QUARTERLY UPDATES

Sample

Quarterly Updates

Table of Contents

COMMODITIES

INSURANCE

FINANCIAL PLANNING

SOCIAL SECURITY

QUARTERLY UPDATES

STOCKS

MID CAP STOCKS

Mid caps have been described as the "sweet spot" of the market, companies that normally have higher growth rates than large caps while more seasoned and proven management compared to small cap corporations. From 1979 to the second half of 2010, a $10,000 investment in the Russell Midcap Index grew to $459,000, compared to $271,000 for the Russell 2000 and $227,000 for the Russell Top 200 (*source*: FactSet, 7/1/2010).

Looking at 5-year returns on a rolling monthly basis, from the beginning of 1984 through the first half of 2010, **mid caps outpaced large caps 62% of the time; 88% of the time compared to small cap stocks**. Performance figures are even more impressive for mid caps on a *risk-adjusted* return basis. Using the Sharpe ratio, mid caps outdistanced small caps 96% of the time and 54% of the time compared to large caps (using Russell Midcap, Russell 2000 and Russell Top 200 indexes for the same rolling periods).

Mid caps account for 27% of the domestic equity universe *but only 15% of the equity mutual fund marketplace* (*source*: Morningstar). The mid cap universe offers **less information efficiency** than large caps; fewer analysts cover these stocks. Examples of mid cap stocks include: Northern Trust, Lowe's, Kimberly-Clark, ConAgra Foods and Chubb.

THREE WORST YEARS

The table below shows the three worst returns for the S&P, long-term corporate bonds and medium-term government bonds for the 50-year period, 1961-2010.

Worst Three Years: 1961-2010

	3 Worst Years		
Small cap stocks	-37% (2008)	-31% (1973)	-22% (1990)
S&P 500	-37% (2008)	-26% (1974)	-22% (2002)
Long-term corporate bonds	-8% (1969)	-7% (1999)	-6% (1994)
Med-term government bonds	-5% (1994)	-2% (2009)	-2% (1999)

A review of all three of the worst years for stock returns shows having bonds would have greatly reduced portfolio losses. While stocks suffered huge losses in **2008**, bonds had positive returns: +9% (long-term corporate), +26% (long-term gov't) and +13% (med-term gov't).

Having a portfolio with a 50% weighting in fixed income would have also been beneficial in **1974**: -3% (long-term corporate), +4% (long-term gov't) and +6% (med-term gov't). Losses would have also been reduced in **1973**: +1% (long-term corporate), -1% (long-term gov't) and +5% (med-term gov't). The same was true with **2002**: +16% (long-term corporate), +18% (long-term gov't) and +13% (med-term gov't). Diversification also helped in **1990**: +7% (long-term corporate), +8% (long-term gov't) and +10% (med-term gov't).

S&P 500 STOCK CORRELATIONS

An example as to how quickly correlations can change, consider the stocks comprising the S&P 500. Between 2000 and 2006, these stocks had a 27% performance correlation to each other. Just before the Iraq war in 2003, correlations were just under 60%. Between 2008 and February 2009, the height of the financial crisis, correlations hit 80%. When stocks rallied in 2009, the figure fell to 40% and then went back to over 80% during the European debt crisis. By September 2010, the correlation was 66% (*source*: Barclays).

HOW TO TIME THE MARKET

Financial writer, James Stewart (*Common Sense* column in the *WSJ*), believes "in a disciplined approach to personal investing that minimizes emotions in decision-making, respects the past, which is knowledge, and never tries to predict the future." By following his *Common Sense* system, he "never buys stocks at market peaks and never sells at a bottom." Stewart's goal is to buy lower and sell higher. Here is how his system works:

"When the market is dropping, I buy stocks at intervals of 10% declines from the most recent peak. When it is rising, I sell at intervals of 25% gains from the most recent low. These figures are roughly one-half the historical average losses of 20% in bear markets and gains of 50% in bull markets since 1979. I use the NASDAQ composite index as my benchmark."

QUARTERLY UPDATES

BONDS

WHEN TREASURYS LOSE PRINCIPAL

Retirees frequently use Treasurys as part of a conservative portfolio. However, many investors do not think something backed by the government can lose money. Investors understand the ups and downs of stocks, but, for some reason, believe the value of their government securities is stable. The next two tables show the volatility of Treasury bond's. Both of these tables reflect value of principal *and do not factor in interest payments*. The first table deals with 5-year Treasurys, the second table covers 20-year Treasurys. As you can see, *if you exclude interest payments*, quality bonds post negative returns about once every 2 ½ years. Losses of principal in the next two tables are even greater if mutual funds, ETFs or variable annuities are used (since all three of these assets have an expense ratio—*something not reflected in these two tables*.

5-Year Treasury Returns
[excluding interest payments]

Year	Loss	Year	Loss	Year	Loss
1977	-5%	1983	-3%	1999	-7%
1978	-4%	1987	-5%	2004	-1%
1979	-5%	1988	-2%	2005	-3%
1980	-7%	1994	-11%	2006	-2%
1981	-5%	1996	-4%	2009	-4%

From 1977 through 2010, 5-year Treasurys experienced a principal loss 15 times, or 44% of the time (15/34 years); the average loss was 4.2%. Over the same period, 20-year Treasurys also experienced a loss 44% of the time; the average loss was 9.1%. In both cases, ***it is assumed client spent the interest income***.

20-Year Treasury Returns
[excluding interest payments]

Year	Loss	Year	Loss	Year	Loss
1977	-8%	1983	-10%	1999	-14%
1978	-9%	1987	-11%	2001	-2%
1979	-10%	1990	-3%	2003	-3%
1980	-14%	1994	-14%	2006	-4%
1981	-10%	1996	-7%	2009	18%

Standard Deviation

Year	S&P 500	Small Stocks	L.T. Bonds	M.T. Bonds
2009	29%	42%	**15%**	**5%**
2008	14%	20%	**23%**	**7%**
2007	10%	12%	**8%**	**5%**
2005	8%	16%	**10%**	**4%**
2001	18%	35%	**10%**	**5%**
2000	16%	40%	**7%**	**3%**

TREASURY VOLATILITY

History shows owning Treasurys can be painful. In 2003, the 10-year Treasury yield jumped one percentage point in just two months, causing an 8.2% loss in the 10-year Treasury and a 13.3% drop in the 30-year bond. Federal Chairperson Paul Volcker raised the federal funds rate to as high as 22.4% in July 1982; yields on 10-year Treasurys went from 8.8% to 15.8%. If a 10-year Treasury yields 4% and rates increase a full percentage point, the loss would be 7%, 10% for the 30-year Treasury.

THE ROLE OF BONDS

Bonds play three important roles in a portfolio. **First**, they provide a fixed stream of income. **Second**, bonds offer return of capital when held until maturity. (Corporate bonds are not completely without risk, so be sure to monitor the fiscal health of the issuer.) **Finally**, bonds have historically had low correlations with stocks. (When stock prices *zig*, bond prices often *zag*.) Thus, even in the current low-yield environment, bonds should not be ignored.

DEFAULT RATES FOR HIGH-YIELD BONDS

By the end of 2010, the default rate of high-yield corporate bonds was less than 3%, according to Moody's Investors Service, a stunning drop from the 14.6% peak rate of November 2009. The projected default rate for 2011 is 2-3%.

SOVEREIGN DEBT

Over $5 trillion of U.S. debt comes due over the next three years (September 2010 to September 2013), representing 60% of the $8.3 trillion outstanding. The average weighted cost of U.S. sovereign debt is just 1.2%, about the same rate 5-year T-notes were paying in September 2010. A rise in 5-year yields to the 20-year average of 4.9% would increase additional interest expense cost to the government by 43% or an additional $190 billion annually.

Holders of U.S. Treasurys [2010]

Country	**Amount**	**Country**	**Amount**
China	$889 billion	Hong Kong	$147 billion
Japan	$765 billion	Russia	$124 billion
Oil Exporters	$218 billion	Taiwan	$120 billion
U.K.	$206 billion	Switzerland	$84 billion
Brazil	$169 billion		

MUNICIPAL BOND DEFAULTS

History is on the side of prudent municipal bond investors. Among more than 18,000 municipal bonds rated by Moody's **during the 40 years from 1970 to 2009—*a period that includes five recessions*—only 54 issuers defaulted (a 0.003% rate)**.

It is important to keep in mind that 49 out of 50 states (Vermont is the exception) are required to have a balanced budget. Historically, the largest default occurred with Washington Public Power Supply System (WHOOPS) in the 1980s; the default was on $2.3 billion; investors ultimately recovered 40%, according to Moody's.

About $348 million in municipal debt defaulted in 2007. That figure rose to $8.2 billion in 2008 and $6.4 billion in 2009. But those amounts are still proportionally smaller compared with defaults in the corporate debt market, where $145 billion defaulted in 2009. And most of the municipal defaults came from debt sponsored by nonrated issuers financing high-risk projects. In fact, nearly half of the 183 issuers that defaulted last year were Florida real estate development projects.

Tax Supported Debt as % of Gross State Domestic Product

States With Highest Ratio	States With Lowest Ratio
Massachusetts 8%	Nebraska 0.0%
Hawaii 8%	Wyoming 0.1%
Connecticut 8%	Iowa 0.2%
New Jersey 7%	South Dakota 0.3%
New York 5%	North Dakota 0.7%
Mississippi 5%	Tennessee 0.8%
Rhode Island 5%	Colorado 0.8%
California 5%	Arkansas 0.9%
	National Median 2.2%

I BONDS VS. EE BONDS

	I Bonds	**EE Bonds**
Denominations	Any amount over $25; paper I Bonds are offered in denominations ranging from $50 to $5,000	Any amount over $25; paper EE Bonds are offered in denominations ranging from $50 to $10,000
Annual Purchase Limit	$5,000 per Social Security number (but an additional $5,000 in paper I Bonds can be purchased per SS#)	$5,000 per Social Security number (but an additional $5,000 in paper I Bonds can be purchased per SS#)
Earned Interest	Fixed rate on principal CPI-adjusted semiannually; compounds up to 30 years	Fixed rate; compounds up to 30 years
Redemption	Anytime after 12 months	Anytime after 12 months
Early Penalty	3-month interest penalty if redeemed first 5 years	3-month interest penalty if redeemed first 5 years
Income Taxes	Exempt from state & local tax; interest is tax-free if used for qualified education	Exempt from state & local tax; interest is tax-free if used for qualified education

Treasurys and savings bonds are both issued by Treasury Department. The major difference between these two securities is that savings bonds are not marketable—there is no secondary marketplace. There are two types of savings bonds: I Bonds and EE Bonds. Interest earned on I Bonds and TIPS is adjusted for inflation. However, interest from TIPS must be reported and taxes paid each year; interest from I Bonds and EE Bonds can be deferred for up to 30 years.

Although often overlooked by advisors, I Bonds may be an excellent alternative to TIPS for three reasons: **[1]** no market or interest rate risk, **[2]** interest is tax deferred indefinitely and **[3]** interest earned is tax free if used for qualified educational expenses.

QUARTERLY UPDATES

MUTUAL FUNDS, ETFS AND ANNUITIES

DALBAR

From 1990-2009, the S&P 500 had an annualized return of 8.2%. Over the same period, the average stock fund investor averaged 3.2% a year, due to excessive trading (*source*: *Quantitative Analysis of Investor Behavior*, 2010, DALBAR).

MONEY MARKET FUND RISK

August 2010 SEC rules require money market funds to keep at least 30% of their assets in securities maturing within seven days, post holdings online each month and to perform "stress tests" in which the fund analyzes its ability to withstand market shocks. Among U.S. prime money funds rated by Moody's, the top 20 corporate issuers accounted for 36% of money market assets as of June 2010.

BOND FUND SAFETY

During September 2010, Morningstar changed the way it calculates the average credit quality of bond funds. The result was a lowering of ratings for more than half of domestic taxable bond funds. About 43% of the taxable bond funds it rates saw their overall credit rating drop by one credit grade; 13% dropped by two credit ratings (*source*: Morningstar, September 2010).

For **example**, under the new Morningstar system, the percentage of domestic taxable bond funds with an average credit rating of AA fell from 36% down to 14%. Funds with average credit ratings of BB more than doubled from 5% up to 13%. The table below shows some of the more extreme examples.

Morningstar Bond Funds: Average Quality Changes [September 2010]

Fund	Previous	New Credit Quality
Cavanal Hill Intermediate Bond	AA	BB
Federated Real Return Bond	AAA	BBB
Neuberger Berman Short Duration Bond	AA	BB
TCW Short Term Bond	AA	BB

ALPHA

If a fund beats its benchmark, the excess performance is referred to as "alpha" or "tracking error." Either description may be appropriate *but tracking error suggests something bad, while positive alpha implies something good.*

The appropriate alpha measurement for a diversified portfolio is likely to be a target date retirement fund index, not the weighted average of individual asset alpha's within the portfolio. The alpha of an indexed ETF or mutual fund is either going to be zero or slightly negative (due to expense ratios). After every rebalancing, risk and return equal the benchmark—nothing more and nothing less (except expense ratios). Because of this reality, a positive alpha can only be obtained by using a different benchmark such as a target date retirement fund index. A target date retirement fund index offers several comparison advantages for the advisor:

- ✓ Includes "real world" costs, as reflected by the average expense ratio.
- ✓ Combines passive with actively managed portfolios.
- ✓ Positive alpha is achievable by substituting retirement fund categories:
  - Emphasize value over growth stocks
  - Increase equity REIT exposure
  - Replace cash equivalents with short- or med-term quality bonds
  - Include TIPS or I Bonds
  - Add emerging markets bonds
  - Increase emerging markets stock weighting
  - Replace EAFE stocks with two index funds: Europe *and* Pacific Basin
  - Add mid caps
  - Replace any commodity weighting with natural resource stock funds
  - Possibly replace taxable with tax-free bonds
  - Fixed-rate annuities to eliminate/minimize interest rate and reinvestment risk

MORNINGSTAR FUND FAMILY RANKINGS

The July 2010 issue of *Morningstar FundInvestor* includes a ranking of the top mutual fund families, based on Morningstar criteria of category performance, stewardship, tenure, average manager investment in the fund and 5-year manager retention rate. The top 15 fund families are shown below.

Morningstar Fund Company Rankings [July 2010]

T. Rowe Price	Janus	Wells Fargo Advantage
American Funds	Franklin Templeton	Legg Mason/Western
Dodge & Cox	Harbor	JPMorgan
Vanguard	PIMCO	Lord Abbett
MFS	Eaton Vance	American Century

CLOSED-END FUNDS

	CEFs	Mutual Funds	ETFs	Individual Stocks	Individual Bonds
Regular distributions	✓	✓	✓	some	✓
Actively managed	✓	✓			
Portfolio of securities	✓	✓	✓		
Leverage potential	✓	✓	✓		
Exchange traded	✓		✓	✓	
Sells at premium or discount	✓		sometimes		
Buy or redeem from fund company		✓	✓	sometimes	sometimes

ACTUAL MUTUAL FUND COSTS

According to the web site, KaChing, actual mutual fund expenses for stock funds average 3.4% a year, not the 1.2% figure quoted by the Investment Company Institute, the mutual fund trade group. KaChing's figure is substantially higher because it includes things such as trading commissions (0.2%) and the investor's tax liability (0.94%). ICI uses figures that weight each fund by the amount of assets it manages; KaChing treats each fund equally.

ETF TRACKING ERRORS

For the 2009 calendar year, ETFs missed their target (index) by an average of 1.25 percentage points, a gap more than twice as wide as the 0.52 percentage point average they posted in 2008 (*source*: Morgan Stanley). During 2009, 54 ETFs showed tracked errors of more than three percentage points, up from just four funds in 2008. A handful of the 54 missed by more than 10 percentage points.

Many of the larger ETFs that follow the broad market usually produce returns that miss their benchmark by only a few hundredths of a percentage point (e.g., SPY missed matching the S&P 500 by 0.19 percentage point). Large cap stock funds from Barclays and Vanguard were even more precise. However, the $40 billion iShares MSCI Emerging Markets Index ETF (EEM) returned 71.8% in 2009, lagging the 78.5% return for its benchmark. This same ETF outperformed its benchmark in 2008; since its 2003 inception, the ETF has averaged 23.2% compared to 23.1% for its benchmark.

For 2009, the $4 billion SPDR Capital High Yield Bond ETF (JNK) posted a return of 50.5% versus 63.5% for the index it tracks. The same year, the $200 million Vanguard Telecom Services ETF returned 30% while the index it tracks was up 13%.

Excluding ETF expenses, the disparity is largely caused by a fund not owning all of the securities in the index it mimics. By holding just a representative sample, the ETF decreases its trading costs; ETF market makers are also exposed to less. A less liquid security could greatly benefit during a bull market or greatly suffer during a market sell off. An ETF not holding those illiquid securities (but instead owning a more representative sample of the index) could enhance or hurt its returns, depending on the type of market. More than $1 trillion of investor money directly tracks the S&P 500.

ETF UNIVERSE

ETFs are dominated by three large companies: BlackRock (iShares), State Street and Vanguard. BlackRock and State Street were ETF pioneers while Vanguard lists most of its ETFs as a publicly traded share class of its mutual funds, making the ETF shares more marketable. Together, these three companies oversee 85% of ETF assets; BlackRock controls 51% of the ETF marketplace (215 ETFs), followed by State Street (18%) and Vanguard (16%). By the beginning of 2011, ETF assets were just under $1.1 trillion (vs. $11.6 trillion invested in mutual funds).

EQUITY FUNDS VS. WILSHIRE 5000 INDEX

From **1971 to 2008**, the Wilshire 5000 Index outperformed returns from diversified equity funds. For the entire period, the **average return on the index was 11.4%, *a percentage point greater than that of the average mutual fund***. The Vanguard Total Stock market Index portfolio, which tracks the Wilshire 5000, charges an expense ratio of 0.2% and incurs trading costs of ~0.1%, making the difference between diversified equity funds and the Wilshire 5000 Index drop down to 0.7% per year. For this particular period of time, the Wilshire 5000 Index outperformed the average diversified equity fund in 23 of the 38 years (without making any adjustments for owning an index fund that incurs trading costs and has an expense ratio).

Wilshire 5000 Index vs. Diversified Equity Funds

Year	Index	Funds	Year	Index	Funds
1971		✓	**1991**	✓	
1972	✓		**1992**	✓	
1973	✓		**1993**		✓
1974		✓	**1994**	✓	
1975	✓		**1995**	✓	
1976	✓		**1996**	✓	
1977		✓	**1997**	✓	
1978		✓	**1998**	✓	
1979		✓	**1999**		✓
1980	✓		**2000**		✓
1981		✓	**2001**		✓
1982		✓	**2002**	✓	
1983	✓		**2003**		✓
1984	✓		**2004**	✓	
1985	✓		**2005**		✓
1986	✓		**2006**		✓
1987	✓		**2007**		✓
1988	✓		**2008**	✓	
1989	✓		**2009**	n/a	n/a
1990	✓		**2010**	n/a	n/a

BANK LOAN RECOVERY RATE

Bank loan investors typically have a greater chance of getting their money back in a default than bondholders. In 2008, bank loans had a 62% recovery rate, compared with 34% for bonds (source: Credit Suisse). Bank-loan funds had a -27% return in 2008, slightly worse than junk bond funds.

TARGET DATE FUNDS

For target date funds designed for investors retiring in 10 years, the allocation to stocks versus fixed income varies wildly: T. Rowe Price Retirement 2020 had a 72/28 (stock/bond) split as of December 2010, while Wells Fargo Advantage Dow Jones Target 2020 had a 44/52/4 (stock/bond/cash) split. According to Morningstar, the average equity exposure for 2020 funds is 57%.

MORNINGSTAR EVOLUTION

In 1996, Morningstar changed its traditional broad classification of mutual funds by introducing 45 more-focused categories in four asset classes. Other changes include:

September 2003—Foreign Stock category replaced with: Foreign Large Value, Foreign Large Blend, Foreign Large Growth, Foreign Small/Mid Value and Foreign Small/Mid Growth.

May 2004—Muni Single State Intermediate/Short category replaced with: Muni Single State Intermediate and Muni Single State Short.

February 2006—Five categories added: Inflation-Protected Bond, Long-Short, Target Date 2000-2014, Target Date 2015-2029 and Target Date 2030+.

July 2008—Muni Florida dropped and three categories added: Global Real Estate, Currency and Alternative Asset Class.

January 2009—Target Date categories expanded from three to eight, general in 5-year increments; Retirement Income is also added as a new category.

June 2009—Commodities category replaced with Commodities Asset Class, comprised of six categories: Broad Basket, Energy, Precious Metals, Agriculture, Industrial Materials and Miscellaneous; also added to the U.S. stock categories: Consumer Discretionary, Consumer Staples, Equity Energy and Industrials.

October 2010—Three categories added: China Region, Market Neutral and Aggressive Allocation.

INVESTING IN UNPOPULAR FUND CATEGORIES

Investing in mutual fund categories that other investors are selling can be a profitable, contrary strategy. During the 2000s, such an approach generated a 3.7% annualized return, for the period 1/1/2000 through 7/31/2010; the most popular fund categories lost an average of 1.2% a year and the S&P 500 lost 0.8% annually.

VARIABLE ANNUITY SALES

The top four sellers of variable annuities accounted for close to 50% of all variable annuity sales in the U.S. for 2010. The four market leaders, Jackson National, MetLife, Prudential and TIAA-CREF sold roughly $60 billion of variable annuities.

FIXED-RATE ANNUITY BENEFITS

- Guaranteed minimum crediting rates.
- Guaranteed return of principal at anytime.
- Guaranteed lifetime or period certain income.
- Insurer's fixed-rate annuity investments are regulated and limited.
- Guarantees backed by multibillion-dollar institutions.
- Within limits, guarantees are backed by full faith and credit of the state.
- No reinvestment risk (unlike Treasurys, bonds or CDs).
- No chance of even a periodic loss (unlike Treasurys, CDs or TIPS).
- Indefinite tax deferral.
- Free withdrawals for nursing-home confinement or terminal illness.
- Annuity assets are not subject to probate.
- Values not subject to creditor claims, depending on state and dollar limit.
- Annuitized payments receive special tax treatment.
- Deposit amounts are virtually unlimited.

The importance and simplicity of lifetime annuitization cannot be overemphasized. Client perceptions about retirement are often wrong. For **example**, a 2008 MetLife survey showed people believed if their money was earning 10% a year, 10% of assets could be annually withdrawal indefinitely.

QUARTERLY UPDATES

COMMODITIES

COTTON PRICES

When viewing commodity prices, it is important to look beyond gold and oil. For example, September 2010 represented the second time cotton traded for more than $1 a pound *since the Civil War*. During October of 2010, cotton futures prices hit a high of $1.30 a pound, well below the inflation-adjusted high of $5.26 a pound set in 1918.

SILVER PRICES

During the middle of September 2010, gold reached $1,292 an ounce, an all-time high (not adjusted for inflation). At the same time, silver hit $20.75 an ounce, its highest level since October 15, 1980. The price of silver hit its all time high in January 1980 when it briefly sold for $48.70 an ounce, fueled by the Hunt brothers' buying. ***On an inflation-adjusted basis***, the last time silver was higher than it was in September 2010 was October 15, 1980 when it settled at $20.98 (or $55.94 in 2010 dollars). Still, from the beginning of 2009 until September 2010, silver prices had climbed over 75% while gold was up 45%.

OIL CONSUMPTION

The world spends $4 million on oil every minute of every day, amounting to $2 trillion bought and moved annually. The world produces nearly 1,000 barrels of oil every second; 80% of the world's oil reserves are nationalized and controlled by governments.

U.S. TRADING PARTNERS

Top U.S. Trading Partners [2010]

Canada $430 billion	Germany $115 billion
China $366 billion	U.K. $93 billion
Mexico $306 billion	S. Korea $68 billion
Japan $147 billion	

source: U.S. Census Bureau

NATURAL GAS RESERVES

As of the beginning of 2011, industry experts believed North America had more than 3,000 trillion cubic feet of proven natural gas reserves—enough to meet the current rate of U.S. consumption for more than 100 years.

There are more than 300 natural gas-fired electricity plants in the U.S., using just 40% of their 171,000-megawatt capacity (*source*: Congressional Research Service Report, Jan. 2010).

COMMODITY CONTANGO

Before futures contracts expire, mutual funds and ETFs who have such commodity positions must trade out of them and into new ones. New contracts usually cost more than the old ones because of financing and storage costs for commodities. During 2009 and 2010, this ***contango*** effect was much stronger than usual. Investors of commodity-based ETFs and mutual funds did not enjoy the same gains as the underlying commodities because of losses incurred when a contract is rolled over.

For **example**, U.S. Oil Fund is an ETF designed to track spot prices of light sweet crude oil as reflected in futures trading on the New York Mercantile Exchange. Since its April 2006 inception, the $1.9 billion fund lost 44.4% (through December 15th, 2010) *even though spot prices rose 27.8%*. S&P estimates that contango has eroded 52.2 percentage points of investor returns in S&P's GSCI, a commodity index, since the beginning of 2009. Without negative rolling costs, investors would have earned 65% instead of the actual 12.8%. Investing in the front month's contract, the one closest to expiration, is the simplest way to invest in commodities and track spot prices, since these contracts are the most liquid. But these contracts tend to see the steepest contango.

QUARTERLY UPDATES

INSURANCE

VIATICAL SETTLEMENTS

Life expectancies are a key factor in the business of investing in strangers' life insurance. If estimates are too low, payout is delayed and investor must keep paying insurance premiums as the person lives on. For **example**, Life Partners often underestimates the life expectancies of people whose policies its customers invest in. According to a *Wall Street Journal* investigation, over 81% of Life Partner's policies lasted longer than expected; less than 7% died at or before life expectancy (11.9% had not yet reached life expectancy). The profit margins to Life Partners is quite appealing. The company earned over $29 million on $113 million of revenue for the year ending February 2010.

In 1992, Life Partners brokered investments in 297 policies. According to actuaries, if life expectancy projections are properly done, half should die by their projected dates. In the case of Life Partners, 95% of the insured were still alive at the end of life expectancy. Policies brokered in 2003 and 2004 showed similar patterns. In September 2008, Life Partners sold its clients a $10.8 million policy on a 78-year old man, telling the investors he had a 3-5 year remaining life expectancy. Two independent firms earlier the same year projected the man would live another 11 years.

Since its founding almost 20 years ago, Life Partners has sold $2.8 billion of policies covering 6,400 life insurance contracts. Clients pay a sum to cover the purchase price and Life Partner fees. The money is deposited into an escrow account to cover premium payments during the insured's remaining life expectancy. If the insured lives longer than expected, investors must come up with additional money.

In late 2005, Life Partners acquired a $1 million policy on an 80-year old woman, paying her $300,000; later the same day, it sold the policy to its clients for $492,000 plus five years of future premiums, *an additional $58,000*. ***An executive at Life Partners estimates this spread is lower than normal.*** **The executive estimates Life Partners sells a policy for about 2.4 times what the owner is paid.** Life Partners does not tell its investors about longevity predictions besides its own.

In 2002, Life Partners put a life expectancy of two years or less on the insured person in a third of the 297 policies it sold, and four years or less on all but a handful. Most were listed as HIV-positive. However, instead of half being dead by the end of 2009, 262 were still alive; 64% had already lived at least twice as long as their life expectancy.

LIFE SETTLEMENT TRANSACTIONS

In a *life-settlement transaction*, an investor buys a stranger's life insurance policy for a lump sum. The investor continues to pay premiums until insured (stranger) dies, when investor collects the death benefit. The longer insured lives, the lower investor's rate of return.

The secondary life policy secondary market dates back to the 1980s, when AIDS patients sold their policies to raise cash for medical treatment. In recent years, the marketplace has become dominated by older policy owners who no longer can afford or want the coverage. The total face value of whole life policies purchased in the secondary market fell to $7 billion in 2009, down from $13 billion in 2008. ***Prices paid for policies have also fallen, to an average of 13% of the death benefit in 2009 from 21% in 2006*** (*source*: U.S. Government Accountability Office).

Seller Options

Before a policyowner sells a life insurance policy, alternatives should be considered. For **example**, cash values from a whole life policy can be taken out at as a loan for a nominal interest rate charge. The policy may also be restructured, making premiums more affordable. There is also a tax-efficient way to exchange one policy for another. ***An often-overlooked strategy is to exchange (tax-free) a life insurance policy for an annuity.*** The annuity could either provide tax deferred growth or an income stream for life or a specified period.

A number of policies allow those with a terminal illness to take at least some of the policy's death benefit tax-free. To qualify as an "accelerated death benefit," a doctor must certify the insured has a health condition that could "reasonably be expected to result in death within 24 months" (*source*: IRS).

QUARTERLY UPDATES

FINANCIAL PLANNING

ASSET CATEGORY RETURNS BY DECADE

Asset Category Returns By Decade [through 2010]

	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s
Inflation	*-2%*	*5%*	*2%*	*3%*	*7%*	*5%*	*3%*	*3%*
Large Stocks	0%	9%	**19%**	8%	6%	18%	**18%**	1%
Small Stocks	1%	**21%**	17%	**15%**	11%	14%	13%	6%
H/Y Bonds	1%	10%	5%	3%	5%	14%	11%	9%
LT Bonds	**7%**	3%	1%	2%	6%	13%	9%	7%
MT Bonds	5%	2%	1%	3%	7%	12%	7%	6%
T-Bills	½%	½%	2%	4%	6%	9%	5%	3%
Commodities	n/a	n/a	n/a	n/a	**21%**	11%	6%	6%
Foreign Stocks	n/a	n/a	n/a	n/a	9%	**22%**	7%	3%
R.E. Securities	n/a	n/a	n/a	n/a	n/a	16%	4%	**10%**
TIPS	n/a	n/a	n/a	n/a	n/a	n/a	n/a	7%

CORRELATION COEFFICIENTS [1981-2010]

U.S. stocks								
0.8	**Foreign stocks**							
1.0	0.7	**Growth stocks**						
0.9	0.7	0.8	**Value stocks**					
0.8	0.7	0.8	0.8	**Small/Mid stocks**				
0.1	0.1	0.1	0.2	0.1	**U.S. Bonds**			
0.1	0.2	0.0	0.1	0.0	0.6	**Global bonds**		
0.5	0.5	0.4	0.6	0.6	0.2	0.1	**Equity REITs**	
0.2	0.4	0.2	0.2	0.3	0.1	0.2	0.2	**Commodities**

CURRENCY EFFECTS

The currency variable means advisors considering foreign stock and bond funds must consider more than just fund holdings, track record and management. **The advisor must also discern whether or not the international portfolio uses currency hedging and whether or not a hedged or unhedged position is desired.**

Annual and semiannual mutual fund reports describe any instruments held by the fund for hedging purposes. Funds most often use currency forward contracts to hedge. **The cost of hedging varies over different periods and with different currencies. The cost variable is based on the disparity between domestic and foreign interest rates. Most international stock funds do not hedge their currencies.** The advisor needs to think more broadly about currency hedging.

For **example**, a number of U.S. companies derive a modest or substantial portion of their sales from overseas operations. A company in India may have most of sales denominated in euros, thereby eliminating any concern about the value of the dollar. Still other global companies may already use currency hedging to reduce or eliminate and exchange rate surprises.

U.S. SECTOR PROFITABILITY

U.S. Sector Profitability [2010 net profit margins]

Energy 9%	Health Care 8%
Materials 8%	Financials 9%
Industrials 8%	Information Technology 15%
Consumer Discretionary 7%	Telecom 5%
Consumer Staples 7%	Utilities 9%

HOME PRICES

According to a September 2010 *WSJ* article, "new home prices have fallen an average of 30%" (from their previous peak). This means **home occupancy cost to a family has fallen from 25% to 15% of family income**. The article estimates that prices are expected to fall an additional 5-10%, resulting in ~40% of American homeowners with *negative equity*. For financial planners, this means an asset has now turned into a liability (and reduction of net worth) for those 40%. By September 2010, the commercial property price index (CPPI) was 43% below its October 2007 peak (*source*: Moody's/REAL). Residential construction was 6.3% of GDP at its 2005-2006 peak; it was just 2.4% of GDP by September 2010.

The index produced by the Office of Federal Housing Enterprise Oversight, based on millions of loans purchased by Fannie Mae and Freddie Mac over the 30 years ending December 31st, 2006 is considered one of the best measures of house prices in the U.S. **According to this index, housing prices increased every quarter since 1993.** During 2006, prices increased about 4%.

BANK PROFITS ON HOME LOANS

Real estate discussions often minimize the role of banks and home mortgages, *particularly on a global basis*. The September 2010 table below shows the difference in percentage points between interest rates banks charge on mortgages and the official base, or reference, rate in each country. In most cases, the 2010 figures shown below are substantially higher than they were between 2004 and 2007. In the case of the U.S., the spread barely changed between 2004 and 2010; in the U.K., the spread went from 0.2% to 2.5%, a huge increase. The **spread represents the bank's profit margin.**

Bank Profit Margins (Spread) on New Mortgages [September 2010]

Country	Spread	Country	Spread
Denmark	0.5%	Sweden	1.0%
Germany	0.8%	Italy	1.4%
France	0.8%	Australia	1.9%
U.S.	0.9%	Canada	2.2%
Spain	1.0%	U.K.	2.5%

PORTFOLIO RETURNS

The table below shows annual returns for nine asset categories as well as returns for a diversified portfolio that contains equal weightings of the nine asset categories. The final column shows annualized returns for the 20-year period 1990-2009.

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	20 yrs.
Commodities	REITs	*Commodities*	Sm/Mid Cap	REITs	*Commodities*	REITs	*Commodities*	Global Bonds	LC Growth	Sm/Mid Cap
32%	15%	26%	46%	30%	21%	34%	16%	12%	37%	10%
REITs	Bonds	Global Bonds	EAFE	EAFE	EAFE	EAFE	LC Growth	Bonds	Sm/Mid Cap	REITs
26%	8%	19%	39%	21%	14%	27%	12%	5%	34%	9%
Bonds	Cash	Bonds	REITs	Sm/Mid Cap	REITs	LC Value	EAFE	Cash	EAFE	LC Value
12%	4%	10%	38%	18%	8%	22%	12%	2%	32%	9%
LC Value	Sm/Mid Cap	REITs	LC Value	LC Value	Sm/Mid Cap	Sm/Mid Cap	Global Bonds	**Diversified**	REITs	**Diversified**
7%	1%	6%	30%	16%	8%	16%	11%	**-27%**	27%	**8%**
Cash	Global Bonds	Cash	LC Growth	**Diversified**	**Diversified**	**Diversified**	Bonds	*Commodities*	**Diversified**	LC Growth
6%	-1%	2%	30%	**15%**	**8%**	**15%**	7%	-36%	**23%**	7%
Diversified	**Diversified**	**Diversified**	**Diversified**	Global Bonds	LC Value	LC Growth	**Diversified**	Sm/Mid Cap	LC Value	Global Bonds
5%	**-5%**	**-3%**	**28%**	10%	7%	9%	**5%**	-37%	20%	7%
Sm/Mid Cap	LC Value	LC Value	*Commodities*	*Commodities*	LC Growth	Global Bonds	Cash	LC Value	*Commodities*	Bonds
4%	-6%	-16%	24%	9%	5%	6%	5%	-37%	19%	7%
Global Bonds	*Commodities*	EAFE	Global Bonds	LC Growth	Cash	Cash	Sm/Mid Cap	REITs	Bonds	*Commodities*
2%	-20%	-16%	15%	6%	3%	5%	1%	-37%	6%	6%
EAFE	LC Growth	Sm/Mid Cap	Bonds	Bonds	Bonds	Bonds	LC Value	LC Growth	Global Bonds	EAFE
-14%	-20%	-18%	4%	4%	2%	4%	0%	-38%	2%	4%
LC Growth	EAFE	LC Growth	Cash	Cash	Global Bonds	*Commodities*	REITs	EAFE	Cash	Cash
-22%	-21%	-28%	1%	1%	-7%	2%	-18%	-43%	0%	4%

20-year Annualized Returns (Standard Deviation)

Return (Std. Dev.)	Return (Std. Dev.)
Small/Mid Cap 10% (18%)	Global Bonds 7% (7%)
REITs 9% (19%)	Bonds 7% (4%)
Large Cap Value 9% (15%)	Commodities 6% (15%)
Diversified Portfolio 8% (10%)	EAFE Index 4% (17%)
Large Cap Growth 7% (18%)	Cash 4% (1%)

INCOME TAX RATES

Federal Income Tax Rates 2010

Rate	% of Filers	Income Range (married, jt. Return)
10%	18%	< $17,000
15%	35%	$17,000 to $70,000
25%	17%	$70,000 to $141,000
28%	3%	$141,000 to $214,000
33%	1%	$214,000 to $383,000
35%	.7%	> $383,000

Roughly 45% of all American households either do not earn enough to be taxed or take so many credits and deductions resulting in a zero tax liability. Most still get hit with Medicare and Social Security payroll taxes; but **13% of all households pay neither federal income nor payroll taxes.**

2009 Median U.S. Household Income

Ethnicity	2009 Median Income
All	$50,000
Asian	$65,000
White	$52,000
Hispanic	$38,000
Black	$33,000

The top 1% of U.S. taxpayers had pre-tax income of $900,000 in 2008. As recently as the early 1980s, roughly 30% of Americans lived in households in which an individual was receiving Social Security, subsidized housing, jobless benefits or other government-provided relief. By September 2008, 44% were (source: Census Bureau data). Over 14% of Americans live in poverty. The threshold for poverty in the U.S. in 2009 was a family of four earning $21,760.

HOME PRICES

According to a September 2010 *WSJ* article, "new home prices have fallen an average of 30%" (from their previous peak). This means **home occupancy cost to a family has fallen from 25% to 15% of family income**. The article estimates that prices are expected to fall an additional 5-10%, resulting in ~40% of American homeowners with *negative equity*. For financial planners, this means an asset has now turned into a liability (and reduction of net worth) for those 40%. By September 2010, the commercial property price index (CPPI) was 43% below its October 2007 peak (*source*: Moody's/REAL). Residential construction was 6.3% of GDP at its 2005-2006 peak; it was just 2.4% of GDP by September 2010.

LONG-TERM CARE INSURANCE PREMIUMS

According to a 2010 report by the American Association for Long-Term Care Insurance (AALTCI), almost three-quarters of those ages 61-75 who buy LTCI pay $1,500 or more in annual premiums. The organization reviewed data from more than 93,000 new LTCI buyers.

Long-Term Care Insurance Premiums [June 2010]

Annual Premium	< Age 61	Age 61-75	> Age 75
< $500	2%	< 0.2%	1%
$500-$1,000	26%	9%	10%
$1,000 to $1,500	15%	11%	11%
$1,500 to $2,500	24%	32%	19%
$2,500 to $3,500	12%	21%	24%
$3,500 to $4,000	3%	6%	7%
> $4,000	6%	15%	28%

PENSION PLAN PROJECTED RETURNS

The median expected investment annual return for more than 100 U.S. public pension plans for 2010 is 8%, the same as it was in 2001 (*source*: National Association of State Retirement Administrators, September 2010). The country's 15 biggest public pension systems projected 7.8% for the 2010 calendar year. Surprisingly, as of the end of 2009, the median expected annualized investment return for public pensions was 20% for 2010, -1% for three years, 4% for five and 10 years and 8-9% per year for 25 years (*source*: Callan Associates/Nasra).

REVERSE MORTGAGES

One of the biggest criticisms of reverse mortgages has been fees, *which can total 5% of the home's value*. The 2010 cuts in fees mean some homeowners can save $10,000 or more on closing costs.

Lenders are reducing fees to attract business. From October 2009 to March 2010, home equity-conversion mortgage volume fell 22% from the same period the previous year. One reason for the drop in activity was that HUD reduced the amount a homeowner could receive from a reverse mortgage by 10%. This meant many owners would no longer qualify for enough of a reverse mortgage to pay off their regular mortgage—*a requirement for getting approval for a reverse mortgage*.

Origination fees can be as high as $6,000. The reverse mortgage (home-equity conversion mortgage) backed by HUD accounts for over 60% of all such loans. HUD requires borrowers to have mortgage insurance. New lower closing costs on reverse mortgages could help homeowners save thousands of dollars. For **example**, a 70-year-old borrower (eligible for a reverse mortgage up to $387,500 on a $625,000 home) would incur the following costs:

$387,500 Reverse Mortgage on a $625,000 home

Closing Costs	**Old Pricing**	**New Pricing**
Origination fee	$6,000	$0
Set-aside for monthly service fee	$4,997	$0
HUD insurance	$12,500	$12,500
Other costs (approx.)	$5,400	$5,400
What homeowner gets	**$358,603**	**$369,600**

FOUR QUESTIONS TO ASK A CLIENT

- What lifetime goals are most important?
- What has been your biggest financial frustration?
- What can I do to help achieve your financial objectives?
- What are you looking for in a financial advisor?

PAST IS NOT A PREDICTOR

A 2009 study by Fama (University of Chicago) and French (Dartmouth) ran 10,000 simulations as to what could be expected from actively managed funds. The results were that, outside the top 3% of funds, active management lags behind the results that would be obtained due simply to chance.

INVESTMENT POLICY STATEMENT

Drafting an investment policy statement (IPS) is commonly associated with qualified retirement plans and ERISA (Employee Retirement Income Security Act). However, **a "modified" policy statement can be contained as part of an investment or financial plan for an individual or couple, whether the money is qualified or not.** Such a statement and/or outline can help clarify what the practitioner is supposed to be doing for the client; it can serve as a framework from which to work within as well. Investment policy statements are not required, but they are recommended. They are a **"mission statement" that acts as a yardstick for the client to objectively measure performance**.

When used for retirement accounts such as 401(k) plans, the investment policy **includes reference to** the investment committee, advisor, asset manager and plan participants. Responsibilities and roles for each of these parties are described below.

Roles and Responsibilities

The **investment committee** supervises plan investments and makes all decisions concerning selection and retention. The committee may select funds and/or investment managers. Committee selection, performance analysis and monitoring do *not* need to be based on recommendations of an investment advisor.

If an **investment advisor** is used, he will offer resources for additional due diligence as well as independent third-party analysis. Specifically, advisor may offer guidance and specific recommendations and monitoring. The advisor may recommend investment managers.

An **investment manager** is someone who is qualified under ERISA and to whom fiduciaries delegate responsibility for investing and managing plan assets in accordance with employer's IPS.

Plan participants are authorized to direct investments in their accounts, selecting investment options offered under the company's plan in order to meet personal retirement savings objectives. Plan fiduciaries are not liable for losses resulting from participant (employee) directed investments.

Contents

In its traditional form, an IPS describes the process a company has adopted to make investment-related decisions that are in compliance with ERISA fiduciary conduct. **The statement lists financial goals and objectives, describes the processes to be used for selecting investments, plus sets forth measurement indexes to be used in comparing returns and risk against the policy's stated investment objectives.** The policy statement typically defines the roles of the parties involved in the management and administration of the plan and its assets. The statement also:

1. **acknowledges applicable ERISA standards**, such as the Prudent Expert Rule, Exclusive Benefit Rule and Investment Diversification Rule;
2. **details procedural prudence for written records** and the frequency, quorum, voting and membership rules for committee meetings;
3. **identifies specific asset classes to be offered** (e.g., capital preservation, small growth, balanced, value equity, large blend, passive, etc.);
4. shows **intention to select a diversified range of mutual funds and/or other investment vehicles**;
5. **identifies at least three investment options with differing risk and return characteristics** as sanctioned by ERISA Section 404(c);
6. sets **criteria for asset selection and minimum return requirements**;
7. **considers fees and expense ratios** as well as **how closely the vehicle adheres to its stated investment objectives** *and*
8. **identifies asset class, risk and historical returns of each investment option, as well as the specific benchmarks to be used when reviewed** (which must be at least annually).

The investment committee's selection criteria should also factor in the investment company's size, structure, history, staff experience and depth, plus a profile of management and its investment philosophy. A number of the points listed above are items that can (and should) be incorporated into a written plan or oral discussion with a client. **The IPS can easily be contained within a few pages (less than one page if ERISA guidelines are not used).** Inclusion of such guidelines for non-entity clients or prospects will show professionalism and dedication to detail. Practitioners should contact their compliance department and favorite fund (or variable annuity) group for sample policy statement documentation.

LONG-TERM CARE INSURANCE PREMIUMS

According to a 2010 report by the American Association for Long-Term Care Insurance (AALTCI), almost three-quarters of those ages 61-75 who buy LTCI pay $1,500 or more in annual premiums. The organization reviewed data from more than 93,000 new LTCI buyers.

Long-Term Care Insurance Premiums [June 2010]

Annual Premium	< Age 61	Age 61-75	> Age 75
< $500	2%	< 0.2%	1%
$500-$1,000	26%	9%	10%
$1,000 to $1,500	15%	11%	11%
$1,500 to $2,500	24%	32%	19%
$2,500 to $3,500	12%	21%	24%
$3,500 to $4,000	3%	6%	7%
> $4,000	6%	15%	28%

CONSIDER LIFE EXPECTANCY

Life expectancies for 65-year-olds are about 17 to 20 years, according to the U.S. Department of Health and Human Services. But a 65-year-old man has about a 19% chance of living past age 90. For a woman, that jumps to 30%. The chance that at least one member of a typical male/female couple will live at least to 90 is 43%.

U.S. HOUSEHOLD BALANCE SHEET

Assets	**$ Billions**	**% Total**
Real Assets		
Real Estate	$22,070	31.3%
Consumer Durables	4,082	5.8
Other	243	0.3
Total real assets	*$26,395*	*37.5%*
Financial Assets		
Deposits	$7,588	10.8%
Life insurance reserves	1,184	1.7
Pension reserves	12,163	17.3
Corporate equity	4,898	7.0
Non-corporate equity	7,935	11.3
Mutual fund shares	4,736	6.7
Debt securities	3,895	5.5
Other	1,672	2.4
Total financial assets	$44,071	62.5
Total	*$70,466*	*100%*
Liabilities and Net Worth		
Mortgages	$10,864	15.4%
Consumer credit	2,543	3.6
Bank and other loans	247	0.4
Security card	363	0.5
Other	479	0.7
Total liabilities	*$14,496*	*20.6%*
Net worth	**$55,970**	**79.4%**
	$70,466	100%

source: Flow of Funds Accounts of the U.S., Board of Governors of the Federal Reserve, June 2008

EARLY SAVER VS. LATE SAVER

The table below shows the advantage of early compounding: the "early saver" invests $6,000 a year for just eight years while the "later saver" also invests $6,000 a year, but for 17 years. The **early saver starts saving at age 40 while the late investor begins at age 48**. Assuming both savers experience 8% annual compounding, the gap between the two investors at age 65 is $36,324 (*despite the fact the late investor contributed $54,000 more than the early investor*).

Age	Early Saver	Late Saver	Age	Early Saver	Late Saver
40	$6k	0	48	0	$6k
41	$6k	0	49	0	$6k
42	$6k	0	50	0	$6k
43	$6k	0	51	0	$6k
44	$6k	0	52	0	$6k
45	$6k	0	53	0	$6k
46	$6k	0	54	0	$6k
47	$6k	0	55	0	$6k
			56	0	$6k
			57	0	$6k
			58	0	$6k
			59	0	$6k
			60	0	$6k
			61	0	$6k
			62	0	$6k
			63	0	$6k
			64	0	$6k
			65	0	$6k
Total Invested				$48,000	$102,000
Amount at Age 65				**$255,024**	**$218,700**

COMMONLY USED TRUSTS

The table below shows five of most commonly used trusts along with a brief description of each as well as income, gift and estate tax consequences.

Trust Type	Description	Income Taxes	Gift Taxes	Estate Taxes
Revocable	Created during grantor's life; can manage assets for beneficiaries	All tax events flow to grantor while alive	$0 since grantor has made no gift & retains control	Possible benefit for married couple
Irrevocable	Created during grantor's life; grantor gives up all control	Trust pays taxes on income accumulated but not distributed; beneficiaries pay taxes on distributions	Gift is completed once asset is placed in the trust; gifts qualify for annual exclusion	No estate tax since grantor gifted assets prior to death (*note*: life insurance must be gifted 3 years before death)
Testamentary	Created upon death pursuant to a will	None	None	Taxable as part of testator's estate
Minor's	Created during grantor's life; accumulated income and principal must be distributed to minor at age 21	Trust pays taxes on accumulated income; beneficiary pays taxes on whatever is distributed	Assets placed in trust are a gift that qualifies for annual exclusion	Not included in grantor's estate [also called a 2503(c) trust]
Income	Created during grantor's life; trust must distribute annual income but does not have to ever be distributed to beneficiary	Beneficiaries pay taxes on amounts received	Assets placed in trust are a gift that qualifies for annual exclusion	Not included in grantor's estate [also called a 2503(b) trust]; note life insurance 3 year rule

TAX DIVERSIFICATION

With tax diversification, the advisor is hedging client accounts by allocating assets across a range of accounts that are taxed differently—from tax deferred accounts such as traditional retirement accounts and annuities to taxable accounts such as brokerage accounts and bank CDs to tax-free accounts such as a Roth IRA and Roth 401(k). **By holding a variety of accounts with different tax characteristics, putting the right kinds of investments into each one and tapping them strategically, the advisor can maximize the client's after-tax returns, particularly during retirement.**

Ideally, taxable bank and brokerage accounts are where living expense and emergency money. Tax-deferred and tax-free accounts are where the bulk of a client's assets should be—with tax-advantaged assets possibly going into a taxable or tax-favored account, as evidenced by the table below.

Tax Diversification: Where Assets Should Be Placed

Taxable Accounts	Tax-Deferred Accounts	Tax-Free Accounts
municipal bonds	taxable bonds	taxable bonds
stocks*	stocks*	stocks*
	REITs	REITs
	commodities	commodities

* depends on amount of dividend and if qualified dividend rates are in effect; decision also depends upon likely holding period—if positions are held for more than one year, a taxable account is favored, particularly if the dividend is low.

Retirement Example

Imagine you have a 65-year old couple with their entire net worth of $1 million in a traditional IRA. The couple needs $80,000 a year to live on; Social Security benefits total $40,000 a year so an additional $40,000 will need to be liquidated from the IRA each year. The couple will actually have to liquidate $70,000 from the traditional IRA in order to net $40,000—IRA withdrawals are generally fully taxable plus such withdrawals are included in the "provisional income" formula that determines taxation of Social Security benefits (85% of such benefits in this case).

If, instead, the couple had $600,000 in a traditional IRA and $400,000 in a brokerage account, taxes could be greatly reduced. By liquidating $40,000 of securities with little or no taxable gain each year (tax harvesting), a total of $150,000 would be saved over a 5-year period. Once the couple turns 70½, IRA withdrawals must begin, but just 4-10% of the IRA account must be liquidated for each of the first five years.

RETIREMENT IN 10 YEARS

A December 2010 *Wall Street Journal* survey shows workers are less prepared for retirement than before. Consider the following survey results:

[1] $140,000 was the average 401(k) balance at year-end 2009 for employees in their 50s who had been in the plan for at least six years, versus $107,000 at year-end 2008 but still below the $147,000 level of 2007.

[2] By year-end 2009, 60% of 401(k) money was invested in stock funds, the balance was invested in target-date funds, balanced funds and employer stock.

[3] 6% of 401(k) participants who can select employer stock have over 80% of their 401(k) money in those shares.

[4] For those who have at least $100,000 to invest, stated they had "no idea" as to what dollar figure their nest egg will need to grow to in order to "retire fully."

BABY BOOMER STATS

On January 1st, 2011, the first of some 78 million baby boomers began turning 65. The information below is from a study by New York Life Insurance Company.

Baby Boomers by the Numbers

26% = percentage of U.S. population
22% = identify their health as "excellent"
40% = overweight
51% = grandparents
48% = those without a financial advisor
$62,300 = median household income
79/83 = life expectancy of male/female baby boomers
96.4 = number of male baby boomers for every 100 women
8.9 million = number of baby boomers in California (the most of any state)
30% = amount of Vermont's population that are baby boomers

How Baby Boomers View Retirement

40% must delay retirement in order to afford the lifestyle they want
38% can retire whenever they want
22% must delay retirement in order to cover basic expenses

What Baby Boomers Worry About

45% -- health care costs
17% -- outliving income
16% -- decline in Social Security benefits
9% -- another market decline
7% -- inflation
6% -- income taxes or capital gains taxes

Baby Boomers Who Will Postpone Retirement

59% plan on saving more
40% will adjust their portfolio allocations
28% will seek help from a financial professional
19% will not take any other steps, other than working longer
13% will leave less money to heirs
10% will sell their homes
9% will sell other assets
6% will do "other things" to reduce the time until retirement

What Baby Boomers Consider "Basic Needs"

84% Internet connection
66% shopping (birthday/special occasion)
51% pet care
50% annual family vacation
46% weekend getaways
43% professional hair color/cut
42% funding children's/grandchildren's education
38% dining out

PROJECTED SAVINGS FOR HEALTH CARE

Individuals who plan to retire in 2020 at 65 are expected to need the following savings for health care expenses (*source*: Employee Benefit Research Institute):

	50% Likelihood	75% Likelihood	90% Likelihood
Men	$109,000	$163,000	$208,000
Women	$156,000	$203,000	$255,000
Married Couples	$265,000	$365,000	$454,000

POSSIBLE LEADING INDICATOR

The Architecture Billings Index may be a leading, *but largely unnoticed*, market indicator. The index peaked in late 2006 and almost reached that peak again during the last half of 2007, before dropping radically at the end of 2007 and hitting bottom at the beginning of 2009. From the beginning of 2009 until the first half of 2010, the index moved up significantly, an overall level that can be described as positive.

THE 2007-2009 RECESSION

According to the National Bureau of Economic Research Business Cycle Dating Committee (NBER), *academic economists who determine the beginning, end and magnitude of U.S. recessions*, the 2007-2009 recession ended in 2009, **18 months after it began**. The Bureau points out that an end to a recession does not signal a healthy economy—*only declining economy activity such as output and incomes have ended*. This recession wiped out 7.3 million jobs and cost Americans 21% of their net worth. It also represented the longest recession the U.S. has experienced since the Great Depression. During the Great Depression, GDP was down as much as 33% at one point.

U.S. Recessions 1940-2010

Recession	GDP Loss	Recession	GDP Loss
Nov. 1948 to Oct. 1949	-1.6%	Nov. 1973 to March 1975	-3.2%
July 1953 to May 1954	-2.5%	Jan. 1980 to July 1980	-2.2%
Aug. 1957 to April 1958	-3.1%	July 1981 to Nov. 1982	-2.6%
April 1960 to Feb. 1961	-0.5%	July 1990 to March 1991	-1.4%
Dec. 1969 to Nov. 1970	-0.2%	March 2001 to Nov. 2001	-4.1%
		Dec. 2007 to June 2009	-4.1%

A study of all postwar recessions and the Great Depression leads to the following empirical statement: **If there is no recovery in housing expenditures, confirmed by a recovery in consumer durable goods expenditures, then there is no economic recovery** (*source*: Steven Gjerstad and Vernon L. Smith). The average increase in new residential construction in the first year following the previous 10 postwar recessions has been 26%. The largest increase in residential construction followed the 1981-82 recession, when it increased over 75%.

Stock market holdings account for ~20% of total household financial assets; total household real estate and financial assets were at $55-60 billion by the first half of 2010. This means the average net worth per person was ~$182,000 (*note*: the average number is greatly increased by the very wealthy). Total household debt outstanding was $13.5 trillion by June 2010 (a figure similar to what banks and other investors wrote off in credit card and mortgage debt after borrowers defaulted). Looking at household assets, real estate and stocks *each represent* ~$16 trillion; financial assets other than stocks and real estate account for another $32 trillion.

QUARTERLY UPDATES

SOCIAL SECURITY

TAKING SOCIAL SECURITY BENEFITS EARLY

Workers have the option of taking Social Security benefits as early as age 62 or as late as age 70. For **example**, you have a client who is in his late 50s. The client has just learned he has the following Social Security retirement options: $1,450 per month (benefits start at age 62), $1,920 per month (benefits start at age 66) or $2,540 (benefits start at age 70). Well over half of retirees receive early (reduced) benefits. Whether or not your client should take benefits early will depend up a number of factors:

[1] health (life expectancy)

[2] level of earned income (if working while receiving early benefits)

[3] how benefits will be invested (if not used for current income)

[4] how long benefits will be invested (if not used for current income)

Normal Retirement Age

Birth Year	Normal Retirement	Birth Year	Normal Retirement
1940	65 years, 6 months	1956	66 years, 4 months
1941	65 years, 8 months	1957	66 years, 6 months
1942	65 years, 10 months	1958	66 years, 8 months
1943-1954	66 years	1959	66 years, 10 months
1955	66 years, 4 months	1960+	67 years

Health

Obviously, if the client is in poor health or has a family history of poor health, early benefits should strongly be considered, regardless of other considerations. For **example**, someone receiving $1,450 monthly benefits at age 62 will have accumulated (or spent) $69,600 by age 66 ($1,450 x 12 months x 4 years).

As a generality, if someone age 62 has a life expectancy of less than 10 years, that person should commence taking benefits at age 62, regardless of earned income or need for additional money (see later *Crossover Point* table).

Level of earned income in *years before* normal retirement

Benefits received before "normal retirement age" can be reduced if the recipient is working and has earned income greater than $14,200, Benefits are reduced $**1 for every $2 of earnings above $14,200**, or $1,183 per month (for 2010). Thus, someone receiving $1,450 per month in Social Security early retirement benefits would receive $1,000 a month in benefits if she had earnings of $2,083 ($1,183 threshold + $900). If the same person were making more than $4,083 per month ($1,183 + $2,900), Social Security benefits would be zero.

Social Security Benefit Reduction: $1 for every $2 earned for years prior to normal retirement age [based on $1,450 in monthly benefits]

Annual Earnings	SS Benefit	Benefit Reduction	Revised Benefit
< $14,200	$17,400 year	$0	$17,400 year
$20,200	$17,400 year	$3,000	$14,400 year
$26,200	$17,400 year	$6,000	$11,400 year
$32,200	$17,400 year	$9,000	$8,400 year
$38,200	$17,400 year	$12,000	$5,400 year
$44,200	$17,400 year	$15,000	$2,400 year
$49,000+	$17,400 year	$17,400	$0 year

Social Security Benefit Reduction: $1 for every $3 earned for *year* when normal retirement age is reached [based on $1,450 in monthly benefits]

Annual Earnings	SS Benefit	Benefit Reduction	Revised Benefit
< $37,700	$17,400 year	$0	$17,400 year
$43,700	$17,400 year	$2,000	$15,400 year
$49,700	$17,400 year	$4,000	$13,600 year
55,700	$17,400 year	$6,000	$11,400 year
$61,700	$17,400 year	$8,000	$9,400 year
$67,700	$17,400 year	$10,000	$7,400 year
$89,900+	$17,400 year	$17,400	$0 year

Level of earned income *during year* of normal retirement

The reduction in benefits is less painful for those with earned income received during *the year before* their normal retirement age. Benefits are reduced **$1 for every $3 of earnings above $37,700**.

For **example**, your client is receiving Social Security benefits and will reach his normal retirement age in June 2010. For the first five months of 2010, your client will earn $40,700 (*note*: formula excludes earnings made *during the month* when "normal retirement" is first reached). The client has $3,000 of earnings above the $37,700 threshold; his benefits for 2010 will be cumulatively reduced by $1,000 (since it is a 3-to-1 formula). This formula is used for one specific year—*the year normal retirement age is reached*.

The early benefit reduction is based on ***earned income*** (e.g., salary, tips, bonuses and commissions) and ***not unearned income*** (e.g., dividends, interest, rental income and capital gains). To recap, Social Security early retirement benefits are:

Reduced $1 for every $2 of earnings > $14,200
(applies to all calendar years before normal retirement age is reached)

Reduced $1 for every $3 of earnings > $37,700
(applies only to calendar year normal retirement age is reached)

If early benefits are spent

If your client needs the extra income from Social Security or has a life expectancy of less than ~10 years, *no comparisons are needed*—benefits need to be taken early. However, you may have clients that do not need the extra income and are in decent health. Such clients might want to know the "crossover point," when taking early benefits does not equal the higher benefits received by postponing retirement.

If all early benefits are invested (+ earned income < $14.2k)

Two assumptions must be made when computing the crossover point: **[1]** after-tax rate of return earned on early benefits invested and **[2]** the CPI annual benefit adjustment (2.7% over the past 20 years). The higher the earnings rate, the better early benefits look; to a lesser degree, the higher the inflation rate, the better early benefits look. The next table shows the crossover point, assuming early benefits are invested at after-tax rates of return ranging from 0-6% (and assuming a CPI of ~2.8% a year).

Crossover Point: Early Benefits Invested vs. Later Higher Benefits

Investment Return	Crossover Reached	Investment Return	Crossover Reached
0%	13 years	6%	19.2 years
2%	14.5 years	8%	25.5 years
4%	16.2 years	10%	49.2 years

For **example**, your 60-year old client is in excellent health, has no need for extra income and is thinking about retiring (*or earning < $14,200 or $37,700 earned prior to the month for the calendar year when normal retirement is reached*) and taking Social Security benefits early, beginning at age 62. The client assumes she can invest the Social Security checks and earn 8% on an after-tax basis. If this assumption turns out to be correct, in hindsight, taking early benefits will have been the smart move assuming she dies before reaching age 87½ (age 62 + 25.5 years). As a side note, life expectancy for a 62-year old man is ~22 years.

Non-Smoker Standard Mortality Table

Age	Male	Female
50	29 more years	33 more years
55	25 more years	28 more years
60	21 more years	24 more years
65	17 more years	20 more years
70	13 more years	16 more years
75	10 more years	13 more years
79	8 more years	11 more years

The table above does not reflect ***smokers***: a male age 65 who smokes has a life expectancy of 14.5 years (not 17 years shown above); a female smoker age 65 has a life expectancy of 16.7 years (not 20 years shown above).

Creating an emergency fund

Comparisons of early vs. normal retirement benefits rarely factor in the value of creating an emergency fund (early benefits invested). Benefits of an increased net worth by having an emergency fund include: [**1]** pool of money that can invested, **[2]** easier to qualify for a loan or refinancing a mortgage, **[3]** peace of mind due to greater financial security, **[4]** extra money that can be gifted or bequeathed to loved ones *and* **[5]** increased net worth may mean client is willing to be more equity-oriented for parts of his/her portfolio. For **example**, someone who can invest $17,400 a year tax-deferred will end up with:

$17,400 Invested Each Year For 4 or 8 Years

	0%	**4%**	**6%**	**8%**	**10%**	**12%**
After 4 years	$69.6k	$74k	$76k	$78k	$81k	$83k
After 8 years	$139.2k	$160k	$172k	$185k	$199k	$214k

Summary

Whether or not your client needs extra income or is in excellent health, taking early benefits is likely the best course of action (provided there is little or no earned income during such "early" years): **[1]** emergency fund creation, **[2]** greater current income (until cross-over point is reached) *and* **[3]** greater flexibility (e.g., more money to help others, not worrying about Congress changing future benefits, increased likelihood more money can be invested in equities—due to less need for current income, at least for the next 1-4 years).

SPOUSAL BENEFIT

The level of Social Security (normal age) retirement benefits depends upon the qualifying worker's: **[1]** retirement age, **[2]** earnings record and **[3]** marital status. The non-working spouse is entitled to half of what the worker receives—*provided the non-working spouse is age 62 or older*. A divorced spouse who has not remarried for at least 10 years before the date the divorce become final is entitled to the same spousal benefit. In either case, the spouse has the option of either taking the 50% benefit *or his/her own work record*—spouse should choose the option resulting in the higher monthly benefit.

For **example**, Mr. Smith is going to retire in a few months and will initially receive $1,450 in monthly benefits. Mrs. Smith, who is also age 62, has worked 40 quarters (10 years) and has her own projected benefit of $800 a month. Mrs. Smith should rely on her own work record and take $800 a month instead of the $725 she would be entitled to under her husband's work record.

2010 SOCIAL SECURITY BENEFITS: NORMAL AGE

The table below provides a rough estimate of what your client will be entitled to in monthly Social Security benefits—assuming *normal retirement age* has been reached (*note*: once normal retirement age has been reached, Social Security benefits are not reduced regardless of worker's earned or unearned income).

Annual Earnings	Born 1948	Born 1949-1953	Born 1954-1958	Born 1959-1963
$50k	$1,500	$1,600	$1,700	$1,800
$70k	$1,800	$1,900	$2,000	$2,100
$90k	$2,000	$2,100	$2,200	$2,300
$107k+	$2,160	$2,210	$2,280	$2,370

The next table shows how benefits are reduced if worker starts taking Social Security benefits 12, 24, 36 or 48 months *before reaching normal retirement age.*

Taking Early Benefits

Months Before Normal Retirement	Percent Reduction
12	7%
24	13%
36	20%
48	25%

TAXATION OF SOCIAL SECURITY BENEFITS

Social Security benefits may be taxable, depending upon recipient's *modified* adjusted gross income (MAGI). Taxation depends upon taxpayer's *base amount*: $25,000 if single and $32,000 if married filing a joint return. The **base amount** is: MAGI + ½ of recipient's Social Security benefits. If the base amount is below these dollar figures, Social Security benefits are not taxable. MAGI is AGI *plus* municipal bond interest.

If your client's base amount is greater than $25,000 ($32k if married), than up to 85% of benefits are taxable. **Actual taxable amount depends upon whether taxpayer falls under *tier one* or *tier two*.** Under **first tier**, if MAGI plus one-half of Social Security benefits exceeds the base amount, taxpayer must include (as gross income) the lesser of: **[1]** 50% of the benefit *or* **[2]** 50% of the amount in excess of the base amount (either $25k or $32k).

Under **second tier**, if taxpayer's adjusted base amount, taxpayer must include (as gross income) *the lesser of*: **[1]** 85% of the benefit *or* **[2]** the sum of **(a)** 85% of the excess over the adjusted base amount plus **(b)** the smaller of the amount included under the first tier or $4,500 (single) *or* $6,000 (married, joint return). **The adjusted base amount is $34,000 if single, $44,000 if married (joint return).** For **example**, a married couple (joint return) has AGI of $37,000 plus $3,000 of tax-exempt interest plus $14,000 of Social Security benefits. This couple has a taxable benefit of $8,550:

		Lesser of…
85% of $14k (SS benefit)		$11,900
		or
MAGI + ½ SS (½ of $14k)	$40k + $7k = $44k	
Minus adjusted base ($44k)	$47k - $44k = $3k	
85% of resulting number	85% x $3k = $2.55k	
+ lesser of 1st tier ($7k) or $6k (jt.)	$6k + $2.55k = $8.55k	$8,550

REDUCING SOCIAL SECURITY BENEFIT TAXATION

It is possible to reduce taxation of Social Security benefits by: **[1]** gifting income-producing assets to those not receiving benefits, **[2]** "bunching up income" (see below) **[3]** postponing Social Security benefits until taxpayer is age 70 (*note*: benefits do not increase past age 69, except for annual CPI increases) *or* **[4]** repositioning assets so distributions are of principal *and not* interest, dividends or capital gains. Discussion will be limited to the final option (asset repositioning).

Gifting

Gifting income-producing assets (e.g., bond funds, CDs, Treasurys, etc.) is an easy way to reduce one's taxable and/or tax-free income. However, it is doubtful your clients will want to greatly reduce their asset base prior to death, even if the shifting is to children or grandchildren. Still, these same clients often make annual or sporadic gifts to provide for a child's education or simply to help out the kids.

Thus, a married couple could take advantage of the annual gift tax exclusion ($13,000 per done) and gift up to $26,000 per child, grandchild or friend. A couple with three children and four grandchildren could gift up to $81,000 each year (7 x $13k) without filing a gift tax return or eating into their $1 million lifetime gift exclusion. An individual or couple could also use part of their lifetime gift exemption of $5 million.

Income bunching

Another way to possibly reduce the taxation of Social Security *benefits every other year* is to "bunch up" income. This means taking out more income one year and then less than "normal" income the next year. Such a strategy is not always possible since retirees often have little control over required distributions and other sources of income.

The strategy means taxpayer may easily surpass the base amount (or adjusted base amount) used to determine if Social Security benefits are taxable for years 1-3-5, etc. but reduce income in years 2-4-6, etc. so that income in those years is below the base amount (or adjusted base amount for those earning more). Obviously, the advisor needs to compare additional income taxes paid in years 1-3-5, etc. *to the reduced taxes paid in years 2-4-6, etc*.

Postponing Social Security benefit

An easy solution to the taxation of Social Security benefits is to postpone receiving such benefits for as many years as possible. Instead of taking benefits at age 62, 65 or whatever age, do not apply for such benefits until one or more years later. Not only will benefits not be taxed (since none are received), when benefits do begin, they will be 7-30% higher (ages 63-67), depending upon year of birth and the number of years one waits past age 62. The postponement of Social Security benefits might not be an option—the client may need extra money as soon as possible. Or, the client may like the idea of receiving benefits as soon as possible and investing them, thereby creating a new emergency fund (see section, *Taking Social Security Benefits Early*).

Repositioning assets

The final way to possible reduce taxation is to reposition assets. The idea behind repositioning is to: **[1]** take advantage of tax-advantaged investments (tax deferred or capital gains) *and/or* **[2]** replace tax-free or taxable income with asset liquidation (since return of capital is not a taxable event).

tax-advantaged investments

The goal is to receive the same amount of income, but with a smaller tax liability—which will, hopefully, reduce or eliminate the taxation of Social Security benefits. For **example**, client receives $10,000 a year in interest from a taxable bond fund; the entire $10,000 is included as part of AGI. By selling the bond fund and investing in an equity fund, $10,000 of gains could be sold each year; with a long-term capital gains tax liability of 0% or 15% (depending upon taxpayer's AGI). Being taxed at this rate is far better than paying ordinary income taxes that may be as high as 35% (plus state income tax rates).

However, risk level increases when bonds are sold and stocks are bought. Moreover, there certainly is no assurance the stock fund will produce a gain any given year. **A far more secure strategy is to sell taxable fixed income assets and buy an immediate annuity.** An annuity can be annuitized for any period of three years or greater. The ***exclusion ratio*** (the portion of each distribution not taxable) will range from over 96% to 50% or less (depending upon annuitization period and general level of interest rates). The taxpayer's AGI (and MAGI) do not include the exclusion ratio amount (since IRS considers it a return of principal).

asset liquidation

The notion of liquidating any asset, for whatever reason, will initially scare most of your clients. However, this is likely the best strategy *if risk is a concern.* As mentioned above, liquidation of principal is not a taxable event and does not add to AGI or MAGI (which is used to determine the possible taxation of Social Security benefits). The strategy is straightforward: liquidate asset ABC over 3-10 years and replenish the loss by building up asset XYZ, preferably using something tax advantaged.

For **example**, your client has $300,000 in Treasurys that generate $12,000 a year of taxable income. Sell off $240,000 of the Treasurys and invest in a tax-deferred annuity. The remaining $60,000 of Treasurys will be sold off over the next five years ($12k a year). Since little income will be generated from the Treasurys, particularly after the 2-3 year, taxable income will be reduced from $12,000 down to ~$2,400 the first year (and then 20% less each subsequent year). The resulting ~$10,000 reduction of income each year will result in some meaningful tax reduction; it may also result in minimization or elimination of the Social Security tax.

VIEWING SOCIAL SECURITY AS AN ANNUITY

The sophisticated (or esoteric) advisor may want to rethink *how* certain assets are characterized or counted—specifically pension plans and any other income stream. Social security benefits are equivalent to an immediate annuity, *except annuitization probably does not include an annual CPI benefit increase*.

Consider the portfolio of a 65-year old retired married couple: $600,000 in equities and $400,000 in fixed income *plus* $3,000 a month in Social Security benefits. The monthly benefits increase each year and the level of benefits does not decrease while both spouses are alive. Thus, for a male age 65, it would cost $470,000 to buy an immediate annuity that paid out $3,000 a month for life (assume wife will outlive husband). The cost for a female age 65 would be $505,000. For a male age 70, the cost would be $415,000.

If Social Security is viewed as an annuity, the retired couple's portfolio has now changed from 60/40 (stocks/bonds) to 41/59 (fixed income portion is now $400k + $470k). The shift to fixed income would be even greater if a monthly pension benefit were also treated as an annuity. What all this means is that the couple's fixed income weighting may now be too much and ~$100,000 to ~$240,000 of the bond portfolio can be repositioned into equities.

Social Security Benefits As Immediate Lifetime Annuity

Recipient's Age	Social Security	Annuity
62 (male)	$15,000 year	$240,000
62 (female)	***$15,000 year***	***$265,000***
65 (male)	$15,000 year	$230,000
65 (female)	***$15,000 year***	***$250,000***
68 (male)	$15,000 year	$215,000
68 (female)	***$15,000 year***	***$230,000***
71 (male)	$15,000 year	$195,000
71 (female)	***$15,000 year***	***$220,000***
74 (male)	$15,000 year	$180,000
74 (female)	***$15,000 year***	***$200,000***
77 (male)	$15,000 year	$160,000
77 (female)	***$15,000 year***	***$180,000***

Although not reflected in the table or discussion above, **the annuity's value is ~50% greater if an immediate annuity *with a CPI adjustment* is purchased.** The 50% premium would be lower or higher, depending on recipient's life expectancy.

EARLY RETIREMENT SOCIAL SECURITY BENEFITS

Social Security: Impact of Early Retirement Benefits at Age 62

DOB	Full Retirement Age	Months B/W Age 62 & Full Retirement Age	$1,000 Benefit Reduced To	$500 Spousal Benefit Reduced To
1940	65 + 6 mos.	42	$775 (*or* 22%)	$362 (*or* 27%)
1941	65 + 8 mos.	44	$766 (*or* 23%)	$358 (*or* 28%)
1942	65 + 10 mos.	46	$775 (*or* 24%)	$354 (*or* 29%)
1943-54	66	48	$766 (*or* 25%)	$350 (*or* 30%)
1955	66 + 2 mos.	50	$775 (*or* 26%)	$345 (*or* 31%)
1956	66 + 4 mos.	52	$766 (*or* 27%)	$341 (*or* 32%)
1957	66 + 6 mos.	54	$775 (*or* 27%)	$337 (*or* 32%)
1958	66 + 8 mos.	56	$766 (*or* 28%)	$333 (*or* 33%)
1959	66 + 10 mos.	58	$775 (*or* 29%)	$329 (*or* 34%)
1960+	67	60	$766 (*or* 30%)	$325 (*or* 35%)

2011 MEDICARE BENEFIT SUMMARY

Medicare is for people age 65 and older. Medicare claims are paid by commercial insurance companies under contract with the Centers for Medicare & Medicaid Services (CMS). Medicare Part C (Medicare Advantage) includes extra benefits. Part D is the prescription drug plan; for 2011, the average monthly premium is expected to be ~$32 a month.

	Benefit	**You Pay**	**Medicare Pays**
Hospital (Part A)			
Hospitalization	1st 60 days	$1,132 flat fee	balance
	61st to 90th day	$283 day	balance
	91st to 150th day	$566 day	balance
	beyond 150 days	all costs	nothing
Nursing Facility	1st 20 days	nothing	all (as approved)
	next 80 days	$142 day	balance
	beyond 100 days	All costs	nothing
Home Health Care	1st 100 days	nothing for services	all
	in spell of illness	20% for durable medical equipment	balance
Hospice Care	unlimited (doctor certified)	outpatient drugs + respite care	balance
Medical (Part B)			
Medical Expenses		$162 deductible + 20% remaining	all
Lab Services		nothing	all
Home Health Care		nothing for services (20% for equipment)	balance
Outpatient Hospital	Unlimited	$162 deductible + 20% of remaining	balance

Medicare Premiums For 2011

Hospital (Part A)		
Monthly premium*	**Quarters of Medicare-Covered Employment**	
$0	40 or more	
$254	30-39	
$450		
Medical (Part B)		
	Taxable Income of Medicare Patients	
	Joint Return	**Single Return**
Monthly premium		
$115	0-$170k	0-$85k
$162	$170k-214k	$85k-$107k
$231	$214k-320k	$107k-$160k
$300	$320k-$428k	$160k-$214k
$370	$428k+	$214k+

TAXATION OF DISABILITY PREMIUMS & BENEFITS

	Premium	**Benefits**
Policy purchased by you	Not deductible	Tax-free income
Employer-provided plan	Employer deductible and not included as employee compensation Employer deductible but included as employee compensation	Generally taxable to employee Tax-free income
Workers' compensation	Employer deductible and not taxed to employee	Generally tax-free income
Social Security	Employer portion of SS tax not taxable to employee; employee's portion paid w/ after-tax income	Taxable