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FOCUS ON FINANCIAL FREEDOM® WINTER 2011

Retirement in the New Economy

The fact is that the recent recession has changed the way that we think about our money, today and into the future. Young and old, we find ourselves asking, "What does this 'new economy' mean for my retirement?"

A study conducted last year by AgeWave and Harris Interactive titled, "Retirement at the Tipping Point: The Year That Changed Everything," looked into how the recession is impacting Americans' "retirement fears, hopes, attitudes,

advice, and plans." They interviewed thousands of Americans across four generations to gather their data.

The results were somewhat predictable in that they unveiled overall trepidation and shifting plans, with a new outlook on the role of retirees in America. The results predict a new era of cautiousness after many saw their retirements, as they had planned them, change dramatically. Yet amidst all of that fear-based caution, there is also an underlying sense of hope. Looking into the survey data further, we find:

"People who complain about taxes can be divided into two classes — men and women." – Author Unknown

Tax season is typically wrought with anxiety. Countless hours may be spent reviewing financial details. The deadline looms, especially for those who are not well-prepared.

Many are faced with the daunting challenge of reconstructing their financial history during tax season. Time is wasted pouring through files (and piles). There may be surprises and regrets. It is not unusual to hear people say, "If I'd only known, I could have...would have..."

These sentiments are often accompanied by a new resolve to organize files and monitor finances more closely. However, the anguish may be forgotten once the return is filed. Another year will pass and nothing changes. Inevitably, the anxiety of tax season will return once again.

There is no magic to organizing your finances. This just requires time and commitment. Whether you are planning for retirement or tax filing, these records are the foundation of your financial life.

Take steps now to improve your financial recordkeeping. Simplify your tax filing process for 2011! In the meantime, challenge yourself to complete your portion of the tax preparation process by March 25, if not sooner.

There is better weather ahead — make sure you have time to enjoy it!

Charlene K. Dolan

Retirement in the new economy may mean working longer. Nearly 60% of Americans have lost money in mutual funds, 401(k) plans, or the stock market. Respondents of the AgeWave/Harris Interactive survey believe it will take an average of seven years for their investments to recover. The report cites that "today's preretirees say they will need to postpone their retirement 4.2 years on average, which would be the first time in history that retirement age significantly increased in America."

Retirement in the new economy means worrying about the cost of health care. The biggest financial

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Retirement

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concern among respondents age 55 or older is being able to afford medical expenses during retirement. For them, it is the biggest unknown. Medicare coverage, though helpful, is limited. Retirees are considering supplemental insurance, known as “medigap,” as the financial burden of health care can quickly deplete a person’s retirement fund.

Nearly 70% of Americans over the age of 65 will need some long-term care, such as home care, assisted living, or nursing home care. In 2008, the average annual cost for a room in a private nursing home was \$76,460 a year (Source: Genworth Financial, 2009).

Retirement in the new economy means being more fiscally responsible. Only 4% of respondents strongly agreed that Americans behave in a financially responsible manner. An astounding 81% said that to “live within your means” was the most important financial advice parents could pass on to their children.

Retirement in the new economy means stabilizing your funds. Generally, you should have a larger share of your investments in equities the further you are from retirement; as you approach retirement, you should gradually decrease your equity investments and increase your bond and fixed-income assets — shifting from growth toward income generation. In other words, dialing down the risk in your portfolio as you approach retirement is important.



Retirement in the new economy means finding a new purpose. The majority of Americans — 60% — now say they view retirement to be “a new, exciting chapter in life” and 70% *want* to work in retirement as a way to contribute to their community and remain stimulated. It seems that a longer life span now means a longer work span...out of choice as well as necessity.

What’s more, we want retirees to work. Nearly 75% of all survey respondents think our country would benefit if retirees were more involved in contributing their skills and experience to community and civic life.

There is no doubt that the

recession created anxiety across the nation. As we all take a deep breath and assess our retirement funds, we assess with a new outlook. We have learned a lot. We have learned that working longer can create a new purpose. We have learned that our health is something we need to plan for as much as — if not more than — our retirement. We have learned that being fiscally responsible cannot be overemphasized. We have learned — again — that Americans are resilient and adaptable. We will get through this economic downturn...and be all the wiser.

If you’d like some help assessing your retirement plans, please call. ○○○

Selling Your Home at a Loss

When selling a home, the basic tax rule is you can exclude gains of up to \$250,000 if you are a single taxpayer and up to \$500,000 if you are married filing jointly, provided the home was your primary residence in at least two of the preceding five years. But what happens if you have a loss on the sale? Since your primary home is not considered investment property, you cannot deduct a loss on your income tax return.

Although not a short-term solution, one way around this is to convert your home to rental property. Then, when the property is sold, the loss can be deducted as a capital loss, as long as you can prove the home was permanently converted to income-producing property. Your basis for calculating the loss is the lesser of your actual cost or the property’s fair market value when it was converted to rental property. For instance, if you bought a home for \$250,000, converted it to rental property when it was worth \$225,000, and sold it for \$200,000, your loss would be \$25,000, not \$50,000.

When calculating your gain or

loss on the sale of your home, don’t confuse your mortgage balance with the basis in your home. Your basis is the amount you paid for the home plus any improvements. It is possible for your mortgage and equity loans to exceed the sales price. If you sell the home for less than your mortgage amount, then you will owe more than you received, but it is still possible to have a gain for tax purposes. For instance, assume you purchased a home many years ago for \$200,000, have a mortgage and equity loan totaling \$300,000, and sell the home for \$250,000. Although you have to pay \$50,000 out of pocket for the mortgage and equity loan, you will have a \$50,000 gain for tax purposes.

Due to the home sale gain exclusion, you can exclude up to \$250,000 if you are a single taxpayer and up to \$500,000 if you are married filing jointly, provided the home was your primary residence in at least two of the preceding five years. If you move out of the house and it takes longer than three years to sell your home, your gain could be taxable. Please call if you’d like to discuss this in more detail. ○○○

The Basics of Roth 401(k) Plans

Although Roth 401(k) plans became effective on January 1, 2006, they have only recently started to gain momentum. Originally, Roth 401(k)s were scheduled to expire after 2010, so companies were not willing to start a plan that would expire after a few years. However, the Pension Protection Act of 2006 made Roth 401(k)s permanent.

The Roth 401(k) is patterned after the Roth individual retirement account (IRA) — contributions are made from after-tax earnings that grow tax free, and qualified distributions are withdrawn tax free. Here are the basics, including how Roth 401(k)s differ from Roth IRAs:

- **Eligibility** — Employees eligible for their employer's 401(k) plan are also eligible for the Roth 401(k). There are no income limitations for contributions to a Roth 401(k). With a Roth IRA, single taxpayers with modified adjusted gross income (AGI) less than \$105,000 and married taxpayers filing jointly with modified AGI less than \$167,000 in 2010 can make contributions, regardless of their participation in a qualified retirement plan. Contributions are phased out for single taxpayers with modified AGI between \$105,000 and \$120,000 and for married taxpayers filing jointly with modified AGI between \$167,000 and \$177,000 in 2010.
- **Contributions** — The contribution limits for the Roth 401(k) are the same as for the regular 401(k) plan. In 2011, you can contribute a maximum of \$16,500 plus a \$5,500 catch-up contribution for those age 50 and over, if permitted by the plan. However, your employer may set lower limits to comply with nondiscrimination rules. Contributions can be split between a regular and Roth 401(k), as long as total contributions do not exceed the maximum. Funds contributed to each type must be held in separate accounts. Any matching contributions made by the

employer must be held in the regular 401(k) account, so they will be taxable when withdrawn. In 2011, the contribution limits for a Roth IRA are \$6,000 plus an additional \$1,000 catch-up contribution for individuals age 50 and over. You can make contributions to both a Roth 401(k) and a Roth IRA, as long as you meet the income eligibility rules for the Roth IRA.

- **Required distributions** — With a Roth IRA, you are not required to take distributions during your lifetime. Thus, Roth IRAs are a good estate planning vehicle for individuals who want to leave tax-advantaged assets to beneficiaries, since beneficiaries can also withdraw qualified distributions without paying federal income

taxes. With a Roth 401(k), annual distributions must be taken after age 70½. However, funds in the Roth 401(k) can be rolled over to a Roth IRA, which would not require distributions.

- **Conversions** — Starting in 2010, all taxpayers, regardless of income level, can convert a regular IRA to a Roth IRA. There is no provision to convert a regular 401(k) to a Roth 401(k).

Keep in mind that this does not have to be an either/or decision. You can split your contributions between the Roth and regular 401(k) plans, although matching employer contributions must be contributed to the regular 401(k). Please call if you'd like to discuss the Roth 401(k) in more detail. ○○○

Make Saving a Habit

Habits are all about the principle of human inertia — we tend to keep doing what we've always done, and shy away from doing something new. The principle may work against you at first. If you're not used to saving money, it can be hard to get started. But once you gain some momentum with your new saving habits, it will be relatively easy to keep it up. If you haven't started saving or aren't saving enough, here are some tips:

- **Take full advantage of payroll saving plans.** Payroll deduction is a great financial innovation. With one authorization form, you can start a savings program that works for you without any more effort on your part. It doesn't matter what type of plan it is or how much you put in. Just get started, and you have a new habit.
- **Aim to max out your company match.** When a company offers you a matching contribution, it's like they are saying, "Here's some free money. Want it?"

Make sure you contribute enough to get the full matching contribution.

- **Treat saving as a bill.** The old adage for saving is, "Pay yourself first." The trick is to treat saving like any other bill. Name an amount and a date to pay it, then make the payment when it comes due.
- **Set annual goals for account balances.** You can never reach a goal if you don't have one. Specific annual targets for your account balances become incentives to save, and by dividing the difference between your current balance and your target, you can easily derive the periodic amount you need to contribute.
- **Devote your raises to saving.** When you get a raise, don't forget to increase your savings. If you can afford to, bank the entire raise. If you can't do that, at least increase your savings by a portion of the raise.

Please call if you'd like to discuss saving in more detail. ○○○

Are Your Retirement Funds Adequate?

Whether retirement is just around the corner or you are decades away from your final day in the office, knowing how much you'll need and how your nest egg measures up is important.

There are many online retirement calculators available that can begin to give you a picture of the current condition of your funds as well as an idea of how much more you need to save before reaching your target retirement age. Yet most of these calculators' value ends there. How do you know if the retirement vehicles you are invested in are the best ones? And what other vehicles might be better?

Know your goal. Knowing your target goal of how much cash you will need *at retirement* is the first step. Very simply, take your current gross income and deduct the expenses you no longer expect to have in retirement — payroll taxes, the amount you are currently putting away for retirement, college funds (if your

kids are already through), and mortgage payments (if your house will be paid off by retirement). That budget will create the framework for interpreting whether your current funds are sufficient.

Estimate your Social Security benefits and other sources of income. Utilize Social Security Administration online calculators to create a ballpark estimate of the monthly payment you might expect. Then think about other sources of fixed income — company pension payments, for example, and add them to the tally.

Basically, by (1) finding your target retirement income and then (2) subtracting the estimated income from Social Security and any company pension, you will have the “magic number” of how much your personal retirement savings must contribute to your retirement income. From there, we move on to analyzing how your retirement savings are allocated.

Analyze which financial vehicles are best given your retirement road map. Many people who were approaching retirement recently were overinvested in equities. When the market crashed in March 2009, equity prices fell 57% from the market's peak in October 2007. Retirement balances fell \$2.8 trillion, a full \$1 trillion of that from

baby boomer's accounts (Source: Huffington Post, 2010). While the magnitude of those losses is rare, it reinforces two general retirement investment principles:

- **Diversification is king.** Being overinvested in any one area isn't wise. Blending stock and bond investments, large-cap and small-cap funds, and foreign with domestic choices can offer the best balance between risk and reward.
- **Appropriate asset allocation depends on your life stage.** Generally, the younger you are, the larger share of your money should be in growth investments like equities. As you near retirement, transition into income-generating investments like bonds. (And while many people need both income *and* growth investments during retirement, the decreasing-risk rule still holds — and there are a number of less-risky growth investments available.)

Once you know your goal, understand your retirement income and expenses, and have committed to diversification, it's a great time to review your retirement investments. Please call if you'd like help. ○○○

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Almost half of individuals age 65 or older said they pay more for insurance and health care expenses than they had anticipated when planning for retirement. Less than one-third of retirees had saved specifically for the cost of health care in retirement during their working years (Source: *Employee Benefit News*, 2010).

The overall value of employer-financed retirement benefits, including retiree medical and life insurance plans, fell by 19% over the past decade (Source: Towers Watson, 2010).

Did You Know?

A study by the Federal Reserve found that the median borrower who strategically defaulted on a mortgage did so only after the loan amount exceeded the home's value by 62%. The study also tracked borrowers in Arizona, California, Florida, and Nevada who bought homes in 2006 using nonprime mortgages with 100% financing. By September 2009, almost 80% of those mortgages were in default (Source: Federal Reserve, 2010).

In a recent survey, 39% of respondents defined financial success as being debt free. The appeal of being debt free varied according to age, with half of those age 65 and older citing no debt as a measure of success, compared with only 30% of those between the ages of 18 and 34. Nearly one-third of all respondents defined financial success as being able to save for long-term goals such as education and retirement (Source: TD Ameritrade, 2010). ○○○