

The Abel Advisor

a Financial Stewardship Newsletter



Abel Financial Strategies

Augustus W. Abel, CFP®
Financial Advisor
3775 Attucks Dr.
Powell, OH 43065
phone (614) 389-2075
Cell (614) 499-1201
aw@awabelfinancial.com
www.awabelfinancial.com

Hi Everyone,

2012 is almost at an end. I hope it has been a blessed year for you and your family!

We have just celebrated the birth of Jesus Christ and all of the blessings that we have because of his birth. Please focus on these blessings as you go forward this year. Remember how much better everything is because of Jesus sacrifice for us!

Pray for the leaders of our country and for them to have wisdom and the resolve to deal with the difficult issues they face. Pray for leaders of the world to always look for peaceful ways to solve issues. Pray for the many people who live in terrible situations in our country and around the world.

I am blessed with your business and our relationship!

God's Peace to you and your family!
Best Wishes for a Wonderful New Year!

A.W. Abel

January 2013

High-Yield Bonds: The Pros and Cons
Compounding Can Add Fuel to Your Portfolio

Life Insurance Tax Traps for the Unwary
Is winter storm damage covered by my homeowners insurance policy?

*Abel Financial
Strategies*



High-Yield Bonds: The Pros and Cons

Interest rates at historically low levels are great for those looking to refinance a mortgage or borrow money to start a business. However, people who rely on their investments for income have sought out a variety of alternatives to rock-bottom yields on U.S. Treasuries, including high-yield bonds. If you're considering investing in high-yield bonds--sometimes called "junk bonds"--yield shouldn't be the only factor in your decision.

What are high-yield bonds?

High-yield bonds are corporate bonds considered less than investment grade (a rating of BB or lower from Standard & Poor's or Fitch, Ba or lower from Moody's). A bond can fail to achieve investment-grade status for many reasons. A company may be in a turnaround situation; high-yield bonds have frequently been used as a way to finance large-scale leveraged buyouts, such as that of RJR Nabisco in the 1980s. Or the company might already have substantial debt on the books, or have a risky or untested business model. Whatever the reason, there is greater uncertainty about the company's ability to repay its debt.

The advantages

So why would an investor be willing to face those risks? In a word, yield. The more uncertainty about an issuer's ability to repay its debt, the higher the interest rate investors typically demand from its bonds. As of early November 2012, one benchmark index of high-yield bonds was yielding almost 4% more than a comparable index of corporate bonds, and almost 5% more than a 10-year Treasury.*

Because a junk bond's yield is often more dependent on the quality of the issuer than on other factors, it can sometimes be less affected by interest rate changes than investment-grade yields. That difference can provide an additional level of diversification for a bond portfolio (though diversification alone cannot guarantee a profit or protect against potential loss). You can provide still another level of diversification by investing in a variety of high-yield bonds from different issuers in different industries.

Don't forget that even high-yield bonds typically

have precedence over common stocks in the event of a bankruptcy; that increases the odds that you would receive at least part of your original investment if the issuer went under.

Factors to consider

Not surprisingly, default rates on high-yield bonds tend to be lower when the economy is robust; renewed recession could mean more defaults by companies already on shaky ground. Also, remember that selling any bond before it matures could mean a loss of principal. While interest rates are expected to remain low for another couple of years, bond values generally are likely to fall when rates begin to rise. A credit rating downgrade of your high-yield bond also would likely reduce its market value. Finally, recent investor interest has boosted prices of high-yield bonds generally; consider getting expert help in deciding whether high-yield, investment-grade debt, or dividend-paying equities represent a better investment at current valuations.

If you're a long-term investor, there's another factor to consider. Bonds can have a call provision that lets the issuer redeem the bond before it matures. The lower current interest rates are, the more likely they are to trigger call provisions on bonds with a higher rate. If you rely on the interest from a high-yield bond and it gets called, you'll be faced with the challenge of replacing that income.

Also, individual high-yield bonds can sometimes be less liquid than investment-grade bonds, so you might have some difficulty selling the bond at your asking price. And during periods of global uncertainty, high-yield bond values can drop as investors flock to less risky investments generally. As with any investment, make sure you're being compensated for the level of risk you're willing to take.

*Data based on yields reported for Merrill Lynch High Yield Constrained Index, Barclays Capital U.S. Corporate Bond Index, and daily Treasury yield curve rates as of November 7, 2012.



Note: The examples in this article are hypothetical and for illustrative purposes only. They assume a steady 6% annual rate of return, which does not represent the return on any actual investment and cannot be guaranteed. Moreover, the examples do not take into account fees and taxes, which would have lowered the final results. Speak with a financial professional about how these examples might relate to your own investing circumstances.

Compounding Can Add Fuel to Your Portfolio

If you enter the terms "Albert Einstein" and "compounding" into an Internet search engine, you'll discover a wide variety of quotes attributed to the great inventor. Some results say Einstein called compounding the "greatest mathematical discovery of all time," while others say he called it the "most powerful force in the universe." Despite the many variations, Einstein's point is valid: compounding can add fuel to your portfolio's growth. The key is to allow enough time to let it go to work.

Time and money can work together

The premise behind compounding is fairly simple. If an investment's earnings are reinvested back into a portfolio, those earnings may themselves earn returns. Then those returns earn returns, and so on. For instance, say you invest \$1,000 and earn a return of 6%--or \$60--in one year. If you reinvest, combining that \$60 with your \$1,000 principal, and earn the same 6% the following year, your earnings in year two would increase to \$63.60. Over time, compounding can snowball and really add up.

Say at age 45 you begin investing \$3,000 annually in an account that earns 6% per year, with earnings reinvested. At age 65, your \$60,000 principal investment would be worth almost twice as much--about \$117,000. That's not bad, right?

Now consider what happens if you begin investing at age 35, using the same assumptions. By 65, your \$90,000 principal would nearly triple to just over \$250,000.

Finally, consider the results if you start at age 20: your \$135,000 investment would be worth a jaw-dropping five times as much--\$676,524. That's the power of compounding at work.

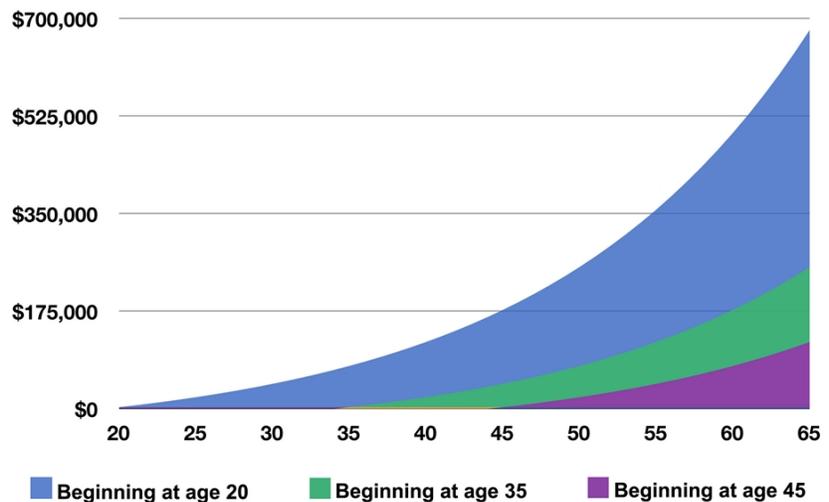
But how long do I have to wait?

If you'd like to estimate how long it might take for your investment to double, you can use a principle known in investment circles as the "Rule of 72." To use the rule, simply divide 72 by the expected rate of return. For example, if you expect to earn an average of 8% over time, the Rule of 72 gauges that your investment would double in approximately nine years. (This rule applies to lump-sum investments, not periodic investment plans such as those given as examples in this article.)

With compounding, the more patience you have, the better off you may be over the long term. The examples in this article assume a steady 6% rate of return each year; however, in reality, no investment return can be guaranteed. Your actual earnings will rise and fall with the changing economic and market conditions. That's why it's so important to stay focused on the long term. Over time, the ups and downs may average out, and your earnings can potentially go to work for you.

Perhaps that's why Einstein called compounding "man's greatest invention." Or was it the "eighth wonder of the world"? Regardless ... you get the idea. When it comes to investing, time can be the power behind your potential success.

Potential Growth of \$3,000 Invested Annually





If you take a loan against your cash value, the death benefit available to your survivors will be reduced by the amount of the loan. In addition, policy loans may reduce available cash value and can cause your policy to lapse. Finally, you could face tax consequences if you surrender the policy with an outstanding loan against it.



Life Insurance Tax Traps for the Unwary

Life insurance has been recognized as a useful way to provide for your heirs and loved ones when you die. Lawmakers have long recognized the social significance of life insurance as a source of funds for widowed spouses and children, and have offered liberal tax benefits as an incentive to those who put their hard-earned dollars into life insurance policies. However, there are a number of situations that can easily lead to unintended and adverse tax consequences. Here are some of the life insurance tax traps you may want to avoid.

Policy loans

One area fraught with unintended tax ramifications involves life insurance policy loans. A number of different scenarios involving policy loans can result in unplanned taxes, but one of the most common situations arises when a policy is surrendered (cancelled) or lapses with an outstanding policy loan.

Generally, if a policy is surrendered or lapses while a loan is still outstanding, the loan balance becomes taxable to the policyowner as ordinary income to the extent the cash value exceeds the owner's basis (net premiums paid less any tax-free distributions received) in the policy--it's as if cash from the policy is distributed to pay off the loan.

Example: *You own a life insurance policy into which you paid premiums of \$100,000 (your basis); the policy cash value is \$200,000; and there is an outstanding policy loan of \$150,000. You surrender the policy for \$50,000 cash (the difference between your cash value and loan balance). However, much to your surprise, you'll have to include \$100,000 as ordinary income for the tax year in which you surrender the policy (\$150,000 loan balance + \$50,000 cash - \$100,000 premiums).*

Modified endowment contract (MEC)

Since 1988, if the total premiums paid during the first seven years of the policy exceed a maximum amount based on the death benefit, then the policy becomes a MEC. The tax-free treatment of the death benefit and the tax-deferred cash accumulation are generally the same for MEC and non-MEC life insurance, although the tax consequences for pre-death withdrawals are different.

For non-MEC policies, partial and full surrenders are taxed on a first-in, first-out basis, meaning cash value withdrawals are considered first coming from your investment in the policy (i.e., your premiums) then from any

gain in the cash value (i.e., interest/earnings). Generally, policy loans from non-MECs are not subject to income tax.

But any withdrawals (including loans and partial or full surrenders) taken from the cash value of a MEC are treated as coming from earnings first and are taxed as ordinary income to the extent the policy's cash value exceeds your basis. In addition, if the policyowner is under age 59½, a 10% tax penalty may be assessed on the amount withdrawn from a MEC that's includible as income unless an exception applies.

Example: *You purchased a cash value life insurance policy with a single premium of \$100,000, making the policy a MEC. The policy cash value has grown to \$150,000. If you take out a loan of \$75,000 against the cash value, you will have to include \$50,000 of the loan amount as ordinary income (\$50,000 of the total amount borrowed represents gain in the policy).*

Estate planning

Generally, the life insurance death benefit is includible in the estate of the policyowner and may be subject to federal and/or state estate tax. Often, attempts to remove the policy from the owner's estate create problems. A quick solution has the owner transferring ownership of the policy to another person or an irrevocable life insurance trust (ILIT), in an attempt to remove the policy from the estate. However, if an insured owns a policy on his or her own life and gives the policy to another person, trust, or entity and then dies within three years of the transfer, the death benefit will be included in the estate of the insured/transferor, subject to possible estate tax.

Issues may arise when the policyowner, insured, and beneficiary are three different parties. If the insured is the first to die, the policy proceeds are considered a gift from the owner to the beneficiary, subject to potential gift tax. Generally, the owner and insured should be the same, or the owner and beneficiary should be the same party.

Unintended ownership issues may result if the insurance policyowner and insured are different parties, and the owner is the first to die. If the policy owner did not name a successor owner, then the policy will be subject to probate, including possible creditors' claims and unnecessary costs. To avoid this scenario, the owner should name a successor owner.



Abel Financial Strategies

Augustus W. Abel, CFP®
Financial Advisor
3775 Attucks Dr.
Powell, OH 43065
phone (614) 389-2075
Cell (614) 499-1201
aw@awabelfinancial.com
www.awabelfinancial.com

Securities offered through **First Heartland Capital®**, Inc. Member FINRA/SIPC. Advisory Services offered through **First Heartland® Consultants, Inc.** (Abel Financial Strategies is not affiliated with First Heartland Capital®, Inc.)



Is winter storm damage covered by my homeowners insurance policy?

Whether or not winter storm damage is covered by your homeowners insurance policy will depend on the type of policy you have and the type of damage that occurs.

Most standard homeowners insurance policies provide coverage for winter-related storm damage that occurs as a result of wind, snow, ice, freezing rain, and severe temperatures. You'll want to review your homeowners policy to find out which wintertime perils are specifically covered.

It is important to note that standard homeowners insurance policies do not provide coverage for flood damage. So if your home has suffered damage from winter-related flooding (e.g., a heavy snow melt), you generally won't be covered unless you have a separate flood insurance policy in place.

Finally, if your home suffers damage while you leave it unattended during the winter, you'll have some additional issues to consider. For example, certain homeowners policies have exclusions for damages that result from a home not being properly winterized (e.g., not shutting

off the water and draining the pipes) or a home being left unoccupied for a long period of time (e.g., more than 30 days).

While your insurance may provide some coverage for winter storm damage, the best option is to take steps to prevent winter-related damage from occurring in the first place. The following are some tips to help protect your home from harsh winter weather:

- Clean your gutters and downspouts so that melting snow can flow freely away from your home
- Inspect and repair roof shingles and flashing to prevent water damage
- Trim tree branches on your property
- Apply weather stripping and caulking around doors and windows and inspect storm doors and windows for broken glass
- Drain water from pipes leading to exterior faucets and remove garden hoses
- Insulate pipes that are susceptible to freezing
- Have your heating system cleaned and inspected



I just installed a new furnace in my home. Is the energy tax credit still available?

Unfortunately, most of the tax credits for making energy-efficient improvements to your home, such as installing a new furnace, are no longer available.

The Energy Tax Incentives Act of 2005 provided tax credits for a variety of energy-saving home improvements, such as installing new windows, water heaters, and furnaces. Unfortunately, these tax credits expired at the end of 2011. However, there are still a few energy tax credits that are available through 2016 for the installation of larger, more costly energy-saving systems, such as geothermal heat pumps and solar energy systems.

Even though the furnace-related energy tax credit is no longer available, you may still be able to save money on the installation of your furnace. Check to see if rebates for energy-saving home improvements are offered through your utility company or your state or local municipality. You can go to www.energy.gov for more information.

While the rebates may not equal the expired tax

credits in terms of cost savings, they often provide incentives of up to a few hundred dollars per installation. When applying for an energy rebate, consider the following:

- Energy rebates usually require the product to be ENERGY STAR certified
- The amount of the rebate may hinge on the energy efficiency of the product (e.g., a furnace that has a higher efficiency will be eligible for a larger rebate)
- The rebate may only be available for products that have been installed by a certified contractor
- You may have to apply for the rebate within a certain time period after the installation of your energy-saving product

Finally, keep in mind that even though you missed out on the financial benefits of a tax credit, installing a more energy-efficient furnace can end up saving you money in the long run. According to the U.S. Department of Energy, installing a higher-efficiency heating system along with making energy-efficient upgrades can often result in cutting your winter home heating costs in half.

*Abel Financial
Strategies*

