Financial Decision Partners
Donald H. McCarty, Jr., CFP ®
donald_mccarty@bellsouth.net
www.fdp-planners.com
770-985-4071

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Inflation Rates Keep Falling: How Long Can It Last?

Economists and market watchers have been warning investors about the prospect of increased inflation since the housing bubble burst in 2007. But the inflation rate keeps going lower, not higher.

As of April 30, 2013, the Consumer Price Index (CPI) stood at a paltry 1.1%, under the Federal Reserve's target of 2% annually.[1] Why is this troubling? For a number of reasons:

- When companies don't have any leeway to raise prices, they're more apt to cut costs, which could mean a cutback in hiring.
- When inflation is low, it doesn't offer a large buffer against deflation if an economic shock occurs. Deflation -- when prices fall -- often freezes up spending. Why would you buy an item now if you expect it to be cheaper in a few months?

And it's not just the United States that is dealing with lower inflation -- or even deflation -- rates. Many of the world's top industrialized nations are in the same boat.

Inflation Rates Around the World (as of April 30, 2013)[2]

Country	Rate
Canada	1.00%
China	2.40%
France	1.00%
Germany	1.15%
Italy	1.10%
Japan	-0.90%
South Korea	1.20%
Spain	1.40%
United Kingdom	2.80%
United States	1.10%

Stay Diversified
For investors, whether inflation continues to remain low or starts to rise, a well-rounded portfolio may be your best weapon. The key is to consider your time frame, your anticipated income needs, and how much volatility you are willing to accept, and then construct a portfolio with the mix of investments with which you are comfortable.

- **CDs and Other Cash Instruments --** The Fed is still keeping a tight lid on interest rates, forcing investors who hope to keep pace with inflation by investing in cash instruments face a harsh reality. Average rates on a 1-year CD are hovering around 0.25%, while a 5-year CD is yielding an average of 0.78% nationwide, according to Bankrate.com. Money market accounts are averaging a microscopic 0.11%.[3]

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- **Bonds --** Historically, investors have turned to shorter-term corporate and high-yield bonds for protection in rising-rate environments.[4] There are two types of bonds that receive a lot of investor interest when inflation starts to rise: Treasury Inflation-Protected Securities (TIPS) and I Savings Bonds. Both TIPS and I bonds are types of fixed-interest rate bonds whose value rises as inflation rates rise.
- **Domestic Stocks --** Although past performance is no guarantee of future returns, historically, stocks have provided the best potential for long-term returns that exceed inflation.[5] An analysis of holding periods between 1926 and December 31, 2012, found that the annualized return for a portfolio composed exclusively of stocks in the S&P 500® index was 9.90% -- well above the average inflation rate of 2.98% for the same period. The results are almost as good over the short term as well. For the 10 years ended December 31, 2012, the S&P 500 returned an average of 7.10%, compared with an average inflation rate of 2.41%.[6]
- **International Stocks[7] --** During the same 10-year span that ended December 31, 2012, the Morgan Stanley Capital International (MSCI) EAFE, which is composed of established economies such as Germany and Japan, outpaced the S&P 500 with an average return of 8.70%. The MSCI Emerging Markets index -- which tracks developing world economies such as Brazil and China, and is even more risky than MSCI EAFE -- was even more stellar, returning an average of 16.89%.[8]

Remember, diversification does not ensure a profit or protect against a loss. Consult your financial professional to discuss your specific needs and options.

Source/Disclaimer:
[1]Source: U.S. Bureau of Labor Statistics, May 2013.
[2]Sources: TradingEconomics.com, May 2013; U.S. Bureau of Labor Statistics, May 2013.
[3]Source: Bankrate.com, May 15, 2013.
[4]Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.
[5]Investing in stocks involves risk, including loss of principal.
[6]Sources: Standard & Poor's; U.S. Bureau of Labor Statistics. The S&P 500 is an unmanaged index. It is not possible to invest directly in an index. Past performance is no guarantee of future results.
[7]Foreign investing involves certain risks, including currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, less liquidity, and the potential for market volatility and political instability.
[8]Source: Morgan Stanley. The MSCI EAFE and MSCI EM are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

Six Tips for Managing an Inheritance

A sizeable inheritance can represent a life-changing opportunity. Here are six tips to help you prudently manage your windfall.

Tip 1: Consult With a Financial Professional and Tax Professional
Depending on the type of inheritance (e.g., investments, life insurance, retirement account), you could be dealing with substantial federal and/or state inheritance taxes.

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Working with a financial advisor and/or a tax professional could help you plan the sale of any assets and deal with the tax implications.

- If your inheritance was from your spouse, there may be no taxes due.
- Life insurance proceeds are usually tax free.
- Non-retirement assets are taxed when sold, and those assets typically receive a "step up" in cost basis. That means that any capital gains tax you owe will be based on the asset's fair market value at the date of death of the benefactor.

If you inherit an annuity or traditional workplace retirement account or IRA, you will have to pay taxes on the distributions. Be very careful when taking your distributions. For example, if you cash out your uncle's IRA and roll the money over into your own IRA, the entire amount of the rollover will be subject to ordinary income taxes. Note too that there are considerations for spouses rolling over their deceased spouse's retirement account.

Tip 2: Park the Cash
Before you make any plans or major purchases, stop. Deposit the inheritance or investments in a bank or brokerage account. If you are married, you need to determine whether to put the account solely in your name or jointly with your spouse. Note that inheritances are considered separate property, in case of divorce. However, once they are commingled in a joint account, those assets lose that protection.

Tip 3: Cut Down/Eliminate Your Debt
Your inheritance may allow you the ability to pay off your debt, including your mortgage. But first consider paying off those loans with higher interest rates, such as credit cards, personal loans, and car loans. Then consider paying off your mortgage. Also fund an emergency account with at least six months' worth of living expenses.

Tip 4: Think About Your Other Goals
Identifying your financial goals can help you determine what types of investments to make or other types of accounts to open. These goals could include:

- Contributing to charity
- Setting up a trust or foundation
- Paying for a family member's education
- Helping out loved ones
- Adding to your retirement savings

Tip 5: Review Your Insurance and Estate Planning Needs
If you've inherited a significant sum, it may be wise to increase the liability limits on your homeowners and automotive policies. If you inherited jewelry, artwork, or real estate, you may need to increase your property and casualty coverage. Consider an umbrella policy. Does the inheritance inflate the size of your estate so that it will be subject to estate taxes? Are you thinking about setting up a trust to provide for family or charity?

Tip 6: Do Something Nice for Yourself
Set aside a small percentage -- no more than 5% to 10% -- of your inheritance for "splurges." Take a trip. Buy a new car. Just be sure to keep it small. After all, inheritances don't grow on trees.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

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How to Calculate Your Retirement Needs

Calculating a retirement savings goal is one of the most important steps investors can take to help determine if they are on track to meet that goal. However, less than half of American workers have tried to figure out how much money they will need to accumulate for retirement.[1] And the wide majority of those who did admit doing so either guessed or did their own calculations. What about you?

Planning Matters

What's important to realize is that the exercise of calculating a retirement savings goal does more than simply provide you with a dollars and cents estimate of how much you'll need for the future. It also requires you to visualize the specific details of your retirement dreams and to assess whether your current financial plans are realistic, comprehensive, and up-to-date.

Action Plans

The following five strategies will help you do a better job of identifying and pursuing your retirement savings goals.

1. **Double-check your assumptions.** Before you do anything else, answer these important questions: When do you plan to retire? How much money will you need each year? Where and when do you plan to get your retirement income? Are your investment expectations in line with the performance potential of the investments you own?
2. **Understand your projected life span.** The average life expectancy for a 45-year-old man today is 78. For a woman, it's 82. According to pension mortality tables, at least one member of a 65-year-old couple has a 72% chance of living to age 85 and a 45% chance of living to age 90.[2]
3. **Use a proper "calculator."** The best way to calculate your goal is by using one of the many interactive worksheets now available free of charge online and in print. Each type features questions about your financial situation as well as blank spaces for you to provide answers. An online version will perform the calculation automatically and respond almost instantly with an estimate of how much you may need for retirement and how much more you should try to save to pursue that goal. If you do the calculation on a paper worksheet, however, you might want to have a traditional calculator on hand to help with the math. Remember that your ultimate goal is to save as much money as possible for retirement regardless of what any calculator might suggest.
4. **Contribute more.** Do you think you could manage to save another $10 or $20 extra each pay period? If so, here's some motivation to actually do it: Contributing an extra $20 each week to your plan could provide you with an additional $130,237 after 30 years, assuming 8% annual investment returns.[3] At the very least, you should try to contribute at least enough to receive the full amount of your employer's matching contribution (if offered). It's also a good idea to increase contributions annually, such as after a pay raise.
5. **Meet with an advisor.** A financial professional can help you determine a strategy -- and help you stick to it.

Retirement will likely be one of the biggest expenses in your life, so it's important to maintain an accurate price estimate and financial plan. Make it a priority to calculate your savings goal at least once a year.

Source/Disclaimer:

[1]Source: Employee Benefit Research Institute, *2013 Retirement Confidence Survey*, March 2013.
[2]Source: Social Security Administration, *Period Life Table* (2007, latest data available).
[3]This example is hypothetical and for illustrative purposes only. Your results will vary. Investment returns cannot be guaranteed.

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Custodial Accounts: A Way to Transfer Wealth

Setting up a custodial account can be a savvy move for adults who want to gift their assets and help their children become financially independent. They are simpler to set up than trusts. But there are many considerations -- and consequences -- to weigh before opening an account. Here are some key points to keep in mind.

UGMA and UTMA

The two types of custodial accounts you can use to gift assets to your youngster are called a Uniform Gift to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA). Which one you use will depend on your state of residence. Most states -- with the exception of Vermont and South Carolina -- have phased out UGMA accounts and now only offer UTMA accounts. UTMA accounts allow the donor to gift most security types, including bank deposits, individual securities, and real estate. UGMA accounts limit gifts to bank deposits, individual securities, and insurance policies.

- **There are no contribution limits.** Parents, grandparents, other relatives, and even non-related adults can contribute any amount to an UGMA/UTMA at any time. Note that the annual federal gift tax exclusion is currently $14,000 per year ($28,000 for married couples). Gifts up to this limit do not reduce the $1 million federal gift tax exemption.
- **The assets gifted are irrevocable.** Once you establish an UGMA or UTMA, the assets you gift cannot be retrieved. Parents can set themselves up as the account's custodian(s), but any money they take from the account can only be used for the benefit of the custodial child. Note that basic "parental obligations," such as food, clothing, shelter, and medical care cannot be considered as viable expenses to be deducted from the account.
- **Taxes are due -- potentially for both you and your child.** Some parents may initially find custodial accounts appealing to help them reduce their tax burden. But it's not that simple. The first $1,000 of unearned income is tax exempt from the minor child. The second $1,000 of unearned income is taxable at the child's tax rate, which could trigger the need for you to file a separate tax return for your child. Any amounts over $2,000 are taxable at either the child's or the adult's tax rate, whichever is higher. Note that state income taxes are also due, where applicable.
- **Your child will eventually gain complete control.** Once your child reaches the age of trust termination recognized by your state of residence (usually 18 or 21), he or she will have full access to the funds in the account. Be warned that your child could have different priorities for the assets in the account than you do. Money that parents had earmarked as paying for college tuition could instead be used to purchase a sports car or fund a suspect business venture.

Financial Aid Considerations

For financial aid purposes, custodial assets are considered the assets of the student. If the assets in the account could jeopardize your child's chances of receiving financial aid, speak to your tax and/or financial professional. One of your options could involve liquidating the UGMA/UTMA and establishing a 529 account.

Before making any decisions about establishing a custodial account, be sure to talk to your tax and financial professionals.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation.

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