

# THE PERSONAL PLANNER

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



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Just like the summer weather, the financial markets have seen streaks of fair and foul this month. August saw our retreat from real estate positions in our Active Portfolio Risk Management strategy, joining foreign bonds, emerging market stocks, and commodities on the sidelines. Thanks to the impressive July stock market, however, it's probably safe to say that the summer will end with net gains even if August ends down.

With September we should see increased news from Washington as there are many important issues to be addressed, not the least of which is a replacement for Fed Chairman Ben Bernanke. So while politics and the markets remain unpredictable, they also remain interesting. Stay tuned.

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## September 2013

Why You Need a Power of Attorney and Medical Directive

Stretch IRAs

Is College Debt the Next Bubble?

What rate of return should I expect from stocks?

 **HELING ASSOCIATES**  
Bringing the Personal to Financial Planning

## Why You Need a Power of Attorney and Medical Directive



It's late at night and you're waiting for your husband to arrive home from a business trip. Suddenly the phone rings and the voice on the other end informs you that your husband was in a terrible car accident and

has been rushed to the hospital. You arrive to find several doctors awaiting permission to operate on your unconscious husband. They ask if he has a medical directive that authorizes someone, preferably you, to make health-care decisions on your husband's behalf.

A few days pass and your husband survives the accident, but he's going to be laid up for several weeks or months. Household bills need to be paid, but the primary source of income is your husband's business and you're not named on any of the business bank accounts. The bank representative asks whether your husband has a durable power of attorney naming you as his agent for financial matters.

These are everyday examples that highlight the importance of a medical directive and a durable power of attorney. Without these documents in place, you and your family could face personal and financial disaster.

### What is a medical directive?

A medical directive lets others know what medical treatment you would want, and allows someone to make medical decisions for you, in the event you can't express your wishes yourself. There are two basic types of advanced medical directives--a durable power of attorney for health care and a living will--which generally vary by state. So be sure your documents comply with the laws of your state of residence.

A durable power of attorney for health care (known as a health-care proxy in some states) allows you to appoint a representative (health-care agent) to make medical decisions for you if you are unable to do so yourself. You can appoint almost anyone as your agent (as long as they are of legal age, usually age 18 or older). You decide how much power your representative will or won't have.

A living will allows you to approve or decline certain types of medical care, even if you will die as a result of that choice. In most states, living wills take effect only under certain circumstances, such as terminal injury or illness. Typically, a living will can be used to decline medical treatment that "serves only to postpone the moment of death." In those states that do not authorize living wills, you may still want to have one to serve as an expression of your wishes.

### What is a durable power of attorney?

A durable power of attorney (DPOA) can help protect your property in the event you become physically unable or mentally incompetent to handle financial matters. If no one is ready to look after your financial affairs, your property may be wasted, abused, or lost. A DPOA allows you to authorize someone else to act on your behalf, so he or she can do things like pay everyday expenses, collect benefits, watch over your investments, and file taxes.

A DPOA may be effective immediately (this may be appropriate if you face a serious operation or illness), or it may only become effective upon the occurrence of an event, such as your incapacity (sometimes referred to as a springing power of attorney).

**Caution:** A springing power of attorney is not permitted in some states, so you'll want to check with an attorney for its availability in your state.

### Additional things to consider

When creating either a DPOA or medical directive such as a durable power of attorney for health care (HPOA), it is important that you choose an appropriate agent. While you may select the same person to serve as agent in both documents, you are not compelled to do so. And be sure the person you select as agent is aware of that fact. Also, let them know where you keep these documents (you may want to give a copy of your HPOA to your agent and primary care physician as well).

Once you have these documents, review them periodically to be sure they still accomplish what you intend them to do.

## Stretch IRAs



*The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow.*

The term "stretch IRA" has become a popular way to refer to an IRA (either traditional or Roth) with provisions that make it easier to "stretch out" the time period that funds can stay in your IRA after your death, even over several generations. It's not a special IRA, and there's nothing dramatic about this "stretch" language. Any IRA can include stretch provisions, but not all do.

### Why is "stretching" important?

Any earnings in an IRA grow tax deferred. Over time, this tax-deferred growth can help you accumulate significant retirement funds. If you're able to support yourself in retirement without the need to tap into your IRA, you may want to continue this tax-deferred growth for as long as possible. In fact, you may want your heirs to benefit--to the greatest extent possible--from this tax-deferred growth as well.

But funds can't stay in your IRA forever. Required minimum distribution (RMD) rules will apply after your death (for traditional IRAs, minimum distributions are also required during your lifetime after age 70½).

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow. You'll want to check your IRA custodial or trust agreement carefully to make sure that it contains the following important stretch provisions.

### Key stretch provision #1

The RMD rules let your beneficiary take distributions from an inherited IRA over a fixed period of time, based on your beneficiary's life expectancy. For example, if your beneficiary is age 20 in the year following your death, he or she can take payments over 63 additional years (special rules apply to spousal beneficiaries).

As you can see, this rule can keep your IRA funds growing tax deferred for a very long time. But even though the RMD rules allow your beneficiary to "stretch out" payments over his or her life expectancy, your particular IRA may not. For example, your IRA might require your beneficiary to take a lump-sum payment, or receive payments within 5 years after your death. If stretching payments out over time is important to you, make sure your IRA contract lets your beneficiary take payments over his or her life expectancy.

### Key stretch provision #2

What happens if your beneficiary elects to take distributions over his or her life expectancy but dies a few years later, with funds still in the

inherited IRA? This is where the IRA language becomes crucial.

If, as is commonly the case, the IRA language doesn't address what happens when your beneficiary dies, then the IRA balance is typically paid to your beneficiary's estate.

However, IRA providers are increasingly allowing an original beneficiary to name a successor beneficiary. In this case, when your original beneficiary dies, the successor beneficiary "steps into the shoes" of your original beneficiary and can continue to take RMDs over the original beneficiary's remaining distribution schedule.

When reviewing your IRA language, it's important to understand that a successor beneficiary is not the same as a contingent beneficiary. Most IRA providers allow you to name a contingent beneficiary. Your contingent beneficiary becomes entitled to your IRA proceeds only if your original beneficiary dies before you.

### Stretch even further ...

If you name your spouse as beneficiary, your IRA can stretch even further. This is because your spouse can elect to treat your IRA as his or her own, or to transfer the IRA assets to his or her own IRA. Your spouse then becomes the owner of your IRA, rather than a beneficiary. As owner, your spouse won't have to start taking distributions from your traditional IRA until he or she reaches age 70½ (and no lifetime RMDs are required from your Roth IRA). Plus, your spouse can name a new beneficiary to continue receiving payments after he or she dies.

### What if your IRA doesn't stretch?

If your IRA doesn't contain the appropriate stretch provisions, don't fret--you can always transfer your funds to an IRA that contains the desired language. In addition, upon your death, your beneficiary can transfer the IRA funds (in your name) directly to another IRA that has the appropriate stretch language.

### A word of caution

While you might appreciate the value of tax-deferred growth, your beneficiary might prefer instant gratification. If so, there's little to prevent your beneficiary from simply taking a lump-sum distribution upon inheriting the IRA, rather than "stretching out" distributions over his or her life expectancy. It's possible, though, to name a trust as the beneficiary of your IRA to establish some control over how distributions will be taken after your death.



### Growing debt

The average amount of student loan debt for the Class of 2011 was \$26,600, a 5% increase from 2010 (source: *Project on Student Debt, Student Debt and the Class of 2011, October 2012*). But some students--and their parents--borrow much, much more.

### Sources

<sup>1</sup> Mark Kantrowitz, *Student Loan Debt Clock Reaches \$1 Trillion, May 8, 2012*

<sup>2</sup> Federal Reserve Bank of New York, *Grading Student Loans, March 5, 2012*

<sup>3</sup> Federal Reserve Bank of New York, *Q4 2012 Quarterly Report on Household Debt and Credit, February 28, 2013*

<sup>4</sup> U.S. Census Bureau, *America's Families and Living Arrangements: 2011*

<sup>5</sup> Federal Reserve Bank of New York, *Q4 2012 Quarterly Report on Household Debt and Credit, February 28, 2013*

## Is College Debt the Next Bubble?

What might a 23-year-old recent college graduate, a 45-year-old entrepreneur, and a 60-year-old pre-retiree have in common financially? They may all be hobbled by student loan debt. According to financial aid expert Mark Kantrowitz, the student loan "debt clock" reached the \$1 trillion milestone last year.<sup>1</sup> And even as Americans have reduced their credit card debt over the past few years, student loan debt has continued to climb--both for students and for parents borrowing on their behalf.

### A perfect storm

The last few years have stirred up the perfect storm for student loan debt: soaring college costs, stagnating incomes, declining home values, rising unemployment (particularly for young adults), and increasing exhortations about the importance of a college degree--all of which have led to an increase in borrowing to pay for college. According to the Federal Reserve Bank of New York, as of 2011, there were approximately 37 million student loan borrowers with outstanding loans.<sup>2</sup> And from 2004 through 2012, the number of student loan borrowers increased by 70%.<sup>3</sup>

With total costs at four-year private colleges pushing \$250,000, the maximum borrowing limit for dependent undergraduate students of \$31,000 for federal Stafford Loans (the most popular type of federal student loan) hardly makes a dent, leading many families to turn to additional borrowing, most commonly: (1) private student loans, which parents typically must cosign, leaving them on the hook later if their child can't repay; and/or (2) federal PLUS Loans, where parents with good credit histories can generally borrow the full remaining cost of their child's undergraduate education from Uncle Sam.

### The ripple effect

The implications of student loan debt are ominous--both for students and the economy as a whole. Students who borrow too much are often forced to delay life events that traditionally have marked the transition into adulthood, such as living on their own, getting married, and having children. According to the U.S. Census Bureau, there has been a marked increase in the number of young adults between the ages of 25 and 34 living at home with their parents--19% of men and 10% of women in 2011 (up from 14% and 8%, respectively, in 2005).<sup>4</sup> This demographic group often finds themselves trapped: with a greater percentage of their salary going to student loan payments, many young adults are unable to amass a down payment for a home or even qualify for a mortgage.

And it's not just young people who are having problems managing their student loan debt. Borrowers who extended their student loan payments beyond the traditional 10-year repayment period, postponed their loans through repeated deferments, or took out more loans to attend graduate school may discover that their student loans are now competing with the need to save for their own children's college education. And parents who cosigned private student loans and/or took out federal PLUS Loans to help pay for their children's education may find themselves saddled with education debt just as they reach their retirement years.

There's evidence that major cracks are starting to appear. According to the Federal Reserve Bank of New York, as of 2012, 17% of the 37 million student loan borrowers with outstanding balances had loans at least 90 days past due--the official definition of "delinquent."<sup>5</sup> Unfortunately, student loan debt is the only type of consumer debt that generally can't be discharged in bankruptcy, and in a classic catch-22, defaulting on a student loan can ruin a borrower's credit--and chances of landing a job.

### Tools to help

The federal government has made a big push in recent years to help families research college costs and borrowers repay student loans. For example, net price calculators, which give students an estimate of how much grant aid they'll likely be eligible for based on their individual financial and academic profiles, are now required on all college websites. The government also expanded its income-based repayment (IBR) program last year for federal student loans (called Pay As You Earn)--monthly payments are now limited to 10% of a borrower's discretionary income, and all debt is generally forgiven after 20 years of on-time payments. (Private student loans don't have an equivalent repayment option.)

Families are taking a much more active role, too. Increasingly, they are researching majors, job prospects, and salary ranges, as well as comparing out-of-pocket costs and job placement results at different schools to determine a college's return on investment (ROI). For example, parents might find that, with similar majors and job placement success but widely disparate costs, State U has a better ROI than Private U. At the end of the day, it's up to parents to make sure that their children--and they--don't borrow too much for college. Otherwise, they may find themselves living under a big, black cloud.

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## What rate of return should I expect from stocks?

That depends on many factors, including your time frame and the types of stocks involved. Many retirement planning calculators project a portfolio's future value based on historical returns. However, past performance is no guarantee of future results, and you should take any such assumptions with a grain of salt.

You may have heard that stocks have historically averaged a 10% return. However, be careful about relying too much on that number. First, the figure on which that statement is based--9.8%--reflects the compounded annual total return of the S&P 500 between 1926 and 2012. Is your time frame likely to be that long? Second, equities' performance in recent years hasn't been as robust. The last time the S&P's compounded annual 10-year total return was 9.8% or more was 2004; from 1999 to 2008 it was negative for the first time in decades, and from 2003 to 2012, it was 7.1%.\*

Third, that 7.1% was the index's nominal return; it doesn't take into account inflation or taxes. As of April, the annual inflation rate was a little over 1%, according to the Bureau of Labor

Statistics. That would cut that 7.1% to just over 6%. And a 1% inflation rate is very low; over the last 20 years, it has averaged roughly 2.4% a year, which would mean an inflation-adjusted return under 5%. That's less than half the often-quoted 10% average, not including any taxes owed.

What would that mean to a hypothetical \$100,000 portfolio? Even if you managed to achieve a 9.8% nominal return compounded annually for 10 years, adjusting it for 2.4% inflation would mean a projected balance of almost \$255,000 would actually be worth roughly \$200,000 before taxes. That's a pretty substantial gap.

Returns for stocks other than the large caps of the S&P 500 can be different. Still, when planning for income or long-term goals, focusing on real returns could help keep your expectations realistic.

\*Calculations based on total returns compounded annually through December 2012 on the S&P 500 Index, which is an unmanaged market-cap weighted index composed of the common stocks of 500 leading companies in leading U.S. industries. It is not available for direct investment.



## What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual income or growth potential, you'll need to understand the difference between nominal return and real return, and how that difference can affect your ability to achieve financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new five-year CD you're considering is 1.5%. It's not great, you think, but it's better than the 0.85% offered by a five-year Treasury note.\*

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you've also got to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Consumer prices have gone up by roughly 1% over the past year.\*\*

Adjust your 1.08% after-tax return for inflation, and suddenly you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is called your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

In some cases, the security an investment offers may be important enough that you're essentially willing to pay someone to keep your money safe. For example, Treasury yields have sometimes been negative when people worried more about protecting their principal than about their real return. However, you should understand the cost of such a decision.

\*Source: Department of the Treasury Resource Center ([www.treasury.gov](http://www.treasury.gov)) as of April 2013.

\*\*Source: Bureau of Labor Statistics, Consumer Price Index as of April 2013.