Greetings from the entire staff of
Cambridge Connection, Inc.
- Please enjoy our End of Summer-Fall newsletter

Fiduciary Responsibility

It's in the news, on the radio, broadcast on television - Financial Advisors are now being "held to a fiduciary responsibility". The FPA (Financial Planners Association) describes this responsibility as the powerful bond that is formed when you look your financial advisor in the eye and share family information, finances, and estate plans, just to name a few.

What's new in the news is not new at Cambridge. We have held ourselves to a higher fiduciary standard for over 30 years. We have a formal Code of Conduct and follow a Code of Ethics. They are published on the SEC website (see Client Notice below) and at www.cambridgeconnection.com.

Most everyone has heard our long standing ethical standard. "Our fees are not contingent upon the outcome of any transaction where the client relies on our advice". We're honored that NAPFA (National Association of Financial Advisors) has recently adopted this as their policy.

Recently a new client at our Tucson office discussed how we distinguish ourselves in the industry. She is so excited about the Cambridge system and the changes it has already made in her life and often shares her experience with her friends. She asked for help on what she should say to tell others. It's understandable as she hears 'how do you know you can trust them, remember Bernie Maddoff" or "my financial guy is always asking me about additional money I have that can be invested with him, but if I ask for his advice on buying a new car or some investment property, he either doesn't know how to help or pushes me to invest".

At Cambridge Connection, we sit on your side of the table. Since we are both comprehensive and holistic, we want clients to discuss all their financial issues with us. Often our value added advice comes from keeping clients from making bad financial choices. We have worked with many clients dealing with major financial concerns during trying emotional times; imagine a child needing rehabilitation from drug abuse for example. Or one of our favorites, helping clients to make the decision (not) to by a timeshare or that property they may vacation in once a year! Recommendations are made that we would make for ourselves.

Many thanks to all of our clients for your continued support and belief in the Cambridge System. If you know someone struggling in these adverse economical times, we are available for one-time Cambridge Financial Reviews.

Bert's Blog, by Pam: Year-end Tax Tips

I have turned this blog over to my esteemed colleague Pamela Landy, M.B.A., CFP, J.D., as she is better versed on many of these pointers than I am. These next three months will be a terrific opportunity for tax-smart citizens!

Visit "Bert's Blog"* http://bertwhitehead.blogspot.com/ *to read -
From the Desk of . . . Pamela Landy, MBA, JD, CFP®, CSA®
2010: A Challenging Year for Tax Planning

Staff
Bert Whitehead, President
Serving Michigan/Arizona/California/Florida
Chris Zehnder, Senior Advisor – Florida/California –Bert's Team
Melissa Scenga, Associate Paraplanner –Bert's Team
Sean Ryan, Associate Paraplanner –Bert's Team
Jane Miller, Associate Paraplanner –Bert's Team
Pamela Landy, Senior Advisor - Michigan
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Samuel Chow, Associate Paraplanner –Pamela's Team
Tracy Moore, Team Organizer –Pamela's Team
Tiger Whitehead – Business Consultant
Carol Johnson, Operations & Compliance
Carrie El-Manaseer, Strategic Coordinator

www.cambridgeconnection.com

MICHIGAN
Also serving Arizona, California & Nevada
26111 W 14 Mile Rd, Ste LL6
Franklin, Michigan 48025
248.737.7090 ♦ 800.224.1040

FLORIDA
Also serving Georgia
The Danley Professional Building
2013 Live Oak Blvd, Suite L
St Cloud, FL 34772
407.957.0074

ARIZONA
4435 E. Calle del Conde
PO Box 65865
Tucson, Arizona 85718
520.529-9788 ♦ 800.244.1040

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financial focus

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Summer 2010

THREE CRUCIAL NUMBERS FOR ROTH CONVERSIONS

by Jo Anne Paynter, CFP® Grove City, OH

In the last issue of Financial Focus, we discussed why you might want to do a Roth conversion. We can see some of the most interesting benefits of Roth conversions by looking at three numbers: investment years, marginal tax rate, and tax drag.

Investment Years

What are your plans for the account you're going to convert to a Roth? Will you to tap it as an income source during your and your spouse's lifetimes? Or do you want to pass it on to your children or grandchildren?

Depending on your longevity, you could have quite a few investment years ahead of you. The number of investment years describes how long the account will be able to accumulate value.

A 45-year-old investor (who happens to be converting an IRA to a Roth this year) could very well live to age 85. In those 40 years, a $10,000 Roth conversion, left untapped and earning 7.5% per year, would grow to about $180,000. If left to grow to age 95, the value would reach about $370,000.

The accumulation doesn't have to stop there. Because Roth accounts aren't subject to Required Minimum Distributions (RMDs) until after the original owner dies, you could let it continue to grow, taking nothing for yourself and leaving it to your children or grandchildren. The number of investment years would then extend for the remainder of your life, plus the number of years your beneficiaries live on. You might be creating an account that will grow for more than a century!

Of course, once the beneficiaries receive the account, they are required to take out RMDs over their lifetimes. But these distributions start out as fairly small compared with the growth of the account. For instance, a 25-year-old beneficiary needs to take an RMD of only about 1.72% of the account balance, leaving the remainder to grow until the next year. A 35- or 45-year-old would need to take only about 2.06% or 2.58%, respectively. This leaves the great majority of the account untapped, accumulating value for your beneficiaries.

Marginal Tax Rate

You may know that for your traditional IRA, you must take your own RMD when you reach age 70½. (Beneficiaries must take RMDs no matter what their age.) These distributions are taxed at the recipient's marginal tax rate, the income tax rate applied to additional income they receive.

But distributions from a Roth account aren't taxable (assuming you've met all the requirements, like the five-year holding rule and being at least age 59½). Roth assets don't require RMDs from the original account owner, and it's nice to have a Roth account to dip into for an unexpected expense. Whether you have a chance to take a trip or you need to deal with an emergency repair, you don't have to worry about the tax consequences of taking a Roth distribution the same way you do for a traditional IRA.

If it's your heirs who will be taking the distributions—and they will be required to take RMDs—the non-taxability of these distributions can be especially beneficial. If the kids or grandkids have been successful in their own right, they could be in the top income tax brackets. For 2010, this means a Roth distribution saves the beneficiary up to 35% in federal tax, compared with having to take money from a traditional IRA. These savings would only increase in 2011 when the tax reductions put in place in the early 2000s expire and the top

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AS WORKER SHORTAGES INCREASE, SO WILL INCENTIVES TO KEEP BOOMERS ON THE JOB

by Karen Folk, PhD, CFP® Urbana, IL

For several years now, various agencies and academics have predicted a systemic labor shortage over the next 25 to 30 years. An employment gap is expected to widen between the number of retiring baby boomers and the number of college-educated workers entering the workforce. This labor shortage trend can pay off for those who want to retire gradually. Some boomers are finding that their bosses will make interesting compromises to give them an incentive to stay on full or part time.

What would convince you to stay on the job longer, semi-retire, or go back to work? In a survey of older workers published by the nonpartisan Employee Benefit Research Institute (EBRI) in the July 2008 EBRI Issue Brief, 29% of workers said that feeling truly needed for an assignment was one of the top three draws for staying on the job. Other incentives that ranked high included:

- Receiving a full or partial pension while working part time.
- A pay increase.
- Continuing company-subsidized health insurance at the same level as full-time workers.

If you are offered incentives to keep working as you phase into retirement, talk with your ACA advisor. You may want to consider several issues.

Consider a working retirement as a possible scenario. If you're 5 to 10 years from retirement, it makes sense to ask yourself under what conditions you'd return to the workplace. You obviously need to project what your potential retirement income will be if you retire fully. Then consider what working conditions and income would satisfy you in your post-retirement working life.

Consider how a return to the workplace will affect you personally and socially. If you're 40, 50, or 60, working right now probably feels quite natural. But it may not be the most appealing option after a year or two out of the workplace, especially if you don't find the incentives offered by your employer to be attractive. Give this some thought. If you get the call, be prepared with a counterproposal, to let the employer know what would convince you to come back.

Consider income taxes. Tax issues shouldn't determine your ambitions and goals, but it's important to consider the impact of employment income on your retirement. Will additional post-retirement income tip you into the Alternative Minimum Tax (AMT) or increase the amount of Social Security benefits that are taxed? Look for ways to control the taxes you'll ultimately pay, including continued participation in qualified plans, IRAs, and other tax-favored accumulation vehicles.

Consider how additional earnings will affect your other retirement resources. How might your return to work change the way you plan to draw on your retirement savings, investments, and Social Security? For instance, waiting until later (up to age 70) to start Social Security can have a dramatic effect on the amount of monthly benefits, providing an extra cushion of inflation-adjusted income when you fully retire.

Consider insurance issues. If you are already receiving Medicare or are covered by a Medigap policy, you may be able to lower your costs or improve your coverage by accepting employer-provided group coverage as your primary insurer. Because those over age 55 generally use the health-care system more than others, it's particularly important that you run these coverage issues by a financial expert.

Keep saving. If you return to the workplace, take advantage of your new employer's 401(k) plan or other tax-advantaged retirement savings benefit, particularly if an employer matches your contribution. Or if you're eligible, make new IRA contributions. Don't miss a chance to enhance your retirement savings.

Karen Folk, CFP®, a member of the FPA and ACA, adapted this column produced by the Financial Planning Association, the membership organization for the financial planning community.

BE PREPARED FOR AN IRS AUDIT: BUSINESS AND ITEMIZED DEDUCTIONS

by Stewart Farnell, PhD, CFP® Boulder, CO

To emerge from an IRS audit in good shape, you need to be prepared. And the time to prepare is now!

Naturally, you report all your taxable income and strive to report all legitimate deductions. Next, be sure you have good records to support your deductions. Record keeping is critical because with good records it is more difficult for the IRS to quarrel with your deductions. But if you lack records, the IRS has little reason to take your word that you are entitled to a deduction.

What records should you keep? This depends on the deductions you want to claim. Certainly, you need records for charitable contributions, unreimbursed work expenses, home offices, investment advice, business expenses, and more. To document these you generally can use receipts or cancelled checks. A charitable contribution by payroll deduction will show up on the Form W-2 or other documentation from an employer. Special rules apply to charitable contributions of $250 or more made in one day to one organization. In this case, a written receipt or acknowledgment letter from the organization is needed; a cancelled check from the organization will not suffice.

To claim mileage (for business, medical trips, and charitable work) you must keep a log of your travel. Many people do not do this, but you should. It is much easier to remember the details at the time of the trip than to piece it all together later. All you need to note is the date of the trip, destination, miles driven, and the purpose of the trip. Also note your odometer reading at the beginning and end of each year because the IRS often requires us to provide total miles driven for the year as well as deductible miles for business, medical, or charitable purposes. If you have not yet logged your miles for tax year 2010 to claim a deduction on your 2010 tax return, create your log now. Clearly mark that it was reconstructed from whatever sources you are using (calendar, PDA, diary, planner, etc.) and the date of reconstruction. Going forward, keep up your log regularly.

If you do not do a lot of deductible travel, your log can be very simple. If you do travel a lot, there are GPS devices to track miles, let you add notes as needed, and print reports. If you need an actual log book, your ACA advisor may be able to provide one for you. However you manage your mileage record keeping, just do it! If you're audited, you'll be very glad you did.

THREE CRUCIAL NUMBERS FOR ROTH CONVERSIONS

(continued from page 1)

tax bracket jumps up to 39.6%.

And that's just for federal income tax. Traditional IRA distributions can be subject to state tax as well. Although future income tax brackets are impossible to predict accurately, we can be quite sure we'll be glad to have assets to draw on that won't increase our tax liability or that of our beneficiaries.

Tax Drag

Closely related to marginal tax rate is tax drag, the tax cost associated with assets that could be put into a Roth account.

For instance, suppose you are in a fairly high tax bracket (perhaps 28% in 2010, which will be going up to 31% at the start of 2011). You may have assets that generate interest, or unqualified dividends, or capital gains. Those streams of income create tax liability each year at your marginal tax rate or capital gains tax rate, as the case may be. That part of your tax bill from the IRS (and the state, if applicable) is the tax drag on your net investable assets.

The new federal health-care legislation will only magnify tax drag for some investors. Beginning in 2013, the law imposes an additional 3.8% tax on all unearned income for high-income earners (those earning more than $200,000 per year for single taxpayers or $250,000 for married couples). That means additional tax on rents, royalties, dividends, capital gains, interest, and annuities. So your tax drag will grow as your taxable assets grow. Using a Roth could shelter future retirement distributions from taxation, reducing tax drag and thereby enhancing overall investment performance.

These three numbers—investment years, marginal tax rate, and tax drag—have something in common: we don't have direct control over any of them. Like many aspects of personal finance, we often need to make decisions without being able to completely predict the outcome. Roth conversion decisions bring with them lots of possible issues that can affect families in different ways. Your advisor can help you evaluate how these three numbers affect your Roth conversion plans.

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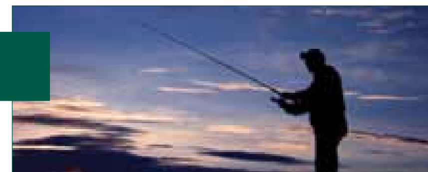

IF YOU'RE NOT SAVING, YOU'RE SPENDING TOO MUCH

by William Cuthbertson, MBA, EA., CFP® San Juan Capistrano, CA

Remember the good old days when popular wisdom said that as long as you're not living in debt, you're doing OK? Was that ever really true? Or like other so-called popular wisdom, was something missing?

I recently met a couple who asked, "How much do we need to save to get ready for retirement?" In a general sense, such a question can be answered fairly straightforwardly. However this particular couple has a much bigger task on their hands than they expected.

They have gross income of approximately $150,000 per year—and a net worth of only $50,000. Neither of their two children is financially independent. And they would like to stop working within the next 10 years.

So they have an entire decade to get ready. No problem, right? Well, let's go through the numbers.

Because they make $150,000 per year and save nothing, they're used to spending approximately $115,000 per year after taxes. They don't own a home, so their living expenses are exposed to the full effects of inflation. Both are healthy, with good longevity in their family history. They agree that they should project living until at least age 95. Because their children plan to be fully independent within the next five years, this couple believes that planning to live on $95,000 per year after taxes is the right number for their circumstances.

So how much do they need to save to be able to have this much income? Let's assume they'll get approximately $20,000 per year from Social Security and they'll want to plan for inflation and some unexpected spending. This brings the magic number for their nest egg to approximately $1.7 million in investable assets. That's not much these days, right? Well, assuming a reasonable rate of return of 7% for their tiny portfolio, our couple faces some pretty glum news.

They need to save roughly $138,000 per year, about 20% more than they take home to potentially accumulate the assets necessary to fund their goal in 10 years. Certainly this is not going to happen. To solve this dilemma, our couple is left only with dissatisfying choices: work longer, plan on a much reduced lifestyle in retirement, or a combination of both.

Fortunately, it doesn't have to be this way for you.

Obviously, avoiding debt is not enough to establish lifelong financial security. You need to take steps to build net worth as well. Regardless of what you may have heard, establishing an early habit of saving and diversified investing is one of the best ways to do this. How do you get started?

Here's the most effective answer: immediately implement the *pay yourself first* principle. This is powerful medicine. Not only does it set you on the path to financial freedom, it eliminates the need to budget individual expenses (provided you don't go into debt). Equally important, it helps to establish your standard of living at a lifetime sustainable level. Consequently, when you want to have the resources available to be able to choose how you spend your time without having to go to work, you won't have to cut back on your lifestyle to do so. And thanks to the power of compound interest, the sooner you get started, the smaller the savings impact will need to be on your income and the more total lifetime wealth you'll accumulate.

How much you need to put aside and manage, first for emergencies, and then for growth, depends on your age and income. According to economist Roger Ibbotson of Yale University, a 25-year-old making $40,000 per year needs to save almost 10% of her income. Should the same person wait 15 years and begin saving when she's earning $80,000 per year, she will need to adjust her savings rate to almost three times the original percentage (29%) and almost six times as much in actual dollars.

Clearly, if you haven't done so already, one of the best things you can ever do for yourself is to start saving—*now*. ■ ■ ■