Nicholson Financial Services

Did you know...?

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Spring came a bit early this year and with it, tons of rain. It also brought with it the first market correction since the recovery began last March. This shouldn't have come as a surprise considering the S&P 500 had rebounded almost 70% from it's 2009 lows. In my opinion, many traders were looking for excuses to take profits. They got good ones in the European Debt Crisis and the BP oil disaster in the Gulf of Mexico. However, for long-term investors, event such as these can create potential opportunities. I still see an economy that is slowly recovering and I believe that recovery will begin to accelerate. This is not to say that there are not risks to a global recovery. However, in the words of the great Napoleon Hill: "Opportunity often comes in disguised in the form of misfortune, or temporary defeat."

Nicholson Financial Services, Inc. is an independent firm.

In this issue:

Learning from mistakes

Many of us have been taught from when we were little to "learn from other people's mistakes." This hopefully would prevent us from making the same mistake ourselves. Of course, we should always learn from our own mistakes. I always thought this was good advice yet I continue to be amazed by how many of us don't learn from either. As a society, I certainly hope we have all learned enough over the last few years to avoid repeating the mistakes that lead us into the economic crisis from which we are now still recovering. It is up to all of us to pressure our elected officials to make sure that the proper amount of regulatory oversight is taking place.

Many have pointed fingers at the mortgage industry, the banking industry and Wall Street for causing the economic crisis. Each has certainly played a part. However, the greed that drives those institutions is a necessary part of a capitalist economy. These companies will take every opportunity to make money, and it has been that way longer than any of us has been alive. When the parameters in which they can operate are expanded (like they were in the mortgage industry in 2003), regulatory oversight needs to be increased to protect against abuses. That didn't happen and in fact, the oversight was reduced. In my opinion, this was just one of the factors that contributed to the "perfect storm" financial crisis of late 2008, albeit a major one.

I would like to share with you two possible scenarios. As you probably know by now, I strongly advise proper estate planning. This involves a current will, health care proxy, durable power of attorney, and other vital legal documents. These stories will explain why. Let's assume two clients pass away. Both had between $750,000 and $1.5 Million in assets each. One of them followed through and did all of the estate planning that was advised. They met with the estate attorney and continued the process until it was completed. As a result, the children (especially the executor) would receive the greatest benefit from the planning. They would have to deal with fewer issues after their parent's death, and would be keeping more of the money instead of it going to the government in taxes, fees and penalties.

In the above case, the estate would be settled in roughly a year; most settlements take longer. Most likely, the settlement would be smooth and the executor would have few issues.

Now, the second client (let's call him Ed) didn't work out so well. Ed would always listen to what he was told about estate planning and he would agree that he needed to get it done. Problem was, he never did. When Ed passed, his son had no idea what and where most of the assets were, as Ed never consolidated his accounts as he had planned. The will was over 20 years old, drawn up in another state (yes that is a problem) and left money to an ex-wife. The worst part was that Ed had a 401K with over $300,000 in it. He was advised several times to roll it over to an IRA, but he never did. Want to guess who the beneficiary was? Right, the ex-wife, who he had not spoken to in over 10 years. This type of estate can often take years to settle. The longer the process, the greater the cost to get it completed. Moreover, the person stuck being executor of it can feel like it is a second full-time job.

My hope is that many will learn from this and ensure their estate plan is up to date and complete. If my assistant or I contact you about a beneficiary review, I hope you will appreciate the importance of it. I should add that one main reason that someone could be in Ed's situation is that they pass away unexpectedly and young. So in closing, I would advise regular medical checkups as well as legal and financial ones.

"Some of us learn from other people's mistakes and the rest of us have to be other people." - Zig Ziglar

Understanding Mutual Fund Expense Ratios

Every mutual fund must disclose certain costs associated with running the fund. Those costs represent a fund's expense ratio, which is expressed as a percentage of a fund's assets. For example, a fund that has $100 million in assets and annual expenses of $1 million would report a 1% expense ratio (1% of $100 million = $1 million).

Why is a fund's expense ratio important? First, it can help you gauge how efficiently the fund operates. A high expense ratio reduces the amount that is paid to you as a shareholder. Second, a fund's expenses affect your net returns, particularly over the long term. For example, let's look at a hypothetical illustration (which doesn't reflect the performance of any actual security). Assume you have $10,000 in one stock fund that earns a 5.5% return and $10,000 in another stock fund that earns exactly the same return but that costs you an extra half-percent in expenses. The difference between 5.5% and 5% over 20 years means a $2,645 reduction in your bottom line.

That's not to say that you should automatically reject a fund just because it has a high expense ratio if the fund's performance is worth the higher cost. However, you do need to take expenses into account, especially if you're investing for the long term.

Some general categories of funds tend to have higher expense ratios than others. For example, a stock fund that specializes in emerging markets may have to spend more on research than a fund that invests only in large-cap U.S. stocks for which a great deal of information is readily available. A fund that is actively managed may have higher expenses than a fund that mirrors an index.

Each mutual fund's prospectus must include a table in the front that you can use to compare the expenses of various funds. The table lists the fund's expense ratio as well as a breakdown of the costs included in it, which fall into three general areas: management fees, marketing costs, and administrative fees.

Management fees

Every fund has an investment management or advisor firm that manages the fund and makes investment decisions. Even an index fund, which does relatively little trading and whose investments basically duplicate those of an index, will have a firm or an individual who handles any transactions. Management fees often represent the single largest portion of a typical fund's expense ratio.

Marketing costs

These costs also are known as 12b-1 fees, after the legal provision that permits them. They were originally designed to let funds recoup costs associated with distribution and advertising, on the theory that attracting new investors and additional assets would help make a fund more cost-effective for each investor. In recent years, there has been discussion of whether 12b-1 fees should be eliminated--especially for funds that are closed to new investors and therefore should have little need to market themselves--but they are still very common.

Administrative fees

This category of fees includes the cost of recordkeeping, custodianship, taxes, and legal, accounting, and auditing services.

What's not included in an expense ratio

Trading expenses represent the cost of buying or selling securities, and also can have a substantial impact on your net return over time. Trading costs, which include commissions paid by the fund when it buys or sells a security, aren't included in a fund's expense ratio. However, funds are required to report the per-share cost of their annual commissions; this can be found in a fund's annual report or Statement of Additional Information.

Also not included in the expense ratio is any redemption fee a fund might charge if you sell your shares before a specified time, or any sales charge the fund might impose at the time of purchase or sale.

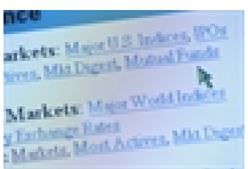
Before investing in a mutual fund, carefully consider its investment objectives and risks as well as its charges and expenses. This information is available in the prospectus, which can be obtained from the fund. Read it carefully before investing.

Comparison shopping

The "Tools and Calculators" section of the Financial Industry Regulatory Authority (FINRA) website includes an online Fund Analyzer that lets you compare the impact over time of the fees and expenses of as many as three funds.

Running the numbers

To get a true picture of a fund's performance, you do not need to deduct a fund's expense ratio from the returns quoted in its prospectus. The figures that measure average annual and cumulative return have already taken both operating and trading costs into account.



"Some general categories of funds tend to have higher expense ratios than others."

10 Financial Terms Everyone Should Know

Understanding financial matters can be difficult because of the jargon used. Becoming familiar with these ten financial terms may help make your financial picture clearer.

1. Time value of money

The time value of money is the concept that money on hand today is worth more than the same amount of money in the future because the money today can be invested to earn interest. *Why is it important?* Understanding that money today is worth more than the same amount in the future can help you evaluate and compare investments that offer returns at different times.

2. Market volatility

Market volatility measures the rate at which the price of a security moves up and down. If the price of a security historically changes rapidly over a short period of time, its volatility is high. Conversely, if the price of a security rarely changes, its volatility is low. *Why is it important?* Understanding volatility can help you evaluate whether a particular investment is suited to your investing style and risk tolerance.

3. Inflation

Inflation reflects any overall upward movement in the price of goods and services in the economy. *Why is it important?* Because inflation generally pushes the cost of goods and services higher, any estimate of how much you'll need in the future--for example, how much you'll need to save for retirement-- should take into account the potential impact of inflation.

4. Asset allocation

This strategy means spreading investments over a variety of asset categories, such as equities, cash, bonds, etc. *Why is it important?* How you allocate your assets depends on a number of factors, including your risk tolerance and your desired return. Diversifying your investments over asset classes can potentially help you manage risk and volatility.

5. Net worth

Net worth is what your total holdings are worth after subtracting all of your financial obligations. *Why is it important?* Your net worth will probably fund most of your retirement years. Therefore, the faster and bigger your net worth grows, the earlier and more comfortably you will be able to retire. Once retired, preserving your net worth to last through your retirement years is your goal.

6. Five C's of credit

These are character, capacity, capital, collateral, and conditions. They're the primary elements lenders evaluate to determine whether to make you a loan. *Why is it important?* With a better understanding of how your banker is going to view and assess your creditworthiness, you will be better prepared to deliver appropriate information to obtain the loan you want or get a better interest rate.

7. Sustainable withdrawal rate

Sustainable withdrawal rate is the maximum percentage that you can withdraw from an investment portfolio each year to provide income that will last, with reasonable certainty, as long as you need it. *Why is it important?* Your retirement lifestyle will depend not only on your assets and investment choices, but also on how quickly you draw down your retirement portfolio.

8. Tax deferral

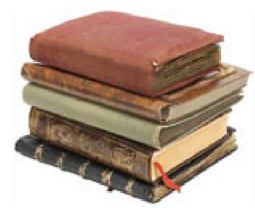
Tax deferral refers to the opportunity to pay income taxes in the future for investment interest and appreciation earned in the current year. *Why is it important?* Tax-deferred vehicles like IRAs and annuities produce earnings that are not taxed until withdrawn. This allows those earnings to compound,further adding to potential investment growth.

9. Risk/return trade-off

This concept holds that, in order to achieve a higher personal investment return, you must be willing to accept greater risk. *Why is it important?* When considering your investments, the goal is investing to get the greatest return for the level of risk you're willing to take, or to minimize the risk involved in trying for a given return.

10. Annuity

An annuity is a contract where you pay money to an insurance company in return for the insurer's promise to pay it back, with interest, in the future. *Why is it important?* You can supplement other retirement savings with tax-deferred annuity funds, and you can add to your retirement income with payments from your annuity for a fixed period of time or for the rest of your life.



Ten more terms to look up

- *Equity*
- *Gross Domestic Product*
- *Working capital*
- *Recession*
- *Triple net lease*
- *Net income*
- *Roth IRA*
- *Earned income*
- *Debt/equity ratio*
- *P/E ratio*

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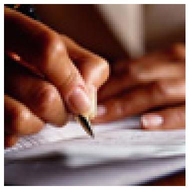
Ask the Experts



What is the premature distribution tax?

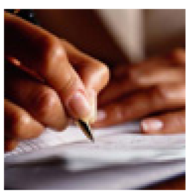
Taxable distributions you receive from an IRA, 403(b), 401(k), or qualified employer plan before age 59½ are generally referred to as premature distributions, or early withdrawals.

To discourage early withdrawals, they're subject to a 10% federal penalty tax (and possibly a state penalty tax) in addition to any federal and state income taxes. This 10% penalty tax is commonly referred to as the premature distribution tax. Not all distributions before age 59½ are subject to this penalty, however.

Here are the most important exceptions:

- Distributions due to a qualifying disability
- Distributions to your beneficiary after your death
- Distributions up to the amount of your tax-deductible medical expenses
- Distributions made pursuant to a qualified domestic relations order (QDRO)
- Qualified reservist distributions
- Distributions from an IRA (but not an employer plan) to pay first-time homebuyer expenses (up to $10,000 lifetime)
- Distributions from an IRA (but not an employer plan) to pay qualified higher education expenses
- Distributions from an employer plan (but not an IRA) after separation from service at 55 or older
- Certain distributions from an IRA (but not an employer plan) while you're unemployed up to the amount you paid for health insurance premiums
- Amounts levied by the IRS
- Distributions that qualify as a series of substantially equal periodic payments (SEPPs)

If you must take a distribution from your IRA or employer plan before age 59½, be sure to determine if one of these exceptions applies to you.



What is the "SEPP" exception to the premature distribution tax?

Taxable distributions you receive from an IRA or 401(k) plan before age 59½ are subject to a 10% early withdrawal penalty unless an exception applies. One important, but sometimes overlooked, exception is for SEPPs--substantially equal periodic payments.

SEPPs are amounts you withdraw from your IRA or employer plan over your lifetime (or life expectancy) or the joint lives (or joint life expectancy) of you and your beneficiary. To avoid the 10% penalty, you must calculate your lifetime payments using one of three IRS-approved distribution methods and take at least one distribution annually.

You can take advantage of the SEPP exception at any age. But payments from an employer plan must begin *after* you separate from service.

Even though SEPPs are initially determined based on lifetime payments, you can change--or even stop--the payments after five years, or after you reach age 59½, whichever is later. For example, you could start taking SEPPs from your IRA at age 50, without penalty, and then, if you no longer need the funds, reduce (or stop the payments altogether) once you reach age 59½.

But be careful--if you "modify" the payments before the required waiting period ends, the IRS will apply the 10% penalty tax (plus interest) to all taxable payments you received before age 59½ (unless the modification was due to death or disability).

If you have more than one IRA, you can take SEPPs from just one of your IRAs or you can aggregate two or more of your IRAs and calculate the SEPPs from the total balance. You can also use tax-free rollovers to ensure that the IRA(s) that will be the source of your periodic payments contain the exact amount necessary to generate the payment amount you want based on the IRS formulas.

SEPPs can be complicated--especially the modification rules. But taking the time to understand this important financial planning tool can be well worth the effort.