FINANCIAL SERVICES ADVISORY
INCORPORATED

Second Quarter 2012 | www.fsainvest.com | (800) 235-4567

College Savings: How Much Do You Need Each Month?

The ever-rising cost of college shows no sign of abating. According to the nonprofit College Board, tuition and fees for the 2010-2011 academic year at four-year public colleges increased on average by 7.9% from the previous year, to \$7,605, for in-state students, and by 4.6%, to \$8,535, for those from out of state. For private colleges, tuition and fees jumped an average of 4.5%, to \$27,293. And that's not counting room and board, books, supplies, and transportation, which together may add more than \$10,000 to the yearly total. At many top private schools, the annual cost now runs more than \$50,000.

So how much savings will it take for you to send your children to college when they're ready? Your expense will vary depending on what schools your kids attend, how much savings you've already set aside, any financial aid you get, and the rate of inflation for tuition prices. Still, you can get a rough idea of how much you need to save by plugging a few key assumptions into an online calculator.

Consider John and Jane Smith. The Smiths have two children, Michael, age 13, and Susan, who's eight. The kids are five and 10 years, respectively, from when they'll start college. Let's begin by assuming John and Jane haven't saved anything yet. Based on a current tuition cost of \$15,000, a conservative expected interest rate of 3% and an expected inflation rate of 3%, in five years the cost of four years of college for Michael will be \$72,749.55. To have that much set aside when he starts his freshman year, the Smiths would need to save \$708.47 each month. Using the same assumptions, Susan's four-year tuition bill will come to \$84,336.67—and require an additional \$465.24 in monthly savings. (Keep in mind that this is for tuition only; the actual costs of sending the kids off to college will be substantially higher.)

Now let's change the scenario slightly. Suppose the Smiths have already managed to set aside \$50,000 for each child. Using the same \$15,000 annual tuition cost, the 3% expected return on their savings, and 3% inflation, the additional monthly savings needed to meet Michael's tuition costs drops to \$116.53, and just \$75.74 more each month would get Susan to her goal.

Suppose we change another variable. This time, we'll still assume the Smiths have saved \$50,000 for each child, but now they anticipate that the children will be attending schools where tuition is currently \$20,000, instead of \$15,000. We will also keep the same 3% expected interest rate for their savings and 3% annual inflation. In this case, the overall savings goal for Michael to attend school for four years increases to \$96,999.41, and the Smiths will have to save \$352.68 per month to have that much ready when he starts

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30 Years Of Service And Counting; Thank You So Very Much

The announcements are mailed, the calendar is clear: We are celebrating 30 years of service at FSA. While very proud of this accomplishment, we are aware that our success is dependent on the trust you place in us. Personal financial planning is – there's no other way to say this – personal. It's been an honor to be on this journey with you.

As part of our anniversary celebration, we invited Greg Valliere, popular CNBC political analyst, to enlighten our clients about the upcoming election and what investors may face in different November scenarios.

Check the FSA Vault for audio clips of the May event if you were unable to join us in person. And stay tuned for announcements regarding upcoming events. We'll be celebrating all year.

In this issue, we included an array of articles that address several basic financial planning topics. Ever wonder where to go first for money? IRAs, joint or personal accounts, and Roth IRAs all have different tax consequences. Want to avoid unpleasant surprises? Read the article regarding safety when using your ATM card.

Most importantly, thank you for marking this business milestone with us. We are most grateful for your confidence in us and are rededicating ourselves to delivering the highest quality service and advice going forward. Here's to the next 30!

Jim Joseph, CFP®
Vice President

Six Disability Facts To Consider

You probably already understand the importance of having life insurance. The proceeds from a life policy can help cover your family's current expenses and may provide a cushion for the future if you die prematurely. But another kind of coverage—disability income (DI) insurance—is often ignored or neglected. And that's a mistake, because DI insurance can be even more vital than life insurance in maintaining a family's financial well-being. A new white paper from the Council for Disability Awareness, an independent nonprofit group, provides these six startling facts.

1. More than one in four of today's 20-year-olds will become disabled before they retire. (Source: Social Security Administration, Fact Sheet, March 18, 2011)

2. Some 8.5 million disabled U.S. wage earners were receiving Social Security Disability Insurance (SSDI) benefits at the end of September 2011. (Source: Social Security Administration, Office of Disability and Income Security Programs)

3. Ninety percent of new long-term disability claims are the result of an illness, not an accident, and fewer than 5% of claims are work-related. (Source: 2011 Council for Disability Awareness Long-Term Disability Claims Study)

4. The average long-term disability claim lasts 31.2 months. (Source: 2010 GenRe Disability Fact Book)

5. New applications for Social Security Disability Insurance (SSDI) benefits increased 27% from 2008 to 2010. (Source: Social Security Administration, Office of Disability and Income Security Programs)

6. About 100 million workers lack private disability income insurance. (Source: Social Security Administration, Fact Sheet, March 18, 2011)

If you don't have DI insurance, either through a policy from your employer or one you've bought on your own, you can choose from among a wide array of products whose costs and benefits vary widely. Here are several factors you'll need to take into account.

- How a policy defines "disability" is crucial. The best policies pay benefits if you can't work in your chosen profession, and they don't consider the nature of an injury.
- DI insurance policies generally require a waiting period before paying benefits, and a shorter waiting period normally translates into higher premiums.
- Typically, a policy will state how long and under what circumstances it will pay disability income benefits. It could, for example, provide benefits only until you qualify to receive Social Security retirement benefits.
- If you opt for a noncancellable policy, the insurer can't drop you off its rolls if your health declines.

Finally, don't be seduced by the low costs of a fly-by-night operation. You'll be better off opting for an experienced company with a good reputation.

Four Smart Ways To Gift This Year

No one knows for sure what *will* happen to estate and gift tax laws at the end of 2012, but it's crystal clear what *could* occur. Unless Congress acts, the current $5.12-million exemption for estate and gift taxes will drop to $1 million, making it much more expensive to transfer large amounts to your heirs. With that immense change looming, you may want to take action now.

One possibility is to establish an irrevocable trust. You transfer assets to a trust for designated beneficiaries, such as your children, and the high current exemption amount means you're unlikely to face dire estate or gift tax ramifications. But "irrevocable" means just that—you can't get your money back later if you have a squabble with your kids or they make bad lifestyle choices.

Depending on your situation, one of these four alternatives could play a role in your estate plan while helping you take advantage of this year's generous rules.

1. Self-settled trusts. Here you essentially give assets away now, using the high current exemption, but you retain the right to get at the money if you need it. Self-settled trusts are available in just a handful of states, but non-residents can transfer assets to a trustee in one of those states. The trustee decides whether an eligible beneficiary can receive a requested distribution, and assets are generally off-limits to your creditors. But the laws in this area are still evolving.

2. Trust protectors. You also might establish a trust now but design it to have a third-party protector—such as an experienced relative—who oversees the professional trustee and can remove a beneficiary, veto distributions, amend trust terms, or shift the trust to another state. You also can form committees to make key decisions.

3. Grantor trusts. Make sure that

Which Retirement Funds To Withdraw First?

In planning for retirement, most of the emphasis is on accumulation—how to save and invest as much as you can in your company's retirement plan, traditional and Roth IRAs, and other accounts. But what happens when you leave work and need to start using what you've saved? How can you deploy your assets as efficiently as possible, so that they'll be there to sustain a comfortable lifestyle for the rest of your life? And when it's time to tap your retirement nest egg, where should you begin?

Although there are several economic and personal factors involved—including your level of assets, the investment mix of your portfolio, and your age and health status—decisions about retirement spending often boil down to questions of tax efficiency. And, with tax increases looming, making the right choices is crucial.

To begin that process, make sure you know the basic tax rules for different types of accounts. Here's a quick rundown.

Personal accounts. Investment income that you earn outside of your retirement accounts and IRAs—for example, in brokerage and interest-bearing accounts—is generally taxable in the year you receive it. If you sell securities or other capital assets, any profits will be taxed as capital gains—at your regular income rate if you held the asset for a year or less, but otherwise at a more favorable long-term capital gains rate.

401(k)s and other company retirement plans. The 401(k) is by far the most popular type of "qualified" retirement plan, but SIMPLEs, SEPs, and pension plans also work the same way. These plans offer pre-tax contributions and tax-sheltered investment growth, but payouts during retirement are taxed at ordinary income rates. Other rules penalize early withdrawals before age 59½, unless a special exception applies, and retirees must begin "required minimum distributions" (RMDs) after age 70½.

Traditional IRAs. Here, too, the amount of any distribution representing tax-deductible contributions and earnings is taxable at ordinary income rates, and comparable rules for early withdrawals and RMDs also apply.

Roth IRAs. Unlike money that you withdraw from a traditional IRA, qualified distributions from a Roth in existence at least five years are 100% tax-free. Another advantage is that you don't have to take RMDs during your lifetime.

Understanding the tax implications for each kind of account will become even more significant next year, if scheduled tax increases take effect. Ordinary income tax rates are set to rise, cresting at a top tax rate of 39.6% (up from 35% in 2011). And whereas long-term capital gains and qualified dividends have been taxed at a maximum rate of 15%, the rate for long-term gains will jump to 20% and dividends will be taxed at ordinary income rates. Finally, a new 3.8% Medicare surtax will also affect some high-income investors. The surtax applies to the lesser of your annual net investment income or the amount by which your modified adjusted gross income (MAGI) exceeds $250,000 ($200,000 for single filers).

With rates going up, future distributions from retirement accounts could result in much higher tax liability. Against that backdrop, the general rule of thumb calls for taking retirement funding from your savings in this order:

1. Personal accounts
2. Company retirement plans and IRAs
3. Roth IRAs

Tapping your accounts in that sequence is designed to produce the lowest possible tax bill, to allow for maximum tax-deferred growth, and to provide optimum portfolio longevity. The main thrust is to keep tax-advantaged accounts growing for as long as possible. Also, this approach reflects the necessity of eventually taking RMDs from qualified retirement plans and traditional IRAs. The Roth IRA, which can deliver tax-free income and isn't subject to the rules for RMDs, is normally the last resource to use.

But this sequence assumes that you'll be in a higher tax bracket in the future—and unless Congress acts to renew expiring tax breaks, it's very likely you will be. In 2013 or later, you could be taxed at a rate as high as 43.4% if you're hit by the 3.8% Medicare surtax.

If, on the other hand, you anticipate that your future tax rates will be lower than your current rate, you might take distributions first from your tax-free accounts. And there are other times when you might deviate from the typical approach, depending on your circumstances.

The analysis is tricky, so don't jump to conclusions. We would be glad to provide the guidance you need to choose an approach that works best in your situation. ●

any trust you create in 2012 is designated as a grantor trust. As grantor, you'll pay any tax on annual trust income, and those payments won't be treated as gifts now or in future years, when gift tax rules may be more onerous. One sophisticated version is the "intentionally defective irrevocable trust" (IDIT), purposely designed to be treated as a grantor trust while freezing the value of assets for estate tax purposes.

4. Spousal beneficiaries. A simpler way to keep access to money while taking advantage of current tax rules is to create a traditional trust and designate your spouse as a "discretionary beneficiary." The trust can be structured to allow occasional distributions to your spouse, who could establish a separate trust for you. But you'll have to do this carefully so the trusts won't be considered reciprocal.

Bear in mind that this is only a brief overview of four gift tax ideas. Obtain more details for your situation. ●

How To Guard Against "Skimmers"

In this age of technology, you probably don't think twice about using the ATM at your bank, the self-checkout machine at the supermarket, or various credit card terminals around town. It's never been a problem before. But a new type of crime called "skimming" may give you pause.

Essentially, skimming is the practice of stealing your credit card information, usually through the use of high-tech equipment. Then the thief makes purchases under your name or sells the data to someone else. Either way, you could end up with an exorbitant credit card bill or an empty bank account.

Typically, a skimmer installs an electronic device over the actual card reader on the ATM or credit card machine. As your card slides through, the device reads its magnetic strip, capturing your vital financial information. The level of sophistication can vary from cheap skimmers that should be relatively easy to spot to more expensive versions that are virtually undetectable by the naked eye.

Usually, the skimming device captures and stores your PIN (personal identification number) as well as the card's security code. Some skimmers feature a false keypad that goes on top of the actual keypad reading the PIN, while newer devices utilize pinhole cameras mounted above the keypad. The information may be stored locally and picked up by the thief or transmitted via a phone line or even wirelessly.

How can you protect yourself against skimming? Here are a few practical suggestions.

• Look carefully at the ATM or credit card terminal before using it. Although sophisticated skimming devices may be hard to detect, cheaper versions are often clumsily attached to the reader. If something is sticking out or doesn't fit with the rest of machine, walk away.

• Before you insert your credit card, pull on the reader or jostle the card around the slot to see if anything is loose. Again, don't use the terminal if your suspicions are aroused.

• Be aware of people hanging around the ATM for a long time. The skimming criminal could be lurking nearby to collect the information.

• Avoid ATMs in isolated locations that don't seem to be part of a store or bank. There have been instances where fake terminals have been set up without an establishment's knowledge.

• When you enter your PIN, use your free hand to block the view. That can shield your information from a camera mounted above the PIN keypad.

Finally, pay close attention to your credit card and bank statements. Fraudulent charges or unauthorized cash withdrawals often indicate that your data has been compromised. If that's the case, contact your bank or credit card issuer right away.

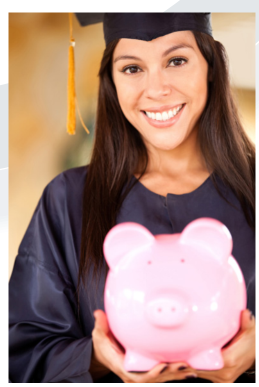
College Savings: How Muc h?

(Continued from page 1)

college. For Susan, the savings goal increases to $112,448.90—or $230.82 a month during the 10 years until she reaches college age.

Finally, let's change the facts one last time. We will keep a $20,000 tuition fee, $50,000 of college savings per child, and an expected 3% inflation rate, but we'll double the expected interest rate from 3% to 6%. With this higher investment return, the projected savings goal to send Michael to school for four years can be achieved with monthly savings of $208.54. The goal for Susan, who will enter college in 10 years, is reduced to just $60.37.

Of course, these figures are hypothetical and not indicative of any particular investment. Be aware that investors also face the risk of lower returns and a loss of principal if markets decline. In addition, depending on how this money is saved, there may be tax consequences to liquidating investments to make the payments.



Keeping all of the variables in mind, you can see that making college savings a top priority is critical. You'll also need to consider what savings vehicle to use. For many families, 529 college savings plans offer compelling advantages—you won't be taxed on investment gains or when you pull out money to pay qualified college expenses, and some of these state-sponsored plans let state residents deduct contributions on their state tax returns. Financial aid formulas also tend to make smaller reductions in potential aid when savings are held in 529 plans. But other options may work better in some cases. And whatever vehicle you choose, the most important thing is to start saving as soon as possible and to be diligent about adding to your education accounts. With tuition costs likely to continue to rise faster than overall inflation, the high cost of college could move much higher in the years ahead. ●

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