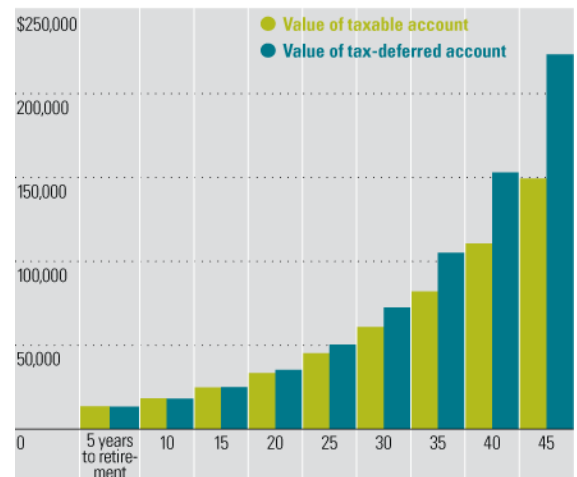


## Take Advantage of Tax-Deferred Accounts

One of the main reasons why retirement accounts are so beneficial is the power of tax deferral. In a tax-deferred investment vehicle, such as a 401(k) plan or an IRA, your earnings are not taxed until you begin withdrawing money from your account in retirement. Consider the image. A hypothetical value of \$10,000 is invested in both a taxable and a tax-deferred account. The difference in value between the two accounts becomes quite substantial after 20+ years. For investors with a long investment horizon, a tax-deferred portfolio is an excellent choice.

Please keep in mind that once you begin to withdraw money from your retirement account, you will be taxed accordingly. However, since you will most likely earn less in retirement, withdrawals from a deferred portfolio may be taxed at a lower rate.

### Benefits of Deferring Taxes



Withdrawals of tax-deferred accumulations are subject to ordinary income taxes. A 10% federal tax penalty may apply to withdrawals made before age 59½. Returns and principal invested in stocks are not guaranteed.

Source: This hypothetical example is for an investor in the 28% bracket using the 2011 tax code (estimated to become the 31% tax bracket in 2013). \$10,000 is invested in stocks at the beginning of year 1 (2012). Assumes an 8% annual total return (6% price return and 2% income return) and a 15% tax rate on capital gains and dividends in year 1 (2012) after which the rates revert to 20% and the investor's marginal tax rate, respectively. The investment is taxed at a 28% marginal tax rate in year 1 (2012) and then reverts to 31%. Taxes are assessed yearly on the taxable account but only at the end of the period on the tax-deferred account. Estimates are not guaranteed.

#### About Ohanesian / Lecours

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## Dividends and Taxes: Dos and Don'ts

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Dividend-paying stocks have enjoyed a renaissance during the past several years. Despite the high-profile blowups of many financial stocks, dividend payers generally outperformed non-dividend payers during the financial crisis. Further burnishing dividend payers' appeal is the currently benign tax treatment of dividends: Those in the 25% tax bracket and above pay taxes at a 15% rate on qualified dividends, while those in the 10% and 15% tax brackets pay no taxes at all on such dividends. That's a big attraction, but investors need to do their research before embracing dividend payers for their taxable accounts. Here are some dos and don'ts.

**Do Understand the Difference between Qualified and Nonqualified Dividends:** You often hear that the dividend tax rate is either 15% or 0%, depending on your tax bracket. But if it's not the right kind of dividend, you could actually owe ordinary income tax on your dividends (as much as 35%, depending on your tax bracket). That's because the Internal Revenue Service separates dividends into qualified and nonqualified categories. One big type of nonqualified dividends are those that REITs kick off; while their yields might be lush relative to the income you receive from other stocks, you'll owe ordinary income tax on that income. Owing to that tax treatment, investors in the typical real estate fund have paid a tax-cost ratio of 1.9% per year during the past decade, far higher than any other equity category. (Foreign-stock dividends may not necessarily qualify for the low tax treatment, either.)

**Do Watch Out for Income-Focused Funds:** If you buy and hold individual stocks, you can do your homework and downplay nonqualified dividend payers. But if you own stock mutual funds focused on dividend payers, such as those with "Equity Income" or "Dividend" in their names, you won't have the same opportunity to pick and choose. Unless a dividend-focused fund is explicitly tax managed, the manager's only goal is to maximize income and total return. That means it's highly possible that the fund will hold companies that kick off nonqualified dividends, and such a fund may even own some bonds, to boot. So before you park an equity-income fund in your taxable account, first spend some time looking under the hood.

**Don't Assume It Will Stay This Way:** We've gotten spoiled with the low tax rate on dividends. But the current policy has only been around since 2003, and it's set to revert to pre-2003 levels in 2013. That means that dividend income will again be taxed at investors' ordinary income tax rates. If that happens, you might decide you want to get those dividend payers into a tax-sheltered wrapper like an IRA or 401(k) post-haste. After all, it's better to let those dividends compound rather than letting the IRS take a big cut right off the top.

**Don't Hold Very High Dividend Payers in Taxable Accounts:** Even if a company's or fund's dividends are qualified all the way, companies and funds that kick off very high levels of income are still usually best left in your tax-sheltered accounts. That's because you're going to receive that high income stream whether you need the money or not, and in turn, you'll owe taxes on that dividend for the year in which you received it. By holding non-dividend payers in your taxable accounts, by contrast, you won't be on the hook for taxes unless you take action and sell shares. Of course, you might decide that dividend payers' fundamental attractions supersede the tax considerations, but all else equal, dividend payers are less tax-efficient than non-dividend payers, even in the current low-tax environment.

This is for illustrative purposes only and should not be viewed as investment advice. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment, tax, or legal advice. Please consult with a tax and/or financial professional before making any investment decisions.

## Roth IRA Versus Defined Contribution Plan

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Contemplating whether to contribute to a Roth IRA or a defined contribution plan (such as a 401k)?

Words of advice: Follow the money! If your company offers you a match for your DC plan contribution, you should keep investing in the account up to the maximum percentage that it will match. This is free money, and you won't find a better deal any place else.

After you've maxed out the match, it's probably wise to invest any remaining cash in a Roth IRA. You can put in as much as \$5,000 in 2012 (\$6,000 if you are 50 years or older), as long as your income doesn't top certain levels. You won't get any tax deductions with the Roth, but you won't have to pay any taxes on it for the rest of your life, which can turn out to be an advantage over a DC plan. Another plus for the Roth is that you can keep your money there forever, as opposed to a plan like a 401(k), from which you have to start taking withdrawals by age 70 1/2.

With a Roth IRA, one big advantage is the ability to take certain early distributions without paying the early distribution penalty. However, if you withdraw assets from an employer plan before retirement, you'll pay a penalty and taxes, but many firms offer employees the option of taking loans from their accounts.

If you're fortunate enough to still have money to invest after you've maxed out on your Roth IRA, then by all means start putting it back into your DC plan. It's a good idea to have retirement money in different types of accounts, because you never know what the tax laws will be 30 years down the road. Please consult with a financial advisor or tax professional for the latest rules and regulations.

## The Art of Asset Location

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Asset location is a part of the investing strategy that involves deciding which investments to hold in which accounts, and taxes play an important role in this decision. Here are a few basic guidelines.

**Hold in Your Tax-Sheltered Accounts: Assets With High Tax Costs.** In general, government or corporate bonds and bond funds may be a better fit for tax-sheltered accounts (like IRAs and 401(k)s) than for taxable accounts because their payouts are taxed at an investor's ordinary income tax rate. If you need to hold bonds in your taxable accounts, a municipal bond or municipal bond fund might offer you a better after-tax yield than a taxable bond investment, because income from munis is exempt of federal income taxes.

**Hold in Your Taxable Accounts: Assets With Low Tax Costs.** By contrast, stocks and stock funds may generally be a better bet for taxable accounts. Long-

term capital gains, which is what you have when you sell a stock that you've held for at least a year, are taxed at a much lower rate than bond income (however, these favorable tax rates are set to expire at the end of 2012).

Stocks are not guaranteed and have been more volatile than the other asset classes. Dividends are not guaranteed. Bonds are subject to credit/default risk and interest-rate risk. Municipal bonds may be subject to the alternative minimum tax (AMT) and state and local taxes, and federal taxes apply to any capital gains distributions. Retirement accounts are tax-deferred vehicles designed for retirement savings. Any withdrawals of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. This should not be considered tax or financial planning advice. Please consult a tax and/or financial professional for advice specific to your individual circumstances.

# What Investors Can Learn From Their Tax Returns

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Your 1040 can reveal a lot about your investment habits. Are you withholding too much or too little? Taking advantage of all the credits available to you? Before you stash a copy of your tax return in a drawer, take note of the following line items on your 1040.

**Line 8-Interest Income:** The raw dollar amounts of your interest income are shown on line 8 of your 1040 form; line 8a shows taxable income and line 8b shows tax-exempt income, generally from municipal bonds. If you have a high level of taxable interest income, pay careful attention to asset location and assess whether taxable bonds, rather than municipals, are truly the better bet once the tax effects are factored in.

**Line 9-Dividend Income:** Line 9a shows the total amount of ordinary dividends you received last year; dividends on line 9b count as qualified, meaning that they are subject to more favorable tax treatment. As with taxable interest above, take a hard look at any investments, such as REITs, that are paying nonqualified dividends; those investments may be better housed in a tax-sheltered account such as an IRA.

**Line 13-Capital Gain (or Loss):** Capital gains are often a sign of investment success. But if you see a big number on this line, make sure you're paying due attention to proper tax management. Do you periodically scout around your taxable portfolio for losing positions that you can use to offset gains? If your losses exceed your gains, you can use them to offset up to \$3,000 in ordinary income. If one of your fund holdings made a big capital-gain distribution last year, have you considered whether that fund might be a better fit in a tax-sheltered account?

**Line 25-Health Savings Account Deduction:** Have you evaluated whether a health savings account, used in conjunction with a high-deductible health-care plan, is a good fit for you? For those who are relatively healthy and have cash on hand to cover out-of-pocket expenses that might arise until they hit the maximum for the year, HSAs can serve as supplemental savings vehicles. You'll enjoy tax benefits on your contributions and the money in your HSA will roll over from one year to the next.

**Line 32-IRA Deduction:** If you are closing in on retirement, haven't saved much, and can deduct your contribution, funding a traditional IRA may be a better bet than putting money into a Roth IRA. If you're not contributing to a company retirement plan, you can deduct your traditional IRA contribution regardless of income level. Individuals earning less than \$68,000 in 2012 who are covered by a company retirement plan can make at least a partially deductible contribution to a traditional IRA. Married couples filing jointly can make at least a partially deductible IRA contribution if they earn less than \$112,000.

The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment, tax, or legal advice. Please consult with your financial professional regarding such services. Dividends are not guaranteed. REITs typically provide high dividends plus the potential for moderate, long-term capital appreciation. A REIT must distribute at least 90% of its taxable income to shareholders annually. Real estate investment options are subject to certain risks, such as risks associated with general and local economic conditions, interest rate fluctuation, credit risks, liquidity risks and corporate structure. Municipal bonds may be subject to the alternative minimum tax (AMT) and state and local taxes, and federal taxes would apply to any capital gains distributions. Stocks and REITs are not guaranteed and have been more volatile than bonds. Funds in a regular IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free as money withdrawn is not taxed. Penalties may apply for withdrawals prior to the age of 59 1/2.

## Tax-friendly States for Retirees

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Federal taxes are the same wherever you choose to retire; however, state and local taxes add up depending on the state you pick to spend your retirement years. Taxes may apply to your retirement/pension income, purchases, real estate and social security benefits.

Taxes on individual and pension income differ from state to state. Seven states in the U.S. (Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming) currently do not tax individual income. On the other hand, California, District of Columbia, Hawaii, Iowa, Maine, New Jersey, New York, Oregon, and Vermont tax retirement income at a rate of 8% or higher. Pennsylvania and Mississippi exempt pension income completely, while states like Michigan and Maine exempt only a portion of pension income. If you estimate receiving considerable income in retirement, state income taxes could play a significant role in what you get to keep.

In addition to state taxes on retirement and pension income, retirees also need to look at sales tax charged on items they purchase. Sales tax varies from state to state with some states charging sales tax as high as 7%, while others adopt a “no sales tax” policy. Alaska, Delaware, Montana, New Hampshire, and Oregon have no state sales tax, while California has the highest sales tax rate of 8.25%. Retirees who rely only on a fixed source of income in retirement should also carefully consider property taxes and estate taxes when estimating their tax liabilities.

Source: 2011 CCH Whole Ball of Tax. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment, tax, or legal advice. The information provided is as of October 2011. Please consult with your financial professional regarding such services.

## Reducing the IRS' Bite with Tax-Efficient Funds

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Handing over a portion of your investment earnings to the IRS is never pleasant. Fortunately, a specific category of mutual funds, called tax-efficient funds, might help you keep the amount you send to Uncle Sam to a minimum. Here's how tax-efficient funds work. Mutual funds must pay you almost all of the money they make from interest, dividends, or capital gains (money made from selling stock) in a year. That's called a taxable distribution (since you must pay taxes on that money). Tax-efficient funds keep their taxable distributions as small as possible, thus lowering the amount you have to pay in taxes. Tax-efficient funds can use several strategies to keep distributions low. They avoid stocks that pay dividends. They don't sell their stocks very often. When they do sell stocks, they might also try to sell some that have lost money to offset those that have made money. They could also hold stocks for more than one year before selling, since the profits are taxed at a lower long-term capital gains rate than short-term transactions. These methods, as

well as some others, keep your tax bill lower.

While tax-efficient funds seem extremely attractive, there are a few drawbacks to note. First, there are only a handful of these funds available from which to choose (relative to other categories). Second, of the funds that do exist, few have long-term investment records that you can analyze. Finally, most tax-efficient funds stick mainly with large-company stocks and tax-free (municipal) bonds. That means you might have to look at non-tax-efficient funds to get exposure to other types of investments in an effort to build a diversified portfolio.

Diversification does not eliminate the risk of experiencing investment losses. Past performance is no guarantee of future results.

# U.S. Stocks and Bonds Before and After Taxes

Even though investors don't always realize it, taxes can have a dramatic effect on an investment portfolio, especially in today's relatively uncertain tax environment. The tax law enacted in December 2010 was only intended to last for two years, and new changes may be effected in 2013.

The image illustrates the hypothetical growth of inflation and a \$1 investment in stocks and bonds before and after taxes since 1926. Over the long run, the adverse effect of taxes on investment returns becomes especially pronounced. Stocks are the only asset class depicted that provided any significant long-term growth. After considering taxes, government bonds barely outperformed inflation over this time period. In a world with taxes, focusing on fixed-income assets alone has not provided investors with a substantial increase in wealth. If you desire substantial after-tax growth, you may want to consider a larger allocation to stocks. Another alternative, if you are able, is to consider tax-deferred investment vehicles.

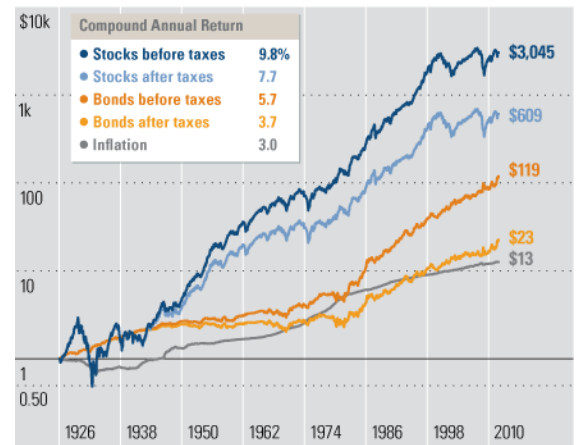
Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed. Stocks have been more volatile than the other asset classes.

Federal income tax is calculated using the historical marginal and capital gains tax rates for a single taxpayer earning \$110,000 in 2010 dollars every year. This annual income is adjusted using the Consumer Price Index in order to obtain the corresponding income level for each year. Income is taxed at the appropriate federal income tax rate as it occurs. When realized, capital gains are calculated assuming the appropriate capital gains rates. The holding period for capital gains tax calculation is assumed to be five years for stocks, while government bonds are held until replaced in the index. No capital gains taxes on municipal bonds are assumed. No state income taxes are included.

Stocks in this example are represented by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500® index thereafter, which is an unmanaged group of securities and considered to be

representative of the U.S. stock market in general. Government bonds are represented by the 20-year U.S. government bond, and inflation by the Consumer Price Index. An investment cannot be made directly in an index.

## U.S. Stocks and Bonds Before and After Taxes: 1926–2011



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.

# How to Handle Beneficiary Designations

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Designating beneficiaries for your company retirement plan, life insurance policies, and other assets might seem like a no-brainer. Chances are you would like those near and dear to you to inherit any money you've accumulated during your lifetime, so making sure that happens should be as simple as writing their names on the appropriate forms, right? Well, if only it were that simple. Naming beneficiaries can be more complicated than you might think, and it's a decision that may have significant repercussions for your loved ones.

**Know the Basics:** You can name almost anyone, or anything, as your beneficiary, including individuals, charities, and trusts. However, it is important to note that children under the age of majority—18 or 21, depending on the state in which you live—cannot be named as beneficiaries of life insurance policies, retirement plans, or annuities. If a beneficiary is not designated, assets will have to go through probate, which can be a lengthy and costly process. Also, be aware that beneficiary designations will override bequests you've made in your will, so please do not rely on your will to sort out these issues. This leads to our second point.

**Keep Your Designations up to Date:** It would be advisable to review your beneficiary designations on a regular schedule, ideally as part of an annual review of your finances. Major life events, such as a marriage, a divorce, the birth of a child, or the death of a loved one may require that you make changes to your designations. Don't procrastinate on this, as it may end up affecting others' lives. Moreover, you'll also want to review your designations if you or your employer have recently switched retirement-plan or insurance providers. You should not assume that the beneficiaries you specified with your previous provider will automatically carry over to the new one.

**Bear in Mind the Tax Consequences:** If you decide to designate someone other than your spouse as the beneficiary of your company retirement-plan assets, he or she may have to take mandatory distributions from that plan and, in turn, pay taxes on the money. Your spouse, on the other hand, will be able to roll over your retirement-plan assets into his or her own individual retirement account (IRA) and won't have to

pay taxes until distributions begin. There can also be estate taxes to keep in mind if you name a beneficiary other than your spouse. Needless to say, it would be in your best interest to speak with a tax advisor or someone who specializes in estate planning to go over possible tax ramifications.

**Be Specific:** It pays to be as specific as possible when designating beneficiaries. Most beneficiary designation forms allow you to name multiple primary and contingent beneficiaries and to specify what percentage of assets you'd like distributed to each upon your death. For example, you can state: "I hereby designate my wife, Jane Smith, as primary beneficiary" or "I hereby designate my two children, John Smith and Allison Smith, as contingent beneficiaries, with the proceeds to be divided equally among them." Of course, it is recommended that you discuss these important matters with your family members beforehand, so that they are prepared and know what to expect.

**You Can Use a Legal Trust as a Beneficiary:** What if you are in a situation where you can't (or you don't want to) name a person as a beneficiary? You can use what is called a legal trust. A trust means that you don't leave the money directly to the beneficiary, but to an institution (such as a bank) who manages it for the beneficiary. This is especially useful when minor children or disabled relatives are involved. A trust can be revocable (you can change the provisions later), or irrevocable (can't be undone).

# Straightforward Strategies & Solutions

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Whether you're preparing for retirement, managing investments, making sense of insurance products or need assistance with your corporate retirement plan, our seasoned advisors can help you navigate the ever changing financial landscape to ensure that you reach your financial goals.

**Informed decisions:** Our goal is to untangle financial complexities and develop an accessible, realistic plan to meet your goals and your lifestyle.

**Individual attention:** From the start of our relationship, our goal is to gain a detailed understanding of your expectations, from investment performance to client service.

**Strategies that meets your goals:** We take an active approach to understanding your needs, establishing individual benchmarks, choosing investments that

meet your strategy, and striving to surpass your goals through responsible asset stewardship.

**A fiduciary-responsible partner:** We take a structured, prudent approach to managing and implementing your investment decisions. Specifically, as investment stewards, we have the legal responsibility to manage your money to the highest standard of care.

**Partner with an expert:** We have a solid 25-year legacy of establishing and achieving financial objectives for our clients. Over time, we have successfully weathered many market cycles by maintaining a solid, long-term investment perspective and a disciplined approach to meeting client objectives and expectations.

To learn more, contact your advisor by calling 800.525.9295.

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