INVESTMENT HOUSE, LLC

Financial Solutions Under One Roof

Investment House, LLC
Nisonger, Smestad & Mungall
Joanne D. Mungall, CFP®
1515 Lincoln Avenue
San Jose, CA 95125
408-286-8483
joanne@yourinvestmenthouse.com

Making the Most of Your 401(k) Plan

A 401(k) plan represents one of the most powerful retirement savings opportunities available today. If your employer offers a 401(k) plan and you're not participating in it, you should be.

Contribute as much as possible

The more you can save for retirement, the better your chances of enjoying a comfortable retirement. If you can, max out your contribution up to the legal limit ($17,500 in 2013, $23,000 if you're age 50 or older). If you need to free up money to do that, try to cut certain expenses. (Note: some plans limit the amount you can contribute.)

Why invest your retirement dollars in a 401(k) plan instead of somewhere else? One reason is that your pretax contributions lower your taxable income for the year. This means you save money in taxes immediately when you contribute to the plan--a big advantage if you're in a high tax bracket. For example, if you earn $100,000 a year and contribute $17,500 to a 401(k) plan, you'll only pay federal income taxes on $82,500 instead of $100,000.

Another reason is the power of tax-deferred growth. Any investment earnings compound year after year and aren't taxable as long as they remain in the plan. Over the long term, this gives you the opportunity to build an substantial sum in your employer's plan. (Your pretax contributions and any earnings will be taxed when paid to you from the plan.)

Consider Roth contributions

Your 401(k) plan may also allow you to make after-tax Roth contributions. Unlike pre-tax contributions, Roth contributions don't lower your current taxable income so there's no immediate tax savings. But because you've already paid taxes on those contributions, they're free from federal income taxes when paid from the plan. And if your distribution is "qualified" (that is, the distribution is made after you satisfy a five-year holding period, and after you reach age 59½, become disabled, or die) any earnings are also tax free.

If your distribution isn't qualified, any earnings you receive are subject to income tax. A 10% early distribution penalty may also be imposed if you haven't reached age 59½ (unless an exception applies).

Capture the full employer match

Many employers will match all or part of your contributions. If you can't max out your 401(k) contributions, you should at least try to contribute as much as necessary to get the full employer match. Employer matching contributions are basically free money. By capturing the full benefit of your employer's match, you'll be surprised how much faster your balance grows. If you don't take advantage of your employer's generosity, you could be passing up a significant contribution towards your retirement.

Access funds if you must

Another beneficial feature that many 401(k) plans offer is the ability to borrow against your vested balance at a reasonable interest rate. You can use a plan loan to pay off high-interest debts or meet other large expenses, like the purchase of a car. You typically won't be taxed or penalized on amounts you borrow as long as the loan is repaid within five years. Immediate repayment may be required, however, if you leave your employer--if you can't repay the loan, you may be treated as having taken a taxable distribution from the plan.

And remember that when you take a loan from your 401(k) plan, the funds you borrow are generally removed from your plan account until you repay the loan, so you may miss out on the opportunity for additional tax-deferred investment earnings. So loans (and withdrawals if available) should be a last resort.

Evaluate your investment choices

Choose your investments carefully. The right investment mix could be one of your keys to a comfortable retirement. That's because over the long term, varying rates of return can make a big difference in the size of your 401(k) plan account.

March 2013

Looking Backward and Forward on Entitlement Programs

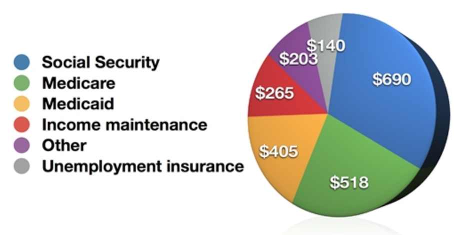
An unsustainable path

The bipartisan Bowles/Simpson Deficit Reduction Commission stated that "our nation is on an unsustainable fiscal path" in regard to entitlement spending.

Last year's presidential election, along with the more recent fiscal cliff and debt ceiling negotiations, have put the spotlight on our nation's tax policy, deficit, and entitlement programs. For some, entitlement programs are necessary--a social compact for America in an era of longer life spans, the decline of employer-provided pensions and health insurance in retirement, and a widening gap between the haves and the have-nots. For others, the current level of entitlement spending is jeopardizing our country's fiscal health and creating an "entitlement lifestyle." No matter where you stand in the debate, do you know the basic facts on our country's largest entitlement programs?

Where the money goes

All entitlement spending isn't created equal. The "Big Three" of Social Security, Medicare, and Medicaid account for more than two-thirds of all federal entitlement spending. Social Security and Medicare are primarily age-based programs, whereas Medicaid is based on income level. According to the U.S. Bureau of Economic Analysis, in 2010, the federal government spent a total of $2.2 trillion on entitlement programs, with the Big Three accounting for $1.6 trillion of this total. The largest expenditure was for Social Security ($690 billion), followed by Medicare ($518 billion) and Medicaid ($405 billion).



A history of growth

Alexis de Tocqueville, the famous French political thinker who traveled to the United States in the early 1830s and wrote about the uniqueness of our young nation's individual self-reliance in his famous book, *Democracy in America,* would likely be surprised to observe the growth in spending on entitlement programs that has occurred in the United States over the past 50 years. According to the Bureau of Economic Analysis, in 1960, U.S. government transfers to individuals totaled about $24 billion in current dollars. By 2010, that figure was $2.2 trillion, almost 100 times as much.

Current status

Let's look at our two main entitlement programs--Social Security and Medicare.

Social Security. Created in 1935, Social Security is a "pay-as-you-go" system, meaning that payments to current retirees come primarily from payments into the system by current wage earners in the form of a 12.4% Social Security payroll tax (6.2% each from employee and employer). These payroll taxes are put into two Social Security Trust Funds, which also earn interest. According to projections by the Social Security Administration, the trust funds will continue to show net growth until 2022, after which, without increases in the payroll tax or cuts in benefits, fund assets are projected to decrease each year until they are fully depleted in 2033. At that time, it's estimated that payroll taxes would only be able to cover approximately 75% of program obligations.

Medicare. Created in 1965, Medicare is a national health insurance program available to all Americans age 65 and older, regardless of income or medical history. It consists of Part A (hospital care) and Part B (outpatient care)--which together make up "traditional" Medicare; Part C (Medicare Advantage, which is private insurance partly paid by the government); and Part D (outpatient prescription drugs through private plans only). Medicare Part A is primarily funded by a 2.9% Medicare payroll tax (1.45% each from employee and employer), which in 2013 is increased by 0.9% for employees with incomes above $200,000 (single filers) or $250,000 (married filing jointly). In addition, starting in 2013, a new 3.8% Medicare contribution tax on the net investment income of high-earning taxpayers will take effect.

Looking ahead, Medicare and Medicaid are expected to face the most serious financial challenges, due primarily to increasing enrollment. The Congressional Budget Office, in its report *Budget and Economic Outlook: Fiscal Years 2012 to 2022,* predicts that federal spending on Medicare will exceed $1 trillion by 2022, while federal spending on Medicaid will reach $605 billion (state spending for Medicaid is also expected to increase). According to the CBO, reining in the costs of Medicare and Medicaid over the coming years will be the central long-term challenge in setting federal fiscal policy.

Reform

There has been little national consensus by policymakers on how to deal with rising entitlement costs. At some point, though, reform is inevitable. That's why it's a good idea to make sure your financial plan offers enough flexibility to accommodate an uncertain future.

How a Low-Interest-Rate Environment Can Affect a Market-Value-Adjusted Fixed Annuity

Annuity guarantees are subject to the claims-paying ability of the annuity issuer and are entirely dependent on the insurer's ability to meet its financial obligations.

Interest rates continue to run at historically low levels. For investors, that's the bad news. The good news is that presumably there's only one direction interest rates can eventually trend--upwards. If you own a market-value-adjusted (MVA) fixed annuity, the current low rates will have a big effect on your annuity's cash surrender value. Whether that effect is favorable or unfavorable, though, depends on how current interest rates compare to the interest rate your annuity is paying.

What is a market-value-adjusted annuity?

Not all fixed annuities contain an MVA provision, but those that do typically provide that the annuity's cash surrender value during the surrender charge period may be increased or decreased based on a comparison of the interest rate paid by the annuity to the current interest rate. In its simplest terms, an MVA provision affects your annuity's cash surrender value either positively or negatively, depending on the annuity's interest rate compared to prevailing interest rates. For example, if your annuity is crediting your account with an interest rate of 6%, but prevailing interest rates are only 2%, then the cash surrender value will increase to reflect the higher annuity rate. Conversely, if the annuity is paying 2%, but the prevailing interest rate is 6%, then the annuity's cash surrender value will be lower (i.e., you'd get less if you cashed it in).

Why is this? Contracts that contain an MVA provision basically share the risk of fluctuating interest rates with you, the annuity owner. Insurance companies generally credit interest on their fixed annuities based on the interest rate they receive on the vehicles into which they invest your annuity premium (such as bonds). When you surrender (i.e., cash in) your annuity before it has reached maturity, the insurer must sell those underlying investments to get the cash to pay you. If the investments backing your annuity (e.g., bonds) are paying 6%, but the prevailing interest rate for similar bonds is only 2%, the insurer will get more than the bonds' face value. Conversely, if the insurer's bonds are paying 2%, but prevailing bond rates are paying 6%, the insurer will receive less than the bonds' face value upon sale.

With an MVA annuity, if the insurer has a gain upon the sale of the bonds, a portion of that gain will be added to your annuity surrender value. If the insurer has to sell the bonds at a discount (loss), then some of that loss will be recouped from your annuity's cash surrender value.

What does all this mean for you?

It could mean nothing if you simply hold your MVA annuity until the end of its term (maturity). Then you can cash it in at its full value with no adjustment, either positive or negative. But if you want to cash in your annuity during the surrender period, the MVA provision may either help or hurt your annuity's value. Say your annuity is paying an interest rate that's much higher than prevailing rates, but if you cashed it in, your account would be subject to a surrender (early withdrawal) penalty of 5%. However, due to a favorable market-value adjustment, the insurer would actually add 7% to your surrender value, meaning your annuity's surrender value would actually realize a net gain of 2%.

But what if your annuity is paying only 2% and you wanted to cash it in? If prevailing rates are higher, then you might not only have to pay a surrender penalty, but your account would be further reduced to make up for the loss the insurer takes on the discounted sale of the underlying investments.

Factors to consider

MVA fixed annuities are generally intended as long-term savings vehicles. Surrendering or cashing in your annuity may have unintended consequences. Before surrendering your annuity, consider the following:

- Will the investment alternatives available to you provide the same benefits as the current annuity (e.g., comparable interest rate, the potential for tax-deferred growth)?
- By surrendering your annuity, are you giving up benefits such as an increased death benefit or the option to convert your annuity to an income stream that can last for the rest of your life?
- What are the tax consequences to you? Generally upon surrender, any gain in your annuity is taxable to you (the annuity owner) as ordinary income.

Before surrendering your annuity, consult a tax professional and your financial professional to be sure you understand the potential ramifications.

Investment House, LLC
Nisonger, Smestad & Mungall
Joanne D. Mungall, CFP®
1515 Lincoln Avenue
San Jose, CA 95125
408-286-8483
joanne@yourinvestmenthouse.com

What is pet insurance?

For many, a pet is a full-fledged member of the family. And just as health-care costs for human family members have risen over the years, so has the cost of veterinary care. It's probably not surprising, then, that pet insurance has gone in a fairly short period of time from relative obscurity to something that more and more people are considering.

With pet insurance, you pay premiums to a pet insurance provider; in return, the provider agrees to pay for some of your pet's medical costs, according to the specific terms and limits detailed in the policy agreement. How much you pay in premiums and the coverage you receive vary widely by provider, and depend on factors that include breed and age.

If you are considering pet insurance, it's important to request quotes from several providers (a list of 12 pet insurance providers, along with some helpful information, is available at www.avma.org, the website of the American Veterinary Medical Association). After obtaining quotes from multiple providers, look carefully at the coverage details offered by each company.

With pet insurance, costs associated with "wellness" care (e.g., regular office visits and vaccinations) generally aren't covered. Pre-existing conditions are also generally excluded. Some providers also exclude certain hereditary or common conditions--for example, many pet insurance providers exclude coverage for hip dysplasia, a disease often associated with larger dog breeds.

In addition to comparing coverages, make sure that you understand your out-of-pocket responsibilities. You may be responsible for a co-payment. You're probably also responsible for a specified deductible amount before a policy will make any payment. And once you've satisfied any deductible, a policy is likely to pay only a certain percentage of covered costs. So, for example, you might have a policy that pays 80% of covered costs after you satisfy the policy deductible. Some providers also cap benefits on a per-illness, annual, or lifetime basis.

One final note--with your health insurance, your provider probably bills your insurance directly. That's generally not the case with pet insurance. Typically, you pay all costs up front, and then you submit claims to the pet insurance provider for reimbursement.

Is pet insurance worth the cost?

The last thing you want is to have to forgo lifesaving treatment for your pet sometime down the road because you simply don't have the money to pay for it. But that's a situation many pet owners eventually face. Pet insurance can provide some peace of mind, but is it worth the cost? That's a tough question to answer.

Let's say that you have a two-year-old Labrador retriever. You get quotes from all the major pet insurance providers, and after carefully comparing coverages and details, you decide on a policy that will pay 80% of covered costs after you satisfy an annual $250 deductible. Your cost for the policy is $40 each month. In most years, you don't have any reimbursable claims--just routine visits or claims that don't exceed the deductible. After six years, your lovable Lab swallows a sock, things go horribly wrong, and he needs surgery at a cost of $4,000. Good thing you purchased the insurance, right?

Remember, you have a $250 deductible, so you will have to cover that yourself. And, the insurance policy will only reimburse you for 80% of the remaining $3,750, or $3,000. Consider this: If, instead of purchasing the pet insurance policy, you set aside $40 each month into an account earning 3%, you would have a little over $3,000--the same amount you would receive from the insurance policy--saved by the time the operation was needed. Of course, this example assumes that you have the discipline to set money aside each month. And, of course, if the great sock catastrophe happened in year two instead of year six, the insurance might seem like a wise purchase.

The bottom line is that pet insurance companies are in business to make a profit, and that is how they set their rates. By purchasing a pet insurance policy, you're shifting some of the potential financial risk from you to the insurance provider, and you are paying for that as part of your premiums. That doesn't mean purchasing pet insurance is a bad decision; you just have to consider the numbers carefully. At the same time, you have to factor in that it's not all about the numbers--you may believe now that there's a limit to what you will spend to treat a pet, but if and when that time comes, emotions often have a tendency to trump logic.