



Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

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Which Retirement Funds Should You 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.

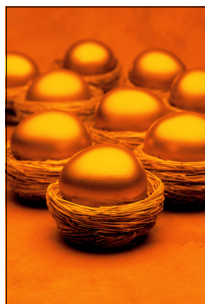
Traditional IRAs.

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%

(Continued on page 4)



2012 Tax Updates Start Planning For This Year's Return

Please be aware of these 2012 tax-related updates:

- Standard Mileage Rates. Business: 55.5 cents per mile; Charitable: 14 cents per mile; and Medical/Moving: 23.5 cents per mile.
- Maximum IRA amounts remain at \$5,000 (\$6,000 if at least age 50). Maximum 401(k) contributions have increased to \$17,000 (\$22,500 if age 50). The option to convert to a Roth IRA is still available regardless of income, but the tax-deferral opportunity is gone and all conversion taxes must be paid this tax year.
- The maximum Iowa tax deductible contribution to College Savings Iowa for 2012 is \$2,975 per person (participant) per child beneficiary.
- The American Opportunity Tax Credit, which offsets higher education expenses, is set to expire after 2012. It may be beneficial to pay 2013 tuition in 2012 to take full advantage of this tax credit, up to \$2,500, before it expires.

The 2012 update of our Registered Investment Advisor Disclosure Brochure is now available, which highlights the qualifications and business practices of our fee-only investment advisory services. Please contact us for a copy!

Please note: our hours will be 8:00am to 4:00pm Monday-Thursday and 8:00am to 3:00pm on Fridays now through December.

Steven L. Kane, CPA/PFS, CFP®

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.



Start Harvesting Gains In 2012

If you're in the same tax boat as most other investors, you should start thinking about harvesting capital gains from securities sales in 2012.

That's right—harvesting gains, not losses. The normal advice is to look for valuable tax losses, especially at the end of the year, that you can use to offset capital gains as well as up to \$3,000 of ordinary income. (You can carry over excess losses to the following year.)

But this year is different. The current maximum tax rate of 15% on long-term capital gains—realized on the sale of securities you've held

longer than a year—is scheduled to increase to 20% in 2013. Furthermore, the tax rate for short-term gains (from the sale of assets held one year or less) will also rise, especially for high-income investors. Short-term gains are taxed at ordinary income rates that currently reach no higher than 35%. Beginning in 2013, however, the top rate for ordinary income is set to rise to 39.6%. Next year you may also be subject to a 3.8% Medicare surtax that will apply to net investment income if you exceed a specified threshold.

Congress could still act to preserve some or all of the lower tax rates, but even if that happens, it probably won't

be until after the November elections. Therefore, the optimal approach, at least for now, is to focus on the current tax benefits of selling stocks that have appreciated significantly during the time you've owned them. If you believe those shares are likely to continue to increase in value, it probably makes sense to hold on to them and not to worry about future tax consequences. But if the outlook for future gains is uncertain, you might want to take advantage of today's favorable tax treatment of long-term capital gains.

Let's suppose, hypothetically, that you're holding a stock position you

Modern Portfolio Theory: Does It Still Work?

Modern portfolio theory (MPT), introduced more than half a century ago by Nobel-laureate Harry Markowitz, is all about diversification. It's based on the notion that over the long term, a properly balanced group of investments will perform better than any single holding would do on its own. MPT looks at the historical returns and volatility of stocks, bonds, and other assets to create a portfolio mix that can maximize expected returns based on how much risk an investor is willing to take. The riskier a portfolio is, the higher its potential return may be.

For decades, MPT has been a bedrock principle for creating investment portfolios. Asset managers have used it for the mutual funds they run, and financial advisors have put it to work in choosing investments for their clients. But in recent years, particularly since the economic crisis and market meltdown that began in 2008, MPT has come under fire. Many people contend that it no longer works. They point to the fact that in 2008 and 2009, almost every kind of investment lost value, and that even perfectly diversified portfolios let investors down.

Yet the idea that MPT has outlived its usefulness—and that it failed during the recent financial crisis—ignores the reality that an analysis of market history

confirms, says independent economist Fritz Meyer. Modern portfolio theory remains “the best mousetrap yet devised” for managing investments, Meyer says, and he analyzes 40 years of market performance data, from 1970 to 2010, to prove his point.

Meyer looked at what would have happened to a portfolio, created in 1970, that was divided evenly among seven kinds of assets: cash; large-cap U.S. stocks; small-cap U.S. stocks; non U.S. stocks; U.S. bonds; real estate; and commodities. Maintaining an equal exposure to those asset classes would have yielded an average annual return of more than 10% during the subsequent 40 years, compared with just under 10% a year for the Standard & Poor's 500. Yet the diversified portfolio would have had half the volatility of the S&P, according to Meyer.

So why are so many people convinced that MPT doesn't work in today's markets? Meyer suggests that in many cases, it may be because investors succumbed to the natural human tendency to stop the pain during a bear market and sold their holdings at what turned out to be the worst possible time. “Our generation has learned a very important investment truth the hard way,” says Meyer. And many of those who got out of the market in 2008 or 2009 remain on the sidelines, he says, waiting until they

regain their confidence. In the meantime, of course, they have missed out on several years of strong market gains.

Another problem, Meyer says, is the tendency to confuse modern portfolio theory with “buy and hold”—the idea that simply staying the course with investment choices will produce the best results over the long haul. MPT may indeed resemble a buy-and-hold strategy, Meyer notes, because an investor who subscribes to MPT will remain fully invested. But that doesn't mean that a portfolio will sit there unmanaged no matter what occurs in financial markets.

Even an investment portfolio run according to the principles of MPT will need periodic changes, Meyer says. Rebalancing holdings to keep them in line with their original portfolio percentages is especially important, and ought to be done either quarterly or annually, according to Meyer. Without such adjustments, assets that were performing well would soon make up an outsized proportion of overall holdings, and the portfolio's returns could suffer when stocks, for example, then lose ground during an investment cycle. Beyond rebalancing, other kinds of shifts may also be made to MPT portfolios based on an analysis of economic or industry factors.

Meyer is skeptical of the alternatives to MPT that many advisors and investors have turned to recently. Absolute return strategies, tactical asset allocation, and attempting to time the market simply don't work, he says, and though fleeing stocks and other comparatively risky assets during market swings may seem like a good idea, it can put investors in a hole that it will be difficult to dig themselves out of. Meyer notes that some who sold out during the worst of the recent bear market may have had to postpone retirement or permanently reduce their standard of living.

With a disciplined MPT approach, on the other hand, you're taking advantage of a powerful tool that has long proven its ability to maximize returns and minimize risks, Meyer concludes. ●

bought 10 years ago for \$10,000 that is now worth \$25,000. If you sell the stock in 2012 and have no other capital gains or losses during the year, you'll pay tax of \$2,250 (15% of your \$15,000 profit). But if you wait until next year to sell at the same \$25,000 price, you'll owe tax of \$3,000 (20% of the \$15,000 profit). That's an extra \$750 in tax you could avoid.

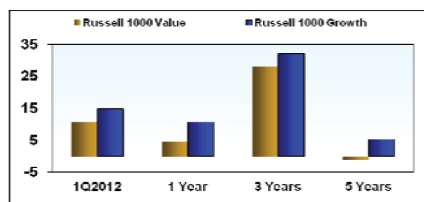
Tax planning that involves investing decisions can quickly become

complicated, and it's always important not to let the “tax tail wag the investment dog”—that is, to put tax considerations before sound investment strategies. That's why this year, in particular, it's wise to start considering the possibilities long before year-end deadlines and

to consult with your tax and investment advisors. We can help you stay on top of possible changes to the tax laws and work with you to make choices that are right for your situation. ●

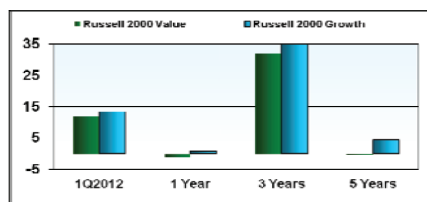


Market Data Bank: 1st Quarter 2012



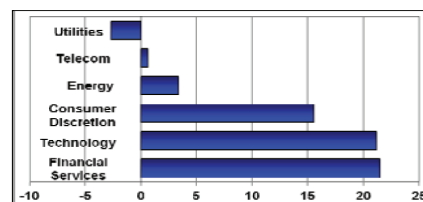
LARGE VALUE VS. LARGE GROWTH

Growth moved back into focus in 1Q2012 as brightening U.S. economic prospects returned to the spotlight. Large growth-oriented stocks ended the quarter up 14.6% while large value gained 10.9%.



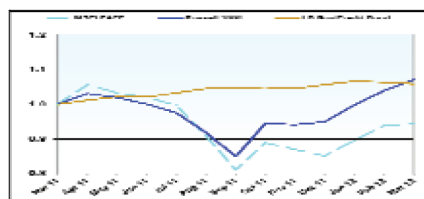
SMALL VALUE VS. SMALL GROWTH

After leading the U.S. market in late 2011, small-cap stocks gave up their leadership but still delivered solid performance. Here too, growth fared best, up 13.4% compared to small value's 11.6% gain



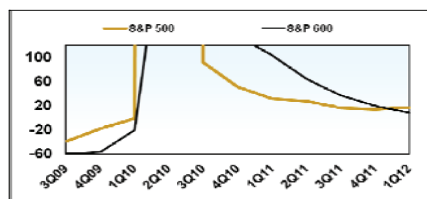
THREE BEST AND WORST SECTORS

Growth-driven industries outperformed traditionally value-oriented counterparts, but still-recovering financial stocks proved the quarter's strongest sector. Only the deeply defensive utility group lost ground.



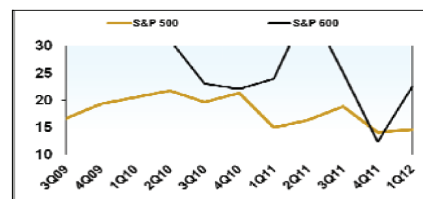
FOREIGN, US STOCKS & US BONDS

While recovering euro sentiment helped foreign stocks recover their footing, the MSCI EAFE remains depressed compared to 2011 levels. U.S. stocks won the day as bond prices leveled out.



LARGE VS. SMALL STOCK EARNINGS

Small, domestically oriented companies continued to capture growth in 1Q2012. However, their gigantic counterparts had difficulty further enhancing their profits at home as well as in overseas markets.



PRICE-TO-EARNINGS RATIO

The rate of economic growth continued to outpace stock prices, making equities cheaper on a fundamental basis. The valuations on large stocks dipped to their lowest levels since the 2008 recession.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability, and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

Which Retirement Funds?

(Continued from page 1)

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. ●

