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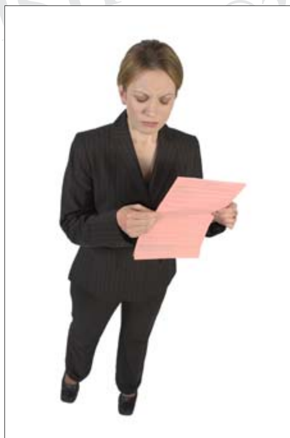
FINANCIAL ASSOCIATES
First Quarter 2010
Guide...Protect...Preserve

Many Leaving Their Job Also Leave 401(k) Behind

If you're leaving your company because of a downsizing or a switch in jobs, you wouldn't think of going without cleaning out your office. But what about the assets in your 401(k) plan? All too often, departing employees leave behind their retirement plans without giving much thought to the consequences.



According to a recent survey by Charles Schwab, almost half of the money held in 401(k) plans by employees who left their jobs during the first quarter of 2008 had not been moved a year later. Though there's no penalty for keeping your funds in an ex-employer's plan, you can't continue contributing to the account. Also, you may have concerns about how the account will be administered after you've gone, and you could face obstacles in recovering the money if the company goes under.

But you don't have to let your assets languish in a former employer's plan. You have three other principal options: take a cash distribution, move the funds to a new employer's plan, or roll over the assets to an IRA.

Take a cash distribution. Frequently, an employee will elect to take a lump-sum distribution from a 401(k) plan when leaving a job, especially if money is tight. But that could result in a hefty tax bill. The amount representing pre-tax contributions and earnings in the 401(k) is taxed at ordinary income rates reaching as high as 35% on the federal level. If you're under age 59½, the IRS will generally tack on a 10% "early withdrawal" penalty. And don't forget about state and local taxes and state penalties.

Besides incurring tax liability now, this approach means forfeiting the future benefit of tax-deferred savings and putting a hole in your retirement plan. After 60 days have passed, you'll have lost the opportunity to transfer the funds to another tax-advantaged plan. And don't think you'll receive the full balance of assets in your account. The employer's 401(k) administrator will automatically withhold 20% of the payout, regardless of your personal circumstances. Unless you have a dire need for funds, you would do better choosing one of the other options.

Transfer assets to a new employer's plan. If you find another job, you often can move your 401(k) balance to another 401(k) or other tax-qualified retirement plan available through your new company. That way, your assets will continue to grow tax-deferred without interruption. This direct transfer is also exempt from the early withdrawal penalty, and there's no tax withholding as long as you arrange a trustee-to-trustee transfer from one plan to another. If you take the funds yourself, you have 60 days to complete the transfer, but 20% will be withheld,

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We've Faced And Overcome Tough Times Before

It's hard to believe that it has been over eight years since that infamous day in September 2001 when more than 3,000 perished in al Queda's attack on America. Since then, our country has avoided another direct attack, though the fear remains and the struggle against terrorism around the world continues. While the enemies we face now are frightening, we have overcome danger before.

The 65th anniversary of the D-Day invasion in June makes us recall how the U.S. and its allies united and succeeded against the common enemy in World War II. We also overcame the pervasive fear of the Cold War era. No wonder we are confident that we can succeed in our latest battles, no matter how difficult it is to measure that "success."

Over the long haul, the U.S. economy and financial system have always come through these scary times just fine. That's not bluster—it's history. Cycles come and go, but the basic system has always survived and prospered, despite the internal or external chaos.

While you need to remain realistic and prepare for inevitable times of volatility, you must also keep a cool head and stay invested. A successful investor doesn't let the fear and emotions of frightening times affect investment decisions. As professional investors, we understand the importance of keeping level-headed in times of adversity, and we can help you develop and stay true to a financial plan that will help you reach your goals.

Mary Jane Callaghan & Mitch Glicksman

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A Welcome Spike In Personal Savings

Are you looking for something good that may have come out of the recession? As a result of the economic downturn, Americans have generally been spending less and saving more. The savings rate in U.S. households in 2009 reached a high point of 6.9% of after-tax personal income in May. Even though the savings rate has slipped slightly since then, the watershed mark was the highest rate since 1992, when savings peaked at 7.7%.

While it's not an exact measure of fiscal health, the savings rate is the percentage of household disposable income that is put into savings rather than consumed. Mortgage payments are not considered savings, but retirement plan allocations (not capital gains) are. Although a sub-7% savings rate isn't much to brag about in most parts of the world—the annual percentage in other countries routinely hits double digits—it marks a dramatic shift in our personal financial habits. During recent years, the percentage of savings actually dipped below 1%, bottoming out at 0.4% in both 2006 and 2007. In 2008, the saving rate was still only 1.8%.

What's behind the trend towards more savings? During the preceding two decades, rising stock market values and home prices had enticed consumers into thinking they had money to burn, and they became less and less inclined to save for retirement and other needs. Even retirees were encouraged to spend like there was no tomorrow.

But the recent precipitous decline in household wealth ended the wild spending spree. Real estate values around the country have dropped by an estimated 35%, and during the past two years, U.S. household wealth has been reduced by a whopping 140% of annual disposable income. That's a total of $14 trillion.

Faced with daunting economic news, people have been forced to rein in spending, while increasing their efforts to prepare for a secure retirement. For instance, instead of buying goods with their checks from the economic stimulus package or taking advantage of other tax incentives, many people have chosen to hold on to the money. And it doesn't look as if things will change radically anytime soon.

How long will the latest trend last? Most economists predict a slow, steady climb back to better times rather than a quick return to another financial boom. But cutbacks in domestic consumption will also slow down the economic recovery. In the meantime, the savings rate is expected to rise gradually until it hits the 10% mark at some point during the next 10 years. Other financial experts believe the recovery period could last even longer.

Of course, an increased savings rate is to be applauded, especially after it had plummeted dangerously close to zero. Americans will have to adjust to a lower standard of living compared with the heyday of 2007. But if forgoing a few luxuries is the price you have to pay for protecting your financial future, that's probably a trade-off you'd be willing to make. ●

Estate Planning For A Non-Citizen Spouse

With estate laws in flux, planning is especially difficult right now. But it is even more complex if you or your spouse isn't a U.S. citizen. Special measures may be needed to avoid a large estate tax bill.

Under the rules of the landmark 2001 tax cut, the top tax rate on inheritances has been gradually reduced from 55% to 45%, while the maximum amount that can be passed along exempt from estate taxes has risen, to $3.5 million in 2009. The estate tax is scheduled to expire in 2010 but will be revived in 2011, with a top rate of 55% and an exemption of $1 million.

Although Congress is expected to take action on a permanent fix for estate rules, no one knows exactly what will happen. The only thing that's reasonably certain is that there will continue to be an unlimited marital deduction. That has been a constant of estate law—that a spouse may inherit unlimited wealth without any estate tax liability.

But that rule doesn't apply if your spouse is not a U.S. citizen. Even permanent U.S. residents don't qualify for the unlimited marital deduction; instead, they may owe estate tax on inherited assets that exceed the normal exemption for bequests to non-spouses. There are, however, a couple of ways for non-citizens to sidestep problems.

Reduce a taxable estate through lifetime gifts to a spouse. If the citizen spouse has substantially more wealth than the non-citizen, a series of gifts could shift the balance. Tax rules allow tax-free gifts to a non-citizen spouse of up to $133,000 in 2009. (The amount is indexed for inflation.) This is a strategy you'll need to establish early, and it may work best as a complement to the second approach.

Establish a qualified domestic trust (QDOT). This trust lets a non-citizen spouse take advantage of the

Vulture Real Estate Investors Beware

Nationwide, home prices fell 30% between 2006 and the summer of 2009 after the bottom fell out of the real estate market. Subsequent signs of price stabilization may have you thinking about jumping in to this market as an investor, perhaps in the interest of diversification and asset allocation. After all, the mantra is "buy low, sell high," right? However, there's another old saying that also applies: "Look before you leap."

First and foremost, you need to determine if you should be buying real estate at all given the various management, liability, cash flow, and other issues associated with it. A simpler and often lower risk alternative could be to purchase shares in real estate investment trusts (REITs), which usually invest in commercial real estate rather than houses but which are more liquid and easier to manage within your overall portfolio. You could also buy stock in construction firms, housing suppliers, or other companies likely to benefit as real estate rebounds.

If you can tolerate the risks and responsibilities of buying a property and can do so while maintaining sufficient diversification in other assets, be sure to consider the following factors.

All real estate is local. Prices may (or may not) have hit rock bottom in terms of the national average, but that doesn't mean the carnage has ended in your neck of the woods. While home prices stabilized in most areas of the country during the second half of 2009, overbuilt areas and those facing the highest unemployment levels continued to see declines, most notoriously in Las Vegas and Detroit.

What's the foreclosure rate? To determine the level of foreclosure turmoil in your target community, you need up-to-date information, and the only way to obtain that is to contact local organizations that have the pulse of the community. These groups include the Association of Realtors, Mortgage Bankers Association, city or county housing departments, and state agencies that deal with housing, banking, or economic development.

States With Highest Foreclosure Rates

State	Foreclosure rate
Nevada	1 in 23 households
California	1 in 53 households
Arizona	1 in 53 households
Florida	1 in 56 households
National average	1 in 136 households

Source: RealtyTrac U.S. Foreclosure Market Data by State, Q3 2009

Ask for figures that let you compare the current level of foreclosure with past figures. The bigger the difference between past and present, the more influence higher foreclosure rates are likely to exert over home prices in coming months and years.

Buying a foreclosed home. Banks will sometimes sell foreclosed homes at a significant discount in order to clear them off the books. But buying distressed property carries extra risks. These steps can help you limit the danger.

- Make sure the house you're considering is located in a neighborhood with good schools, low crime, and a steady job market. Homes in troubled neighborhoods may not recover value quickly, or at all.
- Do a title search to find any liens on the property or back taxes that may be owed.
- Get the house inspected. Foreclosed homes are notorious for sustaining damage from previous occupants and for a general lack of maintenance.
- Favor homes that a bank has placed on the market after paying off taxes and other debt and making repairs. Buying at auction can be riskier, because you're likely to know little about the home.
- Look at recent home purchases in the neighborhood to make sure you aren't overpaying. While foreclosures often offer bargains, home prices have plummeted so rapidly that sometimes even distressed properties turn out to be overpriced.
- Get preapproved for a mortgage, because lenders are especially nervous about making loans on distressed properties.
- Consider other factors, such as an area's demographic trends, the likelihood that local or state taxes may go up, whether the area is prone to flooding or other natural disasters, and insurance costs. ●

While it may be tempting to plunge into today's housing market as an investor, it's a rough-and-tumble arena, and buyers are subject to a wide variety of sometimes hidden risks. We can help guide you through the process, working to minimize risks and maximize results.

There are special risks associated with REIT investments including but not limited to:

- **The value of the units or shares of the trust will fluctuate with the portfolio of the underlying real estate properties.**
- **Redemption will be at a price which may be more or less than the original price paid for the units.**
- **There can be no assurance that the issuer will maintain a secondary market for REITs. Therefore, there is the risk that a REIT investment may be illiquid.**
- **Special risks of investing in real estate including market risk, company risk, real estate investing risk, real estate securities risk, interest rate risk, small-cap risk, credit risk, income volatility risk, prepayment risk, extension risk, and foreign investment risk.**

deceased spouse's assets without paying estate tax. All trust income must be paid to the surviving spouse, and no estate tax is owed until the second spouse dies and the remaining trust principal is distributed to heirs (usually the couple's children). To qualify for these advantages, the QDOT must meet these requirements.

- At least one trustee must be a U.S. citizen or a domestic corporation.
- The trust must be established no later than nine months after the first spouse's death.
- The executor must make an election for the QDOT on the deceased spouse's estate tax return.
- If QDOT assets exceed $2 million, the U.S. trustee must be a bank, or an individual trustee must furnish a bond or letter of credit equal to 65% of the value of trust assets.

If you or your spouse isn't a citizen, timely estate planning could be crucial. We can work with you and your attorney to make sure your estate plan takes that special circumstance into account and helps you avoid unnecessary taxes. ●

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Do You Really Need That Inheritance?

Sometimes it pays just to say "no thanks" to a generous bequest—even from your own spouse. There may be estate planning benefits to having the assets go directly to contingent beneficiaries named by the decedent. If those beneficiaries are your children, this strategy could help them keep more of the bequest.

Officially declining an inheritance involves executing a legal document known as a "qualified disclaimer." This refusal, which can apply to all or part of a bequest, must be executed within nine months of the donor's death and before you've received any income from the inheritance. While this is generally a reactive measure, similar results can be obtained setting up a disclaimer trust as part of your estate plan.

One factor in deciding whether to refuse an inheritance is the uncertain future of the federal estate tax. Repealed for 2010, it will be revived in 2011 under unfavorable conditions.

The amount of an estate that's exempt from federal tax, which was gradually increased to $3.5 million for those who died in 2009, will drop back to $1 million for 2011, unless Congress enacts new legislation.

Also, after gradually being reduced to 45%, the top estate tax rate will return to 55%. The Obama administration and Congress will likely adjust the rules or change the timetable, but most experts expect the estate tax to continue to exist in some form. A qualified disclaimer or a disclaimer trust could help you prepare for whatever comes.

Suppose that under your current will, all of your assets are to go to your spouse if you die first, and vice versa. Then, at the death of the surviving spouse, the remaining assets will be divided among your children. With this arrangement, there's no estate tax due after the first death—because a spouse can inherit an unlimited amount tax free—and the surviving spouse's estate can be reduced, for tax purposes, by whatever individual exemption is in effect at the time.

But this wastes the exemption of the first spouse to die. Instead, the surviving spouse could disclaim an amount equal to the estate tax exemption, passing it directly to contingent beneficiaries. The first spouse's exemption relieves the heirs of any current estate tax liability, and later the surviving spouse's own exemption can be used.

Before disclaiming any assets, one's current and future potential need for the disclaimed assets needs to be carefully analyzed by a financial planner, since this is an irrevocable decision. We can work with you and your attorney to consider whether turning down an inheritance might make sense for you, and help you follow the rules that govern the process.

Also, if your net worth nears or exceeds federal estate tax exemption limits, we can discuss how setting up a disclaimer trust now can benefit your heirs. ●

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Leaving 401(k) Behind

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and you won't be able to recover that money until you file your tax return for the year of the transfer.

The main potential drawback to this option is that you'll be limited to the investment choices in your new employer's plan. Those may be better or worse than you had before, but the third option—rolling over assets to an IRA—is likely to provide more investing flexibility and a wider menu of choices.

Move your account balance to a rollover IRA. Just as when you transfer assets to a new 401(k) plan, you may continue tax-deferred savings by rolling over your retirement savings to a traditional IRA. And here, too, you can avoid automatic tax withholding by using a trustee-to-trustee transfer. Otherwise, you have 60 days to complete the rollover without triggering income tax liability or an early withdrawal penalty.

This may be the most advantageous approach. Again, an IRA generally offers greater investment flexibility, letting you invest in a wide variety of stocks, bonds, and mutual funds, compared with 401(k) choices that tend to be more limited. And the IRA may give you greater control over distributions during retirement.

Beginning in 2010, all employees now also have a fourth option—rolling over employer plan funds to a Roth IRA that provides tax-free distributions during retirement. (Previously, Roth conversions were allowed only in a year in which your adjusted gross income didn't exceed $100,000.) But moving money to a Roth means paying income tax on the untaxed portion of your account, unless you have large tax deductions that you can claim to offset this extra income.

Almost all of these options are likely to be preferable to leaving your 401(k) account with your former employer. We can help you explore the possibilities and find the best approach for your situation. ●

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