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Seasons Greetings!
Best wishes to everyone for a Holly Jolly Holiday Season and a Healthy and Prosperous 2013!

The election is passed, now we are into the process of clearing up the uncertainty regarding the tax code. The "fiscal cliff" dominates news stories with lots of speculation. Congress will act at some point in December and we should have better clarity about these issues. Your questions and comments are always welcomed even in these uncertain times.

With the start 2013, give some thought to your financial habits that need to be tuned up. The New Year is a fresh start for all of us to make improvements in our personal, professional and financial lives! Make it a good one!

Best wishes to all.

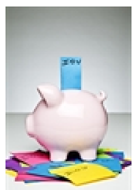
December 2012

GARRETT PLANNING NETWORK

The Economics of Borrowing from Your 401(k)

When times are tough, that pool of dollars sitting in your 401(k) plan account may start to look attractive. But before you decide to take a plan loan, be sure you understand the financial impact. It's not as simple as you think.

The basics of borrowing



A 401(k) plan will usually let you borrow as much as 50% of your vested account balance, up to $50,000. (Plans aren't required to let you borrow, and may impose various restrictions, so check with your plan administrator.) You pay the loan back, with interest, from your paycheck. Most plan loans carry a favorable interest rate, usually prime plus one or two percentage points. Generally, you have up to five years to repay your loan, longer if you use the loan to purchase your principal residence. Many plans let you apply for a loan online, making the process quick and easy.

You pay the interest to yourself, but...

When you make payments of principal and interest on the loan, the plan generally deposits those payments back into your individual plan account (in accordance with your latest investment direction). This means that you're not only receiving back your loan principal, but you're also paying the loan interest to yourself instead of to a financial institution. However, the benefits of paying interest to yourself are somewhat illusory. Here's why.

To pay interest on a plan loan, you first need to earn money and pay income tax on those earnings. With what's left over after taxes, you pay the interest on your loan. That interest is treated as taxable earnings in your 401(k) plan account. When you later withdraw those dollars from the plan (at retirement, for example), they're taxed again because plan distributions are treated as taxable income. In effect, you're paying income tax twice on the funds you use to pay interest on the loan. (If you're borrowing from a Roth 401(k) account, the interest won't be taxed when paid out if your distribution is "qualified"--i.e., it's been at least 5 years since you made your first Roth contribution to the plan, and you're 59½ or disabled.)

...consider the opportunity cost

When you take a loan from your 401(k) plan, the funds you borrow are removed from your plan account until you repay the loan. While removed from your account, the funds aren't continuing to grow tax deferred within the plan. So the economics of a plan loan depend in part on how much those borrowed funds would have earned if they were still inside the plan, compared to the amount of interest you're paying yourself. This is known as the opportunity cost of a plan loan, because by borrowing you may miss out on the opportunity for additional tax-deferred investment earnings.

Other factors

There are other factors to think about before borrowing from your 401(k) plan. If you take a loan, will you be able to afford to pay it back and continue to contribute to the plan at the same time? If not, borrowing may be a very bad idea in the long run, especially if you'll wind up losing your employer's matching contribution.

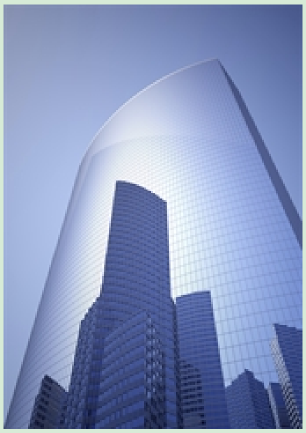
Also, if you leave your job, most plans provide that your loan becomes immediately payable. If you don't have the funds to pay it off, the outstanding balance will be taxed as if you received a distribution from the plan, and if you're not yet 55 years old, a 10% early payment penalty may also apply to the taxable portion of that "deemed distribution."

Still, plan loans may make sense in certain cases (for example, to pay off high-interest credit card debt or to purchase a home). But make sure you compare the cost of borrowing from your plan with other financing options, including loans from banks, credit unions, friends, and family. To do an adequate comparison, you should consider:

- Interest rates applicable to each alternative
- Whether the interest will be tax deductible (for example, interest paid on home equity loans is usually deductible, but interest on plan loans usually isn't)
- The amount of investment earnings you may miss out on by removing funds from your 401(k) plan

Real Estate Investment Trusts (REITs)

Before investing in a REIT, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the issuer. Read the prospectus carefully before investing.



Though shares of a REIT may be easier to liquidate than an actual real estate property, you shouldn't purchase a REIT that is not traded on an exchange or that is a private placement if you're counting on a quick sale. The market for resale of a private placement or REIT that is publicly registered but non-exchange traded is often extremely limited. Also, there may be limits on your ability to redeem your shares, and the high fees typically associated with purchasing such REITs can erode total return, particularly in the case of early redemption or sale. Make sure you're able to handle the risks of investing in something that you could be unable to sell for many years.

Many investors whose incomes are suffering from low interest rates have begun to seek investment alternatives to help supplement those incomes. One possibility often suggested is a real estate investment trust (REIT). REITs are a way to invest in commercial real estate without the responsibility of managing a property yourself, and with a much smaller investment than might otherwise be needed. However, REITs aren't suitable for every investor, and there are many factors to consider carefully before you buy.

Types of REITs

REITs can be classified based on their holdings. Equity REITs typically buy, sell, renovate, manage, and maintain real estate properties, and their return comes primarily from tenants' rents. Equity REITs may specialize in a specific type of property, such as warehouses, office or apartment buildings, health-care facilities, or shopping centers, or diversify across a variety of holdings. Mortgage REITs, which are less common than equity REITs, invest in mortgages and mortgage-backed securities or lend money to real estate owners or developers. Their income is derived largely from interest on those loans or securities plus any change in the value of those securities. Hybrid REITs employ both strategies.

REITs can be publicly traded on an exchange like stocks, or publicly registered but not publicly traded. They also can be private placements, which are not subject to the same disclosure or SEC registration requirements as either exchange-traded or nontraded REITs, and are only available to high-net-worth individuals. However, remember that even registration with the Securities and Exchange Commission doesn't necessarily mean that a REIT will be a good investment or appropriate for you.

Why invest in a REIT?

Diversification: Because the performance of REITs may not be highly correlated with the performance of stocks or bonds, they may offer another way to broaden your investment portfolio. Though diversification alone can't guarantee a profit or protect against the possibility of loss, it can potentially help you manage your portfolio's overall level of risk.

Income: As long as it pays out at least 90% of its net income, a REIT can deduct dividends paid to shareholders from its corporate taxable income. That lack of a tax burden can increase the amount available to distribute to shareholders, potentially making a REIT a source of ongoing income.

Potential tax advantages: The legal structure of some REITs allows them to use depreciation and deductions to offset or eliminate current tax liability on their cash distributions, essentially creating a tax-deferred income stream for shareholders. The tax code treats those distributions as a return of capital rather than corporate dividends, and they are used to adjust the shareholder's cost basis when the shares are sold.

Potential for keeping pace with inflation: Though current inflation is low, some experts worry that the Federal Reserve's efforts to stimulate the economy could eventually change that. Because landlords may be able to raise rents to keep pace with rising costs, real estate has traditionally been considered to be more inflation-resistant than bonds.

Factors to be aware of

Potential liquidity issues: In the past, individual rather than institutional investors have been the primary market for some types of REITs. Because institutions represent such a large percentage of the investing universe, that could potentially affect your ability to sell your shares at the price you expect. And be aware that non-exchange-traded and private-placement REITs are often extremely illiquid (see sidebar).

Valuations: Investors who have sought out REIT dividends as an alternative to the low interest being paid by U.S. Treasury bonds have helped drive up prices on many REITs in recent months, potentially increasing the danger that you could pay too much for shares. Before investing in a REIT, make sure you've carefully assessed its potential for further price appreciation along with other factors such as the stability of the rents on which a REIT's dividends are based. You also should compare the share price to the actual market value of the underlying properties minus any outstanding debt, though this can be extremely difficult in the case of a nontraded REIT or private placement. Remember that REIT securities' value can be affected by declines in rental income, changes in interest rates, property management, environmental issues, uninsured damage, competitive factors, or changes in real estate laws.

Potential tax complexity: Even though some REITs may provide a current tax benefit, they may require more attention at tax time. You'll also need to consider the type of account in which you plan to hold a REIT. The potential tax benefits mentioned above for certain REITs can be negated if they're held in a tax-advantaged retirement account.

Healthy Personal Finance Resolutions for the New Year

The start of a new year may also be a good time to meet with a financial professional. A financial professional can help you:

- ***Determine your income, assets, and liabilities***
- ***Identify financial goals***
- ***Understand specific products/services***
- ***Monitor your overall financial plan***
- ***Adjust your plan if needed***

The new year is the time when many individuals start making resolutions to live a healthier lifestyle. And while resolving to eat better and exercise more is a good thing, you should be sure to make resolutions that pertain to the overall health of your personal finances as well.

Develop a budget and stick with it

A good way to start the year on the right track financially is to make sure that you have a budgeting system in place. Start by identifying your income and expenses. Next, add them up and compare the two totals to make sure you are spending less than you earn. If you find that your expenses outweigh your income, you'll need to make some adjustments to your budget plan (e.g., reduce discretionary spending).

Once you have a budget, it's important to stick with it. And while straying from your budget from time to time is to be expected, there are some ways to help make working within your budget a bit easier:

- Make budgeting a part of your daily routine
- Be sure to build occasional rewards into your budget
- Evaluate your budget regularly and make changes if necessary
- Use budgeting software/smart phone applications

Set financial goals or reprioritize current ones

The new year is also a good time to set new financial goals and reprioritize your current ones. Take a look back at the financial goals you set for yourself last year--both short- and long-term. Perhaps you wanted to increase your cash reserve or save money for a down payment on a home. Maybe you wanted to invest more money towards your retirement. Did you accomplish any of your goals? If so, do you have any new goals that you would now like to achieve?

Finally, have your personal or financial circumstances changed during the past year (e.g., marriage, a child, job promotion)? If so, would any of these changes warrant a reprioritization of some of your goals?

Make sure your investment portfolio is still on target

You'll also want to be sure to review your investment portfolio to ensure that it is still on target to help you achieve your financial goals for the upcoming year. To determine whether your investments are suitable for reaching your financial goals, you'll want to ask yourself the following questions:

- Do I still have the same time horizon for investing as I did last year?
- Has my tolerance for risk changed?
- Do I have an increased need for liquidity?
- Does any investment now represent too large (or too small) a part of my portfolio?

Make it a priority to reduce debt

Any healthy financial plan is one that makes reducing debt a priority. Whether it is debt from student loans, a mortgage, or credit cards, it is important to have a plan in place to pay down your debt load as quickly as possible. The following are some tips to help you manage your debt:

- Keep track of all of your credit card balances and be aware of interest rates and hidden fees
- Develop a plan to manage your payments so that you avoid late fees
- Optimize your repayments by paying off high-interest debt first or consider taking advantage of debt consolidation/refinancing programs
- Avoid charging more than you can pay off at the end of each billing cycle

Review/take steps to improve your credit history

Having good credit is an important part of any sound financial plan, and the new year is as good a time as any to check on your credit history. Your credit report contains information about your past and present credit transactions and is used by potential lenders to evaluate your creditworthiness. A positive credit history is important since it allows you to obtain credit when you need it and at a lower interest rate. Good credit is even sometimes viewed by employers as a prerequisite for employment.

Review your credit report and check it for any inaccuracies. You'll also want to find out whether or not you need to take steps to improve your credit history. To establish a good track record with creditors, make sure that you always make your monthly bill payments on time. In addition, you should try to avoid having too many credit inquiries on your report (these are made every time you apply for a new credit card). You're entitled to a free copy of your credit report once a year from each of the three major credit reporting agencies. You can go to www.annualcreditreport.com for more information.

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Should I be worried about recent municipal bankruptcies?

Municipal bonds have received a lot of attention recently, in part because their tax advantages could become more valuable in 2013. However, they also have come under scrutiny because of some widely publicized bankruptcy filings by local governments.

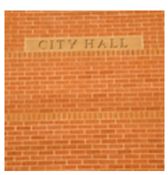
Economic problems, lower investment returns, and cuts in federal aid have led to an increase in the number of local governments filing under Chapter 9 of the U.S. bankruptcy code. They included the single largest U.S. municipal bankruptcy on record (Stockton, California, one of three municipalities in the state to file for bankruptcy in a single month).

Despite the increased pace of filings, muni bankruptcies are still extremely rare. From June 2011 to June 2012, only 17 municipalities or local government entities filed for bankruptcy in federal courts. Compare that to the 9,285 Chapter 11 filings by businesses during the same time.*

One way to check on your muni holdings is to use information available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA®) database, available at http://emma.msrb.org . You'll need to know the bond's CUSIP number; this nine-digit identifier can be found on a trade confirmation or brokerage statement. The information available generally includes the revenue sources pledged to repay a bond and whether any bond insurance, letter of credit, or other guarantees have been provided for its repayment.

The database doesn't include all municipal offerings, and though it's updated yearly, information can become outdated. The bond's current credit rating from one of the three major ratings agencies can suggest its most recent status. However, remember that a high credit rating doesn't reflect or guarantee a bond's market value or liquidity.

*According to the Administrative Office of the U.S. Courts.



Are municipal bonds still a good investment?

That may depend on your situation. Bond prices generally have benefitted greatly over the last few years from low interest rates, and munis have been no exception. Also, income from munis is generally exempt from federal income taxes; that has enhanced their after-tax return relative to corporate bonds or U.S. Treasuries, especially since Treasury yields are at historically low levels.

Some munis, known as private activity bonds, may be subject to the alternative minimum tax. However, if there is no further legislative action to avert impending tax increases scheduled for 2013, the tax advantages of munis are likely to become even more valuable. If investors in higher tax brackets adjust their portfolios to try to minimize next year's tax bite, increased demand for munis might have a positive effect on prices. (There are no guarantees that will happen, of course, especially given the uncertainty over whether there will be a political bargain to avert the so-called "fiscal cliff.")

Because many local governments are struggling to balance their books, bankruptcy filings by local governments have increased in the last year. However, they are still extremely rare. According to statistics from the Administrative Office of the U.S. Courts, from June 2011 to June 2012 there were only 17 muni bankruptcy filings compared to 9,285 Chapter 11 filings for businesses, though some analysts have expressed concern that the number could pick up if economic hard times, cuts in federal aid, underfunded pension obligations, and challenges in global credit markets continue to take a toll. So far, dire predictions of disaster in the muni market haven't come to pass, but the situation is worth keeping an eye on.

Also, remember that current low interest rates won't last forever. Because bond prices move in the opposite direction from interest rates, when rates do begin to go up, the increase likely will affect the value of all of your bond holdings, including municipals.

Though transparency in muni markets has increased in recent years, bonds can be more challenging to research on your own than stocks. If you're unsure about whether munis are a good investment for you, or whether you should rethink their role in your portfolio, don't hesitate to get expert help.