Nicholson Financial Services

Did You Know...?

Spring 2008

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With the arrival of spring we have experienced warmer weather...and an improving investment climate as well. The stock market, which was down 9.92% in the first quarter, rebounded in April and recovered about half of that loss. About half way through May, the markets are up again, albeit modestly. We have seen the daily volatility in the markets decrease and I believe that is a sign that investor fears are calming. In my opinion, the markets have discounted the risk of a recession and are looking forward to better economic growth in the second half of the year. However, if the volatility continues, just remember the advice given to those who get seasick while sailing. If you focus on the choppy sea, you will get seasick. If you focus on the horizon, you will feel a whole lot better.

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In this issue:

It's Not What You Earn--It's What You Keep

You work hard for your money. So why shouldn't you try to keep as much of it for yourself as you can? Here are some ways to pay less tax and keep more of your hard-earned dollars.

Tax deferrals rule

Take advantage of tax-deferred retirement plans, such as 401(k), 403(b), and 457(b) plans, offered by your employer. They all allow you to make pretax contributions of up to $15,500 in 2008 ($20,500 if you're age 50 or older), and 403(b) and 457(b) plans may also have special catch-up rules that might let you defer even more. The tax savings can be significant. For example, if your marginal tax rate is 28% and you defer $15,500, you'll save $4,340 in current taxes. Your $15,500 contribution will generate tax-deferred earnings for you until you withdraw the funds from the plan, when you may be in a lower tax bracket. And, if your employer matches your contributions, the deal is even sweeter.

Another common way to use tax deferrals to save more of what you earn is by setting up a health-care flexible spending account (FSA) at work. Your contributions reduce your taxable income, saving current taxes, and the funds you set aside can be withdrawn tax free to pay a wide variety of health-related expenses that aren't covered by your health plan. See IRS Publication 502, *Medical and Dental Expenses*, for a list of qualifying expenses.

And don't forget traditional IRAs. If neither you nor your spouse is covered by a retirement plan at work, and you're not yet 70½, you can make a deductible contribution of up to $5,000 to an IRA in 2008 ($6,000 if you're age 50 or older). Even if you or your spouse is covered by a plan, all or part of your contribution may be deductible, depending on your income.

But tax free is even better

If you're an income-oriented investor, consider investing in municipal bonds. The income generated is free from federal income taxes and, in some cases, state income taxes as well. (Be sure to compare yields between taxable and tax-free securities, and keep in mind that certain municipal bond income may be subject to the alternative minimum tax.)

Another way you can generate tax-free income is by contributing to a Roth IRA, Roth 401(k), or Roth 403(b) plan. Unlike pretax deferrals, Roth contributions don't reduce your income, so there's no current tax savings. Because you've already paid tax on your contributions, they won't be taxed again when you withdraw them from the plan. But what really sets Roth contributions apart, and makes them so appealing, is that all earnings are also tax free if you satisfy a five-year holding period and certain other requirements are met.

If you have children, don't pass up the tax incentives offered by Section 529 plans and Coverdell education savings accounts (ESAs). Again, your contributions to these plans aren't tax deductible, but your savings grow tax deferred and withdrawals are tax free at the federal level (and typically at the state level too) when used to pay qualifying educational expenses. You can contribute up to $2,000 to a child's Coverdell ESA in 2008, and most 529 plans let you contribute more than $300,000 over the life of the plan.

Think long term--for capital gains

Long-term capital gains tax rates are currently very attractive--a maximum of 15% through 2010. Short-term capital gains, on the other hand, are generally taxed at ordinary income tax rates--currently as high as 35%. To qualify for long-term capital gains treatment, make sure you hold your securities and other capital assets for more than one year before selling them.

Coping with a Slower Economy

Economics isn't called the "dismal science" for nothing. There's an old joke that accuses economists of having predicted 9 of the last 5 recessions (and yes, those figures are in the correct order). However, forecasting the direction of the economy can seem easy compared with trying to figure out how to weatherproof your finances. It can help to understand some of the questions that many investors ask themselves if they're concerned about the potential impact of slower growth.

Is it time to check my portfolio?

Changing consumption patterns can have implications for a variety of companies and industries, and create investing opportunities. Some investing sectors might be especially economically sensitive and might therefore suffer from any economic downturn. On the other hand, some industries or companies may actually benefit from a slower economy. For example, companies that produce high-end goods might be relatively immune from economic pressures--or maybe not. Shifts in spending patterns could also mean that consumers continue to spend money but choose less expensive alternatives, or focus more on getting the greatest value from each dollar.

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If you rely on your investments for income, you may want to review how sensitive your portfolio might be to changes in interest rates. If the Federal Reserve Board sees greater danger from a slowing economy than from the possibility of higher inflation, lower interest rates could cut into your income. Conversely, if the Fed becomes increasingly concerned about inflation, rates could go up. It might be a good time to see whether the yields you're receiving are competitive, and what kind of impact on your monthly income you might expect from any changes in rates.

Should I review my asset allocation?

Now might also be a good time to reexamine how your assets are divided among various types of investments. If you decide you need to shift a portion of your portfolio, those changes don't necessarily have to be made all at once. Consider:

- Adjusting only a portion of your bond or stock holdings
- Using systematic investing to shift allocations over time
- Investing any new money differently to increase your exposure to asset classes you may have neglected

How close am I to the edge financially?

The benefits of reducing debt should be pretty obvious, given the recent credit crisis. Troubles in the mortgage industry have driven home the importance of managing debt wisely. The last thing you need if you're worried about uncertain economic times is to lock yourself into spending patterns that push you beyond your means.

Whether the economy is in robust health or seems to be catching the flu, it's never a bad idea to have a cushion against unexpected financial stress. An unanticipated medical emergency--and is there any other kind?--a sudden job loss, or anything else that affects your income stream can bring the effects of a slower economy home in a dramatic way.

If you're employed in a highly cyclical industry or one that's undergoing substantial changes, having a financial reserve becomes even more important. And if a lot of your retirement plan savings are invested in your employer's stock, think about whether your long-term finances might potentially face a double whammy. Serious financial trouble at your company could mean the possibility of layoffs, a drop in the value of your holdings--or both.

Have I planned for the unexpected?

If you're planning to retire in the next few years, consider the potential impact if you were to be "retired" prematurely. It's easy to assume you'll work until a certain date or earn income after retirement, but health concerns and the job market don't always permit that. Doing some "what if?" calculations with an earlier retirement date than you might otherwise choose could prepare you for what might happen if you were laid off and had difficulty finding new employment, or were unable to work for health reasons.

A transition to a post-retirement career is likely to be easier if you plan thoroughly. For example, launching a small business can be challenging under the best of circumstances; try to have as much of the groundwork laid as possible before relying on it for your entire income. Sales estimates that are more conservative than they might otherwise be may help minimize cash flow problems.

Asking questions such as these lets you hope for the best while preparing for the worst.

Tips for Selling Your Home in an Uncertain Market

Will the combination of lower mortgage interest rates, higher inventory, and falling prices send buyers to open houses in droves this summer? No one knows for sure, but here are some ways you can increase the odds that your home will be sold at the best possible price before the leaves fall.

Price your home to sell, not sit

Pricing your home correctly is extremely important. Although it's tempting to "test the market" by setting a high asking price, this may turn off prospective buyers, or result in lowball offers, and your home may continue to sit on the market. A better alternative? Ask a real estate agent to do a comparative market analysis to help determine a realistic asking price, taking into consideration how much similar properties have recently sold for, and the average number of days homes have been on the market. It's especially hard to pinpoint the right asking price in areas where sales are slow and prices are falling, so remain ready to adjust your asking price later if necessary.

Sellers are often afraid of shortchanging themselves by setting their asking price too low, but a lower asking price may actually generate more interest, potentially leading to a much higher sale price if buyers submit competing offers. Even if no bidding war is triggered, you may end up selling your home quickly, an advantage if you've already found another home to purchase.

Advertise, advertise, advertise

Whether you're selling your home yourself or using a real estate agent, advertising is key, especially when there are many homes on the market. Make sure that any sales materials you or your agent prepare emphasize the features that might convince someone to choose your home over another. Target the right audience, too. For example, if your home is right for a growing family, why not highlight the flexible floor plan, the child-friendly neighborhood, and the large yard?

Buyers today expect to begin their search for a new home without ever leaving home, and online advertising has become an indispensable tool for marketing real estate. According to the National Association of Realtors®, 74% of people who used the Internet to search for a new home eventually drove by or viewed a home that they saw online, so make sure that your home is prominently featured on a real estate website. And remember, a picture is worth a thousand words. Buyers will look more closely at homes with numerous high-quality photos, and may bypass homes with none. For maximum exposure, consider adding a virtual tour that shows off your home's best features, even if it costs a little bit more to do so.

Sweeten the deal

To really make your home stand apart from the competition, consider offering incentives such as cash back at closing, payment of homeowners association dues, a home warranty, or even a gift card to a local furniture store. Incentives may help increase the number of home showings and encourage potential buyers to choose your home over another.

Enhance your home's appeal

How many times have you seen a home for sale that has obvious shortcomings--overgrown shrubs, peeling paint, or a jarring color scheme, for example? That's a home that may languish on the market while other similar homes sell quickly, because the owners are unaware that the appearance or condition of their home is the reason it isn't selling. Take a close and impartial look at your home, or better yet, ask your real estate agent to do so. Potential buyers may be noticing something that you're not. Often, completing simple tasks such as painting, cleaning, and getting rid of clutter can make your home more appealing to buyers. If your home needs updating, prioritize areas that are the most important and visible, such as the front of your home, the kitchen, and the bathrooms.

Don't curb your enthusiasm

One hazard of having a home on the market for a while is that your enthusiasm may wane over time. Buyer interest often peaks quickly (within the first few weeks after your home is listed), and it's easy to get discouraged if you don't receive any acceptable offers. But if you really want to sell your home, it's up to you to keep the momentum going. Schedule another open house, keep your home in good repair, and look for new ways to advertise. If your home hasn't sold within a reasonable time, you may have to reevaluate your asking price or even your decision to sell, but before you throw in the towel, make sure that you've done all that you can to attract qualified buyers.

Is it a beautiful day in your neighborhood?

An often-used phrase in the real estate industry is that "real estate is local." Though the news may be full of stories about nationwide housing trends, what's really important is what's going on in your area. A real estate agent can help you identify local housing patterns, such as which homes are selling (and for what price), so that you can maximize your chances of success.

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Ask the Experts

What can we learn from the subprime mortgage mess?

The collapse of the subprime mortgage market and the jitters it's sending through the entire economy contain lessons for us all. Here are a few:

If it sounds too good to be true, it probably is. Based in part on wishful thinking ("housing values will always appreciate") and in part on misleading information ("that's a great rate"), many homebuyers became convinced they could afford mortgages they later found they really couldn't. Similarly, many investors were led to believe that mortgage-backed securities were all about huge rewards with minimal risk. So, the lesson here is: When faced with what appears to be a rosy best-case scenario, always remember to ask "But what if …?"

Experience counts. When seeking a mortgage broker, loan originator, investment firm and/or fund manager, check out their credentials, and look for those with lengthy experience who are respected within their fields.

Read (and understand) the fine print. Many people, both homebuyers and investors, got burned in the subprime mortgage mess because they didn't know the details of the contracts they entered--and the devil is always in the details. Review all mortgage documents and/or investment prospectuses carefully before you make a commitment. If you don't understand the ramifications of what you've read, seek assistance from an unbiased qualified professional.

The best regulation is self-regulation. Federal regulations designed to protect the consumer cover many loans resold to quasi-government agencies like Freddie Mac, and loans insured by the Federal Housing Administration also carry strict guidelines. But oversight of these loans is not always as diligent as it should be. What's more, many mortgages are now originated by unregulated nonbank lenders. As a result, you shouldn't assume that governmental and/or institutional regulations will always protect you from getting into financial trouble. Only you can do that.

When's the best time to refinance my mortgage?

Any time you can refinance your mortgage to save money is a good time to contemplate doing so. Generally, there are two situations when it may be wise to consider this.

If you have an adjustable rate mortgage (ARM) and the rate is about to go up (either because your existing loan is scheduled to reset or because the economy enters a period of rising interest rates), you may save money if you can refinance to a fixed rate mortgage--particularly if the fixed rate is similar to or lower than your current ARM rate.

The other time it's a good idea to refinance (even if you already have a fixed rate loan) is when you'll save money by getting a lower interest rate. An old rule of thumb said that you shouldn't refinance unless the new interest rate will be at least 2% lower than your existing rate, but (depending on the refinancing cost) even a much smaller differential may be worthwhile to some homeowners.

Your refinancing cost is the total of any points, closing costs, and private mortgage insurance premiums (if any) that you'll have to pay when you take out the new loan. Ultimately, it may make sense to refinance if you'll recoup the cost of doing so while you still own the home.

To determine the time it'll take to recoup your refinancing cost, divide that figure by the monthly mortgage payment savings you'll realize by refinancing. The result indicates how many months you'll need to stay in the home to recoup your cost. If you don't remain in your home long enough to recover that cost, then refinancing may not be worthwhile.

One final note: If you're experiencing cash flow difficulties, you may be tempted to lower your monthly mortgage payments by refinancing to extend the term of the loan. From a savings perspective, this is not a good reason to refinance. Unless you get a lower interest rate on the new loan as part of the bargain, you're not really saving any money; in fact, you may end up owing more. Extending the term without changing anything else may alleviate your short-term cash flow problem, but it'll cost you more total interest in the long run.