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It has been a wild few weeks in the stock market and the question on everyone's mind right now is - what to do about it? Sell everything and run to the nearest gold dealer? Just put everything in cash?

I recommend you not make any dramatic moves. Right now, your account statements are reflecting the drop in market value. This is a 'paper loss only'. If you were to sell right now, you will be locking in a real loss.

It is important to look back at the history of our economy. A prudent long term investment strategy has had a steady march upward. It is not possible to predict the future. However a broad based, diversified portfolio will continue to serve you within the froth of volatility.

I know the headlines are scary but remember the reporter's job is to play off your fear to boost their ratings.

Please don't hesitate to write or call if you need to talk.

Julie

August 2011

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The Spousal IRA Rule

Generally, you can contribute up to $5,000 to an IRA in 2011 ($6,000 if you'll be age 50 or older by the end of the year), as long as you have taxable compensation at least equal to the amount of your IRA contribution. But what if you have little or no taxable compensation for the year? The spousal IRA rule may help. If you're married, file a joint federal income tax return, and earn less than your spouse, the amount you can contribute to an IRA is based on the combined compensation of you and your spouse.

How it works

The rule is especially helpful if one spouse has little or no compensation. For example, Mary (age 45) and Joe (age 50) are married and file a joint return for 2011. Mary earned $100,000 in 2011 and Joe, a stay-at-home dad, earned nothing for the year. Mary contributes $5,000 to her IRAs for 2011. Even though Joe has no earnings, he can still contribute up to $6,000 to his IRAs for 2011, because Joe and Mary's combined compensation is at least $11,000.

It gets just a little more complicated if your combined compensation is less than the maximum IRA contribution allowed. Assume Nicole earns $4,000 in 2011, and Jack earns $2,000, for total compensation of $6,000. If Nicole makes no contribution at all to her IRAs in 2011, Jack can contribute up to $5,000 to his IRA ($6,000 if he's 50 or older). If Nicole contributes $4,000 to her IRAs for 2011, then Jack can contribute up to $2,000 to his IRA. Note that the spousal IRA rule applies only to the spouse with the lesser amount of compensation. In the previous example, the maximum amount that Nicole (the higher earning spouse) can contribute to her IRAs is $4,000, because she's not entitled to take Jack's earnings into account.

Here's the actual contribution formula, as stated by the IRS: The spouse with the lesser amount of taxable compensation can contribute the smaller of the following two amounts:

1. $5,000 ($6,000 if age 50 or older)
2. The total amount the couple includes in gross income for the year, reduced by the amount the higher earning spouse contributes to his or her own IRAs (traditional or Roth) for that year

Source of funds

The spousal IRA rule only determines how much you can contribute. It doesn't matter where the money you use to fund your IRA actually comes from. For instance, in the first example, Mary earned $100,000 and Joe earned nothing in 2011. But Joe could still contribute up to $6,000 to his IRA because of the spousal IRA rule. It doesn't matter if the money Joe actually uses to fund his IRA comes from Mary, from savings, from a gift Joe receives, or from any other particular source. The spousal IRA rule doesn't require you to track the source of your contribution.

Impact on other IRA rules

The spousal IRA rule doesn't change any of the other rules that generally apply to IRAs. You can contribute to a traditional IRA, to a Roth IRA, or both. However, you can't make regular contributions to a traditional IRA for the year you turn 70½ or thereafter. And your contributions to a traditional IRA are deductible only if neither you nor your spouse is covered by an employer retirement plan or, if either of you is covered by a plan, your combined income is within certain limits.

If you aren't eligible to make deductible contributions to a traditional IRA because you and your spouse earned too much, you can make nondeductible contributions instead. However, you may be better off contributing to a Roth IRA (if you qualify) instead of making nondeductible contributions to a traditional IRA.

Your ability to make annual contributions to a Roth IRA may also be limited, or eliminated, depending on the amount of your combined income. If you're eligible, though, you can contribute to a Roth IRA at any age--the 70½ rule doesn't apply. And it doesn't matter if you or your spouse is covered by an employer plan.

All about Indices

Before investing in a mutual fund, you should carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing. And don't forget that any investment involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.

To produce a figure that indicates the value of the aggregated securities, an index divisor is typically applied to produce a more manageable figure that is easier to quote than the index's actual value.

No doubt you've seen headlines reporting that a particular index is up or down. But do you know how an index works, and why understanding the nuts and bolts of a specific index can make a difference to your portfolio?

An index is simply a way to measure and report the fluctuations of a securities market or a particular segment of a market. An index is developed by a company that sets specific criteria to determine which securities are included in the index--factors such as a company's size or location, or the liquidity of its stock. For example, the S&P 500 is a collection of large-cap U.S.-based companies that Standard and Poor's considers to be leading representatives of a cross section of industries.

The company that develops the index tracks the performance of its components and aggregates the data to produce a single figure that represents the index as a whole. Virtually every asset class has at least one index that tracks it, but because of the size and variety of the stock market, there are more stock indexes than any other type.

How indices are used

In addition to providing valuable information needed to monitor how a particular market is faring, an index can serve as the basis for mutual funds or exchange-traded funds that attempt to replicate its performance; that process is known as indexing. An index also can be used as a benchmark for funds that invest in the same asset class, regardless of whether a fund includes the same specific securities. Finally, some investment products do not attempt to replicate an index's performance but represent a bet on the index's general movements, though such investments can be challenging and are not appropriate for every investor.

You can't invest in an index

You cannot invest directly in an index. You could always purchase each and every security in the index and do the necessary trading to ensure that the portfolio continues to mirror the index, but the financial services industry has saved you the trouble. As noted above, investment products such as index mutual funds and exchange-traded funds are used by investors to try to capture a particular market's performance.

However, an index-based investment may not match the return of an index exactly. One reason is what's known as "tracking error." Costs such as taxes, operating expenses (even minimal ones), and transaction costs can differ among mutual funds. As a result, your return may be slightly different from that of the index or even other funds based on the same index, even though most index funds try to keep tracking error to a minimum.

Indices don't stay static

Though an index adheres to a set of guidelines for selection of the securities it includes, the company that oversees the index generally reviews the security selection periodically. For example, some indices are rebalanced if an individual security grows so large that it dominates the index. Others have a limit on how much of the index can be devoted to a particular sector or industry, and rebalance if the proportion gets skewed. And in some cases, an index is altered because of serious problems with one of its components (for example, Flowserve Corp. replaced Washington Mutual Inc. in the S&P 500 after WaMu was closed by the Office of Thrift Supervision in 2008).

Weight watching

Even indices that include the same securities may not operate in precisely the same way. Why? Because different indices may weight the relative importance of the same securities in different ways. The way an index is weighted determines how much of each individual security is included in it--for example, how many shares of stock. That weighting in turn can affect the overall index's performance.

Some indices are weighted based on market capitalization; the companies with the highest market cap (total value of stock outstanding) make up a larger share of the index than companies with a smaller market cap. As a result, those companies can have a disproportionate impact on the performance of an index weighted by market cap. For example, a 10% decline in the price of the largest company in the S&P 500 index would affect the index's overall return more dramatically than a 10% drop in the price of a much smaller company, because the S&P 500 is weighted by market cap.

Other indices are weighted by price; the most expensive stocks receive greater weight than lower-priced stocks. The Dow Jones Industrial Average, which includes 30 large, blue-chip industrial stocks and is commonly referred to as the Dow even though there are several Dow indices, is price-weighted. A relatively new approach to weighting an index is to use certain fundamental attributes, such as dividends or cash flow, as the basis for weighting the stocks that comprise the index.

Health Flexible Spending Accounts

An employer-offered health flexible spending account (FSA) can provide you with a tax-favored way to pay for your qualified medical expenses.

An employer-offered health flexible spending account (FSA) can provide you with a tax-favored way to pay for your qualified medical expenses. You can make contributions to the health FSA that reduce your federal taxable wages, and the health FSA can reimburse you tax free for qualified medical expenses.

Health FSA basics

At the beginning of each plan year, you elect the amount (if any) of your wages that will be contributed to a health FSA during the year. The plan must specify a maximum dollar amount or maximum percentage of compensation that can be contributed to your health FSA. You might base your election on prior experience, as well as expectations for the upcoming year. Your employer will then withhold a proportionate part of those contributions from each paycheck. The salary reduction contributions reduce your federal taxable wages. (In some plans, your employer may also make nontaxable contributions on your behalf to the plan.)

When you incur qualified medical expenses during the year, you (or the service provider) submit those expenses to the health FSA. The expenses cannot be paid for or reimbursed under any other plan. Certain written documentation may be required. The health FSA reimburses you (or the service provider) for those expenses, up to the amount that you elected to contribute to the health FSA for the year. You receive the reimbursements tax free. You cannot claim an income tax itemized deduction for medical expenses that are reimbursed to you by the health FSA.

Special rules may apply to highly compensated participants and key employees.

Use-it-or-lose-it rule

Health FSAs are "use-it-or-lose-it" plans. Amounts in the account that remain at the end of the plan year cannot be carried over to the next year; they are paid to the employer and cannot be refunded to you. However, the health FSA can provide a grace period of up to 2½ months after the end of the plan year. For a plan using a calendar year, a grace period until March 15 of the following year might be used. Expenses incurred during the grace period can be paid from amounts remaining in the health FSA at the end of the previous plan year. Know when your plan year ends and whether you have a grace period. If you have money left in your health FSA at the end of your plan year and you have a grace period, look for ways to use up the money during the grace period (for example, by purchasing glasses or contacts, stocking up on prescription drugs, or having dental work done--whatever can be reimbursed by your health FSA).

One-time HSA distributions

If you were covered by a health FSA on September 21, 2006, you may have until the end of 2011 to take a onetime distribution from your health FSA that is transferred directly to your health savings account (HSA) as a qualified HSA distribution. A qualified HSA distribution is treated as a nontaxable rollover from the FSA to the HSA. Various conditions must be met to make a qualified HSA distribution. Consult a financial professional familiar with FSAs and HSAs.

Recent changes

- *Coverage expanded for children under age 27.* A health FSA can generally reimburse you for qualified medical expenses incurred by you, your spouse, and your dependents. Effective March 30, 2010, qualified medical expenses that can be reimbursed by a health FSA were expanded to include expenses incurred by any child of yours who is under age 27 at the end of your tax year. Prior to March 30, 2010, reimbursement by a health FSA for expenses of a child was generally limited to a child under age 19 (or under age 24 for a full-time student). Such expanded coverage is available only if your employer amends the plan documents to provide it to you.
- *Prescriptions needed for over-the-counter medicine reimbursement.* As of 2011, you will generally need a prescription if you wish to be reimbursed by a health FSA for the cost of over-the-counter medicines. From about 2003 through 2010, a health FSA could reimburse you for over-the-counter medicines without the need for a prescription. The change makes the health FSA definition of medicine or drugs the same as the definition you would use if you were itemizing the deduction for medical expenses for federal income tax purposes: a prescribed drug or insulin.
- *New dollar limit for health FSAs in cafeteria plans.* Starting in 2013, there will be a new annual $2,500 limit for salary reduction contributions that you can make to a health FSA that is part of a cafeteria plan. If your employer wishes, the cafeteria plan can impose a lower dollar limit. The $2,500 amount will be indexed for inflation starting in 2014. Prior to 2013, there is no statutory limit. The new $2,500 limit does not apply to a stand-alone health FSA.

Ask the Experts

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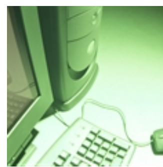
What happens to my online accounts when I die?

These days, using a personal computer is just a normal part of life. You may have e-mail or online accounts that require a password, or you may have pictures, videos, or documents stored online or on your hard drive. You may even maintain a blog or website. Like your physical assets, these "digital" or "cyber" assets can have both sentimental and economic value. Chances are, nobody else knows your cyber assets even exist, and if they do, they may not know where those assets are stored or how to access them. It's important that you make plans for the disposition of your cyber assets in the event of your incapacity or death. If you don't, your survivors may have to deal with time-consuming and costly searches, or worse, the assets may be overlooked and lost altogether.

What happens to your cyber assets at your death depends on what type of asset it is, and while the laws regarding cyber assets are not well settled, there are some broad guidelines. Domain names, once registered, become your personal property under property law, and your websites and blog content are yours under federal copyright law. These types of cyber assets are clearly defined by law and are transferable to your heirs (e.g., through your will). On the other hand, certain online accounts, such as e-mail accounts, Facebook, Twitter, eBay, or PayPal, may not be classified as property in the legal sense; you are merely given a license by the website when you agree to its terms of service. Under these terms of service, transferability of your accounts may be limited or even prohibited altogether. Terms of service vary widely from site to site. Some sites, such as YouTube, will allow persons with legal power of attorney to access your accounts, and they post instructions on how to do so. Other sites, such as Facebook, will put your accounts into a "memorial state." Many sites, however, will terminate and permanently delete your accounts upon notification of your death. You should read and understand all terms of service and make any necessary legal arrangements so your heirs will have access to your accounts.

Note: On the flip side, you may have certain private accounts to which you want to ensure that no one is given access and which will be terminated immediately upon your death.



How do I include my cyber assets in my estate plan?

Your cyber (or digital) assets may have sentimental and/or economic value, and you should consider including them in your estate plan. Here's how:

1. Identify your cyber assets. They include (a) domain names, websites, and blogs, (b) photos, videos, and documents stored on sharing sites such as Flickr, YouTube, and Google Docs, (c) e-mail accounts, (d) online bank, credit card, investment, and other such accounts that typically require a password, (e) accounts with online companies such as Facebook, Twitter, and eBay, and (f) documents, spreadsheets, photos, and other such items that are stored on your computers, hard drives, DVDs, smartphones, flash drives, and other offline or online servers or backup servers.
2. Understand which assets are transferable to other persons and which are not. Your domain names, websites, and blogs are transferable under property and copyright laws; however, your online accounts may or may not be transferable, depending on the online site's terms of service (you may merely have a license). Read all terms of service to understand what can be done with the account upon your death. You will find that many accounts will automatically terminate upon notice of your death, and other accounts, such as one on Facebook, may be put into a "memorial state."
3. Inventory your cyber assets. List all your assets indicating (a) where they are located, (b) how they are accessed, including URLs, usernames, and passwords, (c) what you wish to have happen to the asset at your death (e.g., transfer to an heir, terminate, memorialize), and (d) who will be responsible for carrying out those wishes (e.g., spouse, executor). Refer to but do not include this inventory in your will, because wills become public and this is private information. Put it in a safe place and let others know of its existence.
4. Include specific bequests of certain valuable cyber assets (domain names, websites, blogs) in your will, and execute powers of attorney for those accounts that will require it.

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