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AN INDEPENDENT PERSPECTIVE.

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Crisis Investing: Keeping Your Head

When a crisis creates uncertainty, markets often become volatile, especially when the scope of the disaster isn't clear. A crisis is like Janus, the Roman god with faces that looked forward and back. For some investors, it may represent a threat; for others, it may spell opportunity. Not every crisis requires a reaction; sticking to a long-term plan is still the best strategy for most people.

Here are some examples of factors that investors sometimes overlook when considering which face of Janus to focus on during a crisis.

Watch the global supply chain

Companies and economies increasingly operate in a global context. The more heavily an industry or company relies on global partners, the more it might be affected by crisis conditions. Think not only about companies that are affected directly by turmoil, but about other companies that rely on them.

For example, China has become in many ways the world's factory floor, and many information technology services are now outsourced to India. How would a crisis in either country affect global supply chains or communications infrastructure? Might competitors not affected by the crisis pick up at least some of the slack? How might a particular industry be hit by shortages of parts or raw materials? Is a large multinational so geographically spread out that a crisis in one part of the world may have little impact on its overall operations? Oil is perhaps the most obvious example of how a crisis can affect global supply chains. A perceived threat to supplies can affect prices of other assets.

Consider currency fluctuations

Currency fluctuations are another factor to consider. Crises in one part of the world can affect that region's currency. That in turn can affect companies located elsewhere. The 2010 panic over potential default by several eurozone countries strengthened the dollar, and though that may sound like good news, a stronger dollar can hurt U.S. exports.

Currency issues are also important because of what's called the "carry trade." This happens

when investors use money from a country where interest rates are relatively low--the Japanese yen and the U.S. dollar have been prime examples in recent years--to invest elsewhere at a better rate of return. However, if the cheaper currency suddenly increases in value, the carry trade can reverse as investors put their capital back into the so-called funding currency. That can affect assets denominated in other currencies. For example, the yen soared as investors anticipated that money would be repatriated to deal with Japan's earthquake/tsunami/nuclear disaster. Some investments denominated in other currencies suffered when investors sold them to invest in yen.

Think both long term and short term

Nothing lasts forever. A crisis could create opportunities that eventually peter out, or challenges that later seem trivial. Or it could have little short-term impact but mean profound change over a period of years. When considering whether a crisis represents a challenge or an opportunity, think both short term and long term.

A crisis with potentially long-term opportunities or harmful consequences may mean you may be able to take more time with a decision. If the window of opportunity is smaller or the potential devastation more short term, remember that there are alternatives to an all-or-nothing approach. For example, you could take a small position and see how your investment thesis plays out before committing more. Even if the window of opportunity slams shut, new opportunities often emerge during even the worst of times; missing one now doesn't mean you won't find others later. If you're worried about a potential downturn, you could use other investments to hedge your exposure while retaining a long-term stake, or take profits to protect part of your holdings but leave some money invested in case the crisis is short-lived.

Note: Any investment approach involves some type of risk, including the possible loss of principal, and there's no guarantee any strategy or technique will be successful.



It's obvious, but the earlier you retire, the less time you'll have to save, and the more years you'll be living off your retirement savings. For example, if you retire at age 70 instead of age 65, and save an additional \$22,000 per year at a hypothetical 6% rate of return, you can potentially add \$124,016 to your retirement fund (and any existing savings will have five more years of potential growth). (This is a hypothetical example and not intended to reflect the actual performance of any specific investment. Earnings are pretax, and may be subject to income tax when distributed.)

Getting an Early Start on Saving for Retirement

Many people assume they can hold off saving for retirement and make up the difference later. But this can be a costly mistake. Waiting too long to start saving can make it very difficult to catch up, and only a few years can make a big difference in how much you'll accumulate. This doesn't mean there's no hope if you haven't set aside anything for retirement yet. It just makes it all the more important that you implement a plan today.

Start saving now

Start saving as much as you can, as soon as you can. The earlier you start, the longer compounding can work for you. For example, a 20 year old who saves \$200 a month until age 65 and earns exactly 6% on saved funds annually would have accumulated around \$550,000. But a 40 year old contributing the same amount each month at the same earnings rate would have accumulated only \$138,600 by age 65.

Contribute \$200/month to age 65 at different hypothetical earnings rates				
	Start at age 20	Start at age 30	Start at age 40	Start at age 50
2%	\$174,931	\$121,510	\$77,764	\$41,943
4%	\$301,894	\$182,746	\$102,826	\$49,218
6%	\$551,199	\$284,942	\$138,599	\$58,164
8%	\$1,054,908	\$458,776	\$190,205	\$69,208

(This is a hypothetical example and is not intended to reflect the actual performance of any specific investment. Earnings are pretax, and may be subject to income tax when distributed.)

Take advantage of employer plans

Chances are your employer offers a 401(k), 403(b), or similar retirement savings plan. You can contribute up to \$16,500 to a 401(k) plan in 2011. And if you're 50 years old or older, you can make additional "catch-up" contributions of up to \$5,500, for a total of \$22,000 in 2011.

Since pretax contributions are excluded from your paycheck, you'll enjoy an immediate tax savings when you contribute to one of these plans. For example, if your effective income tax rate is 30%, a \$22,000 annual pretax contribution will only "cost" you \$15,400 once the tax benefit is factored in. Of course, you'll have to pay income tax when you start receiving distributions from the plan, but it's possible you'll be in a lower tax bracket at that time (note that distributions made prior to age 59½ may be subject to a 10% additional

penalty tax unless an exception applies). Your employer's plan may also allow you to make Roth contributions. There's no immediate tax benefit (contributions are made with after-tax dollars), but qualified distributions are entirely free from federal (and most states') income tax.

Even if you can't contribute the maximum allowed, you should at least try to contribute as much as necessary to get any matching contributions that your employer offers. This is essentially "free money." However, you may need to work up to six years before you're fully vested in (that is, before you fully own) any employer matching contributions.

Don't forget IRAs

You can contribute up to \$5,000 to an IRA in 2011. You can also make catch-up contributions to an IRA if you're 50 or older--up to an additional \$1,000 in 2011.

Your contributions to a traditional IRA may be deductible if neither you nor your spouse are covered by an employer retirement plan, or (if either of you are covered) your income falls within specified limits. Like pretax 401(k) contributions, deductible IRA contributions can result in an immediate tax savings, and as with 401(k) plans, withdrawals made prior to age 59½ may be subject to an additional 10% penalty tax unless an exception applies.

But even if you can't make deductible contributions to a traditional IRA, you can generally make nondeductible (after-tax) contributions. There are no up-front tax benefits, but your contributions will be tax free when withdrawn, and any earnings will grow tax deferred until distributed.

If your income is within prescribed limits, you can also make after-tax contributions to a Roth IRA. In this case, even the earnings are tax-free if your distribution is "qualified." Distributions are qualified if you satisfy a five-year holding requirement, and the distribution is made after you reach age 59½, become disabled, or die, or the funds are used to purchase your first home (up to \$10,000 lifetime).

Make saving a priority

Saving even a little money can really add up if you do it consistently. Consider ways to free up more money to save for retirement--by reducing discretionary spending, for example. And, put retirement ahead of competing goals, even important goals like saving for your child's education.



The situations described here relate to deferred annuities. Different tax rules may apply to annuities in the payment stage (annuitization).



These Deferred Annuity Mistakes Can Be Taxing

The tax treatment of nonqualified deferred annuities (annuities that are not part of a tax-qualified plan such as an IRA or 401(k)) appears to be fairly clear-cut:

- A distribution that represents a return of your investment in the contract is not taxed
- Earnings aren't taxed until they're withdrawn
- Earnings are taxed as ordinary income and not capital gains, and
- A distribution of earnings taken before age 59½ is subject to a 10% tax penalty unless an exception applies

Simple, right? Yes--except for those particular circumstances that trigger unexpected tax consequences.

Ownership by a "non-natural entity"

"Non-natural entity" is tax speak meaning the annuity owner is not a human being, but is an entity (e.g., trust, partnership, corporation). This creates a situation where the annuity is not treated as a tax-deferred annuity, so any earnings will be taxed to the annuity owner/entity as ordinary income during the current year--even if the earnings haven't been distributed.

There are some exceptions to this rule. It doesn't apply to immediate annuities or those considered qualified funding assets (e.g., annuities held for periodic payments due to personal injury settlements). Also, the annuity may not lose its tax-deferred status if the non-natural entity/owner is acting as the agent for a natural person. For example, ownership of the annuity by the estate of a deceased annuity owner, or the trustee of an IRA or qualified plan, will not, in and of itself, remove its tax-deferred status.

Certain revocable (grantor) trusts may also be the annuity owner without negating the annuity's tax-deferred status, as long as all of the trust beneficiaries are natural persons. However, if an irrevocable (non-grantor) trust, such as a credit shelter trust, is the annuity owner, distributions of earnings from the annuity may be subject to an additional 10% tax penalty. That's because exceptions to this penalty that are available to a person/annuity owner don't apply to a non-natural entity. For example, a non-natural entity can't claim to be over age 59½, nor can it be disabled from work.

Gifting an annuity contract

If you make a gift of an annuity you own, special income tax rules apply. If you owned the annuity for some time before making the gift, you are subject to a tax on the difference between the value of the annuity (its cash

surrender value) and the amount you have invested in the contract (your premiums). You would have to claim the income in the tax year you make the gift. This rule applies to gifts of annuities to charities and charitable remainder trusts as well. A gift of an annuity contract between spouses generally does not trigger this tax, however.

A trust as your annuity beneficiary

Revocable living trusts are a common estate planning tool. Often, an annuity owner/trustor will name the trust as beneficiary of an annuity. However, if you're survived by a spouse, naming the trust as the annuity beneficiary may remove some settlement options your spouse would otherwise have.

Generally, a surviving spouse named as beneficiary of a deferred annuity has four options available: (1) take the full death benefit in a lump sum (the earnings will be treated as taxable income at the time the benefit is paid); (2) take the annuity proceeds over a period of five years; (3) elect to receive the annuity payments over a period of time not to exceed his or her lifetime (with the last two options, each payment is part nontaxable return of investment and part taxable earnings); or (4) the surviving spouse may also have the unique option of becoming the new owner of the inherited annuity, in which case the annuity can continue in deferral (the spouse doesn't have to take any payments).

However, by naming the trust as beneficiary instead of your spouse, you'd be eliminating the last two options for your spouse--even if your spouse is the beneficiary of the trust. With the trust as beneficiary, the annuity proceeds would have to be paid in a lump sum or over five years following your death. If your annuity has significant earnings, those earnings would be taxed upon distribution, even if your spouse neither needs nor wants the proceeds.

Using an annuity as collateral for a loan

Using your deferred annuity as collateral for a loan may result in the unwanted realization of taxable income to you. For instance, say the basis (premiums paid) in your annuity is \$100,000 and it's now worth \$150,000. If you use this annuity as collateral for a loan, the collateral assignment is treated like a distribution and all of the gain (i.e., \$50,000) will be taxable to you as ordinary income.

The income tax rules for deferred annuities can be tricky, so before making any ownership or beneficiary designation changes, consult your financial or tax professional.

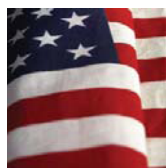
Ask the Experts

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Am I eligible for a veteran's pension?

Honorably discharged veterans who have limited incomes and nonservice related health problems may be eligible for a pension from the Department of Veterans Affairs.

To be eligible for this pension, you must be age 65 or older, or you must be permanently and totally disabled; you must have limited income and assets; and you must have served a minimum of 90 days of active duty with at least one day of active duty during wartime. If you entered active duty after September 7, 1980, you must have served at least 24 months, or the full period for which you were called to active duty.

Your countable income must be below an annual pension limit set by law. This pension limit is higher based on whether you have a spouse and/or dependents. You can reduce your countable income by deducting unreimbursed medical expenses that exceed 5% of the appropriate annual pension limit.

While there's no stated limitation on your net worth in order to qualify for pension benefits, the VA states that net worth can't be excessive. Generally, you may not be eligible for benefits if

your net worth is large enough to live on for a reasonable period of time.

Your benefits are calculated by totaling all of your countable income reduced by eligible unreimbursed medical expenses. This figure is subtracted from the appropriate annual pension limit to determine your total annual pension, which is then paid monthly. For example, assume the appropriate annual pension limit is \$11,830; you have unreimbursed medical expenses of \$1,500 and countable annual income of \$8,500. Your countable income (\$8,500) is reduced by your unreimbursed medical expenses that exceed 5% of the appropriate annual pension limit ($\$1,500 - \$592 = \$908$). Your countable income ($\$8,500 - \$908 = \$7,592$) is then subtracted from the appropriate annual pension limit ($\$11,830 - \$7,592$), resulting in an annual pension of \$4,238, or \$353 per month. Your monthly benefit may be increased if you're eligible for Aid and Attendance or housebound benefits. For additional information, visit the United States Department of Veterans Affairs website at www.va.gov.



What is Aid and Attendance?

Aid and Attendance (A&A) is a monthly benefit paid to qualifying veterans and their surviving spouses who need the aid of another person to help them with activities of routine

daily living. It is a benefit paid in addition to the monthly veteran's pension. To be eligible, the honorably discharged veteran or the surviving spouse must:

- Need another person to assist with activities of daily living, such as bathing, feeding, dressing, or taking care of needs of nature; or
- Be disabled to the extent that he or she must remain in bed apart from any prescribed course of convalescence or treatment; or
- Be a patient in a nursing home or assisted living facility due to mental or physical incapacity; or
- Be blind

Eligibility for A&A is not dependent on a service-connected disability; however, the benefit may not be paid unless the claimant is eligible for the veteran's pension, or in the case of a surviving spouse, the veteran's death pension.

The tax-free applicable monthly benefit amount can be as much as \$1,644 for a veteran, \$1,056 for a surviving spouse, and \$1,949 for a married veteran.

Housebound benefits are similar to A&A benefits, although a claimant can't receive both housebound and A&A benefits. To receive housebound benefits, the claimant must be eligible for pension benefits (VA death pension for a surviving spouse) and benefits are paid in addition to the monthly pension. Housebound benefits are paid to a veteran (or surviving spouse) who is 100% disabled due to a single disability and, due to that disability, is confined to his or her home or immediate premises, or if not so confined, the claimant is 100% disabled due to a single permanent disability and has another disability or disabilities that are at least 60% disabling.

Determining eligibility for these benefits depends on a number of factors. For more information including how and where to apply for these benefits, visit the United States Department of Veterans Affairs website at www.va.gov.

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