Niehaus Financial News

Your Peace of Mind is Our Priority

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Assessing Portfolio Performance: Choose Your Benchmarks Wisely

You can't help but hear about the frequent ups and downs of the Dow Jones Industrial Average or the S&P 500 index. The performance of both major indexes is widely reported and analyzed in detail by financial news outlets around the nation.

Like the Dow, the S&P 500 tracks the stocks of large domestic companies. With 500 stocks compared to the Dow's 30, the S&P 500 comprises a much broader segment of the stock market and is considered to be representative of U.S. stocks in general. Both indexes are generally useful tools for tracking stock market trends, but some investors mistakenly think of them as benchmarks for how well their own portfolios should be doing.

However, it doesn't make much sense to compare a broadly diversified, multi-asset portfolio to just one of its own components. Expecting portfolio returns to meet or beat "the market" is usually unrealistic, unless you are willing to expose 100% of your life savings to the risk and volatility associated with stock investments.

Asset allocation: It's personal

Just about every financial market in the world is tracked by one or more indexes that investors can use to look at current and historical performance. In fact, there are hundreds of indexes based on a wide variety of asset classes (stocks/bonds), market segments (large/small cap), and styles (growth/value).

Investor portfolios are typically divided among asset classes that tend to perform differently under different market conditions. An appropriate mix of stocks, bonds, and other investments depends on the investor's age, risk tolerance, and financial goals.

Consequently, there may or may not be a single benchmark that matches your actual holdings and the composition of your individual portfolio. It could take a combination of several benchmarks to provide a meaningful performance picture.

Keep the proper perspective

Seasoned investors understand that short-term results may have little to do with the effectiveness of a long-term investment strategy. Even so, the desire to become a more disciplined investor is often tested by the arrival of quarterly or annual financial statements.

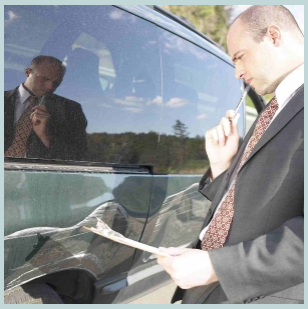
The main problem with making decisions based on last year's performance figures is that asset classes, market segments, or industries that do well during one period don't always continue to perform as well. When an investment experiences dramatic upside performance, it may mean that much of the opportunity for market gains has already passed. Conversely, moving out of an investment when it has a down year could mean you are no longer in a position to benefit when that segment starts to recover.

On the other hand, portfolios that are left unattended may drift and begin to take on too much risk or become too conservative. Rebalancing periodically could help bring your asset mix back in line with your preferred allocation.

There's really nothing you can do about global economic conditions or the level of returns delivered by the financial markets, but you can control the composition of your portfolio. Evaluating investment results through the correct lens may help you make appropriate adjustments and effectively plan for the future.

Note: *Keep in mind that the performance of an unmanaged index is not indicative of the performance of any specific security, and individuals cannot invest directly in an index. Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss. All investments are subject to market fluctuation, risk, and loss of principal. Shares, when sold, may be worth more or less than their original cost. Investments that seek a higher return tend to involve greater risk. Rebalancing may result in commission costs, as well as taxes if you sell investments for a profit.*

Are There Gaps in Your Insurance Coverage?



If you own a condo, your association's property insurance may leave gaps in coverage. For example, most association insurance doesn't cover your furniture, wall coverings, electronics, interior walls, and structural improvements made to the interior of your unit. Review your condo documents, particularly the association's master deed, its by-laws, rules and regulations, which may describe those parts of your unit the association insurance covers, and which parts you may need to insure.

Buying insurance is about sharing or shifting risk. For example, health insurance will cover some of the cost of medical care. Homeowners insurance will assume some of the risk of loss in the event your home is damaged or destroyed. But oftentimes we think we're covered for specific losses when, in fact, we're not. Here are some common coverage gaps to consider when reviewing your own insurance coverage.

Life insurance

In general, you want to have enough life insurance coverage (when coupled with savings and income) to allow your family to continue living the lifestyle to which they're accustomed. But changing circumstances may leave a gap in your life insurance coverage.

For example, if you have life insurance through your employer, changing jobs could affect your insurance coverage. You may not have the same amount of insurance, or the policy provisions may differ. Whereas your prior employer may have provided permanent life insurance, now you may have term insurance that will expire on a predetermined date. Review your income, savings, and expenses annually and compare them to your insurance coverage, and be mindful that changing circumstances may require a change in the amount of insurance coverage.

Homeowners insurance

It's not always clear from reading your homeowners policy which perils are covered and how much damage will be paid for. It's important to know what your homeowners policy covers and, more important, what it doesn't cover.

You might think your insurer would pay the full cost to replace your home if it were destroyed by a covered occurrence. But many policies place a cap on replacement cost up to the face amount stated on the policy. You may want to check with a building contractor to get an idea of the replacement cost for your home, then compare it to your policy to be sure you have enough coverage.

Even if your policy states that "all perils" are covered, most policies carve out many exceptions or exclusions to this general provision. For example, damage caused by floods, earthquakes, and hurricanes may be covered only by special addendums to your policy, or in some cases by separate insurance policies altogether. Also, your insurer may not cover the extra cost of rebuilding attributable to more stringent building codes, or your policy may limit how much and how long it will pay for temporary housing while repairs are made.

To avoid these gaps in coverage, review your policy annually with your insurer. Also, pay attention to notices you may receive. What may look like boilerplate language could actually be significant changes to your coverage. Don't rely on your interpretations--seek an explanation from your insurer or agent.

Auto insurance

Which drivers and what vehicles are covered by your auto insurance? Most policies provide coverage for you and family members residing with you, but it's not always clear-cut. For instance, a child who is living in a college dorm is probably covered, but a child who lives in an off-campus apartment might be excluded from coverage. If you and your spouse divorce, which policy insures your children, particularly if they are living with each parent at different times of the year? Notify your insurer about any change in living arrangements to avoid a gap in coverage.

Other gaps include no coverage for damaged batteries, tires, and shocks. And you might not be covered for stolen or damaged cell phones or other electronic devices. Your policy may also limit the amount paid for a rental while your vehicle is being repaired.

In fact, insurance coverage for rental cars may also pose a problem. For instance, your own collision coverage may apply to the rental car you're driving, but it may not pay for all the damage alleged by a rental company, such as loss of use charges. If you're leasing a car long term, your policy may cover the replacement cost only if the car is a total loss or is stolen. But that amount may not be enough to pay for the outstanding balance of your lease. Gap insurance can cover any difference between what your insurer pays and the balance of your lease.

Policy terms and conditions aren't always easily understood, and you may not be sure what's covered until it's time to file a claim. So review your insurance policy to be sure you've filled all the gaps in your coverage.

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What You Need to Know About Private Student Loans

Students and parents borrowed $106.1 billion in education loans in 2014-2015. (Source: Trends in Student Aid, College Board, 2015)

It's an unfortunate trend in college pricing--the average cost of tuition and fees at four-year public and private institutions are significantly higher than they were just a decade ago. For example, the average published tuition and fee price of a full-time year at a public four-year institution is 40% higher, after adjusting for inflation, in 2015-16 than it was in 2005-06. (Source: Trends in College Pricing, College Board, 2015) As a result of these rising costs, many individuals have to rely on student loans to help fund their college education.

Will I have to take out private loans to finance my college education?

What can be surprising to many first-time student borrowers is how little federal student loan debt they may be allowed to take on. Currently, the maximum amount students can borrow for college in federal Direct Stafford Loans is $5,500 during their first year, $6,500 during their second year, and $7,500 during their third and fourth years. (Source: Federal Student Aid, U.S. Department of Education, 2015)

In most cases this amount is not nearly enough to cover the cost of attending a four-year college, and many student borrowers must look to private student loans to help close this gap. And while taking out private loans to pay for college is a fact of life for many individuals, there are some important questions you'll want answered before taking out these types of loans.

What is the interest rate on the loan?

Private student loans tend to have higher fixed interest rates than federal Direct Stafford Loans. However, depending on the lender, you may be able to choose a loan that offers a lower variable interest rate.

Keep in mind that with a fixed rate, the interest rate remains the same from the day you take out the loan until the day you pay it off. With a variable rate, your interest rate may initially be lower than a fixed rate but then will be adjusted periodically to keep up with changes in market conditions. If your interest rate rises, your monthly payment and/or the number of payments required will increase.

What repayment options are available?

Unlike federal student loans, which offer repayment programs such as pay as you earn, income-based repayment plans and student loan forgiveness, private lenders are not required to offer specific repayment assistance to borrowers struggling to make payments. However, most private student loan companies do offer limited forms of repayment options, such as loan forbearance or extended repayment schedules. The types of repayment programs offered will vary from lender to lender.

Is a co-signer required?

Some private lenders may require borrowers to have a co-signer guarantee a loan, especially if a borrower has little or no credit history. Having a co-signer may also help you obtain a lower interest rate for your loan and improve your chances for loan approval.

The good news is that the co-signer doesn't necessarily have to be tied to the loan forever. Most lenders will allow borrowers to apply for a co-signer release after a certain number of on-time payments have been made and other loan conditions have been met.

Are the terms of the loan favorable?

As a result of recent increased regulatory scrutiny surrounding private loans, many of the larger lenders have improved the lending process by offering more attractive loan terms.

For example, certain lenders have eliminated "auto defaults," which is when a co-signer dies or declares bankruptcy and the lender demands that the loan be paid back immediately by the borrower. Others have made the process for obtaining a co-signer release easier and more transparent. Loan costs, discounts, terms, and conditions can differ greatly, depending on the lender. It's important to thoroughly research each potential lender and carefully compare all offers before signing a loan agreement.

Are other financing options available?

When it comes to using private loans to pay for college, student borrowers should try to graduate with the least amount of private student loan debt possible. It's generally a good idea to exhaust all federal student loan options and avoid taking out loans for the maximum amount that is offered by private lenders unless absolutely necessary.

Additional financing options should also be considered, such as:

- Parent PLUS loans
- Grants or scholarships
- Parent/family loans
- State-sponsored student loan programs
- Part-time employment

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Should I loan my child money for a down payment on a house?

For a lot of young people today, it's difficult to purchase a home without at least some financial assistance. As a result, many young adults turn to their parents or other family members for help with a down payment.

If you plan on lending your child money for a down payment on a house, you should try to assume the role of a commercial lender. Setting the terms of the loan in writing will demonstrate to your child that you take both your responsibility as lender and your child's responsibility as borrower seriously.

While having an actual loan contract may seem too businesslike to some parents, doing so can help set expectations between you and your child. The loan contract should spell out the exact loan amount, the interest rate and a repayment schedule. To avoid the uncomfortable situation of having to remind your child that a payment is due, consider asking him or her to set up automatic monthly transfers from his or her bank account to yours.

This type of loan documentation is also important for IRS purposes because there may be potential income and gift tax issues with these types of loans. For example, interest paid by your child will be considered taxable income, and if adequate interest is not charged for the loan, special imputed interest rules may apply.

If you don't feel comfortable lending your child money, you may want to consider making a smaller, no-strings-attached gift that doesn't have to be repaid. Currently, you can gift up to $14,000 annually per person under the gift tax exclusion. However, if you do gift money for a down payment, your child's lender may still require him or her to put up some of his or her own money, depending on the type of mortgage chosen.

Keep in mind that lending money to family members can be a tricky proposition. Before entering into this type of financial arrangement, you should take the time to carefully weigh both the financial and emotional costs.

What are required minimum distributions (RMDs)?

Traditional IRAs and employer retirement plans such as 401(k)s and 403(b)s offer several tax advantages, including the ability to defer income taxes on both contributions and earnings until they're distributed from the plan.

But, unfortunately, you can't keep your money in these retirement accounts forever. The law requires that you begin taking distributions, called "required minimum distributions" or RMDs, when you reach age 70½ (or in some cases, when you retire), whether you need the money or not. (Minimum distributions are not required from Roth IRAs during your lifetime.)

Your IRA trustee or custodian must either tell you the required amount each year or offer to calculate it for you. For an employer plan, the plan administrator will generally calculate the RMD. But you're ultimately responsible for determining the correct amount. It's easy to do. The IRS, in Publication 590-B, provides a chart called the Uniform Lifetime Table. In most cases, you simply find the distribution period for your age and then divide your account balance as of the end of the prior year by the distribution period to arrive at your RMD for the year.

For example, if you turn 76 in 2016, your distribution period under the Uniform Lifetime Table is 22 years. You divide your account balance as of December 31, 2015, by 22 to arrive at your RMD for 2016.

The only exception is if you're married and your spouse is more than 10 years younger than you. If this special situation applies, use IRS Table II (also found in Publication 590-B) instead of the Uniform Lifetime Table. Table II provides a distribution period that's based on the joint life expectancy of you and your spouse.

If you have multiple IRAs, an RMD is calculated separately for each IRA. However, you can withdraw the required amount from any of your IRAs. Inherited IRAs aren't included with your own for this purpose. (Similar rules apply to Section 403(b) accounts.) If you participate in more than one employer retirement plan, your RMD is calculated separately for each plan and must be paid from that plan.

Remember, you can always withdraw more than the required amount, but if you withdraw less you will be hit with a penalty tax equal to 50% of the amount you failed to withdraw.

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