FINANCIAL MANAGEMENT STRATEGIES
Solutions Today for a Prosperous Tomorrow

March 2010

Foresight

In This Issue

Quick Links

About Us

Information Request

Headlines

Join Our Mailing List!

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Greetings!

Thanks again for sharing some of your valuable time to read this edition of Foresight, my monthly online publication. Each month I'll share thoughts on various topics in the world of personal finance, investing, economics, and business through my writings below. May you find my musings informative, thought provoking and enjoyable.

Thoughtfully,

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Rx for Your Portfolio

While health, healthy eating, healthy living, etc. are always topics of interest to most everyone; clearly it is hard for any of us today to not have an opinion on the topic of healthcare. Now of course healthcare, and the system that provides it to millions of Americans will have a significant, ever growing impact on a society that at least 16% of its population will be 65 or older by the year 2020. Though clearly there are many areas of the debate that have been poorly discussed, over emphasized, or barely mentioned at any meaningful length, there is one area of healthcare I want to help you examine this month. Do you have a healthy investment portfolio?

Whether you ask a doctor or nurse, a pharmacist or herbalist, or even an executive at a pharmaceutical or insurance company, all would agree that prevention, proper diagnosis and early treatment are essential in maintaining good health.

Prevention. Regular examinations and review are the bedrock of good healthcare whether it is your dentist, gynecologist, or primary care physician and the same is true for maintaining the health of your investments. When working with your medical professional, the personal goal for you is essentially live long and live well (stay healthy).While the specific approach that you take to pursue personal health goals is based on your pre-determined needs, health history, and personality, your progress can be measured and your strategy updated as necessary. This same customized, goal-oriented methodology should also apply to the design, construction, and maintenance of your investment portfolio, as it is an indicator of your long-term financial health.

Diagnose Your Needs. Why are you investing? What do you hope to achieve? How quickly do you want to reach your goal? How much risk are you willing to take? How well would you sleep tonight if your portfolio dropped 10% today? Or as those of us that have fresh memories of 2001 and 2008 can recall how we slept as our portfolios dropped 25% in a month. Importantly when I use the word "risk" I always want you to think in terms of how much you are willing to loose in the short term (and at all) to achieve your long term objectives.

Does your spouse have investments? Do they complement yours? The answers to all of these questions and more should come together to help you make decisions about the types of investments that you should own and the percentage of your portfolio that each investment should represent. The composition that you decide upon is known, in investment terms, as your "asset allocation."

The Most Important Decision You Can Make. A Nobel Prize-winning study by Dr. Harry Markowitz published in 1952 recognized that asset allocation has a greater impact on portfolio return than any other decision an investor can make. A portfolio composed of aggressive investments exposes investors to greater risk, but should theoretically provide higher returns. Conversely, a conservative portfolio offers less risk, but the tradeoff for safety is likely to be lower returns. The key then is to find an asset allocation that strikes a balance between the statistical likelihood of a given return and your willingness to accept the associated level of risk.

It's not as easy as it sounds, though the explanation is quite simple, and moreover Dr. Markowitz's study and related work were based on a time period when there were far less individual investors from all over the world participating in the markets. Diversification and strategic asset allocation do not guarantee a profit nor protect against a loss in declining markets. Thus it is important from my perspective that you consider statistical models as important guides for examining the data that you use to make your decisions, as they are neither perfect nor exact science, any more than our doctors can be a 100% correct with all of their treatments.

Asset Allocation Is as Complex as Life Itself. Determining an appropriate asset allocation for you is not a one-time decision it is an ongoing campaign. Just as the proper actions for you to maintain your physical health as a 20 something will be different then the actions needed when you are a 60 something. Remember too, that most of us who become 50 something's in this century are likely to live to be 80 something's or older.

Debts, salaries, family concerns, age, and lifestyle decisions all play a role. While many have seen so-called "asset allocation quizzes" (answer a handful of questions, get an asset allocation recommendation), these simple, cookie-cutter solutions alone don't provide an adequate replacement for a well-constructed financial strategy, where your asset allocation changes over time in tandem with your needs, means, and priorities. Your financial needs (like your body) over time require more personal attention and care, so with a busy lifestyle, and dynamic changing goals a one-size-fits-all approach, will not adequately address your investment portfolio health needs. Regardless of the final healthcare bill, to maintain proper financial health find a good practitioner that you are comfortable with and get regular examinations/reviews, diagnosis/analysis, and a strategy/treatment that works for you.

Tax Tips: Strategies for Making the Most out of Your Return

At FMS I strive at taking a holistic comprehensive approach for the implementation of every strategy that I recommend. As tax season is upon us in full swing I wanted to share some guidelines and ideas that you should take a look at for this and coming tax years. You can use the following list of tax strategies to help you better carry out your planning on a regular and ongoing basis. You can view these tax tips in their entirety here or click on links below to learn more about each strategy. Tax planning is an activity that is best pursued year-round in conjunction with your tax advisor (s).

Before-Tax IRA Earnings. Contributing before-tax earnings to an IRA account can make a big difference in your retirement savings, since you can defer paying taxes on whatever your investment earns in an IRA. Learn more about the allowances and limits for 2010 here. You may find that other tax-deferred retirement investments are a better deal. Some other options are described below. The IRS publication (590) is available here.

SEP IRAs. A "Simplified Employee Pension IRA" is a tax-deferred retirement plan provided by sole proprietors or small businesses, most of which don't have any other retirement plan. Contributions are made by the employer, and unlike the traditional IRA, can be as high as 25% of each employee's total compensation, with a maximum contribution of $49,000 (subject to adjustments for inflation after 2010). For a sole proprietor, this can be a significant opportunity to save for retirement on a tax-deferred basis. Employees with SEP-IRAs can also invest in regular IRAs. Learn more about SEP IRA's here.

401 (k)s. A 401(k) plan is an employer sponsored plan that lets you contribute a percentage of your salary to a trust account, putting off any taxes on that money until you withdraw it, usually after age 59-1/2. Companies often match some of your contribution, and any taxes on those matching funds are also deferred, as long as the total going into the account does not exceed the limit for the year. As with IRAs, the earnings in the account grow, tax free, until you withdraw the money, and if you expect your tax rate to drop after your retirement, because you have less income, your savings could amount to an even bigger nest egg. Learn more about payroll deduction and penalties for early withdrawal here.

20% Withholding on Distributions from Qualified Employer Plans. Income tax withholding may apply to distributions made from qualified employer plans. Withholding at a rate of 20% is required on a distribution, unless it is transferred directly from your employer to an IRA trustee or another employer plan. Find out more about withholding rules and rollovers here.

ROTH IRA. A ROTH IRA is in some respects the opposite of a traditional IRA: You pay taxes on the money that you put into the account up front, but once you reach age 59-1/2, (after having had the Roth IRA for five years), you can withdraw the money, including interest earned, tax free.For some people, paying taxes now to enjoy tax-free income later may actually make more financial sense in the long term. Read more on contributions and limits and how these affect you if you are married. Did you withdraw money to pay for medical expenses or medical insurance? Find out how penalties may be waived.

Health Savings Accounts (HSA) and Medical Savings Accounts (MSA). If you use these or participate in these types of plans, learn more about what they are here.
For 2010, the annual out-of-pocket expenses under a MSA plan cannot exceed $4050 for individual coverage and $7400 for family coverage. Out-of-pocket expenses include deductibles, co-payments and other amounts the participant must pay for covered benefits, but do not include premiums. For HSAs, ontributions by an individual are tax deductible. Individuals, their employers, or both can contribute tax-deductible funds each year up to the amount of the policy's annual deductible, subject to a cap of $3050 for individuals and $5,950 for families. Individuals aged 55-64 can make additional contributions. The interest and investment earnings generated by the account are also not taxable while in the HSA. Learn more about deductions for these plans here.

Long-Term Care Insurance Contracts. Under the law, you can exclude from gross income amounts received under a long-term care insurance contract for long-term care services. You can also exclude employer-provided coverage under a long-term care insurance contract. Self-employed taxpayers can take long-term care insurance premiums into account in calculating their health insurance deduction. Unreimbursed long-term care services and long-term care insurance premiums are treated as deductible medical expenses subject to current limitations.

Life Insurance Paid before Death of Insured. Certain payments received under a life insurance contract on behalf of a terminally or chronically ill individual (an accelerated death benefit) can be excluded from your income.

Personal and Dependent Exemptions. There are two types of exemptions:

- Personal exemptions for taxpayer and spouse
- Dependency exemptions for dependents

Personal and dependent exemptions reduce your taxable income. For 2009, each exemption equals $3,650 (which remains the same for 2010). Learn more about filing statuses and how they may affect your exemptions.

Married Filing Separately. Learn what to do if you are married and you file a separate return, keep in mind that you must be consistent in claiming the standard deduction or itemized deductions.

Limit on Itemized Deductions. Congress placed an additional "overall" limitation on the deductibility of a certain group of itemized deductions. In 2009, this limitation applies only if your adjusted gross income is greater than $166,800 ($83,400 if married filing separately). Learn more about itemized deductions here. Also note that The Economic Growth and Tax Relief Act of 2001 gradually eliminates this limitation beginning 2006. The limitation is:

- Repealed for 2010.

Business and Travel Entertainment. The total amount of most miscellaneous itemized deductions claimed on Schedule A of Form 1040 must be reduced by 2% of your adjusted gross income. In other words, you can claim the amount of expenses that is more than 2% of your adjusted gross income. Generally, only 50% of the amount spent for business meals (including meals away from home overnight on business) and entertainment will be deductible. This limit must be applied before arriving at the amount subject to the 2% floor.

Charitable Contributions. In order to claim a deduction for a charitable contribution to a qualified organization you are required to have proof of your deduction such as a bank record (such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount) or a written communication from the charity...

Gross Income. One of the most important decisions you have to make in determining your correct taxable income is what payments to include. Keep in mind that a taxable payment is not limited to cash. It may be property, stock, or other assets. Also, you must include in your gross income the fair market value of payments in kind. For example, if your employer provides you with a car that is used for both business and personal purposes, then the value of the personal use of the car is included in your earnings and is taxable to you. Or, assume you assist a group of investors in purchasing a piece of real estate. In consideration for your services, the investors award you an unconditional percentage of ownership in the acquired asset, and you have not invested any of your personal funds. The fair market value of your ownership interest is considered as wages taxable to you in the year of transfer.

Interest and Dividends. Interest that you receive on bank accounts, on loans that you have made to others, or from other sources is taxable. However, interest you receive on obligations of a state or one of its political subdivisions, the District of Columbia, or a United States possession or one of its political divisions, is usually tax-exempt for federal tax purposes. Find out more about interest and dividends and how they are taxed.

How Capital Gains Are Taxed. Generally, the maximum capital gains rate is now 15% (0% for individuals in the 10% or 15% bracket for the years 2008 through 2010). These capital gains rates apply to individuals, estates and trusts. A capital asset need only be held "more than 12 months" in order to have the lowest capital gain rate apply. The same tax rates apply to dividends for 2008 through 2010.

Limitations on the Deductibility of Travel and Entertainment Expenses. Keep in mind that there are limits on the deductibility of certain expenditures for travel, business meals, entertainment activities, and entertainment facilities. For example, there is a 50% deduction limitation for business-related meals, entertainment, and entertainment facilities. In addition, there are special record-keeping requirements imposed on taxpayers claiming deductions for these items. Special rules also apply to deductions for cars and other property used for transportation, foreign travel, and attendance at foreign locations.

Vehicle Expenses. If you began using a car, van, pickup, or panel truck for business purposes, you may be able to deduct the expenses you incur in operating the vehicle. You generally can use either the actual expense method or the standard rate method to figure your expenses. If you deduct actual expenses, you must keep records of the cost of operating the vehicle, such as car insurance, interest, taxes, licenses, maintenance, repairs, depreciation, gas and oil. If you lease a vehicle, you must also keep records of these costs.

Club Dues. Dues paid for membership in professional organizations, such as the AICPA (the American Institute of Certified Public Accountants), AIA (the American Institute of Architects), or the ABA (American Bar Association), or public service organizations, such as the Rotary or Kiwanis clubs, may be deductible if paid for business reasons and the organization's principal purpose is not the conduct of entertainment activities.

Recordkeeping. Travel and entertainment expenses that are an ordinary and necessary part of your business may not be deducted, unless you meet specific substantiation requirements.

You are required to maintain documentary evidence, such as a diary, log, statement of expense, account book, or similar business records, for (1) any lodging expenditure, and (2) any other expenditure of $25 or more. Learn more about recordkeeping here.

Selling Your Home. An individual may exclude from income up to $250,000 of gain ($500,000 on a joint return in most situations) realized on the sale or exchange of a residence. The individual must have owned and occupied the residence as a principal residence for an aggregate of at least two of the five years before the sale or exchange. The exclusion may not be used more frequently than once every two years. The required two years of ownership and use need not be continuous. The test is met if the individual owned and used the property as a principal residence for a total of 730 days (365 days X 2) during the five-year period before the sale. Short temporary absences for vacations or seasonal absences are counted as periods of use, even if the taxpayer rents out the property during those periods.

Home Mortgage Interest. Acquisition indebtedness is debt incurred in acquiring, constructing, or substantially improving a qualified residence and secured by such residence. Any such debt that is refinanced is treated as acquisition debt to the extent that it does not exceed the principal amount of acquisition debt immediately before refinancing. Learn more about deductions and possible limitations here. If you own more than tow homes, find out how more about limitations on interest deductions. If you paid points on your loan, learn more about deductions here.

Home Office Expenses. To qualify for a deduction for home office expenses you must use the home office exclusively as an office, and it must be your primary place of business. In determining whether you meet this standard, there are 2 qualifying conditions:

- Exclusively and regularly as their principal place of business, as a place to meet or deal with patients, clients or customers in the normal course of their business, or in connection with their trade or business where there is a separate structure not attached to the home; or
- On a regular basis for certain storage use such as inventory or product samples, as rental property, or as a home daycare facility.

Learn more about home office expenses here.

Deferring Gains and Accelerating Losses. Generally it is preferable to defer gains and accelerate losses for the simple reason that the later the taxes are paid, the longer you have the use of the money. Find out more about gains and losses here and significance this can have on your tax return.

Worthless Securities. Learn more about how: The deduction for a worthless security must be taken in the year in which it becomes worthless, even if it is sold for a nominal sum in the following year.

Vacant Rental Property. You may deduct expenses on your rental property during a period in which it is not being rented as long as it is actively being held out for rent. This rule applies to a period between rentals as well as to the period during which a property is being marketed as a rental property for the first time. The IRS can disallow these deductions if you are unable to show that you were actively seeking a profit and had a reasonable expectation of achieving one. However, the deduction cannot be disallowed merely because your property is difficult to rent.

Please consult your tax advisor before seeking to utilize any of these strategies as FMS is neither an accounting firm nor tax advisor, and the listing of these strategies should not be interpreted as an expressed recommendation for you to use any of them.

Financial Management Strategies, LLC (FMS) is a Registered Investment Advisory firm in the State of Maryland. We specialize in comprehensive wealth management and wealth preservation for individuals and small businesses, providing premium services in financial planning, business consulting, financial analysis and research, wealth management and real estate development.