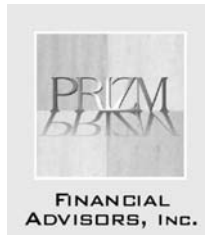


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# PRIZM PERSPECTIVE

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## Getting the Money Out

**T**raditional deductible and Roth IRAs have significantly different tax rules. With a traditional deductible IRA, current contributions are not taxed in the year the contributions are made, but you must pay income taxes on withdrawals. In contrast, with a Roth IRA, you do not get a current tax deduction for contributions, but withdrawals are taken income-tax free.

The tax laws regarding withdrawals from individual retirement accounts (IRAs) are complex. To avoid unnecessary penalties and to ensure you withdraw the funds efficiently, here are the basics:

### Before Age 59 1/2

In addition to any income taxes that may be due, withdrawals before the age of 59 1/2 are subject to a 10% federal income tax penalty.

(Withdrawals of contributions from a Roth IRA are never subject to a 10% penalty tax. Contributions are deemed to be withdrawn first.) However, the 10% penalty will not be assessed in the following situations:

- Distributions are made to beneficiaries after the IRA owner's death.\*\*
- Distributions are made to the IRA owner due to his/her disability.\*\*
- Distributions equal medical expenses paid in excess of 7.5% of adjusted gross income.\*
- Distributions are made to certain unemployed IRA owners to pay health insurance premiums.\*
- Distributions are made for up to the \$10,000 lifetime limit for qualifying first-time homebuyer expenses.\*\*
- Distributions are made to pay qualified higher-education expenses for the IRA owner, his/her spouse, children, or grandchildren.\*
- Distributions are made as a series of annual withdrawals in substantially equal amounts over the owner's life expectancy or the joint life expectancy of the owner and beneficiary.\*

*\* These types of Roth IRA withdrawals are subject to ordinary income taxes on any earnings, but distributions are exempt from the 10% federal income tax penalty.*

## Keep Saving after Retirement

**J**ust because you're retired doesn't mean you should stop saving. Carefully managing your money and looking for ways to save will help ensure you remain financially fit during retirement. Consider these tips:

- **Consider part-time employment.** Especially if you retire at a relatively young age, you might want to work on at least a part-time basis. Even earning a modest amount can help significantly with retirement expenses. However, if you receive Social Security benefits and are between the ages of 62 and full retirement age, you will lose \$1 of benefits for every \$2 of earnings above \$14,160 in 2009. You might want to keep your income below that threshold or delay Social Security benefits until later in retirement.
- **Contribute to your 401(k) plan or individual retirement account (IRA).** If you work after retirement, put some of that money into a 401(k) plan or IRA. As long as you have earned income and meet the eligibility requirements, you can contribute to these plans.
- **Try before you buy.** Want to relocate to another city or purchase a recreational vehicle to travel around the country? Before you buy a home in an unfamiliar city or purchase an expensive recreational vehicle, try renting first.
- **Keep debt to a minimum.** Most consumer loans and credit cards charge high interest rates that aren't tax deductible. During retirement, that can put a serious strain on your finances. If you can't pay cash, avoid the purchase. ○○○

*Continued on page 2*

## Money

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**\*\* These Roth IRA withdrawals are penalty free and income-tax free.**

### Between Ages 59 1/2 and 70 1/2

Between these ages, you can withdraw as much or as little as you like from traditional and Roth IRAs. Both contributions and earnings withdrawn from a traditional deductible IRA and earnings from a nondeductible IRA will be subject to ordinary income taxes. As long as the first contribution was made at least five years previously, Roth IRA distributions will not be subject to federal income taxes. Generally, you should postpone withdrawals as long as possible to continue tax-advantaged growth. However, in years when income is low, you may want to take distributions from a traditional IRA to take advantage of lower income tax rates. You may also want to convert all or part of a traditional IRA to a Roth IRA during low-income years. While you will have to pay income taxes on the conversion, future earnings will accumulate tax free as long as you make qualified distributions.

### After Age 70 1/2

You are not required to take distributions from a Roth IRA after age 70 1/2. You must, however, take required minimum distributions (RMDs) from your traditional IRAs every year, or you will be assessed a 50% penalty on amounts that should have been withdrawn. (RMDs are not required in 2009). You can always take out more than the RMD. Your RMD is calculated by taking the account balance as of the preceding year divided by the life expectancy factor from a uniform table. The table is based on joint life expectancies and assumes your beneficiary is 10 years younger than you. If your spouse is your sole beneficiary and is more than 10 years younger, you can use either the uniform table or a table based on the actual joint life expectancy of you and your spouse.

Your first RMD must be made by the required beginning date (RBD), which is April 1 of the year after you

## Should You Defer Income Taxes?

**S**hould you pay income taxes now, so you can withdraw funds after retirement tax free? Or are you better off delaying income taxes until after retirement? This is the basic decision when choosing between a traditional deductible individual retirement account (IRA) and a Roth IRA, or between a 401(k) plan and a Roth 401(k) plan.

The standard advice is to consider whether your tax bracket will be higher or lower in retirement. If you are likely to be in a higher tax bracket, you'll usually benefit from the Roth options, because you are paying taxes at a lower rate now. If you're likely to be in a lower tax bracket, you may benefit more from the traditional IRA and 401(k) plan, because you'll pay taxes at a lower rate after retirement.

Most people naturally assume that their tax rate will be lower in retirement, since their income will typically be lower. That assumes that income tax rates will stay constant over that time period, even though tax rates are at historically low levels. However, many believe that income tax rates have nowhere to go but up.

Thus, it may be prudent to use tax diversification for your portfolio. Tax diversification attempts to protect your portfolio against tax rate fluctuations. With tax diversification, you invest in a number of investment vehicles with different tax ramifications. Thus, during retirement, you can monitor your tax situation and withdraw money from the assets that make the most sense in any particular year.

Please call if you'd like to discuss this concept in more detail. ○○○

turn 70 1/2. However, if you take the distribution in the following year, you will then take both your first and second distributions in the same year. Evaluate your tax situation before doing that. Two distributions may increase your income so you are in a higher tax bracket, lose tax deductions or credits, or Social Security benefits become taxable. In those situations, you may be better off taking your first RMD in the year you turn 70 1/2.

### After Death

Heirs must generally start taking distributions by December 31 of the year after your death. Distributions by heirs are based on who your beneficiary is and whether you died before or after the RBD:

- If the account has a designated beneficiary, which includes individuals and certain trusts, the account balance can be withdrawn over the beneficiary's life expectancy, based on a single life expectancy table. This calculation is used whether you die before or after your RBD. Spouses who

inherit traditional IRAs can delay distributions until attaining age 70 1/2, while spouses who inherit a Roth IRA do not have to make withdrawals during their lifetime.

- A spouse can treat an inherited IRA as his/her own, but the surviving spouse has to be the sole beneficiary. However, if a spouse and other beneficiaries inherit an IRA, the account can be split so the spouse solely owns his/her portion.
- If the account does not have a designated beneficiary, which includes your estate, charitable organizations, and certain trusts, and you die after your RBD, the balance is paid out over your remaining life expectancy. If you die before your RBD, then the balance must be paid out within five years of your death.

The decisions you make regarding IRA withdrawals have important consequences for your retirement and for your beneficiaries. Please call if you'd like help making these decisions. ○○○

## Should You Favor Growth or Value Stocks?

The two basic investing styles are growth and value. While one style tends to perform better at any given time, the dominant style varies over time. The basic elements of each style include:

- Growth investors look for stocks with above-average growth in sales and earnings, typically at a 15% or higher annual rate. These are typically stocks of younger companies in a rapid growth stage of development, although larger companies can also qualify as growth companies. Growth companies tend to have higher price/earnings ratios with little or no dividends, since earnings are typically used to finance future growth. As growth stocks gain favor, investors tend to bid their prices up to lofty levels. Thus, the price/earnings (P/E) ratios of growth companies can be two or three times higher than the overall market. Earnings projections largely drive the value of these companies, so earnings disappointments can dramatically impact their value. The rise and fall of technology stocks is a classic example of this pattern.
- Value investors emphasize stocks with market values that are low based on earnings, dividends, or assets. Companies in this category typically include those in out-of-favor industries, turnaround or troubled companies, or mature and stable companies with modest growth expectations. Dividend yields may be higher than average since the stock price is low. Signals that a company may be turning around include insider buying, improving profit margins, increasing earnings estimates, or higher trading volumes. Value investors must typically exhibit patience since it can take a while for the market to realize a particular stock's value.

Growth stocks typically perform well when the economy is growing and the stock market is rising, while value stocks typically perform well when the stock market is peaking or falling. Many investors are naturally drawn to a growth investing style since growth stocks usually have exciting news, capturing much press attention. Value companies often receive unfavorable press, requiring more resolve on the investor's part to continue holding them.

So which style will excel in the future? Just as you can't predict where the market is headed, it is difficult to determine when each style will dominate. Thus, it may make more sense to include both styles in your portfolio. That way, it will not matter what style dominates, it will be represented in your portfolio. Please call if you'd like to discuss investing styles and their impact on your portfolio. ○○○

## Social Security Benefits for Couples

Married couples need to understand the rules before applying for Social Security benefits.

If benefits start at full retirement age, you are entitled to the larger of 100% of your benefits based on your earnings or 50% of your spouse's benefits. However, if you elect benefits before full retirement age, your spouse's benefits will be reduced by a larger percentage than your benefits were reduced. After your death, your spouse receives the larger of his/her benefits or 100% of your benefits, provided he/she is over full retirement age. If not, your spouse receives between 71.5% and 100% of your benefits. Thus, the larger your benefits are, the larger your spouse's benefits may be after your death.

For individuals turning 62 this year, full retirement age for Social Security purposes is 66. If benefits are claimed at age 62, that individual would receive 75% of full retirement benefits. For each year past age 66, benefits increase by 8% per year, for maximum benefits at age 70 that are 132% of full retirement benefits. These amounts have been actuarially calculated, so that if you live to the average age, the benefits are approximately the same for a single individual, no matter when you start

those benefits.

However, for married couples, benefits are not actuarially the same. Typically, the man is older, has higher earnings, and will not live as long as the woman. Because the surviving spouse can elect to receive 100% of the other spouse's benefits, it typically makes sense for the man to wait until age 70 to claim Social Security benefits, in order to provide his wife with the highest benefits possible after his death. On the other hand, there is usually no reason for the woman to wait beyond ages 62 to 66 to start Social Security benefits, provided she can claim benefits on her own earnings record. While the wife's benefits may be lower when her husband is alive, she will receive his higher benefits after his death.

A spouse who can't claim benefits on his/her own earnings record can claim spousal benefits, but he/she must wait until his/her spouse starts benefits or reaches full retirement age. Spousal benefits are reduced when taken at age 62, but do not continue to grow after full retirement age. However, a worker can apply for Social Security benefits at full retirement age, allowing his/her spouse to collect benefits, and then suspend his/her own benefits, reapplying at a later date. ○○○

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# Don't Underestimate Inflation in Retirement

Inflation has been tame for so long that it's easy to ignore when planning for retirement. However, even inflation of 2% or 3% per year over a period of many years can seriously erode the purchasing power of your funds. At 2.5% inflation, \$1 today will be worth 78 cents in 10 years, 61 cents in 20 years, and 48 cents in 30 years. And recently, inflation has been increasing at a higher rate. That can have a major impact on those entering retirement for several reasons:

- New retirees are less likely to have defined-benefit pensions. Thus, they must rely more on Social Security benefits and personal savings, including defined-contribution plans such as 401(k) plans.
- Cost of living adjustments for Social Security benefits are less generous. While Social Security benefits are still adjusted for inflation based on the consumer price index (CPI), the methodology for calculating the CPI changed dramatically in 1999,



reducing increases in the CPI.

- Health-care costs are becoming more of a burden to retirees. More and more companies are reducing benefits or eliminating health-care insurance for retirees, and health-care costs tend to increase faster than overall inflation. For instance, in 2006, the overall CPI increased 3.2%, while medical care costs increased 4.0% and hospital and related services increased 6.4% (Source: Bureau of Labor Statistics, 2007).

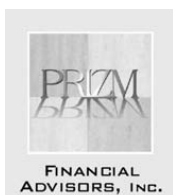
To combat the effects of inflation on your retirement income, consider these tips:

- **Use a conservative inflation rate for planning purposes.** Since your retirement is likely to span decades, consider inflation over long time periods. For instance, while inflation has averaged 2.54% over the past 10 years, it has averaged 4.2% over the past 30 years (Source: Bureau of Labor Statistics, 2008).
- **Consider investment alternatives likely to stay ahead of inflation.** Thus, a significant portion of your portfolio will probably be invested in stocks, which have typically earned returns in excess of inflation.
- **Invest in tax-advantaged investment vehicles.** Look into 401(k) plans, individual retirement

accounts, and other retirement vehicles. While each has different rules for taxing contributions and earnings, all provide some tax-free or tax-deferred benefits. Since you aren't paying income taxes on earnings throughout the years, that typically means you'll have a larger balance at retirement than if you were paying taxes throughout the years. Thus, you'll start out with a larger retirement base to help combat inflation's effects.

- **Decide how you will deal with health-care costs.** While Medicare will help once you turn age 65, it still does not cover many health-care costs. Look into Medigap policies and prescription coverage to help with those noncovered expenditures, especially if your employer does not provide health insurance after retirement.
- **Minimize withdrawals from your retirement assets, especially during the early years of retirement.** To counter inflation, you need to withdraw larger and larger sums just to maintain the same purchasing power. To make sure you don't run out of funds late in life, keep withdrawals during the early years to a minimum. ○○○

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