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Making Financial Resolutions? Look Back at Last Year



Each new year brings the chance for a fresh start, and the opportunity to improve your financial picture. As you make financial resolutions for 2012, looking back at what happened last year can help you make some positive changes this year.

Automate your retirement savings

In 2011: The economic slowdown took its toll on retirement savings.

In 2012: While the economy--and its impact on financial markets--may be out of your hands, you can still look for ways to increase your retirement savings. First, determine whether you're leaving any money on the table. If you participate in an employer-sponsored retirement plan such as a 401(k) or a 403(b), contribute the maximum amount you can--particularly if your employer matches some or all of your contributions.

Contributing to an employer-sponsored retirement plan can help you save more consistently. Because your contributions are deducted automatically from your salary each pay period, you won't be tempted to skip one now and then. And this year, why not resolve to steadily increase your retirement contributions? Your employer may allow you to sign up for automatic contribution increases based on a certain schedule or triggering event (e.g., annually or whenever your pay increases).

If you're self-employed or contributing to a traditional or Roth IRA on your own, you can still automate your contributions by having money sent directly from a savings or checking account to your retirement account.

Plan ahead for a cash crunch

In 2011: According to the Federal Reserve, use of consumer credit rose in 2011 after falling for two straight years.

In 2012: If you've reigned in your spending but are still burdened by debt (especially credit card debt), your lack of emergency savings may be partly to blame. For example, even if you pay much more than your monthly minimum credit card payment, you'll be caught in an endless

cycle of debt unless you can avoid using your credit card for new expenses. Resolve to have at least three to six months of your living expenses set aside in a liquid account such as a savings or money market account so that you have cash on hand to pay for unexpected expenses (e.g., costly car or home repairs, large medical bills) instead of racking up new credit card debt and interest charges.

Review your investments

In 2011: Market volatility was the norm.

In 2012: You can't control the market, but you can control your response to market volatility. Is your asset allocation still in line with your investment goals, time horizon, and risk tolerance? Is it time to rebalance your allocation in light of changing market conditions and/or your changing needs? Are you taking appropriate advantage of available investment products or offerings? Reviewing your portfolio periodically can help you stay on track.

Check your insurance coverage

In 2011: Floods, hurricanes, tornadoes, earthquakes, and wildfires were widespread.

In 2012: The federal government issued more disaster declarations in 2011 than in any other year on record, serving as a reminder that it's important to review your property and casualty coverage to make sure you're adequately protected. Is there coverage you really should have (e.g., personal umbrella liability, renters insurance, or flood protection), but don't?

Update your estate plan

In 2011: New estate and gift tax laws took effect.

In 2012: Your estate plan should be reviewed in light of the changes made last year to estate and gift tax laws. Certain life events, such as changes in employment, family circumstances (marriages, divorces, births, illness or incapacity, and deaths), or even the valuation of your estate, may also affect your estate plan.

Debt Payoff Strategies



Certain debt payoff strategies can reduce the time payments must be made and the total interest paid. Before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

In these uncertain economic times, you may be thinking of reducing your debt load. There are a number of strategies for paying off debt that you might consider. However, before starting any debt payoff strategy (or combination of strategies), be sure you understand the terms of your debts, including any penalties for prepayment.

Minimum payments

You are generally required to make minimum payments on your debts, based on factors set by the lender. Failure to make the minimum payments can result in penalties, increased interest rates, and default. If you make only the minimum payments, it may take a long time to pay off the debt, and you may have to pay large amounts of interest over the life of the loan. This is especially true of credit card debt.

Your credit card statement will indicate the amount of your current monthly minimum payment. To find the minimum payment factors, you will need to review terms in your credit card contract. These terms can change over time.

For credit cards, the minimum payment is usually equal to the greater of a minimum percentage multiplied by the card's balance (plus interest on the balance, in some cases) or some minimal amount (such as \$15). For example, assume you have a credit card with a current balance of \$2,000, an interest rate of 18%, a minimum percentage of 2% plus interest, and a minimum amount of \$15. The initial minimum payment required would be \$70 [greater of $(\$2,000 \times 2\%) + (\$2,000 \times (18\% / 12))$ or \$15]. If you made only the minimum payment each month, it would take you 114 months to pay off the debt, and you would pay total interest of \$1,314.

For other types of loans, the minimum payment is generally the same as the regular monthly payment.

Make additional payments

Making payments in addition to your regular payments or the minimum payments can reduce the time payments must be made and the total interest paid. The additional payments could be made periodically, such as monthly, quarterly, or annually.

For example, if you made monthly payments of \$100 on the credit card debt above (the initial minimum payment was \$70), it would take you only 24 months to pay off the debt, and you would pay total interest of just \$396.

As another example, let's assume you have a current debt on which you owe \$100,000, the interest rate is 7.125%, the monthly payment is

\$898, and you have a remaining term of 15 years and 3 months. If you make regular payments, you will pay total interest of \$62,247. However, if you pay an additional \$200 each month, it will take you only 11 years to pay off the debt, and you will pay total interest of just \$44,364.

Another strategy is to pay one-half of your regular monthly mortgage payment every two weeks. By the end of the year, you will have made 26 payments of one-half the monthly amount, or essentially 13 monthly payments. In other words, you will have made an extra monthly payment for the year. Furthermore, payments are made earlier than required, thus reducing the total interest you will have to pay.

Pay off highest interest rate debts first

One way to potentially optimize payment of your debt is to first make the minimum payments required for each debt, and then allocate any remaining dollars to the debts with the highest interest rates.

For example, let's assume you have two debts, you owe \$10,000 on each, and each has a monthly payment of \$200. The interest rate for one debt is 8%; the interest rate for the other is 18%. If you make regular payments, it will take you 94 months until both debts are paid off, and you will pay total interest of \$10,827. However, if you make monthly payments of \$600, with the extra \$200 paying off the debt with an 18% interest rate first, it will take you only 41 months to pay off the debts, and you will pay total interest of just \$4,457.

Get a debt consolidation loan

If you have multiple debts with high interest rates, it may be possible to pay off those debts by getting a debt consolidation loan. This type of loan will typically be a home equity loan. Therefore, the interest rate on it will often be much lower than the interest rates on the debts being consolidated. Furthermore, if you itemize deductions, interest paid on home equity debt of up to \$100,000 is generally deductible for income tax purposes, thus reducing the effective interest rate on the debt consolidation loan even further. However, a home equity loan potentially puts your home at risk because it serves as collateral, and the lender could foreclose if you fail to repay. There also may be closing costs and other charges associated with the loan.

Note: All examples are hypothetical and for illustrative purposes only.



Q & A on Filing the Federal Financial Aid Application



The FAFSA relies on financial information from your previous year's federal income tax return; for example, a FAFSA completed in 2012 will rely on information contained in your 2011 return.

The federal government's Free Application for Federal Student Aid, the FAFSA, should be filed as soon after January 1 as possible in the year your child will be attending college. The reason is that some federal aid programs operate on a first-come, first-served basis, so filing the application early ensures your child has the best chance of receiving the most favorable aid package.

Here are some common questions and answers regarding the application process.

What documents will I need to fill out the FAFSA?

The FAFSA relies on financial information from your previous year's federal income tax return; for example, a FAFSA completed in 2012 will rely on information contained in your 2011 return. So the papers and statements you use to file your tax return are generally the same ones you would need to fill out the FAFSA, such as Social Security numbers, W-2 information, and information on savings, investments, and business assets. Your child will also need to have this information.

But here's a dilemma: since most parents probably won't complete their federal income tax return in January, how can they fill out the FAFSA, which relies on figures from their tax return? There are two possible solutions. The first is to prepare your tax return earlier. The second is to prepare (or hire a tax professional to prepare) an estimated tax return, which can then be used to complete the FAFSA—a practice the federal government deems acceptable. If you use an estimated tax return, keep in mind that you will need to provide a final tax return later on.

Tip: *Even if you don't expect your child to qualify for federal aid, you should still consider filing the FAFSA because colleges often require it as a prerequisite for students to be eligible for the college's own institutional aid.*

How do I file the FAFSA?

You can complete a paper FAFSA or file it electronically. The way you submit the FAFSA does not affect your child's eligibility for aid.

You can get a paper FAFSA at your child's high school or your local library. Once it's complete, you should make a copy for your records and mail it in the preaddressed envelope that comes with the form.

You can file an electronic FAFSA at www.fafsa.ed.gov. You'll need to apply for a PIN before you can actually start filling out the online application. Electronic FAFSAs offer several advantages over paper FAFSAs:

detailed online help screens, an online chat option with a customer service representative, built-in error detectors, confirmation that the application was transmitted successfully, and faster processing—one week as opposed to two to four weeks for paper FAFSAs.

Tip: *If you've previously filled out the FAFSA4caster, the federal government's online financial aid forecasting tool, the online FAFSA will be automatically populated with your data.*

What happens after I file the FAFSA?

After your FAFSA is processed, you will receive a Student Aid Report (SAR) either in the mail or electronically (depending on how you filed the FAFSA). This document summarizes data from your FAFSA and indicates your official expected family contribution (EFC), which is the amount of money the government expects your family to contribute to college costs for the current year to be eligible for financial aid. For example, "EFC25000" means that your expected family contribution is \$25,000.

You should review the SAR carefully to make sure it contains your correct income and asset information. Any corrections should be made immediately and sent back for reprocessing. If you have questions, you can contact the Federal Student Aid Information Center at 1-800-433-3243.

Tip: *If there is an asterisk (*) next to your EFC figure, you have been selected for verification. FAFSAs are selected for verification randomly, or because the FAFSA is incomplete or contains estimated tax information. If you are selected for verification, you will need to provide additional documentation that might include a final tax return, household information, or appraisals for certain assets listed on the FAFSA. Not all families selected for verification will need to submit the same documents.*

The SAR is also sent to each college you listed on your FAFSA. Once the college receives your child's SAR, the financial aid administrator at each school that has accepted your child will craft an aid package that tries to meet your child's financial need (remember, colleges aren't obligated to meet all of it). To determine your child's need, the administrator subtracts your EFC from the cost of attendance at that particular college. Your child will then be notified of the college's aid package in an award letter sent out in the spring. The package typically includes various combinations of federal and college loans, grants, scholarships, and work-study jobs.



Ask the Experts

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Is a stop limit the same as a stop order?

A stop limit is typically used when you're trading during a volatile market and want to target a specific price as closely as possible. When placing a market order, the price you pay is the best price available in the market at the time the order is executed. With a market order you can't be sure of the price you'll get, especially for more thinly traded securities or larger orders that may need to be handled in multiple transactions.

A stop order instructs your broker to buy a stock only when it is selling at or below a specified price (or if you're selling, when it is at or above a certain price). Once the stop is triggered--in other words, once your specified price is reached--your order becomes a market order and is executed at the market price. However, if markets are volatile or the security is illiquid, the market price can change between the time the stop is triggered and when the order is fully executed. If you're buying a stock and that price is lower, you benefit, but if the execution price is higher, you may pay more than you expected. For example, if you're buying a thinly traded security and your order

isn't fully executed before the end of the trading day, you could run the risk of the market opening up strongly the next day--a phenomenon sometimes known as "gapping up"--potentially taking the price of your targeted stock with it. Conversely, if you're selling a stock and the price moves lower before the trade is fully executed, you might make less from the sale than you intended.

A stop-limit order puts a limit on the price you're willing to pay for your purchase (or accept if you're selling). It mandates that a purchase be executed at a specific price or better; that price can be different from the stop level that triggers a trade, and increases the odds of the transaction meeting your expectations. If you're selling, a stop-limit order also can be used to set a minimum price for the sale. Stop limits are typically good for a specific time frame, such as a day, a week, or a month.

Why wouldn't everyone use a stop-limit order with every trade? Because they typically cost more to use than market orders. As a result, a stop limit probably makes the most sense for large orders in volatile markets, when a difference of even a penny or two per share can mount up.



Can a stop-loss order really protect me from losses?

As the name implies, stop-loss orders are a way to help you manage the amount of loss you can suffer on a single holding. Also known as a stop order or stop-market order, a stop-loss order sets a level at which your broker is instructed to sell all or part of a particular position once the stop-loss point is reached.

With a stop-loss, you can specify a share price below which you do not want to hold a stock. Once the bid price hits that level, the position would be sold automatically at the market price. You also can employ what's known as a trailing stop-loss to adjust the stop upward if a security's price rises. The stop might be calculated as a percentage or a dollar amount relative to the bid price (for example, a loss of 10% or a \$2 per share drop). If the stock's price moves higher, your stop level also rises. That can help protect a portion of your paper profits while potentially allowing you to participate in any further upward appreciation. If the price falls, the holding simply moves closer to the level at which it will be sold.

In addition to helping you minimize losses you can't handle, stop-loss orders are one way to

remove emotion from your investment decision-making. They also can be especially useful if you're anxious about volatile markets at a time when you know you'll be traveling in remote areas and unable to monitor your accounts easily.

However, under certain circumstances, stop-loss orders can be a mixed blessing. Just because you've specified a certain stop-loss level doesn't mean your trade will be executed at that exact price; once your specified level is triggered, the trade will be executed at a market price. If markets are extremely volatile or if a security is thinly traded, you might lose more than the amount you expected.

For example, during the 2010 "flash crash," when prices plummeted and markets were temporarily illiquid, some stock positions were sold at prices well below the stop loss. Some of those trades were subsequently voided, but it's still a good idea not to take the protection of stop-loss orders for granted, and to know that there can be a gap between expectations and execution.