



Martin Northern
Branch Manager

RETIREMENT INVESTING

SPECIALIZING IN INVESTMENT MANAGEMENT AND ASSET PROTECTION

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A Christmas Message

At this special time of the year, we all renew our sense of wonder in recalling the story of the first Christmas in Bethlehem over 2000 years ago. Some celebrate Christmas as the birthday of a great and good philosopher and teacher. Others of us believe in the divinity of the child born in Bethlehem, that He was and is the promised Prince of Peace.

By any measure, this past year has been an unforgettable one. We are all deeply saddened and concerned about the recent events that have taken place in our nation. We will certainly continue to remember everyone involved in our prayers. I, as I am sure you, have drawn great comfort in difficult times from Christ's words and example. I believe that the Christian message, in the words of a familiar blessing, remains profoundly important to us all: *"Go forth into the world in peace, be of good courage, hold fast that which is good, render to no man evil for evil, strengthen the fainthearted, support the weak, help the afflicted, honor all men."*

It is a simple message of compassion, and is still as powerful as ever today, over 2000 years after Christ's birth.

I hope that this Christmas Season will be as special for you as it is for me. My family joins me in extending our best wishes to you and your family for a wonderful Christmas celebration and every happiness in the New Year!

New Tax Breaks: Choose Wisely

The new tax law, known as the Economic Growth and Tax Relief Reconciliation Act of 2001, signed by President Bush in June, provides for a number of generous tax breaks for Americans with specific savings goals in mind, such as education or retirement.

But is it too much of a good thing?

The menu of tax breaks is so appealing that it may tempt some people to overindulge by plowing more money than they should into 401(k) accounts, 529 college plans and other savings vehicles. Often, mutual funds are the investments of choice for these accounts. The risk: Savers who later are forced to tap this money for other purposes--say, buying a house or starting a business--will be slammed with taxes and penalties that could overwhelm the tax breaks they sought in the first place.

"You really have to revisit what you're investing for," said Meloni Hallock, partner in the personal financial planning group at Ernst & Young in Los Angeles. "If you use the money for the intended purpose, these [tax-favored] accounts are great. But if you don't, you would be better off investing your money elsewhere"--such as in a standard taxable account.

Consider, for example, 529 college savings plans. Investments made via these state-run plans grow tax-deferred, and starting in 2002, withdrawals will be tax free--if the money indeed is used to pay for schooling.

The catch: If the money is withdrawn for something other than education, profits earned in the account are subject to the contributor's regular income tax rate plus a 10% penalty charge, said Joseph Hurley, author of "The Best Way to Save for College: A Complete Guide to 529 Plans" (BonaCom, 2001). That can wipe out the benefits and then some.

Other education savings plans--such as the Education IRA--and most of the retirement savings plans that were boosted under the new tax law have similar penalties.

The one exception is the Roth IRA. Roth IRAs are set up to allow savers to make early withdrawals of more of their money before taxes and penalties.

“If you're not certain that you can leave the money alone, go for the Roth,” provided you meet the income qualifications, said Ed Slott, a New York certified public accountant and editor of Ed Slott's IRA Advisor.

Here are some of the other enhanced opportunities for tax-deferred savings under the new law and the penalties for cashing out if you need the money prematurely or for something else.

Allowable contributions to all types of retirement plans will rise over the next 10 years. Currently, investors can contribute \$10,500 annually to a 401(k) or a 403(b) plan, \$8,500 to a 457 plan--a type of defined-contribution retirement plan available to public employees--and \$2,000 to an IRA.

Next year, those limits will rise to \$11,000 for 401(k) and 403(b) plans, \$11,000 for 457 plans and \$3,000 for IRAs. Also, those age 50 and older will be able to make additional, "catch-up" contributions of \$1,000 annually to company-sponsored retirement plans and \$500 to IRAs.

The penalty for pre-retirement use of money in these plans depends on whether your contributions were tax-deductible. Generally, the withdrawal of earnings and any deductible contributions are subject to regular income taxes and the 10% penalty.

For instance, if you tap your 401(k) or 403(b) plan prematurely, you will typically owe taxes and the penalty on the entire amount you withdraw because all of your contributions were deductible. If you made nondeductible contributions to a Traditional IRA, you can escape paying the tax and penalty on the portion of the withdrawal that represents those after-tax contributions.

When penalties are imposed, the total bill can be steep: Note that some states, including California, impose penalties of their own. For middle-income taxpayers, that means you could pay 40 to 50 cents in total (federal and state) taxes for each \$1 you pull out of the account.

For money saved in a 457 plan, you may not be able to get at it at all, said Nicholas Kaster, a pension expert at CCH Inc., a publisher of tax and pension information based in Riverwoods, Illinois. Non-retired participants can withdraw money from 457 plans only if they no longer work for that employer, are age 70 1/2 or older, or have a serious and unforeseen economic emergency.

Allowable contributions to Education IRAs also were increased under the new law. Starting next year, you can contribute up to \$2,000 per year to an Education IRA, up from \$500. Contributions aren't tax-deductible, but the money is tax-free when it's withdrawn, provided all the proceeds are used to finance school expenses.

If you pull out more from the account than you use on qualified education expenses, the profits are subject to income tax at your regular rate and you are generally subject to a 10% tax penalty. The one exception: The penalty is waived if the reason you are not using the Education IRA money is that the recipient received a scholarship.

The same penalties and penalty waivers apply to 529 education savings plans. Contribution limits on these plans are set by individual states that sponsor them, with some allowing you to save as much as \$250,000 per student.

The bottom line for all of these plans: Don't overlook the potential penalty risk of locking away too much of your money. You may not enjoy paying taxes each year on a conventional investment account, but once paid that money is yours free and clear.

Higher Limits

The new tax law gradually raises the contribution limits for all types of tax-favored retirement plans. Those 50 and older can make additional, "catch-up" contributions.

Only A Few Days Remain to Capture This 2001 Tax Benefit

Every year, thousands of investors in stocks and mutual funds miss the benefit of tax loss selling. Tax loss selling is when you let the government share your investment losses by reducing your taxes for the current tax year.

If you bought a stock at \$20 and it's now \$15, even if you plan to hold it for the long term, you can sell it now. By selling, you then can report a \$5 loss per share on your 2001 tax return. You can take a deduction, or offset other stock gains, and reduce your current tax bill. You can then buy the shares back in 31 days and keep them as long as you like.

If you continue with your paper loss, the government will not share the loss with you, unless you sell that stock or mutual fund at a loss at a later date. You must actually make a sale at a loss to capture the tax benefit.

If you believe that this strategy might be of benefit to you, give us a call as soon as possible. After December 31, this tax break will be lost for another year.

Worst Time for Seniors in 40 Years

Seniors are more affected by declining interest rates than any other age group, since many depend on income from their investments to pay current living expenses. I continually meet retirees with a heavy reliance on CDs and Treasury Securities for current income. These rates are now the lowest in more than 40 years. If these investors continue to depend on these sources for income, they may continue to find their income declining. This may lead to a personal financial disaster—living expenses continuing to increase while current income is decreasing.

Is there a way out? Yes, the solution is the same as it has always been - which is to invest for the long term. The appropriate investment time horizon for retirees is their life expectancy. Today, an investor age 70 has a life expectancy of approximately 16 years. That investor may need to purchase securities

with a 16-year term, not 6 months or one year. If you have a choice, would you rather outlive your money or have your money outlive you?

Before judging this advice, consider if it has historically been correct. If you are a senior in search of income-producing investments, and had invested 10 years ago, or even 5 years ago, with your life expectancy at that time as your time horizon, would you be better or worse off now? You may have been better off because you would have invested in long-term fixed income securities and locked in at more attractive interest rates.

Unfortunately, many retired investors still invest out of fear, opting for short-term securities with low income payments. The result is what we see today—falling income and many times a worsening individual financial picture. So what can retirees do now?

Invest for the long term! There are still many sources available that provide an income stream superior to today's short-term rates.

Give us a call to schedule time for an Income Planning Review. We can advise you about various sources of income which would be most appropriate for your individual circumstances.

2002 Workshops

“Unlocking The Secrets To A Successful Retirement”

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Martin Northern
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**Martin Northern
Great Nation Investment Corp.
P.O. Box 1302
Benton, AR 72018-1302**