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PRIZM PERSPECTIVE

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Maintaining Your Income through a Long Retirement

Saving enough by age 65 to ensure that you can maintain your standard of living through a long retirement has become increasingly difficult. Consider just this one fact. Current retirees receive close to 70% of their retirement income from Social Security and defined-benefit pension plans, while today's workers will probably only receive one-third of their retirement income from those

sources (Source: Ibbotson Associates, 2007).

While that means you'll be responsible for a significant portion of that income, Social Security and defined-benefit plans are a valuable component of your retirement income. For years, we've heard that Social Security benefits are modest at best and should not be counted on as our only source of retirement income.

Sometimes, it's even suggested to completely forget about Social Security benefits when planning for retirement, because changes in the system will probably be necessary when the huge number of baby boomers start retiring. But the fact is that Social Security benefits are a very valuable benefit, especially since benefits are adjusted for inflation annually.

For instance, the maximum Social Security benefit in 2008 for workers retiring at full retirement age is \$2,185 monthly. While that might not seem like that much money, consider how much you'd need to accumulate to generate that monthly income. A 66-year-old male would have to pay approximately \$377,000 for an annuity that would pay \$2,165 monthly for life with annual inflation adjustments, while a 66-year-old woman would pay approximately \$421,000 (Source: Vanguard, 2008).

While only 21% of the work force is currently covered by a defined-benefit plan, it is a valuable benefit if you are covered by one. Defined-benefit plans typically don't adjust your benefits for inflation, but they will pay a benefit for your life or the joint lives of you and your spouse, depending on the option you choose.

But despite the value of Social Security and defined-benefit plans, you will probably be responsible for the majority of your retirement

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Regularly Review Your Life Insurance

Periodically, you should review your life insurance policies to ensure that they still meet your insurance needs for your current situation. Consider the following points during that review:

Are your policy limits still appropriate? Whether you took out the policy 20 years ago or four years ago, it makes sense to revisit the initial selections you made. You may now find that you need more or less insurance than you originally purchased. However, if you have too much coverage, don't cancel the policy without further analysis. The policy's return may make it a worthwhile investment on its own, or you may be able to convert to a smaller, paid-up policy.

Is the projected rate of return still competitive? If you have a cash-value insurance policy, ask the insurance company for an in-force illustration based on current dividends and interest rates.

Is the insurance company financially sound? Check your insurance company's ratings to make sure its financial strength has not deteriorated.

Is the policy owned by the appropriate party? Changes in your estate needs may necessitate changes in the policy's ownership. Consider all tax and estate factors before deciding who should own the policy.

Are your beneficiaries still appropriate? People's lives are constantly changing. Sons and daughters become adults, get married, have children. Family members die. Husbands and wives divorce. Such events have an impact on your life insurance beneficiaries, so you may want to change your beneficiaries due to changes in your personal situation. ○○○

Retirement

Continued from page 1

income, whether you obtain that income from 401(k) plans, individual retirement accounts (IRAs), or taxable investments. Before retiring, you'll want to ensure that you have sufficient savings to support yourself for 20, 30, or even 40 years, depending on your age when you retire.

Deciding how much you need to accumulate by retirement age is difficult, since so many of the variables that go into that calculation are uncertain. To come up with an estimate, you need to make assumptions about your life expectancy, how much income you'll need during retirement, how much you'll receive from other retirement sources, when you will retire, your long-term rate of return on investments, future inflation, and future income tax rates. If your estimates are inaccurate, you could end up with little in the way of income in the later years of your life.

Because of all the uncertainty, it is typically recommended that you only withdraw modest amounts from your retirement savings, especially in the early years of your retirement. A common rule of thumb is to withdraw no more than 4% annually from your retirement funds. So if you want to withdraw \$75,000 annually from your retirement assets, you'll need to accumulate \$1,875,000 by retirement age.

But that 4% figure is based on the value of your investments when you are ready to make the withdrawal and is not a static number based on your savings when you retire. During periods of market volatility, your asset balances can fluctuate significantly, causing substantial changes in the recommended withdrawal amounts. Market fluctuations are especially dangerous during the early years of your retirement, when it can be difficult to make up for market declines while you are withdrawing money from those reduced balances. If you aren't able to overcome market declines,

you could be forced to drastically change your retirement plans.

How can you ensure that your retirement savings will last a lifetime? Consider these points:

- **Annuitize a portion of your retirement assets.** This will provide you with a definite monthly income for the rest of your life. Annuities can be purchased with or without inflation protection. Since an annuity is paid for the rest of your life, it protects you from outliving your savings and from the risk that lower-than-expected investment returns will reduce your portfolio. Typically, the benefits will end once you (and your spouse if you elect joint benefits) die, although some annuities will pay a lump sum or periodic benefit to beneficiaries. Thus, it is important to understand that if you (and your spouse if you elect joint benefits) die at a relatively young age, your benefits may not equal the purchase price of the annuity. While you probably do not want to use all of your retirement assets to purchase an annuity, you may want to use enough to purchase an annuity that will cover your regular monthly expenses.
- **Withdraw conservative amounts from your retirement assets.** If you limit your withdrawals to 3% or 4% of your balance, the assets should last for decades. At least annually, reassess your retirement assets and make sure that your withdrawals are reasonable based on your current balances. Market fluctuations can cause your asset allocation to get out of line, so you should rebalance at least annually. Even during retirement, you should allocate your assets among a variety of investment types, ensuring that your allocation is appropriate for your specific situation.
- **Maximize other sources of income.** While Social Security benefits and defined-benefit plan benefits will likely only provide moderate income, don't totally

discount these income sources. Delay Social Security benefits as long as possible, until age 70, to maximize the benefits you'll receive. These benefits are also adjusted annually for inflation. While defined-benefit plans are becoming increasingly rare, make sure you apply for benefits if you are covered.

- **Look for other ways to remove risk from your retirement investments.** There are a variety of portfolio strategies that can help cushion the impact of market fluctuations. If your portfolio is properly diversified, downturns in one asset class can be offset to at least some extent by the performance of other assets in your portfolio.
- **Reach retirement with minimal expenses.** Cut back on your living expenses before retirement, and try to enter retirement with as few debts as possible. Mortgage and consumer debt payments consume a significant portion of most people's income. Pay off those debts by retirement, and you can significantly reduce your cost of living. This can have a two-fold impact on your retirement. First, it frees up money to set aside for retirement. Second, you get used to a lower standard of living, which should also reduce the cost of your retirement lifestyle.
- **Work as long as possible.** Working a few more years can go a long way in helping fund your retirement. Those years are typically your highest earning years, so hopefully, you'll save significant sums during that period. Also, every year you work is one year you don't have to support yourself with your retirement savings. Once you are ready to retire, try to work at least part-time during the early years of your retirement. Even modest earnings can help significantly with retirement expenses.

Please call if you'd like help planning for your retirement. ○○○

Protecting Your Family

Too many people in blended families assume that their estate will be distributed to their spouse and children when they die.

Without an up-to-date estate plan, you could end up bequeathing part of your estate to an ex-spouse, disinheriting your own children, leaving less than you intended to your current spouse, or paying too much in estate taxes. Fortunately, there are a number of estate planning tools that can help avoid these

unintended consequences.

- **Disinherit your ex-spouse** — To avoid accidentally bequeathing part of your estate to your ex-spouse, review how all assets are titled and check beneficiaries on all life insurance policies and retirement accounts. Update estate planning documents, removing your ex-spouse.
- **Protect your own children** — Consider a trust for the benefit of your children. Even if one or more of your children predeceases

your ex-spouse, their inheritance can go to their children or be split up among the trust's other beneficiaries.

- **Provide for your current spouse** — If you leave your estate to your current spouse without explicitly providing for your own children, your estate could end up in the hands of your spouse's children when he/she dies, leaving your children out of the picture. A qualified terminable interest property (QTIP) trust can help prevent that from happening. A QTIP trust can pay income and part of the principal to your current spouse for the remainder of his/her life, and then transfer the remaining assets to your children when your spouse dies.

- **Minimize estate taxes** — If an insurance policy is set up properly, the proceeds are distributed free of both income and estate taxes. Another benefit is that the life insurance policy can be used to pay proceeds to specific beneficiaries you designate.

- **Protect your individual assets** — If you're heading into marriage, a prenuptial agreement can detail what will happen to your individual assets in the event of divorce or death. Think carefully about holding property jointly. No matter what your estate planning documents state, property held in joint tenancy with rights of survivorship passes to the other owner.

Making estate-planning decisions in a blended family environment can be complex, but it is a subject that should not be ignored. Please call if you'd like to discuss this topic in more detail. ○○○



Taking Advantage of the 0% Capital Gains Tax Rate

From 2008 to 2010, the capital gains tax rate for individuals in the 10% or 15% tax bracket will be 0% (down from 5% last year). After 2010, the rates will revert to pre-2001 rates, unless further legislation is passed. Who will benefit from this reduction?

Many parents with children in college or near college age in 2008 to 2010 were planning to gift appreciated investments to children, who could then sell them during these years and pay 0% tax on any gains. However, legislation that went into effect last year raised the age limit for application of the "kiddie tax" to all children under age 19 (previously under age 18) and to students under age 24. The "kiddie tax" refers to the manner in which unearned income is taxed for children. In 2008, the first \$900 of unearned income is tax free, the second \$900 is taxed at the child's marginal tax rate, and any remaining unearned income is taxed at the parents' marginal tax rate.

Thus, it will be difficult for individuals with students under age 24 to take advantage of the 0%

capital gains tax rate. However, if you have older children in graduate school, medical school, or law school, you may be able to sell investments and pay 0% capital gains tax. Another alternative is to make sure your student has significant earned income. If the earned income of an individual over age 17 exceeds half of his/her support, the "kiddie tax" does not apply. Scholarships are not considered for this test.

Individuals retiring in 2008 through 2010 may be in the best position to take advantage of the 0% tax bracket. With no or low salary, even high-income individuals may find themselves in the 10% or 15% tax bracket in the early years of retirement, although it may be necessary to delay benefits from pension plans and Social Security to do so. If that is the case, this would be a good opportunity to sell highly appreciated assets without incurring any taxes.

Please call if you'd like to discuss the 0% capital gains tax rate in more detail. ○○○

Dealing with Health Insurance in Retirement

While there are many variables to consider when deciding when to retire, a significant factor is the availability of health insurance benefits during retirement. Medicare benefits are not available until age 65, even though you can elect reduced Social Security benefits at age 62. One study found that people who retired after age 65 were more likely to not have employer-provided health insurance in retirement than early retirees (Source: *What Happens to Health Benefits after Retirement?*, February 2007).

A recent report estimates that a 65-year-old couple will need \$215,000 to cover health care expenses in retirement, including costs for supplemental insurance and Medicare Part B and Part D. This amount does not include potential long-term-care expenses. It was estimated that a 65-year-old earning \$60,000 in the year he/she retires could spend approximately half of pretax Social Security benefits on health care (Source: Plansponsor.com, 2007). Currently, only 33% of employers with more than 200 employees provide retiree health insurance, compared to



66% in 1988 (Source: *Financial Planning*, April 2008).

Your concerns and options will depend on your age when you retire.

Before Age 65

Determine what health insurance coverage is provided by your employer when retiring before age 65. In situations where the employer is encouraging early retirement, health insurance benefits are typically part of the retirement package. However, many companies are taking steps to reduce the cost of this coverage. Some offer no benefits when retiring before age 65, while others provide coverage for only a short time. Some require many years of service to qualify for benefits. Often, you will have to pay part or all of the premium. If your spouse is younger than you, find out if he/she can continue health insurance coverage after you qualify for Medicare.

If your employer doesn't provide retiree health insurance, find out if COBRA is available. With COBRA, you can pay for 18 months of coverage at 102% of the premium (the 2% covers administrative expenses). If COBRA ends before you're eligible for Medicare, you can typically convert to an individual policy with the same insurance company. However, the conversion policy does not have to provide the same benefits and may be more expensive.

At Age 65 or Older

Once you turn 65, you're eligible for

Medicare coverage. However, your spouse is not eligible until he/she turns 65. When enrolling, you'll have to decide whether you want traditional Medicare or a Medicare Advantage plan. Make sure you understand the benefits provided by Medicare, because there are excluded services and significant deductibles. Therefore, you might want to obtain a separate Medicare supplement insurance policy, also called a Medigap plan, to help cover some of those costs. You will also need to decide whether to sign up for Medicare Part D, which covers prescription drugs. If you don't sign up for Part D immediately but later decide to get the coverage, you will have to pay a penalty.

Your employer may offer supplemental Medicare coverage when retiring at age 65. Employers are increasingly placing caps on how much they'll pay for health insurance benefits for retirees. Once that cap is reached, you'll pay more of the premium costs. Find out how the cap works and how much you may have to pay. This can represent a significant expense that must be planned for.

For help assessing your health insurance coverage in retirement, please call. ○○○

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