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# THE Financial Standard

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## A New Year, a New Tax Deal

**In the final days of 2010 a sweeping tax package was enacted by Congress. The bill, aimed at boosting the languid pace of economic recovery, extends a series of tax breaks put in place during the George W. Bush Administration through December 2012. It also put in place some unexpected tax incentives for workers while extending unemployment benefits for the long-term jobless for 13 months.**

Following are some of the key provisions of the bill affecting American taxpayers and investors.

**Income tax rates** — Nothing new to report here. Current individual income tax brackets will stay in place for two more years, with the highest bracket topping out at 35%. Dollar amounts have been adjusted slightly to reflect a modest uptick in inflation. (See Table below.)

**Investment income** — The rate on long-term capital gains (on investments held for 12 months or longer) and qualified dividends will remain at historic lows at least through December 31, 2012. For taxpayers in the 15% income tax bracket and below, that means a 0% tax rate. For everyone else, the rate stays at 15%.

**Payroll (FICA) tax** — One of the bill's surprise provisions aimed squarely at workers' wallets was a 2% cut in Social Security (FICA) payroll tax. There are no "phaseouts" associated with the tax break, which, depending on your income level, could add up to a maximum savings of \$2,136 per worker. (As an example, a worker earning \$50,000 annually would save \$1,000 for the year). The one big caveat to keep in mind is that the payroll tax cut is in effect for one year only. Expiration date: December 31, 2011.

**Estate and gift taxes** — Another new provision overhauls the estate tax system, which was repealed entirely in 2010. The new law reinstates the estate tax for two years at a maximum rate of 35% with a

(Continued on back)

### Federal Tax Brackets

Taxable Income				
Single		Married Filing Jointly		Marginal Rate (%)
2011	2010	2011	2010	
Up to \$8,500	Up to \$8,375	Up to \$17,000	Up to \$16,750	10%
Up to \$34,500	Up to \$34,000	Up to \$69,000	Up to \$68,000	15%
Up to \$83,600	Up to \$82,400	Up to \$139,350	Up to \$137,300	25%
Up to \$174,400	Up to \$171,850	Up to \$212,300	Up to \$209,250	28%
Up to \$379,150	Up to \$373,650	Up to \$379,150	Up to \$373,650	33%
Above \$379,150	Above \$373,650	Above \$379,150	Above \$373,650	35%

Source: The Internal Revenue Service.



## Socially Responsible Investing Update on a Growing Trend

**A decade or two ago, it was relatively easy for CEOs to marginalize “socially responsible” or “sustainable” investors as well-meaning minority stockholders whose interests were unrelated to, or even in conflict with, the company’s financial health and profits.**

— Richard S. Levick and Charles Slack, *The Communicators: Leadership in the Age of Crisis*

Not so anymore. Today, socially responsible investing (SRI) accounts for nearly \$1 out of every \$8 under professional management in the United States — or roughly 12% of the \$25.2 trillion in total assets under management.<sup>1</sup> Perhaps even more telling, SRI investments emerged from the recent financial crisis doing much better than the overall market in terms of holding on to assets and attracting new investments. Specifically, from the start of 2007 to the end of 2009, SRI assets grew some 13%, from \$2.71 trillion to \$3.07 trillion, while the broader universe of assets grew by less than 1%.<sup>1</sup>

What is the impetus behind such growth? According to the Social Investment Forum, a membership organization supporting professionals and institutions engaged in socially responsible and sustainable investing, the robust growth is due to such factors as net inflows into existing SRI products, the development of new SRI products and the adoption of SRI strategies by managers and institutions not previously involved in the field.<sup>2</sup> Commenting further, Lisa Woll, CEO of the Social Investment Forum, stated, “All signs point to more investors looking for investments that support good governance and greater transparency and disclosure.”

### **The Evolution of SRI**

Socially responsible investing used to begin and end by simply screening out “sin stocks” — stocks of companies that derive earnings from gambling and/or the production of firearms, alcohol or tobacco. Today the concept — and

the investment opportunities — have evolved to reflect a much broader landscape, from environmentally friendly green investments to investments in companies with a strong commitment to good corporate governance, shareholder transparency and/or social justice.

Instead of researching individual stocks, investors seeking to incorporate a socially conscious theme in their investment choices may find the simplest route is to invest in one or more mutual funds. Among SRI assets that screen for environmental, social and governance (ESG) criteria, the largest share by far is held in mutual funds. Today, some \$316 billion in SRI assets are held in 250 different funds.<sup>3</sup>

### **The Performance Question**

All good intentions aside, the goal of these strategies is to deliver positive returns to investors. And on that score, SRI has not disappointed. For instance, for the past 20 years, the MSCI KLD Social 400 Index (formerly the KLD Domini Social 400 Index), which tracks stocks issued by U.S. companies defined as socially responsible, has posted annualized returns of 9.88% versus 9.14% for the S&P 500, an index which is generally considered to represent the broader U.S. stock market.<sup>4</sup>

<sup>1,2,3</sup>Source: The Social Investment Forum, *2010 Report on Socially Responsible Investing Trends in the United States*, press release, November 9, 2010.

<sup>4</sup>Sources: Standard & Poor’s; Morgan Stanley Capital International; KLD Research & Analytics, Inc. For the 20-year period ended December 31, 2010. Past performance is no guarantee of future results. Investing in stocks and/or mutual funds involves risks, including loss of principal.

# Planning for Healthcare Costs in Retirement

**The issue of healthcare costs in retirement is becoming a centerpiece of any financial planning discussion. And it is the unpredictable nature of healthcare costs that pose the biggest threat to retirees' financial security.**

One of the problems with trying to put a price tag on healthcare costs in retirement is that costs will vary considerably depending on the state of your individual health, the type of healthcare coverage you carry, etc. One recent study estimated the lifetime uninsured healthcare expenses for a typical 65-year-old couple to be about \$197,000 — a sobering number when you consider that just 59% of workers in their 50s and 60s have 401(k) balances in excess of \$100,000.<sup>1,2</sup>

## Plan for What You Know

The majority of “known” costs are associated with Medicare. The government deducts premiums for Medicare Part B (physician and outpatient services) and Medicare Part D (prescription drug expenses) directly from recipients' Social Security checks before they are distributed. Other Medicare-related costs include copayments and premiums for supplemental health insurance, or Medigap policies, that help to pay for services not covered by Medicare. While these costs can be substantial, they are for the most part known and can be budgeted for in advance.

In addition, the healthcare reform legislation of 2010 contained provisions aimed at lowering Medicare costs to retirees. The law called for an immediate \$250 rebate for individuals caught in the so-called Medicare Part D “donut hole” — a significant gap in coverage that affects millions. Starting in 2011, those affected also will receive a 50% discount on prescription drugs.

## Unpredictable Costs — The Wild Card You Cannot Ignore

The real unknown risk to retiree financial security is the risk that you or your spouse will need nursing home care at some point in the future. According to the study cited above, when nursing home costs were added into the equation, the amount spent on healthcare for a typical 65-year-old couple jumps to \$260,000 with a 5% risk of it exceeding \$570,000.<sup>1</sup>

How likely are you to need nursing home care? It is difficult to say. According to the study, about one-third of individuals who turned 65 in 2010 will need at least three months of nursing home care; 24% will need more than a year of such care.



## Helpful Resources

- Medicare: [www.medicare.gov](http://www.medicare.gov)
- Center for Retirement Research at Boston College: [www.bc.edu/crr](http://www.bc.edu/crr)
- The Henry J. Kaiser Family Foundation: [www.kff.org](http://www.kff.org)

With a price tag that now exceeds an average of \$83,000 a year nationwide, it is easy to see why nursing home care is the real wild card risk that should not be ignored.

## Take Charge of Your Healthcare Planning

There is a lot at stake for today's preretirees. When planning how much to save for retirement and how quickly to draw down your savings during retirement, speak with a trusted retirement planning expert about how much risk you are willing to accept — and whether you should insure against healthcare “unknowns” by purchasing a long-term care insurance policy.

<sup>1</sup>Source: The Center for Retirement Research at Boston College, “What Is the Distribution of Lifetime Healthcare Costs From Age 65?” March 2010.

<sup>2</sup>Source: Employee Benefit Research Institute, “401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009,” November 2010.

# Americans Score an “F” in Personal Finance

Consider, for a moment, that your financial future depends on your ability to score high on a quiz about financial products, services and concepts. Could you answer questions like the following with ease, or would you struggle and perhaps fail?

- (a) For the past 10 years, what has the annual rate of inflation been closer to?
- 3%
  - 6%
  - 9%
- (b) When interest rates decline, what does the price of a bond generally do?
- decrease
  - increase
- (c) What is a 529 plan designed to be used for?
- retirement
  - education
  - medical care

If you are drawing blanks, don't worry. You are not alone. In fact most of the 1,600+ Americans who took an online survey aimed at assessing Americans' financial knowledge received a failing grade.

But Americans are not completely clueless when it comes to financial concepts. In fact, the vast majority understands the definition of diversification (88%), and a solid majority know what asset allocation (79%) and dollar cost averaging (57%) mean.

## Where Are We Tripping Up?

- **Inflation** — Just 35% know that inflation has averaged 3% over the past decade.
- **Stocks vs. bonds** — Half believe (incorrectly) that bonds offer the best defense against inflation compared with stocks.
- **Money market funds** — Just 35% know that money market funds are made up of short-term (cash) instruments.
- **Insurance products** — Only 27% realize that permanent life insurance can pay dividends, and 49% believe (incorrectly) that term life is more likely to have cash value than permanent life insurance.

Every journey in life begins with a first step. Let your journey toward a secure financial future begin with a call to a financial advisor. An advisor can help you begin to better understand and make more informed decisions about your money.

## Answers:

- (a) 3% (b) increase (c) education

Source: Northwestern Mutual, November 9, 2010.

## A New Year, a New Tax Deal

(Continued from page 1)

new exemption threshold of \$5 million per individual estate — \$10 million for the estates of married couples. In addition, for the first time, the same \$5 million exemption applies to estate, gift and generation-skipping taxes, thereby encouraging the gifting of assets during an individual's lifetime.

**IRA transfer to charity** — In keeping with the estate planning theme, the tax bill extended for another year the rule that allows IRA holders over the age of 70½ to gift distributions from their accounts to qualified charities tax-free.

**Alternative Minimum Tax (AMT)** — Upwards of 21 million American taxpayers will be spared the AMT in 2010 and 2011 thanks to a “patch” included in the tax bill that keeps the AMT exemption at or very near current levels.

**Tax credits for education** — The bill also renews the American Opportunity Tax Credit (formerly the HOPE credit), which provides college students a credit of up to \$2,500 toward the cost of tuition. Several other education benefits were also extended through 2012, and deductions for expenses teachers incur were extended through 2011.

## A Short-Term Fix?

As welcome as these tax relief measures may be, it is important to remember that they are, for the most part, temporary. Most of the provisions are set to expire in two years; some even sooner. In the meantime, the broader issue facing the nation, the ballooning deficit — to which the tax bill adds a reported \$858 billion — is yet to be addressed. What does this mean to you? Enjoy the benefits while you have them, but start reviewing your finances now, including your investment portfolio, and strategizing for whatever tax changes may be coming your way in the not-too-distant future.

LPL Financial does not provide tax advice. As with any transactions having tax implications, clients should consult their tax and/or legal advisors.