Atlanta Wealth Consultants

Peter Miralles, CFP®CIMA®CLU
President
Two Ravinia Drive
Suite 1590
Atlanta, GA 30346
770-394-4448
877-473-0830
pmiralles@awc2.com
www.AWC2.com

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The individual investor should act consistently as an investor and not as a speculator. - Ben Graham

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Market-Moving Indicators for Monitoring Europe

If you've struggled to make sense of the ongoing European debt debacle, you're not alone. It's difficult even to keep track of all the pieces of this financial Rube Goldberg puzzle, let alone understand how they can influence one another.

Though new aspects of the situation seem to crop up every month, here are some of the most common factors that either reflect or affect sentiment about what's happening in Europe. Knowing about them might help you understand why markets react to a seemingly obscure headline. After all, one of the few things that almost everyone seems to agree on is that the situation isn't likely to be solved overnight.

Take an interest in interest rates

Interest rates on sovereign debt are perhaps the most closely watched indicator. When demand for a country's bonds is low because investors are concerned about the possibility that they might not be repaid in full and on time, that country must offer a higher interest rate in order to borrow money to finance its day-to-day operations.

Interest rates become particularly worrisome when they reach or exceed 7%. That's the level that prompted Greece, Ireland, and Portugal to seek bailouts from their European peers, and it's widely seen as unsustainable. When a country must pay that much simply to service its debt, investors become concerned that high borrowing costs will make a country's financial situation even worse.

Watch credit ratings

Troubled European countries are struggling to deal with a devilish Catch-22. In many cases, unsustainable debt burdens have led to stringent austerity measures; however, such measures also can hamper economic growth, which reduces tax revenue and can potentially increase deficits. Higher deficits can lead to a lower credit rating that in turn can mean higher borrowing costs, bringing on the problems discussed above and potentially launching a new downward economic cycle. Thus, a downgrade to a country's credit rating tends to raise concerns.

However, investor reaction also can be unpredictable. For example, Standard & Poor's January downgrade of nine sovereign nations and the European Financial Stability Fund was largely met with a shrug by investors. There's been so much pessimism about Europe for so long that in some cases, markets may already have priced in much of the bad news.

Monitor credit default swap costs

A credit default swap (CDS) is a form of insurance against the possibility that a bond issuer might default or fail to make a payment on its obligations. Bondholders buy a CDS from a financial institution or insurance company that promises to reimburse the bondholder for any losses sustained in the event of a default. The cost of that insurance is seen as a proxy for the perceived risk involved in investing in a particular country's bonds. The higher the cost of a CDS on, say, Italian sovereign debt, the greater the anxiety about whether the bond issuer will default and the CDS issuer will have to pay.

Follow the money

To prevent credit markets from seizing up, the European Central Bank late last year provided almost €500 billion in three-year loans to European banks, making it easier for them to refinance their debt. The level of borrowing at the ECB is seen as one indicator of how banks are being affected by their holdings of sovereign debt. The greater the need to borrow from the ECB, the greater the banks' perceived level of vulnerability.

Bailouts: Nein nein nein?

U.S. voters aren't the only ones who are sensitive about bailouts; so are Germans. As Europe's most powerful economy and the one with the best credit rating, Germany is the tentpole upon which European financial stability hangs. However, by the end of 2011, the German economy had begun to slow. Any indications that economic pressure could threaten Germany's ability and willingness to remain strong in its support of the eurozone can spook anxious investors.

Retirement Rules of Thumb

Rules of thumb are usually based on a sound financial principle, and can provide a good starting point for assessing your retirement needs.

Because retirement rules of thumb are guidelines designed for the average situation, they'll tend to be "wrong" for a particular retiree as often as they're "right." However, rules of thumb are usually based on a sound financial principle, and can provide a good starting point for assessing your retirement needs. Here are four common retirement rules of thumb.

The percentage of stock in a portfolio should equal 100 minus your age

Financial professionals often advise that if you're saving for retirement, the younger you are, the more money you should put in stocks. Though past performance is no guarantee of future results, over the long term, stocks have historically provided higher returns and capital appreciation than other commonly held securities. As you age, you have less time to recover from downturns in the stock market. Therefore, many professionals suggest that as you approach and enter retirement, you should begin converting more of your volatile growth-oriented investments to fixed-income securities such as bonds.

A simple rule of thumb is to subtract your age from 100. The difference represents the percentage of stocks you should keep in your portfolio. For example, if you followed this rule at age 40, 60% (100 minus 40) of your portfolio would consist of stock. However, this estimate is not a substitute for a comprehensive investment plan, and many experts suggest modifying the result after considering other factors, such as your risk tolerance, financial goals, the fact that bond yields are at historic lows, and the fact that individuals are now living longer and may have fewer safety nets to rely on than in the past.

A "safe" withdrawal rate is 4%

Your retirement income plan depends not only upon your asset allocation and investment choices, but also on how quickly you draw down your personal savings. Basically, you want to withdraw at least enough to provide the current income you need, but not so much that you run out too quickly, leaving nothing for later retirement years. The percentage you withdraw annually from your savings and investments is called your withdrawal rate. The maximum percentage that you can withdraw each year and still reasonably expect not to deplete your savings is referred to as your "sustainable withdrawal rate."

A common rule of thumb is that withdrawal of a dollar amount each year equal to 4% of your savings at retirement (adjusted for inflation) will be a sustainable withdrawal rate. However, this rule of thumb has critics, and there are other strategies and models that are used to calculate sustainable withdrawal rates. For example, some experts suggest withdrawing a lesser or higher fixed percentage each year; some promote a rate based on your investment performance each year; and some recommend a withdrawal rate based on age. Factors to consider include the value of your savings, the amount of income you anticipate needing, your life expectancy, the rate of return you anticipate from your investments, inflation, taxes, and whether you're planning for one or two retired lives.

You need 70% of your preretirement income during retirement

You've probably heard this many times before, and the number may have been 60%, 80%, 90%, or even 100%, depending on who you're talking to. But using a rule of thumb like this one, while easy, really isn't very helpful because it doesn't take into consideration your unique circumstances, expectations, and goals.

Instead of basing an estimate of your annual income needs on a percentage of your current income, focus instead on your actual expenses today and think about whether they'll stay the same, increase, decrease, or even disappear by the time you retire. While some expenses may disappear, like a mortgage or costs for transportation to and from work, new expenses may arise, like yard care services, snow removal, or home maintenance--things that you might currently take care of yourself but may not want to (or be able to) do in the future. Additionally, if travel or hobby activities are going to be part of your retirement, be sure to factor these costs into your retirement expenses. This approach can help you determine a more realistic forecast of how much income you'll need during retirement.

Save 10% of your pay for retirement

While this seems like a perfectly reasonable rule of thumb, again, it's not for everyone. For example, if you've started saving for retirement in your later years, 10% may not provide you with a large enough nest egg for a comfortable retirement, simply because you have fewer years to save.

However, a related rule of thumb, that you should direct your savings first into a 401(k) plan or other plan that provides employer matching contributions, is almost universally true. Employer matching contributions are essentially "free money," even though you'll pay taxes when you ultimately withdraw them from the plan.

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Of Taxes Past, Present, and Future

With the 2011 tax filing season behind us, much attention is being paid to the expiring "Bush tax cuts"--the reduced federal income tax rates, and benefits, that will expire at the end of 2012 unless additional legislation is passed. In fact, though, several important federal income tax provisions already expired at the end of 2011. Here's a quick rundown of where things stand today.

What's already expired?

A series of temporary legislative "patches" over the last several years has prevented a dramatic increase in the number of individuals subject to the alternative minimum tax (AMT)--essentially a parallel federal income tax system with its own rates and rules. The last such patch expired at the end of 2011. Unless new legislation is passed, your odds of being caught in the AMT net greatly increase in 2012, because AMT exemption amounts will be significantly lower, and you won't be able to offset the AMT with most nonrefundable personal tax credits.

Other provisions that have already expired:

- *Bonus depreciation and IRC Section 179 expense limits*-- If you're a small business owner or self-employed individual, you were allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011; this "bonus" depreciation drops to 50% for property acquired and placed in service during 2012, and disappears altogether in 2013. For 2011, the maximum amount that you could expense under IRC Section 179 was $500,000; in 2012, the maximum is $139,000; and in 2013, the maximum will be $25,000.
- *State and local sales tax*-- If you itemize your deductions, 2011 was the last tax year for which you could elect to deduct state and local general sales tax in lieu of state and local income tax.
- *Education deductions*-- The above-the-line deduction (maximum $4,000 deduction) for qualified higher education expenses, and the above-the-line deduction for up to $250 of out-of-pocket classroom expenses paid by education professionals both expired at the end of 2011.

What's expiring at the end of 2012?

After December 31, 2012, we're scheduled to go from six federal tax brackets (10%, 15%, 25%, 28%, 33%, and 35%) to five (15%, 28%, 31%, 36%, and 39.6%). The rates that apply to long-term capital gains and dividends will change as well. Currently, long-term capital gains are generally taxed at a maximum rate of 15%. And, if you're in the 10% or 15% marginal income tax bracket, a special 0% rate generally applies. Starting in 2013, however, the maximum rate on long-term capital gains will generally increase to 20%, with a 10% rate applying to those in the lowest (15%) tax bracket (though slightly lower rates might apply to qualifying property held for five or more years). And while the current lower long-term capital gain rates now apply to qualifying dividends, starting in 2013, dividends will be taxed at ordinary income tax rates.

Other provisions expiring at the end of the year:

- *2% payroll tax reduction*-- The recently extended 2% reduction in the Social Security portion of the Federal Insurance Contributions Act (FICA) payroll tax expires at the end of 2012.
- *Itemized deductions and personal exemptions*-- Beginning in 2013, itemized deductions and personal and dependency exemptions will once again be phased out for individuals with high adjusted gross incomes (AGIs).
- *Tax credits and deductions*-- The earned income tax credit, the child tax credit, and the American Opportunity (Hope) tax credit revert to old, lower limits and (less generous) rules of application. Also gone in 2013 is the ability to deduct interest on student loans after the first 60 months of repayment.

New Medicare taxes in 2013

New Medicare taxes created by the health-care reform legislation passed in 2010 take effect in just a few short months. Beginning in 2013, the hospital insurance (HI) portion of the payroll tax--commonly referred to as the Medicare portion--increases by 0.9% for high-wage individuals. Also beginning in 2013, a new 3.8% Medicare contribution tax is imposed on the unearned income of high-income individuals.

Who is affected? The 0.9% payroll tax increase affects those with wages exceeding $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately). The 3.8% contribution tax on unearned income generally applies to the net investment income of individuals with modified adjusted gross income that exceeds $200,000 ($250,000 for married couples filing a joint federal income tax return, and $125,000 for married individuals filing separately).

Qualified charitable distributions

A popular provision allowing individuals age 70½ or older to make qualified charitable distributions of up to $100,000 from an IRA directly to a qualified charity expired at the end of 2011. These charitable distributions were excluded from income, and counted towards satisfying any required minimum distributions that you would have had to take from your IRA for the year.

Return of the "marriage penalty"?

Tax changes that were originally made to address a perceived "marriage penalty" expire at the end of 2012. If you're married and file a joint return with your spouse, you'll see the effect in the form of a reduced 2013 standard deduction amount, as well as in lower 2013 tax bracket thresholds in the tax rate tables (i.e., couples move into higher rate brackets at lower levels of income).

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WEALTH CONSULTANTS LLC

Atlanta Wealth Consultants
Peter Miralles, CFP®CIMA®CLU
President
Two Ravinia Drive
Suite 1590
Atlanta, GA 30346
770-394-4448
877-473-0830
pmiralles@awc2.com
www.AWC2.com

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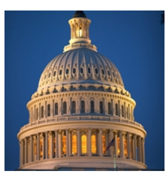
What happens to my retirement benefits if my employer goes out of business?

If your employer goes out of business, any retirement plan your employer sponsored will be terminated. If the plan is a 401(k) or other defined contribution plan, your benefits are held in trust, apart from your employer's assets, and you'll generally be entitled to receive your full account balance in a lump sum. (You can take the cash, or roll your payout into an IRA or another employer's plan.)

But if your employer sponsors a defined benefit plan, it gets a little more complicated. A defined benefit plan promises to pay you a specific monthly benefit at retirement. While defined benefit plan assets are also held in trust (or insurance contracts), apart from your employer's assets, whether a particular plan has enough cash to pay promised benefits depends on your employer's contributions and the plan's investment earnings and actuarial experience.

When a defined benefit plan is about to terminate, the Pension Benefit Guaranty Corporation (PBGC), a federal agency created specifically to protect employees covered by these plans, is notified. If the plan has enough money to cover all benefits that participants have accrued up to the plan termination date, then the PBGC will permit a "standard termination," and your employer will either purchase an annuity from an insurance company (which will provide lifetime benefits when you retire) or, if your plan permits, let you choose a lump-sum equivalent.

However, if the plan doesn't have enough money to pay all promised benefits earned up until plan termination (that is, the plan is "underfunded"), the PBGC will take over the plan as trustee in a "distress termination," and assume the obligation to pay basic plan benefits up to legal limits. For plans ending in 2012, the maximum annual benefit (payable as a single life annuity) is $55,840 for a worker who retires at age 65. If you begin receiving payments before age 65, or if your pension includes benefits for a survivor or other beneficiary, or if your plan was adopted (or amended to increase benefits) within five years of the termination, the maximum amount is lower. According to the PBGC, only 16% of retirees in recent years have seen their benefit reduced because of the annual dollar limits.



What is the Pension Benefit Guaranty Corporation?

The Pension Benefit Guaranty Corporation (PBGC) is a federal agency created by the Employee Retirement Income Security Act of 1974 (ERISA) to help protect pension plan benefits. When a pension plan ends (a "plan termination") without enough money to pay all benefits owed to participants, the PBGC takes over and assumes the obligation to pay those benefits.

The PBGC only protects defined benefit plans--that is, qualified employer pension plans that promise to pay a specific monthly benefit at retirement, based on your pay and years of service with your employer. The PBGC doesn't protect 401(k) or other defined contribution plans, plans not covered by ERISA (for example, governmental plans and certain church plans), or plans offered by professional service employers (such as doctors and lawyers) with fewer than 26 employees.

The PBGC guarantees that you'll receive basic pension benefits up to a specified dollar amount. Basic benefits include normal and early retirement benefits, survivor annuities, and disability benefits. The maximum pension benefit is set by law and adjusted yearly. For plans ending in 2012, the maximum annual amount (based on a single life annuity) is $55,840.92 (or $4,653.41 per month) for a worker who retires at age 65. According to the PBGC, most people receive the full benefit they had earned before the plan terminated. However, this amount may be lower than the benefit you had counted on from your plan at retirement.

The PBGC maintains two insurance programs: the single-employer program protects about 33.6 million workers and retirees in about 27,600 pension plans, and the multiemployer program protects 10.4 million workers and retirees in about 1,500 pension plans. (Multiemployer plans are set up by collectively bargained agreements involving more than one unrelated employer, generally in one industry, such as trucking or construction.)

The PBGC isn't funded by general tax revenues. Rather, the PBGC collects insurance premiums from employers that sponsor insured pension plans, receives funds from the pension plans it takes over, and earns money on its investments. Employers are required by ERISA to pay insurance premiums to the PBGC.