



IN THIS ISSUE:

Cash Flows: The wind in your financial life plan's sails1

Roth IRA's: Divide and Conquer3

Ask the Experts4

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.

Cash Flows: The wind in your financial life plan's sails

Can you have too much of a good thing?

In this issue of Pathways, we'll begin to bridge certain aspects of your financial life planning process with the more traditional concepts. To learn more about our unique financial planning process as well as the EVOKE method of financial life planning, visit our website at www.newwealthadvisors.net as well as this related web site, www.kinderinstitute.com

Do you ever wonder where your money goes each month? Does it seem like you've gotten sidetracked when it comes to reaching your financial goals? If so, you may want to review and perhaps revise your budget. Doing so can help you determine how you're spending your money, and that might show you what you need to do to get back on track.

"Oh, we don't need a budget," you might be saying, "We have plenty of money." If that's true, great! But if you aren't reaching your financial goals, there's a reason for that. Reviewing (or simply creating) your budget might help you find out what that reason is.

Examine your financial goals

Prior to reviewing your budget there should be an examination of your financial goals. After all, planning any trip's itinerary depends in part on knowing where you want to go!

Unfortunately, our experience is that an honest, effective review and prioritization of one's goals is usually the step that is shortchanged, when left to one's own. The reasons for this are many, oftentimes deep, and will be explored further in our future issues. Too often, absent the insight, guidance, structure, and most importantly some very real listening offered by an integral financial life planner, a person's truest aspirations will remain uncovered or unspoken. As a result, even the most sound financial planning available would, at best, usher one to the wrong finish line. For anyone undertaking a review of their cash flows and budget planning, and especially couples, we

strongly advise a visit with a financial life planner beforehand, to ensure you're driving toward your truly desired destination.

Keeping track

Budgeting is largely about tracking and projecting your income and expenses. You can use one of the many software programs or web-based applications designed for this purpose. Be warned, online tools that are easier to use tend to lack in depth and flexibility, whereas the more robust modules are not very intuitive for the casual user to use correctly, and often come with a hefty license fee. At New Wealth Advisors, our planners use comprehensive cash flow planning software, to go well beyond current budgeting into thorough forecasting and "what-if" planning. This also frees up considerable time and hassle for you, allowing you to focus on the results. The most important element of this process is to do it consistently.

Income and Expenses

Much of your income may come from your salary, government benefits such as Social Security, a pension, or retirement account distributions. But don't forget to include all forms of income, such as child support and/or alimony, portfolio earnings, annuities, and variable items related to business holdings, private investments, and the like.

Expenses generally fall into two categories. Fixed expenses are the "have-to" basics: housing, utilities, food, clothing, and transportation. Discretionary expenses are "want-to" items: dining out, entertainment, vacations, and hobbies.



EVOKE®

The 5 Phase Life Planning Process

Strive to treat your personal wealth like a business, capping fixed expenses wherever possible, and monitoring for ever-increasing or highly variable discretionary expenses. Discipline and foresight go a long way to ensure your expenses do not derail your dreams.

Irregular expenses can't be predicted, but they always occur: car repairs and home maintenance are good examples. Remember to include these types of expenses in your accounting. For example, if you paint your home every 5 years, one-fifth of the total is your annual expense.

When projecting cash flows over a longer timeframe, inflation must be considered and may be quite different for various costs. Consider for example health care or education rate increases vs. say, utilities. Lastly, income taxes are often one of the largest budget items, and can be difficult to project over a period of time. Using a flat rate or simple estimate could cause budgets to vary greatly from your actual tax, wreaking havoc with your planning. All the planners at New Wealth Advisors hold a Masters degree in tax, bringing clarity into this significant aspect of your cash flow planning, not to mention insight as to how to lower your taxes.

Finally, prioritize the funds you'll need to meet both your short- and long-term goals as regular expenses in your budget.

And the answer is...

A clear projection of your cash flows lays the groundwork for the real planning to begin. It allows for efficiency and utilization reviews, and effective prioritization. You might dispense with various lesser (though seemingly harmless) costs that aren't tied to your prime aspirations, and accept a new or higher expense that is directly related to a key goal. Refinancing options, source funding reviews, and revenue alternatives can be better addressed when overlaid onto well crafted cash flow plans. Projected surpluses provide freedom to accelerate goals, pursue new interests, relax asset allocations, and pave the way for much more fundamental life changes, such as work/life balance, charitable endeavors, significant change in residency, or to finally start writing that novel. But you'll want to have a high level of certainty as to your sustainable cash flows if you wish to start down that new path with no second guessing.

THE FINANCIAL LIFE PLANNING PROCESS

- Exploration
- **Vision**
- Obstacles review
- **Knowledge transfer**
- Execution and monitoring

Of course, if you're spending more than you're making, you're running a deficit. You might not feel the pinch if you're very good at juggling or funding it with increasing credit card debt or a home equity line of credit. But even the best of jugglers drop the balls sometimes, and increasing your debt can be dangerous. If that's what you're doing, you're sidetracking your budget into a dead-end spur.

So, to balance your budget and get back on track toward meeting your goals, you'll have to either increase your income, reduce your expenses, modify your investment allocations, sacrifice future goals, or all of the above. Not fun. As you may have seen while tracking your expenses, it's often your discretionary spending that leads to a derailment when it comes to meeting your goals. Rather than shortchange your goals (you'll only be shortchanging yourself if you do), work on reducing discretionary expenses.

But what about *carpe diem*?

What if my current level of discretionary spending IS my goal? A valid and common point. After all, utility is in the eye of the spender. It's best, however, to have a clear grasp on your ongoing ability to maintain such levels under varying circumstances. Stress-test your future cash flows now, and take any corrective action sooner while it's relatively painless, vs. later when it may be too late. The current record of short-sales, foreclosures, and former multi-millionaires rejoining the ranks of the working class all echo the same sentiment, "if only..." Committing to your most meaningful goals, while reducing and redirecting most expenditures toward those aims, can have a dual benefit of marrying meaning with your money, while eliminating deficits.

Staying on track

You'll need to monitor your budget to keep it on track. Remember that, like life itself, you'll need to keep your budget as flexible as your changing circumstances may demand. Hiring a financial life planner as your personal CFO might be just the ticket to make sure you stay on track.



Roth IRAs: Divide and Conquer

As my MFA Partner Jim Guarino mentioned in a November 2009 blog post on Roth IRA conversions, starting this year all taxpayers — regardless of income levels — can now convert a traditional IRA to a Roth IRA. This change applies to 2010 and beyond but carries a special tax incentive for 2010 conversions; the income tax due on the 2010 conversion can be spread equally over the following two tax years (2011 and 2012).

I'd like to follow on Jim's blog post and offer some additional food for thought on the subject of Roth IRA conversions. In particular, I'd like to share a little known Roth conversion strategy that is worthy of consideration. In essence, it's a strategy that involves converting a traditional IRA to multiple Roth IRAs, each with a single, distinct asset class. By implementing this type of strategy, investors allow themselves the time and the opportunity to assess the performance of each Roth IRA separately before committing to making the conversion permanent.

Under current Roth IRA conversion rules, investors can “undo” conversions any time before the tax filing deadline for the conversion year. This is what's known as a “Roth recharacterization.” Understand though, that recharacterization is an “all or nothing” decision. The IRA owner cannot “cherry pick” and recharacterize only those Roth IRA assets that declined in value. If one elects to recharacterize, the entire Roth IRA must be recharacterized, hence the reason for creating a number of Roth IRAs, each with a single, distinct asset class.

Putting a Roth Segregation Strategy Into Play

To put a Roth segregation strategy into play, investors simply convert the portion of the traditional IRA they wish to convert into multiple Roth IRAs, each of which holds a different asset class (bonds, U.S. equities, international equities, real assets, private equity, etc.). The idea behind this allocation strategy is to isolate (or segregate) the returns from each asset class, as they will likely all perform differently, and then keep the best performers as Roth IRAs and recharacterize the losers back to traditional IRAs. It doesn't change the fact that certain investments lost money, but at least no taxes are due on the Roths that declined in value. Investors will only owe taxes on the Roth IRAs left converted and will have eliminated paying taxes on the Roth amounts that were recharacterized.

To illustrate, let's consider the following scenario.

Barbara has a single, \$100,000 traditional IRA. She would like to convert the entire \$100,000 into four Roth IRAs, each invested in a different asset class. In order to do so, she splits her \$100,000 into four separate IRAs based on these distinct asset classes. She then converts those four IRAs into four separate Roth IRAs. Once that's done, it's time to sit back and watch how they perform.

Prior to April 15th of the following year (or October 15th if an extension is filed), Barbara will assess which Roth IRAs performed well and which declined in value. Let's say two declined substantially. Barbara can “undo” those two Roth IRAs by recharacterizing them back to traditional IRAs. By doing so, Barbara will not have to pay taxes on the total \$100,000 she initially converted; instead, she will only pay taxes on the two remaining Roth IRAs.

Now, the story doesn't end there. Barbara can take advantage of the decline in value to once again convert those recharacterized IRAs back to Roth IRAs, but now at lower values and thus lower taxes. The only stipulation is that she wait 30 days after the recharacterization or one year after the initial conversion, whichever is later. By continuing to use this segregated conversion approach, Barbara has in effect adopted a strategy that minimizes conversion taxes within the larger goal of ultimately converting her traditional IRA to Roths.

This strategy combined with the ability to recharacterize may be beneficial in other areas. For example, anticipated tax law changes, changes in one's financial situation or other planning considerations may prompt an IRA owner to consider recharacterizing a portion of their Roth IRA before the deadline. An all-or-nothing recharacterization scenario can leave one handcuffed, whereas the flexibility and hindsight offered by this strategy could prove to be invaluable. The new Roths don't have to be segregated by asset class, either. One holding private equity in an IRA might hedge their conversion approach by segregating unit holdings into multiple IRAs, and then monitoring valuation changes near the tax filing deadline. Beyond the tax benefits is the ability to far more easily benchmark the performance of your various investment holdings within IRAs — tough to do in the all too common “pooled” IRA approach.

Although this strategy is straightforward, it does require the insight of a financial planner with extensive tax experience to ensure conversion taxes are minimized without impeding on the overall conversion strategy and financial plan. Be sure to contact a skilled practitioner for guidance.



What is the premature distribution tax?

Taxable distributions you receive from an IRA, 403(b), 401(k), or qualified employer plan before age 59½ are generally referred to as premature distributions, or early withdrawals.

To discourage early withdrawals, they're subject to a 10% federal penalty tax (and possibly a state penalty tax) in addition to any federal and state income taxes. This 10% penalty tax is commonly referred to as the premature distribution tax. Not all distributions before age 59½ are subject to this penalty, however.

Here are the most important exceptions:

- Distributions due to a qualifying disability
- Distributions to your beneficiary after your death
- Distributions up to the amount of your tax-deductible medical expenses
- Distributions made pursuant to a qualified domestic relations order (QDRO)
- Qualified reservist distributions
- Distributions from an IRA (but not an employer plan) to pay first-time homebuyer expenses (up to \$10,000 lifetime)
- Distributions from an IRA (but not an employer plan) to pay qualified higher education expenses
- Distributions from an employer plan (but not an IRA) after separation from service at 55 or older
- Certain distributions from an IRA (but not an employer plan) while you're unemployed up to the amount you paid for health insurance premiums
- Amounts levied by the IRS
- Distributions that qualify as a series of substantially equal periodic payments (SEPPs)

If you must take a distribution from your IRA or employer plan before age 59½, be sure to determine if one of these exceptions applies to you.

What is the "SEPP" exception to the premature distribution tax?

Taxable distributions you receive from an IRA or 401(k) plan before age 59½ are subject to a 10% early withdrawal penalty unless an exception applies. One important, but sometimes overlooked, exception is for SEPPs - substantially equal periodic payments.

SEPPs are amounts you withdraw from your IRA or employer plan over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually.

You can take advantage of the SEPP exception at any age. But payments from an employer plan must begin after you separate from service. Even though SEPPs are initially determined based on lifetime payments, you can change - or even stop--the payments after five years, or after you reach age 59½, whichever is later.

For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce (or stop the payments altogether) once you reach age 59½.

But be careful--if you "modify" the payments before the required waiting period ends, the IRS will apply the 10% penalty tax (plus interest) to all taxable payments you received before age 59½ (unless the modification was due to death or disability).

If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

SEPPs can be complicated--especially the modification rules. But taking the time to understand this important financial planning tool can be well worth the effort.

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