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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

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Happy 2014 to all of our readers! I hope you are all beating the cold - it has been a brutal winter! Enjoy the 1st newsletter of 2014 & let us know if you have any questions!

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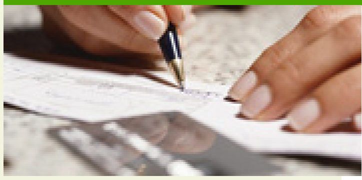

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Four Tips to Help Reduce Your Debt

The recession -- and subsequent slow recovery -- has caused millions of Americans to focus even more closely on living within their means. If you are ready to face up to your own financial realities, one crucial step is to set out a plan of action. Here are some key considerations to keep in mind.

Tip 1: Keep Track of Your Spending

It's hard to reduce your spending if you don't have a good idea of how much you are spending. Keep track of your typical monthly expenses for three months to find out where your money is going. To get an even more realistic idea, factor in some unexpected expenses -- such as auto and home repairs. Once you have a record of your spending, compare your average monthly outlay to your monthly income. If you have a surplus, this is the amount you can apply each month to paying down debt and building savings. If you have a shortfall, you'll need to examine your expenses more closely to see what you can potentially cut back or cut out.

Tip 2: Keep Saving

One way to establish good saving habits is to make saving even easier than spending. A handy tip is to set up separate savings accounts with separate goals attached to them. Here are three suggestions that can help you better allocate your savings.

- "Emergency Account" -- Your goal for this account should be to build up at least three to six months of living expenses. This way, if you lose your job or need a lump sum to pay for a significant expense, you may not have to tap into your other savings or ring up more debt.
- "Family Account" -- This account can help fund your children's school expenses (such as class trips and team uniforms) or vacations.
- "Investment Account" -- This account should be reserved for general or long-term saving goals. Hopefully, you already have a retirement savings account (either through your workplace or on your own) and perhaps a college savings plan. But having another account to save for other longer-term goals -- maybe to start your own business or remodel your home -- can be a smart move.

Tip 3: Keep a Tight Rein on Your Credit Cards

If you've accumulated significant credit card debt, you've first got to stop the bad behavior. Paying off debt is easier once you stop using your credit cards.

- Pay off your highest interest credit card debt first, making sure you avoid the "minimum balance trap." Paying more than the minimum can make a big difference.
- Consolidate your debt by transferring outstanding balances to lower-rate cards. If you don't want to transfer your balances, you may be able to get your current credit card company to match the interest rate of a competitor.
- Cancel all cards except for the one that offers the lowest interest rate.
- Finally, set up a realistic payment timetable and stick with it. If you have trouble keeping pace, talk to a professional.

Tip 4: Negotiate More Favorable Payment Terms

Call your lenders, explain your exact circumstances, and ask them to consider revised terms that will benefit you going forward. Whether this involves an adapted payment schedule or the implementation of a reduced interest rate, it can help you to pay off your debt without incurring more.

Dealing With the Risks of Investing

Familiarizing yourself with the different kinds of risk is the first step in learning how to manage it within your portfolio.

Investment risk comes in many forms, and each can affect how you pursue your financial goals. The key to dealing with investment risk is learning how to manage it. This three-step process will show you how.

Step One: Understand Risk

Fear of losing some money is probably one reason why people may choose conservative investments, even for long-term savings. While investment risk does refer to the general risk of loss, it can be broken down into more specific classifications. Familiarizing yourself with the different kinds of risk is the first step in learning how to manage it within your portfolio.

Risk comes in many forms, including:

- **Market risk:** Also known as systematic risk, market risk is the likelihood that the value of a security will move in tandem with its overall market. For example, if the stock market is experiencing a decline, the stock mutual funds in your portfolio may decline as well. Or if bond prices are rising, the value of your bonds may also go up.
- **Interest rate risk:** Most often associated with fixed-income investments, this is the risk that the price of a bond or the price of a bond fund will fall with rising interest rates.
- **Inflation risk:** This is the risk that the value of your portfolio will be eroded by a decline in the purchasing power of your savings, as a result of inflation.
- **Credit risk:** This type of risk comes into play with bonds and bond funds. It refers to a bond issuer's ability to repay its debt as promised when the bond matures.

International investments also involve additional risks, including the possibility of fluctuating currency values (currency risk) and the risk that political and economic upheavals may affect a country's markets.

Step Two: Diversify[1]

The process of diversification, spreading your money among several different investments and investment classes, is used specifically to help minimize market risk in a portfolio. Because they invest in many different securities, mutual funds may be ideal ways to diversify. Selecting more than one mutual fund for your portfolio can help further reduce risk.

Also consider the potential benefits of selecting investments from more than one asset class: When stocks are particularly hard hit due to changing conditions, bonds may not be affected as dramatically. In part, that may be because bond total returns may be tied more to income (which can cushion a portfolio) than price changes.

Step Three: Match Investments to Goals

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your savings goals. Is your goal preservation of principal, generating income for current expenses, or building the value of your principal over and above inflation? How you answer this will enable you to find an appropriate balance between the return you hope to achieve and the risk you are willing to assume.

Examine your time horizon for meeting your goals, and consider how comfortable you may be riding out short-term losses in the value of your investments. Remember, the longer your time horizon, the more volatility you may be able to tolerate in your portfolio.

By devoting time to examining your goals, conducting some research, and working with a financial professional, you can learn how to manage risk in your portfolio by choosing appropriate investments.

[1]*Diversification does not ensure a profit or protect against a loss.*

Understanding Employee Stock Option Plans

Most stock options have an exercise period of 10 years; that is, you have 10 years from the time you receive the options to actually purchase the stock.

In the "dot com" boom years of the 1990s and early 2000s, many companies made liberal use of employee stock option plans (ESOPs) to both reward and retain valued staff, from executives to temporary administrative help. While the current economic climate has produced fewer "company stock millionaires" these days, stock option programs continue to be popular with public and private companies. And employees certainly can benefit from them, if they take some time to learn the basics.

What Is a Stock Option?

If you've been granted stock options, you've been given the right to purchase shares of your company's stock at a certain price under certain conditions set by company management.

- If you have immediate options, you can purchase your alloted shares at any time.
- If your options are vested, you can only purchase a set number of shares after you've worked at the company a certain period of time.
- If your options are performance based, they will vest once certain goals are met.

The two most common types of ESOPs are incentive stock option (ISO) and nonqualified stock option (NSO) plans. Usually, key executives are granted ISOs, while less senior employees are given NSOs. The chief difference between the two is tax treatment.

- An ISO can be taxed under long-term capital gains, assuming the employee holds the stock for at least two years from the option grant date and one year from the exercise date. They are also taxed only when the stock is sold, making them tax-deferred plans. Note that ISOs can trigger the alternative minimum tax (AMT).
- NSOs are taxed as both income and capital gains -- and the tax is owed once the options are exercised. This is an important consideration to anyone who is thinking of exercising options. If you don't have enough cash on hand to cover the tax bill, you may need to sell shares you've just purchased to cover the costs.

Exercising Options

Most stock options have an exercise period of 10 years; that is, you have 10 years from the time you receive the options to actually purchase the stock. You are not obligated to buy any shares, particularly if your company's stock price is trading below your set exercise price. If you don't make a purchase during the exercise period, your options will expire worthless.

Companies have the flexibility to exchange option grants if its stock has been negatively affected by market activity. For example, if your stock options are priced at $25 a share and your company stock has been trading at only $20 a share for a prolonged period, the company may exchange your $25 strike price options for a new set that gives you a lower strike price.

If you are participating in an ESOP, be sure to consult with a financial and/or tax professional who can help you decide when to exercise your shares and how to deal with the tax consequences.

"Stretch"-ing Your Wealth to Future Generations

You probably understand that an IRA can be an effective way to save for retirement. But did you know that it can also be an effective estate-planning tool, allowing you to transfer wealth to future generations while reducing, deferring, or even eliminating income taxes on your retirement savings. Transferring wealth with a multigenerational "stretch" IRA could be an ideal solution for you.

A stretch IRA is a traditional IRA that passes from the account owner to a younger beneficiary at the time of the account owner's death. Since the younger beneficiary has a longer life expectancy than the original IRA owner, he or she will be able to "stretch" the life of the IRA by receiving smaller required minimum distributions (RMDs) each year over his or her life span. More money can then remain in the IRA with the potential for continued tax-deferred growth.

Creating a stretch IRA has no effect on the account owner's minimum distribution requirements, which continue to be based on his or her life expectancy.

Creating a stretch IRA has no effect on the account owner's minimum distribution requirements, which continue to be based on his or her life expectancy. Once the account owner dies, however, beneficiaries begin taking RMDs based on their own life expectancies. Whereas the owner of a stretch IRA must begin receiving RMDs after reaching age 70½, beneficiaries of a stretch IRA begin receiving RMDs after the account owner's death. In either scenario, distributions are taxable to the payee at then-current income tax rates.

Beneficiaries also have the right to receive the full value of their inherited IRA assets by the end of the fifth year following the year of the account owner's death. However, by opting to take only the required minimum amount instead, a beneficiary can theoretically stretch the IRA -- and tax-deferred growth -- throughout his or her lifetime.

If you do not currently have any IRA beneficiaries, employing the stretch technique by naming a beneficiary could provide significantly more long-term benefits than simply allowing the account balance to be paid out to your estate as a taxable lump-sum distribution. So if you're unlikely to deplete your IRA assets during retirement, consider creating a multigenerational stretch IRA. By doing so, you could help to build long-term financial security for a loved one.

Consider the Implications

- The ability to name new beneficiaries after RMDs have begun means that you can include a child in your stretch IRA strategy regardless of when the child was born.
- The ability to change beneficiary designations after the account owner's death means that one beneficiary may choose to disclaim his or her own beneficiary status so that more assets pass to another beneficiary. For example, if an account owner names his son as the primary beneficiary and his grandson as the secondary beneficiary, the son could remove himself as a beneficiary and allow the entire IRA to pass to the grandson. RMDs would then be based on the grandson's life expectancy, not on the son's life expectancy, as would have been the case if the son remained a beneficiary. (When there is more than one beneficiary, RMDs are calculated using the life expectancy of the oldest beneficiary.)
- The ability of beneficiaries to base RMDs on their own life expectancy means that the money you accumulate in your IRA and leave to heirs has the potential to last longer and produce more wealth for younger generations.

Keep in mind that this information is presented for educational purposes only and does not represent tax or financial advice. While it's true that recent regulatory changes have indeed made it much easier to incorporate a stretch IRA into your multigenerational financial planning initiatives, it's always a good idea to speak with a tax professional before implementing any new tax strategy.