

# Investing in Your Future

Real life tips for those just getting started, getting married, buying a house, or saving for college.

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# Getting Started: How to Buy a Mutual Fund



## What you will learn:

- ▶ You can choose to work with an advisor or do it yourself
- ▶ You can buy a mutual fund directly from the fund group or even a fund supermarket
- ▶ Don't forget to diversify your investments

## Getting Started

Investing in a mutual fund may seem tremendously overwhelming at first. Instead of choosing just one company and one stock (one price, one ticker, one exchange, and so on), you're suddenly charged with committing to a whole portfolio, choosing an investment approach, monitoring someone else's record, and getting to know a whole new vocabulary. Before you get mired in those details, you need to decide whether you want some help choosing your funds or whether you'd rather do it on your own. Like most everything in life, both paths have benefits and drawbacks.

## Working With an Advisor

Maybe you don't have the time or interest to design your own mutual fund portfolio. Fine! All sorts of financial advisors, from planners to brokers, can help you pull together a financial plan and a basket of funds that can help you achieve your goals.

Of course, this service isn't free. If you work with an advisor, you might pay an up-front fee of some sort, perhaps a percentage of your investment money. Or your advisor may forgo a fee and earn a commission by investing your money in what are called load funds. A load, or sales charge, is deducted from your investment when you buy or sell shares, depending on the fee structure.

This load is used to compensate the advisor for selling you the fund. (Note that the load does not go to the fund manager; he or she receives another fee, called the management fee.) Some advisors are fee- and commission-based, which means they'll charge you some combination of the two.

## Pros and Cons: Working With an Advisor

The advantages of working with an advisor are clear: You have someone helping you make financial decisions, taking care of paperwork for you, monitoring fund performance, and forcing you to stick to your investment plan for tomorrow instead of cashing in for an around-the-world jaunt today.

The drawbacks include cost, of course. There's also the challenge of finding an advisor with whom you work well, someone you can trust to put your interests before his or her own, and who will turn your financial dreams into realities, not nightmares. Further, you want to find an advisor who is willing to take the time to teach you about investing and about what he or she is doing with your portfolio. It's your money, after all, and you need to understand why it's invested the way it is.

Those with the time and interest to learn about investing and to monitor their own portfolios can invest in funds without the help of an advisor. If you choose to invest on your own, focus on no-load funds, which do not charge any sales commissions. Why pay a commission if you're not getting any investment advice in return?

## Buy Directly from the Fund Group

Go-it-alone types can buy funds directly from no-load fund groups (also called fund families) such as Fidelity, Vanguard, and T. Rowe Price. To buy a fund from a fund family, request an application from the fund group by calling its 800 number. You can find these numbers in the Morningstar

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Investment Research Center fund data reports. Most fund families provide prospectuses and applications on their websites, as well.

### **Don't Forget to Diversify**

New investors who plan to buy more than one fund might choose one of the larger no-load families. Why? Because these families are diversified: They offer stock and bond funds, domestic and international funds, and large- and small-company funds. Take it from us: Most fund investors eventually own more than one fund because of the need for diversification; by investing with one of the major fund families, you can easily transfer assets from one fund to another.

Investing with a single fund family—even a large one—can be limiting, however. For example, some families don't offer a wide array of funds. Take the Janus Funds, for example. The group specializes in large-company growth investing, but the company offers very few bond funds of any kind.

Another way to diversify, then, is to invest with several fund families, a series of specialists who do one thing particularly well. You could buy a large-company growth fund from, say, Janus, a small-company fund from Royce Funds, a bond fund from PIMCO, and an international fund from Tweedy, Browne. But that would mean a lot of paperwork; each family would send you separate account and tax statements. If you own more than a few funds, the paperwork can become maddening.

### **Are Supermarkets for You?**

Do-it-yourselfers who hate paperwork but want a lot of choices shouldn't despair: No-transaction-fee networks, also known as "supermarkets," are a popular solution. If you invest through a major supermarket, you can choose from thousands of funds offered by dozens of fund families, and there's no direct cost to you. So you could buy one fund from, say, Janus, another from Royce, yet another from PIMCO, and one from Tweedy, Browne and receive all of your information about performance, taxes, and more on just one consolidated statement. There are a number of fund supermarkets today, and more and more fund families are getting into the act with supermarkets that include funds outside of their own families.

What could the drawbacks here possibly be? Surprisingly, one drawback is cost. Although it is true that fund supermarkets do not charge you when you invest in a fund through their programs, they charge the fund companies to be included in their programs. That charge ranges from 0.25% to 0.40% of assets per year. As any student of economics knows, that fee acts a whole lot like a tax, and it's passed right along to shareholders—that's right, to you—as part of a fund's expense ratio, the fee the fund charges you each year for managing your money. The real kicker is that shareholders are paying these fees whether they buy the funds through the fund supermarket or directly from the fund family.

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# How to Pick a Financial Advisor

## What you will learn:

- ▶ How to distinguish between the many certifications financial professionals carry
- ▶ Different fee structures for financial advisors make sense in different contexts
- ▶ Where to locate a financial advisor

Whether you no longer have the time to manage your own investments, face a complicated tax situation, or simply want a second opinion, there are occasions when it makes sense to hire a professional.

But choosing to work with a professional is only the first decision you must make. From there, the flurry of different certifications and fee structures can confuse even experienced investors. Here is a guide to help you navigate your options.

## Types of Professionals

Financial planners can carry an array of designations. Which one you should choose depends on the services you need. Most people seek out a Certified Financial Planner, Certified Public Accountant/Personal Financial Specialist, or Chartered Financial Consultant, or ChFC. ChFCs tend to sell insurance as part of their services; the other two usually do not. The CFP designation requires passing a series of exams and having at least three years of experience. If you want someone who knows taxes, choose a Certified Public Accountant. If you are looking for someone to help you choose individual securities, you may want a Chartered Financial Analyst, the designation that signifies expertise in the investment field. Many advisors have multiple designations.

## Fee Structures

Again, the one that is right for you will vary depending on the type of service you want. For example, you might want someone to manage your investments or simply to meet with you a couple of times each year to guide you. There are three types of fee structures:

**Fee only:** The advisor is compensated solely by the client. Fee-only advisors can charge in a variety of ways. The fee can be a percentage of assets or a flat or hourly rate. The advisor is not selling any investment product and is not getting directly compensated for recommending specific investments. If you want a one-time checkup, it makes sense to find someone who charges by session or by hour. If you want ongoing portfolio advice, it might be more cost effective to find someone who charges a percentage of your assets. When the compensation is a percentage of your assets, your advisor's financial interests are aligned with yours. For example, when your portfolio's value increases, your advisor earns more money; when it decreases, your advisor earns less.

**Commission:** The advisor is compensated by selling you products, such as mutual funds or an insurance policy. The advisor's pay is not tied to the performance of your portfolio. This might be the cheapest option, but there are potential conflicts of interest because the advisor is paid based on which securities you purchase and not based on how well your portfolio performs.

**A combination of fee and commission:** Advisors who are paid this way usually call it "fee-based" compensation. Do not confuse this term with "fee only." Under this structure, advisors still receive compensation from selling you particular products.

The fee-only option offers two big benefits. First, the advisor's investment recommendations are not driven by a commission. Second, it is more transparent—you will receive a bill and know exactly how much you paid for the services. With a commission-

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based advisor, you do not know how much the advisor has earned from you and how commissions affected your investment recommendations.

What is a reasonable fee? Asset-based fees are typically around 1%, while hourly rates range from \$150 to \$300, according to *Money* magazine. The amount you pay will vary based on your advisor's particular fee structure. Many advisors charge different asset-based fees depending on the value of your account, so you can expect to pay a lower percentage if you have a large amount under management.

### Where to Find One

Several websites can help you locate a financial professional who matches your needs. The Financial Planning Association is a national organization for all types of planners. The National Association of Personal Financial Advisors represents fee-only planners. The American Institute of Certified Public Accountants has a credential called Personal Financial Specialist. People who have this credential are CPAs who also have passed a series of exams on financial planning.

### Questions to Ask

**1. What are your certifications?** How many years of experience do you have? Look for someone with at least five years in the industry.

**2. How are you compensated?**

**3. Do you accept fiduciary responsibility?**

Meaning, are they required to act in the best interest of clients?

**4. What types of clients do you see most often?**

Choose someone who regularly deals with the issues you face. Ask if you can speak to a couple of clients as references. It's unlikely you will be referred to an unsatisfied client, but you can still get a sense of how the advisor operates.

**5. What is your investment philosophy?**

What criteria are used to select securities? What role do expenses play when deciding between funds? Look for evidence that the advisor is considering quality of management rather than just past performance.

**6. How often do you trade?** Do you tend to buy and hold or do you trade frequently?

**7. What kind of software do you use?** See if the advisor is comfortable discussing how it works and try to determine if there is too much reliance on a computer for calculations and recommendations.

**8. Ask to see the advisor's ADV form,** which all Registered Investment Advisors must file with their state or the SEC. This will show you any past compliance or legal issues. Advisors who manage more than \$25 million in assets must register with the SEC, and you can search for information about them at [http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd\\_OrgSearch.aspx](http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_OrgSearch.aspx).

# Choosing a Retirement Account

## What you will learn:

- ▶ Retirement plans can be employer-based or individual
- ▶ Traditional plans are tax-deferred (that is, you will pay taxes only when you withdraw money in retirement) but somewhat more restrictive
- ▶ Roth plans allow you to contribute aftertax dollars, but you won't have to pay taxes when you withdraw the funds in retirement

## Employer-Based Retirement Plans

### Traditional 401(k) Plans

**What it is:** A 401(k) is an employer-sponsored tax-deferred retirement savings account. Your employer automatically deducts pretax contributions from your paycheck each pay period. The money then gets distributed into investments you've selected from a menu of options. You pay taxes when you withdraw money in retirement.

**Advantages:** You won't pay taxes until you withdraw the money in retirement. And, because 401(k) contributions come out of your paycheck automatically and on a regular basis, 401(k) plans enforce investment discipline. Additionally, many employers offer a "match" for all or part of your contributions. For example, for every dollar you contribute to your plan, your employer might invest an additional \$0.50—an instant return on your investment. There are no income limitations.

**Disadvantages:** Once you put money in, you generally cannot take it out without penalty until you are retired. You also have to take required minimum distributions, or RMDs, starting at age 70 1/2.

### Roth 401(k) Plans

**What it is:** An employer-sponsored aftertax retirement savings account. Your employer automatically deducts money from each paycheck, which gets put into investments you selected, just like in a traditional 401(k), except the contributions are aftertax dollars.

**Advantages:** The trade-off is that you'll be able to withdraw your contributions and any earnings without having to pay taxes in retirement. There are no income limitations.

**Disadvantages:** You have to pay taxes now, so this option does not make sense if you think you will be in a lower income bracket when you retire. As in traditional 401(k)s, you must take required minimum distributions (but you can avoid them by rolling over to a Roth IRA).

### 403(b) and 457 Plans

Nonprofit organizations, such as schools and charities, offer 403(b)s instead of 401(k)s. These accounts are similar to 401(k)s in that they are tax-deferred retirement savings plans, but 403(b)s rarely offer employer matches.

457 plans are similar to 401(k) and 403(b) plans, and are available to state and local governmental employees. They are also offered by certain nonprofit organizations.

## Individual Retirement Accounts

### Traditional Individual Retirement Account (IRA)

**What it is:** A traditional Individual Retirement Account, or IRA, is a tax-deferred retirement savings account that is in many ways similar to a 401(k) but is not connected to an employer. You pay taxes when you withdraw money in retirement. Anyone can contribute to an IRA, but beyond a certain income level, contributions are not tax-deductible. Regardless of income, contributions accumulate tax-deferred.

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**Advantages:** There's tax-deferred compounding, as in a 401(k). You will not have to pay taxes until you begin withdrawals. IRAs offer more flexibility than 401(k)s, as you are not limited to an employer's investment options.

**Disadvantages:** As in 401(k)s, you generally cannot withdraw money without penalty before age 59 1/2. IRAs also have rules governing required minimum distributions.

### **Roth Individual Retirement Account (IRA)**

**What it is:** Roth IRAs function similarly to Roth 401(k)s in that you contribute aftertax dollars, but like traditional IRAs, they are not connected to an employer. Income limits, though not as strict as those for deductible IRAs, apply, but as of 2010 investors now have the option to get in through the back door by opening a traditional IRA and then converting to a Roth.

**Advantages:** As in a Roth 401(k), your earnings increase tax free, and you do not have to pay taxes on withdrawals. You can also withdraw your contributions (but not earnings) without penalty at any time. Roth IRAs also offer a unique benefit: you do not have to take required minimum distributions.

**Disadvantages:** You have to pay taxes up front, so you will end up paying more in taxes if you are in a lower income bracket during retirement.

# Invest or Pay Off Debt: How to Manage and Control Your Bills

## What you will learn:

- ▶ It comes down to comparing the potential investment returns on your investment accounts with the interest you are paying on your debt
- ▶ Setting up automatic-payments systems prevents you from forgetting to pay the bills on time and offers a considerable convenience
- ▶ Regularly reviewing your account balances is key when it comes to avoiding unpleasant financial surprises

## It Pays to Pay Off Loans

Choosing whether to pay off some of your debt or invest your money is a daunting task for most individuals. It is even more important considering the large amounts of debt an average household has accumulated.

Most people overlook the fact that paying off some of the high-interest debt may as well be the best investment they will ever make. This type of “investment” carries no risk as the payoffs are clear from the start and you save the interest payments over the lifetime of the debt instrument, be it a credit card or a student loan. In most cases, savings will be quite substantial.

## Knowing What You Owe

To start paying down debt you must take a simple first step: identify your current debt level, which includes home loans, student loans, auto loans, credit card balances, consumer loans, and other types of debt. The best way to accomplish this is to use a worksheet. A sample can be found at [http://finance.morningstar.com/ThirtyMinPDF/HouseholdBudget/30Min\\_Worsheet8-1.pdf](http://finance.morningstar.com/ThirtyMinPDF/HouseholdBudget/30Min_Worsheet8-1.pdf). You may also use an Excel spreadsheet to identify the loans you currently hold, the type of interest rate (variable or fixed), and whether the interest is tax-deductible. Keep in my mind that the variable interest rate carries a higher amount of risk. Although it looks appealing in a low-interest-rate environment, should the interest rates rise, your monthly payments will increase, as well. You might also want to check whether your variable interest rates have ceilings; if that is the

case, you at least know the maximum interest rate you may be charged, should the macroeconomic landscape change. If your variable rates do not have a ceiling, you potentially are exposed to unlimited amount of risk as your monthly payments may rise substantially and affect your monthly cash flow to a degree not anticipated before. This is one of the “hidden risks variable interest rates carry.

## Identifying Your Assets

On the worksheet, you must also identify your current investment accounts. Write down whether you are receiving any tax benefits and whether you are receiving a matching contribution on your 401(k) plan. Next, you must identify stock/bond/cash mix for each of your investment accounts. After finding the breakdown, calculate the expected return for each account, considering the different return characteristics for each asset class. Morningstar suggests you use 2% return for cash, 4% for bonds and 6% for stocks. Now you can calculate the expected return for your investment accounts by weighting each asset class according to its percentage in the total asset breakdown of your portfolio. For example, a 10% cash-50% bond-40% stock combination would be calculated as follows:  $(2\% \times .10) + (4\% \times .50) + (6\% \times .40) = 4.6\%$ .

Now compare the potential investment returns on your investment accounts with the interest you are paying on your debt. If the interest rate on your credit cards or student loans is higher than your expected returns from your invested assets, you are essentially losing money by not

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paying off your debts. For instance, if your investment accounts are expected to return 10% annually, but you hold a high-interest-rate credit card with a 22% interest rate, it is clear that you would be better off by paying the high-interest credit card first and then focusing on putting money away in the investment account yielding 10%.

The last example should make it clear what your priority should be: paying off debt with the highest interest rates relative to what you are expected to make on your assets. Keep in mind that you should look at the aftertax interest rate. However, this will likely only apply to your mortgage and student loans as interest for most consumer loans are not tax-deductible. If the interest rate on the debt instruments exceeds the expected return on the investment accounts, it should be paid off prior to saving. It is also helpful to look at the cumulative dollar amounts you owe versus dollar amounts you have invested.

### **Taking Control of Your Debt: Step by Step**

Most of us will not be able to take control of the debt and pay it off in one day. Here are some strategies you may consider in the meanwhile:

- 1. Schedule all bills to be due at the same time of the month.** Many bills allow you to change your due date. Select a due date a few days after you receive your paycheck each month. Designating a “bill day” will keep you from worrying throughout the rest of the month and ensure that bills do not fall under the radar.
- 2. Set up automatic payments.** Automatic

payments ensure that you will not miss a payment, but they are not a license to stop thinking about your bills. You may find that it makes sense to automate some of your bills and not others. Bills that are the same every month, such as your mortgage or gym payment, are prime candidates for automation. Payments that vary monthly, such as credit cards, are better suited for manual payment so that you can examine the bill--and your spending habits--before signing off. Even if you choose this option, please make sure that you check your automatic payments for accuracy. Also, always make sure that you have sufficient funds in your bank account in order to avoid overdraft and returned payment fees.

- 3. When bills come in the mail, deal with them immediately.** If you have scheduled an automatic payment, file the paper bill for your records. If the bill is not one you pay automatically, either pay it right after you open it, or designate a place for pending payments and set aside a day each month to pay your paper bills. Do not stack bills with other mail to deal with later, or you risk losing or forgetting them.

- 4. Give yourself wiggle room.** Schedule online payments for two to three days before payment is actually due to ensure adequate processing time. This will again help avoid late payment fees, which can be substantial.

- 5. Regularly review your account balances.** Services that allow you to see all of your accounts in one place make it easier to stay apprised of your overall financial standing. In addition to allow-

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ing you to schedule automatic payments, online bill-pay services have the added benefit of presenting all of your bills in one place. Mint.com, though not a bill-pay service, is another free, helpful tool that aggregates all of your account information in one place. Alternatively, you may keep an Excel spreadsheet with all your financial records and keep track of your bills that way. The need to keep this Excel spreadsheet up to date will also ensure that you take a look at all your bills on a monthly basis, including the ones with automatically scheduled payments. Keeping yourself informed is the best way to avoid financial surprises.

### **Keeping Up**

If you follow the steps, you will most definitely know what you owe. This step is crucial when it comes to bringing your debt under control. Also, make sure that you keep up with interest-rate changes on your credit cards and other debt; most of the interest rates are variable so they may change and thus alter your monthly payments, as well. If you are on a tight budget, this is crucial because even small interest-rate hikes can affect your monthly cash flow to a substantial degree, especially if the cumulative amount you owe is rather large. Keeping up with the interest rates will also give you an option to check in with the lenders about possible rate reductions and ability to transfer balances from higher-interest lenders to the lowest ones.

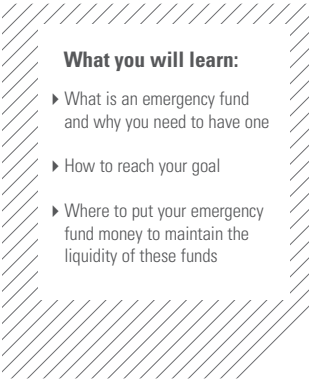
### **Be Prepared**

Even though paying off debt is important, don't forget to set up an emergency fund, as well.

An emergency fund is your financial cushion to help protect you from unexpected expenses (like car repairs) or changes in your income (such as losing your job). You should keep this fund in a money market or savings account for emergencies only. How much should you keep in an emergency fund? Start by saving three months' worth of expenses and work your way up to six months'. This may not be easy to accomplish and living within your means is definitely key. Stick to cash whenever possible for future purchases. If you don't want to carry cash, use a debit card instead of a credit card.

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# Setting Up Your Emergency Fund



## What you will learn:

- ▶ What is an emergency fund and why you need to have one
- ▶ How to reach your goal
- ▶ Where to put your emergency fund money to maintain the liquidity of these funds

## What Is an Emergency Fund?

An emergency fund is money set aside to cover unforeseen expenses, to be used when the alternatives are tapping your longer-term investments or going into debt. Think about where money would come from if you had an unexpected home or car repair, or if you lost your job. An emergency fund offers a cushion for such situations.

## When Should I Create an Emergency Fund?

Setting up an emergency fund is essential to getting--and keeping--your finances in order and should be one of your first priorities. Creating a safety net for yourself can be just as important as paying down debt, as it protects you from digging yourself into an even deeper hole should an unexpected expense arise. Ensure you have enough in your emergency fund to protect yourself from the unexpected before you do any other investing.

## Calculate Your Cushion

Typical financial-planner wisdom says to save enough to cover three to six months worth of expenses, but it's best to save more if possible. How much time would you like to have to find a new job if you lost yours? The more you get paid, the more you'll need in your emergency fund. That's because if you do lose a high-paying job, it takes longer, on average, to find a comparable position than if you're in a lower-paying job.

## Reach Your Goal

Once you know the total amount you'd like to set aside, the next step is to figure out how much you will need to save each month and where you

can cut back in spending to reach your goal. Creating a budget can help you identify nonessential spending. Simple steps like brewing your own coffee and cooking a few more nights a week can save you a significant amount without requiring a big sacrifice. If the amount seems overwhelming, set an initial goal of having enough to cover 3 months. Once you reach that first goal, aim for 6 months.

## Where to Put Your Money: First Three to Six Months

Put the first three to six months' worth of savings in highly liquid, stable investments, such as a money market account or fund. You want to be able to gain access to this money easily in case the unexpected happens. Certificates of deposit (CDs) are also an option but are slightly less liquid. Many money market accounts and funds allow you to set up automatic investments, which ensures you will contribute each month. You won't earn much interest on this money, but at least you can rest easy knowing you won't need to tap your long-term assets or go into debt in an emergency.

## Where to Put Your Money: Six Months or Longer

If you are saving enough to cover a more extended period, you can put money beyond what you would need immediately into a short-term bond fund to capture more yield. The trade-off is that short-term bond funds can be more volatile, so they only make sense for the money you would not need right away.

# Should You Buy or Rent?

## What you will learn:

- ▶ Take a serious look at your finances; check your debt and savings to determine if you can afford to own a place
- ▶ Determine if buying makes sense given your personal situation, and if you are ready to settle down in a particular geographical area
- ▶ Look at calculators, but make your own decision based on your finances and personal situation

## Check Your Debt

What type of debt do you have? Paying off high-interest credit card debt offers a guaranteed return that almost certainly beats the benefits of home ownership.

However, low-interest debt, like some student loans, does not automatically mean you should not buy. Compare the interest rate on your loan to the benefits of owning a house and see if it makes more sense to invest in a home or use your savings to pay down your debt faster.

## Can You Afford a Down Payment?

A traditional 20% down payment is still the safest route. Paying more up front will save you money on interest, reduce your monthly payments, and keep you afloat in case the value of your home falls. Additionally, you usually need to buy private mortgage insurance if you put less than 20% down, costing 0.5% to 1.0% of your loan's value. If you have a \$400,000 loan, you could owe an extra \$4,000 each year. Avoid "creative financing" and be vigilant about adjustable-rate mortgages, or ARMs, which have low "teaser" interest rates that can balloon after a few years, massively increasing payments. Rent until you have saved enough to make a substantial down payment.

## Check Your Savings

Beyond the down payment, you also need to ensure you have enough saved in an emergency fund. Putting all of your money into your home puts you at risk for not being able to cover your payments in the event of an emergency.

## How Long Will You Be in the Area?

Rent until you are sure you will settle somewhere for at least five years. If you think you might need to relocate for work or if you're just not sure you want to commit yourself to your current city, don't buy. You do not want to be stuck if plans change.

## Could Your Living Situation Change?

Do you think you might get married or have children in the next several years? The property that meets your needs now might not be a match in a few years, so it makes sense to rent until you are more settled.

## Are You Prepared to Maintain a Home?

Basic upkeep requires significant time, effort, and expenses that your landlord would be responsible for if you rented. If you lack either the time or inclination to undertake home repairs, consider renting.

## Research Your Area

Compare what you get for the same amount of money renting versus buying. It could be that it simply doesn't make sense to buy in your area even if everything is in order on your end.

Calculate the price to buy/rent ratio by dividing the purchase price by the annual rent you would pay to lease a comparable home. If the ratio is close to 20 or higher, be wary. For context, the national average in the 1970s, '80s, and '90s was between 10 and 14 according to *The New York Times*, but the ratio remains above 20 in many areas of the country after prices outpaced rents during the past decade.

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### **Try Calculators**

Several sites offer calculators that compute a response based on variables you enter. Check out the buy versus rent calculators at [BankRate.com](http://BankRate.com) and *The New York Times* ([nytimes.com](http://nytimes.com)) to help with your decision but remember that these tools cannot fully capture your personal situation.

# Starting a Life Together? What About Finances?

## What you will learn:

- ▶ You should start the dialogue sooner than later; if you haven't started it yet, now is the time
- ▶ One of the first steps is to take inventory of everything you both have: assets, debt, and earnings
- ▶ Compare your employer benefits and check your insurance needs; you'll have to figure out what makes sense in your situation and how to save the most money
- ▶ Budget for a life together in order to not feel guilty of over spending or being too frugal; transparency is the key
- ▶ It's never too early to prepare for retirement

If you are considering marriage or are recently married, there's probably a lot on your mind. Sitting down to discuss money issues might not be at the top of your list, but it's one of the most important tasks to tackle if you're starting a life with someone.

## Start the Dialogue

Regularly discussing your financial goals and current standing is a good habit to start now, if you haven't already. What shared and unshared goals do you have? What type of lifestyle do you want? Do either of you have student loans or outstanding credit card debt? How do you each feel about it? Get any financial anxieties in the open sooner rather than later.

Discuss upcoming financial plans, such as whether you will buy a house or if one of you is considering returning to school. Do you expect any major financial changes?

Ideally, these conversations should begin before you tie the knot. If you are already married, though, there's no better time to start than now.

## Take Inventory

Once the two of you are on the same page, the next step is to map out your combined earnings, assets, and debts. Include your income, investments, credit card debt, and student loans. Also include any mortgages, car loans, and any other amounts you own or owe. Make a master list of each of your checking, savings, and investment accounts so you both know where everything is.

The worksheet at [http://news.morningstar.com/pdfs/Net\\_Worth\\_Worksheet.pdf](http://news.morningstar.com/pdfs/Net_Worth_Worksheet.pdf) can help you get started. Listing all of your assets and liabilities together will highlight any problem areas and help you see the big picture. Do you have two cars when you could get by with one? Do you have more combined debt than you realized? Once you know what you're dealing with, you can discuss how you will approach and prioritize complex issues together.

## Compare Your Employer Benefits

If you are already married, one of your first tasks to take on together is a side-by-side comparison of your options for health-care coverage. If you are not married, some companies also offer coverage for domestic partnerships--check with your human resources department for details. If you are both employed, you have the benefit of choosing from either plan. If one of you is in school or self-employed, your best option may be clearer cut.

Ask yourselves if it makes sense to keep separate coverage, or if one of your plans is better. Look at each policy's premiums, coverage, deductibles, prescription costs, and doctors covered to see if there is a clear winner. Also compare your vision and dental plans and life and disability insurance policies. Check with your employer(s) about rates to add coverage for your spouse.

## Check Up on Other Insurance Needs

Even unmarried couples can frequently save money by streamlining insurance policies. Change your car insurance and homeowners or renters insurance so that you are both on the same policy.

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Usually, you receive a discount for using the same provider for multiple types of insurance. Also check in with your insurance agent about insuring personal articles, such as your ring or other jewelry, which may not be covered under your homeowners or renters insurance.

More important than precisely outlining your combined net worth and optimizing your insurance policies, however, is making sure you understand each other's financial attitudes and goals. Openly discussing your combined financial situation together from the outset will enable you to deal with the array of financial tasks and challenges you will inevitably face in your lives together as a team.

### **Budget for a Life Together**

Setting up a joint budget is one of the first steps to getting your finances in order as a couple. It frequently makes sense to make a budget even before you get married, especially if you're already living together. Although you might dread the idea of setting up a budget, the process can actually reduce anxiety.

A budget is meant to help you see the big picture and plan how your money will be used. It isn't simply about helping you stay within spending boundaries. A joint budget is also a tool to ensure you agree on spending guidelines and to carve out money that's OK to spend on items that might not be absolute necessities.

### **Prepare for Retirement Together**

First, you'll need to decide where to put your sav-

ings and set up accounts for each of you if you haven't already. You have the option to invest pretax dollars in a traditional 401(k) or IRA, or to invest aftertax dollars in a Roth IRA (or Roth 401(k) if your employer offers it). But don't think of it as an either/or choice; a combination of different types of accounts makes a lot of sense. Saving some assets in a Roth account and some in a traditional account will give you options when it's time to withdraw your money in retirement.

If you're both employed, first check your employer plans, which may be a 401(k), 457, or 403(b), depending on if you work in the private sector, for the government, or for a nonprofit organization. If your employers offer a match, make sure you each contribute at least enough to receive it.

Once you contribute enough to get any employer matching, start a Roth IRA for additional flexibility in retirement (if your employer doesn't offer a match, you may consider starting the Roth right off the bat).

Roth assets have two main advantages: They will be free from required minimum distributions in retirement, and they diversify your tax hit so that you will have a basket of tax-free assets to tap in retirement. IRA contributions are currently limited to \$5,000 for individuals under age 50, however, so plan to contribute to your company plan again once you max out your IRA.

It's important that you each have a retirement account, even if one of you isn't working.

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If only one of you has a retirement account, you miss out on your full allotment of tax-advantaged treatment. Because you can each contribute \$5,000 to an IRA, for example, you can receive tax-advantaged treatment for \$10,000 if you both have an IRA. The same goes for 401(k)s: In 2010, you can each contribute up to \$16,500 if you are under age 50. If you're over age 50, limits are higher for both IRAs and 401(k)s to allow for extra "catch-up" contributions. In addition to being a sensible tax move, it's also a good idea to have retirement savings in your own name in case happily-ever-after turns into happy-for-a-while.

A spouse without income can contribute to an IRA as long as the couple's income covers the contributions both spouses make (that is, if one person makes at least \$10,000 per year, both people can contribute the maximum \$5,000).

Once you've figured out what combination of accounts makes sense for you and your spouse, it's time to look at your actual investments.

Now that you're married, there are apt to be at least two retirement accounts to keep on track. Look at your accounts as a whole rather than checking up on each in isolation. Even though the money is being saved in separate wrappers, your accounts should make sense in aggregate. For couples who already have significant retirement savings, it's particularly important to take inventory of each of your accounts and make sure your investments are streamlined and in step with your spouse's.

### **Designing Beneficiaries**

There is one important step left once you have your accounts on track: designating beneficiaries. Unlike bank and brokerage accounts, retirement accounts cannot be held in both of your names; you each have separate accounts. It is critical to specify who would receive the assets in your account if something were to happen to you.

# Saving for College

## What you will learn:

- ▶ It is never too late to start saving for your kids' education; the sooner you start, the better
- ▶ Beware of risky investments as the loss of principal potentially means that your kid might be losing the opportunity to obtain higher education altogether
- ▶ It is worth exploring 529 plans that get more conservative in terms of asset allocation as your child nears the college age
- ▶ Beware of high-expense 529 plans, as your take-home returns will be substantially lower

Saving for college can be a challenging and daunting task, especially when there are so many other financial needs to manage. Nevertheless, avoiding the issue won't make it go away, and the sooner you tackle it, the better off you are. Plus, there are a number of college-savings solutions out there that you might not have considered. Several make sense for a broad swath of parents, even those who think they're getting a late start. Read on for a look at our best tips for getting going today.

## Step 1: Do not ignore college expenses; they won't go away.

Even if you manage to save only a small amount between now and the time your child is ready for college, he/she is going to have to borrow that much less for tuition. The key is taking that first step.

## Step 2: Don't play catch-up by chasing overly risky investments.

Some parents, especially the ones who are behind with college savings, are often tempted to choose overly risky investments in order to make up for the fact that too little is saved to date. However, every finance professional will tell you that the investments with higher returns carry much higher risks associated with them. The key is not to focus on a single risky stock, sector, or high-yield bond, but rather to look at a well-diversified portfolio with a stock/bond mix that fits your child's time horizon.

Bear in mind that if your child's college years are drawing near, you'll want to be taking fewer

risks with any money you have earmarked for college, not more. Although savings for children under 10 might safely be invested in stock funds, storing more and more of your child's college savings in cash and bonds as he/she makes his/her through high school is sensible. True, bonds and cash don't have the same return potential as stocks do. But if you're afraid that your college savings will come up short when it comes time to matriculate, your best option is to plan to save more, or plan to rely on loans and financial aid, rather than venturing into inappropriately risky investments.

## Step 3: Consider a 529 plan.

Some 529 college-savings plans have high expenses and substandard investment choices, and several plans got caught with overly risky investments in 2008. But given that 529s permit extremely generous contributions and offer tax benefits to boot, these programs can be ideal for late-start college savers who need to sock away as much as possible in a short period of time. The key is to choose carefully.

Although Section 529 prepaid-tuition programs essentially allow you to lock in today's tuition rates, such plans can be somewhat inflexible. You might also be able to earn a higher rate of return by investing on your own.

In contrast to the prepaid programs, money invested in Section 529 college-savings plans can be used at any college in the United States. There are no earnings restrictions on who can contribute to a 529 plan, and you can contribute up to \$65,000 per year per child without triggering

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the gift tax (\$130,000 for joint filers). Flush 529 savers could, in theory, sock away enough in a single year to cover a child's complete education. Your contributions to a 529 plan can grow free of federal taxes, you can take tax-free withdrawals to pay for college expenses, and you might also enjoy a state-tax break. Finally, the 529 assets are held in the parents' name, meaning that these assets receive more favorable treatment than the child's assets in financial-aid calculations.

**Step 4: Simplify with all-in-one funds.**

For college-savings plans, funds that mature, or grow more conservative, as the child nears college age make a lot of sense. The closer your child is to needing to tap into those assets, the thinking goes, the less fluctuation you want to see in your principal value. Many 529 plans feature such one-stop, age-based options, and they make perfect sense for parents who would prefer to select a plan and tune out.

**Step 5: Cheap out.**

If your investment horizon is relatively short, it's all the more important to pay attention to how much you're shelling out in fund fees. That's because cash and bonds--which should form the bulk of your child's portfolio as college draws near--have low returns from the start. If you layer on excessive expenses, your take-home return will be that much lower. For your college-savings plan, focus on stock funds that charge less (preferably much less) than 1.00% per year in annual operating expenses; look for bond funds with expense ratios of 0.75% or lower.

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# How to Cut Your Daily Expenses



## What you will learn:

- ▶ You guessed it: cutting daily expenses is not easy
- ▶ Proper budgeting is key when it comes to reducing your daily spending habits
- ▶ We have compiled 101 ideas to help you to get started

We often discuss ways to invest money for various goals like college funding, big-ticket purchases, and retirement. But before investors can tackle where to *put* the money, they need to tackle where to *find* the money.

Proper budgeting and cost-cutting can help you free up funds for investment, emergency accounts, or debt-paydown. We've compiled 101 ideas to help you stretch your dollars to the max. If you follow through on them, you'll make significant progress in cutting costs in your day-to-day life.

1. Watch out for shipping costs when buying via the Internet. Use the Internet to comparison shop, then pick up the item locally.
2. If you see something in a catalog that you want to buy, wait a week before ordering to see if you still really want it.
3. Use the public library to check out movies or books for free.
4. Consider dropping your land line phone at home. Your cell phone may be all you need, and some come with free long-distance services.
5. When traveling, look online before you leave for ideas and/or coupons. Once on site, ask the locals for low-cost favorite spots.
6. Try a vacation at home (staycation). See and do the things you've always wanted to do and save on hotel costs.
7. Compare rates for cable and satellite. Go with the less expensive option. Only sign up for the channels you know you'll watch.
8. Send free e-cards and save on postage.
9. Consider buying a certified preowned car instead of a new one.
10. Cut back trips to Starbucks or other premium coffee shops.
11. Stop buying clothes that are "dry clean only." Learn to iron.
12. Don't renew subscriptions to publications you don't have time to read.
13. Don't watch so much TV. You won't see all the ads and be as tempted to buy. Take a walk instead or play with your kids.
14. Make IRA contributions early in the year to take advantage of additional months of tax deferral.
15. Lock in a fixed mortgage rate so your interest rate can't increase to a point you can no longer make your house payments.
16. Only use ATMs where you won't be charged service fees.
17. Give your time/services instead of "things" for gifts.
18. Give up expensive health-club memberships. Learn to exercise outdoors, at home, or through the park district. Or join the YMCA.
19. Choosing a small hybrid car over a similarly priced mid-sized non-hybrid will save you unnecessary pain at the pump, especially with the uncertainty of higher gas prices.
20. Wait a little longer between manicures (try doing one yourself!), massages, or highlights (try a local training school).
21. Let your hair go gray. There's speculation about whether hair dyes are linked to cancer or not, but as the baby boomers age, gray is "in."

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22. Play golf less often, look for tee times when rates are reduced, or play at lower-cost public courses.
  23. Pay off your credit cards monthly and avoid paying interest.
  24. If you must charge, switch to a no-fee or low-fee credit card. Go to [Bankrate.com](http://Bankrate.com) to compare rates.
  25. If you own a house, shift your higher-rate credit card debt to a lower-rate line of credit. Deduct the interest on your tax return.
  26. If you own a house, use a home-equity loan to pay off auto loans. The interest is tax-deductible.
  27. Pay your mortgage payment biweekly instead of monthly--you'll save on interest costs and pay off your mortgage sooner.
  28. Pay extra premium payments when paying your mortgage. As above, you'll save interest payments and be able to pay off your mortgage sooner.
  29. If your house down payment was less than 20%, cancel your private mortgage insurance once your mortgage balance is 80% or less of your home's value.
  30. Pay cash when possible. Psychologically it's harder to spend cash than using credit cards, and you'll save on interest charges.
  31. Check your credit history. Go to [annualcreditreport.com](http://annualcreditreport.com) and make sure everything is accurate. Good credit may mean lower interest charges.
  32. If you have a tendency to bounce checks, deduct a "cushion" from your balance. Then if you accidentally let your balance go below zero, you'll hit that cushion instead of paying fees for insufficient funds.
  33. Set up one checking account for regular recurring expenses and another for bigger-ticket items. (Only buy if you've saved enough.)
  34. Participate in company retirement plans to save on taxes. Your taxable income will go down and you'll defer taxes to the future.
  35. Take advantage of your employer match in your 401(k) or other retirement plan.
  36. Don't take a loan from your 401(k) plan--you'll save on double taxation of that repaid interest.
  37. Take advantage of company-sponsored reimbursement plans. If your company sponsors free retirement advice, take advantage of it.
  38. Talk to financial planners at no cost. Look for newspaper money shows or local events where this service may be offered.
  39. Take advantage of free health screenings at work (if offered).
  40. Switch to an HMO from a PPO for health insurance.
  41. If self-employed, consider switching health insurance plans to high-deductible plans to take advantage of HSAs.
  42. Take advantage of medical prescription drug cards.
  43. Get multiple quotes on insurance. It pays to shop around.
  44. Raise the deductible on your homeowners and car insurance policies.
  45. Increase the waiting period to six months or longer on your long-term care insurance.
  46. Review life insurance premiums. Can the dividends pay the premium instead of purchasing more coverage?

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47. Buy term instead of whole life or universal life insurance.
  48. Check with the state or federal government to see if you have money owed to you. To find out more about claims in your state, go to the National Association of Unclaimed Property Administrators' website.
  49. If considering moving or retirement, look into places where the cost of living and/or state tax rates are cheaper.
  50. Keep track of your cost basis on investments to save money on taxes when you sell an investment.
  51. If you have a loss on your Roth IRA (the current balance is less than what you contributed), consider taking out the balance and claiming a deduction for the loss on Schedule A of your tax return.
  52. Avoid paying penalties on retirement distributions by waiting until you're over age 59 1/2 to make withdrawals. Start required minimum distributions from traditional IRAs when you're age 70 1/2.
  53. Do a 1035 annuity exchange to a company with lower expenses.
  54. Put investments that generate ordinary income in tax-deferred accounts.
  55. Use tax-exempt bonds in taxable accounts.
  56. Put investments that generate capital gains or dividends (both generally taxed at lower rates than ordinary income) in taxable accounts.
  57. If you've inherited an IRA, understand how to stretch out the tax deferral by taking the correct minimum required distribution.
  58. Pay attention to the expense ratios on mutual funds you buy.
  59. Consider using exchange-traded funds (ETFs).
  60. Pay attention to mutual fund brokerage fees.
  61. Use prior-year capital-loss carryforwards to net out realized capital gains. You'll pay less tax.
  62. If you have stock options, consider holding the shares after exercise for at least one year. You'll pay capital gains tax on the appreciation when you sell.
  63. Don't get divorced.
  64. Quit smoking.
  65. Save all your change and use it to buy gifts next year.
  66. Go to matinee movies instead of movies at night.
  67. Cook in bulk and freeze.
  68. Turn down your home thermostat a couple degrees in the winter.
  69. Only do full loads of laundry and fill the dish washer before running it.
  70. Plan parties where everyone brings something.
  71. Bring your lunch to work or scout out the inexpensive places to buy lunch. Look for inexpensive items on the menu, like soup.
  72. Have cocktails at home and then go out; have dessert at home.
  73. Order vegetarian when you're out.
  74. Look up phone numbers in the phone book or via the Internet instead of paying for directory assistance.
  75. Sell stuff you don't need or use anymore on eBay.
  76. Get a roommate and share expenses.
  77. Investigate phone service via the Internet.
  78. Use regular gas instead of premium.
  79. Cut back on eating out.

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80. Be a smart grocery shopper--cut coupons, shop at discount stores, and stock up on sale items. Check out Costco or Sam's Club.
  81. Buy energy-efficient appliances. They're cheaper in the long run.
  82. Get rid of "add on" services with phone, TV, and so on.
  83. Shop resale shops or estate sales.
  84. Shop the clearance racks.
  85. Make your own greeting cards on a computer.
  86. Fill prescriptions with the generic form of the drug.
  87. Plan your purchases--avoid impulse buying.
  88. Use public transportation.
  89. Keep up maintenance on cars. It may prevent costly future problems.
  90. Get annual physicals to prevent costly future problems.
  91. Track your spending. If you write it all down, you'll probably spend less. And you'll know exactly where your money goes.
  92. Use your senior discount (if eligible). Go to [AARP.org](http://AARP.org) for information about member discounts and services.
  93. Skip paying cab fare now and then. Walk or take the bus.
  94. Wash your car at home and skip the car wash.
  95. Pay bills online. Save postage.
  96. Don't buy mutual funds just before capital gains distributions.
  97. Use a budget--especially for items like gifts.
  98. Trade in your car with high insurance premiums for a car with lower insurance premiums. Go to [Bankrate.com](http://Bankrate.com) for more ideas.
  99. Buy an I-PASS and save on highway tolls (in Illinois).
  100. Sign up for a Upromise credit card. A percentage of your purchases will go into a college savings fund for your children.
  101. Do your own home improvements. Home Depot and Lowe's employees can walk you through what you need to know.

# Mutual Fund Tax Traps and How to Avoid Them

## What you will learn:

- ▶ Mutual funds can deliver you surprises on Tax Day if you aren't careful and prepared
- ▶ Investors should never buy shares of a fund right before it distributes its capital gains
- ▶ You should consider potential tax liabilities by making note of a fund's unrealized gains before making a purchase
- ▶ Heavy trading by fund managers and high turnover can generate a large tax bill for you

Although there's a lot to like about mutual funds--all-in-one diversification and professional management, to name two of the most important benefits--the potential tax penalties from capital gains distributions are not always fair or transparent.

That lack of fairness owes to the fact that the tax treatment for mutual fund capital gains is far more complex and potentially more costly than it would be for an investor who directly owns the same stocks that are held by the fund. Not only do fund investors have to pay capital gains when they sell a fund that has appreciated in price since they bought it, but they're also on the hook for the capital gains that the fund itself has realized by selling winning securities in a given year.

Even if you reinvest your capital gains right back into the fund, these payments are taxable unless the fund is held in a tax-advantaged account like an IRA or a 401(k). They can also be costly. While capital gains on holdings held for more than a year are taxed at a rate of 0%-15%, depending on your tax bracket, short-term capital gains (on securities the fund held for less than a year) are taxed as ordinary income. As critics of mutual fund capital gains treatment often point out, it's also possible for a newly arrived shareholder in a fund to receive a taxable capital gains payout, even though that new shareholder has never pocketed a dime in profits.

It pays to do your homework to ensure that a fund you own--or one you're about to buy--isn't a tax trap. Below, we've outlined some key red flags of which you should be aware.

## Impending Capital Gains Payouts

This trap is easy to avoid: Mutual funds typically make capital gains distributions to shareholders near the end of the calendar year for any gains that were made during the year from its underlying securities. For that reason, investors should not purchase shares of a mutual fund without taking note of realized capital gains that the fund has not yet distributed. ("Realized" means the fund has already sold the winning security.)

Moreover, investors should never buy shares of a fund right before it distributes its capital gains. A quick phone call or visit to the company's website for details about its policy on capital gains distributions--how much it plans to pay and when--will help investors avoid a tax bill for gains they never received. If you discover that a fund is right around the corner from distributing its capital gains, hold off on buying shares until that distribution has been made. (Don't get too cute about selling a fund you own right before it makes a distribution, unless you wanted to sell it anyway. In so doing, you could generate a taxable capital gain of your own.)

## Gains on the Way?

Investors who are considering a new purchase of a fund should also consider potential tax liabilities by making note of a fund's unrealized gains (that is, securities have appreciated since the manager bought them but the manager hasn't yet sold them). Those unrealized gains, while not taxable today, might later become taxable realized gains if management decides to sell.

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One way for investors to get an idea of the potential tax consequences of an investment is by looking at a fund's potential capital gains exposure, or PCGE, which can be found within the "Tax" tab on any individual Fund Analyst report in the Morningstar Investment Research Center database. This data point measures the percentage of a fund's assets that consist of gains that have not yet been distributed to shareholders or taxed. A high PCGE can be a precursor to future tax pain; if the manager were to sell positions that have appreciated a great deal since the original purchase, a big tax bill could be on the way. But that's a pretty big if.

Low-turnover funds with no change in management, strategy, or asset size can hum along with high PCGEs for years without paying out sizable capital gains to shareholders. Big market downturns, such as the one from 2007 through 2009, can also take a fund's PCGE from lofty to negative in short order.

When a high PCGE is combined with some fundamental change in the fund, however, that can be a red flag. A new manager behind the helm of a fund could initiate a strategy change, which usually entails shedding some long-held positions and bringing in fresh purchase ideas. If that new manager were to go on a selling spree, a fund's potential capital gains can change to realized capital gains in a hurry.

Shareholders should also be on high alert if their fund has a high PCGE and has recently seen a rash of shareholder redemptions. This phenomenon was especially rampant in 2008, when managers had to sell off long-term positions because investors were exiting funds en masse and seeking

redemptions of their shares. Managers were forced to sell long-held securities and pass on the tax penalties to the shareholders who stuck around.

In a similar vein, a fund's closing can also lead to higher tax bills for those who own the fund. It's rarely a bad thing when a fund closes its doors. But as with the above scenario, keep in mind that big capital gains distributed over a restricted base of shareholders means that each investor gets a larger slice of the capital gains pie.

#### **Another Red Flag: High Turnover**

If you're holding a fund in a taxable account, another red flag is heavy trading, which could result in frequent capital gains distributions, some of them short-term. Keep an eye on a fund's turnover ratio and seek low numbers here--preferably less than 25--for funds whose managers aren't doing a whole lot of buying and selling. Higher turnover isn't always a bad thing--in fact, a fund that has a relatively high turnover rate but delivers strong aftertax returns might still be worth a look. But high turnover can result in capital gains, some of them short-term, as well as higher trading costs associated with all of that buying and selling.

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# Taxation and Stocks: The Basics

## What you will learn:

- ▶ Holding securities for at least a year can help you save tax dollars
- ▶ Consider taking a loss in order to offset some of the gains you've made
- ▶ Timing matters--time the capital gains and losses strategically

## Hold Securities for at Least a Year

Capital gains--the difference between what you sell a stock for versus what you paid for it--are "tax preferred," or taxed at lower rates than ordinary income, but you are only entitled to the capital gains tax rate if you have owned the security for more than one year. If you hold a security for less than a year, your gains will be taxed at ordinary income rates. Capital gains are taxed at the much lower rate of 15%, and taxpayers in the 10% and 15% tax brackets will not owe capital gains tax on the sale of assets they've owned for a year or more.

## Consider Taking a Loss

Although it's never fun to lose money, you can reduce your tax bill by using capital losses to offset capital gains. If you happen to have both short-term and long-term capital gains, you may want to consider realizing short-term capital losses on stocks you have held for less than one year. These short-term losses will offset your short-term gains, which are taxed at higher ordinary income rates. This will give you the most tax mileage for your capital loss.

## Time Capital Gains and Losses Strategically

When faced with large capital gains and losses, it may be advantageous for you to realize both in the same year. Suppose you have \$30,000 of capital gains and \$30,000 of capital losses. If you realize only the gain in 2010, you will have to pay tax on the entire \$30,000. If you decide to realize only your loss in 2010, you'd have no capital gains to offset it, and you could only deduct \$3,000 against your other income. The remaining \$27,000 loss must be carried over into future

years. Instead of delaying the tax benefits of your loss, you could choose to realize both the capital gain and loss in the same year. Because they completely offset each other, you would not owe any taxes.

On the other hand, if you do not have a large capital loss to offset, you should generally time the realization of long-term capital gains--which will be taxed at favorable rates--for years when you do not realize any capital losses. Then you can realize your future capital losses in years when you can immediately deduct them against other income that might be taxed at higher ordinary income rates.



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