cost, you may be able to conveniently pay premiums via payroll deduction.

Many employers sweeten benefit packages by offering discounts on various health-related products and services, such as gym memberships, wellness programs, and eyeglasses. Find out what your employer offers--otherwise you may miss out on some saving opportunities. Your employer may also offer incentives for employees who take steps to maintain a healthy lifestyle. For example, you may be eligible for a monetary reward for completing a health assessment, or you may be reimbursed for the cost of fitness classes.

Do you need more information?

Ask your benefits administrator for help if you have any questions about your health plan, the options available to you, or enrollment instructions or deadlines.

Factoring Health-Care Costs into Retirement Planning

Will living a healthy lifestyle reduce health-care costs in retirement? Not necessarily. While living a healthy lifestyle may aid in reducing annual health-care costs, that same lifestyle generally promotes longevity, which may translate to higher total health-care expenditures over a longer lifetime. The moral of the story is even if you're healthy, you still face illnesses and diseases, so don't wait until your health begins to fail to plan for these costs in retirement.

There are many factors to consider in determining how much you'll need to save in order to enjoy a comfortable and financially secure retirement. One often overlooked retirement expense is the cost of health care. You may presume that when you reach age 65, Medicare will cover most health-care costs. However, Medicare currently only pays for a portion of the cost for most health-care services, leaving a potentially large amount of uninsured medical expenses. Without proper planning, health-care costs can sap retirement income in a hurry, leaving you financially strapped.

How much will you need?

How much you'll spend generally may depend on when you retire, how long you live, your health status, and the cost of medical care in your area. But the costs can add up. You won't have to pay for Medicare Part A hospital insurance (unless you don't qualify and have to buy into the program), but you will likely pay either $96.40 or $110.50 each month in 2011 for Medicare Part B physician's coverage (although you may pay higher premiums based on income and other factors), and an average of $30 per month for Medicare Part D prescription coverage. In addition, there are co-pays and deductibles to consider (e.g., after paying the first $162 in Part B expenses per year, you pay 20% of the Medicare-approved amount for services thereafter).

The cost of health care is rising. The Centers for Medicare & Medicaid Services (CMS) reports that national health expenditures grew by 4% in 2009. And the CMS Office of the Actuary estimates that out-of-pocket spending is projected to grow at an average rate of 5% from 2015 through 2020.

What can you do?

It's clear that health care is an important factor in retirement planning. And while you may be able to buy a cheaper car, live in a smaller home, or take fewer vacations in order to stay within your retirement income budget, you can't do without necessary medical care. So what can you do? You can better prepare for these expenses by taking the following steps:

- Acknowledge that paying for health care in retirement is an issue to consider. Don't presume Medicare and Medigap insurance will cover all your expenses--they probably won't. Include potential health-care costs in your retirement plan.
- Evaluate your present health and project your future medical needs. That might be easier said than done, but taking stock of your overall health now and factoring in your family's health history may help you determine the type of care you might need in retirement. Are you currently being treated for high blood pressure or diabetes? Do you live a healthy lifestyle? Does heart disease run in your family?
- Understand what Medicare covers and what it costs. For instance, Medicare (Part A, Part B, and Part D) generally provides benefits for inpatient hospital care, medically necessary doctor's visits, and prescriptions. But Medicare doesn't cover everything. Examples of services generally not covered by Medicare include most chiropractic care, dental or vision care, and long-term care. You'll also have to account for deductibles, co-insurance costs for some services, and a monthly premium for Medicare Parts B and D.
- Consider the cost of supplemental insurance. Medigap plans are standardized policies sold by private insurance companies that pay for some or all of the costs not covered by Medicare. In addition to Medigap policies, other types of supplemental insurance include long-term care insurance, dental insurance, and vision insurance. The type and amount of coverage that's best for you depends on a number of factors, including how much premium you can afford, what benefits you need, your financial resources, your health, and your anticipated medical needs.
- Don't forget to factor in the cost of long-term care. The National Clearinghouse for Long-Term Care Information estimates that at least 70% of people over age 65 will require some long-term care services. Medicare does not pay for custodial (nonskilled) long-term care services, and Medicaid pays only if you and your spouse meet income and asset criteria.
- Save, save, save. You may have already begun saving for your retirement, but if you fail to include the cost of health care in your plan, you're likely leaving out a big expense. Your financial professional can help you figure out how much you may need to save and adjust your retirement planning strategies to account for potential health-care costs in retirement.

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I'm retiring to a state with no income tax. Can my former state tax my retirement benefits?

The short answer is "no."

In the past, several states enacted "source tax" laws that attempted to tax retirement benefits if they were earned in that state, regardless of where a taxpayer resided when the benefits were ultimately paid. For example, if you earned a $50,000 annual pension while working in California, and then retired to Florida, California would attempt to tax those benefits, even though you were no longer a California resident.

But, in 1996, a federal law was enacted (P.L. 104-95) that prohibited states from taxing certain retirement benefits paid to nonresidents. As a result, if your retirement benefits are covered by the law (most are, see below), only the state in which you reside (or are domiciled) can tax those benefits.

Whether you're a resident of, or domiciled in, a state is determined by the laws of that particular state. In general, your residence is the place you actually live. Your domicile is your permanent legal residence; even if you don't currently live there, you have an intent to return and remain there.

The law applies to all qualified plans (this includes 401(k)s, profit-sharing plans, and defined benefit plans), IRAs, SEP-IRAs, Internal Revenue Section 403(a) annuities, Section 403(b) plans, Section 457(b) plans, and governmental plans.

The law provides only limited protection for nonqualified deferred compensation plan benefits. Benefits paid from nonqualified plans that are designed *solely* to pay benefits in excess of certain Internal Revenue Code limits (for example, Section 415 excess benefit plans) are covered by the law. Also covered are nonqualified plan (for example, top-hat plan) benefits that are paid over the employee's lifetime, or over a period of at least 10 years.

Examples of benefits that are not covered by the law include stock options, stock appreciation rights (SARs), and restricted stock.

What state tax issues should I consider when deciding where to retire?

If you're retired, or about to retire, you may be thinking about relocating to a state that has low (or no) income taxes, or that provides special tax benefits to retirees. Here are some state tax issues to investigate before making your move.

State income taxes typically account for a large percentage of the total taxes you pay. So, consider yourself lucky if you're planning a move to one of the seven no-income-tax states--Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming (New Hampshire and Tennessee impose income tax only on interest and dividends).

If you're considering a state that does impose an income tax, you'll need to know how that state treats Social Security and retirement income. Social Security is completely exempt from tax in more than half the states. Some states tax your Social Security benefits only if your income is above certain levels. Still others provide a general retirement income exclusion that takes Social Security benefits into account. Most of the remaining states tax Social Security benefits to the same extent they're taxed for federal income tax purposes.

Most states with an income tax fully or partially exempt retirement income--only California, Indiana, Nebraska, Rhode Island, and Vermont do not. But the exemptions vary considerably by state. Some states exempt public pensions from taxation but tax private pensions, or exempt public pensions earned in that state, but not public pensions earned in another state.

Some states exempt employer retirement benefits from tax, but not IRA income. Other states exempt a specific dollar amount of retirement income, but only if you've reached a certain age or have income within certain limits. In certain states, military pensions are fully or partially exempt, while in others they're fully taxable. Some states exempt defined benefit pension payments, but tax 401(k) benefits.

Remember that states may also impose many other kinds of taxes (for example, sales, real estate, and gift and estate taxes). Check to see if the state you're considering offers tax breaks to seniors, like property tax reductions, or additional exemptions, standard deductions, or credits based on age.