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PRIZM PERSPECTIVE

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Securing Your Financial Life

While there might not be much we can do on an individual level to reduce crime, war, or even stock market corrections, we can take all appropriate steps to mitigate the risks under our control. If you're looking for ways to increase your financial security, consider the following tips:

❍ **Get your estate in order.** While dealing with your own mortality is often difficult, it is one of the most important things you can do to ensure your family can survive financially in the event of your death. Make sure your will reflects your current desires for the disposition of your assets and names a guardian for your minor children. You should also consider a durable power of attorney, which designates someone to control your financial affairs if you become incapacitated, and a health care proxy, which delegates health care decisions when you are unable to make them.

❍ **Review your portfolio.** If you're saving for goals that are decades away, stocks probably should continue to hold a major position in your portfolio. The lesson we should learn from recent stock market fluctuations is that our portfolios should be diversified. A properly diversified portfolio will help protect its value during market declines, while still offering higher return potential.

❍ **Take another look at your life insurance.** You need to purchase an appropriate amount of insurance to protect your family in the event of your death. The amount needed will depend on your current net worth, the lifestyle you want to provide for your family,

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Calculating an Investment's Basis

Your capital gain or loss on the sale of an investment equals the proceeds from the sale less your basis (the cost of acquiring the investment). When you purchase an investment, your basis equals the price you paid plus any fees or commissions. While the calculation is fairly straightforward, other factors can affect your basis calculations:

❍ Reinvested dividends are added to your basis at full market value plus any fees or commissions.

❍ The basis of any investment received as a gift is the donor's original basis plus any gift tax paid by the donor. However, if you then sell the investment at a loss, your basis is equal to the lesser of the donor's basis or the investment's fair market value on the date of the gift.

❍ For inherited investments, the basis is the market value on the date you inherited the investment, typically the date of the donor's death.

❍ Your basis in stock that has been split is the same as your basis before the stock split. Your per-share basis, however, will now equal your total basis divided by the number of shares you own after the split.

❍ When you exercise a stock option, your basis equals the price you paid for the shares plus any fees or commissions, which may be lower than market value. Shares must be retained for at least one year after purchase and for two years after receipt of the option, or any gains will be taxed as ordinary income.

Please call if you'd like help calculating your basis in an investment. ❍❍❍

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Your Financial Life

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and your personal circumstances and desires. Since your insurance needs will change over time, assess your insurance coverage periodically.

❍ **Obtain sufficient disability income insurance.** You should consider disability income insurance if your current assets won't support you until age 65. Many companies provide short-term disability insurance, which covers 100% of your salary for three to six months. Long-term disability insurance is typically less common and less generous. Thus, even if you have long-term disability insurance at work, you may want to obtain additional coverage.

❍ **Make sure you have an emergency cash reserve.** Consider setting aside at least three to six months of living expenses, although the exact amount will depend on your age, health, job outlook, and borrowing capacity.

❍ **Consider long-term-care insurance.** This coverage may be especially important for women, who tend to outlive their husbands. You should probably purchase the insurance while you are in your 50s or 60s. After that, the premiums get much more expensive. Also, if you develop a serious health condition, you may not be able to purchase the insurance.

❍ **Protect your financial identity.** While you typically won't have to pay for anything charged by an identity thief, you will have to work to restore your credit and to ensure all fraudulent accounts are closed. That can be time consuming as well as expensive. To help protect your financial identity, only give out your Social Security number when it is required, shred financial documents, cut up old credit cards, and review your credit reports periodically.

❍ **Keep your homeowners insurance up to date.** Review your homeowners policy carefully so you understand what would happen if your home was totally destroyed. It is your responsibility to make sure you have adequate policy limits.

❍ **Protect your home.** Obtain a good security system for your home. Make sure all doors are metal or solid wood with deadbolt locks, use bars or locks to secure sliding glass doors, and keep all entrances well lit.

❍ **Properly store important documents.** Documents that you might need when the bank is closed can be kept in a fireproof home safe. Other documents, such as deeds, stock certificates, and titles, should be kept in a safe deposit box in a bank.

Please call if you'd like to review these tips in more detail. ❍❍❍

When to Use Tax-Advantaged Accounts

Tax-advantaged savings plans help your money grow faster than taxable investments, but they're not always the right place for all of your savings. There are circumstances when it can be more advantageous to keep your money in a taxable investment vehicle.

Put your money in a tax-advantaged saving plan when:

❍ Your employer matches your contribution. It's rare that taking advantage of free money doesn't make sense. It's like getting an immediate return on your investment.

❍ You have savings equal to at least three months of living expenses in safe and readily available savings vehicles and, if you have dependents, adequate life insurance coverage.

❍ You own a home and are comfortably meeting your monthly mortgage payments.

❍ You haven't met your goal for a retirement nest egg and need the return-enhancing advantage of tax-free compounding to reach it.

Consider *not* contributing to a tax-advantaged plan when:

❍ Either you're at the limit of your employer's matching contribution or your employer doesn't offer one. (Though even in these cases, it may still make sense to contribute to your 401(k), as long as the plan's fees and expenses are low and it offers sufficient diversification.)

❍ The investment choices in your employer's plan charge high annual expense fees. The pretax advantage of contributing to a 401(k) plan can be eroded by fees of 1.5% a year.

❍ You're in a high tax bracket and want to invest in individual equities for long-term capital gains. Rates on long-term gains are well below the highest federal income tax bracket; and unless you contribute to a Roth IRA or Roth 401(k) plan, you'll have to pay ordinary income taxes on stock gains in a traditional IRA or 401(k) plan.

❍ You want to diversify beyond the choices available in an employer's retirement plan. If this is the case, you may still want to contribute to an IRA, but through an account with sufficient diversification options.

❍ You want municipal bonds to be part of your portfolio. If you hold municipal bonds in a traditional IRA or 401(k) plan, any interest income, even if tax-exempt, will be taxed at ordinary income tax rates when withdrawn. It is better to hold municipal bonds in taxable accounts so tax-exempt interest income is not taxable. ❍❍❍

Six Rules for Deducting Charitable Contributions

The IRS permits taxpayers to deduct the value of charitable contributions up to a certain limit (generally, the deduction cannot be more than 50% of your adjusted gross income, though lower limits may apply). As a deduction, qualified charitable contributions reduce the amount of income subject to tax. Here are six other rules you'll need to know if you plan to claim the charitable contribution deduction.

1. Not every donation counts as a deductible contribution. A charitable contribution, per the IRS, is "a donation or gift to, or for the use of, a qualified organization. It is voluntary and is made without getting, or expecting to get, anything of equal value." Deductible contributions include:

❍ Money or property you give to religious organizations; federal, state, and local governments (if your contribution is solely for public purposes); nonprofit schools and hospitals; qualified organizations; and war veterans' groups.

❍ Expenses paid for a student living with you, when that student is sponsored by a qualified organization.

❍ Out-of-pocket expenses when you serve a qualified organization as a volunteer.

Donations that are ***not*** considered deductible contributions include:

❍ Money or property you give to civic leagues, social and sports clubs, labor unions, and chambers of commerce; foreign organizations (except certain Canadian, Israeli, and Mexican charities); groups that are run for personal profit; groups whose purpose is to lobby for law changes; homeowners associations; individuals; and political groups or candidates for public office.

❍ The cost of raffle, bingo, or lottery tickets.

❍ Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups.

❍ Tuition.

❍ The value of your time or services.

❍ The value of blood given to a blood bank.

2. Not every nonprofit is a qualified organization. The IRS rules stipulate that a charitable contribution is one given to a qualified organization, which includes nonprofit groups that are religious, charitable, educational, scientific, or literary in purpose, or that work to prevent cruelty to children or animals. Fortunately, you don't have to discern which organizations qualify from the IRS' vague definition; the IRS keeps a list of qualifying organizations at: www.irs.gov/Charities-&-Non-Profits/Search-for-Charities.

3. If you want to deduct charitable contributions, you have to itemize. The IRS gives taxpayers two options for deducting certain types of expenses from income. One option is to take the standard deduction, which in 2015 is $6,300 for most taxpayers ($12,600 for those filing jointly). The other option is to itemize deductions, which means you actually list all of those qualifying expenses and deduct them from your income. Common deductions include mortgage interest and charitable contributions.

4. You must have a record. Every time you make a contribution to a qualified organization, get a receipt. If your donation is a monetary gift, you need to keep a bank record, payroll deduction record, or a written communication from the organization containing the name of the organization, the date of the contribution, and the amount. If you donate items rather than money, the organization needs to list each item donated, its condition, and its fair market value. For donations of property valued at $500-$4,999, you must also have a record of when and how you got the property. For donations valued at more than $5,000, you will also need an official appraisal.

5. You can deduct unreimbursed out-of-pocket expenses and mileage when you're volunteering, but you can't deduct the value of your time. If you donate to charity by volunteering your time and/or talents, you can deduct out-of-pocket expenses if the organization hasn't reimbursed you. You can also deduct the cost of transportation to and from the location where you volunteered (if you drive, you can either compute actual costs or use the standard rate of 14 cents a mile). You cannot, however, deduct the value of the time you spent volunteering; nor can you deduct the expense of childcare.

6. If you receive something in return, you have to deduct its value. IRS rules define a charitable contribution as one that you make without expecting to get anything of equal value in return. However, organizations will often provide incentives for individuals to donate — meals out, tickets to a sporting event, a t-shirt, etc. If you received anything in return for your donation, you must subtract the value of what you received from the amount of your donation. For example, if you donated $100 to a qualified organization and you received a $20 t-shirt in exchange, you can only deduct $80. ❍❍❍

Muni Bonds: What You Need to Know

Municipal bonds are critical financing tools for state and local government entities. But are they the right place for you to invest?

Muni Advantages

In addition to the income stream that municipal bonds generate is another benefit: they are tax-advantaged. For the vast majority of municipal bonds, interest received is not subject to federal tax.

Munis are the only security with that tax benefit (even Treasury securities are typically subject to federal tax). And in most cases, if you live in the state or city issuing the bond, you may be exempt from state and/or city taxes as well.

Do the tax advantages of munis outweigh the often-lower yields they generate? Would it be better to invest in a corporate bond with taxable interest? Here's a quick formula to answer that question:

❍ Add your federal, state, and any local income tax rates.

❍ Subtract the total from 1.00.

❍ Divide the remainder into the municipal bond's current yield (if you're buying it in the secondary market) or coupon (if it's a new issue) to find the taxable equivalent yield.

❍ Compare the bond's taxable equivalent yield to the current yield or coupon of the taxable bond you're comparing.

What to Watch Out For

❍ **Call risk** — When a muni is callable, the issuer has the right to retire a bond before its maturity date. The issuer might do that if the interest rate falls below a certain point (in effect refinancing the muni).

Many municipal bonds are callable. If you're looking to hold a bond to maturity, check out the call/ redemption provisions listed in the bond's Official Statement.

❍ **Liquidity risk** — Municipal securities are typically less liquid than Treasuries. While there is a secondary market for munis, it is typically more difficult to sell a municipal bond before its maturity, as most muni investors plan to hold the bond until maturity.

❍ **Credit risk** — As with any bond, municipal bonds are guaranteed to return the principal at maturity — but only if the issuer remains solvent. Local government defaults are rare, but they do happen. The city of Detroit, for example, filed for bankruptcy protection in 2013. In 2008, Jefferson County, Alabama, defaulted on payments on $3.8 billion of sewer bonds.

Credit risk can be mitigated in two ways: First, by paying attention to the issuer's credit rating. All three major credit rating agencies — Standard & Poor's, Moody's, and Fitch — rate municipal bonds. While the scales differ slightly among rating agencies, triple-A is the highest-rated muni bond, determined to be the least risky. C-rated munis are deemed to be relatively high credit risks.

The second way to mitigate the risk of a default is to diversify your municipal bond holdings across regions. While it's generally true that when the national economy is doing well or poorly, state and local economies are too, there are different patterns in regional business cycles. Take advantage of those by diversifying across regions.

Interested in exploring how municipal bonds might add to your investment portfolio? Please call if you'd like to discuss this in more detail. ❍❍❍

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