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Why Does Europe Affect Your Portfolio?

When a possible default on Greek sovereign debt becomes headline news, a lot of people find themselves wondering, "How can the problems of a country so small and so far away create such turmoil in the world's financial markets?" What's happening in Europe is probably affecting your portfolio right now, regardless of the quality of your holdings or how well diversified you are.

Bank exposure

One of the chief concerns about the possibility of default on sovereign debt has to do with the financial stability of banks that hold it. For example, some of the largest French banks have already seen their credit ratings downgraded because of their extensive holdings of debt from troubled European countries. If a Greek default made banks reluctant to lend to one another, that could affect credit markets worldwide.

American banks hold very little Greek debt compared to European banks; however, they could face a different challenge. Derivatives known as credit default swaps can create a ripple effect, multiplying a default's impact beyond the bondholders to other financial institutions and institutional investors. U.S. financial institutions are major issuers of credit default swaps, and the potential impact that a Greek default would have is unclear. However, since the 2008 financial crisis, banks have been forced to hold greater capital reserves to deal with contingencies.

Potential for tighter credit creating recession

Lending worldwide hasn't fully recovered from the last financial crisis, and has helped keep global economic recovery sluggish. If banks' lending ability were impaired further by a financial crisis brought on by a default on sovereign debt, pessimists argue that a slowing global economy could be thrown into recession. Europe represents a major market for many U.S. companies, and a recession there would be felt around the globe.

Greece could be the tip of the iceberg

Even though Greece is the immediate concern, Europe's larger economies could pose a bigger threat. Italy and Spain both face debt and deficit problems. Italy's economy is more than five times that of Greece; Spain's is more than four times bigger (CIA World Factbook 2011). If a Greek default would have a ripple effect, default by Spain or Italy could create waves.

To compound the problem, borrowing costs for troubled countries have risen. At recent auctions, nervous investors have demanded higher interest rates to compensate them for their higher perceived risk. As any credit card holder knows, having to pay a higher interest rate makes paying off debt and balancing the budget more difficult.

All politics is local

Recently there have been signs that voters in stronger European countries, such as Germany, may be questioning why they should continue to support others when their own economies are slowing. Also, investors worry that the financial support available from the European Financial Stability Fund (EFSF) may not be sufficient or available quickly enough to avert problems. Though there's no shortage of suggestions for how to deal with the situation--issuance of euro bonds backed by all eurozone members, leveraging the EFSF's existing assets, greater fiscal integration among countries, Greece abandoning the euro--questions about the ability and willingness of other eurozone countries to support weaker members have contributed to investor anxiety.

Financial markets hate uncertainty, and the situation has contributed to the recent volatility across a variety of asset classes. However, eurozone leaders have the benefit of having watched the United States during the 2008 crisis. Also, they have generally reaffirmed their determination to defend the euro.

Uncertainty about Europe could persist for months, so while it's important to monitor the situation, don't let every twist and turn derail a carefully constructed investment game plan. To determine how market events might affect your own portfolio, don't hesitate to ask questions and get expert help.

How Much Do You Know about Social Security?

For more information, visit the Social Security website at www.socialsecurity.gov or call 800-772-1213.

Social Security is in the news more and more, as the first wave of baby boomers retire and economic pressures on the program increase. More than 90% of Americans are covered by Social Security,* but how much do you know about this important program?

How is Social Security funded?

Unlike many government programs, Social Security is funded primarily through the collection of payroll taxes. In 2010, 81.9% of funding came from this source, with the rest derived from interest earned on government bonds held by Social Security trust funds and income taxes paid on benefits.* That's why Social Security is known as a "pay-as-you-go" system. However, someone working and paying Social Security taxes today is not funding his or her own benefits, but is funding the benefits of someone who is receiving them now or in the near future--one of the reasons why Social Security is facing a potential funding shortfall. According to the Social Security Administration (SSA), the number of retired workers will double in less than 30 years, but there will be fewer workers paying into the system. And with life expectancies increasing, benefits will be paid for a longer period.*

How are earnings reported to the SSA?

If you work for an employer, your employer will send a copy of your W-2 form annually to the SSA. If you're self-employed, the IRS will report your earnings to the SSA annually after your federal income tax return has been processed.

What benefits are available?

Although Social Security is known as a retirement program, benefits are paid to people of all ages, including surviving family members and disabled individuals. In 2010, 5.7 million people were awarded Social Security benefits. Of those, 46% were retired workers, 36% were survivors or spouses/children of retired or disabled workers, and 18% were disabled workers.*

How do you qualify for benefits?

As you work and pay payroll taxes, you earn Social Security credits. Generally, you need to work 10 years to earn enough credits to qualify for retirement benefits--other benefits have different requirements. Contact the SSA if you have any questions about your benefit entitlement.

Do most people apply for early retirement benefits?

Yes. According to a report by the Government Accounting Office (GAO), 43% of people take early retirement benefits at age 62, while almost 73% of people apply for benefits before they reach full retirement age.**

How much more will you receive if you delay applying for benefits?

For each year past your full retirement age you delay receiving benefits, your Social Security benefit will increase by a certain percentage (8% for anyone who was born in 1943 or later). For example, if your full retirement age is 66 and you delay receiving benefits until age 70, your annual benefit will be 32% higher.

Can you receive benefits based on an ex-spouse's record?

You may qualify for divorced spousal benefits if you were married for at least 10 years, you haven't remarried, you are age 62 or older, and you don't qualify for a higher benefit based on your own work record.

Do workers with lower earnings receive more from Social Security?

A worker who has lower earnings will receive a lower monthly benefit than someone with higher earnings because benefits are based on average lifetime earnings (the highest 35 years of earnings are used in the calculation). However, the Social Security benefit formula is designed to ensure that workers with lower earnings receive a greater percentage of their preretirement earnings. For example, a worker with relatively low earnings may receive a benefit that is approximately 55% of his or her preretirement earnings, while a worker with relatively high earnings may receive a benefit that is approximately 25% of his or her earnings.***

Do you have to stop working to receive Social Security retirement benefits?

No. As long as you've reached early retirement age and meet eligibility requirements, you can apply for Social Security benefits even if you decide to continue working. However, if you're younger than full retirement age and earn more than a certain amount, your benefits will be temporarily reduced (once you reach full retirement age, your benefits will be increased to account for the money that was withheld).

***Source:** *Fast Facts & Figures About Social Security, 2011*

****Source:** *GAO-11-400, Retirement Income, June 2011, based on data compiled by the SSA Office of the Chief Actuary*

*****Source:** *SSA Publication No. 05-10045, 2011*

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Factoring Health-Care Costs into Retirement Planning

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.

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.

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Ask the Experts

Does the federal financial aid formula count all parental assets?

The federal methodology for financial aid examines your family's income, assets, and household information to calculate your expected family contribution, or EFC. Your EFC represents the amount of money the government deems you can afford to put toward college costs each year before any financial aid is forthcoming.

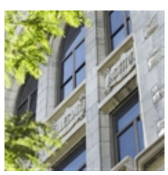
The federal methodology counts some parental assets and excludes others in arriving at your EFC (these assets are referred to as assessable and non-assessable assets). The more assessable assets your family has, the higher your EFC. The following assets are excluded from the federal methodology:

- Retirement accounts (e.g., 401(k)s, all IRAs)
- Annuities
- Cash value life insurance
- Home equity in primary residence
- Personal items (e.g., cars, furniture)
- A family farm

Keep in mind that your assets for financial aid purposes are those you own at the time you sign the FAFSA.

Assessable assets are all other assets of the parent. These include items such as checking and savings accounts, money market accounts, certificates of deposit, stocks, bonds, mutual funds, U.S. savings bonds, certain 529 plans, trusts, limited partnerships, vacation homes, investment properties, and business assets.

When a family's total assessable assets are counted, the federal methodology grants parents an asset protection allowance that lets them exclude a certain portion of their assets from the final tally. The amount of the allowance varies, depending on the age of the older parent at the time the student applies for aid--the older the parent, the greater the allowance. For example, for the 2011/2012 school year, the asset protection allowance for a two-parent family where the older parent is 48 years old is $46,200; the figure jumps to $54,300 if the older parent is 54 years old.



How are 529 plans treated for federal financial aid purposes?

There are three instances when 529 plans--which include both college savings plans and prepaid tuition plans--need to be listed as an asset on the federal government's financial aid application, the FAFSA: (1) the account owner of the 529 plan is the parent; (2) the account owner of the 529 plan is the student, and the student files the FAFSA as a dependent student; or (3) the 529 plan is a custodial 529 account (UTMA/UGMA custodial funds have been used to establish and/or fund the 529 plan), and the student files the FAFSA as a dependent student. In each of these cases, the 529 plan must be listed as a parental asset on the FAFSA.

What does this mean? Under the federal methodology for financial aid, a parent's assets are assessed (counted) at a rate of 5.6%. This means that every year, the government deems 5.6% of a parent's assets available to contribute to college costs. (Student assets are assessed at a rate of 20%.)

When does a 529 plan not need to be listed on the FAFSA? Even if the account owner falls into one of the three categories above, if the account owner has an adjusted gross income below $50,000 (and a few other requirements are met), the 529 plan doesn't need to be listed. Also, if a grandparent, other relative, or friend is the account owner of the 529 plan, it doesn't need to be listed on the FAFSA.

A corollary to the rule that a parent-owned 529 plan must be listed as an asset on the FAFSA is that if a parent is the account owner of multiple 529 plans (which may be the case if a parent opens separate 529 accounts for each child in the family), then the parent must list the value of *all* 529 plans, even if only one beneficiary is currently applying for aid. Colleges, however, generally apply a more logical rule when deciding whether to count 529 plans for purposes of distributing their own institutional aid. Specifically, families must list the value of all 529 plans that name the student as beneficiary, so a plan owned by a grandparent with the student as beneficiary would have to be reported, while a plan owned by a parent with the student's younger sibling as beneficiary would not.