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Pathways

November 2008

The Benefits of Investing with a Financial Plan

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Life is a relentless teacher. Lately, the same can be said for the market. The current market turmoil has almost every investor reconsidering the extent to which they should be invested in the stock market. Many investors are looking at their declining investment values and wondering if they would be better off investing in a money market account or other "safe" asset.

It is admittedly tough to stomach what have become almost daily 300-500 point swings in the Dow and these past several weeks have been harsh for most investors. The Dow is off 40% from its October 2007 high, and the more diversified S&P 500 is off 42%. If only we had a crystal ball, we could have sold every portfolio to cash and Treasuries early last October. But that is the last thing that long-term investors should do now.

Investors typically sell after market downturns and don't buy back until late in recoveries. This causes investors to feel the pain twice. First, investors lock in their losses, then they risk missing out on the eventual recovery. Studies show that investors who cashed-out during a bear market and waited until the market recovered before getting back in, typically lost out on double digit gains. Investors who held on through the last 12 bear markets gained an average of 32.5% in the first year following the market's recovery. Investors who jumped back into the market just 3 months late gave up over 17% of the market's gains and it took them an additional 1 1⁄2 years to recoup their losses.

Despite these recurring trends and lessons to be learned from the past, the same mistakes are no doubt being made during this downturn. For most investors, this cycle feels different from the past ones, more permanent, as it always has felt before, yet somehow forgotten. While these feelings are understandable, discussions and informal surveys among the Certified Financial Planner community are revealing something interesting. The investors who work with Certified Financial Planners, while certainly concerned about these recent and historic events, are generally not experiencing the same level of angst and uncertainty as the average investor. The reason is clear. These investors developed a sound personal financial plan.

Their financial plan was developed prior to investing in the stock market. They became educated beforehand as to the history and reality of market uncertainty. Their investment plan was derived based on their unique financial make up, including their particular goals, income needs, investment time horizons, true risk tolerance, and numerous other considerations unique to them. Their thoroughly developed plan anticipated not only growth, but also the inevitable and random periods of decline, and was exhaustively stress tested for failure, in our clients' cases literally 10,000 times. This proactive, reality based approach to designing an investment plan allows clients to know in advance that their investments can withstand this volatility, and when the downturns do arrive, there is no need to panic. These investors are benefiting more now then ever because they are working with a Certified Financial Planner.

Having a disciplined, long-term approach gives investors the best chance of achieving success. This investment strategy is best developed with a Certified Financial Planner. Having the insight and clarity provided by a thoroughly designed personal financial plan allows the investor to do what needs to be done right now - staying their course

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.

2008 Year-End Tax Planning Tips

Despite passing several major pieces of tax legislation in the past year, Congress is still considering a host of expired and expiring provisions. While it's likely that several of these provisions will be renewed for the 2008 tax year, the uncertainty creates a challenging planning environment. With the window of opportunity for many tax-saving moves closing on December 31, it makes sense to focus on the basics, while staying ready to take advantage of any late-breaking legislative developments.

Timing is everything

Year-end tax planning is as much about the 2009 tax year as it is about the 2008 tax year. There's a real opportunity for tax savings when you can predict that you'll be paying taxes at a lower rate (for example, if your income will be significantly different) in one year than in the other. If that's the case, some simple year-end moves can pay off in a big way. For example, you may be able to defer a yearend bonus, or delay the collection of business debts, rents, and payments for services. Similarly, you may be able to accelerate deductions into 2008 by paying some deductible expenses in December rather than in January.

Alternative minimum tax (AMT) facts

If you're subject to the AMT, traditional yearend maneuvers, like deferring income and accelerating deductions, can actually hurt you.

The AMT—essentially a separate federal income tax system with its own rates and rules— effectively disallows a number of itemized deductions, making it a significant consideration when it comes to year-end moves. For example, if you're subject to the AMT in 2008, prepaying 2009 state and local taxes won't help your 2008 tax situation, but could hurt your 2009 bottom line.

Don't overlook IRA and retirement plan opportunities

Traditional IRAs (assuming you qualify to make deductible contributions) and employer sponsored retirement plans, such as 401(k) plans, allow you to contribute funds pretax, reducing your 2008 income. Contributions you make to a Roth IRA or Roth 401(k) aren't deductible, so there's no benefit for 2008, but qualified Roth distributions are completely free from federal income tax—making these retirement savings vehicles very appealing.

For 2008, the maximum amount you can contribute to an IRA has increased to $5,000, and you can contribute up to $15,500 to a 401(k) plan. If you're age 50 or older, you can contribute up to $6,000 to an IRA, and up to $20,500 to a 401(k). The window to make 2008 contributions to your 401(k) closes at the end of the year, while you can generally make 2008 contributions to your IRA until April 15, 2009.

If you qualify, consider whether it makes sense to convert some or all of your traditional IRA assets to a Roth IRA. Funds that you convert, to the extent the funds represent investment earnings and deductible contributions, are considered taxable income. Nevertheless, the potential future tax benefit could outweigh the current tax bill.

Expired provisions that were renewed

In addition to AMT relief, other provisions that were to expire at the end of 2007, but were renewed, included:

- Election to take an itemized deduction for state and local sales tax in lieu of state and local income tax
- Above-the-line deduction for qualified tuition and related expenses
- Above-the-line deduction for certain expenses of elementary and secondary school teachers
- Tax-free distributions from IRAs for charitable purposes of up to $100,000 per person, per year

It's always difficult, at best, to anticipate what Congress will do. In an election year, it's even more unpredictable. If the last few years are any indication, though, it's not unreasonable to assume that we might see some legislation late in the year, so stay alert.

AMT triggers

You're more likely to be subject to the AMT if you claim a large number of personal exemptions, deductible medical expenses, state and local taxes, and miscellaneous itemized deductions. Other common triggers include home equity loan interest when proceeds aren't used to buy, build, or improve your home, and the exercise of incentive stock options.

Roth conversions

Individuals who would like to contribute to a Roth IRA but don't qualify because of income limitations might benefit from making nondeductible contributions to a traditional IRA today, and converting the funds to a Roth IRA in 2010, when the income limits no longer apply. Additionally, for Roth conversions in 2010 only, any resulting taxable income will be deferred until 2011 and 2012 (with 50% taxed in each year).

Ten Gifting Traps You Should Avoid

Lifetime gifting can be a powerful estate planning tool. Transferring property during your life, instead of at your death, has many advantages. Making lifetime gifts can be desirable for personal reasons (e.g., to help your children or other family members) or for financial reasons (e.g., saving taxes). No matter what your reasons for starting a gifting program, there are a few gifting traps you should be aware of.

1. The kiddie tax rules

Beware of the kiddie tax rules when transferring income-producing property to your children. Investment income over $1,800 (for 2008) will be taxed at your marginal income tax rate, not your child's.

The kiddie tax rules apply to children who are: (1) under age 18, (2) age 18 with earned income that doesn't exceed one-half of their support, and (3) ages 19 to 23 who are fulltime students with earned income that doesn't exceed one-half of their support.

2. Gifts of retained interests or powers

Be careful when making gifts of property in which you retain some financial interest (e.g., a life estate, right of reversion, or right of revocation) or powers (e.g., the power of appointment). This property may be includible in your estate for estate tax purposes.

For example, say you transfer ownership of your home to your son on the condition that you're allowed to continue living in the home for the rest of your life. You have retained a financial interest in the home, and this interest may be includible in your estate for estate tax purposes.

3. Income taxation of gifts made to a trust

Some types of trusts are taxpaying entities, which are taxed at more compressed income tax rates than individual taxpayers. If you'll be using such a trust, be sure to consider the consequences of paying income tax on trust income at higher income tax rates.

4. Delays in making a gift of life insurance

Do not delay making a gift of a life insurance policy on your life. A transfer of an insurance policy by gift within three years of death results in the proceeds being includible in your estate for estate tax purposes.

5. Delays in planning your estate to meet percentage tests

Do not delay removing certain nonbusiness assets to help your estate meet the percentage tests to qualify for Section 303 (redemption of stock), Section 2032A (special use valuation), or Section 6166 (installment payout of taxes) tax treatment. This technique will work only if the gift is made more than three years prior to your death.

6. Payments for tuition or medical care made to the donee

Payments you make for tuition or medical care on behalf of another are exempt from federal gift tax. However, to qualify, you must make the gifts directly to the educational or medical institution—do not make such payments to the donee.

7. Overlooking gift splitting

For 2008, you can give $12,000 per donee federal gift tax free under the annual gift tax exclusion. There is also a gift-splitting privilege for spouses who qualify that can double the exclusion.

8. "Reverse" gifting if death is imminent

Reverse gifting is a technique where a healthy individual transfers low-basis assets to a dying individual. If the decedent lives for more than one year from the date of the transfer, the basis gets stepped up to fair market value. However, the basis will not get stepped up if the decedent dies within a year of receiving the gift, and should this happen, you may end up needlessly paying gift tax and/or using up your $1 million gift tax applicable exclusion amount.

9. Overlooking the benefit of taxable lifetime gifts

Don't assume that lifetime gifts and transfers made at death result in the same tax effect. Paying gift tax on taxable lifetime gifts can result in an overall tax savings because the tax you pay is also removed from your estate.

10. Selecting property that does not attain your tax savings objectives

There are some types of property that you should avoid giving if you want to enjoy tax savings, such as property that has depreciated in value or is likely to depreciate.

No matter what your reasons for starting a gifting program, there are a few gifting traps you should be aware of.

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