



A Creative Personal Finance Report



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August 2008

Two Sad Stories

Robert takes a new job. His share of the retirement plan where he worked for many years is \$100,000. He does not transfer the distribution directly to his new employer's qualified plan and receives \$80,000 with \$20,000 in taxes withheld. Rather than rolling over the entire amount into an IRA, Robert spends the \$80,000 and now owes taxes on the entire \$100,000 plus a 10 percent penalty (assuming Robert is under age 59 1/2) on the entire \$100,000. Assuming a 36 percent tax rate (31 federal and 5 state on average), Robert incurs \$46,000 in taxes and penalties.

Anne, who is under age 55 is laid off and is entitled to a \$100,000 distribution from her former employer. She receives a check for \$80,000 and rolls over the entire \$80,000 within 60 days into an IRA.



Nevertheless, under the law, Anne incurs penalties on the \$20,000 in taxes withheld. Assuming a 36 percent tax rate, Anne loses the tax deferral on future earnings on the \$20,000 and pays \$9,200 in taxes and penalties.

And there are more sad stories yet to be told.

Whether you are retiring, changing jobs, or have lost your job, arranging for

Benefits of Personal Financial Goals

If you're not sure where to start in designing a blueprint for financial decision-making, this strategies primer may help. It establishes priorities for anyone at any financial stage of life and lays out, in eight simple steps, just how to take control of your finances.

Step 1. Organize your financial records.

Step 2. Identify and write down your financial goals and objectives (and the strategies to reach them).

Step 3. Calculate your net worth. This is simply a matter of figuring out what you own less what you owe.

Step 4. Establish a spending plan. A spending plan details where your money comes from and where it goes.

Step 5. Build an emergency fund. Ideally, you want to have enough cash on hand to cover three to six months of basic living expenses should you lose your regular sources of income.

Step 6. Reduce or minimize consumer debt. Debt drags down the rest of your financial efforts like a heavy anchor.

Step 7. Obtain adequate and carefully selected insurance.

Step 8. Draft four key estate-planning documents. Every adult should have (1) a will; (2) a durable power of attorney, which appoints someone to handle your legal and financial affairs if you're unable to; (3) a living will, which declares what life-sustaining medical treatments you want should you be incapacitated; and (4) a health-care durable power of attorney.

your employer to transfer your distribution directly to another plan or an IRA offers a number of advantages:

- Uninterrupted earnings on the entire sum and on future earnings,
Continuing tax deferral on the entire sum,
Reduced temptation to spend money set aside for retirement, and
Avoidance of an immediate 20 percent withholding requirement with possible tax and penalty payments.

Your employer generally must withhold 20 percent of most distributions when you depart if you do not transfer them directly to an eligible plan.

There was a time when you could take the entire amount with you when you left, and as long as you transferred the amount into another retirement plan or rolled it over into an IRA within 60 days, you could avoid any tax or penalty payments. This is no longer true.

Call if you're expecting distributions.

## Questions & Answers

**Q.** I've heard so many different stories about how long I should keep tax records that I'm really confused. What's the final word?

**A.** Of course, you can keep tax records as long as you wish, but I get the impression that you want to get rid of some old files.

Generally speaking, the IRS can come after you for taxes three years from the date you file your return. But there are exceptions. First, if you fail to claim income that amounts to more than 25 percent of your actual income, the IRS has six years to audit you and get the extra tax. Second, if you file a fraudulent return, there is no time limit.

Therefore, the three- and six-year rules apply for tax purposes as long as no fraud is involved.

**Q.** Must I contribute the full amount to open an IRA?

**A.** No. An IRA may be opened with any amount that the investment vehicle will permit.

While it may be wise to fund your IRA to the full amount possible, there is no requirement to do so.

**Q.** In your opinion, what are the worst investor sins?

**A.** Two take the honors, in our opinion. First is failure to invest regularly and the second is failure to diversify. Although systematic investing does not assure a profit or preclude loss, getting into the "habit" of investing on a regular basis is one of the cardinal investment rules.

One's portfolio should be well-balanced in order to be well-preserved. Of course, investors can over-diversify, which can also be dangerous. The opinion of a professional advisor can really be helpful when considering portfolio diversity.

*We will accept questions from readers and reprint selected answers in this column. Send your question(s) to us; we'll answer as many as we can.*

# Financial Notes Worth Noting

## Your Boat Just Docked. What to do?

All of a sudden, you're the recipient of a windfall. It may be the result of someone else's catastrophe (e.g., an inheritance), winnings, retirement plan distribution, proceeds from sale of your home or you just plain good luck. It doesn't matter how you got rich or "quasi-rich" or just "a little better off" than you were before, depending on how you look at it. There are a few ideas that you should take into consideration:

**1. Stay calm.** While those about you are going bananas over your new-found wealth, you must make rational and careful decisions with your money. Check for any deadlines (like the 60-day rollover provision in retirement plan distributions) and then take your time.

**2. Prioritize your spending/investment ideas.** Are you in the market for an education fund? Are you beyond that consideration and looking for a life of leisure? Is a vacation home on the horizon or a larger personal residence? Do you need long-term care insurance? Are you interested in going into business for yourself? or bolstering your retirement fund balances?

**3. Get advice.** Don't try to do it on your own; let professionals guide you in your decision-making. You need not give up control . . . just consider professional advice.

**4. Invest the money well while you decide its ultimate fate.** You might consider several short-term, safe and secure investments until your entire money management plan is designed and ready to implement.

**5. Consider getting out of debt.** Under current law, personal debt is not beneficial. Consider paying down debt that does not allow for tax write-offs.

**6. Carefully consider the tax consequences of each move you consider.**

## On Refinancing an Auto Loan

No matter how much lower car loan interest rates go, it is probably not wise to refinance an auto loan. First of all, if your car was new when you originally financed it, you are now looking at a used car loan which is, on average, more expensive than a new-car loan. Should you find a really low rate, carefully investigate up-front fees that might mitigate your interest rate savings. If you currently are in the middle of, say a four-year loan (with only two years to go), don't consider extending the loan. Although your payments may be lower, your interest payments will quickly eradicate any money you might save on lower rates.

## Quotable Quotes on Economists

We have two classes of economic forecasters: Those who don't know and those who don't know they don't know.

**John Kenneth Galbraith**

**The First Law of Economists:**

For every economist, there exists an equal and opposite economist.

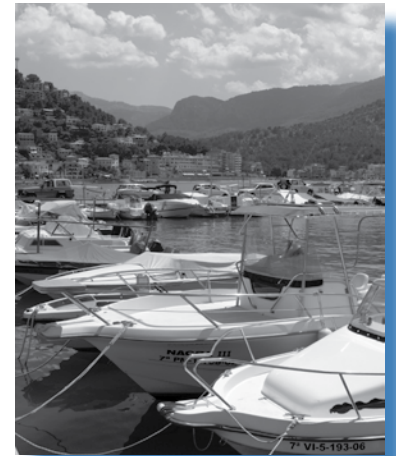
**The Second Law of Economists:**

They are both wrong.

**Anonymous**

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## Fixed Income Securities

# On Investing for Income and Stability

**A**s we know, investors are all different. But we usually talk about the need to be diversified in investment vehicles and that it is usually wise for some investments in every portfolio to provide income and stability, although diversification neither ensures a profit nor guards against loss.

Below, we review Fixed Income instruments or bonds, which may provide both income and stability.

### What are fixed income securities?

Generally referred to as bonds, fixed income securities are debt obligations and are typically issued by a government (municipal, state or federal) or a corporation. The bond issuer promises to pay a stated rate of interest to the bond purchasers over a specified period of time and, finally, pays back the principal (or face value) of the bond at "maturity."

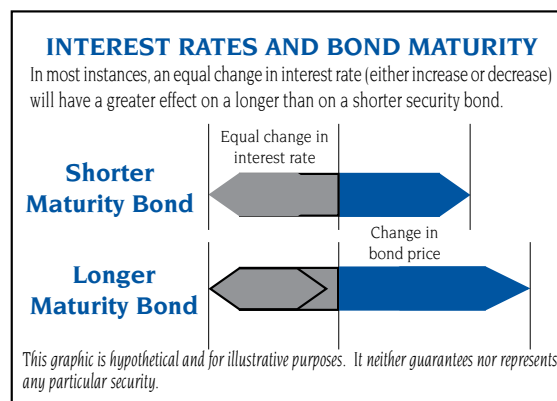
### What are the types of bonds?

There are four basic bond types: government bonds, corporate bonds, municipal bonds and mortgage-backed bonds. We'll review each of them briefly:

**U.S. Government Bonds** are fixed income securities issued by and backed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. (And, as we all

know, the government may always borrow more money to meet those obligations.)

**Corporate Bonds** are issued by



companies and are backed by the corporation's ability to repay principal and interest to the investors. These bonds normally pay a higher rate of interest than government bonds (and, usually, carry a higher rate of risk).

**Municipal Bonds** are issued by states or municipalities and are usually used to finance projects like the building of highways, bridges or large municipal buildings. The interest paid on municipal bonds may be exempt from federal and state taxes in the state of issue, offering an attractive feature to certain investors although potential earnings may be subject to the Alternative Minimum Tax.

**Mortgage-Backed Securities** are designed by pooling various types of mortgages. These pooled mortgages are sold to investors in the form of fixed-income securities. The income for these securities is created as the interest and principal is paid by the individual mortgagors. Risks associated with mortgage backed securities include, among others, credit and default, prepayment, extension and interest-rate risk.

As a fixed income investor, you should be aware of at least four items as you consider the purchase of bonds: yield, maturity, yield to maturity and the

quality of credit.

**Yield.** When you purchase a bond, the interest the bond will pay is based primarily on the prevailing interest rate at the time of purchase, in relationship to the coupon. Since interest rates fluctuate, the price of your bond will likely change. Consider a bond with a 5 percent coupon. If interest rates move to 6 percent, the 5 percent coupon bond becomes less attractive, causing the price to fall. Likewise, if interest rates should fall to 4 percent, investors would find the 5 percent bond attractive, forcing the price of the bond up. The result: price volatility, which might be somewhat controlled



by a managed portfolio of bonds with differing maturities.

**Maturity.** The maturity of a bond has a large impact on the bond's yield as well as its price volatility. Normally, the longer the maturity of the bond, the higher its yield. If sold before maturity, an investor could certainly lose money.

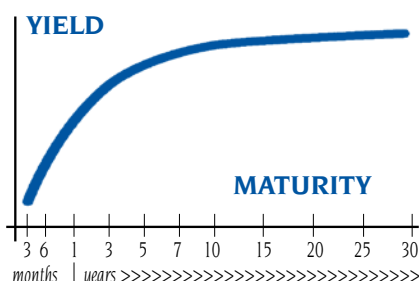
**Yield to Maturity (or redemption yield)** is a measure of the return of the bond, which allows investors to calculate the fair value of the bond. The Yield to Maturity is almost always provided in terms of annual effective rate.

**Credit Quality.** Last, but not least, the credit quality of the issuer of a bond is a very important consideration. The higher the credit quality, the less likely the issuer will fail to pay the principal and the interest.

Source: The Walsh Group

### NORMAL YIELD CURVE

In most instances, the yield of a fixed income security increases incrementally with an increase in maturity.



*This graphic is hypothetical and for illustrative purposes. It neither guarantees nor represents any particular security.*

## Boomers Worried About Money

# 44 - 62: The Gloomiest Generation?

America's baby boomers are in a collective funk. Members of the large generation born from 1946 to 1964 are more downbeat about their lives than are adults who are younger or older, according to a Pew Research Center Social and Demographic Trends survey.

Not only do boomers give their overall quality of life a lower rating than adults in other generations, they also are more likely to worry that their incomes won't keep up with inflation -- this despite the fact that boomers enjoy the highest incomes of any age group.

More so than those in other generations, boomers believe it is harder to get ahead now than it was 10 years ago. And they are less apt than others to say their standard of living exceeds the one their parents had when their parents were the age they are now.

These gloomy assessments come from a generation that always has been identified with youth (witness the resilience of their label: "baby boomers") but that's now well into -- and even beyond -- middle age. (Boomers turn 44 to 62 this year.)

However, it is by no means certain that the boomers' current bleak mood is a function of their current stage of life. When it comes to quality-of-life assessments, data suggest the boomers generally have been downbeat, compared with other age groups, for the past two decades -- starting back when some were still in their twenties. So their current sour ratings may be related to getting older, but they also may be related to the attitudes and expectations about life they formed when they were young.

In early 2008, a randomly selected nationally representative sample of 2,413 adults were asked to rate their present life on a scale of zero to 10. Boomers, on average, give their lives a rating of 6.2. In contrast, adults older than boomers (those who are ages 63 and above) give their lives an average rating of 6.7. Adults younger than boomers

(those who are ages 18 to 43) give their lives an average rating of 6.5.

This "quality of life" gap between boomers and non-boomers admittedly is modest.

A pattern of gaps, however, has lasted throughout the two decades the Pew Research Center has been asking this question, although in some years the differences are too small to be statistically significant.

Since 1989, boomers self-rankings have trailed those of adults who are older than them. As for adults who are younger than boomers, the pattern is more mixed.

### Worried About Money

The latest Pew survey finds that the boomers' glum assessments about their lives overall are matched by relatively high levels of anxiety about their personal finances. Some 55% say it is likely that their incomes will not keep up with the cost of living over the next year. That majority makes them the exception among all adults. Only four-in-ten younger Americans (44%) or older ones (43%) have that concern.

The anomaly here is that boomers are in their peak earning years. As a group, they enjoy higher median household incomes than do younger or older adults. Americans ages 45 to 64 -- roughly the same age range as the boomers -- have a median household income of nearly \$60,000. That compares with about \$53,000 for adults ages 25 to 44, and about \$30,000 for those ages 65 and older. Boomers also are more likely than younger or older adults to own stocks or bonds, and to have retirement accounts.

Even so, boomers are more anxious than other Americans that they will have to cut household spending in the coming year because money is

tight. Nearly three-in-ten boomers (28%) say it is very likely they will have to do so, compared with 22% of younger adults and 18% of older ones.

Asked about changes in their finances over the past year, most boomers (59%) report they had to spend less because money was tight, but so do most younger Americans (58%).



### Progress in Life: Asked to Look Forward and Backward

Asked to compare their standard of living with that of their parents at the same age, boomers are more downbeat than younger or older adults. Nearly four-in-ten (39%) baby boomers say their standard of living is worse, or no better, than that of their parents. That is a higher proportion than among younger adults (32%) or older ones (27%) who say the same thing.

Peering into the future, most baby boomers do not believe their own children will have a higher standard of living than they do. Only 44% of baby boomers believe their sons and daughters will be better off as adults than they are now. That is about the same proportion as among older Americans (41%), but much lower than the 58% of younger Americans who think their children will fare better than they have.

To read the entire report, visit: <http://pewresearch.org/pubs/880/baby-boomers-the-gloomiest-generation>