

WEALTH MANAGEMENT ADVISOR

PERSONAL FINANCE 101:
ADVICE FOR RECENT GRADS

AVOID 2 COSTLY LIFE INSURANCE
SNAFUS WITH AN ILIT

A SILVER LINING
Market drops can provide
long-term opportunity

ARE TAX-FREE INVESTMENTS
REALLY WORTH IT?



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Personal finance 101: Advice for recent grads

With their college degrees in hand, it's time for the recent graduates in your life to take on the responsibilities that come with the rewards of financial independence. And given today's economic challenges, it's critical for them to establish good money management habits from the outset. Here are some key personal financial tips you can give them along with your graduation gift — the tips may even turn out to be the most valuable gift they receive.

Watch your spending

As a new graduate, this may be your first experience with significant, steady cash flow. It can be tempting to spend all of your newfound money, but tread carefully until you've evaluated exactly how much you earn and how much you spend.

To start out on the right financial foot, make a budget and stick to it. Determine your monthly expenses and monthly income (after taxes), and then calculate how much you have left over. As you create your budget, be realistic about your spending — you may be surprised, for example, how much you spend on ATM fees, cab fare or take-out food.

Make retirement savings a priority

Find a prominent place in your budget for retirement savings, and treat your contribution as one of your monthly bills. If you have access to a 401(k), 403(b) or other tax-deferred retirement plan at work, make contributions to the plan a priority in your budget. These plans let you put aside money, pretax, which then can grow tax-deferred. So you're reducing your tax bill while saving for your future. Alternatively, your employer may have a 401(k)-type plan with a Roth option that may be even better for a young person.

If your employer doesn't offer a retirement plan, open up an IRA. If you choose a traditional

IRA, you can deduct your contributions when you file your tax return next year. If you choose a Roth IRA, you can't deduct your contributions, but the withdrawals you make at retirement will be tax free.



Whatever retirement plan you have, the most important factor isn't how much you contribute, but that you start contributing as soon as you can. If at age 22 you begin contributing \$150 per month to a Roth IRA account that earns 8% annually, you'll accumulate \$676,000 by age 65. But if you wait until age 30 to start contributing, you'll need to save twice as much for the rest of your working life to catch up.

If your retirement plan offers an employer match, though, try to at least contribute the amount necessary to get the maximum match. If you don't, you're throwing away free money!

Bear in mind that, if you withdraw funds from your retirement plan before age 59½, you'll be subject to current income taxes and an additional 10% tax penalty.

Manage debt wisely

Many college grads leave school with some form of debt, usually from student loans or credit cards. It's important to develop a favorable credit history, especially in times of tight credit, because lenders want to see that you're a good risk. Damage to your credit rating can impair your ability to qualify for a car loan or mortgage at an attractive rate.

So pay off your credit card bills in full every month. If you do have credit card debt, transfer the balance to a low interest-rate card and pay more than the minimum each month. If you pay only the minimum, it could take you years to pay off the card. Even with a low interest-rate card, that could add up to hundreds, if not thousands, of dollars of non-deductible interest.

If you're having trouble making student loan payments, consider consolidating multiple loans to extend your repayment timeline and reduce monthly payments, or look into getting a deferment. Make sure the rest of your finances are in order before you start attacking your student loan bills too aggressively. Give priority to credit card and other debts with higher interest rates.

Plan for future expenses

In addition to contributing to a retirement plan and paying off your debts, get in the habit of saving for short-term to middle-term expenses. First, save for emergencies — build up enough to cover at least a few months' worth of living

Insure yourself

If your health insurance expired at graduation, make sure that you get covered — either through your new employer or through an individual policy. A health emergency can significantly deplete your funds. Fortunately, you'll find that you're likely relatively cheap to insure because most recent grads are young and generally healthy.

In addition, don't overlook other insurance needs, such as renter's and auto insurance, to make sure that large, unforeseen expenses don't disrupt your finances too greatly. Be sure to shop around for competitive rates.

expenses. Even if you have a good job, you never know what the future will hold, especially in a stressed economy.

Once you've built up your emergency fund, save for other goals. You'll be rewarded with a growing nest egg that may enable you to fund a car, home, wedding or other big items down the road.

Finally, you aren't too young to benefit from the guidance of a professional financial advisor, who can provide specialized advice for your individual situation. ■

Avoid 2 costly life insurance snafus with an ILIT

Life insurance can help you provide for your loved ones' financial security after your death. But careful planning is necessary to avoid decisions that could threaten the estate-tax-free status of your life insurance proceeds and significantly reduce the amount that's left for your family — or that could prevent them from receiving the proceeds according to your wishes. Let's examine two major snafus you can avoid by creating an irrevocable life insurance trust (ILIT).

1. You own the policy

It's not uncommon to purchase life insurance to cover estate taxes. But the policy proceeds intended to pay the estate tax bill can end up *increasing* the bill if you're not careful. Why? Because even though the proceeds are income-tax free for the beneficiaries, the money may be included in your estate and, thus, be subject to estate tax.

One way to prevent this outcome is by creating an ILIT to own the policy. After your attorney

sets up the trust and you name the trustee (such as a friend, family member, lawyer, accountant or bank) and beneficiaries, you can begin making cash deposits into the trust, in essence paying the policy's premiums. Your cash contributions to the trust to cover premium payments are considered taxable gifts, so a gift tax return may be required. With savvy planning, however, you can minimize or even eliminate gift taxes by using annual gift tax exclusion amounts.

Keep in mind that, for the ILIT to be successful, you can't retain any incidents of ownership in the policy. This includes the right to borrow against the policy's cash value or retaining the right to change beneficiaries.

Also try to avoid transferring an existing policy to an ILIT. If you die less than three years after the transfer, the three-year rule will kick in and draw the proceeds back into your estate. By having the ILIT buy a new policy on your life, you can avoid this outcome. Bear in mind that, if your primary goal is to be able to withdraw funds from the policy during your retirement years, an ILIT probably isn't the right vehicle for you.

2. A policy beneficiary is a minor or legally incompetent

You naturally want to ensure that your children will be financially set after your death. But one of the biggest and most common snafus you can make is designating a minor or legally incompetent person as beneficiary of your life insurance policy. Doing so defeats the purpose of providing for your loved ones after you're gone because insurance companies generally won't pay large sums of money directly to a minor or an incompetent person.

Try to avoid transferring an existing policy to an ILIT.

The result? Your executor will have to go through the lengthy and expensive process of arranging a court-appointed guardian before the death benefits are released to your family members. And if the appointed guardian is someone who doesn't have your loved one's best interest at heart, your plans could go up in smoke.



What's more, in the case of a minor, the beneficiary will gain unrestricted access to the funds as soon as he or she reaches the age of majority, regardless of his or her ability to manage the assets.

Designating an ILIT as the beneficiary of the policy can help prevent this outcome. An ILIT provides you with the flexibility to establish detailed criteria for how and when the proceeds will be distributed to or on behalf of your loved ones.

You can instruct the trustee to distribute the funds to beneficiaries at any age you wish, even into adulthood. For example, you can allocate distributions for college tuition or health care, or make them contingent on certain achievements, such as graduating from college, becoming active in the family business or being gainfully employed elsewhere. You can use distributions to reward exemplary behavior, such as becoming involved in a charity, or celebrate certain milestones, such as a birthday or wedding.

For a beneficiary who is severely disabled or otherwise legally incompetent, consider establishing a special needs trust, which provides for his or her comfort without jeopardizing eligibility for government assistance.

Shielding your estate plan

A life insurance policy can help protect your family's financial future. An ILIT can help ensure the policy works as you intend by shielding your estate plan from snafus that make policy proceeds vulnerable to hefty estate taxes or prevent the proceeds from being distributed according to your wishes. Your attorney and financial advisor can help you determine whether an ILIT is right for your situation. ■

A silver lining

Market drops can provide long-term opportunity

The final chapter of the latest economic downturn may not yet have been written, but signs of the extent of damage already are apparent. If you've looked at your retirement plan statements since last fall, for example, you hardly need to be told how incredibly challenging the investment environment has been. But if you can stomach the market's volatility, down markets often provide brave investors with attractive long-term buying opportunities.



Stocks on sale

It's a truism that the way to make money in the market is to buy low and sell high. A declining market can create opportunities to do just that, because you can invest in high-quality companies at low prices, although there are no guarantees that your choices or your timing will be right.

This approach was illustrated last fall by investor Warren Buffett: He took advantage of the market's drop to invest \$3 billion in General Electric and \$5 billion in Goldman Sachs at unusually low valuations. These opportunities aren't exclusive to billionaire investors — you, too, may be positioned to benefit from investing wisely during market downturns when other people are hesitant.

There's no guarantee, of course, that even well-established stocks can't lose more or even that they'll ultimately rebound. Even Warren Buffett has seen that happen. But whenever you have the chance to buy good stocks at historically low prices, it's a potential opportunity worth exploring.

A steady course

During times of market turmoil, the temptation to make bad financial decisions is strong. The lower the market goes, the greater the desire for many investors to get out immediately, whatever the cost.

History, however, comes down squarely in favor of patience. Consider the October 1987 stock market crash. If you had owned an S&P 500 index fund, for example, your losses for the month would have reached 23%. Selling your stocks out of fear would have guaranteed losses of at least that much.

But if you had been patient enough to remain invested, your portfolio would have returned to even just 20 months later. And if you had been intrepid enough to add to your stock holdings at the market's low, your breakeven point would have occurred sooner.

Although there may be good reasons to sell stocks that have fallen far from their highs — for example, if their business prospects have deteriorated meaningfully — indiscriminate selling of underperformers simply locks in your losses.

Market timing mistakes

When stocks are falling, many investors opt to sell their equity holdings and plan to jump back into the market when conditions improve.

Although tempting during market turbulence, this is generally an unwise strategy. The problem with so-called market timing is that, to benefit, you have to be right twice — first when you get out and again when you get back in. And even though it's possible to get lucky on both ends of the market cycle, the odds against it are long.

Markets move quickly and can change direction suddenly, often as a result of unforeseen events, or in anticipation of events that have not yet occurred. Those moves can make a surprisingly big difference in the long-term performance of your portfolio — in most cases, you're best off staying put.

A related form of market timing is to sell “risky” stocks and put them in “safe” fixed-income investments, such as U.S. Treasuries. Even though investing conservatively during down markets may seem like a prudent strategy, playing it safe can be risky over the long term.

Specifically, a bond-heavy portfolio may not generate enough growth to stay ahead of rising inflation over time. In fact, as Wharton business

school finance professor Jeremy Siegel details in *Stocks for the Long Run*, over a 20-year holding period stocks have never delivered a return below the inflation rate, while the same can't be said for fixed-income securities.

Stocks are riskier than bonds over short periods of time, but the longer you can afford to hold onto stocks, the less risky they become in relative terms. Siegel also points out that, in every rolling five-year period between 1802 and 2006, the worst stock performance was -11%, only slightly worse than bonds or Treasuries, while the worst 10-year span for stocks actually *outperformed* fixed-income securities.

Stay strong

The best time to invest is often when you least feel like doing so. There have been market downturns in the past, and history suggests that investors able to ignore the fear and take the long-term view may be rewarded for their resilience and patience.

Bear in mind that past performance does not guarantee future results. Investment returns will fluctuate so that an investor's shares when redeemed may be worth more or less than their original cost. Current performance may be lower or higher than the performance data. ■

Are tax-free investments really worth it?

If you think investing in tax-exempt securities such as state and municipal bonds is an ideal way to diversify your portfolio and enjoy tax-free income, hold that thought. There are a few possible cons to consider along with the potential pros.

The good

Tax-exempt bonds (sometimes referred to as muni bonds) are debt securities issued by state and local governments to finance projects such as highway improvements and new schools, or simply their general obligations. The interest

income from these bonds generally is free from federal income tax.

It may also be free from state income tax in some states if you reside in the same state as the source of the bonds. (Capital gains from the sale of tax-exempt bonds, however, aren't exempt.) So investing in these bonds, especially if you're in a high tax bracket, may significantly lighten your tax burden.

To break down the potential benefits in numbers, calculate the tax-equivalent yield, which incorporates tax savings into the bond's yield.

The formula goes this way: Tax-equivalent yield = actual yield/(1 – your marginal tax rate).

So if you're considering a tax-exempt bond with a 4.5% yield and you're in the 35% tax bracket, the bond's tax-equivalent yield would be $.045 / (1 - .35) = .069$, or 6.9%. In other words, a taxable bond would have to produce a yield of at least 6.9% to provide you with the same after-tax income as an exempt bond with a 4.5% yield. If the bond is also exempt from state and local taxes, the tax advantage is even greater.



Tax-exempt bonds are also liquid, which means your money is accessible by simply cashing out at any time. Just be sure to pay attention to the yield of the bond because, if you have to sell it before maturity, you'll receive the current value rate, not the face amount payable at maturity. This may be a lower amount, particularly if interest rates have increased since you acquired the bond. On the other hand, if the price of your bond has grown substantially, you can sell it in the open market and potentially make more than you could by keeping it until maturity.

The bad

Perhaps the most important con to consider is that tax-exempt bonds typically pay a lower rate of interest than other, taxable securities. So you must determine whether your tax savings are significant enough to make up for the lower yield.

Another investment, such as a corporate bond, might provide a greater return even after taxes are taken into account. In the example above, for instance, a corporate bond yielding 7% would provide a greater after-tax return than the 4.5%-yield tax-exempt bond. And if you

were in the 25% tax bracket rather than the 35% one, a corporate bond yield would need to only exceed 6% to beat the 4.5%-yield tax-exempt bond.

Investing in tax-exempt bonds can also affect your tax bill in other ways. Two significant ones include:

1. Alternative minimum tax. While not subject to federal income tax, certain tax-exempt "private activity" bonds issued after Aug. 7, 1986, may be subject to the federal alternative minimum tax (AMT). If you are already paying AMT or are close to the threshold, these bonds may increase your federal tax because the income they generate gets added to your income for AMT purposes.

2. Social Security benefits. Tax-exempt bond interest counts as part of your income for purposes of determining the taxable portion of Social Security benefits. The IRS looks at your provisional income, which is your modified AGI plus nontaxable interest (which includes tax-exempt bond interest) plus one-half of your Social Security benefits. If the total exceeds \$25,000 (\$32,000 for joint filers), a portion of your Social Security benefits — up to 85% — will be taxable.

Perhaps the most important con to consider is that tax-exempt bonds typically pay a lower rate of interest than other, taxable securities.

Weighing both sides

Investing in tax-exempt bonds may seem like a no-brainer at first. But munis aren't right for everyone. So scrutinize them in the context of your overall tax situation. In addition, consider other important factors such as credit quality, price volatility and the investment's role in your asset allocation strategy to determine if munis are right for you. ■

Municipal bonds' principal and interest are backed by the full faith and credit of the issuing entity and are subject to risk, including loss of principal and interest. Alternative minimum tax (AMT) may apply.

Your source for customized investment and financial planning



Successfully managing personal and family finances means making the right decisions today while considering their implications for the future. At Ferrell Wealth Management, our sole focus is our client's best interest, and we customize portfolios and financial plans to fit each individual's set of goals and objectives.

We provide a full range of investment management and advisory services including:

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By working with our experienced team of advisors, you will benefit from the independent and objective perspective necessary to make your financial vision a reality.



**James W. Ferrell, MBA, CFP®, CPA, PFS, CIMC
President**

A Certified Public Accountant (CPA), Certified Financial Planner (CFP), Personal Financial Specialist (PFS) and Certified Investment Management Consultant (CIMC), Jim is the founding shareholder and President of Ferrell Wealth Management, Inc.

Jim is actively involved in local organizations including: Morning Star Charities, Inc. (President), Winter Park Chamber of Commerce, the University of Central Florida Foundation (Board of Directors), Winter Park YMCA (Board of Directors), on the Center for Entrepreneurship at Rollins College (Board of Directors) and is an Inductee in the UCF College of Business Administration Hall of Fame.



**Katie Miller, MBA
Vice President - Senior Financial Advisor**

A Certified Financial Planner (CFP) candidate with a Master of Business Administration Degree from Rollins College, Katie works as a financial advisor responsible for assisting clients set and achieve their long-term financial goals through investments, tax planning, asset allocation, risk management, retirement planning, and estate planning.

Katie is a member of the Winter Park Community Foundation Advisory Board and Investment Management Consultants Association (IMCA), and involved in such local organizations as the Central Florida YMCA, Orlando Chamber of Commerce, Winter Park Chamber of Commerce, and Camp Boggy Creek.



**Alex Negron, MBA
Senior Financial Advisor**

A Central Floridian for 20 years, Mr. Negron is a Certified Financial Planner (CFP) candidate with a Master of Business Administration Degree from Webster University. Alex is responsible for assisting clients with their financial plan, which includes retirement, estate, and tax planning. He develops asset allocation plans using various types of investments in order to properly diversify and reduce portfolio risk.

Prior to becoming a member of Ferrell Wealth Management, Inc., Alex worked for Charles Schwab & Co., Inc. as a VP- Financial Consultant in Orlando, FL.

Mr. Negron is involved with local organizations such as the Orlando Chamber of Commerce and Leadership Orlando Alumni. He holds the Series 7, 9, 10, 63, and 65 licenses.

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