SAMALIN INVESTMENT COUNSEL

FINANCE FOCUS

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DIVORCE AND YOUR FINANCES

Division of debt and assets may vary depending on whether a couple lives in a community property state.

Divorce can be a complicated and challenging process in which details are easily overlooked. It is important to know the laws that shape divorce proceedings and to understand the impact they have on your assets.

Dividing the Assets

Typically, everything you and your spouse acquired from the day you were married is subject to division. Exceptions include individual inheritances, gifts to an individual spouse, and assets acquired before marriage. When assets are divided, the court considers each spouse's earning potential, the length of the marriage, and each spouse's contribution to building household assets.

The exception to this are the nine community property states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas,

(Continued on page 4)

Inheriting a Loved One's Retirement Assets

Your options in managing retirement assets depend on whether the deceased was your spouse and also on the type of retirement account (401(k)/403(b) plan, IRA, or annuity) that you inherit.

If you recently inherited retirement assets from a deceased loved one, it is important to pay attention to IRS rules that govern this type of bequest. Your options in managing this money typically depend on your relationship to the deceased and the type of retirement account (401(k) or 403(b) plan, IRA, or annuity) that you inherited.

Employer-Sponsored Plans

When inheriting a deceased spouse's assets within an employer-sponsored plan, you are not required to pay federal estate or income taxes if the assets are left intact within the estate. After age 70½, you must begin required minimum distributions (RMDs) based on your life expectancy. The formula for calculating the RMDs, which are taxed as ordinary income, is available in IRS Publication 590. This withdrawal schedule typically is preferred to cashing out the entire bequest at once, which is likely to trigger higher tax payments.

Understanding an employer-sponsored plan's rules for beneficiaries is critical when making decisions about the bequest.

If the deceased was not your spouse, the plan's rules generally determine your course of action. Depending on the plan, you may have one or more of the following options: Leave the money in the plan, transfer the money to an IRA created for this purpose, or elect a cash distribution.

Some employer plans offer nonspousal beneficiaries the option of completing a trustee-to-trustee transfer from an employer-sponsored plan to an IRA established for this purpose. The nonspousal beneficiary is required to take annual distributions based on the beneficiary's life expectancy. Note that in this type of scenario, the IRA is opened in the decedent's name for the beneficiary's benefit, and assets transferred to the IRA cannot be comingled with other IRAs that the beneficiary may have established.

In other instances, employer plans can default to a five-year payout rule and require nonspousal beneficiaries to empty the account within five years of the death of the deceased. Distributions taken by nonspousal heirs are taxed as ordinary income.

Before taking any action, it is critical to determine the rules of the deceased's retirement plan and consult a financial advisor or a tax advisor to make sure that you avoid unnecessary taxes.

IRAs

When inheriting a traditional IRA from a deceased spouse, you may designate yourself as the account owner and treat an inherited IRA as your own. This means you can transfer the assets to an existing IRA. These transfers typically do not trigger tax payments as long as you follow the rules for trustee-to-trustee transfers. You may also begin taking distributions, which are taxed as ordinary income. With a traditional IRA, after age 70½, you are mandated to take annual RMDs, which are based on your life expectancy and are taxed as ordinary income.

If the deceased was not your spouse, you cannot transfer assets within an inherited IRA to your own existing IRA. Instead, you have two options: You may take all distributions within five years of the decedent's death or take annual distributions determined by the life expectancy of you or the decedent, whichever is longer.

Annuities

If you receive a survivor annuity, the tax status of periodic payments to you is determined by how much the decedent paid for the annuity contract, which is known as the cost basis[1]. If the decedent did not pay for the contract (for example, if it was provided by an employer), periodic payments to you are taxable. Assuming the deceased had a cost basis, the amount up to the cost of the contract is not taxable, but amounts in excess of the deceased's cost are taxed as ordinary income.

Because determining the tax status of annuities and other inherited retirement assets can be complicated, you may want to consult an estate planning attorney or a financial advisor to answer any questions you may have.

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Strategies for Managing Volatility

Asset allocation, diversification, and the use of dividend-paying stocks are potential strategies for reducing volatility.

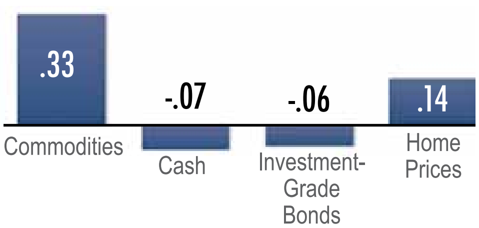
Investors are exposed to financial risk in two ways: company-specific risk or market risk. Long-term investors can reduce exposure to company-specific risk by diversifying among many different securities within the same asset class.[1] Market risk is managed, but not eliminated, by holding investments in several different asset classes.

LOW CORRELATION: THE KEY TO EFFECTIVE ASSET ALLOCATION

Longer term, the market risk associated with an individual asset class, such as stocks, may be reduced by allocating a portion of a portfolio's assets to other types of investments that historically have reacted differently to market and economic events.[2] A statistic known as correlation measures the tendency of two investments to move together. A correlation close to zero indicates that two investments are largely independent of each other. The closer a correlation is to 1.00, the greater the tendency two investments have had to move in tandem. The chart below lists four assets that have had relatively low correlations with U.S. stocks during the past decade. Past performance does not guarantee future results.

A LOOK AT CORRELATION

LARGE-CAP STOCKS



Sources: S&P Capital IQ Financial Communications; Barclays Capital. Large-cap stocks are represented by the S&P 500 Index, commodities by the Standard & Poor's GSCI®, cash by the Barclays 3-Month Treasury Bill Index, investment-grade bonds by the Barclays Aggregate Bond Index, home prices by the S&P/Case-Shiller 20-City Composite Home Price Index. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest, and if held to maturity, offer a fixed rate of return and fixed principal value. Exposure to the commodities markets may subject investors to greater volatility as commodity-linked investments may be affected by changes in overall market movements, commodity index volatility, changes in interest rates, or factors affecting a particular industry or commodity. You cannot invest directly in an index. Past performance is not a guarantee of future results. Data is based on the 10-year period ending December 31, 2011.

MANAGING SINGLE-SECURITY RISK

Modern portfolio theory is founded on the assumption that investment markets do not reward investors for taking on risks that could be eliminated though diversification. A 2003 study found that at least 50 stocks may be required to provide adequate diversification for an equity portfolio.3 Fortunately, there are many strategies available for diversifying a stock portfolio. Investors can allocate portions of a portfolio to domestic and international stocks, which may take turns outperforming depending on circumstances in various global economies.[4] An allocation to small-cap, midcap, and large-cap stocks also provide exposure to companies of various sizes. Although there are no guarantees, smaller companies may be nimble enough to exploit untapped market niches and capitalize on growth potential.[5]

DIVIDEND STRATEGIES

In addition, equity investors looking to limit volatility may want to consider dividend-paying stocks. Although a company can potentially eliminate or reduce dividends at any time, a dividend may provide something in the way of a return even when stock prices are volatile. When evaluating dividend-paying stocks, it may be worthwhile to review how long a company has paid a dividend and whether the dividend has increased over time. According to a study by Standard & Poor's, firms that had increased their dividends for the past 25 years outperformed the S&P 500 and also were less volatile during the 5-year, 10-year, and 15-year periods ending December 31, 2011. Past performance does not guarantee future results.[6] When investing in dividend-paying stocks, be aware that tax rates on qualified dividends are scheduled to increase in 2013 unless Congress changes the tax laws.

For investors interested in managing volatility, asset allocation with low-correlation investments, diversification, and dividend-paying stocks may be worth considering.

1. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

2. Asset allocation does not assure a profit or protect against loss.

3. Source: H. Christine Hsu and H. Jeffrey Wei, "Stock Diversification in the U.S. Equity Market," 2003.

4. Foreign stocks involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.

5. Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments.

6. Source: Standard & Poor's. Returns are based on the Standard & Poor's Dividends Aristocrats portfolio. Volatility is measured by a statistic known as standard deviation. Past performance does not guarantee future results.

Analyzing Your Cash Flow

When analyzing cash flow, review operating activities, capital expenditures, and debt servicing.

As any small-business owner knows, maintaining a positive cash flow is the essence of staying on course with your objectives. Conducting a periodic cash flow analysis will help you determine whether your business generates enough cash to meet your obligations and how cash outflow compares to incoming revenue from sales. Cash flow analysis also is used to forecast changes in your receipts and disbursements and to gauge the effects of those changes on future cash requirements.

(Continued on page 3)

A lack of control over cash flow is one of the leading causes of small-business failure.

Analyzing Your Cash Flow

(Continued from page 2)

The Cash Flow Statement

The cash flow statement reports your business's sources and uses of cash during a specified accounting period (e.g., monthly, semiannually, or annually). When used in conjunction with an income statement and balance sheet, the cash flow statement provides a comprehensive picture of your company's liquidity. The cash flow statement adheres to Generally Accepted Accounting Principles (GAAP) and is divided into three fixed categories:

- **Operating activities:** The change in cash resulting from routine activities that either generate or require cash. This includes incoming receipts (cash and checks) from the sale of goods and/or services, as well as interest and dividend income. Operating activities also include outgoing payments for materials, employee salaries, taxes, insurance, loan repayments, and rent. The net amount of cash from (or used by) operating activities is the most important figure on the cash flow statement.

- **Investing activities:** The change in cash resulting from actions or events that involve the purchase or sale of company assets (e.g., securities, land, buildings, or equipment). Investing activities also include paying or collecting on loans.

- **Financing activities:** The change in cash resulting from payments to or receipts from suppliers of money to the company. For instance, money borrowed in the form of a loan represents cash receipts, while the repayment of loans or dividends to investors represents cash payments.

What Do the Numbers Mean?

When examining a cash flow statement, there are a few questions to examine closely:

- Has the company generated cash from operating activities? If not, look at which components of your working capital are using the most cash and try to determine what might be happening. For instance, if your company recently bought out another company's inventory, the acquisition would explain the additional cash needed. While cash expenditures such as this are not negatives, it is critical to monitor where cash is going.

- Has there been a significant change in incoming or outgoing cash flow from investing activities? Do the numbers shed light on problems that may be developing within the business? For example, if capital expenditures have been reduced, might it be the result of bank constraints or pressure from creditors?

- How much debt has been paid or borrowed? This question reveals unusual financing activities that have not been highlighted elsewhere in the analysis.

In the final analysis, the cash flow statement provides a valuable perspective on your overall financial picture.

Anchor Your Portfolio with Index Funds

Managers of index funds do not employ defensive mechanisms during a stock market downturn.

One of the most basic distinctions among mutual funds is whether the fund manager employs an active or a passive management approach. An active management style means the fund manager uses analytic or forecasting tools to select individual stocks for the fund portfolio. In a passive approach, the fund manager simply buys whatever stocks are represented by a well-known market index. Funds that attempt to match exactly the day-to-day fluctuations of a market index are index funds.

What Are Index Funds?

By investing in an index fund that mimics the S&P 500 stock index, for example, an investor could achieve some measure of diversification in 500 widely held stocks traded on the New York Stock Exchange, the American Stock Exchange, and Nasdaq.[1]

Index funds purchase or sell shares of stocks only when the index replaces stocks or when investors buy or sell shares of the fund. Unlike actively managed funds, index funds do not attempt to buy stocks based on the fund manager's outlook for certain companies or for the market in general.

The passive approach of index funds generally means the expense ratio of index funds is substantially lower than that of actively managed stock funds. The average expense ratio of index funds was 0.75% in 2011, compared with 1.24% for actively managed funds.[2] The higher management expenses of actively managed funds make it more difficult for them to outperform index funds on a consistent basis. Management fees and expenses are deducted from a fund's results in the calculation of returns.

Using Index Funds Within a Portfolio

Asset allocation and diversification may require buying more than one index fund.[3] The 500 companies within the S&P 500 index, for example, constitute only a portion of the U.S. stock market and represent only large-capitalization stocks. The Russell 2000 small-cap index; the S&P 400 MidCap index (an unmanaged index of 400 stocks generally considered representative of the U.S. midcap market); and the Morgan Stanley Europe, Australasia, and Far East index (EAFE) are among the most widely quoted indexes; there are many index funds that track these.[4] The variety of index funds available allows investors to diversify into a wide array of stocks by indexing according to investment goals and risk tolerance.

Index Funds Versus Actively Managed Funds

Index Funds	Actively Managed Funds
Stocks are selected to mirror the underlying index.	Stocks are selected based on investment objectives.
Risk level matches that of the index.	Risk and return may vary.
Fees and expenses are typically lower due to infrequent trading and limited research needs.	Investors pay higher fees and expenses.
Performance is typically slightly below that of the underlying index.	There is potential for above-market performance.

1. Standard & Poor's Composite Index of 500 Stocks is an unmanaged index that is generally considered representative of the U.S. stock market. It is not possible to invest directly in an index. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

2. Sources: Standard & Poor's; Morningstar. Based on all indexed and active U.S. mutual funds tracked by Morningstar as of December 31, 2011.

3. Asset allocation does not assure a profit or protect against a loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a nondiversified portfolio. Diversification does not ensure against market risk.

4. Securities of smaller companies may be more volatile than those of larger companies. The illiquidity of the small-cap market may adversely affect the value of these investments. Foreign investments involve greater risk than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.

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Source/Disclaimer:

[1]An annuity is a long-term, tax-deferred investment vehicle designed for investment purposes and contains both an investment and an insurance component. They are sold only by prospectus. Guarantees are based on the claims-paying ability of the issuer and do not apply to an annuity's separate account or its underlying investments. The investment returns and principal value of the available sub-portfolios will fluctuate so that the value of an investor's unit, when redeemed, may be worth more or less than their original value. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal.

DIVORCE AND YOUR FINANCES

(Continued from page 1)

Washington, and Wisconsin. Under the laws of these states, almost all assets are divided equally.

Dealing With Debt

Do not assume that a divorce will erase any debt. If you live in a community property state, debt, like your assets, will be divided with your former partner. You will be responsible for half of all debt in jointly held accounts and, in some cases, half of a former spouse's debt as well.

If you do not live in a community property state, you remain responsible for your individual debt (but not your spouse's) and any debt in jointly held accounts. Many couples include debt payment as part of the settlement. You may want to consider taking on the responsibility for a portion of the debt yourself, and using your portion of the divorce settlement to reduce it.

If you and your spouse own a home that has appreciated in value, consider whether you want to sell it before the divorce is finalized. Federal tax rules offer an exclusion of up to $500,000 in realized capital gains for married taxpayers. This amount is cut in half for single filers. Be sure to consult a tax advisor for additional information about these rules.

Your Retirement Assets

Money in your 401(k) or pension plan may legally be divided during a divorce. The divisible amount begins to accumulate on the day you are married and ends on the day you are divorced.

To claim a share of a spouse's 401(k) or pension plan benefit, you need to obtain a court order called a Qualified Domestic Relations Order (QDRO) and provide it to your spouse's plan sponsor before distributions are completed. You and your spouse have the option of deciding not to divide retirement plan assets. If you and your spouse elect this option, it may be beneficial to make this agreement in writing and include it as part of the settlement to prevent the courts from declaring the money divisible.

Estate Planning

You may want to review your will, or have one created if you currently do not have a will. It may be beneficial to review and amend your estate plan at the same time you commence a divorce proceeding. Also review beneficiary designations for pensions, 401(k) plans, and life insurance policies. Federal law requires a spouse to be the sole beneficiary of pension or 401(k) benefits unless the spouse waives that right in writing.

If you find yourself faced with divorce, it is essential to protect your financial future. Enlisting the help of an attorney and carefully monitoring the process can ensure that your interests are considered and that you will not need to revisit the proceeding at a later time.