

Financial Insights®

A Creative Personal Finance Report



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November 2009

We're Thankful for the Opportunities

What are the pundits predicting for the rest of 2009 and 2010? Everything! Just as it's been for recordable history, the prognoses are all over the board.

Almost equal numbers say that the Fed will keep interest rates at their all-time low; others say we're due for an increase. Some say the stock markets will come back; others predict a series of mini bear markets or worse. Some say economic expansion is a thing of the past; others indicate that the economy will return to its previous robustness soon/in a few years/in ten years. What



are we to think/do with such differing advice when we already know that past performance is not indicative of future results?

Since the world economy, and the U.S. as an integral subset of it, is based on such a complex, high tech and puzzling mix of things (witness the divided nature of the current debate regarding the cost of war and health insurance, for example), it's impossible to predict anything with accuracy.

Starting to Save Again

In our meetings with clients and from the general press, we note that people are "saving" again. The U.S. government, which keeps some tabs on this, indicates the reasons: we've reduced our debt and cut our spending (possibly not by choice). Whether it's out of fear, loathing or just being more careful, our saving (as a percentage of available income) has gone from a figure that was less than 0 percent (yes, you read that correctly . . . less than ZERO percent, meaning that we were not only NOT saving, but were spending more than we were earning!) to somewhere around 5 percent (the most recent figures from the Bureau of Economic Analysis, a part of the Department of Commerce).

A recent article in the *Wall Street Journal* indicates a need for smart planning with the jump in savings:

- 1. Establish a "cash stash"** (what used to be called an "emergency fund"), usually about 3 - 5 months' living expense. Even at a steady 5 percent savings rate, establishing an emergency fund could take a year or so to accomplish.
- 2. Consider some of your savings for retirement**, especially taking advantage of matching contributions from an employer, if available.
- 3. Contemplate the provision of a "future" account** to handle special items like home remodeling, auto purchases and, yes, maybe even a few "evenings on the town."
- 4. How about establishing a vacation account** in order to avoid the currently inevitable dependence on credit cards when we're away from home?

Saving steadily and more can be a successful and integral part of your financial future. Try it, you'll like it.

As always, the future must be viewed through a dim and tinted crystal ball.

As taxpayers and investors, we complain about taxes, inflation and whatever works against wealth accumulation. But, on occasion, we also think about the many things we have to be thankful for . . . especially our opportunities.

"To live at this time," said Grenville Kleiser, "is an inestimable privilege and a sacred obligation devolves upon you to make right use of our opportunities.

Today is the day in which to attempt to achieve something worthwhile."

As investors, we have the opportunity to use time-honored financial strategies like asset allocation, diversification and wide investment flexibility, none of which, of course, guarantees gain or protects against loss.

We also have the opportunity to invest by OWNING (equity) and LOANING (fixed-income). A mixture of both might be good for the soul and pocketbook.

Questions & Answers

Q. *I've tapped my traditional IRA to pay for college at age 47. Will I have to pay taxes/penalties on the withdrawals?*

A. Although you didn't ask, the habit of dipping into retirement funds at age 47 these days should be a last resort.

You will have to pay taxes on the amount you withdrew for education, but penalties should not be a problem since the law allows an exception for early withdrawal to pay for qualified higher education expenses as long as the distribution is made in the same year that the expenses are paid.

Q. *I know that I should be better at informing my family and spouse about financial matters. A checklist, please*

A. Sure. The following list is what we consider the *minimum* amount of financial information that should be available to your family/spouse. Our reasoning: loved ones should be relieved of the burden of research at a time when they neither want nor need more hassles. Every year, each spouse should update a "letter of information" which includes at least the following:

- Location of important documents (will, trusts, etc.)
- Bank account numbers and locations
- List of T-bills, CDs, money market and other accounts
- List of all securities owned
- Safety deposit box information (location and keys)
- Pension and corporate benefits information
- Real estate holdings and location of papers
- IRAs and other retirement accounts (location/details)
- Professional advisor contacts
- Liabilities (amounts, due dates, name and address)
- Tax returns
- Any other information that will make things easier.

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

Inflation's Tax Parameters for 2010

In late September, the Bureau of Labor Statistics (BLS) released its August estimate of the Consumer Price Index (CPI). The August figure is the final statistic used by the IRS in calculating important tax parameters for tax year 2010. Even though tax returns for 2010 won't be filed until spring 2011, this information is necessary because employers will use these parameters to estimate withholding in 2010.

The numbers indicate that this year will mark the smallest inflation adjustment on record (since the IRS began adjusting tax parameters for inflation on an annual basis in the mid-1980s). While last year saw some of the largest year-over-year increases in most inflation-adjusted tax parameters (4.26%), year-over-year inflation for the purposes of this year's adjustment was less than 0.2 percent.

The table below shows the annual inflation rates for every year since inflation adjustments became part of the individual income tax. As one can see, the past two years are two extremes: one high and one low. That means last year tax parameters like the standard deduction and tax brackets increased substantially in value, while this year they are either increasing very little or not at all. For workers, this means they won't receive as large an increase in take-home pay this January as they did last January given the automatic inflation adjustments (assuming pre-tax wages stay the same).

Tax Year	Inflation Rate	Tax Year	Inflation Rate
1984-85	3.99%	1997-98	2.74%
1985-86	3.78%	1998-99	1.69%
1986-87	2.57%	1999-00	1.82%
1987-88	2.64%	2000-01	3.11%
1988-89	4.14%	2001-02	3.29%
1989-90	4.74%	2002-03	1.59%
1990-91	4.84%	2003-04	2.28%
1991-92	5.28%	2004-05	2.30%
1992-93	3.05%	2005-06	3.11%
1993-94	3.06%	2006-07	3.90%
1994-95	2.60%	2007-08	2.29%
1995-96	2.84%	2008-09	4.26%
1996-97	2.76%	2009-10	0.19%

The previous lowest annual inflation amount (as measured by changes in 12-month CPI average) was 1.59 percent. That was following the previous recession. But it's not even close to the near-zero inflation for 2009-10.

On Distributing Retirement Money: Tax Advantaged Account's The Last Resort

Drawing down your savings in order to support yourself (after voluntary or involuntary retirement) brings new challenges these days.

With healthier and longer lives, ordinary and necessary expenses, high medical and medical insurance costs, cost of living increases and, sometimes, taxes and reduced entitlements, you'll want to be careful about how you tap into retirement money.

Generally, it makes most sense to withdraw money from your taxable accounts before you begin to tap your tax-advantaged accounts. You want your tax-advantaged accounts to continue to grow (if they grow — no guarantees) with either tax deferral or tax-exemption. You may wish to consider rolling a corporate 401(k), for instance, into an IRA after retiring.

Also remember that, with the exception of Roth IRAs, you must begin tapping regular IRAs, 401(k) and other tax-deferred retirement accounts when you turn 70½. It is also recommended that you consider the temporary suspension of the Required Minimum Distribution rules for 2009 only.

Always seek professional tax and financial counsel for important money matters.

HEALTHY, WEALTHY AND WISE (2 OUT OF 3, IN THIS ECONOMY, AIN'T BAD)

In a recent issue of a Sunday newspaper supplement, an advertisement for antioxidants caught our eye. The headline was cute and clever; it shouted HEALTHY, WEALTHY, AND WISE. And, much like the way it is printed here, the word WEALTHY was crossed out. Underneath the headline, in smaller type, it stated: "2 out of 3, in this economy, ain't bad."

It then went on to talk about the importance of antioxidants in our diets and how this company's pomegranate-based product would fulfill the requirement, protecting us from "free radicals," and

commenting that antioxidants are now a necessity, not a luxury.

When you stop to think about that in the context of financial strategies, goals and objectives, you may come to the conclusion that it might not only be true, but it might work toward our human goals of achieving all three.

First, let's look at HEALTH. What with all the current furor over health-care reform, everyone is checking their pocketbooks regarding the cost of health care, reconsidering our tendency to leave wellness on the sidelines since "someone else" is paying for our expenses "when we get sick," and taking a better look at going to the gym a few times a week, or jogging around the block for a half hour each day. Weight and, especially, obesity, has come to the fore as a real burden on American lives and finances, so our eating habits, if not perfect, are at least becoming more monitored. And the big media exposure of the fat, sugar and salt triumvirate being the cause of the decline in health (and the hard-wired reason we all eat too much of it) has made us at least wary of sitting down with the entire half-gallon of ice cream or an entire bag of potato chips.

But even though the cost of health care is out of control, it is clear that those who are healthy spend less time in hospitals and doctors offices, are on less medication and pay substantially less for their health insurance.

That savings alone could lead to more wealth.

Second, let's review WISDOM. Wisdom is, in most quarters, considered

to be the highest form of intelligence. It is more than information and knowledge, it is more than facts, it is more than common sense. It takes all of these things, in certain combinations and

allows us to create decisions that are both practical, functional, efficient and lead to "the good life."

Wisdom allows us to know what to do and when to do it. In the field of finance and investment, this certainly does not become an ability to forecast

the future and certainly does not guarantee anything. But wisdom does give us the ability to do the things that are more apt to bring on that crossed out goal listed above: implementing tried and true strategies like specific goal setting, charting movement toward goals, changing course as needed and identifying roadblocks and creating detours around them, etc.

So, while health and wisdom will not likely bring us WEALTH beyond our dreams, they can both act as stimulants toward that goal.

And even if they do not bring us major changes in our financial wealth, our intellectual and physical "wealth" (in the form of wisdom and health) might be just as "bankable" as cash.

Let us also keep in mind that the field of positive psychology, studying the rules and paths toward happiness are clear: wealth, after a certain level (covering basics, toys and independence) does not provide more happiness. On the other hand, health and wisdom might help us reach both the goals of wealth and happiness.



“Quotes on Health and Wisdom”

Guts are important. Your guts are what digest things. But it is your brains that tell you which things to swallow and which not to swallow.

Austen Dacey

Every human being is the author of his own health or disease. **Buddha**

The function of wisdom is to discriminate between good and evil.

Cicero

He who has health has hope. And he who has hope, has everything.

Anonymous

Wisdom is knowing what to do next; Skill is knowing how to do it, and Virtue is doing it.

David Starr Jordan

It is health that is real wealth and not pieces of gold and silver.

Mahatma Ghandi

The Broken Window Fallacy

While very few forecasters are ready to predict the size of the impact the recent California fires (or any other catastrophes like the heat wave in Chicago and Katrina) will have on the U.S. economy, there are a few ideas we should keep in mind as we move forward.

No matter what happens, we need to make decisions and we need tools with which to make them.

For the time being, a lot of money and activity that might ordinarily travel to California will go to other areas. For instance, just consider the impact that these fires have had on the conference and meeting industry, vacations, sporting events, etc., all being diverted to other locations. On the other hand, lots of government spending, insurance claim payments and private construction money will be going to that California area, mostly to cover reconstruction and rebuilding expenses.

Our pocketbooks have all been affected by catastrophes — at least at the gas pumps. Although we've witnessed some reductions recently, relatively high fuel costs will likely slow the economy a bit — some manufacturers will decide that certain products are not worth the effort, energy and increased cost to make and deliver, causing a reduction in output.

Of course, reconstruction of the devastated areas will provide a bit of an uplift to the construction industry and supply lines of repair items, wood and other building supplies, furniture, etc.

All that being said, pundits are not certain that economic activity will increase substantially. Dollars spent on reconstruction efforts is money that will have to be diverted from cash which would have been spent in other areas and with other goals.

This line of thinking provides us with an opportunity to discuss the **Broken**

Window Fallacy, a fascinating economic theory. It goes like this: if someone throws a stone through a shop window, the owner needs to fix it.

Let's assume the cost to be a hypothetical \$250. The need to repair the window puts people to work and increases total output. Since this creates jobs, might we do well to break lots of windows and repair them?

Most folks think this is nonsense since, although it would employ labor, there would be no benefit to the society at large.

Yet there are many similar schemes, promoted by politicians and supported by the general public, in the name of **jobs**.

Long ago, this fallacy was exposed by the French economist Frederic Bastiat in an essay entitled *What is seen and what is not seen*. Bastiat teaches us to understand the economic reality beneath the superficial appearance of everyday economic life. What is seen is the broken window repaired, the workers working and the money they spend. What is not seen is that these workers and resources would have been employed in something else if not for the broken window. What ultimately benefits society is not jobs, but goods. In this instance, the glass store gains, but the broken window store owner loses (she probably would have spent the money on something else) — and the person that owns the shop that sells what she would have bought has a loss.

According to the late Henry Hazlitt

in *Economics in One Lesson*, "Instead of [the shopkeeper] having a window and \$250, he now has merely a window. Or, as he was planning to buy [a] suit that very afternoon, instead of having both a window and a suit he must be content



with the window or the suit. If we think of him as a part of the community, the community has lost a new suit that might otherwise have come into being, and is just that much poorer."

The **Broken Window Fallacy** endures because of the difficulty of seeing what the shopkeeper would have done. We can see the gain that goes to the glass shop. We can see the new pane of glass in the front of the store. However, we cannot see what the shopkeeper would have done with the money if she had been allowed to keep it, precisely because she wasn't allowed to keep it.

We cannot see the new suit foregone. Since the winners are easily identifiable and the losers not, it's easy to conclude that there are only winners and the economy as a whole is better off.

Overall, the economy will suffer due to continued catastrophes, not benefit as some media pundits have suggested, although the intensity and duration of the suffering is up for grabs.

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