

Asset Strategies Monthly

May 2010

How Will the Health-Care Bill Help You This Year?

The health-care bill that became law in March won't be fully implemented for several years. However, by the end of this year, six important measures (detailed below) will take effect.



Your health insurer can't drop you for making a mistake

In some cases, people have filed claims, only to be told that after reviewing their policy, the insurance company has rescinded their coverage because of inconsistencies in the original application. The new law will require insurers to demonstrate fraud or intentional misrepresentation of a material fact--for example, deliberately concealing an existing illness--in order to rescind coverage after a claim is filed.

A child can stay on your health plan longer

If there's a recent high school or college grad in your family who's struggling to land that first job, you can choose to continue your child's dependent coverage under your plan until his or her 26th birthday. This applies to both individual and group policies (for existing workplace plans, it applies only if your child doesn't have his or her own employer's health plan).

If you or your child has a pre-existing condition, you'll be able to get health insurance

Under the health-care bill, children with pre-existing health conditions may not be denied health insurance coverage. Adults won't have that protection until 2014, but if you have a pre-existing condition, you may be able to obtain coverage beginning this summer through a temporary national high-risk insurance pool. However, only individuals with pre-existing conditions who have been uninsured for at least six months before applying for coverage through this insurance pool will be eligible.

Your total coverage will have no cap

In the past, some people were very happy with their health-care coverage--until they got really, expensively sick. Severe illness or an accident sometimes meant medical bills that exceeded the total amount of coverage their policy provided (so-called "lifetime limits" on coverage). The new law prohibits insurers from establishing lifetime limits on the total dollar value of health benefits that can be paid to any one insured individual.

You may get a rebate for some Medicare drug costs

The health-care bill gradually closes the Medicare prescription drug coverage gap known as the "donut hole." If you're covered by Medicare, you fall into this donut hole once your total prescription drug costs exceed \$2,830 a year; until you've spent an additional \$3,610 out of pocket, Medicare won't cover any of your prescription costs (figures are for 2010). If you're affected by this coverage gap this year, you can look forward to a \$250 rebate check from the federal government to defray at least part of your drug expenses. Next year's benefit could be even bigger; once you fall into the donut hole, you will receive a 50% discount on certain brand-name prescription drugs.

If you're a small business owner, you may receive a tax credit

If you're a qualifying employer who pays at least 50% of the cost of your employees' health insurance premiums, you may receive a tax credit to offset up to 35% of your premium contribution when you file your 2010 federal taxes. The credit is generally available to employers with fewer than 25 full-time workers with an average annual wage of less than \$50,000.

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Evaluating Risk in Your Portfolio

If you're like most people, you probably evaluate your portfolio in terms of the return it earns. However, as we were all reminded in 2008, returns aren't the only factor you should consider when determining whether your portfolio is allocated appropriately. Also important is the level of risk you take in pursuing those returns.

There are a number of ways to estimate the level of risk in a portfolio. The term "risk" is often used interchangeably with "volatility" (the tendency of a portfolio's value to rise or fall sharply, especially within a relatively short period of time). However, for most people, a portfolio is simply a means to an end—paying for retirement or a child's college tuition, for example. In that context, "risk" also means the risk of not meeting your financial needs.



Volatility measures

One of the most common measures of volatility is standard deviation, which gauges the degree of an investment's up-and-down moves. It shows how much the investment's returns have deviated from time to time from its own average. The higher the standard deviation of an investment or portfolio, the bumpier the road to those returns has been.

Another way to assess a portfolio's volatility is to determine its beta. This statistic compares a portfolio's ups and downs to those of a benchmark index, such as the S&P 500, and indicates how sensitive the portfolio might be to overall market movements. An investment or portfolio with a beta of 1 would have exactly as much market risk as its benchmark.

The higher the beta, the more volatile the portfolio. A beta of 1.05 means the portfolio involves 5% more market risk than the benchmark to which it's compared. If the benchmark rises 10%, a portfolio with a beta of 1.05 should theoretically rise 10.5%; a fall of 10% in the benchmark should mean a corresponding 10.5% decline in the portfolio.

A 0.95 beta means a portfolio has 5% less market risk than that index; in theory, the portfolio would rise and fall 5% less than the benchmark. (However, remember that investments also have unique risks that are not related to market behavior. Those risks can create volatility patterns that are different from the underlying benchmark.)

The risk of not achieving your goals

Another way to evaluate risk is to estimate the chances of your portfolio achieving a desired financial goal. In this case, "risk" means not volatility but the odds that your portfolio will succeed in meeting a specific financial liability. A technique known as Monte Carlo simulation uses computer modeling based on multiple scenarios for how various types of investments might perform based on their past returns. Though past performance is no guarantee of future results, such a projection can estimate how close your plan might come to meeting a future target amount.

Let's look at a hypothetical example. Let's say Bob wants to retire in 15 years. A Monte Carlo simulation might suggest that, given his current level of saving and his portfolio's asset allocation, Bob has a 90% chance of achieving his retirement target. If he chose to save more, he might increase his odds of success to 95%. Or Bob might decide that he's comfortable with having an 85% chance of success in reaching his target amount if that also means his portfolio might be less volatile. (However, be aware that though a projection might show a high probability that you'll reach your financial goals, it can't guarantee that outcome.)

Are you getting paid enough to take risk?

Another approach to thinking about portfolio risk involves the reward side of the risk-reward tradeoff.

You can compare a portfolio's return to that of a relatively risk-free investment, such as the inflation-adjusted return on a short-term (3 months or less) U.S. Treasury bill. Modern portfolio theory is based on the assumption that you should receive greater compensation for taking more risk (though there's no guarantee it will work out that way, of course). A stock should offer a potentially higher return than a Treasury bond; the difference between the two returns is the equity's risk premium. A small-cap stock that's relatively new should offer a higher risk premium than a well established, dividend-paying stock. While understanding risk premium doesn't necessarily minimize risk, it can help you evaluate whether the return you're getting is worth the risk you're taking.

Whatever your approach to portfolio risk, understanding the nature and level of the risks you face can be critical in sticking to a long-term investing strategy.



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How Much Life Insurance Is Enough?

Your life insurance needs often depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, your career stage, and your goals.

There are a number of approaches you can use to figure out how much insurance you should have. One method, called the "family needs approach," focuses on the amount of life insurance it would take to allow your family to meet its various financial obligations and expenses in the event of your death.

Family needs approach

With the family needs approach, you divide your family's financial needs into three main categories:

- Immediate needs at death, such as cash needed for estate taxes and settlement costs, credit card and other debts including mortgages (unless you choose to include mortgage payments as part of ongoing family needs), an emergency fund for unexpected costs, and college education expenses.
- Ongoing income needs for expenses related to food, clothing, shelter, and transportation, among other things. These income needs will vary in amount and duration, depending on a number of factors, such as your spouse's age, your children's ages, your surviving spouse's capacity to earn income, your debt (including mortgages), and whether you'll provide funds for your surviving spouse's retirement.
- Special funding needs, such as college funding, charitable bequests, funding a buy/sell agreement, or business succession planning.

Once you determine the total amount of your family's financial needs, you subtract from this total the available assets that your family could use to defray some or all of their expenses. The difference, if any, represents an amount that life insurance proceeds, and the income from future investment of those proceeds, can cover.

Example: John and his wife, Wendy, are estimating the appropriate amount of life insurance to buy on John's life. They first estimate their immediate needs as follows:

- Final medical expenses: \$5,000
- Estate settlement costs including funeral and burial expenses: \$37,500

- Debts, including credit cards and mortgages: \$317,000

- Emergency fund: \$100,000

Subtotal: \$459,500

Next, they estimate ongoing income needs, such as:

- Providing for their dependent children's needs for a period of time: \$500,000

- Wendy's income needs until her retirement: \$450,000

- Wendy's retirement income needs: \$380,000

Subtotal: \$1,330,000

Adding the sub totals together, John and Wendy estimate that, should John die, their family would need \$1,789,500. They then determine that assets available to offset their needs include:

- Bank savings: \$40,000

- Investments: \$220,000

- Retirement assets: \$250,000

- Existing life insurance on John's life: \$300,000

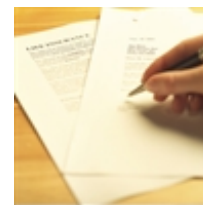
Subtotal: \$810,000

The difference between their family needs (\$1,789,500) and their available assets (\$810,000) equals their life insurance need (\$979,500).

Review your coverage

Trying to figure out how much life insurance is enough isn't always easy, and that amount will likely change with your changing circumstances. By examining your family's anticipated expenses during various periods after your death, you get a more realistic estimate of your life insurance needs.

Unfortunately, many people underestimate their insurance needs and are underinsured. Often, the purchase of life insurance is based on cost instead of what's needed. By the same token, it's possible to have more insurance than you need. You may have purchased a large policy during a particular point in your life, and then didn't adjust your coverage when your insurance need was reduced. Both of these circumstances are reasons to review your insurance coverage periodically with your financial professional. Doing so can reveal opportunities to change your levels of coverage to match your current and projected life insurance needs.

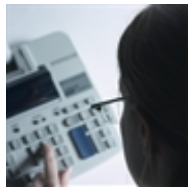


An insurance coverage review is a periodic reassessment of your insurance needs. The main objectives are to confirm that the level of insurance coverage you have is still adequate, to alert you to shortages in coverage that can occur due to changes in your life, and to ensure that any cash value policies are performing as expected.



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Ask the Experts



I started a business that lost money this year. Do I have a net operating loss (NOL)?

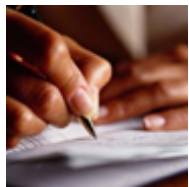
If you're a sole proprietor and your business expenses exceed your business income, you have a reportable loss for income tax purposes. You're generally able to apply this loss against any wage income or other business income that you have (wages are considered business income) and any nonbusiness income (e.g., interest) that remains after taking your allowable nonbusiness deductions. If you still have a business loss remaining after offsetting all your income, you have a "net operating loss" for the year. The net operating loss (NOL) calculation is very complicated, though. For example, certain items, like personal exemption deductions and other nonbusiness deductions, aren't allowed in calculating an NOL.

The general rule is that you get to carry back an NOL for 2 years. This means that you can apply the NOL as a credit against income that was earned in--and reported on the tax returns

for--the 2 years preceding the year in which you have the net operating loss. Any remaining loss is carried forward for up to 20 years after the year in which you have the NOL. You can, however, choose not to carry back the NOL to the prior 2 years and simply carry forward the entire NOL.

While NOLs are generally allowed to be carried back 2 years, special rules apply to NOLs incurred in 2008 and 2009 that allow NOLs to be carried back for up to 5 years. There are also exceptions to the general 2-year carryback rule, and alternative minimum tax (AMT) implications. Even in the most straightforward cases, NOLs are complicated.

If you have an NOL, you'll want to read IRS Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*, and the instructions for IRS Form 1045, *Application for Tentative Refund*. You should also consider discussing your situation with a tax professional.



What is the "SEPP" exception to the premature distribution tax?

Taxable distributions you receive from an IRA or 401(k) plan before age 59½ are subject to a 10% early withdrawal penalty unless an exception applies. One important, but sometimes overlooked, exception is for SEPPs--substantially equal periodic payments.

SEPPs are amounts you withdraw from your IRA or employer plan over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually.

You can take advantage of the SEPP exception at any age. But payments from an employer plan must begin *after* you separate from service.

Even though SEPPs are initially determined based on lifetime payments, you can change--or even stop--the payments after five years, or after you reach age 59½, whichever is

later. For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce (or stop the payments altogether) once you reach age 59½.

But be careful--if you "modify" the payments before the required waiting period ends, the IRS will apply the 10% penalty tax (plus interest) to all taxable payments you received before age 59½ (unless the modification was due to death or disability).

If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

SEPPs can be complicated--especially the modification rules. But taking the time to understand this important financial planning tool can be well worth the effort.

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