

The PHYSICIAN'S *Personal* ADVISORY®

EXCLUSIVE ADVICE ON FINANCIAL, INVESTMENT AND OTHER ASPECTS OF THE SUCCESSFUL PHYSICIAN'S PERSONAL LIFE

Investing

👉 In a tax-deferred account, how much is too much?

Recent changes to tax laws could effect your saving strategies

The 2003 Tax Act, which benefits individual equities and some mutual funds, is prompting advisors to reevaluate the use of tax-deferred accounts such as pension plans, individual retirement arrangements, and 401Ks. The new law knocked the tax rate for capital gains from 20% down to 15%, and sliced the rate for most dividends from 33% to 15%.

The dividends you're stockpiling in a retirement account are tax-free for now, but at retirement, the government will tax your distributions as ordinary income. For a physician, that's a rate of 33%–35%, says advisor Mitchell Kraus.¹

"What was a no-brainer for a lot of situations is now something that one needs to look at more closely," says

Kraus. Your investment timeframe should play a big role in deciding how much to invest in tax-deferred accounts, he adds.

A doctor investing late in life—after completing residency and paying back loans—will have less time to build compound interest to counteract the taxes incurred at retirement. "The real difference in the numbers with the new laws is that the amount of time needed to make a tax-deferring investment a better purchase has increased," says Kraus.

If you're looking to invest later in life, consider bonds for an income boost. You'll lose the immediate tax advantage, but you'll sidestep the 33% slam at retirement, says Kraus. "Depending on your portfolio, municipal bonds in particular might be a good option because most of that income won't be taxable," he says. "Physicians could save some money on taxes and, in the short-run, avoid some risk."

Prevention is the best cure

Diversification will also guard your portfolio against tax burdens. Invest in tax-managed mutual funds, and use caution when taking capital gains on certain stocks, adds Kraus.

Putting your fixed-income assets in a tax shelter is also a savvy way to reduce taxes, says Louis Kokernak, CFP,[®] CFA.² "Fixed income assets are generating interest that's taxable at ordinary income levels

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Our Purpose

To provide doctors with sound, independent, physician-specific advice to better oversee their personal finances and their lives outside of medicine.

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² Contact Louis Kokernak, CFP,[®] CFA, at Haven Financial Advisors in Austin, TX; phone 512/514-6250; e-mail at louis@havenfinancial.com.

Tax-deferred account from p. 1.

of 35% plus, which is not very good," he says. "If a doctor comes to me with a million dollars in investment assets, and of that he has a 401K or profit-sharing plan worth \$350,000, he would want all of his bonds and real estate in the tax shelter, and maybe that's 35% of his investments. Keep your stocks out of the tax shelter, that's a good tax minimization strategy."

Change is nothing new

Although you should think about how the Tax Act affects your investments right now, it's a safe bet the laws will change again, says Alan Schapire, CFP®, CPA, PFS.³

"Taking into account doctors' compensation levels, the type of retirement plan they have, and if they're self-employed or working for a hospital, they may want to put enough into a plan annually to strike a good balance between their current tax situation and the impact of future unknown tax issues."

Schapire suggests that his clients tread carefully when accounting for the tax changes. "I'm sort of hedging the bet, if you will, saying, 'Okay let's put 15% into a retirement account and then balance

that out in a taxable account, but invest in a tax-efficient manner,'" he says. "Right now, tax-efficient means generating either tax-preferred dividends, capital gains, or other income that's not subject to tax."

The big picture counts

Take a look at your entire situation and reconsider the investments that you now have in retirement accounts v. nonretirement accounts, says Schapire.

"Anything that generates taxable interest income, because it's not ever taxed at the preferential rate, you'd want in a retirement account," says Kokernak. "It's ordinary income, whether you receive it today, or when it comes out in a retirement account." Remember, the more money you have locked in retirement accounts, the less you'll be able to spend prior to retirement, says Schapire.

Depending on your spending habits, that could be a good or bad thing. Retirement accounts can provide asset protection in the face of legal judgment, and given today's malpractice issues, that can be an excellent benefit, says Schapire. ■

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Investing**👉 Markets gain momentum from election excitement****The spirit of competition gives strength to stocks, one expert says**

Presidential election years reverberate through the stock market with increased returns, says T. Jon Williams, PhD, CFA,¹ director of MyCFO investor services.

The average returns from the past 19 election years are "substantially higher" (13.8%) than the overall average long-term returns (11%), according to Williams' research. However, the year following an election shows returns below the long-term average, he says.*

A possible explanation for the election-market link is that the spirit of competition and optimism that abound during election years lend strength to Wall Street, suggests Williams.

"I think I'm seeing something in the data that is a reflection of events like the Iowa caucuses. That competition at its purest form makes this country great," he says. "The markets like that kind of

unleashing of freedom that allows the best ideas to win."

Although many events have similar effects on the market, Williams says that few of them are as regularly occurring as presidential elections. That regularity not only creates expectations for investors, but gives analysts a benchmark by which to measure returns and track patterns.

However, take this analysis with a grain of salt, says Williams. There's an interesting trend here, but not much more.

"I wasn't reaching for a deep statistical analysis here—and I don't think one would succeed. That said, this occurrence shouldn't be ignored," says Williams. "Should you use it as your barometer of whether to invest in stocks or not? Of course not." ■

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* Williams uses monthly data for returns. He defines an election year as October 31–October 31. The year following the election is measured from November 1–November 1.