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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Hello everyone! This will be the last newsletter for the year! We will send out an end-of-year email with some good suggestions. Everyone enjoy the newsletter and the holidays - thanks!

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In This Issue

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Common Investment Mistakes -- And How to Avoid Them

Investing is too often driven by emotion. Even the most seasoned investors can make bad decisions based on "gut instincts" or something they heard around the water cooler. Here are some of the more common investment mistakes and how you can avoid them.

- **Go with the herd.** If everyone else is buying it, it must be good, right? Wrong. Investors tend to do what everyone else is doing. Generally speaking, they can be overly optimistic when the market goes up and overly pessimistic when the market goes down. For instance, in 2008, the largest monthly outflow of U.S. domestic equity funds occurred *after* the market had fallen over 25% from its peak. And in 2011, the only time net inflows were recorded was *before* the market slid over 10%.[1] Don't do what everyone else is doing. Instead spend more time creating -- and sticking to -- your investment plan.

- **Buy on tips from friends or pundits.** Who needs professional advice when your new co-worker can give you some great tips? With all the experts out there crowding the airwaves with their recommendations, why not take their advice? No one has ever been 100% correct about forecasting the market. Do your own research and make decisions based on your own factors, including time horizon and risk tolerance.

- **Invest all of your money on one high-flying stock.** Sure, if you had invested all your money in Google 10 years ago, you might be a millionaire today. But what if, instead, you poured all of your assets in Enron, Conseco, WorldCom, Washington Mutual, or Lehman Brothers? All were high flyers at one point, yet all have since filed for bankruptcy, making them perfect candidates for the downwardly mobile investor. Diversify your investments.[2]

- **Hold on to your losers.** Suppose you bought a stock five years ago, and since then, it has lost 70% of its value. What do you do? Hang on to it hoping that someday it will at least break even? What if it is a dog? Admitting you made a bad decision can be tough to swallow. But if the signs point to your investment being a loser, sell and be done with it.

- **Sell when the market is down, and buy when the market is up.** The temptation to sell is always highest when the market drops the furthest. And it's what many inexperienced investors tend to do, locking in losses and precluding future recoveries. The reverse is true when the market rises. Responding to the market's ups and downs is a surefire way to lock in losses. Stay steady and keep your long-term goals in mind.

- **Stay on the sidelines until the markets "calm down."** Since markets almost never calm down, this is the perfect rationale to never get in. In today's world, that means settling for a miniscule "safe" return that may not even keep pace with inflation. Investing involves risk. Set a course that allows you to potentially grow your assets while assuming a comfortable amount of risk.

[1]*Sources: ICI; Standard & Poor's. The stock market is represented by the S&P 500, an unmanaged index considered representative of large-cap U.S. stocks. These hypothetical examples are for illustrative purposes only and are not intended as investment advice.*

[2]*Diversification does not ensure a profit or protect against a loss.*

Rollover Options: Into Your New Plan or Into an IRA

Have you switched jobs recently and are wondering how to handle the rollover of your old account? Which move is better for you: into your new employer's account, or into a rollover IRA? Here are some key factors to help you decide.

Potential Benefits of Rolling Over to Your New Employer's Plan

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Putting all your retirement savings into one 401(k) or 403(b) plan has its advantages.

- Rolling over your assets into your new employer's plan will make it easier for you to track the performance of your assets. You don't have to worry about coordinating your asset allocation and diversification among multiple accounts.
- Your new plan may offer more attractive investment options, as well as additional services, such as financial-planning advice.

Potential Downsides

There are a number of disadvantages to rolling over into your new employer's plan, including:

- Not all plans accept rollovers, so workers must contact the new plan's administrator to determine if a rollover into the new 401(k) plan will be possible.
- Many plans have waiting periods before processing a new employee's rollover, which vary by plan and can last weeks or months.
- Some plans may require a lengthy verification process for rollover funds to ensure they are tax-qualified.
- Beneficiary distributions from employer-sponsored plans are generally taken in lump sums as cash payments.

Potential Benefits of Rollover IRAs

Moving your account to a rollover IRA offers the following benefits:

- As the IRA account owner, you make the key decisions that affect management and administrative costs, overall level of service, investment direction, and asset allocation. You can develop the precise mixture of investments that best reflects your own personal risk tolerance, investment philosophy, and financial goals.
- IRAs can be more useful in estate planning than employer-sponsored plans as the assets can generally be divided among multiple beneficiaries in an estate plan. Each of those beneficiaries can make use of planning structures such as the Stretch IRA concept to maintain tax-advantaged investment management during their lifetimes.

Potential Downsides

While there are many advantages to consolidated IRA rollovers, there are some potential drawbacks to keep in mind.

- Assets greater than $1 million in an IRA may be taken to satisfy your debts in certain personal bankruptcy scenarios.
- Assets in an employer-sponsored plan cannot be readily taken in many circumstances.
- You must begin taking distributions from an IRA by April 1 of the year after you reach 70½ whether or not you continue working, but employer-sponsored plans do not require distributions if you continue working past that age.

Efficient Rollovers Require Careful Planning

One common goal of planning for a lump-sum distribution is averting unnecessary tax withholding. Under federal tax rules, any lump-sum distribution that is not transferred directly from one retirement account to another is subject to a special withholding of 20%. This withholding will apply as long as the employer's check is made out to you -- even if you plan to place equivalent cash in a rollover account immediately.

Keep in mind, too, that the 20% withholding is not your ultimate tax liability. If you spend the lump-sum distribution rather than reinvest it in another tax-qualified retirement account, you'll have to declare the full value of the lump sum as income and pay the full tax at filing time. In addition, the IRS generally imposes a 10% penalty tax on withdrawals taken before age 59½.

Remember, the laws governing retirement assets and taxation are complex. In addition, there are many exceptions and limitations that may apply to your situation. Therefore, you should obtain qualified professional advice before taking any action.

Year-End Planning to Help You Lower Your Tax Bill

Consider taking losses before gains, since unused losses may be carried forward for use in future years, while gains must be taken in the year they are realized.

As the end of the year draws near, the last thing anyone wants to think about is taxes. But if you are looking for ways to minimize your tax bill, there's no better time for tax planning than before year-end. That's because there are a number of tax-smart strategies you can implement now that will reduce your tax bill come April 15. And, with the higher rates put in place with the passage of the American Taxpayer Relief Act of 2012, being tax efficient is more important than ever.

Put Losses to Work

If you expect to realize either short- or long-term capital gains, the IRS allows you to offset these gains with capital losses. Short-term gains (gains on assets held less than a year) are taxed at ordinary rates, which range from 10% to 39.6%, and can be offset with short-term losses. Long-term gains (gains on assets held longer than a year) are taxed at a top rate of 20% and can be reduced by long-term capital losses.[1] To the extent that losses exceed gains, you can deduct up to $3,000 in capital losses against ordinary income on that year's tax return and carry forward any unused losses for future years.

Given these rules, there are several actions you should consider:

- Avoid short-term gains when possible, as these are taxed at higher ordinary rates. Unless you have short-term losses to offset them, try holding the assets for at least one year.
- Take a good look at your portfolio before year-end and estimate your gains and losses. Some investments, such as mutual funds, incur trading gains or losses that must be reported on your tax return and are difficult to predict. But most capital gains and losses will be triggered by the sale of the asset, which you usually control. Are there some winners that have enjoyed a run and are ripe for selling? Are there losers you would be better off liquidating? The important point is to cover as much of the gains with losses as you can, thereby minimizing your capital gains tax.
- Consider taking losses before gains, since unused losses may be carried forward for use in future years, while gains must be taken in the year they are realized.

Unearned Income Tax

A new 3.8% tax on "unearned" income went into effect in 2013, effectively increasing the top rate on most long-term capital gains to 23.8%. The tax applies to "net investment income," which includes interest, dividends, royalties, annuities, rents, and other passive activity income, among other items. Importantly, net investment income does not include distributions from IRAs or qualified retirement plans, annuity payouts, or income from tax-exempt municipal bonds. In general, the new tax applies to single taxpayers with a modified adjusted gross income (MAGI) of $200,000 or more and to those who are married and filing jointly with a MAGI of $250,000 or more.

What's to Come?

While there are currently no major changes in federal tax rules planned for 2014 that have been approved by Congress, there are many steps you can take today to help lighten your tax burden. Work with a financial professional and tax advisor to see what you can do now to reduce your tax bill in April.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

[1] *Under certain circumstances, the IRS permits you to offset long-term gains with net short-term capital losses. See IRS Publication 550, Investment Income and Expenses.*