PARTNERS
WEALTH MANAGEMENT
First Quarter 2013
(630) 778-8088/info@partnerswealth.com

Top Income-Earners Drive U.S. Economic Growth

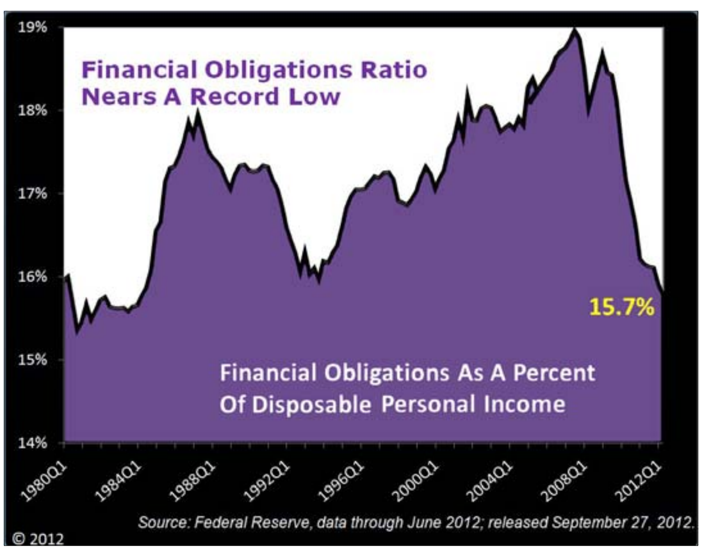
Have you been surprised by the slow but steady growth in the U.S. economy over the last three years and the accompanying doubling in U.S. stock prices in major indexes of the broad stock market? The explanation for these two very positive economic developments may lie in the distribution of income and spending in America, specifically in their skew toward wealthier individuals. To be clear, it's not the top 1% of wealthiest Americans driving the recovery but the top two income quintiles, the middle class — the top 40%.

The top two income quintiles account for 61% of total spending in the U.S. economy, according to statistics released in September 2012 by the U.S. Bureau of Economic Analysis. The bottom two quintiles account for just 22% of total spending.

The top 40% of income earners in the U.S are in good enough financial condition to spend at a level sufficient to fuel slow growth, and recent economic reports indicate that this is likely to continue. Consider the following:

Auto Sales are recovering from the dismal period in 2008 and 2009. Because car sales collapsed during the recession, rising demand for new cars is likely to continue. "Cars have a limited useful life," says Fritz Meyer, an independent economist, "and the age of the fleet should propel new sales in the months ahead."

Housing Starts have rebounded strongly since the recession. The U.S. population increases by about three million a year, according to the U.S. Census Bureau. As a result, the nation needs about 1.5 million housing starts annually, Meyer says. In the years leading up to the recession — the housing bubble of 2005 and 2006 — housing starts soared to nearly two million. After the bubble burst and the recession took hold, housing starts plunged in 2009 to a low of about 400,000 annually. Since then, however, a recovery has pushed the rate to about 700,000 housing starts. Mortgage Bankers Association forecasts, along with the long-term population growth trend, support the case for a continued recovery in housing.



Household Balance Sheets are about as strong as ever. The Federal Reserve's financial obligation ratio, which measures

(Continued on page 4)

Happy New Year!

We have lots to be thankful for that took place in 2012, and we are even more excited about the prospects for 2013.

Much of our gratitude goes to you – the clients and friends of PWM. We wouldn't be here if it weren't for you. We are very thankful for your trust, support and loyalty.

Due to your relationship with us, we are in a position to be hiring. If you are aware of quality individuals who might fit into our PWM family, please send them our way.

At the moment we are especially interested in bringing on an advisor, financial analyst, and client service professional. PWM is doing its share to help drive the economy!

As always, please feel free to call us at any time if we can be of assistance to you, your loved ones or your business partners. You know where to find us.

May 2013 bring you all the purpose, peace and prosperity you desire.

John

Wealthy Investors Return To Alternatives

America's wealthiest investors are returning to hedge funds and other alternative investments in search of higher returns and other benefits.

The ultra-wealthy (those with $25 million or more in net worth) are putting an average of 25% of their total investment assets in alternatives, compared with 20% in 2010 and 16% in 2007, according to Spectrem's $25MM+ Investor 2012 report. Nearly half of these households now own hedge funds, while stocks and bonds currently make up just 18% of their total investments—down from 20% in 2010 and 21% in 2007.

"One of the primary reasons the wealthy are investing in alternatives is because of their expectations for high returns," says Spectrem President George H. Walper, Jr., who noted that 60% of 201 respondents to a survey expect alternative investments to deliver annual returns of more than 9%. "These investors are able to manage their risk more effectively than other households because they have the assets to provide their own safety net," Walper adds.

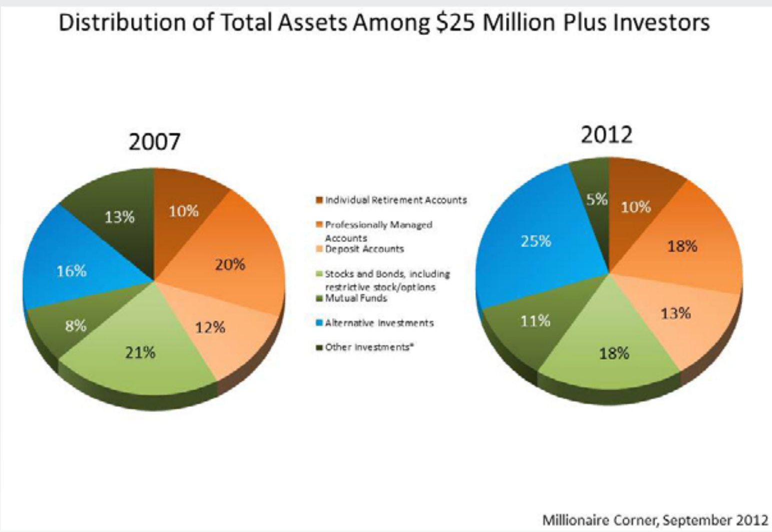
Indeed, 55% of the respondents say it's more important to protect their principal than to grow their investments. Sixty-two percent also invest in individual stocks and 43% in money market funds and checking or savings accounts.

Fifty-five percent of the respondents are invested in private equity and 47% own hedge funds, while 45% own venture capital. Other alternatives mentioned include commodities, limited partnerships, and collateralized debt obligations.

Facing lagging market returns and likely tax increases, these wealthy investors hope alternatives can give them an edge. But should you adopt this strategy as well? Even if your net worth is well below $25 million, alternative investments can play an important part in diversifying your portfolio. And you can get that diversification without hedge funds or private equity. Commodities-related investment vehicles may be more suitable, for instance, or real estate investment trusts. In helping you decide how to proceed, we will look at potential alternative investments within the context of your risk tolerance, goals, and overall financial situation.

Alternative investments have pros and cons that we'll help you factor into your choices. A chief benefit is that alternatives tend not to have a strong correlation with stock market results, so they may help buoy your portfolio when equities are sinking. But alternatives tend to have higher investment costs and to be less liquid than traditional assets. Alternatives also tend to be more complex, requiring specialized knowledge and more extensive research.

Let us help you navigate the complex world of alternative investments as you strive to make the most out of your investment dollars. ●



Take A Closer Look At Your RMDs

The IRS allows you to build up a sizeable nest egg for retirement inside your traditional IRAs. But then the other shoe drops: Whether you want to or not, you must begin taking "required minimum distributions" (RMDs) once you reach a certain age. Otherwise, you could be socked with a hefty tax penalty.

But the tax law does provide some flexibility. Depending on your situation, you might decide to withdraw funds from one of your IRAs, all of your IRAs, or any combination you prefer.

You have to start taking RMDs from your IRAs by April 1st of the year after the year in which you turn age 70½. In other words, if your 70th birthday was on June 1, 2012, you must take an RMD for the 2012 tax year by April 1, 2013. Then you still have to take another RMD for the 2013 tax year by December 31, 2013.

The amount of the RMD is based on the value in your accounts on December 31st of the tax year and is calculated according to IRS-approved life expectancy tables. For example, if you have a total balance of $1 million in your IRAs and your age is 76, the distribution period under the life expectancy table is 22 years. Divide $1 million by 22, and you arrive at an RMD of $45,454.55 for the current tax year.

The penalty for failing to take a timely RMD is equal to 50% of the required amount of the distribution (minus any distribution you actually received). Going back to our example, suppose you've taken an RMD for 2012 of $20,454.55, or $25,000 less than the required amount. In this case, you would owe a penalty of $12,500 (50% of $25,000) on top of the regular income tax. If you're in the 35% tax bracket in 2012, that's a whopping total of $28,409 ($15,909 + $12,500)!

Comparable rules apply to tax-deferred earnings within a tax-qualified

Taxes To Rise, Boosting Life Insurance

With high income individuals facing an onslaught of new taxes, life insurance products are likely to become more appealing because of their tax-advantages.

The top federal tax rate of 35% rises to 39.6% in 2013. Also, the top tax rate of 15% on long-term capital gains will rise to 20%. In addition, qualified dividends, which, in 2012 are taxed at a 15% rate, will be treated as ordinary income starting in 2013, so most investors will pay twice as much or more in taxes on dividends. On top of that, millions of high-income taxpayers will face a new 3.8% Medicare surtax on investment income.

One of the few remaining havens from taxation will be life insurance, which remains immune to the latest tax hikes. Indeed, life insurance provides protection from federal estate taxes as well as federal income taxes. So here's a primer on life insurance.

Forms of life insurance. Although there are many variations, life insurance comes two basic forms: permanent and term insurance.

Permanent life insurance, also called "cash value" insurance, stays in force for your entire life as long as you pay required premiums. These policies offer a death benefit but also build up an investment account with a cash value. Typically, you can borrow against the cash value or surrender the policy during your lifetime to tap the accumulated cash value. The amount you receive is the accumulated cash value minus any applicable surrender charges or fees.

Term insurance is also called "pure insurance" because it provides only a death benefit and no cash value or investment account. This is the most economical way to purchase life insurance and protect loved ones. As the name suggests, term insurance covers you for a specific number of years. You might limit coverage to the years during which you're working, when the loss of your income would be a hardship for your family. Once the term expires, so does the policy, unless you elect to renew it at a higher premium. Due to its temporary nature, term insurance is generally less expensive than permanent insurance for a comparable amount of coverage.

Income-tax advantages. A key benefit of permanent life insurance is that the accumulated cash value is generally exempt from income tax. Also, your beneficiaries won't be taxed on the death benefits paid by the policy. Thus, there is no tax when you acquire a policy, no tax as the policy builds up cash value, and no tax when the proceeds are paid to your beneficiaries. That's a tax trifecta.

Estate tax breaks for life insurance are complicated. If you own a life insurance policy as the insured party, the death benefit will be included in your taxable estate when you die, unless the money goes to your surviving spouse (who generally won't be taxed on an inheritance from you). When death benefits go directly to a beneficiary other than to a surviving spouse—such as a child, sibling, or your estate—the proceeds are subject to federal estate tax.

For this purpose, you're considered to be the owner of the policy if you possess any "incidents of ownership." It doesn't take much to trigger this rule. For instance, you're treated as having incidents of ownership if you retain the power to change policy beneficiaries, change coverage amounts, or cancel the policy. In other words, if you name someone other than your spouse as the beneficiary of a life insurance policy—or if your spouse dies before you and the funds go to a contingent beneficiary—your estate might have to pay a hefty estate tax bill.

Fortunately, you can avoid this adverse tax result by establishing an irrevocable life insurance trust (ILIT). If you name the trust as the owner of your life policy, the ILIT pays the premiums and the death benefit ultimately goes to whomever you name as the beneficiary. With this technique, you avoid any incidents of ownership, so there are no dire income or estate tax consequences associated with the life insurance protection.

We proactively look for opportunities to help clients reduce their taxes by using life insurance, and we welcome any questions about this topic. ●

retirement plan such as a 401(k). But you may postpone RMDs from qualified plans (not IRAs) if you continue working past age 70½ as long as you don't own more than 5% of the company that employs you.

The amount of your annual RMD reflects the value of all your IRAs, but you can actually withdraw the funds from one or more of the IRAs. If you're maintaining separate IRAs with different beneficiaries, you might want to keep the balances in all of them equal—and they may have gotten out of whack because of withdrawals, contributions, fees, and investment performance. So, for instance, if you have three IRAs and you've designated a different beneficiary for each one, you could withdraw the entire RMD amount from the IRA with the highest balance. Or you could get rid of underperforming assets in one of your accounts by liquidating those to provide cash for the RMD.

Keep in mind that you must give explicit instructions about your RMDs to each IRA custodian, and please call us if you have any questions. ●

Which Funds To Tap In Retirement?

Unless you're independently wealthy, eventually you'll have to start using some of the money you've saved for retirement. After all, that's what it's there for, so there's nothing wrong with using those assets. But it could create problems if you spend the "wrong" funds first.

For purposes of deciding what to spend when, let's divide your retirement assets into three baskets: personal accounts, such as stock and bond holdings that are currently taxable; traditional IRAs and qualified retirement plans, such as a 401(k), income from which is typically taxed only when withdrawn during retirement; and non-taxable accounts, such as Roth IRAs.

The rule of thumb is to withdraw funds from your personal accounts first, your traditional IRAs and qualified plans second, and your Roth IRAs third. This spending order is likely to produce the lowest possible tax bill, promote more tax-deferred growth, and allow you to milk your assets for as long as possible. If you were to spend your money in the reverse order, you would pay more in taxes each year, thereby siphoning off funds that could have been reinvested and reducing your overall nest egg—and maybe even exhausting all your funds during your lifetime.

The preferred "spending order" in retirement is only reinforced by tax law changes scheduled to take effect in 2013. Barring last-ditch legislation, the tax brackets for individuals will be adjusted upward, with the current top tax rate of 35% being replaced by 39.6%. Furthermore, the maximum capital gains rate of 15% for most investors (0% for low-income investors) is increasing to 20% (10% for low-income investors). And qualified dividends, currently taxed at a rate no higher than 15%, will be taxable at ordinary income rates.

To add insult to injury for high-income investors, a new 3.8% Medicare surtax debuts in 2013. Under a special tax law provision, an investor must pay the 3.8% surtax on the lesser of "net investment income" or the amount by which modified adjusted gross income (MAGI) exceeds a threshold of $200,000 for single filers or $250,000 for joint filers. "Net investment income" includes most forms of taxable income, such as capital gains and dividends, but not distributions from qualified retirement plans and IRAs or tax-exempt income. Still, those items may increase your MAGI for this calculation.

Despite these tax-based incentives, remember that you generally have to begin taking "required minimum distributions" (RMDs) from qualified retirement plans and IRAs—but not from Roth IRAs—after age 70½. If you've reached that point, you may as well take the RMD amounts first before the regular sequence.

Last but not least: Everyone is different, so you may have valid reasons for changing the usual order. If you have any questions about your situation, please let us know. ●

Top Income-Earners Drive

(Continued from page 1)

consumers' fixed expenses compared to disposable income, has fully recovered since the recession. At 16%, households have 84% of after-tax income with which to make purchases.

"Consumers' ability to cover their monthly 'nut' has seldom been better," according to Meyer. "As incomes have recovered, household debt has been reduced and interest rates remain low."

The financial obligations ratio consists of estimated required payments on outstanding mortgage and consumer debt plus automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance and property tax payments divided by disposable personal income.

The data on the top two income quintiles does not address whether wealth in America is more concentrated. But it does debunk the myth that the top 1% controls the American economy. It also shows, unfortunately, that individuals in the lowest income quintile are finding it difficult to meet expenses. Still, it is comforting to know that the nation's economy and the rise in corporate earnings behind the stock market's three-year rebound are driven by a broad demographic group, and their ability to continue to fuel a slow-growth recovery appears fundamentally sound. ●