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Economic & Market Perspectives

2011 was a volatile and disappointing year for most investors. Expectations entering 2011 featured a continuation of economic recovery around the world from the Great Recession, despite ongoing deleveraging and residual debt and credit concerns. Debt and credit issues, however, obviously exploded over the past year, particularly in Europe. The investment landscape was one driven by fear and anxiety and while corporate earnings were up in most places, stock multiples were down, causing equity markets to struggle.

The average diversified US stock mutual fund fell -3.6% vs. a +2.12% gain for the S&P 500. The Russell 2000 small-cap index fell -4.2%, MSCI EAFE Index returned -11.74%, MSCI Emerging Markets Index lost -18.2%, and the Dow Jones UBS Commodity Index -13.4%.

We continue to operate in a post-credit-bust world, a chief consequence of which is ongoing deleveraging. As a result, economic growth will likely be slow in 2012. Slow growth should be partially offset by the forces of accommodative monetary policy in much of the world, designed to provide the liquidity necessary for solvency and debt repayment. This combination of slow growth and debt repayment / deleveraging is likely to be a difficult one, fraught

with occasional accidents and subject to low tolerance for policy errors.

A scenario of slow, but positive, economic growth should allow for acceptable, but lackluster, earnings growth. Both “risk” and “safe” assets seem priced for such an environment, but not for a “left-tail” event whereby financial contagion could do significant damage. Our mainline scenario assumes a continued “middle-through” global environment, especially regarding the European debt problem. Whenever deflation is a risk factor for the global economy, equity valuations remain under pressure. Importantly, the US household sector has been steadily restructuring its balance sheet and lowering its debt service ratio. This positive step, combined with some increase in the pace of job creation, provides hope for a better year for equities.

On the “what can go right” front, we would list Europe moving toward resolution of its debt crisis, the US heading toward fiscal responsibility, the emergence of a US manufacturing renaissance, a housing recovery and/or an increase in confidence. The “what can go wrong” list would include a systemic banking crisis in Europe, a true double-dip recession in the US, a hard landing in China, a breakout of class warfare in the US, and a Middle

2011 Returns

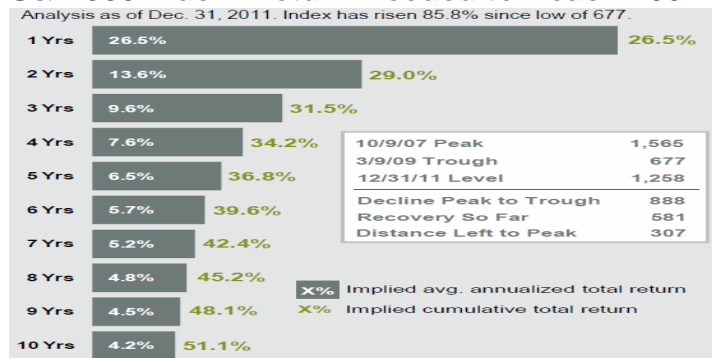
S&P 500	2.14%
NASDAQ	-8.3%
Russell Small Cap	-4.18%
Russell Mid Cap	-1.55%
MSCI EAFE	-12.14%
MSCI World	-5.54%
Barclay US Agg	8.35%
Barclay Muni.	12.12%

East flare-up that drives the price of oil to \$150.

In summary, 2012 is likely to feature a slow-growth world that includes a recession in Europe. The US faces headwinds, but manages to achieve growth of between 2% and 2.5%. China and India slow somewhat, but, along with the US, make up two-thirds of global GDP growth. The big risk remains that of a financial breakdown in Europe, which would tip the developed world, if not the emerging world, into recession. Inflation should also continue to move lower. Should the middle-through environment come to pass, we believe decent earnings and some improvement in confidence would allow equity markets to move higher, with US stocks leading the way.

Sources: BlackRock, Lipper

S&P 500 Index: Return Needed to Reach 2007 Peak



Sources: Standard & Poor's, FactsSet, J.P. Morgan Asset Management

Factoring Health-Care Costs into Retirement Planning

There are many factors to consider in determining how much you'll need to save in order to enjoy a comfortable and financially secure retirement. One often overlooked retirement expense is the cost of health care. You may presume that when you reach age 65, Medicare will cover most health-care costs. However, Medicare currently only pays for a portion of the cost for most health-care services, leaving a potentially large amount of uninsured medical expenses. Without proper planning, health-care costs can sap retirement income in a hurry, leaving you financially strapped.

How much will you need?

How much you'll spend generally may depend on when you retire, how long you live, your health status, and the cost of medical care in your area. But the costs can add up. You won't have to pay for Medicare Part A hospital insurance (unless you don't qualify and have to buy into the program), but you will likely pay either \$96.40 or \$110.50 each month in 2011 for Medicare Part B physician's coverage (although you may pay higher premiums based on income and other factors), and an average of \$30 per month for Medicare Part D prescription coverage. In addition, there are co-pays and deductibles to consider (e.g., after paying the first \$162 in Part B expenses per year, you pay 20% of the Medicare-approved amount for services thereafter).

The cost of health care is rising. The Centers for Medicare & Medicaid Services (CMS) reports that national health expenditures

grew by 4% in 2009. And the CMS Office of the Actuary estimates that out-of-pocket spending is projected to grow at an average rate of 5% from 2015 through 2020.

What can you do?

It's clear that health care is an important factor in retirement planning. And while you may be able to buy a cheaper car, live in a smaller home, or take fewer vacations in order to stay within your retirement income budget, you can't do without necessary medical care. So what can you do? You can better prepare for these expenses by taking the following steps:

- Acknowledge that paying for health care in retirement is an issue to consider. Don't presume Medicare and Medigap insurance will cover all your expenses—they probably won't. Include potential health-care costs in your retirement plan.
- Evaluate your present health and project your future medical needs. That might be easier said than done, but taking stock of your overall health now and factoring in your family's health history may help you determine the type of care you might need in retirement. Are you currently being treated for high blood pressure or diabetes? Do you live a healthy lifestyle? Does heart disease run in your family?
- Understand what Medicare covers and what it costs. For instance, Medicare (Part A, Part B, and Part D) generally provides benefits for inpatient hospital care, medically necessary doctor's visits, and prescriptions. But Medicare doesn't cover everything. Examples of services generally not covered

by Medicare include most chiropractic care, dental or vision care, and long-term care. You'll also have to account for deductibles, co-insurance costs for some services, and a monthly premium for Medicare Parts B and D.

- Consider the cost of supplemental insurance. Medigap plans are standardized policies sold by private insurance companies that pay for some or all of the costs not covered by Medicare. In addition to Medigap policies, other types of supplemental insurance include long-term care insurance, dental insurance, and vision insurance. The type and amount of coverage that's best for you depends on a number of factors, including how much premium you can afford, what benefits you need, your financial resources, your health, and your anticipated medical needs.
- Don't forget to factor in the cost of long-term care. The National Clearinghouse for Long-Term Care Information estimates that at least 70% of people over age 65 will require some long-term care services. Medicare does not pay for custodial (non-skilled) long-term care services, and Medicaid pays only if you and your spouse meet income and asset criteria.
- Save, save, save. You may have already begun saving for your retirement, but if you fail to include the cost of health care in your plan, you're likely leaving out a big expense. Your financial professional can help you figure out how much you may need to save and adjust your retirement planning strategies to account for potential health-care costs in retirement.

Tax-Advantaged College Savings Strategies

You're ready to start saving for college, but where should you put your money? There are many college savings options, but you should generally opt for tax-advantaged strategies whenever possible.

Why is it so important to consider strategies that offer tax benefits? Because taxes can eat away at any money you might earn. Following are some tax-advantaged savings options to consider.

529 plans

A 529 plan, sometimes called a qualified tuition program, offers federal, and often state, tax advantages if used to save for col-

lege. There are two types of 529 plans—a college savings plan, which is an individual investment-type account, and a prepaid tuition plan, which is a pooled account that typically promises it will cover a certain percentage of college costs in the future.

With either type of 529 plan, contributions accumulate tax deferred at the federal level and earnings are completely tax free if used to pay the beneficiary's qualified education expenses. In addition, many states offer their own tax benefits, such as income tax deductions for contributions and tax-free withdrawals. If a withdrawal is used for a non-educational expense, the earnings por-

tion of the withdrawal will be subject to federal income tax and a 10% federal penalty.

Investors should consider the investment objectives, risks, charges, expenses, and prerequisites for state tax benefits associated with each 529 plan before investing. More information is available in each 529 plan issuer's official statement, which should be read carefully before investing.

Coverdell education savings accounts

A Coverdell education savings account (ESA) lets you contribute up to \$2,000 per

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How Much Do You Know about Social Security?

Social Security is in the news more and more, as the first wave of baby boomers retire and economic pressures on the program increase. More than 90% of Americans are covered by Social Security, but how much do you know about this important program?

How is Social Security funded?

Unlike many government programs, Social Security is funded primarily through the collection of payroll taxes. In 2010, 81.9% of funding came from this source, with the rest derived from interest earned on government bonds held by Social Security trust funds and income taxes paid on benefits. That's why Social Security is known as a "pay-as-you-go" system. However, someone working and paying Social Security taxes today is not funding his or her own benefits, but is funding the benefits of someone who is receiving them now or in the near future--one of the reasons why Social Security is facing a potential funding shortfall. According to the Social Security Administration (SSA), the number of retired workers will double in less than 30 years, but there will be fewer workers paying into the system. And with life expectancies increasing, benefits will be paid for a longer period.

How are earnings reported to the SSA?

If you work for an employer, your employer will send a copy of your W-2 form annually to the SSA. If you're self-employed, the IRS will report your earnings to the SSA annually after your federal income tax return has been processed.

What benefits are available?

Although Social Security is known as a retirement program, benefits are paid to people of all ages, including surviving family members and disabled individuals. In 2010, 5.7 million people were awarded Social Security benefits. Of those, 46% were retired workers, 36% were survivors or spouses/children of retired or disabled workers, and 18% were disabled workers.

How do you qualify for benefits?

As you work and pay payroll taxes, you earn Social Security credits. Generally, you need to work 10 years to earn enough credits to qualify for retirement benefits--other benefits have different requirements. Contact the SSA if you have any questions about your benefit entitlement.

Do most people apply for early retirement benefits?

Yes. According to a report by the Government Accounting Office (GAO), 43% of people take early retirement benefits at age 62, while almost 73% of people apply for benefits before they reach full retirement age.

How much more will you receive if you delay applying for benefits?

For each year past your full retirement age you delay receiving benefits, your Social Security benefit will increase by a certain percentage (8% for anyone who was born in 1943 or later). For example, if your full retirement age is 66 and you delay receiving benefits until age 70, your annual benefit will be 32% higher.

Can you receive benefits based on an ex-spouse's record?

You may qualify for divorced spousal benefits if you were married for at least 10 years, you haven't remarried, you are age 62 or older, and you don't qualify for a higher benefit based on your own work record.

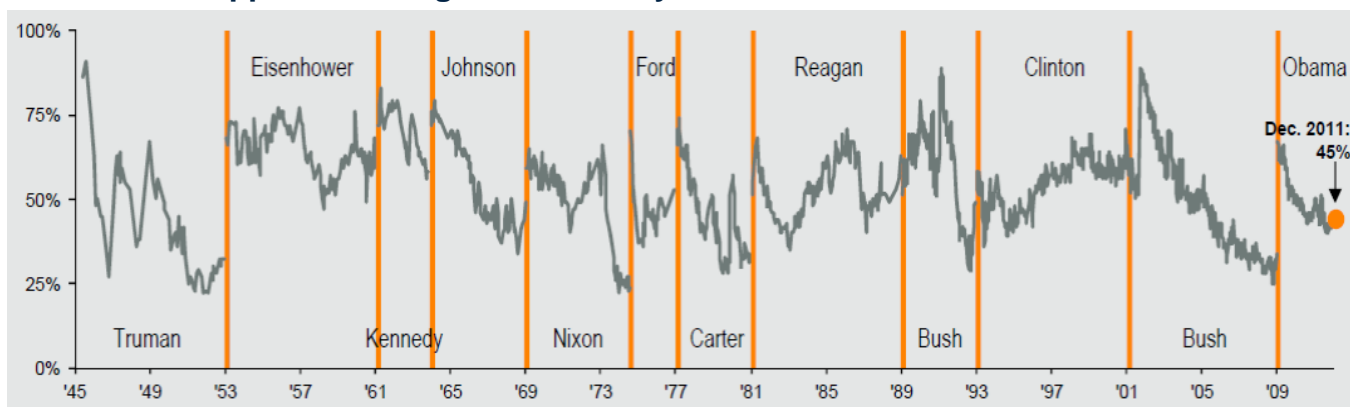
Do workers with lower earnings receive more from Social Security?

A worker who has lower earnings will receive a lower monthly benefit than someone with higher earnings because benefits are based on average lifetime earnings (the highest 35 years of earnings are used in the calculation). However, the Social Security benefit formula is designed to ensure that workers with lower earnings receive a greater percentage of their pre-retirement earnings. For example, a worker with relatively low earnings may receive a benefit that is approximately 55% of his or her pre-retirement earnings, while a worker with relatively high earnings may receive a benefit that is approximately 25% of his or her earnings.

Do you have to stop working to receive Social Security retirement benefits?

No. As long as you've reached early retirement age and meet eligibility requirements, you can apply for Social Security benefits even if you decide to continue working. However, if you're younger than full retirement age and earn more than a certain amount, your benefits will be temporarily reduced (once you reach full retirement age, your benefits will be increased to account for the money that was withheld).

Presidential Approval Rating Over Term Cycles



Sources: Gallup Inc., J.P. Morgan Asset Management

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ETF in the News: PowerShares Fundamental High Yield Corporate Bond

The PowerShares Fundamental High Yield Corporate Bond (PHB) exchange-traded fund seeks to replicate the Rob Arnott Fundamental Index (RAFI) High-Yield Bond Index. The fund normally invests at least 80% of its assets in high yield corporate bonds.

The Underlying Index measures potential returns of a theoretical portfolio of high yield corporate bonds that must be rated

Ba1/BB+ or lower, but not below B3/B- by either Moody's or S&P. Only securities with greater than one year to maturity qualify for inclusion in the Underlying Index.

The fund weights bond issuers according to a variety of fundamental factors, including total sales, profits and stock dividends. Under the fundamental system, companies that have more sales and profits would have heavier

weightings than issuers with small sales and scant profits.

Rob Arnott argues that his fundamental approach gives more emphasis to higher-quality companies. Over time, that should enable the fund to suffer from fewer defaults and outdo cap-weighted high-yield competitors. The fund's current yield is 5.23%.

Sources: Morningstar, TheStreet

Tax-Advantaged College Savings Strategies

year per child for a child's elementary, secondary, and/or college expenses. Like a 529 plan, contributions accumulate tax deferred at the federal level and earnings are tax free when used to pay the beneficiary's qualified education expenses. Similar to a 529 plan, if a withdrawal is for a non-educational expense, the earnings portion of the withdrawal will be subject to federal income tax and a 10% federal penalty.

However, only married couples with a modified adjusted gross income of \$190,000 or less and individuals with an income of \$95,000 or less can contribute the full \$2,000 per year.

The Economic Growth and Tax Relief Reconciliation Act of 2001 increased the annual contribution limit for Coverdell ESAs to \$2,000 from \$500 and expanded the use of funds to K-12. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 extended these provisions through 2012.

U.S. savings bonds

Series EE and Series I savings bonds offer a special tax benefit for college savers--the interest earned by the bonds is exempt from federal income tax if the bonds are used to pay college expenses. However, this benefit is restricted by income level. For 2011, to exclude all of the bond interest, married couples must have a modified adjusted gross income of \$106,650 or less (\$109,250 or less in 2012) at the time the bonds are redeemed (cashed in) and individuals must

have an income of \$71,100 or less (\$72,850 or less in 2012). A partial exemption of interest is allowed for people with incomes slightly above these levels. Income levels are indexed for inflation each year. The interest earned on U.S. savings bonds is always exempt from state income tax, no matter what your income level, even if the bonds aren't used to pay for college.

UTMA/UGMA

A custodial account allows you to hold assets in your child's name without having to set up a trust; these assets must then be used for the benefit of the child. A custodial account doesn't offer federal tax-deferred and tax-free earnings like a 529 plan or a Coverdell account, but it does provide some opportunity for tax savings due to the way earnings generated by the account are taxed.

Specifically, earnings are taxed to the child each year pursuant to the "kiddie tax" rules, and under these rules the first \$950 of earnings is tax exempt and the next \$950 is taxed at the child's rate (any earnings over \$1,900 are taxed at the parent's rate). So, you'll have an opportunity for tax savings if the earnings in the account are \$1,900 or less for the year.

A word about IRAs

Money you withdraw from a traditional IRA or Roth IRA to pay your child's qualified education expenses is not subject to the 10% premature distribution penalty tax that normally applies to

Continued from page 2

taxable IRA distributions made before age 59½.

Federal Financial Aid Formula

The federal methodology for financial aid examines your family's income, assets and household information to calculate your expected family contribution (EFC). Your EFC represents the amount of money the government deems you can afford to put toward college costs each year before any financial aid is forthcoming.

The federal methodology counts some parental assets and excludes others in arriving at your EFC. The following assets are excluded from the federal methodology: Retirement accounts, annuities, cash value life insurance, home equity in primary residence, personal items and a family farm.

When a family's total assessable assets are counted, the federal methodology grants parents an asset protection allowance that lets them exclude a certain portion of their assets from the final tally. The amount depends on the age of the older parent at the time the student applies for aid. For example, for the 2011/2012 school year, the asset protection allowance for a two parent family where the older parent is 48 years old is \$46,200.