# financial *focus*

**Sullivan Mermel, Inc.**
**Fee-Only Financial Advisors**

**Bridget Sullivan Mermel, CFP®, CPA**
3744 North Southport, Ground Unit
Chicago, Illinois 60613
Phone: 773-404-9344
Fax: 773-327-1461

b@sullivanmermel.com • www.sullivanmermel.com

**Summer 2011**

## WHY YOUR WORKING TEEN NEEDS A ROTH IRA

*by Karin E. McKerahan, MBA, CFP® Temecula, CA*

Your teenager may not get rich mowing lawns or babysitting for the neighborhood children, but contributing some of those after-school earnings to a Roth IRA can pave the road to a more secure financial future. Any child with "earned income," regardless of age, is eligible to contribute. Sure, Roth IRA contributions are not tax deductible, but most kids pay little or no taxes anyway. Best of all, the money will grow tax free for decades. Even if your children do not receive a W-2 for their work, have them keep a record of the dates and hours worked and the amounts earned. Your children can add up to $5,000 each year to a Roth IRA, and it doesn't matter where the money comes from. Parents or grandparents often provide the cash for the contributions while the child's actual earnings are saved for college; it doesn't matter as long as the contribution does not exceed the amount of earnings for the calendar year. A Roth IRA can be opened at almost any financial institution: consider a discount brokerage or low-cost mutual fund company; look for no or minimal annual fees; and finally, choose a no-load, low expense ratio index fund as the investment vehicle. The deadline for contributing for the current calendar year is April 15 of the following year.

Here's a detailed example that illustrates how Roth contributions for children work and how contributions made early in life can provide a significant boost to future retirement savings:

Thirteen-year-old Megan babysits a couple of times each month during 2011 and earns $25 each time. With her mother's help, she records her earnings in a simple spreadsheet on her computer. By year's end, she has earned $550. Although this money is deposited to her college savings account, her parents agree to provide the cash for Megan to open a Roth IRA for 2011. And so each year until Megan graduates from high school, she contributes $550 to her Roth IRA.

With her parents' guidance, in early 2012 Megan opens a Roth IRA account online and chooses a diversified no-load equity index fund as the investment vehicle. Because she has no other earned income, Megan is not required to file a tax return and is therefore in the 0% tax bracket. So she is not giving up any tax savings that could potentially be realized with a traditional IRA contribution.

Assuming her Roth IRA earns 7% per year between ages 13 and 18, and she makes six annual contributions of $550, Megan's account will grow to approximately $3,934 by the time she enters college at age 18, a satisfying amount of growth. But during the next 50 years of Megan's college and working years, that sum will grow to an astounding $115,884 assuming the same 7% average annual return! Even with a more modest 4% annual return, Megan's $3,300 in babysitting earnings would grow to $27,958 in 50 years. Had Megan waited until she completed graduate school at age 25 to begin contributing to a Roth IRA, she would need to contribute $468 *every year* for 43 years to end up with the same $115,884 at age 68.

Besides the obvious benefit of Megan's long time horizon over which the compounding of interest works its magic, Megan also learns at a very young age the discipline of regularly saving for retirement. And saving at least 10% of your income for retirement is one of the five fundamentals of fiscal fitness prescribed by all ACA advisors. Contact your advisor if you have questions regarding how to establish Roth IRA accounts for your children.

## INSIDE THIS ISSUE

## DISASTER PLANNING STRATEGIES

# TSUNAMIS, TORNADOES, LIGHTNING BOLTS: WAKE-UP CALLS FOR DISASTER PLANNING

*by Constance A. Stone, CFP®   Chagrin Falls, OH*

Spring 2011: The Japanese are struggling to rebuild their lives after the earthquake and tsunami. A host of tornadoes swept the mid-Atlantic and southern states devastating the lives of thousands. Four people in Michigan were struck by lightning at a church camp. The news reports are full of disasters lately.

Mother Nature reminds us constantly that *she* is in control; we aren't.

Your financial advisor probably gave you a checklist to prepare for a disaster and protect yourself from identity theft. Have you completed it? Most people find the list daunting, if not downright overwhelming. Would you commit to tackling the list over the next six months? Here's a suggested schedule:

### *June*

- ❑ Buy a waterproof/fireproof safe to keep important documents. Make sure the inside is large enough because the outside size can be deceiving. This can be in addition to or as an alternative to a safe deposit box at the bank.
- ❑ Gather all important documents and file them in the safe. Scan some of them each month to your hard drive and/or a CD and re-file the originals in your safe.
- ❑ Provide a list of the contents of your safe, along with the location of the key (or a duplicate key) or combination, to a trusted relative or friend living out of state.
- ❑ Purchase an offsite backup service for your computer if you don't have one already (e.g., you can get MozyPro for $4.95/month at www.mozypro.com).
- ❑ Make a disaster recovery backup file of your hard drive on the offsite backup.
- ❑ Install a firewall and antivirus software on your computer if you haven't already done so.
- ❑ Scan copies of all birth certificates, driver's licenses, passports, Social Security cards, credit cards, and insurance policies to a CD or your hard drive.

### *July*

- ❑ Put some emergency cash in your safe in case banks are closed for several days.
- ❑ Buy a copy of Kiplinger's *Your Family Records Organizer* CD and begin to populate three to five categories of documents.
- ❑ Scan your health-care proxy and general powers of attorney, medical directives, wills, and trusts. Scan retirement plan records, including account numbers and written beneficiary designations.

### *August*

- ❑ Scan your most recent account statements for all assets and liabilities.
- ❑ Scan your real estate deeds, appraisals, and loan agreements.
- ❑ Scan your auto titles and registration (keep photocopies in your car).

### *September*

- ❑ Continue to complete three to five more sections of the *Kiplinger Family Records* CD.
- ❑ Take a videotape or digital camera tour of your house, garage, and outdoor property to serve as a memory aid if your house is destroyed. It also provides documentation for an insurance claim.
- ❑ Scan appraisals of expensive personal property.

### *October*

- ❑ Visit one of the following websites for emergency preparedness checklists and supplies: http://www.ready.gov, http://www.citizencorps.gov, or http://www.bt.cdc.gov/planning.
- ❑ Develop and discuss a household plan in case of emergency. If you live alone, partner with someone you can contact in case of emergency.
- ❑ Gather supplies for a portable emergency kit as recommended above.

### *November*

- ❑ Obtain your credit records from one of the three credit bureaus (Equifax, Experian, and TransUnion) using a free website such as https://www.annualcreditreport.com.
- ❑ Mark your calendar to get a second free credit report from another bureau in 4 months and a third in 8 months. Continue on this schedule once a year.
- ❑ Move your Social Security card, extra credit cards, and your checkbook from your wallet to your safe. Leave them at home until you need them.

### *December*

- ❑ Upon receipt, begin to shred all unwanted mail that contains your Social Security number and confidential account numbers.
- ❑ Start shredding old records you no longer need and keep it up until they're gone! (Ask your financial advisor if you have questions on what to keep and/or see the article in this issue of ***Financial Focus***.)

Once through this list, congratulate yourself. You now have the tools to make identity protection and disaster preparation a part of your routine.

**Be safe! Be proactive! Be secure!**

## WHAT TO KEEP? WHAT TO TOSS?

*by Rob Reed, PhD, CFP® Columbus, OH*

We are being buried in ever-mounting piles of paper, and we are afraid to dig our way out. Just as we are about to toss something, a nagging voice in our head whispers, "Careful! It might be important." Throwing away documents you might need later is not a good idea, but just as bad is keeping so many you have no idea what you have or where anything is. What you're searching for might as well be gone.

A note on storage: You can keep most records in a file cabinet. Your important papers deserve a fireproof box ($75) or a safe deposit box (the rent is tax deductible). Finally, a paper shredder ($40) is a good investment for tossing documents containing your name and important numbers.

### Keep (More or Less) Forever

- Auto title and driver's license
- Birth and death certificates
- Home improvement receipts
- Home purchase or refinance documents
- Insurance policies (current)
- IRA contributions (nondeductible)
- Legal documents (in force)
- Marriage certificate (even if divorced)
- Medicare card
- Military discharge papers
- Passport
- Social Security card


**Auto title and driver's license:** Keep your car title for as long as you own the car. Even if you don't drive anymore, keep your driver's license; it is a generally accepted ID.

**Home improvement receipts:** Keep the bills for permanent improvements, such as a room addition. These costs reduce your capital gain when you sell. Keep all records on your *home purchase or refinance* until you sell your home.

Keep the original and latest renewal statements of any current insurance policies.

You need a record of your nondeductible IRA contributions to prove to the IRS that you already paid tax on the money (so they can't tax it again when you take it out).

In-force legal documents include wills, trusts, financial and health-care powers of attorney, living wills, real estate deeds, and divorce papers. It is a good idea to keep copies of these documents with your attorney or a relative and to leave a record of where the copies are located. If any documents are no longer in force or binding on you, they can be thrown away.

### Keep Less Than Forever

Because you don't want to keep all documents forever, you must periodically weed your files.

▲ **Bills:** Keep bills for major purchases—cars, furniture, and computers are examples—to show proof of their value in case of loss or damage. I staple mine inside the instruction manual. For all other bills, shred them once the payment has cleared or the refund period expires. Shred anything relating to an item you no longer have.

▲ **Credit card receipts and statements:** Keep your receipts until your monthly statement arrives. If it is correct, shred the receipt. But keep a receipt if you are disputing the bill. Keep statements for six years if they contain tax-related items. It is convenient to keep these with the tax return, so when you shred the return you also shred the (now excess) paper supporting it.

▲ **Bank checks and statements:** Keep only what involves tax records. If someone disputes a payment, you can get copies of anything you need from the bank. If tossing this makes you nervous, keep it all until your taxes are prepared; then shred everything not used in your return.

▲ **Mutual fund statements:** Keep your quarterly statements until you receive your annual summary. If everything is OK, shred the quarterlies. Hold the annual statements until you close the account (mutual funds) or retire (retirement statements).

▲ **Brokerage statements:** Most brokerage houses send out annual summaries that recap the year's activity. If so, keep the annual statement and shred the monthly statements. But be sure to check because you need a record of how much you paid for your investments (the basis).

▲ **Pay stubs:** Keep all pay stubs until you get your W-2. If the numbers are correct, shred the stubs. If your company lists vacation/sick leave carryover on your stub, keep the last one for a year. Notify the company if the information doesn't match.

▲ **Tax documents:** Keep a copy of your returns and all attachments, receipts, and other documents you used to prepare the return. The IRS can go back only three years to question a return unless they believe there was deliberate fraud. Then there is no time limitation. If it makes you more comfortable, keep your tax documents forever. After three years, just put them in a box in the attic. (Yeah, yeah, I know that wasn't what I said in the beginning, but it is amazing to pull out a return from 20 years ago and see how little you lived on.) ■ ■ ■

## SIMPLE CREDIT CARD STRATEGIES

*by Claire Emory, CFP®, CFA, MBA Arlington, VA*

It's been hard to avoid reading about the ever-increasing size of the federal deficit and various ideas about what to do about it. Most of us don't have any direct influence over decisions made in Washington, but what about our own personal spending and the height of our household debt ceiling? This kind of spending we *can* control, and when we recognize a problem, we can choose our response.

Of course, overspending is closely tied to credit card debt. The level of credit card debt in the United States has actually decreased during the past few years of financial crisis and sluggish recovery. But credit cards still play an enormous role in the financial life of most households. According to a Federal Reserve Bank survey, Americans hold almost 610 million credit cards, more than three per household. The typical American gets a first credit card at the age of 20, often while still in college, living at home, or not employed full time. The average credit card debt carried by households with a revolving balance currently is $14,750. In addition, of course, there is often a mortgage, auto, or student loan debt.

### Good Debt versus Not-So-Good Debt

Debt is actually a double-edged sword: it can be either a positive or a negative influence on your financial well-being. Good debt includes sensible financing for a purchase that will outlast the duration of the loan and provide positive leverage in a way that gets you more bang for your buck. For instance, a home mortgage can allow you to enjoy your home (which should last longer than the term of the loan), allow you to build equity, and give you a mortgage interest income tax deduction. Likewise, a three-year auto loan for a fuel-efficient vehicle can provide positive leverage if you use it for employment and increased earning potential.

But what about using credit cards to pay for dinner out, or for a spur-of-the-moment Caribbean vacation, or a latte every morning on the way to the office? If you've been lugging a balance around for years while making only the minimum payment, you might want to think about where your choices are leading you. Now that issuers are required to disclose the long-term effects of making only the minimum payment, it's a lot harder for those of us with spending issues to pretend we're not aware of what we're doing. It can be more than a little sobering to see just how much our fleeting pleasures are going to cost us down the road if we fail to adjust our habits.

### Controlling Spending

If you're living in a household that perpetually carries a credit card balance or you sometimes feel you're at risk of heading in that direction, what are some ways to patch the cracks in your financial foundation and improve your peace of mind going forward?

✔ ***Focus on savings.*** Setting money aside upfront to use for a vacation or other desired discretionary purchase can help reduce the temptation to use credit card financing to give yourself the reward you feel you deserve. Watching the vacation or other fund accumulate can bring its own satisfaction.

✔ ***Use cash.*** More than one study has shown that consumers who use a credit card buy more than those who use cash. Give yourself an allotment of cash to spend each week and see how clever you can be in maximizing the value you receive for that amount.

✔ ***Pay off the highest rates first.*** Make a list of your credit card debts and the corresponding interest rates. Focus your strategy on paying as much as possible toward the balance with the highest rate while making the minimum payments on the others.

✔ ***Track the small stuff.*** Keep receipts for every expense or a journal of the amounts you spend on discretionary purchases. It's hard to cut back, and easy to deceive yourself, if you don't know exactly where your money goes.

✔ ***Share responsibility.*** Knowing that money stress hurts marriages and other partnerships, sit down together to set a spending strategy. Teach children the rewards of sound financial habits (the Money Savvy Generation website, www.msgen.com, has great resources such as the Money Savvy Pig for youngsters and the Cash Cache for teenagers as well as materials for parents and teachers).

✔ ***Freeze the cards.*** If you can't bear to cut up your credit cards but still need a serious change, freeze the cards in a block of ice. You know they're there if you really need them, but you can only use them with foresight and planning.

Don't let dysfunctional spending get a grip on your household. If consumer debt is using you rather than the other way around, say "no" to the plastic and reward yourself with financial peace of mind.