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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Thank you for reading our last newsletter of the 2012 year! Forget about the fiscal cliff and have a very happy New Year! If you have any questions, please let me know - thank you!

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In This Issue

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Saving for College: Understanding 529 Plans

Expecting a bundle of joy and wondering if you will be able to afford sending him or her off to college? Fortunately, you have a number of tax-advantaged federal and state college savings vehicles at your disposal, including the 529 plan, which comes in two varieties: the prepaid tuition plan and the savings plan.

The Prepaid 529 Plan

A prepaid plan allows you to pay now at today's rates for school tomorrow. In return, your account is guaranteed to pay for the tuition and fees at the state's public universities and colleges by the time your child graduates from high school. Note that prepaid plans often do not cover the costs for room and board. Your child also may use the prepaid account to attend a private or out-of-state school, but you might risk forfeiting some of its value depending on how the plan values its contracts. Note, too, that most prepaid plans require that you or your child be a resident of the state in which the plan is offered.

The 529 Savings Plan

The 529 college savings plan is far more flexible than the prepaid tuition schemes. The money accumulated may be used at any school you choose and for all qualified higher education expenses, including room and board.

Each state determines what the lifetime contribution limit or account balance cap will be in its 529 plan, but typically such limits range between $100,000 and $270,000. Investment minimums are low (most plans let you sock away as little as $25 a month as long as a minimum of $500 is accumulated within two years of the initial purchase date), and there is no restriction on how much you may contribute every year unless the account is nearing the lifetime cap.

However, since 529 contributions are treated as gifts subject to gift-tax limitations, if you want to make a tax-free contribution, it shouldn't exceed $13,000 annually ($26,000 if you're contributing with your spouse). There's one exception, however: You may contribute as much as $65,000 tax free in one year ($130,000 with your spouse), but that contribution will be treated as if it were being made in $13,000 installments over the next five years. That means you can't make other tax-free gifts to the beneficiary during that time.

Most 529 savings plans offer a menu of age-based portfolios, and some also offer a small selection of stock and bond funds. In the former case, your annual contributions get invested in a pre-selected portfolio of stocks and bonds. Early on, the portfolio is tilted toward stocks, and as the time for college nears, the weighting shifts toward bonds. You can switch investments up to twice a year.

The quality of 529 college savings plans varies by state, but in most instances you may open an account in any state you'd like. All 529 plans offer generous tax breaks, provided you use the money for qualified expenses. While your contribution is not deductible on your federal taxes, your investment will grow tax-deferred and withdrawals will not be subject to federal tax.

You should always compare the 529 plan of your choice with any 529 college savings plan offered by your home state or your beneficiary's home state and consider, before investing, any state tax or other benefits that are only available for investments in the home state's plan. You should always read the Plan Disclosure Document which includes investment objectives, risks, fees, charges and expenses, and other information. You should read the Plan Disclosure Document carefully before investing.

Investment Risks

Investing in college savings plans comes with some risk. Unlike prepaid tuition plans, they don't lock in tuition prices. Nor does the state back or guarantee the investments. There also is the risk with most college savings plan investment options that you may lose money or your investment may not grow enough to pay for college.

Stay or Roll Over? What to Do With Your Old Retirement Accounts

Having your retirement portfolio in one place can make it easier to track performance, ensure proper asset allocation, and make changes.

How many retirement accounts do you have? If you've changed jobs a few times over the years, you could have several accounts housed in different employers' plans.

While it is certainly acceptable to leave money in an old plan, in some instances it may be a better idea to consolidate your assets. (If your account value is less than $5,000, your old employer can cash you out of the plan, making it imperative to have a backup destination for those assets.) Having your retirement portfolio in one place can make it easier to track performance, ensure proper asset allocation, and make changes.[1]

Initiating a rollover isn't difficult. If you are planning to roll over your assets into an IRA, you simply need to contact the financial institution that will house your account. They will either have you fill out a form or have a representative help you through the process.

If you are planning to roll over your assets into your current employer's plan:

- First check your current plan rules to confirm that rollovers are permissible (the vast majority of workplace retirement plans accommodate rollovers).
- Check with your new plan's administrator to see if they offer a rollover service. If not, contact the administrator of your old plan(s) (you can find this information on your statements) to start the process.

Comparison Shop

Before you initiate a rollover, be sure to compare the investment options of your old and new plans -- and/or any IRA option you are considering -- and their associated fees.

- **Diversification:** Were you able to properly diversify your assets in your old plan? If your investment choices were limited, you may want to move your money.
- **Fees:** Are the investment fees in your old plan higher or lower than in your new plan? If you were paying more for the investments in your old plan, it could help save you money to move your assets.

Distributions: A Last Resort

Be sure to understand the difference between a rollover and a distribution. A rollover allows you to transfer your money from one qualified retirement account to another without incurring any tax consequences. A "qualified" account can be either your new employer's plan or a rollover IRA.

A distribution is essentially a withdrawal from your account. If you request a distribution, the account adminstrator is required by law to withhold 20% of your account balance to pay federal taxes. State taxes, if applicable, are also due. If you are under age 59½, you could be subject to an additional 10% federal early withdrawal penalty. You can roll over assets from a distribution within 60 days of receipt and reclaim those tax withholdings. If you wait longer than 60 days, a rollover is not permissible.

[1] *Asset allocation and diversification do not ensure a profit or protect against a loss in a declining market.*

Simple Strategies for Savings

Be sure to set up an automatic contribution from your paycheck or checking account into the savings vehicle you choose.

One of the few positive aspects of the recent recession has been getting Americans to refocus on saving. With so many taking hits due to job losses, investment losses, and home losses, putting together a strategy for savings has become important. But we've still got a long way to go. In a recent survey, 71% of respondents said they were saving too little.[1]

So how can you save more? The steps below should help you put a plan in motion.

Step One: Set a Goal

How much should you save? It depends on a number of factors, including:

- How much debt you have.
- Your job security.
- Whether you have a spouse and children.
- How much you're currently saving for retirement and your children's education.

Before the recession, many experts recommended keeping three to six months of living expenses in reserve in case of emergencies. Now, many have changed that recommendation to six to twelve months. It may also make sense to keep a second fund for future purchases, such as a new car or the down payment on a home.

Step Two: Set a Savings Strategy

First, examine your monthly living expenses. Factor in mortgage or rent, utilities, food, clothing, insurance, and entertainment. Also include credit card and other loan payments as well as other regular savings goals, such as retirement and college. If you don't have any income left over to set aside, consider areas where you could reduce your spending.

Be sure to set up an automatic contribution from your paycheck or checking account into the savings vehicle you choose. Keeping the money separate will reduce the chances of you tapping into the funds.

Step Three: Set an Investment Strategy

Emergency money should be deposited where you can readily access it, such as a bank or credit union savings account or a money market account.[2] Try to avoid CDs as they can charge penalties for early withdrawals.[3] To find the best interest rate, look at various institutions and consider online banks. For your "major purchases" account, you can have a bit more flexibility. Consider CDs, short-term Treasury bills, and bond mutual funds.[4]

[1]*Source: Absolute Strategy Research, "Survey of U.S. Household Finances," September 2012.*

[2]*An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.*

[3]*CDs are FDIC insured and offer a fixed rate of return if held to maturity.*

[4]*Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Investing in mutual funds involves risk, including loss of principal.*