



# Pathways

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## Handling Market Volatility

Conventional wisdom says that what goes up, must come down. But even if you view market volatility as a normal occurrence, it can be tough to handle when it's your money at stake. Though there's no foolproof way to handle the ups and downs of the stock market, the following common sense tips can help.

### Don't put your eggs all in one basket

Diversifying your investment portfolio is one of the key ways you can handle market volatility. Because asset classes typically perform differently under different market conditions, spreading your assets across a variety of investments such as stocks, bonds, and cash equivalents (e.g., money market funds, CDs, and other short-term instruments), has the potential to help reduce your overall risk. Ideally, a decline in one type of asset will be balanced out by a gain in another, but diversification can't eliminate the possibility of market loss. One way to diversify your portfolio is through asset allocation. Asset allocation involves identifying the asset classes that are appropriate for you and allocating a certain percentage of your investment dollars to each class (e.g., 70 percent to stocks, 20 percent to bonds, 10 percent to cash equivalents). The best way to decide on an appropriate mix of investments is to use a financial planner to develop an allocation based on your investment objectives, risk tolerance level, cash flow needs, and investment time horizon.

### Focus on the forest, not on the trees

As the market goes up and down, it's easy to become too focused on day-today returns. Instead, keep your eyes on your long-term investing goals and your overall portfolio. Although only you can decide how much investment risk you can handle, if you still have years to

invest, don't overestimate the effect of short-term price fluctuations on your portfolio.

### Look before you leap

When the market goes down and investment losses pile up, you may be tempted to pull out of the stock market altogether and look for less volatile investments. The small returns that typically accompany low-risk investments may seem attractive when more risky investments are posting negative returns.



But before you leap into a different investment strategy, make sure you're doing it for the right reasons. How you choose to invest your money should be consistent with your goals and time horizon.

For instance, putting a larger percentage of your investment dollars into vehicles that offer safety of principal and liquidity (the opportunity to easily access your funds) may be the right strategy for you if your investment goals are short-term (e.g., you'll need the money soon to buy a house) or if you're growing close to reaching a long-term goal such as retirement. But if you still have years to invest, keep in mind that stocks have historically outperformed stable value investments over time, although past performance is no guarantee of future results. If you move most or all of your investment dollars into conservative investments, you've not only locked in any losses you might have, but you've also sacrificed the potential for higher returns.

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## About New Wealth Advisors.

New Wealth Advisors is an independent, fee-only, SEC-registered investment advisor, operating as a multi-family investment office. We work with newly wealthy individuals and families to protect, grow and manage assets.

## Look for the silver lining

A down market, like every cloud, has a silver lining. The silver lining of a down market is the opportunity you have to buy shares of stock at lower prices.

One of the ways you can do this is by using dollar cost averaging. With dollar cost averaging, you don't try to "time the market" by buying shares at the moment when the price is lowest. In fact, you don't worry about price at all. Instead, you invest money at regular intervals over time.

When the price is higher, your investment dollars buy fewer shares of stock, but when the price is lower, the same dollar amount will buy you more shares.

For example, let's say that you decided to invest \$300 each month towards your child's college education. As the illustration shows, your regular monthly investment of \$300 bought more shares when the price was low and fewer shares when the price was high:



Although dollar cost averaging can't guarantee you a profit or avoid a loss, a regular fixed dollar investment may result in a lower average price per share over time, assuming you continue to invest through all types of markets.

## Don't stick your head in the sand

While focusing too much on short-term gains or losses is unwise, so is ignoring your investments. You should check up on your portfolio at least once a year, more frequently if the market is particularly volatile or when there have been significant changes in your life. You may need to rebalance your portfolio to bring it back in line with your investment goals and risk tolerance. A financial professional can help you decide which investment options are right for you.

### Making dollar cost averaging work for you

- Get started as soon as possible. The longer you have to ride out the ups and downs of the market, the more opportunity you have to build a sizeable investment account over time.
- Stick with it. Dollar cost averaging is a long-term investment strategy. Make sure that you have the financial resources and the discipline to invest continuously through all types of markets, regardless of price fluctuations.
- Take advantage of automatic deductions. Having your investment contributions deducted from your paycheck or bank account is an easy and convenient way to invest, and can help you get in the habit of investing regularly.

## Don't count your chickens before they hatch

As the market recovers from a down cycle, elation quickly sets in. If the upswing lasts long enough, it's easy to believe that investing in the stock market is a sure thing. But, of course, it never is. As many investors have learned the hard way, becoming overly optimistic about investing during the good times can be as detrimental as worrying too much during the bad times. The right approach during all kinds of markets is to be realistic. Have a plan, stick with it, and strike a comfortable balance between risk and return.

## Annuity Maximization: A Strategy to Leave More to Your Heirs

What if you're living comfortably in retirement and find that you don't need a deferred annuity you bought years ago? Instead, you want to leave it to your heirs at your death. What you may not know is that transferring your deferred annuity at death may subject it to both estate and income taxes. A strategy that can minimize the impact of these taxes is called annuity maximization using permanent life insurance.

### Some background

When you die, the portion of the annuity death benefit received by your beneficiaries (either in a lump sum or as periodic payments) that exceeds your investment in the annuity is includible as taxable income to your beneficiaries.

In addition, the full accumulation value of your deferred annuity is includible in your gross estate at your death. If your estate is large enough to owe federal and/or state estate taxes, your deferred annuity will be subject to those taxes as well.

The combination of estate and income taxes can erode a significant portion of your annuity's value. The result is that your beneficiaries may receive an annuity worth much less than you anticipate.

### How annuity maximization works

Here's the basic way this strategy works: you exchange your deferred annuity for a single premium immediate annuity (SPIA) that provides an income stream to you for the rest of your life. You then obtain permanent life insurance with you as the insured, and use the SPIA distributions to pay the insurance premiums. At your death, the SPIA payments stop and the insurance proceeds are paid to your beneficiaries.

Alternatively, if you prefer to retain the deferred annuity instead of converting it to an SPIA, you may be able to take penalty-free withdrawals from your deferred annuity, which also can be used to pay the insurance premiums. However, annuities vary as to penalty free withdrawal availability, so for complete details, be sure to check with the annuity issuer, or review your annuity contract or prospectus.



**Caution:** Annuity distributions before age 59½ may be subject to a 10% federal tax penalty. Annuity guarantees are based on the claims paying the annuity issuer.

The annuity maximization strategy may pose some income tax issues for you. SPIA payments and annuity withdrawals may be taxable to you. A portion of each SPIA payment you receive is subject to income taxes and a portion is considered a nontaxable return of premium. Conversely, withdrawals from your deferred annuity (for annuities issued after 1982) are taxed as income first, meaning the entire withdrawal is includible as income until all of the annuity's earnings are withdrawn, after which withdrawals of principal are not includible as income.

### Why annuity maximization works

Instead of getting the deferred annuity at your death, your beneficiaries receive the life insurance proceeds, income tax free. And you can effectively remove the value of the deferred annuity from your estate by converting it to a SPIA. Since the SPIA payments cease at your death, the SPIA is not included as an asset of your estate.

In addition, the life insurance can escape estate taxes if the policy is not part of your estate at death. To achieve this goal, you can't own the policy; it must be owned by another (e.g., your child or an irrevocable

life insurance trust). You then make gifts to the policy owner equal to the annual insurance premium. However, gifts may be subject to both federal and state gift taxes, so you should consult your tax professional before making such gifts.

### The bottom line

If you own an annuity that you want to transfer to your heirs at your death, a significant portion of its value may be lost to estate and income taxes. Annuity maximization is a strategy that lets you replace part or all of a taxable asset (your deferred annuity) with an asset (permanent life insurance) that may be subject to neither income nor estate taxes at your death. This approach may effectively allow you to increase the amount you pass on to your beneficiaries.



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## ASK THE EXPERTS

### Will the current credit crunch impact my child's ability to get a student loan for college?

It's hard to say whether the credit crunch will prevent students from obtaining the financing they need to pay for college. According to the College Board, last year students and their families borrowed nearly \$60 billion in federal loans and \$17 billion in private loans for college. In order to understand the current student lending market, some background is helpful.

**Federal student loans.** Under the Federal Family Education Loan Program (FFELP), private lenders receive subsidies from the federal government to issue federal student loans at reduced interest rates. But last year, Congress slashed subsidies to FFELP lenders. This, coupled with tightening credit and near paralysis in the secondary debt markets, created the perfect storm—a student lending market in potential turmoil due to the unwillingness and/or inability of some private lenders (to date more than 50) to make, package, and sell federal student loans. The problem was big enough to attract the attention of the federal government—legislation passed in May allows the Department of Education to buy billions of dollars in federal

student loans from private lenders to keep money flowing into the widely used FFELP. The consensus is that there will be enough federal student loan money—Stafford, Perkins, and PLUS Loans—in the FFELP to go around for the 2008/09 academic year.

**Private student loans.** Over the past decade, the use of private student loans to finance college has soared as federal student loans fail to keep up with rising costs. This year, college students in need of private loans are expected to face higher interest rates and more stringent credit checks. Unfortunately, this means that some students who qualified for a loan last year may not this year, or they may have to pay a higher interest rate. The federal government has not proposed buying private student loans, so lenders will be on their own to raise the necessary capital.

### What is a Parent PLUS Loan?

A Parent PLUS Loan is a federal student loan available to parents with good credit histories who want to help pay for their dependent child's undergraduate education. (A similar Graduate PLUS Loan is available to graduate students.) Under the program, parents can borrow up to the full cost of their child's college education each year, less any financial aid received. For example, if college costs \$30,000 this year and a student receives \$10,000 in financial aid, parents would





potentially be eligible for a \$20,000 PLUS Loan. To qualify, students must be attending an eligible school at least half time.

PLUS Loans aren't based on financial need; parents need only pass a credit check. Under new federal

legislation passed in May, parents who are delinquent up to 180 days on their home mortgage or medical debt will still be considered creditworthy to borrow under the program. The interest rate on all PLUS Loans issued on or after July 1, 2006, is capped at 8.5%. (For PLUS Loans issued before this date, the interest rate is variable, adjusted each July, and capped at 9%.)

Interest begins accruing upon the first loan disbursement, but thanks to the recent legislation, parents have the option to defer repayment of the loan for up to six months after their child leaves school. Previously, repayment was required to begin within 60 days of the last loan disbursement for that year.

PLUS Loans can be made either by private lenders who participate in the Federal Family Education Loan Program (FFELP), or directly by the federal government under the William D. Ford Federal Direct Loan Program. The federal government recently took steps to pump liquidity into the FFELP market due to turmoil in the general credit markets, so fund availability isn't expected to be a problem.

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