Korbitz Financial Planning

Newsletter

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Happy New Year! Welcome to the January 2012 newsletter. Attached are four articles that I think you will find of interest. I will be sending out periodic market summaries going forward, so that information will be presented separately.

Please call or email if I can be of assistance.

Eric

January 2012

Keeping Market Volatility in Perspective

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Portability of Basic Exclusion Amount between Spouses

With mortgage rates so low, does it make sense to refinance?

Keeping Market Volatility in Perspective

When markets are volatile, sticking to a long-term investing strategy can be a challenge. Though past performance is no guarantee of future results, it might help you keep the ups and downs in perspective to see how recent market action compares to previous market cycles.

Bears versus bulls

Corrections of 10% or more and bear markets of at least 20% are a regular occurrence. Since 1929, there have been 18 previous 20%-plus bear markets (not including 2011 market action). Losses on the S&P 500 in those markets ranged from almost 21% in 1948-49 to 83% during 1930-1932; the average loss for all 18 bears was 37%.*

However, since 1929, the average bull market has tended to last almost twice as long as the average bear, and has produced average gains of about 79%.* Individual bull market gains have ranged from 21.4% at the end of 2001 to the nearly 302% increase registered during the 1990s.* The worst annual loss--47%--occurred in 1931, but the all-time best annual return--a capital appreciation gain of just under 47%--happened just two years later in 1933.**

Points of reference

Last year's volatility rattled even seasoned investors. For example, during a single week in August, 2 of the Dow's 11 best days in history alternated with 2 of its 11 worst daily point losses ever.***

While by no means normal, the highs and lows are hardly unprecedented. Even though the 634-point drop on August 8 felt historic, it didn't begin to match the real record-holders. The single biggest daily decline occurred in September 2008, when the Dow fell 778 points. The biggest percentage drop was October 1987's "Black Monday," when the Dow fell almost 23%; that makes the Dow's 5.5% loss on August 8, 2011, seem relatively tame by comparison. And August 8 was followed by the Dow's 10th best day ever, with a gain of 430 points. While that upward movement may seem exceptional, the Dow's best day ever came during the dark days of October 2008, when a 936-point move up on October 13 represented a gain of more than 11% in a single day.***

Stocks versus bonds

The last decade has been a challenging one for stocks. Between 2001 and 2010, the S&P 500 had an average annual total return of just 1.4%, while the equivalent figure for Treasury bonds was 6.6%.**** For much of that time, interest rates were falling, helping bonds to outperform stocks. However, interest rates are now at record lows, and rising rates could change the relative performance of stocks and bonds.

While there may be ongoing volatility in the markets that needs to be monitored, it's important to keep things in perspective. Your ability to meet your goals could be affected if you change your overall long-term game plan with every new headline.

Past performance is no guarantee of future results. Market indices listed are unmanaged and are not available for direct investment. All investing involves risk, including the risk of loss of principal, and there can be no guarantee that any investment strategy will be successful. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The Standard & Poor's 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy.

*DATA SOURCES: *Bull and bear market time frames, gains/losses: all calculations based on data from the* Stock Trader's Almanac 2011 *for the Standard & Poor's 500.*

***1931 and 1933 annual stock returns: based on Ibbotson SBBI data for capital appreciation of S&P 500.*

****Based on data from the* Stock Trader's Almanac 2011.

**** *10-year rolling stock returns: based on Ibbotson SBBI data for annual total returns between 2001 and 2010 of S&P 500 and an index of U.S. Treasury bonds with an approximate 20-year maturity.*

Retirement Plan and IRA Limits for 2012

A number of retirement plan and IRA limits are indexed for inflation each year. Many of the limits have increased for 2012.

Many retirement plan and IRA limits are indexed for inflation each year. Some of the key numbers for 2012 are discussed below.

Elective deferrals

If you're lucky enough to be eligible to participate in a 401(k), 403(b), 457(b), or SAR-SEP plan, you can make elective deferrals of up to $17,000 in 2012, up from $16,500 in 2011. If you're age 50 or older, you also can make a catch-up contribution of up to $5,500 to these plans in 2012 (unchanged from 2011). (Special catch-up limits apply to certain participants in 403(b) and 457(b) plans.)

If your 401(k) or 403(b) plan allows Roth contributions, your total elective contributions, pretax and Roth, can't exceed $17,000 ($22,500 with catch-up contributions). You can split your contribution any way you wish. For example, you can make $10,000 of Roth contributions and $7,000 of pretax 401(k) contributions. It's up to you.

If you participate in a SIMPLE IRA or SIMPLE 401(k) plan, you can contribute up to $11,500 in 2012 (unchanged from 2011). If you're age 50 or older, the maximum catch-up contribution to a SIMPLE IRA or SIMPLE 401(k) plan in 2012 is $2,500 (unchanged from 2011).

Contribution limits: 2012 tax year*		
Plan type	Annual dollar limit	Catch-up limit
401(k), 403(b), govt. 457(b) plans	$17,000	$5,500
SIMPLE plans	$11,500	$2,500
Traditional and Roth IRAs	$5,000	$1,000

*Contributions can't exceed 100% of your income. Special catch-up rules apply to 403(b) and governmental 457(b) plans.

IRA limits remain the same for 2012

The amount you can contribute to a traditional or Roth IRA remains at $5,000 (or 100% of your earned income, if less) for 2012, and the maximum catch-up contribution for those age 50 or older remains at $1,000. You can contribute to an IRA in addition to an employer-sponsored retirement plan. But if you (or your spouse) participate in an employer-sponsored plan, your ability to deduct traditional IRA contributions may be limited, depending on your income. Roth contributions are also subject to income limits.

Some other key numbers for 2012

For 2012, the maximum amount of compensation your employer can take into account when calculating contributions and benefits in qualified plans (and certain other plans) is $250,000 (up from $245,000 in 2011).

The maximum annual benefit you can receive from a defined benefit pension plan is limited to $200,000 in 2012 (up from $195,000 in 2011).

And the maximum amount that can be allocated to your account in a defined contribution plan (for example, a 401(k) plan or profit-sharing plan) in 2012 is $50,000 (up from $49,000 in 2011), plus age-50 catch-up contributions. (This includes both your contributions and your employer's contributions. Special rules apply if your employer sponsors more than one retirement plan.)

Income phaseout range for determining deductibility of traditional IRA contributions in 2012	
1. Covered by an employer plan	
Single/head of household	$58,000-$68,000 ($56,000-$66,000 for 2011)
Married filing jointly	$92,000-$112,000 ($90,000-$110,000 for 2011)
Married filing separately	$0-$10,000
2. Not covered by an employer plan, but filing joint return with a spouse who is covered	$173,000-$183,000 ($169,000-$179,000 for 2011)
Income phaseout range for determining ability to fund Roth IRA in 2012	
Single/head of household	$110,000-$125,000 ($107,000-$122,000 for 2011)
Married filing jointly	$173,000-$183,000 ($169,000-$179,000 for 2011)
Married filing separately	$0-$10,000

Portability of Basic Exclusion Amount between Spouses

Portability allows a surviving spouse to use the unused basic exclusion amount of the first spouse to die to shelter property from federal gift and estate taxes. Portability of the exclusion between spouses would seem to make estate planning easier for many estates. However, unless extended by Congress, portability of the unused basic exclusion amount between spouses is set to expire in 2013.

Your estate plans and documents may need to be revised to reflect the tax changes for 2011 and 2012 and for the uncertainty for 2013 and beyond. Flexibility will be key.

Transfers of property during life or at death are generally subject to federal gift or estate taxes. Each taxpayer has an applicable exclusion amount, which is the amount of property that can be sheltered from federal gift and estate taxes by the unified credit.

Prior to 2011, each spouse was entitled to his or her own applicable exclusion amount, and any amount that a spouse did not use was lost, absent special planning.

But, thanks to legislation passed in 2010, the estate of the first spouse to die can now elect to transfer any basic exclusion amount that is not used to the surviving spouse. This is known as "portability." For 2011 and 2012, the applicable exclusion amount is redefined as equal to the sum of the basic exclusion amount of the surviving spouse and the unused basic exclusion amount of the last deceased spouse. For 2011 and 2012, the basic exclusion amount is $5 million (plus indexing in 2012).

Portability of the exclusion between spouses and an increase in the basic exclusion amount would seem to make estate planning easier for many estates. However, unless extended by Congress, in 2013, portability of the unused basic exclusion amount between spouses is set to expire and the exclusion is scheduled to decrease to $1 million.

Simple planning with portability

If you're planning today, you could transfer everything to your spouse and, if you die in 2011 or 2012, your estate can elect to transfer your unused basic exclusion amount to your surviving spouse. Your spouse will then have an applicable exclusion amount equal to the sum of his or her own basic exclusion amount and your unused basic exclusion amount, which your spouse can use for gift or estate tax purposes. For example, if you transfer your $5 million unused basic exclusion to your surviving spouse, who also has a $5 million basic exclusion amount, your spouse then has a $10 million applicable exclusion amount to shelter property from gift and estate taxes. Such simple planning might be very practical for some married couples, especially where the spouses' combined estates are expected to be less than the applicable exclusion amount.

Potential need for more complex planning

There are a number of reasons why such simple planning with portability may not produce the desired or best results. These include:

- Portability is set to expire in 2013, and tax rates are scheduled to increase while the applicable exclusion amount is set to decrease.
- You have family members or individuals other than your spouse that you would like to benefit prior to the death of your spouse.
- You have grandchildren or younger generations that you would like to benefit. The $5 million generation-skipping transfer (GST) tax exemption is not portable between spouses (and is scheduled to decrease to $1 million as indexed in 2013).
- State exclusion amounts may be lower than the federal applicable exclusion amount and may not be portable between spouses.

Use of A/B trust arrangement

Prior to the 2010 legislation, many married couples with estates that were greater than the applicable exclusion amount would set up an A/B (or A/B/C) trust arrangement. In general, the first spouse to die would transfer an amount equal to the applicable exclusion amount to the "B" or credit shelter (bypass) trust. The B trust could benefit the surviving spouse and their children, but the B trust would be designed to bypass the surviving spouse's estate. The balance of the estate would be transferred to the surviving spouse, either outright or by using an "A" marital trust, and qualify for the marital deduction. In some cases, a "C," "Q," or QTIP marital trust was also used if the first spouse to die wanted to control who received the marital trust property at the second spouse's death. The A/B trust arrangement typically assured that there would be no estate tax at the first spouse's death and that neither spouse's applicable exclusion amount was wasted.

An A/B trust arrangement may still be useful whether or not portability is available. For example, the B trust can assure that the applicable exclusion amount of the first spouse to die is not lost, even if portability is not available in the future. The B trust can be used to provide for family members or individuals other than your spouse (and even your spouse) prior to the death of your spouse. You could also allocate your GST tax exemption or state exclusion to the B trust. The A trust could use your spouse's applicable exclusion amount, GST tax exemption, and state exclusion.

Review estate plans and documents

Your documents and plans may need to be revised to reflect the tax changes for 2011 and 2012 and for the uncertainty for 2013 and beyond. To help guide you through these opportunities and uncertain times, consult an experienced estate planning attorney.

Ask the Experts

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With mortgage rates so low, does it make sense to refinance?

Historically low mortgage interest rates have prompted many homeowners to think seriously about refinancing, but there's a lot you need to consider before filling out a loan application.

Start by determining why you want to refinance. Is it primarily to reduce your monthly payments? Do you want to shorten your loan term so that you can save interest and possibly pay off your mortgage earlier? Are you interested in refinancing from one type of mortgage to another (e.g., from an adjustable rate mortgage to a fixed-rate mortgage)? Establishing a goal will help you determine if refinancing makes sense for you and which type of loan will best suit your needs.

Keep in mind that the low mortgage rates that are advertised aren't available to everyone. To get the best rate, you'll need to meet the lender's criteria. For example, you generally need to have an excellent credit score, stable income, and substantial equity in your home--e.g., 20% or more. The type and length of the loan will also affect the rate you receive--in general, the shorter the loan term, the lower the rate. Advertised mortgage rates sometimes also include points that you'll have to pay to obtain the lower rate--each point is equal to 1% of the mortgage amount. Because so much can affect the rate you receive, it's important to shop around and compare interest rates, loan terms, and costs to make sure you're getting the best deal.

Finally, you'll need to consider refinancing costs as well as the new interest rate you'll receive. Refinancing costs may include points, closing costs, and private mortgage insurance premiums (if any) that you'll have to pay when you take out the new loan. Will you be able to recoup these costs while you still own the home? To calculate this, divide your total refinancing costs by the monthly mortgage payment savings you'll realize by refinancing. The result indicates how many months you'll need to stay in the home to recoup your costs. If you don't plan to remain in your home long enough to recoup your costs, then refinancing may not be worthwhile, no matter how low your new interest rate is.

If I owe more than my home is worth, will I be able to refinance?

Home values across the country have declined, and many homeowners owe more on their mortgages than their homes are worth. When you're "underwater" on your mortgage, it may be possible to refinance, but it will depend on your circumstances and the type of mortgage you have.

Refinancing an underwater mortgage is usually difficult, because lenders generally require that you have equity in your property. However, if you meet certain criteria, you may be eligible to refinance your mortgage through the federal Home Affordable Refinance Program (HARP). This program targets homeowners who are underwater but who are having no trouble making their mortgage payments.

To qualify for HARP, your mortgage must be owned or guaranteed by Freddie Mac or Fannie Mae, and you must be current on your mortgage at the time of the refinance. In addition, you must have made no late payments within the past six months, and no more than one late payment in the past twelve months. Other eligibility criteria also apply.

To find out if you're eligible for HARP, start by verifying that your mortgage is backed by Freddie Mac or Fannie Mae. You can do this by visiting www.freddiemac.com or www.fanniemae.com and using their lookup tools. Once you've established that your mortgage meets this basic criteria, contact your current lender or other lenders to see if they offer HARP refinances--not all lenders do. For more information about HARP, visit www.makinghomeaffordable.gov.

Another option you might have is a cash-in refinance. With this type of refinance, you bring cash to the closing to reduce your mortgage balance and increase your home equity, enabling you to meet the lender's loan requirements. Underwater borrowers who can also afford to refinance to a shorter loan term (e.g., from 30 to 15 years) might especially benefit because they may boost their equity stake more quickly. However, home equity isn't liquid and it's possible that home values will continue to decline, sinking borrowers further underwater, so a cash-in refinance is only an option if you have substantial savings and can ride out the ups and downs of the housing market.

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