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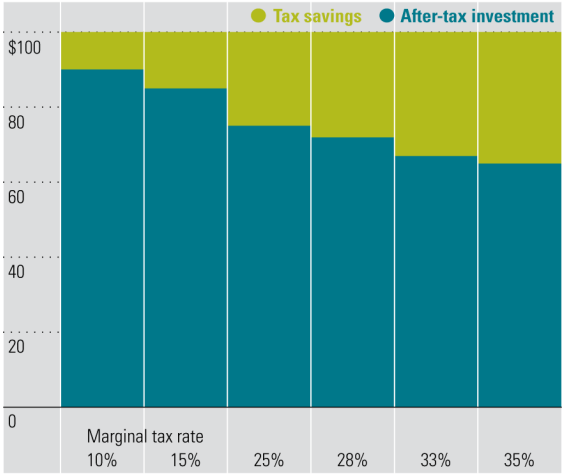
401k Contributions and Tax Savings

A commonly-overlooked benefit of 401k investing is that contributions can be made pre-tax, so that even a small contribution can go a long way. In this situation, 401k contributions are not taxed until you retire. Therefore, the more you contribute to your retirement account, the smaller your taxable income becomes, and the more federal taxes you are able to defer.

The image presents the tax savings (reduction in tax liability) achieved by a 401k contribution of $100 for six marginal tax rates. For example, if you are subject to a 35% marginal tax rate and you choose not to contribute, you will pay $35 in taxes and only have $65 available to invest in another account. If, however, you invest pre-tax in your 401k, you will have $100 that is yours and can grow tax-deferred until you retire.

Tax Savings from Investing in a 401k Plan



This is for illustrative purposes only and should not be viewed as tax advice. Be sure to consult with a financial advisor or tax professional for the latest rules and regulations.

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Advisor Corner

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Market Performance
1-1-11 to 4-30-11
DJIA ^DJI +10.65%
S&P 500 ^GSPC +8.43%
NASDAQ ^IXIC +8.32%
Russell 2000 ^RUT +10.39%
Source: http://finance.yahoo.com
Index figures do NOT include fees or commissions

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Closed-End versus Open-End Funds

The general term "mutual funds" usually refers to investment vehicles more specifically known as open-end mutual funds (the "mutual funds" denomination has become so mainstream that the open-end classification is commonly omitted). However, there exists a second mutual fund category identified as closed-end funds. This category is lesser known and much smaller: Closed-end funds total only $216 billion in net assets, compared to $8.4 trillion for open-end funds. Three important differences between these two categories of mutual funds are outlined below.

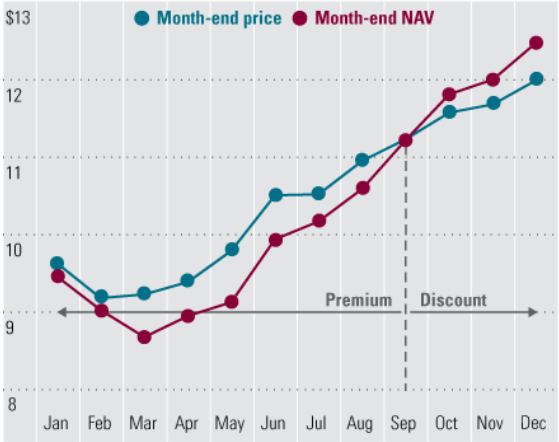
1.Share issuance: Open-end funds can issue an unlimited amount of shares and then redeem them on demand. Closed-end funds generally issue a fixed number of shares at inception in a process known as an initial public offering (IPO). These shares are then traded on an exchange, similar to stocks. A closed-end fund can issue new shares after the IPO, but this is rare. A closed-end fund can, if it chooses, convert itself to an open-end mutual fund and issue an unlimited number of shares.

2.Share transactions: Shares of an open-end mutual fund can be purchased directly from the fund at any given time. An investor can go directly to the fund company and buy shares, or sell shares back to the fund if he or she already owns them. In contrast, closed-end fund shares trade on an exchange, like stocks, and are normally purchased through a broker, who charges a commission. Closed-end shares can be bought and sold during normal market hours and, as a consequence, their market prices also fluctuate throughout the day. Open-end shares are only priced once a day at market close.

3.Share price: The price of open-end fund shares is equal to the net asset value, NAV (the value of all the fund's assets divided by the total number of shares). For closed-end funds, it's not that simple. Since closed-end funds are traded on an exchange, prices are established by the market, and shares can trade at prices different than the fund's net asset value. If the price is higher than the NAV, shares are said to be trading at a premium—investors are willing to pay more than the fund is really worth. Conversely, if the market price is lower than the NAV, the fund is trading at a discount. This can be considered an advantage of closed-end funds over open-end ones: who wouldn't want to buy something at a price lower than its true value?

The image shows how month-end price and net asset value can fluctuate for a hypothetical closed-end fund. From January through September, the fund's market price is higher than its NAV; the fund is trading at a premium. From October through December, however, the situation is reversed and the fund is now trading at a discount.

A Closed-End Fund Can Trade at a Premium or at a Discount



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The closed-end fund represented in the image is a purely hypothetical example and does not represent an actual fund. The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Closed-end funds are subject to unique risks, most notably liquidity risk. **Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses.** Investors should read the prospectus and consider this information carefully before investing or sending money. Total net asset values from Morningstar's database as of April 27, 2011.

The Labyrinth of Financial Statements: The Balance Sheet

Public companies in the United States are required by law to disclose relevant business figures and other information. They do this in the form of financial statements: documents whose purpose is to offer detailed information on the company's financial situation: what the company owns (assets), what it borrowed and therefore has to pay back (liabilities), its stock, profit, cash going in and out, and other figures. All financial statements must follow official accounting rules and must be publicly available. There are three major financial statements: the balance sheet, the income statement, and the cash-flow statement. This article will focus on the balance sheet.

The balance sheet basically lists, in detail, what a company has and what it owes. It is organized into three sections: assets, liabilities, and shareholders' equity. Think of it as an individual sitting down at the end of the year and making a list: 1) Items owned (assets): house, furniture, car, books, and so on.; 2) Items owed (liabilities): mortgage, college loan, etc.; 3) Shareholders' equity can be thought of as total value—an individual's net worth.

1. Assets: Assets refer to resources the company owns. They include cash and cash equivalents, accounts receivable (payments the company is waiting for after the sale of products or services), inventories (supply of materials used in operations), and PP&E (property, plant, and equipment). Assets can be current or non-current. Current assets are defined as cash and other items that will be converted to cash within one year. Cash, accounts receivable, and inventories are considered current assets. Property, plant and equipment are considered non-current assets. An important term you may see in this section is depreciation or accumulated depreciation. This represents the decrease in the value of physical resources caused by wear and tear over time. For example, a piece of factory equipment is originally purchased for $50,000, but after being used for a year, its value decreases to $40,000. The $10,000 difference is depreciation.

2. Liabilities: Just like an individual, when a corporation does not possess the resources necessary for its operations, it has to borrow (from investors or other corporations). When the company borrows, it owes money and is therefore in debt. Debts owed are called liabilities on financial statements. Liabilities include short-term (current) and long-term debt (obligations lasting longer than one year), accounts payable (what the firm has to pay its suppliers, for example), taxes payable (what the firm has to pay in taxes) and interest payable (interest the company owes to its lenders). Who does the company borrow from? A company usually borrows by issuing bonds, which are bought by investors (either individuals or institutions). When you include a bond in your portfolio, you are, in reality, lending money to the company and receiving interest on that money.

3. Shareholders' equity: The third item on the balance sheet is called shareholders' equity (or owners' equity). This represents the total sum of money stockholders have invested in the firm. The shareholders' equity portion of the balance sheet will list the dollar value and the number of shares for the company's common and preferred stock. Total shareholders' equity is composed of paid-in capital and retained earnings. Paid-in capital is the amount the company has raised in the past by issuing stock. Retained earnings represent the sum of past earnings (profit) that have been retained in the business.

A very important point about the balance sheet is what is generally known as the balance-sheet equation: Assets = Liabilities + Shareholders' Equity. Also, it is important to remember that the balance sheet shows the company's financial situation at a specific point in time; for example, Dell's balance sheet as of Dec. 31, 2010.

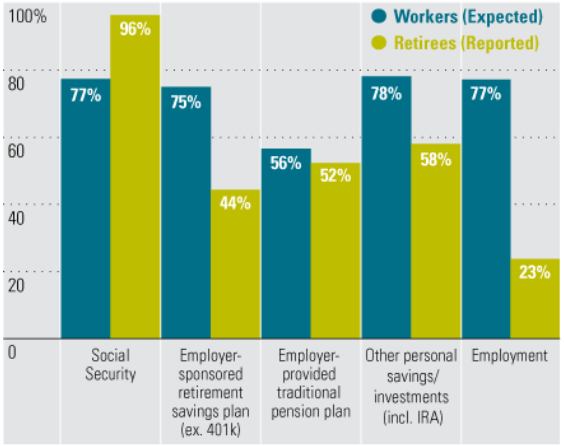
Retirement Income Sources

Concerns about shortfalls in traditional retirement income sources like Social Security and pension plans have caused people to expect to rely more heavily on personal savings to fund their retirement.

The graph illustrates that while only 58% of current retirees utilize their personal savings for retirement income, 78% of current workers anticipate personal savings to play a role during retirement. Further, 75% of workers expect to receive retirement income from an employer-sponsored retirement savings plan, while only 44% of those already retired actually receive income from such a source.

It may be a good idea to plan for a diminished reliance on Social Security or a pension plan. Whatever extra funds you save by taking this more conservative view will make retirement all the more enjoyable.

Times are Changing:
Sources of Retirement Income are Shifting



Source: Employee Benefit Research Institute, 2010 Retirement Confidence Survey.

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