CREATIVE
Wealth Maximization Strategies

Certified Financial Services, LLC
600 Parsippany Rd. Suite 200
Parsippany, NJ 07054
973-263-0622

Richard Aronwald
Financial Specialist

DECEMBER 2012

Responding to Political Ideals and Economic Realities

> "Taxes grow without rain."
> **– Old Jewish proverb**

Shaking off the post-election "hangover"

Elections, and the media hoopla that accompanies them, often prompt intense national conversations about social programs, foreign relations, and economic policies. Candidates want to discuss issues so they can present solutions, demonstrate their fitness for office, and give voters reasons to elect them. Voters want to participate in the process because they know governmental actions have a big impact on their day-to-day lives. And the media loves elections because they are great theater. In the weeks leading up to the first Tuesday in November, the American populace is both participant and spectator in a compelling national reality TV show. It's heady stuff.

But after the drama is over, it's natural to wonder "So what happens now?" It's an important question, especially as to issues that impact personal finance. Income taxes and entitlements must be addressed as part of the national budget discussion, and many provisions of the Patient Protection and Affordable Care Act are scheduled to be implemented this year.

When so much attention is given to the political process, it can be easy to believe that every issue has a political answer. But that's the "election whiskey" talking. A sober evaluation presents a different picture.

No law can guarantee financial outcomes

The principal method for governments to effect change is to enact and enforce new laws – with taxes, regulations, incentives and punishments. But a quick glance at current events indicates legislation hasn't ended global religious and political tensions, lowered unemployment, restored deflated real estate values, or prevented natural disasters. This has been the case throughout history – under monarchies, Marxists or representative democracies – because there are natural, social, and economic factors that can't be controlled by legislation.

This doesn't stop governments from *trying* to control these uncontrollable factors. And the decisions of policymakers definitely impact the financial well-being of individual households. So how does one plan for the impact of national economic policies that may not achieve the intended results?

Sometimes a look to the past can provide some insight for the future. A case in point is Social Security, an ambitious government economic program that began 75 years ago.

The great ideal behind Social Security

In June 1934, President Franklin Delano Roosevelt presented to Congress a new social insurance program intended to provide economic security for the aged. His plan called for workers to contribute to their own future retirement benefit by making regular payments into a joint fund administered by the federal government.

In This Issue…

Roosevelt explained his rationale:

> "Security was attained in the earlier days through the interdependence of members of families upon each other and of the families within a small community upon each other. The complexities of great communities and of organized industry make less real these simple means of security. Therefore, we are compelled to employ the active interest of the Nation as a whole through government in order to encourage a greater security for each individual who composes it..."

The original plan

After more than a year of discussion and alteration, the Social Security Act was signed into law in August 1935. In 1937, workers and employers began paying Social Security taxes, and in 1940, eligible retirees (those over age 65) began receiving benefit checks. In order to qualify for benefits, workers needed to work a minimum number of years, and the size of the monthly benefit depended on one's earnings history.

The original plan exempted the self-employed and workers in several other fields. The initial tax rate was 2% (the employer and employee paying 1% each), applied to a maximum of $3,000 in wages. The original Act called for gradual increases in the tax over the next 12 years. An informational pamphlet explained:

> And finally, beginning in 1949, 12 years from now, you and your employer will each pay 3 cents on each dollar you earn, up to $3,000 a year. **That is the most you will ever pay.** (emphasis added)

Observation #1: With Government Plans, Cost Overruns are Inevitable

	Social Security Tax Rate	
Year	Employee and Employer Combined	Self-Employed
1940	2%	Not applicable
1950	3%	Not applicable
1960	6%	4.5%
1970	8.4%	6.3%
1980	10.16%	7.05%
1990	12.4%	12.4%
2000	12.4%	12.4%
2010	12.4%	12.4%

By and large, politicians are not good at long-term projections. They just aren't. (Honestly, when was the last time any government project came in *under* budget?) So it is no surprise that the costs for providing Social Security have far exceeded the original promises.

Some of the cost overruns can be attributed to those social and economic forces that legislation can't control, like increased life expectancies and the distorted demographics of the Baby Boom. The end result? More people, living longer, and receiving larger sums of benefits.

And oddly enough, it took awhile for legislators to address the problem. Congress delayed increasing Social Security taxes so that the 6% total tax scheduled for 1949 wasn't collected until 1960. Then, to catch up with the demographics, the tax rate doubled over the next three decades. But in 2010 and 2011, Congress temporarily dropped the Social Security payroll tax during 2011 and 2012 from 12.4% to 10.4% by decreasing the amount paid by the employee.

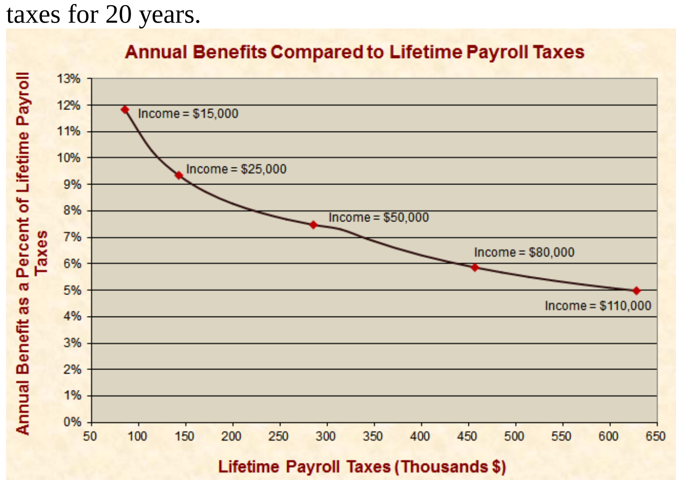
Over time, the portion of income subject to Social Security tax increased as well. Indexed for inflation, $3,000 in 1949 was the equivalent of $27,583 in 2010. The amount of income subject to Social Security in 2010 was $106,800.

Adjusting for inflation, the higher tax rates and higher income threshold result in a tax that is ***8 times greater*** than the "most you will ever pay" promised in the original plan.

Observation #2: With Government Plans, Something for Everyone = Not Enough for Anyone

According to the Social Security Administration, the average monthly Social Security benefit received by workers was about $1,230 in 2012, or $14,760 a year. For fully-vested workers who retired at age 66 in 2012, their starting benefit was $2,513/mo. ($30,156/yr.) Critics of Social Security will point out that many workers would have received a better benefit from their Social Security taxes had they been invested in the stock market. This may be true, but the purpose of Social Security has been to provide a benefit to *all* Americans without compelling them to make investment decisions or take undue risks.

Even though Social Security is a program for all working Americans, people with higher incomes receive a lower percentage of benefits in proportion to the taxes they pay. The graph below compares annual Social Security retirement income to lifetime payroll taxes for 23-year-olds who work until age 67 and receive full benefits. A low-wage earner (with a $15,000 annual income), would receive an annual Social Security benefit of $10,128. This means the worker will "recover" his Social Security taxes in about 8½ years. In contrast, an individual with an annual income of $110,000 would receive $31,260/yr. but not recover his Social Security taxes for 20 years.



Constructed with data from: "Social Security & Medicare Tax Rates." United States Social Security Administration, Office of the Chief Actuary.

In either case, a $10,000-a-year retirement income doesn't go very far, even for someone with a low earnings history. And a $30,000 annual retirement income probably isn't going to be enough for someone who has earned over

$100,000/yr. for 40-plus years. The reality: While Social Security provides 90% of retirement benefits for 36% of people over 65, almost no one is living large because of it.

Observation #3: Achieving Personal Prosperity Requires Additional Resources and Thoughtful Planning

One of the desired outcomes of government financial programs is compelling citizens toward better outcomes by eliminating the decision-making process. Instead of encouraging saving, Social Security simply assesses a tax, eliminating the need for the employee to decide how much to save, and where.

But the "mandatory" saving of Social Security is not enough. If someone desires a comfortable retirement, they are going to have to save additional amounts on their own, make thoughtful investment decisions, and constantly monitor the progress of their plans. Bottom line: There isn't a government program that delivers set-it-and-forget-it financial security.

Applying these insights

In reviewing Social Security's history, it's easy to make some parallels to today's personal financial issues that involve government. More than likely, national health care costs will be higher than projected. More than likely, most people will not get all the health care benefits they want or need. More than likely, the solution will be setting aside additional dollars (perhaps in Health Savings Accounts) to procure the additional health care they want – there will not be a government fix for these challenges. Likewise, taxes will probably overrun their projections and the anticipated benefits (lower national debt, more money for social programs, infrastructure, etc.) will come in below expectations.

These less-than-optimum outcomes bother some people – "I have to save more because Social Security is so messed up? That stinks!" or "I don't understand why national health care doesn't work like it was supposed to." But it is what it is. Policy ideals and economic realities rarely mesh. **The only approach that works: make your own plan, and find a way to fund it.**

It is true that the policy decisions of our legislators can have a big impact on individual financial well-being. Engaging in the political process may influence some of those decisions to your advantage (that's why companies and trade associations hire lobbyists). But the most practical response to changes that may be coming is to set aside the politics and focus on developing personal strategies to succeed – regardless of how the vote turns out.

WANT TO MEET YOUR FINANCIAL OBJECTIVES?

CONVENE YOUR "CABINET" OF ADVISORS AND MAKE YOUR OWN FINANCIAL POLICY! ❖

Disability Protection:

"I have coverage… sort of...I guess?"

Q: In the event of disability, do you have insurance to cover the loss of income?

A: Maybe. Possibly. At least in some circumstances…or maybe not.

Q: Is your disability insurance coverage good enough?

A: Maybe. Possibly. At least in some circumstances…or maybe not.

An incident of disability, i.e., an illness or accident that keeps you from working, is a big deal in a personal household economy. And the odds of having a period of disability are rather high. The Social Security Administration states, "Studies show that a 20-year-old worker has a 3-in-10 chance of becoming disabled before reaching retirement age."

An incident of disability is not only more likely to occur than death, but in some ways may be more devastating to household finances. A premature death deprives the family unit of income, while a disability not only disrupts income, but also introduces the financial burden of ongoing care for the disabled individual.

Because disability can be so disruptive, several forms of automatic, universal income protection have developed in the past century to protect workers from financial ruin. But the amount of coverage these programs provide can be spotty and vary greatly with individual circumstance. The following is a short list of federal, state and employer-sponsored resources that might provide disability benefits.

Workers' Compensation

In the United States, most employees who are injured on the job can receive compensation for their injuries through state-sponsored Workers' Compensation programs. These programs, which were first established in the early part of the 20th century, cover medical costs incurred, as well as monetary compensation for a loss of earnings, as a result of a workplace injury. Benefit payments may be received as monthly income or lump-sum settlements.

The definitions of disability and the terms of compensation will vary from state to state, but all Workers' Compensation programs share one important feature: the coverage applies only to work-related accidents or illnesses.

Social Security Disability Insurance (SSDI)

If you have worked long enough and paid Social Security taxes, you may be eligible for monthly benefits from Social Security Disability Insurance, and these benefits may continue until you reach full retirement age and begin receiving Social Security retirement benefits. Unlike

Workers' Compensation, SSDI benefits are payable for any disability, no matter what type or where it occurred.

However, the standards for eligibility to receive Social Security disability benefits are quite rigorous. For the Social Security Administration, total disability means you are "so severely impaired, physically or mentally, that you cannot perform any substantial, gainful work. The impairment must be expected to last at least one year or result in death." (SSA Publication 05-10029, August 2010)

Applying for and receiving Social Security disability benefits can be a long trek through a bureaucratic maze. Currently, a majority of individuals who apply for SSDI benefits are declined, initially, and receiving benefits may ultimately require a hearing before a judge. Many people find they must retain legal counsel in order to properly navigate this process.

Automobile insurance disability coverage

Some automobile insurance policies may include Death and Disability coverage. These provisions pay benefits if an insured dies or becomes disabled as a result of an auto accident. The benefits vary depending on the nature of the accident and the injuries sustained, but typically include reimbursement for medical expenses as well as some compensation for lost wages. But any compensation is strictly limited to disability that comes as a result of an auto accident.

Group and Individual Disability Insurance

Group and individual disability insurance policies are contracts with insurance companies that provide specific and customized protection in the event of disability. These policies cover disability wherever it occurs, for almost any reason (there may be some exclusions, such as drug abuse). The benefits may be limited to a specific time period – such as five years, or until age 65 – or continue for the insured's lifetime. To protect against inflation, benefits may also increase at regular intervals.

The definition of disability in these programs is typically much more liberal than the definition used by the SSA. An "own-occupation" definition of disability means you are considered disabled if you are unable to perform the duties of your insured activity – even though you may be capable of performing other "substantial gainful work" (the SSDI definition). The definition may also permit benefits to be paid for partial disability, i.e., you are working, but not on a full-time basis.

Group and individual disability insurance policies share many common features, but also differ in several key areas. Among the differences…

Portability. Coverage under most group policies is connected to employment. If you terminate employment, the coverage usually terminates as well. An individually-owned disability policy can "travel" with you, and continue to be in force even if your employer or location changes.

Cancelability. If the group plan isn't profitable, or the perceived risks of loss are too high, group disability insurance policies can be terminated by the insurance company. In contrast, individually-owned disability insurance is usually issued on a non-cancellable basis; as long as the insured pays the premium, the company must honor the terms of the contract.

Guaranteed premiums. Under the terms of a group insurance policy, the insurance company has the option of raising premiums as a condition of continuing to offer the coverage. This means the fixed benefit in a group policy may become increasingly expensive. Individual contracts typically feature fixed premiums that remain the same for the life of the contract.

Benefit caps. Group disability coverage typically expresses benefits as a percentage of current wages (such as 60% or 70%), along with a specified maximum limit, such as $5,000/mo. This figure may or may not include an earner's commissions or bonuses. Individual disability policies usually define benefits as a fixed number, determined at the time of issue, with options for future increases. For highly-compensated employees, the caps present in group policies can result in "reverse discrimination" in that their benefits are proportionally less than lower-compensated employees.

Underwriting and pricing. Because they offer more features and guarantees, individual policies are usually subject to greater scrutiny before they are issued. Applicants may have to provide financial documentation as well as medical history, and submit to an individual exam. On the whole, individual disability coverage will have higher initial premiums, although the comparative costs may change over time since the individual policy premiums will stay the same while group premiums may increase.

Prime candidates for individual disability insurance

Self-employed individuals, highly-compensated professionals and those whose careers lead them to change employers frequently are likely to find individual disability insurance a good fit. The portability of the benefit, along with the certainties of price and coverage are effective long-term solutions for those who are heavily invested in their businesses, professions or careers.

Q: Is your disability insurance coverage good enough?

A: Why not review your coverage with a disability expert and find out! Your ability to earn an income is too valuable an asset to leave unprotected. ❖

What You Can't Delegate

One of the great principles of a free-market economy is the division of labor. Instead of requiring each person to be a jack-of-all-trades, the division of labor allows people to focus their time and energy on what they do best. This results in greater efficiency, more products and services – and higher profits – for everyone.

In the realm of personal finance, the division of labor means letting the experts – accountants, tax preparers, insurance agents, stockbrokers, financial planners, etc. –

focus on their areas of expertise. Ideally, their wisdom and experience moves you further toward your financial objectives.

But there is one aspect of financial management you can't delegate. If you don't learn how to do this for yourself, the benefits of working with financial experts will never accrue to you.

What is one thing that can't be delegated?

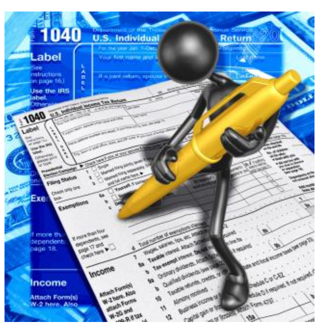
You must figure out how to save money!

The best plans will never work if they aren't properly funded. But if you can master the art and discipline of saving, the opportunities for wealth-building are limitless. Making a habit of saving lays the foundation for substantial long-term wealth accumulation.

While the details will change with your individual circumstances, here are some general principles for improving your savings performance. Save money by:

- regularly "paying yourself first," (15% of your Gross Income)perhaps through payroll deductions or automatic deposits to accumulation accounts (WCA).
- controlling your standard of living. If your outgo exceeds your income, you cannot save.
- avoiding debt. If you have to have Debt make sure it is long term, tax deductible and non-recourse.
- using programs with tax advantages.
- structuring your insurance programs properly…Maximum Protection.

A tongue-in-cheek reminder: Make sure you ***actually save the money***, instead of consuming the "savings" to add to your lifestyle. Honestly, does it make sense when someone says "I saved $4,000 on this car – I got it for $20,000." But if the "saved" $4,000 doesn't show up as a new deposit into an accumulation account, you didn't ***save*** it – you just ***spent*** $20,000! ❖



Making Your List and Checking it Twice (after Christmas)

Sometime in late December, a flurry of financial documents will begin arriving via the U.S. Postal Service – or, in some cases, appear in your e-mail in-box. This small blizzard of annual statements, required notifications and transaction reports may continue through early February. Many of these documents are required to complete your 2012 tax returns, especially if you itemize, so having a plan to collect and organize them as they arrive will save you both time and money.

Here is a list of the most common year-end statements.

W-2s. These are statements of your earnings and deductions from a particular employer in the past year. Depending on the nature of your employment, you may want to cross-check the totals against the cumulative information shown on your last check stub. (For example, if you made contributions to a qualified retirement plan, you can verify the amount by comparing the difference between the Box 1 and Box 3.)

Form 1098. IRS Form 1098 is a report issued by a lender detailing mortgage interest you paid in the past year. You need this information to claim the mortgage interest deduction on your income tax return. Your mortgage lender is responsible for providing you with a Form 1098 by February of each year, but many lenders will include it in the January mortgage statement or notify you that it is available on-line – ***so pay attention to your January statement***. And if you have more than one mortgage, make sure you collect all 1098s.

Form 1099. Form 1099 reports all types of taxable non-wage compensation. This covers everything from commissions and interest earnings to long-term care benefits and canceled debts (see list). While 1099s don't have to be attached to your tax return, the IRS uses them to cross-reference your reporting of non-W-2 income. Discrepancies can occur at year-end, where the payer records a disbursement as an expense for 2012, while the recipient doesn't receive the payment until after January 1, 2013, and wants to exclude it from 2012 income tax calculations.

Form 5498 or year-end IRA account statement. Form 5498 is a report of annual contributions to an IRA. Since IRA contributions for a calendar year can be made up to April 15 of the following year, Form 5498 does not have to be mailed until May. However, Form 5498 can also be used to report the fair market value of an IRA account as of December 31. If used for this purpose, the form must be issued to the IRA owner by January 31. If there have been no contributions, many custodians/trustees simply add a notation to the IRA owner's year-end account statement, stating the December 31 fair market value will be reported to the IRS. This information is important for calculating required minimum distributions once the IRA holder reaches age 70½.

Statements of Charitable Giving. In order for cash contributions to charitable organizations to be deductible, you must have documentation. For contributions less than $250, canceled checks, bank or credit card statements, payroll deduction records, or written statements from the charity (including its name, contribution date and amount) fulfill the record-keeping requirement. However, amounts greater than $250 require a written statement from the charity stating the amount of cash donated and that no goods or services were provided in exchange. Most charitable

MISCELLANEOUS INCOME? THERE'S A 1099 FOR THAT.

The IRS has 16 different Form 1099s to report non-wage income. If you receive one of these forms, it almost certainly will occupy a line in your 2012 personal income tax return. ***And…***if you paid someone else in any of these ways, you may be required to send a 1099, both to the individual and the IRS.

organizations will issue these statements by January 31,

1099-A - Acquisition or Abandonment of Secured Property
1099-B - Proceeds from Broker and Barter Exchange Transactions
1099-C - Cancellation of Debt
1099-CAP - Changes in Corporate Control and Capital Structure
1099-DIV - Dividends and Distributions
1099-G - Certain Government Payments
1099-INT - Interest Income
1099-K - Merchant Card and Third Party Payments
1099-LTC - Long Term Care and Accelerated Death Benefits
1099-MISC - Miscellaneous Income
1099-OID - Original Issue Discount
1099-PATR - Taxable Distributions Received from Cooperatives
1099-Q - Payments From Qualified Education Programs (Under Sections 529 and 530)
1099-R - Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
1099-S - Proceeds from Real Estate Transactions
1099-SA - Distributions from an HSA, Archer MSA, or Medicare Advantage MSA

Cer tifi ed Fin an cial Ser vic es, LL C

2013. ❖

Richard Aronwald
Financial Specialist
raronwald@cfsllc.com

600 Parsippany Rd. Suite 200
Parsippany, NJ 07054
973-263-0622
Richardaronwald.com

PAS DISCLOSURE GOES HERE