

# Financial Insights<sup>®</sup>

A Creative Personal Finance Report



(626) 919-3456  
(800) 365-7749  
FAX (626) 919-6127

**JOSEPH N. RUBINSTEIN, MBA**

Personal Financial Consultant  
General Securities Principal

**DIVERSIFIED SECURITIES INC.**

COMPLETE INVESTMENT AND ADVISORY SERVICES  
1000 LAKES DRIVE, SUITE #420, WEST COVINA, CA 91790  
E-Mail: joerubins@yahoo.com CAL. INS. LIC. #0A68771

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## Tax Spending, Not Investment and Saving

There is some agreement among economists, policy makers, financial researchers and other “money” pundits that we save too little while we borrow and spend too much. We see some of the fallout of those behaviors in our current economic situations.

But why are we surprised at the unwillingness of Americans to save and invest? One reason: the tax code punishes us for doing so.

Economists remind us that savings rates in the United States are in nega-



tive territory recently and have almost always been at lower levels than other industrialized countries.

Why would any taxpayer work hard to save money in order to be taxed not once, but twice? First, we tax wages and then we tax the return on any of those dollars that are saved and invested. Although lower than it was not so many years ago, the United States imposes one of the highest tax rates in the developed world on gains in the value of



assets, further stacking the deck in favor of consumption over investment.

A similar disincentive to investment is found at the corporate level. With current depreciation rules, returns on capital investment in the United States are meager and a long-time coming. An American company under the alternative minimum tax system, recovers about 34 percent of an investment over five years through depreciation allowances and other tax provisions. In those same five years, a business

in Japan, for instance, recovers nearly double that amount.

To a large extent, the U.S. tax code's bias against saving is deliberate. The current tax code was designed in the 1940s when memories of the Great Depression were fresh and pundits thought spending was the driving economic force and saving was a drag.

Wrong. As a nation, we cannot fully provide for economic growth if we raise revenue through what we believe to be an incurably flawed tax system.

## Questions & Answers

**Q.** You often talk about systematic investment, automatic investment and dollar-cost-averaging. They all appear to be the same. Are there differences?

**A.** Yes, although automatic investing and dollar-cost averaging can be linked, and systematic investing is very similar to dollar-cost averaging, there are differences.

**Automatic investing** is based on the idea that you (or your designee) transfer a fixed amount into an investment on a periodic basis. You never see the money or touch it and it “automatically” goes to the investment. Before investing “automatically,” consider your long-term ability to participate in such a plan.

**Systematic investing** is simply investing in a systematic way. Establishing a system through which your investing is done is not necessarily automatic and does not always include dollar-cost-averaging.

**Dollar-cost-averaging** is regularly investing a fixed amount of money in a specific investment. Although there is no guarantee, dollar-cost-averaging might lower the average cost of your investments in the long run. For example, if the investment were shares in a mutual fund, you’ll buy more shares when the price is low and fewer when the price is high.

All three of the techniques are appropriate for most investors although we advise investors to converse with a financial advisor before adopting new investment strategies.

None of the listed strategies (especially dollar-cost-averaging) guarantees a profit or protects against loss in declining markets. Dollar-cost-averaging requires that you a) continue investing on a regular basis, no matter what the financial circumstances/price levels; b) avoid selling investments when the market is low; and c) be able to withstand the potential volatility of investments with variable values.

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*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

## Get Fit and Save Some Tax at the Same Time?

The plight of people on “Main Street” is a hot topic of conversation recently. Let’s look at what is available in the financial rescue bill: the *Emergency Economic Stabilization Act*. Our Congress must have included bunches of stuff for the working class, right?

Well, sort of. There are a lot of credits and tax breaks including some nice incentives for energy efficiency (especially alternative residential energy in case anyone still owns a home). There are also quite a few provisions for continued disaster relief for victims of Hurricanes Gustav and Ike and (yes, believe it or not) Katrina.

But how about this one?: Transportation Fringe Benefit To Bicycle Commuters.

Deep inside the \$700 billion rescue package is a benefit if you BIKE TO WORK! Yep! It is part of the \$110 million in tax breaks that were added to the original legislation.

Ready? Any employee who uses a bicycle to get to and from work can be reimbursed for “reasonable expenses,” such as the purchase of the bicycle, improvements and repairs to it, and for storage. Employees could get \$20 for each month they use their bicycle to commute to work. How about in-line roller blades? A wheelbarrow? And your company can write off the expense!

Bicycling to work is among those benefits that loaded down the bill, with other quirky provisions such as an exemption from excise tax for wooden arrows designed for use by children; increasing the limit on excise tax on rum; and extension of a wool research trust fund.

While a bailout is not necessarily a bad thing, it’s not surprising that taxpayers might be outraged at some of the junk added at the last minute.

*Source: Clytie Bunyan, NewsOK*



## Investment Advice for the Twenty-First Century

We’re often asked for specific advice regarding the purchase of particular types of investments, but more often these days, we are being asked about generalities. People are asking what basic, fundamental strategies and concerns should be uppermost in an investor’s mind for the 2000s?

Herewith our thoughts:

- Retirement, no matter how old you are right now, has to be a main concern. While it gets a bit muddled with other requirements in the early and middle years (like children in college and aging parents), it must be a part of your investment thinking from the beginning of your earning years.
- Don’t invest in things you don’t understand.
- Even if one of life’s great changes does not occur, periodically take a fresh look at your portfolio and re-articulate your goals.
- Shop for your best yield rather than chase after it. For your liquid investments, it is appropriate to search for ways to increase your return. But searching is different than chasing; don’t inadvertently increase your risk. Remember: investments that typically offer a higher yield subject investors to greater risk.
- Invest a windfall with care and caution. People who make investment decisions in the face of a death, retirement, the sale of a business or other special circumstances may not be thinking as clearly as they might. Move slowly and deliberately.

# Is This Investment Right for You? Is It Right For You Right Now?

1

### *What is your specific financial objective?*

Before making any investment, you must decide what it is you want to accomplish with your money. Have you established your goals? Is your end the education of your children, retirement, more income now, decreasing taxes? Every investment should be made with the intention of helping you achieve one or more of your financial objectives.

2

### *Does the objective of the investment match your financial objective?*

If, for instance, your financial objective is income now and your investment is growth-oriented, you obviously have a mismatch. If you are interested in growth for the future and are in an investment that is creating passive income, there's another mismatch. You must make sure that all investments are in line with your objectives. A certain mix of objectives and investments is often OK.

3

### *What is the potential return on the investment?*

There are three ways of obtaining a return on an investment: a) current income after taxes (interest, dividends, rent, etc.), b) growth or appreciation of your original capital, c) tax savings (few and far between at this time, but still available).

4

### *What are the assumptions used in determining the potential return?*

Since no one can predict the future with any accuracy, certain assumptions are made about investments based on available facts and opinions. Other factors that

may be considered include the nature of the investment itself, inflation, economic/political factors and industry or commercial trends.

5

### *Are your assumptions reasonable and realistic?*

Many assumptions are based on fact and expert opinion, but they must be based on common sense as well. For example, if the potential return on an apartment house is based on the assumption of 100 percent occupancy, then you probably have an unrealistic assumption. If the return on a farm is based on the fact that you'll never have a bad crop year, the assumption may be unrealistic.

6

### *What's the track record and how good is it?*

Look at the people who will manage your investment. What is their track record? How long have they been in business? What is their reputation? What have they accomplished? How much is your investment dependent upon them and their expertise? Sometimes a specific type of investment does not have a good track record itself, but the people who will manage it have a long and successful history.

7

### *What could go wrong?*

There is always the possibility of something unforeseen or unlikely happening. It may be improbable, but at least it should be considered. For example, how would your investment weather these potential negatives: Is your investment inflation-proof? Deflation-proof? Is your investment sensitive to international events? Scientific discoveries? Political disasters? Technological advances? Is the potential reward worth the risk to you?

8

There is nothing you can do with money that doesn't involve a risk of some sort. There is a risk of losing your buying power in most guaranteed types of investments (savings account, etc.). There is the risk of losing some or all of your capital in the stock market or in real estate. Some people can accept greater risks than others in order to obtain the opportunity for greater reward. On the other hand, some investors feel much more comfortable accepting a lower potential reward and less risk.

9

### *Are you over-committing yourself to one investment?*

No matter how sound an investment may be, it is not wise to commit a large portion of assets to one investment. Although it cannot eliminate the risk of fluctuating prices, uncertain returns or guarantee to outperform a non-diversified portfolio, diversification or asset allocation provides you with alternatives, e.g., differing maturities, objectives, etc. Diversification enables you to accomplish overall results that otherwise might not be obtained with one investment. For example, one of your investments could provide you with liquidity, another with income and yet another with long-term growth.

10

### *Finally, can you live with this investment?*

We all have different life experiences, with emotions that result from our expectations, education, upbringing and conditioning. Some of us can live with volatile ups and downs in investments; others cannot stand even minimal risk of principal. No matter where you fall in the risk continuum, feeling confident about your investments is an important consideration.

## Information You Can Use

# A Potpourri of Everyday Financial Strategies

### A Do-It-Yourself Financial Test

What follows is a short, do-it-yourself test that may help you assess your current status and your needs for future financial decision-making:

- ▶ If you have a will and have had it reviewed within the last 2 years, enter 2 points \_\_\_\_\_
  - ▶ If you have an IRA and/or have funded your retirement plan to its maximum, enter 2 points \_\_\_\_\_
  - ▶ If you have used investments, savings or home equity to reduce your taxes, enter 3 points \_\_\_\_\_
  - ▶ If you have reviewed and/or established investment and savings goals for 2009/2010, enter 3 points \_\_\_\_\_
  - ▶ If you could have reduced your federal income tax by 10 percent last year, how much would that have been? If you really know the answer, enter 2 points \_\_\_\_\_
  - ▶ If you systematically invest on a specifically-timed basis, enter 3 points \_\_\_\_\_
  - ▶ If you know your combined state and federal marginal tax bracket for 2008, enter 2 points \_\_\_\_\_
  - ▶ If you spent at least as much time planning your finances as you spent planning your vacation this year, enter 3 points \_\_\_\_\_
  - ▶ Although you may be satisfied with the current balance of investments in your portfolio, enter 3 points only if your portfolio mix results from a deliberate investment allocation strategy and not from serendipity. \_\_\_\_\_
- Total \_\_\_\_\_

If you scored 20 or more, your financial strategies are above average. If you scored 17-19, your financial ideas need a review. If you scored 16 or less, we need to talk.

### What Your Family Should Know

**P**rovide your family with important information about your financial affairs and your most important advisors.

You should create a record of basic financial information that will prove invaluable to your family when they need this information the most. The form should include sections to document contact and account information for:

- Insurance policies
- Retirement accounts including lists of beneficiaries
- Other financial accounts (checking, savings, and credit cards)
- Investment accounts
- Lists of financial advisors
- Wills, trust agreements, and attorneys (names and locations).

### On Dying Intestate (Without A Will)

**F**ew of us want to think about our mortality, but, if you die without a will, the state will make decisions regarding the distribution of your property to heirs.

**Without a will**, many states will automatically award one-half to two-thirds of your assets to your children, even if they are adults. This could leave your surviving spouse with far less than you intend.

**Without a will**, your surviving spouse could be forced to wait many months (even years) before gaining possession of your property.

**Without a will**, all of your property will be subject to probate, a time- and asset-consuming process.

Don't put it off. Do it now.

You'll be glad you did . . . and so will your family!

### Your ship just came in? What's your next step?

**N**othing. Not for a while, anyway. And it doesn't matter what the size of the windfall is . . . what matters is how you use it. Whether it's an inheritance, a lottery hit or any other windfall, your best bet is to sit tight for at least a short while and consider your options. A few ideas:

1. Pay down credit card debt. 2. Fund IRAs for this AND next year. 3. Fund your "emergency fund." 4. Refinance your home. 5. Double up mortgage payments.

Of course, you could also spruce up your home so that it's value increases or just take a day off and spend it at a luxurious spa.

Why not? You deserve it!

Investors are reminded that there are risks involved when investing in securities markets, including, but not limited to, the loss of principal. ©2008

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