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# Getting Ready for Tax Season: Changes for 2012

*The IRS has issued cost-of-living adjustments for the 2012 tax year that modify brackets, deductions, and other thresholds for inflation.*

Although most Americans will not have to worry about 2012 taxes until early 2013 when 2012 tax returns are due, self-employed individuals or anyone who must pay quarterly tax payments will want to plan ahead.

And there's good news for those that do. The IRS recently announced cost-of-living adjustments for the 2012 tax year that bump up brackets, deductions, and other thresholds for inflation.

The following is a summary of the key changes for 2012.

**Exemptions are up:** The personal and dependent exemption increases to $3,800, up $100 from 2011.

**Standard deductions have increased:** The 2012 standard deduction increases to $11,900 for married couples filing a joint return, $5,950 for singles and married individuals filing separately, and $8,700 for heads of household.

**Tax-bracket adjustments:** Tax-bracket thresholds have increased for each filing status (see table).

**Estate tax exclusion has increased:** The estate tax exclusion increases to $5,120,000, up from $5,000,000 for 2011. The annual exclusion for gifts will remain at $13,000.

**Earned income credits rise:** The maximum earned income tax credit (EITC) rises to $5,891, up from $5,751 in 2011. The maximum income limit for the EITC increases to $50,270, up from $49,078 in 2011.

**Transportation benefits adjusted:** The monthly limit on the value of qualified transportation benefits exclusion for qualified parking provided by an employer to its employees for 2012 rises to $240, up $10 from the limit in 2011. However, the temporary increase in the monthly limit on the value of the qualified transportation benefits exclusion for transportation in a commuter highway vehicle and transit pass provided by an employer to its employees expires and reverts to $125 for 2012.

Several tax benefits are unchanged in 2012. For example, the additional standard deduction for blind people and senior citizens remains at $1,150 for married individuals and $1,450 for singles and heads of household.

| | Single | Joint Fliers | Married Filing Separately |
|---|---|---|---|
| 10% | $0 - $8,700 | $0 - $17,000 | $0 - $8,700 |
| 15% | $8,700 - $35,350 | $17,400 - $70,700 | $8,700 - $35,350 |
| 25% | $35,350 - $85,650 | $70,700 - $142,700 | $35,350 - $71,350 |
| 28% | $85,650 - $178,650 | $142,700 - $217,450 | $71,350 - 108,725 |
| 33% | $178,650 - $388,350 | $217,450 - $388,350 | $108,725 - $194,175 |
| 35% | Over $388,350 | Over $388,350 | Over $194,175 |

*Details on these and other inflation adjustments can be found in Revenue Procedure 2011-52.*

FINANCE FOCUS

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# What You Need to Know About Currency Risk

*Given the current weakness of the U.S. dollar, it is critical that U.S. investors understand the risks (and potential rewards) involved in foreign currency diversification — and take steps to protect their portfolios.*

The U.S. dollar continues to fall against other major world currencies – and the consensus among economists and analysts is that the greenback's downward spiral may likely continue over the long term.

General investment wisdom states that to hedge a portfolio against the falling dollar, investors should diversify into foreign currency holdings. One of the easiest ways to do that is to acquire shares of U.S. companies with multinational operations, such as Microsoft and Exxon. Yet recent research suggests that this strategy may not be as effective at providing adequate currency diversification as many investors think. A study found that roughly 80% of the international income of multinational companies is hedged back to U.S. dollars.1 Furthermore, the larger the company, the more completely hedged those earnings tend to be.

*(Continued on page 2)*

# Heightened Volatility: THE NEW NORMAL?

The U.S. economy can't find its footing -- and every piece of bad news, whether at home or abroad, has the potential to send the markets reeling. All that volatility can make it tough on investors to stay the course.

*Although you may be rightfully gun shy in the wake of the recent market turmoil, one strategy you should seriously consider is selectively adding to your portfolio.*

**Keep your portfolio balanced when market turmoil threatens to turn everything inside-out.**

**It's not your imagination:** The stock market is bumpier than normal. The U.S. economy can't find its footing – and every piece of bad news, whether at home or abroad, has the potential to send the markets reeling. All that volatility can make it tough on investors to stay the course.

Historically speaking, the market today is about three times more volatile than it has been in the past. Specifically, the S&P 500 rose or fell by 2% or more an average of 5 times per year from 1950 until 1999. Since 2000, however, that average jumped to 12.5 times per year for advances and more than 14 times for declines.1 What's more, 10 of the 20 largest daily upswings and 11 of the 20 largest daily drops since the beginning of 1980 have occurred within the last three years.2

Who or what deserves the blame for heightened market volatility is difficult to say. On the economic side, uncertainty about when and how fully the economy will recover is a major factor. So are factors such as the heightened reliance on government monetary policy, unsustainable fiscal trends, and the apparent lack of collaboration among legislators in Washington. On the investment side, high-frequency trading, hedge funds, and inverse and leveraged ETFs all contribute to the volatility.

## What Can You Do?

Regardless of the drivers, heightened volatility requires individual investors and their advisors to exercise specific investment strategies. While many of these strategies are basic investing concepts that can be applied at any time, they are particularly important in a volatile environment.

**Don't follow the herd.** Don't sell into a rapidly declining market and don't buy into a rapidly rising market. You'll just be following the herd and locking in losses. Panic selling also runs the risk of missing the market's best-performing days. For example, missing just the 5 top-performing days of the 20 years ended December 31, 2010, would have cost you more than $19,000 based on an original investment of $10,000 in the S&P 500. Missing the top 20 days would have reduced your average annual return from 9.14% to 3.00%.2

**Keep a long-term perspective.** It is all too easy to get caught up in the stock market's daily roller-coaster ride. This type of behavior is natural, but can easily lead to bad decisions. Instead, focus on whether your long-term performance objectives, i.e., your average returns over time, are meeting your goals.

**Take advantage of asset allocation.** During volatile times, more risky asset classes such as stocks tend to fluctuate more, while lower-risk assets such as bonds or cash tend to be more stable. By allocating your investments among these different asset classes, you can help smooth out the short-term ups and downs.

**Consider buying opportunities.** Although you may be rightfully gun shy in the wake of the recent market turmoil, one strategy you should seriously consider is selectively adding to your portfolio. This is especially true when prices are low versus historical averages.

**Source/Disclaimer**

*1Source: Standard & Poor's Equity Research Services, "Shaken and Stirred," August 29, 2011.*

*2Source: The New York Times, "Market Swings Are Becoming New Standard," September 11, 2011.*

*3Source: Standard & Poor's. For the period indicated. Stocks are represented by the S&P 500, an unmanaged index that is generally considered representative of the U.S. stock market. Past performance is not a guarantee of future results.*

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SAMALIN INVESTMENT COUNSEL

FINANCE FOCUS

## What You Need to Know About Currency Risk

(Continued from page 1)

So where does this leave investors who think they are gaining global currency exposure through purchases of global U.S. firms? According to the study, many investors are getting only about one-fifth the diversification effect they assume – perhaps much less.

Given the current weakness of the U.S. dollar, it is critical that U.S. investors understand the risks (and potential rewards) involved in foreign currency diversification – and take steps to protect their portfolios.

### Currency Risk 101

Strategies for managing a portfolio's foreign currency exposure fall into three broad categories.

**No hedge.** The simplest approach used by international portfolio managers and investors is to not hedge the currency risks at all. Proponents of this approach say that not hedging foreign currency exposure helps diversify a portfolio. Others believe that currency fluctuations tend to wash out over an extended period of time.

**100% hedge.** Some go to the other extreme and hedge 100% of their currency exposures. This group believes that foreign exchange rates are highly unpredictable and that currency risks in non-dollar securities should always be fully hedged. But hedging costs tend to reduce overall returns over time, compared with an unhedged portfolio.

**Actively managed hedging.** The third strategy falls somewhere in between. Those who use an actively managed hedging approach hedge selectively: sometimes no hedge, sometimes a partial hedge, and sometimes a full hedge. The selective approach is gaining in popularity. Most investment firms now offer some kind of currency service, and some firms with substantial international investments even appoint a separate manager to handle currency as a distinct asset class.

Currency risk is an essential element of international investing and is only one risk of investing across borders. Others include possible increased taxation as well as political uncertainties. Your financial advisor can explain the pros and cons of international investing in more detail.

**Source/Disclaimer**

*1Source: Merk Investments LLC, "U.S. Investors Overexposed to U.S. Dollar Risk," August 29, 2011.*

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## Three Keys to Surviving Market Turbulence

Most stock market investors are looking for the same result: strong and steady gains of their investments. Dealing with a period of sustained falling stock prices is not easy. All too often, investors react to a sharp drop in prices by panic selling or digging in their heels despite deteriorating fundamentals. But more thoughtful investors see a correction or downturn as an opportunity to review the risks in their portfolios and make adjustments where necessary.

When confronted with any adverse market event -- whether it is a one-day blip, a more lengthy market correction (a decline of between 10% to 20%), or a prolonged bear market (a decline of more than 20%) -- take time to review your portfolio. Dealing with volatility can be difficult. Here are three suggestions to help you and your portfolio survive market turbulence.

### *Talk with a professional.*

A financial professional can help you separate emotionally driven decisions from those based on your goals, time horizon, and risk tolerance. Researchers in the field of behavioral finance have found that emotions often lead investors to read too much into recent events even though those events may not reflect long-term realities. With the aid of a financial professional, you can sort through these distinctions, and you'll likely find that if your investment strategy made sense before the crisis, it will still make sense afterward.

*(Continued on page 3)*

### *Organize and review your financial records.*

Crisis events highlight the importance of knowing where your assets are and maintaining organized financial records. Following the September 11, 2001, terrorist attacks, markets closed for several days and many records in the heart of New York City's financial district were destroyed. Yet the nation's financial systems were up and running in a matter of days, and your securities accounts were safe even when the stock exchanges were closed. While you cannot trade investments or access your assets during a market shutdown, securities firms maintain backup facilities and have contingency plans to help them service customers when trading resumes.

### *Keep a long-term perspective.*

The only certainty about the stock market is this: It will always experience ups and downs. That's why it's important to keep emotions in check and stay focused on your financial goals. A buy-and-hold strategy -- making an investment and then holding on to it despite short-term market moves -- can help. The opposite of buy-and-hold investing is market timing -- buying and selling investments based on what you think the market will do next. Market timing, as most investment professionals will tell you, is risky. If your predictions are wrong, you could invest when the market is on its way down or sell when it's on its way up. In other words, you risk locking in a loss or missing the market's best days.

It's important to remember that periods of falling prices are a natural part of investing in the stock market. While some investors will use a variety of trading tools, including individual stock and stock index options, to hedge their portfolios against a sudden drop in the market, perhaps the best move you can make is reevaluating and limiting your overall risk position.

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## When Should You Collect Social Security?

A growing number of Americans have been forced to delay their planned retirement date due to job and savings losses suffered during the past five years. According to a survey, 40% of U.S. workers said they have resolved to retire later due to concerns about outliving their savings and fears of rising health care costs.1 Postponing retirement not only means working longer, but also delaying when you start collecting Social Security. Currently, workers can begin collecting Social Security as early as age 62 and as late as age 70. The longer you wait to start collecting, the higher your monthly payment will be. Your Social Security monthly payment is based on your earnings history and the age at which you begin collecting compared with your normal retirement age. This normal retirement age depends on the year you were born.

Those choosing to collect before their normal retirement age face a reduction in monthly payments by as much as 30%. What's more, there is a stiff penalty for anyone who collects early and earns wages in excess of an annual earnings limit ($14,160 in 2011).

For those opting to delay collecting until after their normal retirement age, monthly payments increase by an amount that varies based on the year you were born. For each month you delay retirement past your normal retirement age, your monthly benefit will increase between 0.29% per month for someone born in 1925, to 0.67% for someone born after 1942.

Which is right for you will depend upon your financial situation as well as your anticipated life expectancy. Anyone with a good pension or substantial savings may want to delay a bit. Similarly, if you're in no hurry to retire, you may want to continue working longer and collect later.

Likewise, those with a family history of longevity who expect to live a long time stand to gain more by delaying. If you think it unlikely to survive beyond age 78, you may want to start collecting at age 62. And if you expect to survive beyond age 82, you might consider a delayed collection.

Whenever you decide to begin collecting, keep in mind that Social Security represents only 38% of the average retiree's income.2 So you'll need to save and plan ahead -- regardless of whether you collect sooner or later.

| Year Born | Normal Retirement Age |
|---|---|
| 1937 or earlier | 65 |
| 1938 | 65 and 2 months |
| 1939 | 65 and 4 months |
| 1940 | 65 and 6 months |
| 1941 | 65 and 8 months |
| 1942 | 65 and 10 months |
| 1943 to 1954 | 66 |
| 1955 | 66 and 2 months |
| 1956 | 66t and 4 months |
| 1957 | 66 and 6 months |
| 1958 | 66 and 8 months |
| 1959 | 66 and 10 months |
| 1960 or later | 67 |

Source/Disclaimer

1Source: Towers Watson, October 2010.

2Source: Social Security Administration, "Fast Facts & Figures About Social Security," August 2011.

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