PLANNING FOR PROSPERITY

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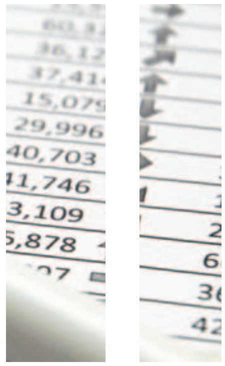

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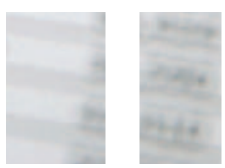

Buying bonds?

Your choices range from conservative to speculative

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Along with stocks and cash, bonds are one of the key building blocks of a diversified portfolio. While over long periods of time bonds historically have offered lower total returns than stocks, they can provide a reliable, steady income stream. What's more, bond prices have often increased when stock prices have fallen, making them potentially useful for diversification purposes. Let's review the main categories of bonds and briefly discuss the pros and cons of each.

Talking Treasuries

Bonds are available with a variety of risk/reward characteristics. At the low end of the risk spectrum are Treasury and government agency bonds. These securities are backed by the "full faith and credit" of our federal government. Consequently, they're thought to have virtually no risk of default. Because of their relative safety, Treasuries offer lower yields than most other bonds.

Treasuries are perhaps the bonds most sensitive to swings in interest rates. Rates and bond prices move in opposite directions, and interest rates are near all-time lows. That means if rates rise appreciably — for example, in response to rising inflation — Treasury prices could fall significantly, especially for longer-term bonds.

However, Treasuries can be an effective hedge against financial upheaval. This point was driven home in 2008, when Treasuries stood virtually alone — even among bonds — as investments that delivered positive returns. Although profits are never guaranteed, this "flight to safety" feature is worth considering when structuring your portfolio.

Mentioning munis

State and municipal bonds (munis) are issued by state and local governments, as well as their agencies and authorities. These bonds generally are exempt from federal income taxes and in some cases state income taxes. Because of their tax-exempt status, munis tend to offer lower yields than even U.S. Treasuries. That said, for investors in high tax brackets, munis can produce better returns than comparable taxable securities after the tax benefits are factored in.

Because municipal bonds are debt obligations of states, cities and towns, they don't have the full faith and credit of the U.S. government behind them. Moreover, the recession has pushed many state and local government budgets nearly to the breaking point. Consequently, munis are a market where you should carefully assess the quality and risk of any potential purchases.

Bond funds vs. individual bonds

For practical purposes, two primary avenues exist for investing in bonds: You can buy individual bonds or purchase a product that pools the capital of a group of investors, such as a bond mutual fund or an exchange-traded fund (ETF).

Bond mutual funds and ETFs have the advantages of being easy to buy and sell, offering more diversification within a single security and having low investment minimums. They also offer a way to buy bonds that would be difficult for individual investors to purchase on their own, such as bonds from emerging market issuers.

That said, individual bonds offer one key advantage: They have a specific maturity date on which your principal must be returned. Even if interest rates have risen and the price of the bond has fallen since it was purchased, your principal is repaid in full at maturity — barring a default, of course.

By contrast, bond funds and ETFs have no particular maturity date on which you're entitled to a return of your principal.

Concentrating on corporates

Corporate bonds are debt securities issued by corporations. As you might expect, corporate debt runs the gamut from the very highest-rated securities, issued by financially solid firms, such as Exxon Mobil and Microsoft, to low-rated bonds floated by companies that are struggling to stave off bankruptcy. Corporate bonds rated BBB or higher are considered investment-grade; those below that level are high-yield or "junk" bonds.

As their name implies, high-yield bonds offer significantly higher levels of income than investment-grade debt. The prices of junk bonds can be extremely volatile, though, as investors discovered in 2008. Moreover, there is significant risk of default, especially as you move down into lower-rated issues.

Investigating international bonds

This category includes foreign sovereign bonds in developed markets (the foreign equivalent of U.S. Treasuries), international corporate bonds and emerging market bonds. Investing in foreign bonds introduces some new risks and opportunities, including currency risk.

For example, if you purchased a German government bond that carries a 5% yield but the euro depreciates by 5% against the dollar, you're back to a break-even return after one year. By the same token, currency movements can sometimes provide a tailwind.

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Investors in foreign bonds also are subject to the credit risk of the countries issuing the bonds. Greece and other eurozone countries made news in early 2011 because of their shaky finances, which drove the yields on their bonds up and the prices down.

The right bond portfolio for you

What's evident from this brief survey is that bonds are a multifaceted market. You should approach bonds the same way you would stocks, matching exposure to the various categories according to your risk tolerance, time horizon and other criteria. ■

The cost of being a member of the Sandwich Generation

Do you find yourself taking care of your children *and* your aging parents? If so, you're among the many people who are part of the Sandwich Generation. Even if you're not yet a member, it's a good idea to start thinking about how you might be affected in the future.

Although it may be personally gratifying to be able to help your parents, it can be a financial burden. What with having to possibly pay for your child's college education and fund your own retirement, you may find your finances stretched thin. The good news is that tax breaks and insurance may help.

Adult-dependent tax exemption

The adult-dependent tax exemption allows qualifying taxpayers to deduct up to $3,700 (in 2011) for each adult dependent claimed. So how do you qualify?

First, for your parent to be considered a dependent, his or her income must be less than $3,700 (in 2011). Social Security generally doesn't count toward this amount, though any income from sources such as dividends, interest, and retirement plan or IRA withdrawals does.

Second, you must contribute more than 50% of your parent's financial support. (If two or more individuals combine to provide more than half the support, such as two children supporting a parent, they can agree that one of them will claim the exemption.)

Here Social Security is a factor in that the amount your parent receives may detract from how much you're contributing. For example, your parent may receive less than $3,700 in income, but if he or she is using Social Security to pay for medicine or other items, you may not be providing enough support to claim the exemption.

On the bright side, if your parent lives in your home, you can factor the fair market rental value of a portion of your residence into how much financial support you're providing. However, your parent does *not* have to live with you for you to claim the exemption. If he or she stays in a separate residence, or lives in a nursing home or assisted living facility, you can still factor your financial support into the 50% test.

If you don't qualify for the exemption because your parent has too much income, you may not be out of luck. You may still be able to deduct combined medical costs that you pay for a parent and your own family in excess of 7.5% of your adjusted gross income.

Long-term care insurance

If you aren't supporting your parents now but are concerned you may have to in the future, you may want to discuss long-term care (LTC) insurance with them. Medicare and supplemental health insurance policies generally don't cover assisted living arrangements, nursing home residence and other LTC costs. LTC insurance can cover a broad range of such costs.

LTC policies typically require a short waiting period, similar to a health care insurance policy's deductible amount. In addition, these policies offer a daily or monthly maximum monetary benefit or a maximum period (in years) for which they'll cover expenses.

The cost of LTC insurance premiums depends on the insured's age and the coverage amount he or she purchases. The younger your parents are when they buy their policy, the lower the monthly premium. But keep in mind that the earlier your parents start their coverage, the longer they're likely to pay premiums. And they must purchase LTC insurance before they actually need it. Those who already have a chronic or degenerative illness or who are disabled likely will face high premiums or not be able to obtain a policy at all.

After deciding to buy an LTC insurance policy, your parents can choose from an individual or group plan. Briefly, an individual plan typically offers more comprehensive coverage and greater benefits options but is more expensive. A group plan generally is less expensive and easier to qualify for, but offers fewer options because benefits are less flexible.

Responsibilities increase

As you grow older, so do your responsibilities. If you're part of the Sandwich Generation, those responsibilities can include raising your children while also taking care of your aging parents. To help ease the financial burden, discuss all of your options with your financial advisor. ■

Mortgage sweet mortgage

Choosing the right loan is just as important as choosing the right home

Buying a home ranks as one of the largest investments most people will ever make. Add in the interest cost of a mortgage, and you're talking about a sizable financial commitment.

For example, if you borrow $500,000 at 5% amortized over 30 years, you'll pay $466,280 in interest over the life of the loan, in addition to repaying the $500,000 principal, for a grand total of $966,280. That's why it pays to make sure you get the right mortgage for your situation.

To lock or not to lock?

An important choice you face is deciding between fixed-rate and adjustable-rate mortgages. With a fixed-rate loan, your interest rate won't change during the life of the loan, but you'll pay a little more for the privilege of "locking in" a rate for 20 or 30 years. That said, if interest rates are low, locking in your rate might be a smart move, especially if you plan to remain in your home for many years.

Adjustable-rate mortgages (ARMs) usually start with lower interest rates than their fixed-rate brethren. If rates remain relatively stable or decrease while you're repaying an ARM, your total cost could be lower than with a fixed-rate mortgage.

However, after a set term, commonly three or five years, ARM rates reset once a year (or in some cases more often). So if rates rise, your monthly payments do, too. Rate hikes typically are capped for any given year and for the life of the loan. Common caps are two percentage points a year and six points over the life of the loan.

A "balloon" mortgage is another way to keep monthly payments smaller. This loan type usually has a lower fixed interest rate than comparable adjustable-rate or traditional fixed-rate loans. However, after a specified period of time — often five or seven years — the borrower must repay the remaining balance of the loan in full. That probably means refinancing at then-current rates, which could be higher.

Jumbo mortgages are larger mortgages. Loans above $417,000 for a single-family home in the continental United States have fallen into the jumbo category in recent years. Despite legislation that has raised these conforming limits, you can still generally expect to pay at least one-half of a percentage point more for loans above this amount.

A word about points

When shopping for a fixed-rate loan, you can usually pay a slightly higher interest rate for a loan with no "points," or a lower rate with one or two points. Points are fees the bank charges when you receive the loan, with one point equal to one percent of your loan amount.

The longer you plan to stay in your home, the more sense it may make to pay the up-front cost of points in exchange for a lower rate. However, if you think you might pay off your mortgage early and thus not be paying interest for the entire loan period, paying points might not be such a good idea.

Income guidelines

Many borrowers got into hot water during the last housing boom because they bought homes they couldn't afford. By sticking to the following rules of thumb, available on Bankrate.com and elsewhere, you'll be less likely to end up with a mortgage you can't afford:

- Your annual mortgage, property tax and homeowner's insurance costs combined should typically not be greater than 28% of your gross (pretax) annual salary.

- Your monthly mortgage, property taxes, utilities, insurance and any assessments and other monthly debt payments combined shouldn't be greater than 36% of your gross (pretax) monthly salary.

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Naturally, individual circumstances may require modifying these guidelines.

Looking for deals

Don't forget to check with local lenders to see if any of them are running special promotions on specific kinds of mortgages that might suit your needs. You can also consult websites such as Lendingtree.com and Bankrate.com to compare rates beyond your local area. Finally, don't forget to talk to your financial advisor. He or she may have suggestions about the right type of loan for your situation and where you can obtain good rates.

Love, marriage and then a *post*nuptial agreement

You've heard of its more famous sister document, the prenuptial agreement, but did you know that you may be able to realize the benefits of that document even if you're already married? A postnuptial agreement can help provide peace of mind regarding what will happen to your assets should your marriage dissolve.

Postnups, which are permitted in many but not all states, usually address issues regarding finances, property and children. Similar to prenups, postnups can include provisions for the division of property and set specific spousal support dollar amounts. If desired, the agreements can be structured to influence behavior, such as through a financial penalty for infidelity. And postnups can be useful when one spouse's financial situation changes drastically — for example, from inheriting a large sum of money.

For a postnup to be legally binding, both you and your spouse must provide "consideration," which means something of value, such as money, assets or even a promise. For a prenup, the marriage vows are the consideration. But because with a postnup the marriage vows have already been exchanged, additional consideration is necessary. This might be a transfer of property or the release of certain property rights.

Courts keep an especially close eye out for any indications of undue influence or fraud in a postnup. To determine the validity of the document, a judge typically will look to see that it provides a full disclosure of the couple's assets, determine if there was any duress in the creation of the document and decide whether it was fair to both parties when signed. It's also important that you and your spouse hire separate attorneys when executing the postnup.