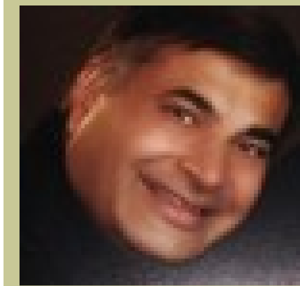

Randhir S.Judge F.L.I.A.,LUTCF

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Dear Friends,
I trust by now, most of you have been in touch with your CPAs or tax planners to submit last year's tax returns. For those of you who have mortgages and dependents, I thought I would share an idea with you.
If you are employed, and received a W2, and if you normally get a refund check from the IRS, I am suggesting that instead of funding the IRS for 15 months, you adjust your W4 by taking into account all the allowances such as mortgage interest, property taxes and dependents.
So, let's say that your mortgage is 6% on a $500,000 mortgage, and the interest amounts to $30,000. You divide $30,000 by $2,500, which gives you a unit of 12. Therefore, you can comfortably claim 13 against your allowances which will result in additional monies via your paychecks each month. You can use these extra funds to leverage an income replacement policy or pay down your credit card debt. Why make the IRS rich?
Sincerely,
Randhir S. Judge

In this issue:

Key Economic Indicators and What They Mean

Late last year, members of the Federal Reserve Board's Open Markets Committee (FOMC) outlined some of the indicators they're watching to help determine when the economy might be stable enough to handle higher interest rates. Here's a primer on some of those indicators and why they're important.

Gross Domestic Product (GDP) indicates whether the economy is growing, shrinking, or stagnant. It represents the value of all goods and services produced in the United States, minus the value of all imports. This is the broadest measure of economic health.

Inflation represents increases in the cost of goods and services. The *Consumer Price Index (CPI)* represents increased costs for everyday expenditures such as housing, transportation, food, energy, and clothing. In addition to serving as an inflation gauge, CPI affects any payments tied to the cost of living, such as Social Security benefits.

A related measure, so-called core CPI, excludes food and energy prices because they can vary dramatically from month to month. Core CPI is closely watched by the Fed in determining whether and when to raise or lower its target interest rate, which in turn affects bond prices and other interest rates.

Still another inflation yardstick is the *Producer Price Index (PPI)*, which reflects prices at the wholesale level. If prices are rising for items used to manufacture a product, manufacturers and wholesalers may pass increased costs on to retailers and/or consumers. As a result, increases in the PPI can be an indicator of potential future inflation at the consumer level.

Unemployment and payroll statistics may seem similar, but they indicate slightly different things. The unemployment percentage usually quoted in news headlines is based on a Bureau of Labor Statistics (BLS) survey of households. However, it doesn't include people who are working part-time involuntarily, or so-called "discouraged workers" who haven't been able to find a job and have given up looking. The BLS payroll figure uses corporate job records to show whether employers are creating or shedding jobs.

The unemployment rate is traditionally considered a lagging economic indicator, because an increase in jobs typically shows up only after other economic indicators, such as business inventories and unused manufacturing capacity, have begun to show signs of health. However, some economists argue that because the economy has relied heavily for many years on consumer spending, unemployment may now be more of a leading indicator than in the past.

Personal incomes as measured by the Commerce Department reflect not only paychecks but corporate and government benefits, pension checks, rental income, dividends, and interest payments; the data can give hints about future spending. *Personal consumption expenditures (PCE)* data show actual consumer spending on goods and services. As with core CPI, the Fed relies on PCE when setting its target interest rate.

Industrial production figures indicate whether factories are producing as much as they're capable of. When resource utilization is low, it suggests that factories are unlikely to experience near-term inventory shortages that could spark inflation. Somewhat related are *durable goods orders,* an indicator of inventory level and business investment in equipment. Also of interest are housing starts, new building permits (which hint at future construction), and new and existing home sales and prices.

These are only some of the data points to watch as guideposts in the months ahead.

Back to Basics: Reviewing Your Budget

Do you ever wonder where your money goes each month? Does it seem like you've gotten sidetracked when it comes to reaching your financial goals? If so, you may want to review and perhaps revise your budget. Doing so can help you determine how you're spending your money, and that might show you what you need to do to get back on track.

"Oh, we don't need a budget," you might be saying. "We have plenty of money." If that's true, great! But if you aren't reaching your financial goals, there's a reason for that. Reviewing (or simply creating) your budget might help you find out what that reason is.

Examine your financial goals

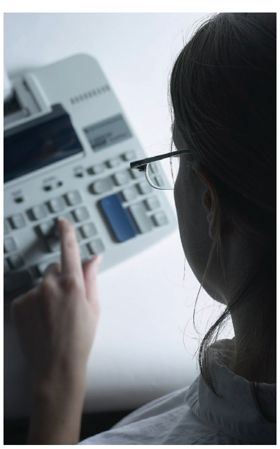
The first part of reviewing your budget should be an examination of your financial goals. After all, planning any trip's itinerary depends in part on knowing where you want to go! Make a list of both your short-term and your long-term goals, and prioritize them. How much will you need to save for each one, and how long will you have to reach them? Should you forestall some of lower priority to reach others of higher priority?

The first part of reviewing your budget should be an examination of your financial goals. After all, planning any trip's itinerary depends in part on knowing where you want to go!

Keeping track

Budgeting is largely about tracking your income and expenses. You can do this with a pen and paper, or you can use one of the many software programs or web-based applications designed for this purpose. The most important element of this process is to do it consistently.

Should you count every penny? Not necessarily, although to some extent you can't control the dollars if you don't track the cents. But focus primarily on meeting the basic expenses of life and then allocating what it will take to meet your goals.



Income and expenses

Much of your income may come from your regular paycheck or (if you're retired) from government benefits such as Social Security, a pension, or retirement account distributions. But don't forget to include all forms of income, such as child support and/or alimony, and even irregular or seasonal income, such as tax refunds, dividends, or interest.

Expenses generally fall into two categories. Fixed expenses are the "have-to" basics: housing, utilities, food, clothing, and transportation. Discretionary expenses are "want-to" items: eating out, entertainment, vacations, and hobbies.

Irregular expenses can't be predicted, but they always occur: car repairs and home maintenance are good examples. Remember to include these types of expenses in your accounting. For example, if you buy tires for your car every 3 years, one-third of the total is your annual expense.

Caution: *While you may find it easy to use your credit card for irregular expenses, do so only as a convenience. Be prepared to pay off the credit card charge with funds you have set aside in your budget for these expenses.*

Finally, prioritize the funds you'll need to meet both your short- and long-term goals as regular expenses in your budget.

And the answer is …

Once you've added up your income and expenses, you'll need to compare the totals. Are you spending exactly what you're making? Congratulations, your budget is perfectly balanced! Even better, if you're spending less than you're making, you have a surplus. If that's the case, you can allocate that surplus to either reaching your goals faster or funding new investment opportunities.

But if you're spending more than you're making, you're running a deficit. You might not feel the pinch if you're very good at juggling or funding it with increasing credit card debt or a home equity line of credit. But even the best of jugglers drop the balls sometimes, and increasing your debt can be dangerous. If that's what you're doing, you're sidetracking your budget into a dead-end spur.

So, to balance your budget and get back on track toward meeting your goals, you'll have to either increase your income or reduce your expenses--or both. As you may have seen while tracking your expenses, it's often your discretionary spending that leads to a derailment when it comes to meeting your goals. Rather than shortchange your goals (you'll only be shortchanging yourself if you do), work on reducing discretionary expenses.

Staying on track

You'll need to monitor your budget to keep it on track. Remember that, like life itself, you'll need to keep your budget as flexible as your changing circumstances may demand.

10 Financial Terms Everyone Should Know

Understanding financial matters can be difficult because of the jargon used. Becoming familiar with these ten financial terms may help make your financial picture clearer.

1. Time value of money

The time value of money is the concept that money on hand today is worth more than the same amount of money in the future because the money today can be invested to earn interest. *Why is it important?* Understanding that money today is worth more than the same amount in the future can help you evaluate and compare investments that offer returns at different times.

2. Market volatility

Market volatility measures the rate at which the price of a security moves up and down. If the price of a security historically changes rapidly over a short period of time, its volatility is high. Conversely, if the price of a security rarely changes, its volatility is low. *Why is it important?* Understanding volatility can help you evaluate whether a particular investment is suited to your investing style and risk tolerance.

3. Inflation

Inflation reflects any overall upward movement in the price of goods and services in the economy. *Why is it important?* Because inflation generally pushes the cost of goods and services higher, any estimate of how much you'll need in the future--for example, how much you'll need to save for retirement--should take into account the potential impact of inflation.

4. Asset allocation

This strategy means spreading investments over a variety of asset categories, such as equities, cash, bonds, etc. *Why is it important?* How you allocate your assets depends on a number of factors, including your risk tolerance and your desired return. Diversifying your investments over asset classes can potentially help you manage risk and volatility.

5. Net worth

Net worth is what your total holdings are worth after subtracting all of your financial obligations. *Why is it important?* Your net worth will probably fund most of your retirement years. Therefore, the faster and bigger your net worth grows, the earlier and more comfortably you will be able to retire. Once retired, preserving your net worth to last through your retirement years is your goal.

6. Five C's of credit

These are character, capacity, capital, collateral, and conditions. They're the primary elements lenders evaluate to determine whether to make you a loan. *Why is it important?* With a better understanding of how your banker is going to view and assess your creditworthiness, you will be better prepared to deliver appropriate information to obtain the loan you want or get a better interest rate.

7. Sustainable withdrawal rate

Sustainable withdrawal rate is the maximum percentage that you can withdraw from an investment portfolio each year to provide income that will last, with reasonable certainty, as long as you need it. *Why is it important?* Your retirement lifestyle will depend not only on your assets and investment choices, but also on how quickly you draw down your retirement portfolio.

8. Tax deferral

Tax deferral refers to the opportunity to pay income taxes in the future for investment interest and appreciation earned in the current year. *Why is it important?* Tax-deferred vehicles like IRAs and annuities produce earnings that are not taxed until withdrawn. This allows those earnings to compound, further adding to potential investment growth.

9. Risk/return trade-off

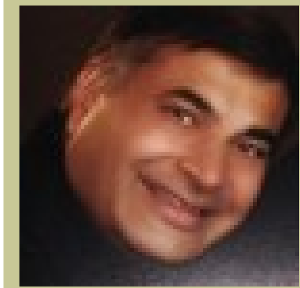
This concept holds that, in order to achieve a higher personal investment return, you must be willing to accept greater risk. *Why is it important?* When considering your investments, the goal is investing to get the greatest return for the level of risk you're willing to take, or to minimize the risk involved in trying for a given return.

10. Annuity

An annuity is a contract where you pay money to an insurance company in return for the insurer's promise to pay it back, with interest, in the future. *Why is it important?* You can supplement other retirement savings with tax-deferred annuity funds, and you can add to your retirement income with payments from your annuity for a fixed period of time or for the rest of your life.

Ten more terms to look up

- *Equity*
- *Gross Domestic Product*
- *Working capital*
- *Recession*
- *Triple net lease*
- *Net income*
- *Roth IRA*
- *Earned income*
- *Debt/equity ratio*
- *P/E ratio*



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Ask the Experts

What is the premature distribution tax?

Taxable distributions you receive from an IRA, 403(b), 401(k), or qualified employer plan before age 59½ are generally referred to as premature distributions, or early withdrawals.

To discourage early withdrawals, they're subject to a 10% federal penalty tax (and possibly a state penalty tax) in addition to any federal and state income taxes. This 10% penalty tax is commonly referred to as the premature distribution tax. Not all distributions before age 59½ are subject to this penalty, however.

Here are the most important exceptions:

- Distributions due to a qualifying disability
- Distributions to your beneficiary after your death
- Distributions up to the amount of your tax-deductible medical expenses
- Distributions made pursuant to a qualified domestic relations order (QDRO)
- Qualified reservist distributions
- Distributions from an IRA (but not an employer plan) to pay first-time home-buyer expenses (up to $10,000 lifetime)
- Distributions from an IRA (but not an employer plan) to pay qualified higher education expenses
- Distributions from an employer plan (but not an IRA) after separation from service at 55 or older
- Certain distributions from an IRA (but not an employer plan) while you're unemployed up to the amount you paid for health insurance premiums
- Amounts levied by the IRS
- Distributions that qualify as a series of substantially equal periodic payments (SEPPs)

If you must take a distribution from your IRA or employer plan before age 59½, be sure to determine if one of these exceptions applies to you.

What is the "SEPP" exception to the premature distribution tax?

Taxable distributions you receive from an IRA or 401(k) plan before age 59½ are subject to a 10% early withdrawal penalty unless an exception applies. One important, but sometimes overlooked, exception is for SEPPs--substantially equal periodic payments.

SEPPs are amounts you withdraw from your IRA or employer plan over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually.

You can take advantage of the SEPP exception at any age. But payments from an employer plan must begin *after* you separate from service.

Even though SEPPs are initially determined based on lifetime payments, you can change--or even stop--the payments after five years, or after you reach age 59½, whichever is later.

For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce (or stop the payments altogether) once you reach age 59½.

But be careful--if you "modify" the payments before the required waiting period ends, the IRS will apply the 10% penalty tax (plus interest) to all taxable payments you received before age 59½ (unless the modification was due to death or disability).

If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

SEPPs can be complicated--especially the modification rules. But taking the time to understand this important financial planning tool can be well worth the effort.