DaVinci Financial Designs
Jim Agostini, CFP®, ChFC®
LPL Registered Principal
3200 Devine Street
Suite 200
Columbia, SC 29205
Office 803-741-0134
Mobile 803-530-5375
jim.agostini@dav-fd.com
www.davincifinancialdesigns.com

Hello!

We hope you find the information in this newsletter valuable. Please feel free to call us if you have any questions or concerns. We look forward to speaking to you soon.

Jim, Brad, Stan, Carolyn, Ashley and Jessica.

October 2013

Why You Need a Power of Attorney and Medical Directive

It's late at night and you're waiting for your husband to arrive home from a business trip. Suddenly the phone rings and the voice on the other end informs you that your husband was in a terrible car accident and has been rushed to the hospital. You arrive to find several doctors awaiting permission to operate on your unconscious husband. They ask if he has a medical directive that authorizes someone, preferably you, to make health-care decisions on your husband's behalf.

A few days pass and your husband survives the accident, but he's going to be laid up for several weeks or months. Household bills need to be paid, but the primary source of income is your husband's business and you're not named on any of the business bank accounts. The bank representative asks whether your husband has a durable power of attorney naming you as his agent for financial matters.

These are everyday examples that highlight the importance of a medical directive and a durable power of attorney. Without these documents in place, you and your family could face personal and financial disaster.

What is a medical directive?

A medical directive lets others know what medical treatment you would want, and allows someone to make medical decisions for you, in the event you can't express your wishes yourself. There are two basic types of advanced medical directives--a durable power of attorney for health care and a living will--which generally vary by state. So be sure your documents comply with the laws of your state of residence.

A durable power of attorney for health care (known as a health-care proxy in some states) allows you to appoint a representative (health-care agent) to make medical decisions for you if you are unable to do so yourself. You can appoint almost anyone as your agent (as long as they are of legal age, usually age 18 or older). You decide how much power your representative will or won't have.

A living will allows you to approve or decline certain types of medical care, even if you will die as a result of that choice. In most states, living wills take effect only under certain circumstances, such as terminal injury or illness. Typically, a living will can be used to decline medical treatment that "serves only to postpone the moment of death." In those states that do not authorize living wills, you may still want to have one to serve as an expression of your wishes.

What is a durable power of attorney?

A durable power of attorney (DPOA) can help protect your property in the event you become physically unable or mentally incompetent to handle financial matters. If no one is ready to look after your financial affairs, your property may be wasted, abused, or lost. A DPOA allows you to authorize someone else to act on your behalf, so he or she can do things like pay everyday expenses, collect benefits, watch over your investments, and file taxes.

A DPOA may be effective immediately (this may be appropriate if you face a serious operation or illness), or it may only become effective upon the occurrence of an event, such as your incapacity (sometimes referred to as a springing power of attorney).

Caution: *A springing power of attorney is not permitted in some states, so you'll want to check with an attorney for its availability in your state.*

Additional things to consider

When creating either a DPOA or medical directive such as a durable power of attorney for health care (HPOA), it is important that you choose an appropriate agent. While you may select the same person to serve as agent in both documents, you are not compelled to do so. And be sure the person you select as agent is aware of that fact. Also, let them know where you keep these documents (you may want to give a copy of your HPOA to your agent and primary care physician as well).

Once you have these documents, review them periodically to be sure they still accomplish what you intend them to do.

Is College Debt the Next Bubble?

What might a 23-year-old recent college graduate, a 45-year-old entrepreneur, and a 60-year-old pre-retiree have in common financially? They may all be hobbled by student loan debt. According to financial aid expert Mark Kantrowitz, the student loan "debt clock" reached the $1 trillion milestone last year.[1] And even as Americans have reduced their credit card debt over the past few years, student loan debt has continued to climb--both for students and for parents borrowing on their behalf.

A perfect storm

The last few years have stirred up the perfect storm for student loan debt: soaring college costs, stagnating incomes, declining home values, rising unemployment (particularly for young adults), and increasing exhortations about the importance of a college degree--all of which have led to an increase in borrowing to pay for college. According to the Federal Reserve Bank of New York, as of 2011, there were approximately 37 million student loan borrowers with outstanding loans.[2] And from 2004 through 2012, the number of student loan borrowers increased by 70%.[3]

With total costs at four-year private colleges pushing $250,000, the maximum borrowing limit for dependent undergraduate students of $31,000 for federal Stafford Loans (the most popular type of federal student loan) hardly makes a dent, leading many families to turn to additional borrowing, most commonly: (1) private student loans, which parents typically must cosign, leaving them on the hook later if their child can't repay; and/or (2) federal PLUS Loans, where parents with good credit histories can generally borrow the full remaining cost of their child's undergraduate education from Uncle Sam.

The ripple effect

The implications of student loan debt are ominous--both for students and the economy as a whole. Students who borrow too much are often forced to delay life events that traditionally have marked the transition into adulthood, such as living on their own, getting married, and having children. According to the U.S. Census Bureau, there has been a marked increase in the number of young adults between the ages of 25 and 34 living at home with their parents--19% of men and 10% of women in 2011 (up from 14% and 8%, respectively, in 2005).[4] This demographic group often finds themselves trapped: with a greater percentage of their salary going to student loan payments, many young adults are unable to amass a down payment for a home or even qualify for a mortgage.

And it's not just young people who are having problems managing their student loan debt. Borrowers who extended their student loan payments beyond the traditional 10-year repayment period, postponed their loans through repeated deferments, or took out more loans to attend graduate school may discover that their student loans are now competing with the need to save for their own children's college education. And parents who cosigned private student loans and/or took out federal PLUS Loans to help pay for their children's education may find themselves saddled with education debt just as they reach their retirement years.

There's evidence that major cracks are starting to appear. According to the Federal Reserve Bank of New York, as of 2012, 17% of the 37 million student loan borrowers with outstanding balances had loans at least 90 days past due--the official definition of "delinquent."[5] Unfortunately, student loan debt is the only type of consumer debt that generally can't be discharged in bankruptcy, and in a classic catch-22, defaulting on a student loan can ruin a borrower's credit--and chances of landing a job.

Tools to help

The federal government has made a big push in recent years to help families research college costs and borrowers repay student loans. For example, net price calculators, which give students an estimate of how much grant aid they'll likely be eligible for based on their individual financial and academic profiles, are now required on all college websites. The government also expanded its income-based repayment (IBR) program last year for federal student loans (called Pay As You Earn)--monthly payments are now limited to 10% of a borrower's discretionary income, and all debt is generally forgiven after 20 years of on-time payments. (Private student loans don't have an equivalent repayment option.)

Families are taking a much more active role, too. Increasingly, they are researching majors, job prospects, and salary ranges, as well as comparing out-of-pocket costs and job placement results at different schools to determine a college's return on investment (ROI). For example, parents might find that, with similar majors and job placement success but widely disparate costs, State U has a better ROI than Private U. At the end of the day, it's up to parents to make sure that their children--and they--don't borrow too much for college. Otherwise, they may find themselves living under a big, black cloud.

Growing debt

The average amount of student loan debt for the Class of 2011 was $26,600, a 5% increase from 2010 (source: Project on Student Debt, Student Debt and the Class of 2011, October 2012). But some students--and their parents--borrow much, much more.

Sources

1 Mark Kantrowitz, Student Loan Debt Clock Reaches $1 Trillion, May 8, 2012

2 Federal Reserve Bank of New York, Grading Student Loans, March 5, 2012

3 Federal Reserve Bank of New York, Q4 2012 Quarterly Report on Household Debt and Credit, February 28, 2013

4 U.S. Census Bureau, America's Families and Living Arrangements: 2011

5 Federal Reserve Bank of New York, Q4 2012 Quarterly Report on Household Debt and Credit, February 28, 2013

Stretch IRAs

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow.

The term "stretch IRA" has become a popular way to refer to an IRA (either traditional or Roth) with provisions that make it easier to "stretch out" the time period that funds can stay in your IRA after your death, even over several generations. It's not a special IRA, and there's nothing dramatic about this "stretch" language. Any IRA can include stretch provisions, but not all do.

Why is "stretching" important?

Any earnings in an IRA grow tax deferred. Over time, this tax-deferred growth can help you accumulate significant retirement funds. If you're able to support yourself in retirement without the need to tap into your IRA, you may want to continue this tax-deferred growth for as long as possible. In fact, you may want your heirs to benefit--to the greatest extent possible--from this tax-deferred growth as well.

But funds can't stay in your IRA forever. Required minimum distribution (RMD) rules will apply after your death (for traditional IRAs, minimum distributions are also required during your lifetime after age 70½).

The goal of a stretch IRA is to make sure your beneficiary can take distributions over the maximum period the RMD rules allow. You'll want to check your IRA custodial or trust agreement carefully to make sure that it contains the following important stretch provisions.

Key stretch provision #1

The RMD rules let your beneficiary take distributions from an inherited IRA over a fixed period of time, based on your beneficiary's life expectancy. For example, if your beneficiary is age 20 in the year following your death, he or she can take payments over 63 additional years (special rules apply to spousal beneficiaries).

As you can see, this rule can keep your IRA funds growing tax deferred for a very long time. But even though the RMD rules allow your beneficiary to "stretch out" payments over his or her life expectancy, your particular IRA may not. For example, your IRA might require your beneficiary to take a lump-sum payment, or receive payments within 5 years after your death. If stretching payments out over time is important to you, make sure your IRA contract lets your beneficiary take payments over his or her life expectancy.

Key stretch provision #2

What happens if your beneficiary elects to take distributions over his or her life expectancy but dies a few years later, with funds still in the inherited IRA? This is where the IRA language becomes crucial.

If, as is commonly the case, the IRA language doesn't address what happens when your beneficiary dies, then the IRA balance is typically paid to your beneficiary's estate.

However, IRA providers are increasingly allowing an original beneficiary to name a successor beneficiary. In this case, when your original beneficiary dies, the successor beneficiary "steps into the shoes" of your original beneficiary and can continue to take RMDs over the original beneficiary's remaining distribution schedule.

When reviewing your IRA language, it's important to understand that a successor beneficiary is not the same as a contingent beneficiary. Most IRA providers allow you to name a contingent beneficiary. Your contingent beneficiary becomes entitled to your IRA proceeds only if your original beneficiary dies before you.

Stretch even further ...

If you name your spouse as beneficiary, your IRA can stretch even further. This is because your spouse can elect to treat your IRA as his or her own, or to transfer the IRA assets to his or her own IRA. Your spouse then becomes the owner of your IRA, rather than a beneficiary. As owner, your spouse won't have to start taking distributions from your traditional IRA until he or she reaches age 70½ (and no lifetime RMDs are required from your Roth IRA). Plus, your spouse can name a new beneficiary to continue receiving payments after he or she dies.

What if your IRA doesn't stretch?

If your IRA doesn't contain the appropriate stretch provisions, don't fret--you can always transfer your funds to an IRA that contains the desired language. In addition, upon your death, your beneficiary can transfer the IRA funds (in your name) directly to another IRA that has the appropriate stretch language.

A word of caution

While you might appreciate the value of tax-deferred growth, your beneficiary might prefer instant gratification. If so, there's little to prevent your beneficiary from simply taking a lump-sum distribution upon inheriting the IRA, rather than "stretching out" distributions over his or her life expectancy. It's possible, though, to name a trust as the beneficiary of your IRA to establish some control over how distributions will be taken after your death.

DaVinci Financial Designs℠
A Financial Life By Design℠

DaVinci Financial Designs
Jim Agostini, CFP®, ChFC®
LPL Registered Principal
3200 Devine Street
Suite 200
Columbia, SC 29205
Office 803-741-0134
Mobile 803-530-5375
jim.agostini@dav-fd.com
www.davincifinancialdesigns.com

IMPORTANT DISCLOSURES

Will interest rates rise this year?

The Fed hasn't yet raised its target interest rate from less than 0.25%, and it has promised not to do so before unemployment reaches roughly 6.5%, which it doesn't expect to happen until next year. However, some interest rates have already begun to go up. For example, according to Freddie Mac, the average interest rate on a 30-year fixed-rate mortgage shot above 4% last June for the first time since late 2011, hitting its highest level in almost 2 years. In the same month, the yield on the 10-year Treasury bond went above 2.5% for the first time since August 2011.

Why are interest rates rising even though the Fed's target rate hasn't? Because bond investors are concerned that higher interest rates in the future will hurt the value of bonds that pay today's lower rates. Immediately after the Fed's June announcement, investors began pulling money out of bond mutual funds in droves, reversing a multiyear trend. If there's less demand for bonds, yields have to rise to attract investors.

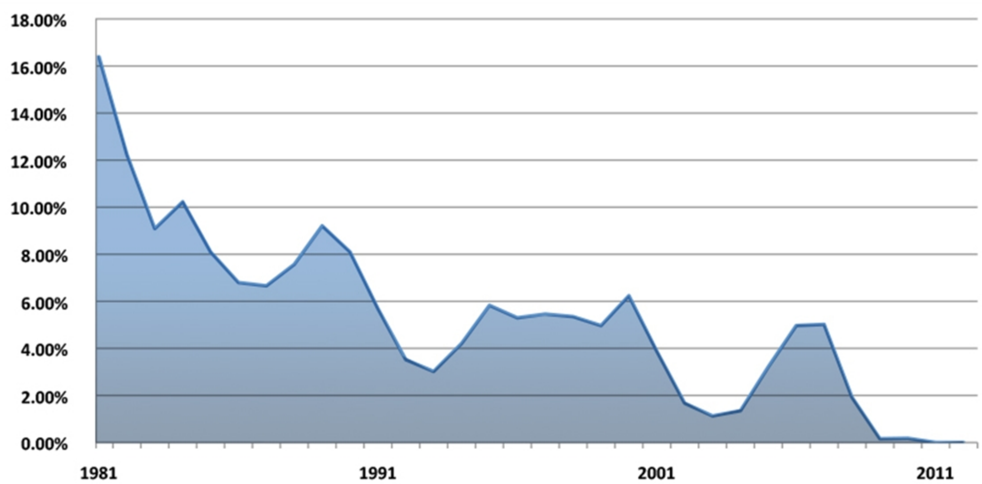
Aside from bonds, why are investors concerned about a possible Fed rate hike? Bonds aren't the only financial asset that can be affected by potential future interest rate changes. Dividend-paying stocks with hefty yields have benefitted in recent years; more competitive bond yields could start to reverse that dynamic. Shares of preferred stock typically behave much like those of bonds, since their dividend payments also are fixed; their values could be affected as well.

Also, higher mortgage rates could potentially slow the housing market recovery, though historically they remain at relatively low levels. And if a Fed rate increase were to bring on higher interest rates abroad, that could create even more problems in countries already struggling with sovereign debt--problems that have provoked global market volatility in the past.

The Fed has said any hikes in its target rate will occur only if the economy seems strong enough. If higher rates seem likely to halt the recovery, the Fed could postpone a rate hike even longer. It also will take other measures before raising rates. Even though the timing and size of any Fed action is uncertain, it's best to be aware of its potential impact.

Graph: Interest Rates 1981-2012

This graph represents the federal funds effective interest rate (the average rate at which banks lend to one another overnight), which has generally declined to historic lows over the 30-year period represented. Investment returns, as well as interest rates on bank loans and other fixed-income instruments, could potentially be affected when this rate rises.



Source: Board of Governors of the Federal Reserve System (www.federalreserve.gov), July 17, 2013