

THE PERSONAL PLANNER

Personal Financial Planning Tips for Today and the Rest of Your Life



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Well, we're well into the new year and things are plodding along. The GOP is narrowing the range of Republican presidential candidates, and that process has been fun to watch. The situation in the Middle East seems to be evolving as we have come to expect based on grass-roots movements of the past year. And the markets seem to be continuing their halting recovery.

If HA manages your portfolio, you'll want to read the Monthly Bulletin article about our partial restoration of equity positions in January.

Also, Schwab has indicated a mid-February release dates for 1099 forms, so you can plan for your tax return preparation.

Finally, winter seems elusive this year... a good thing, I think. I personally wouldn't mind if our very mild winter just slowly evolved into spring. So enjoy it while it lasts!

February 2012

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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.*

2011 Tax Season Considerations



Roth recharacterizations

Did you convert a traditional IRA to a Roth IRA in 2011, only to see the account drop in value as a result of ongoing market volatility? Wish you could go back in time so that you wouldn't have to pay tax on the value of the IRA assets that was lost in the downturn? Turns out, you can.



You don't want to pay more in taxes than you have to. That means taking advantage of every deduction and credit that you're entitled to, and recognizing potential opportunities to save. It also means staying on top of deadlines, and avoiding mistakes that could prove costly down the road. So, here are some things to keep in mind this filing season.

Due date: April 17, 2012

The due date for 2011 federal income tax returns is April 17, 2012 (April 15 is a Sunday, and April 16 is Emancipation Day--a Washington, DC, holiday). Whether you're preparing your own taxes or paying someone else to do them for you, you'll want to start pulling things together sooner rather than later. That includes gathering a copy of last year's tax return, W-2s, 1099s, and deduction records.

If you're not going to be able to file your federal income tax return by the due date, file for an extension using IRS Form 4868, *Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*. Filing this extension gives you an additional six months (to October 15, 2012) to file your return. Don't make the mistake of assuming that the extension gives you additional time to pay any taxes due, though. If you do not pay any taxes you owe by April 17, 2012, you'll owe interest on the tax due, and you may owe penalties as well. Special rules apply if you're living outside the country or serving in the military outside the country on April 17, 2012.

There's still time to contribute to an IRA

You generally have until the due date of your federal income tax return to make contributions to either a Roth IRA or a traditional IRA for the 2011 tax year. That means there's still time to set aside up to \$5,000 (\$6,000 if you're age 50 or older) in one of these retirement savings vehicles. It's worth considering, in part because contributing to an IRA can have an immediate tax benefit. That benefit comes in the form of a potential tax deduction--with a traditional IRA, if you're not covered by a 401(k) or other employer-sponsored retirement plan, you can generally deduct the full amount of your contribution. (If you're covered by an employer-sponsored retirement plan, whether or not you can deduct some or all of your traditional IRA contribution depends on your filing status and income.)

A Roth IRA is a little different; if you qualify to make contributions to a Roth IRA (whether you can contribute depends on your filing status and income), the contributions you make aren't deductible, so there's no 2011 tax benefit.

Nevertheless, a Roth IRA may be worth considering, because qualified Roth distributions will be completely free from federal income tax.

Roth conversion regret?

Did you convert a traditional IRA to a Roth IRA in 2011, only to see the account drop in value as a result of ongoing market volatility? Wish you could go back in time so that you wouldn't have to pay tax on the value of the IRA assets that was lost in the downturn? Turns out, you can.

For example, assume you converted a fully taxable traditional IRA worth \$100,000 to a Roth IRA in 2011, but that Roth IRA is now worth only \$60,000. If you don't undo the conversion you'll pay federal income tax on \$100,000, even though the current value of those assets is only \$60,000. If you undo the conversion, you'll be treated for tax purposes as if the conversion never happened, and you'll wind up with a traditional IRA worth \$60,000--and no resulting tax bill. You generally have until the due date of your 2011 return, including extensions, to recharacterize your 2011 Roth conversion (note that special rules allow individuals who file timely 2011 returns to recharacterize up until October 15, 2012--talk to a tax professional for details).

If you do recharacterize your 2011 conversion, you're allowed to convert those dollars (and any earnings) to a Roth IRA again ("reconvert") but you'll have to wait 30 days, starting with the day you transferred the Roth dollars back to a traditional IRA. If you don't reconvert in 2012, then all taxes due as a result of the reconversion will be included on your 2012 federal income tax return.

Expiring provisions

A number of key provisions have expired. So, without additional legislation, 2011 will be your last chance to take advantage of these opportunities. These now-expired provisions include increased "bonus" depreciation and IRC Section 179 expense limits that drop significantly in 2012. Additionally, 2011 will be the last year that individuals who itemize deductions will be able to elect to deduct state and local general sales tax in lieu of state and local income tax. And, both the above-the-line deduction for qualified higher education expenses and the above-the-line deduction for up to \$250 of out-of-pocket classroom expenses paid by education professionals will not be available starting with the 2012 tax year.

Debt Payoff Strategies



Certain debt payoff strategies can reduce the time payments must be made and the total interest paid. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

In these uncertain economic times, you may be thinking of reducing your debt load. There are a number of strategies for paying off debt that you might consider. However, before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

Minimum payments

You are generally required to make minimum payments on your debts, based on factors set by the lender. Failure to make the minimum payments can result in penalties, increased interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you may have to pay large amounts of interest over the life of the loan. This is especially true of credit card debt.

Your credit card statement will indicate the amount of your current monthly minimum payment. To find the minimum payment factors, you will need to review terms in your credit card contract. These terms can change over time.

For credit cards, the minimum payment is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or some minimal amount (such as \$15). For example, assume you have a credit card with a current balance of \$2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a minimum amount of \$15. The initial minimum payment required would be \$70 [greater of $(\$2,000 \times 2\%) + (\$2,000 \times (18\% / 12))$ or \$15]. If you made only the minimum payment each month, it would take you 114 months to pay off the debt, and you would pay total interest of \$1,314.

For other types of loans, the minimum payment is generally the same as the regular monthly payment.

Make additional payments

Making payments in addition to your regular payments or the minimum payments can reduce the time payments must be made and the total interest paid. The additional payments could be made periodically, such as monthly, quarterly, or annually.

For example, if you made monthly payments of \$100 on the credit card debt above (the initial minimum payment was \$70), it would take you only 24 months to pay off the debt, and you would pay total interest of just \$396.

As another example, let's assume you have a current debt on which you owe \$100,000, the interest rate is 7.125%, the monthly payment is

\$898, and you have a remaining term of 15 years and 3 months. If you make regular payments, you will pay total interest of \$62,247. However, if you pay an additional \$200 each month, it will take you only 11 years to pay off the debt, and you will pay total interest of just \$44,364.

Another strategy is to pay one-half of your regular monthly mortgage payment every two weeks. By the end of the year, you will have made 26 payments of one-half the monthly amount, or essentially 13 monthly payments. In other words, you will have made an extra monthly payment for the year. Furthermore, payments are made earlier than required, thus reducing the total interest you will have to pay.

Pay off highest interest rate debts first

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt, and then allocate any remaining dollars to the debts with the highest interest rates.

For example, let's assume you have two debts, you owe \$10,000 on each, and each has a monthly payment of \$200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments, it will take you 94 months until both debts are paid off, and you will pay total interest of \$10,827. However, if you make monthly payments of \$600, with the extra \$200 paying off the debt with an 18% interest rate first, it will take you only 41 months to pay off the debts, and you will pay total interest of just \$4,457.

Get a debt consolidation loan

If you have multiple debts with high interest rates, it may be possible to pay off those debts by getting a debt consolidation loan. This type of loan will typically be a home equity loan. Therefore, the interest rate on it will often be much lower than the interest rates on the debts being consolidated. Furthermore, if you itemize deductions, interest paid on home equity debt of up to \$100,000 is generally deductible for income tax purposes, thus reducing the effective interest rate on the debt consolidation loan even further. However, a home equity loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

Note: All examples are hypothetical and for illustrative purposes only.

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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.