

Financial Insights[®]

A Creative Personal Finance Report



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Two Sad Stories

Robert takes a new job. His share of the retirement plan where he has 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 withheld for taxes. 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 59½) on the entire \$100,000. Assuming a 36 percent tax rate (31 federal and 5 state on average), Robert owes \$46,000 in taxes and penalties.



Anne has been 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 owes taxes and penalties (assuming she is under age 59½) on the \$20,000 withheld. Assuming a 36 percent tax rate, Anne owes \$9,200 in taxes and penalties and loses the tax deferral on future earnings on the \$20,000.

And there are more sad stories yet to be told. Whether you are retiring,

On Quantifying National Happiness

Happiness is a highly valued matter. Most people agree that it is better to enjoy life than to suffer, endorsing public policies that aim at creating greater happiness for a greater number of people. Though not everybody accepts the utilitarian axiom that happiness is ultimately the only value, the desirability of happiness as such is almost undisputed.

As difficult as happiness is to quantify, Ruut Veenhoven, a Dutch social scientist does it. He's spent years asking people in 148 nations how satisfied and happy they are. After lots of statistical maneuvers (all pretty scientifically acceptable), he comes up with a number between 1 and 10, indicating how happy people are, nation by nation. The Swiss are quite pleased (8.0), but Togo and Tanzania are grim (2.6). Other numbers include Costa Rica, 8.5; Denmark, 8.3; USA, (7 — ranking 20th in the world in 2009); Iceland, 8.2 and Canada, 8.0.

What explains the differences? Wealth is a large factor when basic happiness levels are studied, although it does not increase happiness levels proportionately with greater wealth. Other important factors include personal pride and cultural disposition. For instance, certain Asian cultures are comparatively low on the happiness totem. Explains Veenhoven: "Personal satisfaction is played down in those cultures, meaning that a glass-half-empty rules. Perhaps that's why war-torn Colombia seems to be a happier place than Japan."

You may visit Veenhoven's website and peruse other "happiness quotients" at <http://www.eur.nl/fsw/research/happiness/>.

changing jobs, or have lost your job, arranging for your employer to transfer your distribution directly to another plan 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
- Avoidance of an immediate 20 percent withholding requirement and potential tax/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. Please review the important and new tax credits that were part of the American Recovery and Reinvestment Act of 2009?

A. Sure. The **Making Work Pay Credit** provides up to \$400 per employed or self-employed individual (\$800 for married couples filing jointly). The credit is figured as 6.2% of earned income and begins to phase out with modified adjusted gross income (AGI) of \$75,000 (\$150,000 for couples filing jointly). Taxpayers who are claimed as deductions on someone else's return are not eligible.

The credit was implemented by reducing federal income tax withholding, thereby increasing take-home pay. In some instances, certain taxpayers — especially multiple job-holders or married taxpayers with high combined incomes — may find that they haven't had enough tax withheld. You may increase your withholding for 2010, since the credit is available this year as well.

Residential Energy Credits are also available. For up to \$5,000 that you spend over the course of 2009 and 2010 (combined), you can take a credit of 30% (up to \$1,500) for improvements such as insulation, energy-efficient windows or doors, certain roofs, and energy-efficient heating and air conditioning. Improvements must meet energy efficiency standards, but manufacturer's statements are usually sufficient.

The **American Opportunity Tax Credit** is a temporary improvement to the Hope Credit, which offsets some of the cost of higher education. It may be used for expenses in any of the first four years of college (up from two for the Hope Credit). Qualifying expenses are liberalized to allow for course materials as well as tuition and fees. The amount is also increased. Income phaseouts begin with \$80,000 of modified AGI for single and \$160,000 for joint filers.

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

Best Ten Rules for Investing

- 1. Diversify, diversify, diversify.** Although diversity will not assure a profit or protect against loss and, although you don't want to overdo it, you may want to consider the many ways to diversify: investment vehicles, geography, sectors, etc.
- 2. Invest with proven people at your side.** This would include your financial planner, tax advisor, fund managers, registered investment advisors and money managers, to name a few.
- 3. Learn to live with uncertainty and, on occasion, failure.** Even the best hitter in baseball has a batting average around .300 which means he's failed to hit safely 70 percent of the time.
- 4. Invest systematically.** No matter what the system, investment in your retirement plan, an education fund, and for growth accumulation should be monthly and automatic. While systematic and automatic investment won't guarantee success, it sure helps you stay on track. (See page 4 for more on systematic investing.)
- 5. Start now.** Most failed financial plans can be blamed on procrastination. Over the years, we often have highlighted the performance of investments that are started early in life and compared them to those that are started later. It is never too early to start an investment plan.
- 6. Have patience.** If you begin with reasonable expectations about your investments and have patience, time will be on your side. The best investments are usually those held over a long period of time. Your patience is required for moderate annual improvement.
- 7. A touch of contrariness, imagination and independent thinking can't hurt an investor.** George Bernard Shaw once said, "The golden rule is that there are no golden rules." Once you think you've found the key to investment bliss, someone changes the lock.
- 8. Avoid bias in the selection of investment vehicles.** A good value can be found in almost every investment category. Look carefully at the wide opportunities available for solid investment selections.
- 9. Be flexible when events change.** Recognize and accept change and move / modify / transfer investments when necessary and appropriate.
- 10. Respect the force of government action and monitor what the government does very carefully.** Always take into account federal and state law and policy on taxation, investment and other financial parameters.



Non-Taxable Dollars

We're so used to talking about taxable income (from investments and other sources), that we don't pay a lot of attention to monies you might receive that are NOT taxable. The following is a list of cash or other funds you might receive that a) are not taxable and b) should not be listed on your tax return. Oh, Happy Day!

1. IRA and pension rollovers
2. Child support payments
3. Inheritances
4. Gifts
5. Workers comp (some exceptions)
6. Disability payments if you paid the premiums on the policy.
7. Federal income tax refund
8. Compensatory damages for personal physical injuries
9. Qualified health and accident benefits
10. Most scholarships/fellowships
11. Foreign earned income (up to \$91,500 for 2010)
12. Qualified foster care payments
13. Some social security benefits
14. Gain on the sale of your personal residence (with certain limitations)
15. Roth IRA qualified distributions.

The Financial Journey: “Life is Complex” but You May Create the Future You Want

Like it or not, we all travel the road toward financial independence. Some people make it easily; others get started too late, take the wrong turns, stop and rest for too long or meet up with other detours which keep them from reaching the goal.

But the desire is the same — not necessarily riches, but at least comfort in retirement, having taken care of all the financial needs which come before.

Almost everyone, even if they haven't read the book, know of it:

The Road Less Traveled, by M. Scott Peck, M.D. In most of that earlier book and the book that precipitated this article, **Further Along the Road Less Traveled**, he talks about the “unending journey toward spiritual growth.” There are parallels to the financial journey most of us take. It is a journey of growth and the parameters Peck attributes to the spiritual journey can easily be translated to the financial.

Let's see how the meanings might apply in the financial world:

The first book started off with the words **“Life is difficult.”** The second book begins with another statement: **“Life is complex.”**

We need not argue these statements: we all know that the journey toward financial independence is both difficult and complex. It is difficult because there are so many events and activities that are demanding our financial resources simultaneously. And many of them are important AND deserving. Our best and probably most recent example is the **sandwich generation's** attempt to balance

the demands of their children's education, their own retirement and the needs of their parents.

Likewise, the complexity of the financial world today is mind-boggling: e.g., there are more than 8,000 mutual funds and millions of investments to choose from. Using the word “complex” might even be an oversimplification!

“The journey is not paved with blacktop . . . it is a rocky path through the wilderness,” Peck continues with analogies. What with market, economic and

some people may think that the daily newspaper and other general media include “road signs,” even the best information available in those periodicals are mere glimmers. The financial world is fickle and volatile enough that any “signs” are temporary traffic pattern changes. If you don't like the current situation — wait a minute!

“The path is not linear – don't think that you take one step after another in straightforward progression.” Peck compares the journey to “a series of

concentric circles, expanding out from the core. And there is nothing simple or straightforward about it.” That could mean either that we grow as we gather information along the journey or that we “broaden” our understanding.

After all the problems Peck identifies along the way, he tells us that we do not have to make the journey alone. Just as we can make the spiritual journey with some of our friends and helpers, we can also take our steps

along the financial roadway with financial consultants and other professionals.

He ends by suggesting that, if nothing else, he hopes that his book will assist his readers in thinking “less simplistically.”

“Abandon the urge,” he concludes, “to simplify everything, to look for formulas and easy answers.” He urges us “to think multidimensionally, to glory in the mysteries and paradoxes of life and . . . appreciate that life is complex.”



political conditions constantly changing, the usefulness of hard and fast investment rules is questionable at least. We must constantly review the terrain and make adjustments.

“The journey is not brightly lit.” Along the financial voyage, there have never been bright lights that allow us to see very far ahead or keep us from being blind-sided by things unknown. We must position ourselves somewhat defensively to try and cover the ambush attacks.

“It has no road signs.” Even though

Investment Ideas

Dollar Cost Averaging And Market Volatility

Market volatility has been with us for as long as we've had free markets and is likely to be a part of the investment arena for the foreseeable future. One can (and we have) read any number of the gurus or pundits and get many different viewpoints about "what to do."

There is one thing that virtually all of them refer to: the value of dollar-cost averaging, no matter what is happening in the markets.

We must look at our time horizons. For sure, many of us were hurt by the recent bubbles and the recession. But most people who are invested for the long-term are used to seeing their investments rise and fall in value according to market fluctuations.

If you don't particularly like the market ups and downs (and who does?),

you might smooth them over somewhat with dollar-cost-averaging.

If you fear that you might buy an equity unit at its peak, just before the stock market and your units head into a slump, you should consider dollar-cost-averaging.

Dollar-cost-averaging is a disciplined way to invest a portion of your money at regular intervals without trying to guess when the market will hit its peak or its low point. And guessing is exactly what that would be!

Although certainly not foolproof, the technique of dollar-cost-averaging protects you from extreme fluctuations in any market.

Using the strategy, you buy a fixed dollar amount of a variably priced investment vehicle on a regular basis (e.g., monthly, quarterly).

By doing so, you will purchase a larger number of units when the price is low and a smaller number of units when the price is high. When the time comes to sell, and assuming that the price when you sell is higher than the average price you paid for your periodic purchases, you will show a positive return.

Although it has been a highly effective technique in many instances, dollar-cost-averaging neither assures a profit or protects against losses in a down market.

Dollar-cost-averaging also requires continuous investment, regardless of fluctuations in price. Investors contemplating the technique should consider that investment prices fluctuate and units, when sold, may be worth more or less than their original cost.

Your returns will vary.

HOW DOLLAR-COST-AVERAGING MIGHT WORK

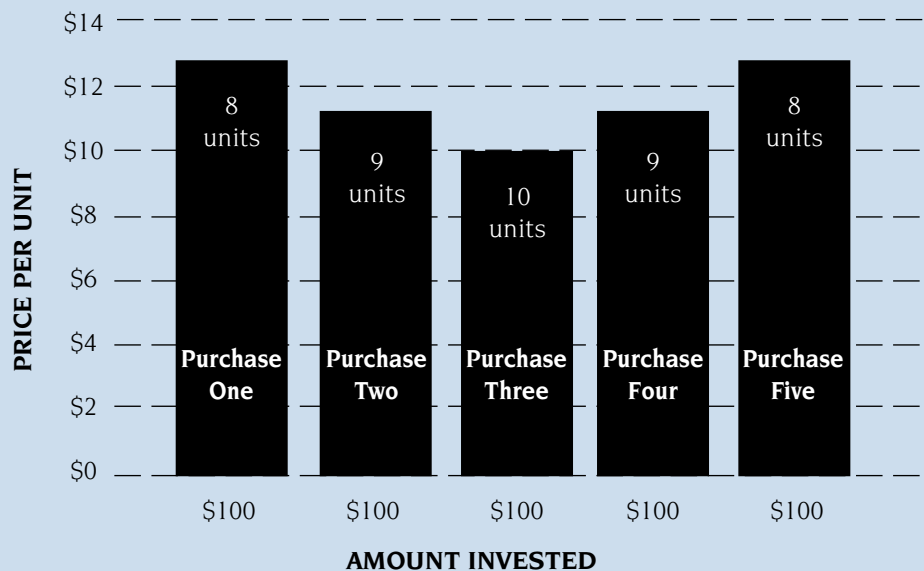
In this simple illustration, five regular investments of \$100 purchased a total of 44 units.

As the unit price fluctuated between \$10 and \$12.50, more units were purchased as the price declined, fewer as the price increased.

Although the net asset value of the units was the same during the first and the fifth purchase, the average purchase price per unit was lower than the final value per unit.

Average purchase price: \$11.36.
Closing Net Asset Value: \$12.50.
Difference: \$1.14 per unit.

This is a hypothetical example, not indicative of any particular investment or return. Your returns will vary.



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