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Hello-

We want to wish everyone a wonderful autumn complete with all the fall activities to be enjoyed, including pumpkin carving, football games, and Kevin's personal favorite - pumpkin spiced lattes! As the year comes to a close, keep in mind we are here for anything you may need.

Also, a friendly reminder to anyone who is age 70 ½ or older that you must take a Required Minimum Distribution (RMD) based upon the combined prior year-end balance of all your tax deferred retirement accounts, including those that may be held outside of Janney. Please feel free to contact us with any questions or concerns you may have about your RMD.

Enjoy the holiday season!

#### 4th Quarter 2011

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# INVESTING PERSPECTIVES

## Year-End Investment Planning: The Clock Is Ticking

Investment planning at the end of 2010 was complicated by uncertainty over whether existing tax rates would be extended. This year, it's the congressional "supercommittee" charged with tackling the country's deficit financing problem that's the source of uncertainty. Even though you may not be sure how the committee's work might ultimately affect you, here are some factors to keep in mind as you plot your year-end strategy.

### Harvest tax losses if appropriate

If you plan to harvest losses to offset capital gains, you may want to think about the cost basis of those shares. To maximize your losses for tax purposes, you would sell shares that have lost the most, which would enable you to offset more gains. Unless you specify which shares of stock are to be sold, your broker will typically treat them as sold based on the FIFO (first in, first out) method, meaning that the first shares bought are considered to be the first shares sold. However, you can designate specific shares as the ones sold or direct the broker to use a different method, such as LIFO (last in, first out) or highest in, first out. You can also use a standing order or instruction to specify that a particular method is to be used.

As of this year, brokers must report to the Internal Revenue Service your cost basis for the sale of any shares of stock bought after January 1, 2011. That will make it even more important to make sure when preparing your tax returns that your cost basis records for such sales are accurate and agree with those of your broker. If you decide to specify stock shares in order to determine your cost basis, you must do so by the settlement date (typically, three days after execution of the trade) in order for your broker's records for the stock sale to be accurate.

Mutual funds, dividend reinvestment plans, bonds, and other securities eventually also will be subject to the same mandatory cost basis reporting requirement.

### Don't procrastinate on tax break for small business stock

If you plan to invest in a qualifying small

business, you may want to do so by December 31. That's because 100% of any capital gains on the sale of qualified small business stock issued after September 27, 2010, and before January 1, 2012, can be excluded from your taxable income. (The exclusion is scheduled to revert to 50% next year.)

To claim the 100% exclusion, you must have acquired the stock at original issue (with some exceptions for stock acquired as an inheritance or gift). Also, the business must satisfy certain requirements, and you must hold the stock for at least five years. There are limits on the total amount of gain that is eligible for the exclusion. There also may be special considerations if you roll over the gain from the sale of your stock to another qualified small business stock, or if you receive qualified stock as part of your deferred compensation plan. Don't hesitate to get expert help with your specific situation.

### Consider the potential impact of higher interest rates

Interest rates have been at historic lows in recent years, but as the economy continues to heal, that won't always be the case. The Federal Reserve Board has said that raising interest rates won't be its first step in reducing the support it has given the monetary system. However, at some point, interest rates are likely to begin moving up again. When that happens--and there's no way to know for sure when that might be--bond prices will begin to feel the impact. As bond yields begin to rise, bond prices will begin to tumble, since prices move in the opposite direction from bond yields.

### Don't let payroll tax increase derail long-term plans

If you've benefitted from the 2% reduction in workers' Social Security taxes in 2011, congratulations! However, be aware that the provision is scheduled to expire at the end of this year. If you've been saving or investing that money, your long-term plans will benefit if you can figure out how to replace that source of funding for your investment efforts.



*Will living a healthy lifestyle reduce health-care costs in retirement? Not necessarily. While living a healthy lifestyle may aid in reducing annual health-care costs, that same lifestyle generally promotes longevity, which may translate to higher total health-care expenditures over a longer lifetime. The moral of the story is even if you're healthy, you still face illnesses and diseases, so don't wait until your health begins to fail to plan for these costs in retirement.*



## Factoring Health-Care Costs into Retirement Planning

There are many factors to consider in determining how much you'll need to save in order to enjoy a comfortable and financially secure retirement. One often overlooked retirement expense is the cost of health care. You may presume that when you reach age 65, Medicare will cover most health-care costs. However, Medicare currently only pays for a portion of the cost for most health-care services, leaving a potentially large amount of uninsured medical expenses. Without proper planning, health-care costs can sap retirement income in a hurry, leaving you financially strapped.

### How much will you need?

How much you'll spend generally may depend on when you retire, how long you live, your health status, and the cost of medical care in your area. But the costs can add up. You won't have to pay for Medicare Part A hospital insurance (unless you don't qualify and have to buy into the program), but you will likely pay either \$96.40 or \$110.50 each month in 2011 for Medicare Part B physician's coverage (although you may pay higher premiums based on income and other factors), and an average of \$30 per month for Medicare Part D prescription coverage. In addition, there are co-pays and deductibles to consider (e.g., after paying the first \$162 in Part B expenses per year, you pay 20% of the Medicare-approved amount for services thereafter).

The cost of health care is rising. The Centers for Medicare & Medicaid Services (CMS) reports that national health expenditures grew by 4% in 2009. And the CMS Office of the Actuary estimates that out-of-pocket spending is projected to grow at an average rate of 5% from 2015 through 2020.

### What can you do?

It's clear that health care is an important factor in retirement planning. And while you may be able to buy a cheaper car, live in a smaller home, or take fewer vacations in order to stay within your retirement income budget, you can't do without necessary medical care. So what can you do? You can better prepare for these expenses by taking the following steps:

- Acknowledge that paying for health care in retirement is an issue to consider. Don't presume Medicare and Medigap insurance will cover all your expenses—they probably won't. Include potential health-care costs in your retirement plan.

- Evaluate your present health and project your future medical needs. That might be easier said than done, but taking stock of your overall health now and factoring in your family's health history may help you determine the type of care you might need in retirement. Are you currently being treated for high blood pressure or diabetes? Do you live a healthy lifestyle? Does heart disease run in your family?
- Understand what Medicare covers and what it costs. For instance, Medicare (Part A, Part B, and Part D) generally provides benefits for inpatient hospital care, medically necessary doctor's visits, and prescriptions. But Medicare doesn't cover everything. Examples of services generally not covered by Medicare include most chiropractic care, dental or vision care, and long-term care. You'll also have to account for deductibles, co-insurance costs for some services, and a monthly premium for Medicare Parts B and D.
- Consider the cost of supplemental insurance. Medigap plans are standardized policies sold by private insurance companies that pay for some or all of the costs not covered by Medicare. In addition to Medigap policies, other types of supplemental insurance include long-term care insurance, dental insurance, and vision insurance. The type and amount of coverage that's best for you depends on a number of factors, including how much premium you can afford, what benefits you need, your financial resources, your health, and your anticipated medical needs.
- Don't forget to factor in the cost of long-term care. The National Clearinghouse for Long-Term Care Information estimates that at least 70% of people over age 65 will require some long-term care services. Medicare does not pay for custodial (nonskilled) long-term care services, and Medicaid pays only if you and your spouse meet income and asset criteria.
- Save, save, save. You may have already begun saving for your retirement, but if you fail to include the cost of health care in your plan, you're likely leaving out a big expense. Your financial professional can help you figure out how much you may need to save and adjust your retirement planning strategies to account for potential health-care costs in retirement.



*Before investing in a mutual fund, you should carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read it carefully before investing. And don't forget that any investment involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.*

*To produce a figure that indicates the value of the aggregated securities, an index divisor is typically applied to produce a more manageable figure that is easier to quote than the index's actual value.*

## All about Indices

No doubt you've seen headlines reporting that a particular index is up or down. But do you know how an index works, and why understanding the nuts and bolts of a specific index can make a difference to your portfolio?

An index is simply a way to measure and report the fluctuations of a securities market or a particular segment of a market. An index is developed by a company that sets specific criteria to determine which securities are included in the index--factors such as a company's size or location, or the liquidity of its stock. For example, the S&P 500 is a collection of large-cap U.S.-based companies that Standard and Poor's considers to be leading representatives of a cross section of industries.

The company that develops the index tracks the performance of its components and aggregates the data to produce a single figure that represents the index as a whole. Virtually every asset class has at least one index that tracks it, but because of the size and variety of the stock market, there are more stock indexes than any other type.

### How indices are used

In addition to providing valuable information needed to monitor how a particular market is faring, an index can serve as the basis for mutual funds or exchange-traded funds that attempt to replicate its performance; that process is known as indexing. An index also can be used as a benchmark for funds that invest in the same asset class, regardless of whether a fund includes the same specific securities. Finally, some investment products do not attempt to replicate an index's performance but represent a bet on the index's general movements, though such investments can be challenging and are not appropriate for every investor.

### You can't invest in an index

You cannot invest directly in an index. You could always purchase each and every security in the index and do the necessary trading to ensure that the portfolio continues to mirror the index, but the financial services industry has saved you the trouble. As noted above, investment products such as index mutual funds and exchange-traded funds are used by investors to try to capture a particular market's performance.

However, an index-based investment may not match the return of an index exactly. One reason is what's known as "tracking error." Costs such as taxes, operating expenses (even minimal ones), and transaction costs can differ among mutual funds. As a result, your return

may be slightly different from that of the index or even other funds based on the same index, even though most index funds try to keep tracking error to a minimum.

### Indices don't stay static

Though an index adheres to a set of guidelines for selection of the securities it includes, the company that oversees the index generally reviews the security selection periodically. For example, some indices are rebalanced if an individual security grows so large that it dominates the index. Others have a limit on how much of the index can be devoted to a particular sector or industry, and rebalance if the proportion gets skewed. And in some cases, an index is altered because of serious problems with one of its components (for example, Flowserve Corp. replaced Washington Mutual Inc. in the S&P 500 after WaMu was closed by the Office of Thrift Supervision in 2008).

### Weight watching

Even indices that include the same securities may not operate in precisely the same way. Why? Because different indices may weight the relative importance of the same securities in different ways. The way an index is weighted determines how much of each individual security is included in it--for example, how many shares of stock. That weighting in turn can affect the overall index's performance.

Some indices are weighted based on market capitalization; the companies with the highest market cap (total value of stock outstanding) make up a larger share of the index than companies with a smaller market cap. As a result, those companies can have a disproportionate impact on the performance of an index weighted by market cap. For example, a 10% decline in the price of the largest company in the S&P 500 index would affect the index's overall return more dramatically than a 10% drop in the price of a much smaller company, because the S&P 500 is weighted by market cap.

Other indices are weighted by price; the most expensive stocks receive greater weight than lower-priced stocks. The Dow Jones Industrial Average, which includes 30 large, blue-chip industrial stocks and is commonly referred to as the Dow even though there are several Dow indices, is price-weighted. A relatively new approach to weighting an index is to use certain fundamental attributes, such as dividends or cash flow, as the basis for weighting the stocks that comprise the index.

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## Ask the Experts



### **I'm retiring to a state with no income tax. Can my former state tax my retirement benefits?**

The short answer is "no."

In the past, several states enacted "source tax" laws that attempted to tax retirement benefits if they were earned in that state, regardless of where a taxpayer resided when the benefits were ultimately paid. For example, if you earned a \$50,000 annual pension while working in California, and then retired to Florida, California would attempt to tax those benefits, even though you were no longer a California resident.

But, in 1996, a federal law was enacted (P.L. 104-95) that prohibited states from taxing certain retirement benefits paid to nonresidents. As a result, if your retirement benefits are covered by the law (most are, see below), only the state in which you reside (or are domiciled) can tax those benefits.

Whether you're a resident of, or domiciled in, a state is determined by the laws of that particular state. In general, your residence is the place you actually live. Your domicile is your

permanent legal residence; even if you don't currently live there, you have an intent to return and remain there.

The law applies to all qualified plans (this includes 401(k)s, profit-sharing plans, and defined benefit plans), IRAs, SEP-IRAs, Internal Revenue Section 403(a) annuities, Section 403(b) plans, Section 457(b) plans, and governmental plans.

The law provides only limited protection for nonqualified deferred compensation plan benefits. Benefits paid from nonqualified plans that are designed *solely* to pay benefits in excess of certain Internal Revenue Code limits (for example, Section 415 excess benefit plans) are covered by the law. Also covered are nonqualified plan (for example, top-hat plan) benefits that are paid over the employee's lifetime, or over a period of at least 10 years.

Examples of benefits that are not covered by the law include stock options, stock appreciation rights (SARs), and restricted stock.