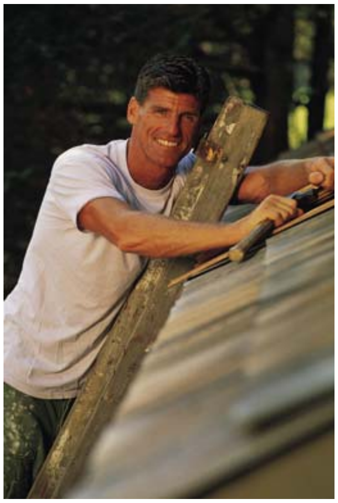
THE PROSPERITY CONSULTING GROUP, LLC
A WEALTH MANAGEMENT COMPANY

Winter 2013
www.prosperityconsult.com

THE WEALTH ADVISOR

Five Ways To Plan Smarter And For The Long Haul

Maybe you're in the homestretch before retirement or perhaps you've already stopped working. If you've been diligent in setting aside funds to sustain you through your golden years, congratulations are in order, but you can't rest on your laurels. As life expectancies continue to increase, it's more important than ever to address concerns that you might outlast your money. As the rebound in the economy and stocks has demonstrated, you need to take steps to plan for the long haul and stick with that plan through downturns. Although there are no guarantees when it comes to investing, consider these five suggestions for planning for the long term:



1. Be able to ride out stock market downturns. Even if investing in equities helped get you where you are today, you may decide that the inherent volatility of the stock market means you should get out of it altogether during retirement. That might not be the best approach.

Instead, try to stay on a path for sustained growth that factors in your personal tolerance for risk. For instance, a conservative investor embarking on retirement might allocate 30% of a portfolio to equities and 70% to fixed-income investments. A more aggressive investor likely would choose a higher percentage—perhaps 40% or 50%—to keep in stocks. But the important thing is to find a balance between risk and reward that helps you meet your goals and that won't send you fleeing from stocks when they decline sharply.

2. Try to live off the income your investments generate. The longer you can go without tapping the principal of your savings, the better. But that doesn't mean that interest and dividends alone always can carry the day. Assume you have a $1-million portfolio that produces 3% in annual income ($30,000), plus you and your spouse receive Social Security benefits of $2,000 a month each. That gives the two of you a total of $78,000 annually before taxes, and that may not be enough to support the lifestyle you have in mind.

Depending on your situation, you could arrange to do some consulting work in retirement, wait until age 70 to begin drawing Social Security—a delay that will earn you a higher monthly benefit—or seek higher investment returns. In any event, look for ways to avoid drawing down your savings too quickly.

3. Weigh the 4% solution. That's a rule of thumb for the percentage of a nest egg you might withdraw annually to take income to fund a 30-year

(Continued on page 4)

New Year's Financial Resolutions

The New Year is a great time to reflect and make financial resolutions that you'd like to achieve. Here are some pledges you might want to consider making this year:

1. Pay down debt – Try to pay more than the minimum each month. Whether you have credit card debt, school loans, or a mortgage, paying just a little more each month can reduce your overall debt dramatically.

2. Increase your 401(k) contributions – Are you maximizing your 401k? Have you received pay raises but neglected to increase your 401(k) contribution? It may surprise you how significant your savings accumulation could be simply by increasing the amount that you put each month into your retirement plan.

3. Prepare a budget – Look at spending patterns and see where you can cut down expenses. There are many apps and online programs that will automate the tracking method for you to simplify the process.

4. Fund education – Do you have kids or grandkids who will be attending college one day? With education expenses increasing, funding a college program is a great way to help save for future college costs.

We're happy to help in any of these areas, whatever your financial goals may be!

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Director of Financial Services

How To Avoid Bad Surprises In Roth IRAs

If you've been tempted to contribute to a Roth IRA, or to convert some or all of the funds in your traditional IRAs into a Roth, it's likely you've been influenced by the lure of future tax-free payouts. However, be aware this tax-favored treatment isn't automatic, by any means. What's more, if you're below a certain age limit, you may be slapped with a tax penalty on top of the regular income tax you'll owe.

At the same time, though, even if the Roth IRA distributions are subject to tax, the impact may be negligible or nonexistent under special IRS "ordering rules." That means that even "taxable" Roth distributions may be effectively tax-free.

Here are the basic rules for Roth IRAs. You don't get any tax break now for contributing to a Roth. But "qualified" distributions from a Roth IRA that has been established for at least five years are 100% exempt from federal income tax. For this purpose, qualified distributions include those made:

- After you reach age 59 ½;
- Because of death or disability; or
- To pay for qualified home buyer expenses (up to a lifetime limit of $10,000).

The rule that often trips people up is the one requiring the Roth IRA to be in existence for at least five years. To compound matters, if you withdraw funds before five years have elapsed and you're under the magic age of 59 ½, you'll have to pay a 10% penalty on the distribution amount.

But here's the silver lining: Under IRS rules, the money you take from a Roth IRA is treated as being distributed in the following order:

1. Roth IRA contributions. That money went in without any tax advantage to you, and you can take it out, for whatever reason, without any penalty or taxes.

2. Contributions made when you converted a traditional IRA into Roth status. These may be withdrawn tax-free even if they are part of a nonqualified distribution, but the 10% penalty tax generally applies to withdrawals within five years, unless you're age 59 ½ or older.

3. Contributions made when you converted nontaxable traditional IRA balances into Roth IRA status. Such contributions also may be withdrawn on a tax-free basis subject to the 10% penalty.

4. Earnings within the Roth IRA. These amounts are taxable when withdrawn unless they meet the definition of qualified distributions. In addition, the 10% penalty tax applies to withdrawals made before age 59 ½.

As you can see, federal income tax on a distribution doesn't kick in until you've gone through the first three categories. For many people with a sizable amount in a Roth, distributions won't be taxable at all, even if funds are withdrawn within five years of setting up the account. ●

Perspective On Stock Market Trends

Just past the middle of 2013, the Dow Jones Industrial Average (DJIA) hit an all-time high of 15,549 points. As noted by Robert Klein, president of the Retirement Income Center, in an article posted on MarketWatch.com, that represented an increase of 9,002 points, or 137.5%, since the DJIA closed at 6,547 on March 9, 2009, after a 17-month decline. The upswing equates to an average annual increase of 31.25% over nearly four-and-a-half years (Source: http://www.marketwatch.com/story/stock-market-gains-arent-what-they-seem-2013-07-22).

But Klein sounded a warning to those jumping on the stock market bandwagon. Before the DJIA began its historic descent, it had closed at a high of 14,165 on October 9, 2007. So the recent 15,549 closing price was only 1,384 points, or 9.8%, above that mark. In the nearly six years it took to reach the mid-2013 milestone, the average annual return was 1.7%.

In other words, your viewpoint on recent stock market trends depends, to a great extent, on your point of reference. If you go back to October 9, 2007, an average annual return of 1.7% seems to leave plenty of room for additional growth in the market, especially if economic indicators are generally positive. On the other hand, suppose you're using March 9, 2009, as your focal point. With an average annual return of 31.25% in the rearview mirror, it may seem conditions are ripe for a significant pullback—and you may wonder just how severe the next downturn will be.

That leaves some investors in a quandary. If you're planning to retire, say, within the next five years, and you're counting on having your stock holdings gain an average increase of 4% a year over the long haul, Klein notes that a major hit to your portfolio just before you retire could be a huge problem. It might force you to delay

Building On Four Tax Pillars Of Real Estate

Commercial real estate can be a productive investment. If rental income flows in, it will provide a steady return on the capital you've invested, and if prices rise, you may be able to sell your interest at a profit. Of course, it doesn't always work out that way. But there also are potential tax advantages that can make such investments very appealing.

There are four key tax advantages relating to rental real estate that you may be able to tap, although a few obstacles could stand in the way.

1. Annual deductions. When you acquire real estate, you likely will have to take a loan and pay interest on it, and you'll also owe property taxes to the local authorities. Both of those expenses are tax-deductible and can help offset the taxable rental income you receive. Moreover, you can recover the cost of investment property through depreciation deductions. IRS rules specify a cost recovery period of 27.5 years for residential property and 39 years for commercial property. Depreciation is one of the biggest tax advantages on the books and can go a long way toward making an investment in real estate worthwhile.

2. Capital gains on property sales. If you sell a property at a profit, you may be able to pay tax on the gain at the 15% rate that applies to most long-term capital gains (for holdings you've owned for more than a year). If you are a single filer with taxable income of more than $400,000 ($406,750 in 2014) or a joint filer with more than $450,000 ($457,600 in 2014), the long-term rate is now 20%—still much better than ordinary income tax rates that now reach as high as 39.6%. In recent years, of course, selling property at a profit often has been problematic, though values now are rising in many parts of the country and investments in real estate have tended to provide favorable returns over extended periods of time.

3. Section 1031 exchanges. One way to avoid a taxable gain on the sale of commercial or investment real estate is to "swap" property with another investor. Under Section 1031 of the tax code, "like-kind" exchanges can be tax-free if certain requirements are met, and the tax law definition of like-kind is quite liberal. For instance, you might be able to swap an apartment building for raw land. Also, to facilitate Section 1031 exchanges involving multiple properties, you're allowed to utilize a qualified intermediary. Such exchanges allow the indefinite deferral of the taxable gain you would have realized on the sale of appreciated property.

4. Step-up in basis at death. If you never sell your real estate property, your heirs will benefit from a "step-up" in the property's cost basis for income tax purposes. The basis of inherited property is adjusted to its value on the date of the death of the person it's coming from. That lets you and your heirs completely avoid tax on the appreciation of the property during your lifetime. There also may be no tax on the transfer of the property. If it goes to your spouse, he or she will be able to take advantage of an unlimited marital deduction, while other heirs may be protected by a $5.34 million exemption (in 2014) for transfers to non-spouse beneficiaries.

There are, however, some restrictions on the tax breaks for real estate owners. Among the most significant is a series of rules relating to "passive activities," such as the ownership of rental real estate by most investors. Those rules could limit the annual loss you can claim for such property. You'll generally be able to deduct no more than the amount of your income from that passive activity for the year.

Still, you might be able to claim a partial tax loss (beyond the amount of your income from the property) if you "materially participate" in rental real estate activity—for example, by managing tenants, arranging repairs, and other such activities. If you qualify, you will be entitled to deduct a loss of up to $25,000. But that benefit begins to phase out when your adjusted gross income exceeds $100,000, and it ends at $150,000.

You also might be able to deduct losses on a property in full if you qualify as a "real estate professional," although those requirements are more stringent than the test for material participation. Generally, you'll be eligible only if more than half of your personal services for the year are devoted to real estate trades or activities and you spend at least 750 hours annually on those trades or businesses. In other words, real estate normally has to be your principal occupation. ●

retirement by several years, as happened to many people who were set to retire in 2009, or result in a downgrade in your retirement lifestyle, or both.

Still, even if you're in that situation, Klein doesn't recommend pulling completely out of the stock market. If you're approaching retirement now, assuming you're in decent health, there's a good chance you'll live 15 to 25-plus years after you retire. Given current rising interest rates and the potential for increased inflation in the future, keeping a healthy dose of diversified equity holdings in your portfolio appears prudent.

No one has a crystal ball to predict what will happen in the stock market later this year and beyond. For the majority of investors nearing retirement, Klein advocates a balanced conservative approach. Whether you use the March 9, 2009, DJIA closing price of 6,547 or the October 9, 2007, closing price of 14,165 as your point of reference, this may the best path to follow. ●

Avoid Squabbling Over Your Estate

Don't assume that you're immune from the sort of dire consequences that can tear apart a family after you're gone. What often starts as a minor beef over a few prized possessions can turn into a full-fledged war. Things can get even worse if distant relatives show up out of the blue, staking their claim. But you might be able to avoid future family squabbles by addressing these issues now. Start by listing your assets and deciding who will get what and when.

Here are several areas that may require some extra attention:

Business ownership. This can be complex if you run a company and have to decide who will be named as your successor. Figure out the best person (or persons) to take the helm. If that arrangement disproportionately benefits one or more heirs, you might designate other assets to go to the others to keep things fair. One possibility is to use a buy-sell agreement facilitating the sale of business interests. Note that it may be crucial to start by establishing the value of any business you own.

Vacation homes. Transferring rights to a principal residence is often straightforward, but what about that cabin in the woods or your seaside cottage? If you have several children, splitting ownership may be a problem if one child's family expects to get more use out of the place. If you can't work out an equitable solution, consider selling the vacation home and dividing the proceeds.

Second marriages. Suppose you've remarried (perhaps more than once) and you or your spouse—or both of you—have children from a prior marriage. Depending on how your will is worded, all of the children from both sides of the family may share evenly in the estate. As an alternative, you could use a trust as a vehicle for passing assets to particular beneficiaries you've chosen.

Jewelry and other valuables. When it comes to handing down your assets, don't leave any stone unturned, especially if it's a rare diamond. Catalog all valuables and family heirlooms and make sure you've accounted for the major pieces in your will.

Of course, it's your business, house, and valuables, and you can do whatever you want with them. But it probably won't hurt—and it most likely will help—to open a dialogue with other family members. You may be able to head off potential problems by clearing the air instead of letting things fester.

One of the best things you can do is spell out your wishes clearly in your will and attach a letter of instructions for clarification. In some cases, it also makes sense to film a video showing that you were of a "sound mind" at the time that you made these decisions. ●

Five Ways To Plan Smarter

(Continued from page 1)

retirement. The idea is to take 4% of your total portfolio during the first year of your retirement and then to adjust that amount in subsequent years to account for inflation.

But like any rule of thumb, this doesn't factor in unusual circumstances, like the economic conditions you may face. You might decide a lower or higher percentage would be appropriate depending on your situation.

4. Let the IRS determine your income. Once you reach age 70½, you'll have to begin taking "required minimum distributions" from 401(k)s and other employer-sponsored plans (if you're no longer working) and IRAs. The size of each year's RMD depends on your account balances and your life expectancy. Another way to determine how much income to draw from your portfolio during retirement is to use the IRS calculation for your RMDs.

Suppose that you are age 70½ and have $500,000 in an IRA. The IRS says your first distribution would be about $18,800. Will that be sufficient to supplement your other sources of income? In some cases, such an approach might work well, but it doesn't take all of your personal circumstances into account.

5. Make a "bucket list." Another possible way to hedge your bets against market downturns and make your savings last is to divide your money into various "buckets." One bucket might be earmarked to supplement Social Security and other reliable income in covering your basic expenses, with the funds kept in conservative, liquid accounts. You could have a second bucket of money for discretionary expenses, such as travel, that you put into short- and intermediate-term bonds. The remainder could go into a third bucket, invested in a mix of stock and bond funds. As you rebalance the portfolio for the third bucket, you could use proceeds from investment sales to replenish the first two buckets.

All of these ideas are for illustrative purposes only. What you do will depend on your personal situation and goals. The important thing is to consider all of your options and come up with a plan that is realistic and based on the long haul. ●