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Seven financial sins to avoid

The “seven deadly sins” often cited in religious writings are wrath, greed, sloth, pride, lust, envy and gluttony. Without the same soul-searching, you may be guilty of some other “financial sins” in the way you handle your personal affairs, particularly as it relates to your investments.

Specifically, here are seven mistakes you may be guilty of that can usually be rectified with relative ease. If you have not made any of these errors before, continue to avoid them.

1. Too emotional.

Do not let your emotions dictate financial strategies. For instance, when the stock market is booming greed can lead you to make some ill-advised decisions. On the flip side, if you are faced with a declining market, you cannot let fear overtake your financial sensibilities. Try to maintain an even keel.

2. Overly optimistic financial plan.

Back in the 1990s, investors took for granted that they would generate annual returns averaging 10% or even higher. But those “salad days” are over, and that idea is no

longer realistic for the average investor. If you lower your expectations slightly, you can better position yourself for what might happen in the future.

3. Excessive fees.

Of course, you usually “get what you pay for,” but that does not mean you should pay exorbitant fees in connection with investments. Rely on trusted financial professionals to steer you in the right direction.

4. Inadequate insurance.

Fixed insurance is a key component of most financial plans. This includes various forms, such as life insurance, health insurance, disability income insurance, etc. Try to have your needs quantified based on your current and future objectives.

5. Overextended risk.

It’s often been said that there is an inherent risk in making investments. Recognize that it is possible to make money, lose money or stay in the same basic position. Do not risk more than you can reasonably afford to lose. Consider your “risk tolerance” as part of your investment decisions.



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6. No emergency fund.

It is generally recommended that you keep enough of a financial “cushion” to sustain your family through six to 12 months if financial disaster should strike. Consider an emergency fund that will last even longer if you are contemplating retirement or have already retired.

7. Not seeking assistance.

This is not to say that you are unqualified to manage your own financial affairs. But almost everyone needs a little help now and then. As mentioned above, you should avoid paying excessive fees, yet that does not mean you should not obtain guidance when the situation calls for it. Do not let your pride get in the way - or this could turn out to be the “deadliest” financial sin of all.

Seeking balance in your life



Living “the good life” is often a question of finding the proper balance between work and home, family and personal pursuits. The same basic principle applies to your investment portfolio. If you can balance things out - in this case, we mean the division of assets based on certain classes - you are more likely to find investing to be a rewarding experience.

Of course, your investment balance will shift over time as asset classes perform differently, just as real life’s balance may change due to your circumstances. But it is relatively easy for most investors to “rebalance” a portfolio to meet their objectives.

There’s more to the story: Let’s suppose that a hypothetical investor has determined that an appropriate asset allocation for her situation is a mix of 50% in stocks, 30% in bonds, and 20% in cash and other vehicles. **Caveat:** Remember, this is a purely hypothetical example and not indicative of a specific portfolio. However, due to an increase in the value of the stocks over the last year, assume her portfolio now reflects an allocation of 70% in stocks, 20% in bonds and 10% in cash and other vehicles.

Assuming that this investor wants to remain true to the same objectives without increasing her risk exposure, she might sell some of the stocks to revert to the previous 50% allocation to stocks. At the same time, the investor can focus on increasing amounts devoted to bonds and cash and other vehicles. The point is that she does not have to stick with the status quo.

Along the same lines, suppose the value of the stocks in the portfolio has declined to the point where the allocation reflects 30% in stocks, 40% in bonds, and 30% in cash and other vehicles. In this case, she can convert some other holdings to stocks or otherwise increase stock holdings to return to her hypothetical mix of 50% in stocks, 30% in bonds and 20% in cash and other vehicles.

How often should you rebalance your portfolio? There are a few ways you can look at this. You might choose to rebalance at different intervals during the year, say on January 1 and July 1, or more frequently if you prefer. Alternatively, you can arrange to have your portfolio rebalanced whenever an asset class in your portfolio strays from its target percentage by a specified amount. For example, if you decide to rebalance any time the percentage deferral reaches ten percentage points, our hypothetical investor would rebalance if the stock allocation rises to 60% or falls to 40%

Reminder: Everyone’s situation is different. Obtain professional guidance to find the proper balance in your life.



Asset allocation does not ensure a profit or protect against a loss in a declining market. Certain kinds of investments may have higher volatility due to political, economic, currency, specific country or region, credit market, narrow focus, lower trading volumes or other kinds of risks.

Traditional vs Roth IRAs: a taste test



Individual Retirement Accounts (IRAs) come in two basic flavors: the traditional (plain vanilla) or the more exotic Roth IRA. It is important to know the similarities and distinctions.

For starters, the annual limit for contributions to all IRAs for the 2012 tax year, in any combination, is \$5,000 (increasing to \$5,500 in 2013). Plus, you can add another \$1,000 if you are age 50 or older. There is no current tax on the earnings within any account. You still have until April 15, 2013, to make contributions for the 2012 tax year, but no extension is permitted. Generally, you can choose from a wide range of investment options for either type of account, but investments in most collectibles are not permitted.

Let's look at the main differences.

Traditional IRAs: Contributions may be wholly or partially deductible. But deductions are phased out if your modified adjusted gross income (MAGI) exceeds a specified level and you (or your spouse if you are married) are an active participant in an employer-sponsored retirement plan. Therefore, for many individuals, no part of the contribution to a traditional IRA is tax-deductible.

When you receive distributions from a traditional IRA, you are taxed at ordinary income tax rates on the portion representing deductible contributions and earnings. In addition, you will have to pay a 10% penalty tax on withdrawals made before age 59½, unless one of the special tax law exceptions applies in your situation.

Roth IRAs: As opposed to a traditional IRA, contributions to a Roth are never tax-deductible, regardless of your MAGI. But there is a potential payoff on the back-end that you cannot realize with a traditional IRA: qualified distributions from a Roth in existence for at least five years are 100% tax-free. For this purpose qualified distributions include withdrawals made after age 59½, those made on account of death or disability, or those used to pay qualified first-time homebuyer expenses (up to a lifetime limit of \$10,000).

Other distributions are taxed at ordinary income rates under special "ordering rules." Contributions are treated as coming out first, followed by conversion and rollover amounts and earnings. Thus, even if you do not receive qualified distributions, part or all of the payout may be tax-free.

Due to the lure of tax-free distributions, you might consider converting some or all of the funds in your traditional IRA to a Roth IRA. This may also protect some taxpayers in the future from the new 3.8% Medicare surtax on net investment income. (See box on page 4. Your financial professionals can provide more details.) But be aware that the conversion itself is taxable at ordinary income rates just like withdrawal. If you have funds being transferred to pay the resulting tax, it will dilute some of the tax benefit.

Which flavor of IRA "tastes" better to you? It will depend on several variables and your personal circumstances. Rely on your financial professionals for guidance.

Should you update your will?

The first rule of estate planning is pretty simple: Have a legally enforceable will drafted before you do anything else. If you already have a will in place, you are ahead of the game, but you are far from finished. In fact, before you turn to other, more sophisticated, related matters, you might have to revisit a will you had drafted years ago.

Case in point: In the time since you had your will drawn up, your circumstances have changed. In that case, you may be able to add to or modify your existing will with a codicil. Because the cost is generally less than the fee for creating

an entire new will, this may save you both time and money. And a "quick fix" may be all that you need.

However, in order to be binding, a codicil must be handled with the same legal formalities as a will, so it should be prepared by a qualified attorney. Here are five examples of when you may need one.

1. Birth or death in the family.

Maybe you had no children or grandchildren when your will was first drafted. Now you do and you want to give them a

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share of your estate. Or perhaps you have decided to include other family members who were not previously named in your will.

2. Change in executor. You may need to choose a new executor (or guardian or trustee) if the one you named in your will has died or become disabled (and there are no contingency provisions). Or maybe you would simply rather assign the job to someone else.

3. Different or new beneficiaries. Besides redistributing a bequest to a beneficiary who is now deceased, you may want to change a bequest to a living beneficiary. For instance, you can revoke a bequest to a daughter-in-law or son-in-law who has divorced your child. Or you may have suddenly come into some money that you may want to earmark for charity.

4. Revalidation. Say the witnesses who can verify the signature on your will are no longer alive or cannot be located. When it is required, a codicil attested to by new witnesses can revalidate the will.



5. Tax law changes. Most likely, the law has changed significantly since your will was first drafted, especially if it was years ago. It may be in your best interest to restructure things now to take maximum advantage of the latest tax rules.

Note that the new tax law just enacted by Congress - the American Taxpayer Relief Act - provides greater clarity for the future. Among other changes in the estate- and gift-tax system, the new law authorizes a \$5.25 million estate-tax exemption and a top 40% estate-tax rate for 2013. We will have more details in an upcoming issue.

Of course, if there has been a major change in your situation, you may need to create a new will in its entirety. Otherwise, a codicil will often suffice. Your attorney can help you coordinate this with other aspects of your estate plan.

MEDICARE SURTAX IN ACTION



Don't ignore the new Medicare surtax for investors. Beginning in 2013, the 3.8% surtax applies to the *lesser* of your "net investment income" (NII) or your modified adjusted gross income (MAGI) over \$200,000 for single filers and \$250,000 for joint filers.

Example 1: An investor who is a single filer has NII of \$100,000 and a MAGI of \$175,000 in 2013. The investor has no Medicare surtax liability.

Example 2: An investor who is a joint filer has NII of \$100,000 and a MAGI of \$300,000 in 2013. The investor owes a surtax of \$1,900 (3.8% of \$50,000).

Consult your tax and investment professionals concerning your personal situation.

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