Trusted Quaker Financial Advisors

Wealth Management, LLC

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Earlier this year, at the age of 92, one of our most incredible clients passed away. Mrs. R was a remarkable woman. She was smart, warm and kind.

She was also an excellent investor. As the markets were diving and investors were in a state of panic on March 9, 2009, the ever savvy Mrs R was working with Dan to increase her stock allocation!

She was a classic "value" investor - her portfolio was chock full of blue chip stocks that paid good dividends. She was an investor, not a trader. Along with her equally savvy daughter, we would often have friendly debates about cashing in some of her profits.

Thank you Mrs. R. You made us better men and better advisors.

Thank you for allowing us to serve you, John and Dan.

Insights - Fall 2013

Keeping it Real

Paying for Long-Term Care Insurance with Tax-Free Funds

Happy Healthday! HSAs Turn 10

What return are you really earning on your money?

Keeping it Real

Let's Get Real

Suppose for a second that a Wall Street magician could grant you a wish for your portfolio of either a guaranteed investment return of a certain percentage per year (e.g. 6%) or a return that was equal to the rate of inflation. What would you choose?

As tempting as a fixed rate might sound, that's probably not the best answer. As we teach our Economics students, saving is nothing more than a decision to delay spending. Therefore, our first goal should be to preserve our purchasing power against the ravages of inflation.

It's essential to consider investment returns within the context of inflation. The national average for a one year CD is now a microscopic 0.7% versus our current rate of inflation of 1.2%. Thus a CD, though safe, has a negative "real return" after inflation.

We place great emphasis on what is "real". Since you plan to spend your portfolio at some point (or fund the splurges of your heirs), the future price of milk, gas, tuition, etc. is the key target. **So measuring your portfolio performance against the price of a Big Mac is more meaningful than some abstract benchmark.**

Compared to the historical average of 3%, inflation seems tame. But our experience in the real world tells us otherwise. For example, Stacy's Cinnamon Pita Chips (a Roccato family favorite) is now $2.99 versus $2.79 last year!

Regardless of the official rate, it is essential that your money is keeping pace.

Strategy

Has-been celebrity hucksters assert that gold is the cure all for inflation. Not true. Historically, gold has been an inconsistent hedge. Stocks and real estate, though volatile, have a better long term record of keeping pace with inflation.

Our strategy is simple. We use high quality short term bond funds that have the dual benefit of minimizing losses as well as being able to add higher yielding bonds as rates increase. We also include inflation protected bonds, dividend-paying stocks and small doses of non-USA stocks and commodities in our portfolio strategy. While not immune to market fluctuations, **we have found this balanced approach to be an effective way to keep pace with the price of Wawa coffee.**

We hope you enjoy the articles about inflation and using Health Care Savings Accounts as a part of a long term care strategy.

Peace be with you during the Holiday season, John and Dan!

Olga's Zucchini Bread

2 cups Bisquick, 1 1/2 cups shredded zucchini, 3/4 cup sugar, 1/4 cup vegetable oil, 3 eggs, 1 teaspoon vanilla, 3 teaspoons cinnamon, 2 teaspoons nutmeg, 1/2 cup chopped walnuts.

Use hand mixer to mix all ingredients in a bowl at low speed for 30 seconds. Then mix at medium speed for 60 seconds.

Bake in a 9" cake pan in a pre-heated oven at 350 degrees for 50-55 minutes. Enjoy!

See disclaimer on final page

Paying for Long-Term Care Insurance with Tax-Free Funds

Generally, to be considered a tax-free exchange rather than a taxable surrender, you cannot receive the annuity proceeds--the proceeds from the annuity must be paid directly to the LTCI company. Also, Section 1035 applies only if the annuity owner and the LTCI policy owner are the same person.

The high cost of long-term care can quickly drain your savings, absorb most of your income, and affect the quality of life for you and your family. Long-term care insurance (LTCI) allows you to share that cost with an insurance company. If you're concerned about protecting your assets and maintaining your financial independence, (LTCI) may be right for you.

But LTCI premiums can be expensive, and cash or income needed to cover those premiums may not be readily available. The good news is that there are several tax-free options that can help you pay for LTCI.

Using a health savings account

A health savings account, or HSA, is a tax advantaged savings account tied to a high deductible health insurance plan. An HSA is funded with pretax contributions up to certain annual limits set by the IRS. Any growth inside an HSA is tax deferred, and what you don't spend in one year can carry over to subsequent years. Just as importantly, withdrawals made from your HSA for qualified medical expenses are tax free.

Tax-qualified LTCI premiums are a qualified medical expense eligible to be paid from HSA funds. The maximum annual premium you can pay tax free is subject to long-term care premium deduction limits.

Convert taxable annuity to tax-free long-term care insurance

Generally, withdrawals from a nonqualified deferred annuity (premiums paid with after-tax dollars) are considered to come first from earnings, then from your investment (premiums paid) in the contract. The earnings portion of the withdrawal is treated as income to the annuity owner, subject to ordinary income taxes. IRC Section 1035 allows you to exchange one annuity for another without any immediate tax consequences, as long as certain requirements are met. But, what you may not know is that the Pension Protection Act (PPA) extends the tax-free exchange of annuities for qualified stand-alone LTCI or combination annuity/LTCI policies. This effectively allows you to purchase LTCI with annuity cash values that would otherwise have been taxable to you if withdrawn.

However, there are some potential drawbacks:

- You may incur annuity surrender charges when transferring your annuity.
- Transferring your annuity means you won't have the potential income the annuity could provide.
- While premiums for qualified LTCI are tax deductible as qualified medical expenses, annuity payments used to pay for long-term care are not tax deductible.
- Not all long-term care policies allow you to pay premiums in a lump sum, so you may have to make partial 1035 exchanges from the annuity to the LTCI company, but not all annuities allow partial 1035 exchanges.

HELPS may help

Another opportunity to pay for LTCI on a tax-free basis may be available to qualifying retired public safety officers. Part of the Pension Protection Act of 2006, the Healthcare Enhancement for Local Public Safety (HELPS) Retirees Act, allows certain retired public safety officers to make tax-free withdrawals from their retirement plans to help pay for LTCI for themselves and their respective spouses and dependents.

Eligible retired public safety officers include law enforcement officers, firefighters, chaplains, and members of a rescue squad or ambulance crew. Public safety officers must have attained normal retirement age or they must be separated from service due to a disability. HELPS does not extend to 911 operators, dispatchers, and administrative personnel. In addition, if an eligible participant dies, the exclusion from tax for withdrawals does not extend to surviving spouses or other beneficiaries of the participant's retirement plan.

Eligible government retirement plans include qualified trusts, Section 403(a) plans, Section 403(b) annuities, and Section 457(b) plans. Up to $3,000 per year may be withdrawn on a pretax basis, and the money must be paid directly from the retirement plan to the LTCI company. However, not all retirement plans may allow for these withdrawals, and some state laws may not allow the tax-free treatment of distributions.

HSAs, the PPA, and the HELPS Act have opened the door to long-term care coverage for people who might otherwise have a hard time affording it. Your financial professional may be able to provide more information on these and other ways to help you plan for the potentially high cost of long-term care.

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Happy Healthday! HSAs Turn 10

HSAs celebrate their 10th anniversary in 2013. If you are eligible to save money in an HSA but don't currently take advantage of it, you may want to consider whether its many potential benefits may be right for you.

Created 10 years ago as part of the Medicare Prescription Drug and Modernization Act of 2003, health savings accounts (HSAs) have gained in popularity over the past decade. According to the Employee Benefit Research Institute (EBRI), more employers and employees have been contributing to HSAs in recent years, and the amount contributed to HSAs has generally been on the rise. For example, the percentage of individuals in employee-only HSAs contributing $1,500 or more rose from 21% in 2006 to 42% in 2012, while the percentage of employees contributing nothing decreased from 28% to 15% over that same period. (Sources: "HRA/HSA Health Plan Contributions Continue to Grow," EBRI, February 20, 2013, and *EBRI Notes,* February 2013.) If you are eligible to contribute to an HSA, you may want to take another look at these savings plans, which could benefit your financial situation both now and in the future.

HSAs explained

Health savings accounts help individuals and families set aside money on a tax-advantaged basis to pay for health-care costs. HSAs are typically offered by employers along with what's known as "high-deductible health plans," or HDHPs--health insurance plans that generally offer lower premium payments in exchange for high annual deductibles (at least $1,250 for individuals and $2,500 for families in 2013).* You must be enrolled in an HDHP in order to participate in an HSA. If your employer provides an HDHP but does not offer an HSA, you may be able to establish an account on your own through a financial institution. Self-employed individuals can also use HSAs.

Here's how an HSA works:

- You can contribute up to $3,250 for individual coverage or $6,450 for family coverage to an HSA in 2013. If you are age 55 or older, you may also make "catch-up" contributions of up to $1,000.
- Your employer may also make contributions on your behalf.
- You can contribute in one lump sum or in periodic (e.g., monthly) amounts.
- You can make contributions for the current year up until your tax-filing deadline (generally, April 15 of the year following the year of coverage).

One of the key advantages of an HSA is that your contributions are tax deductible. If your plan is offered through your employer, you may be able to make automatic contributions on a pretax basis (similar to a work-based retirement savings plan) and any employer contributions are generally excluded from your gross taxable income as well. Moreover, you can typically select from a variety of savings and investment vehicles for your contribution dollars, and the earnings grow tax deferred until you withdraw them. Withdrawals then used for qualified medical expenses are tax free.

Permitted expenses

You can withdraw money from your HSA to pay for qualified expenses for yourself, your spouse, or your dependents. Permitted expenses include:

- Health insurance deductibles and co-payments
- Prescription drugs
- Vision care and eyeglasses
- Dental care
- Laboratory fees
- Hearing aids and more

For a complete list of eligible expenses, please see IRS Publication 502.

On the other hand, HSA distributions that you use for nonqualified expenses are subject to income taxes and a 20% penalty tax.

Eligibility rules

In order to be eligible for an HSA, you must have qualifying HDHP coverage. You won't be eligible if you're covered by another health plan (e.g., your spouse's nonqualified health plan), if you're 65 and enrolled in Medicare, or if someone else can claim you as a dependent. In addition, you may be ineligible if you're covered under a flexible spending account or health reimbursement arrangement that offers coverage similar to the HSA's.

Plans that won't affect your eligibility include dental and vision care insurance, long-term care insurance, and disability and accident insurance.

Rollovers

Unlike flexible spending accounts, where you have to use up all the funds you set aside for a plan year by a certain date or forfeit the money, HSA funds are yours to keep. If you leave your current employer and would like to roll your HSA money into another HSA, you are typically permitted to do so. And provided you are still eligible, you can continue to save in your account on a tax-deferred basis until you enroll in Medicare.

**Total out-of-pocket costs for HDHPs cannot exceed $6,250 for individuals and $12,500 for families.*

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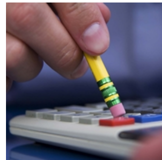

What return are you really earning on your money?

If you're like most people, you probably want to know what return you might expect before you invest. But to translate a given rate of return into actual income or growth potential, you'll need to understand the difference between nominal return and real return, and how that difference can affect your ability to achieve financial goals.

Let's say you have a certificate of deposit (CD) that's about to expire. The yield on the new five-year CD you're considering is 1.5%. It's not great, you think, but it's better than the 0.85% offered by a five-year Treasury note.*

But that 1.5% is the CD's nominal rate of return; it doesn't account for inflation or taxes. If you're taxed at the 28% federal income tax rate, roughly 0.42% of that 1.5% will be gobbled up by federal taxes on the interest. Okay, you say, that still leaves an interest rate of 1.08%; at least you're earning something.

However, you've also got to consider the purchasing power of the interest that the CD pays. Even though inflation is relatively low today, it can still affect your purchasing power, especially over time. Consumer prices have gone up by roughly 1% over the past year.** Adjust your 1.08% after-tax return for inflation, and suddenly you're barely breaking even on your investment.

What's left after the impact of inflation and taxes is called your real return, because that's what you're really earning in actual purchasing power. If the nominal return on an investment is low enough, the real return can actually be negative, depending on your tax bracket and the inflation rate over time. Though this hypothetical example doesn't represent the performance of any actual investment, it illustrates the importance of understanding what you're really earning.

In some cases, the security an investment offers may be important enough that you're essentially willing to pay someone to keep your money safe. For example, Treasury yields have sometimes been negative when people worried more about protecting their principal than about their real return. However, you should understand the cost of such a decision.

*Source: Department of the Treasury Resource Center (www.treasury.gov) as of April 2013.

**Source: Bureau of Labor Statistics, Consumer Price Index as of April 2013.

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