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June...Finally the end of Winter!
Though the seasons have been slow to progress, the busy world keeps moving on. The articles in this issue should help you to get caught up on the financial end. From tax management, to prioritizing funding for retirement and college, decisions on when to start saving, to understanding what will happen to bonds with inflation, there are many details to consider in your financial life.

We can help you navigate those tough decisions.

Check out our website www.craigprudhomme.com, and consider scheduling an appointment to see how we can help you achieve your financial goals.

June 2014

Top 10 Tax Breaks You'll Miss in 2014

Financial Choices: College, Retirement, or Both?

Saving for the Future: Start Now or Start Later?

How much money should a student borrow for college?



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Top 10 Tax Breaks You'll Miss in 2014



You probably didn't notice, but when the clock struck midnight on December 31, 2013, a number of popular tax benefits, commonly included in the list of provisions referred to as "tax extenders" expired. While it's possible that Congress could retroactively extend some or all of these items, you'll have to evaluate your 2014 tax situation based on the fact that they're no longer available.

1. Qualified charitable distributions

For the past few years, a qualified charitable distribution (QCD) of up to \$100,000 could be made from an IRA directly to a qualified charity if you were age 70½ or older. Such distributions were excluded from income *and* counted toward satisfying any required minimum distribution (RMD) that you would otherwise have had to take from your IRA for that tax year. QCDs aren't an option for 2014, however.

2. Qualified small business stock exclusion

For qualified small business stock issued and acquired after September 27, 2010, 100% of the capital gain resulting from a sale or exchange could be excluded from income, provided certain requirements, including a five-year holding period, are met. For qualified small business stock issued and acquired after 2013, however, the amount that can be excluded from income drops to 50%.

3. Deduction for higher education expenses

The above-the-line deduction for qualifying tuition and related expenses that you pay for yourself, your spouse, or a dependent is not available for 2014.

4. Classroom educator expense deduction

The above-the-line deduction for up to \$250 of unreimbursed out-of-pocket classroom expenses paid by qualified education professionals also expired at the end of 2013.

5. State and local sales tax deduction

If you itemize deductions for the 2014 tax year, you won't have the option of claiming a deduction for state and local sales tax in lieu of the deduction for state and local income tax.

6. Depreciation and expense limits

The maximum amount that can be expensed under Internal Revenue Code Section 179 drops significantly from its 2013 level of \$500,000 to \$25,000 for 2014. The special 50% "bonus" first year additional depreciation deduction has also ended.

7. Mortgage insurance premiums

Starting in 2014, individuals who itemize deductions will no longer have the ability to treat premiums paid for qualified mortgage insurance as deductible interest on IRS Form 1040, Schedule A.

8. Employer-provided commuter expenses

For 2013, you could exclude from income up to \$245 per month in transit benefits (e.g., transit passes) and \$245 per month in parking benefits. For 2014, the monthly limit for qualified parking increases to \$250, but the monthly limit for transit benefits drops to \$130.

9. Energy efficient home improvements and property

The nonbusiness energy property credit offset some of the costs associated with the installation of energy efficient qualified home improvements (e.g., insulation, windows) and qualified residential energy property (e.g., water heater, central air). Specific qualifications and limits applied, and an overall lifetime cap of \$500 was in effect for 2013. The credit is not available at all in 2014.

10. Discharge of debt on principal residence

Since 2007, individuals have generally been allowed to exclude from income amounts resulting from the forgiveness of debt on their principal residence. This provision expired at the end of 2013.

Financial Choices: College, Retirement, or Both?



A juggling act

It's the paramount financial conflict many families face, especially as more couples start having children later in life. Should you save for college or retirement? The pressure is fierce on both sides.

Note

*All investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.

Life is full of choices. Should you watch *Breaking Bad* or *Modern Family*? Eat leftovers for dinner or order out? Exercise before work or after? Some choices, though, are much more significant. Here is one such financial dilemma for parents.

Should you save for retirement or college?

It's the paramount financial conflict many parents face, especially as more couples start having children later in life. Should you save for college or retirement? The pressure is fierce on both sides.

Over the past 20 years, college costs have grown roughly 4% to 6% each year—generally double the rate of inflation and typical salary increases—with the price for four years at an average private college now hitting \$192,876, and a whopping \$262,917 at the most expensive private colleges. Even public colleges, whose costs a generation ago could be covered mostly by student summer jobs and some parental scrimping, now total about \$100,000 for four years (Source: College Board's Trends in College Pricing 2013 and assumed 5% annual college inflation). Many parents have more than one child, adding to the strain. Yet without a college degree, many jobs and career paths are off limits.

On the other side, the pressure to save for retirement is intense. Longer life expectancies, disappearing pensions, and the uncertainty of Social Security's long-term fiscal health make it critical to build the biggest nest egg you can during your working years. In order to maintain your current standard of living in retirement, a general guideline is to accumulate enough savings to replace 60% to 90% of your current income in retirement—a sum that could equal hundreds of thousands of dollars or more. And with retirements that can last 20 to 30 years or longer, it's essential to factor in inflation, which can take a big bite out of your purchasing power and has averaged 2.5% per year over the past 20 years (Source: Consumer Price Index data published by the U.S. Department of Labor, 2013).

So with these two competing financial needs and often limited funds, what's a parent to do?

The prevailing wisdom

Answer: retirement should win out. Saving for retirement should be something you do no matter what. It's an investment in your future security when you'll no longer be bringing home a paycheck, and it generally should take precedence over saving for your child's college education.

It's akin to putting on your own oxygen mask first, and then securing your child's. Unless your retirement plan is to have your children be on the hook for taking care of you financially later in life, retirement funding should come first.

And yet ...

It's unrealistic to expect parents to ignore college funding altogether, and that approach really isn't smart anyway because regular contributions—even small ones—can add up over time. One possible solution is to figure out what you can afford to save each month and then split your savings, with a focus on retirement. So, for example, you might decide to allocate 85% of your savings to retirement and 15% to college, or 80/20 or 75/25, or whatever ratio works for you.

Although saving for retirement should take priority, setting aside even a small amount for college can help. For example, parents of a preschooler who save \$100 per month for 15 years would have \$24,609, assuming an average 4% return. Saving \$200 per month in the same scenario would net \$49,218.* These aren't staggering numbers, but you might be able to add to your savings over the years, and if nothing else, think of this sum as a down payment—many parents don't save the full amount before college. Rather, they try to save as much as they can, then look for other ways to help pay the bills at college time. Like what?

Loans, for one. Borrowing excessively isn't prudent, but the federal government allows undergraduate students to borrow up to \$27,000 in Stafford Loans over four years—a relatively reasonable amount—and these loans come with an income-based repayment option down the road. In addition, your child can apply for merit scholarships at the colleges he or she is applying to, and may be eligible for need-based college grants. And there are other ways to lower costs—like attending State U over Private U, living at home, graduating in three years instead of four, earning credits through MOOCs (massive open online courses), working during college, or maybe not attending college right away or even at all.

In fact, last summer, a senior vice president at Google responsible for hiring practices at the company noted that 14% of some teams included people who never went to college, but who nevertheless possessed the problem solving, leadership, intellectual humility, and creative skills Google is looking for ("In Head-Hunting, Big Data May Not Be Such a Big Deal," *New York Times*, June 19, 2013). One more reason to put a check in the retirement column.



Saving for the Future: Start Now or Start Later?



No matter how you save to reach a future goal, there is an advantage to putting your savings and earnings to work for you as early as possible.

All examples are hypothetical and are not guaranteed. Fees and taxes are not shown and could reduce the amount available.

**All investment involves risk, including the possible loss of principal.*

There are many ways to try to reach a future goal. You can save now, or you can save later (or perhaps do both). But there is an advantage to putting your savings and earnings to work for you as early as possible.

Compound earnings

If you save \$1,000 now and invest it at an assumed 6% annual rate of return, in 1 year you would have \$1,060, in 2 years about \$1,124, and in 10 years about \$1,791. Your earnings compound as you earn returns on your earnings. Your \$1,000 initial investment increases through compounding to \$1,791.*

Compounding at work

For example, let's say you start saving now. You save \$5,000 at the beginning of each year in years 1 to 20 and put it into an investment that earns a hypothetical 6% annually. At the end of 30 years, you will have accumulated about \$349,150.

Alternatively, let's say you start 10 years later. You save \$5,000 at the beginning of each year in years 11 to 30. Once again, you earn an assumed 6% annually on that money. At the end of 30 years, you will have accumulated about \$183,928.

In each of these examples, you've put aside a total of \$100,000. However, by starting now, you accumulate about \$165,222 more than if you start later, and all of that is from earnings. By starting now, rather than putting it off, you have put your money and the power of compound earnings to work for you.

| Years | Start Now | Start Later |
|-----------------|-----------|-------------|
| 1 - 10 | \$5,000 | |
| 11 - 20 | \$5,000 | \$5,000 |
| 21 - 30 | | \$5,000 |
| Saved | \$100,000 | \$100,000 |
| Earnings | \$249,150 | \$89,928 |
| Total | \$349,150 | \$183,928 |

Now, let's look at a different situation. Let's say you would like to start later but accumulate the same amount as if you had started putting money aside now. In this case, you would need to save more, about \$8,954 at the beginning of each year in years 11 to 30, in order to accumulate \$349,150 after 30 years.

In this example, you would need to save a total of about \$179,085. That's \$79,085 more than if you had started earlier, when compounding could have helped make up that difference. Compound earnings don't have as much time to

work for you when you postpone getting started.

| Years | Start Now | Start Later |
|-----------------|-----------|-------------|
| 1 - 10 | \$5,000 | |
| 11 - 20 | \$5,000 | \$8,954 |
| 21 - 30 | | \$8,954 |
| Saved | \$100,000 | \$179,085 |
| Earnings | \$249,150 | \$170,065 |
| Total | \$349,150 | \$349,150 |

Strike a balance

Of course, you could accumulate even more if you do both. For example, if you set aside and invest \$5,000 at the beginning of each year in years 1 to 30 and earn an assumed 6% annually on that money, at the end of 30 years, you will have accumulated about \$419,008. This is substantially greater than the \$183,928 accumulated if you invest \$5,000 in years 11 to 30, while somewhat greater than the \$349,150 accumulated if you invest \$5,000 in years 1 to 20.

But maybe you can't afford to set aside \$5,000 now. Could you manage \$3,000 this year, increase that amount for next year by 3% to \$3,090, and continue to increase the amount set aside by 3% each year? If that money earns an assumed 6% annually, you will have accumulated about \$351,520 at the end of 30 years, slightly more than the \$349,150 accumulated if you save \$5,000 each year in years 1 to 20.

Compared to saving \$5,000 a year for 30 years, you've contributed almost as much here (\$142,726 compared to \$150,000), but your earnings are substantially less (\$208,794 compared to \$269,008) because your largest contributions came in later years and had less time to work for you.

| Year | Constant | Increasing |
|-----------------|-----------|------------|
| 1 | \$5,000 | \$3,000 |
| 2 | \$5,000 | \$3,090 |
| ... | | |
| 29 | \$5,000 | \$6,864 |
| 30 | \$5,000 | \$7,070 |
| Saved | \$150,000 | \$142,726 |
| Earnings | \$269,008 | \$208,794 |
| Total | \$419,008 | \$351,520 |



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How much money should a student borrow for college?

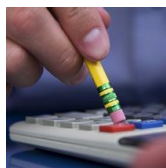
There's no magic formula to determine how much you or your child should borrow to pay for college. That being said, there is such a thing as borrowing too much. How much is too much? Well, college counselors typically recommend that students borrow no more than the amount they expect to earn in their first year out of college, which in turn depends on a student's individual major and job prospects. So, for example, a student planning to get an engineering degree might borrow about \$50,000 or \$60,000 if he or she expects to obtain a job after college paying that much, while a student majoring in social work might borrow much less.

But this guideline is just that--a guideline. Just as many homeowners got burned taking out larger mortgages than they could really afford (even though their lenders may have told them they were "qualified" for that amount), many students are getting burned borrowing amounts that may have seemed reasonable at first glance but now in reality are not.

Remember, student loans will need to be paid back over a term of 10 years or longer. What if

the engineering graduate doesn't have that steady, well-paying job for 10 years? What if he or she decides to step out of the workforce to care for children? What if the company downsizes? What happens when other expenses like housing, utilities, car payments, daycare, and home repairs come down the pike? What if he or she wants to go on to graduate school? Any interruption in the payment of these student loans via deferment or forbearance requests will only add to a borrower's overall balance.

According to the Project on Student Debt, 71% of students who graduated from college in 2012 had student loan debt, and the average balance was \$29,400 (*Student Debt and the Class of 2012*, December 2013). With a 10-year term and a 3.8% interest rate (the current rate on federal Stafford Loans), the monthly payment would be \$295. But borrow a bit more, say \$40,000 total, and the monthly payment jumps to \$401. And these figures are conservative, because the interest rates on federal Stafford Loans and private student loans have nowhere to go but up. So student borrowers beware! Don't be led blindly into excessive student loan debt based on a guideline you didn't create.



What is duration, and why should I pay attention to it?

The Federal Reserve's actions over the next year could be important to bond markets, particularly if and when the Fed decides to increase its target interest rate. Since bond prices typically move in the opposite direction from yields, rising bond yields will translate into a decline in bond prices.

If you have bonds or bond mutual funds in your portfolio, you might want to pay attention to the duration of each one. Technically, a bond or bond fund's duration calculates the length of time it will take to receive the full true value of the investment; duration takes into account the present value of expected future payments of interest and principal.

However, duration's biggest value to an investor is as a gauge of how sensitive a bond might be to changes in interest rates. The longer a bond's duration, the more its price is likely to be affected by an interest rate change. A mutual fund's duration can be found in its prospectus; for an individual bond, you'll probably need to ask your broker or the bond's issuer.

To estimate the impact of an interest rate

change on a specific bond holding, simply multiply its duration by the change in interest rates. For example, for a bond fund with a duration of 5 years, a 1% increase in interest rates would generally result in a 5% drop in the fund's value (1% x 5 years = 5%). Though the Fed's target rate is already at its historic low, the same principle would apply in reverse if interest rates were to fall. A 1% decline in interest rates would likely result in a 3% gain for a bond holding with a duration of 3 years.

Note: *These hypothetical examples are intended as an illustration only and do not reflect the performance of any specific investment. They should not be considered financial advice. Before investing in a mutual fund, consider its investment objective, risks, fees, and expenses, which can be found in the prospectus available from the fund. Read the prospectus carefully before investing.*

Bear in mind that duration can work somewhat differently for specific types of bonds--for example, floating-rate bonds whose interest payments get reset. That's also true for mortgage-backed bonds, since interest rate changes can cause homeowners to refinance their loans.