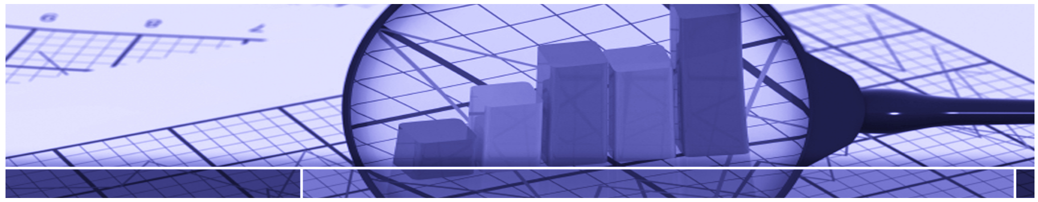

Nicholson Financial Services

Did You Know...?

Bubbles

The word "bubbles" still makes me laugh. If you have seen *Finding Nemo* then you know what I am talking about. Anyone who has had children in the past 10 years has probably seen that movie many, many times as I have. Those are not the type of bubbles we are going to talk about here though. Our focus is on economic bubbles. Over the past 15 years, our economy has seen the impact of two major economic bubbles bursting, and I believe we are now witnessing the potential for another.

In the late 1990's, stocks had a historic run of incredibly strong returns, in spite of valuations. By 2000, equities were very overpriced. There was a lot of conjecture at the time by analysts, economists and investors that the paradigm had shifted. Many thought stocks would tolerate higher valuations going forward and that things were "different this time." They weren't. The "equity valuation bubble" burst from 2000 to 2002 as a multi-year bear market returned stocks to more modest valuation levels. During that time, the Federal Reserve (the Fed) lowered interest rates significantly to spur economic growth. This, combined with relaxing policies in the mortgage industry and other factors, contributed to the next bubble - housing.

The popping housing bubble was one of several main factors that lead to the global financial crisis in 2008. That crisis was really more of a "credit crisis" than anything else. In the fall of 2008, the credit markets froze almost completely, leading to a domino effect on other asset classes. In particular, stocks were hit very hard as many institutions sold their holdings to raise cash. I have discussed those events in these missives numerous times over the past few years, particularly in 2009 & 2010. In order to keep our economy out of a depression, encourage business investing and spur on an economic recovery, the Federal Reserve cut interest rates to all-time lows. Rates literally can't go any lower. This environment is, in my opinion, as much of an anomaly as the early 1980's when rates were higher than 15%. That said, I believe this low rate environment has caused a rapidly expanding bubble in bonds.

Bond prices have an inverse relationship to interest rates. This means that when the Fed lowers rates, bond prices typically go up and visa versa. Considering that rates are the lowest they have been in history, it would follow that overall bond prices are the highest in history as well. As a result of the 2008 crisis, the S&P 500 averaged roughly -1% per year from 2000 to 2009. Over the same time frame, long-term US Treasury bonds averaged better than 7.5% per year. Considering that many investors primarily use past performance to make their investments decisions (something I advise against) and the "flight to safety" after 2008, it is not surprising that billions have poured into bond funds in the past 4 years.

Since March 2009, stocks have generally outperformed bonds by a wide margin. Yet, after the stock market low that month, more money has gone into bond funds than stock funds in every month that followed, save for 3. THREE! Bonds can go no higher from interest rate cuts and now face downside pressure as we get closer to the inevitable interest rate hike from the Fed. The question is not "if" the rate hike will occur, but when. The Fed says they will likely start raising rates in 2015, but it could certainly be sooner if economic growth, and inflation, start to heat up. A rising interest rate environment coupled with bonds underperforming other asset classes like stocks and potentially real estate could lead to a mass exodus from long-term bonds. To put it another way, the bond bubble would pop.

It is my opinion that 1) short-term bonds still offer "safety" but at the sacrifice of return and 2) long-term bonds have built in more interest rate risk than at any point in recorded history. It is unlikely that this bubble bursting will have the kind of negative impact on our economy that the last two bubbles did. Many institutions and savvy investors already know about it and will likely take precautions. My concern is for the average investor who doesn't see it coming. This is especially true for retirees who invested in long-term bonds seeking higher yields. They need to be aware of the possible risks in their portfolios.

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Although 2012 ended with a bit of a "fizzle" due to the fear of the impending "fiscal cliff," the markets had a good year coming back from a soft 2011. The S&P 500 finished 2012 up 16% while the DJIA posted a +10.24% and the Russell 2000 a +16.4%. The international indexes fared better as well. Ironically, the concerns over the "fiscal cliff" lasted only one day into the new year. Our elected officials found a way to do something they haven't done much in recent history - compromise. The first two months of 2013 have shown strong positive moves in the equity markets as well. Going forward, I believe that we will see more political compromise. If so, the gradual economic recovery, low interest rate environment, and favorable valuations may lead to another strong year for stocks.

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See disclaimer on final page

Four Retirement Planning Mistakes to Avoid

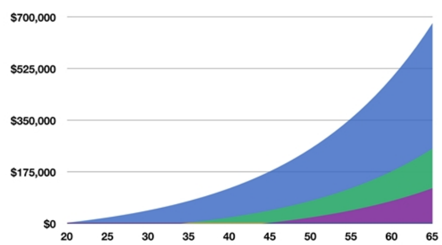
Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

We all recognize the importance of planning and saving for retirement, but too many of us fall victim to one or more common mistakes. Here are four easily avoidable mistakes that could prevent you from reaching your retirement goals.

1. Putting off planning and saving

Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference later. That's because the sooner you start saving, the more time your investments have to grow.

The chart below shows how much you could save by age 65 if you contribute $3,000 annually, starting at ages 20 ($679,500), 35 ($254,400), and 45 ($120,000). As you can see, a few years can make a big difference in how much you'll accumulate.



Note: *Assumes 6% annual growth, no tax, and reinvestment of all earnings. This is a hypothetical example and is not intended to reflect the actual performance of any investment.*

Don't make the mistake of promising yourself that you'll start saving for retirement as soon as you've bought a house or that new car, or after you've fully financed your child's education--it's important that you start saving as much as you can, as soon as you can.

2. Underestimating how much retirement income you'll need

One of the biggest retirement planning mistakes you can make is to underestimate the amount you'll need to accumulate by the time you retire. It's often repeated that you'll need 70% to 80% of your preretirement income after you retire. However, depending on your lifestyle and individual circumstances, it's not inconceivable that you may need to replace 100% or more of your preretirement income.

With the future of Social Security uncertain, and fewer and fewer people covered by traditional pension plans these days, your individual savings are more important than ever. Keep in mind that because people are living longer, healthier lives, your retirement dollars may need to last a long time. The average 65-year-old American can currently expect to live another 19.2 years (Source: National Vital Statistics Report, Volume 60, Number 4, January 2012). However, that's the average--many can expect to live longer, some much longer, lives.

In order to estimate how much you'll need to accumulate, you'll need to estimate the expenses you're likely to incur in retirement. Do you intend to travel? Will your mortgage be paid off? Might you have significant health-care expenses not covered by insurance or Medicare? Try thinking about your current expenses, and how they might change between now and the time you retire.

3. Ignoring tax-favored retirement plans

Probably the best way to accumulate funds for retirement is to take advantage of IRAs and employer retirement plans like 401(k)s, 403(b)s, and 457(b)s. The reason these plans are so important is that they combine the power of compounding with the benefit of tax deferred (and in some cases, tax free) growth. For most people, it makes sense to maximize contributions to these plans, whether it's on a pre-tax or after-tax (Roth) basis.

If your employer's plan has matching contributions, make sure you contribute at least enough to get the full company match. It's essentially free money. (Some plans may require that you work a certain number of years before you're vested in (i.e., before you own) employer matching contributions. Check with your plan administrator.)

4. Investing too conservatively

When you retire, you'll have to rely on your accumulated assets for income. To ensure a consistent and reliable flow of income for the rest of your lifetime, you must provide some safety for your principal. It's common for individuals approaching retirement to shift a portion of their investment portfolio to more secure income-producing investments, like bonds.

Unfortunately, safety comes at the price of reduced growth potential and the risk of erosion of value due to inflation. Safety at the expense of growth can be a critical mistake for those trying to build an adequate retirement nest egg. On the other hand, if you invest too heavily in growth investments, your risk is heightened. A financial professional can help you strike a reasonable balance between safety and growth.

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.

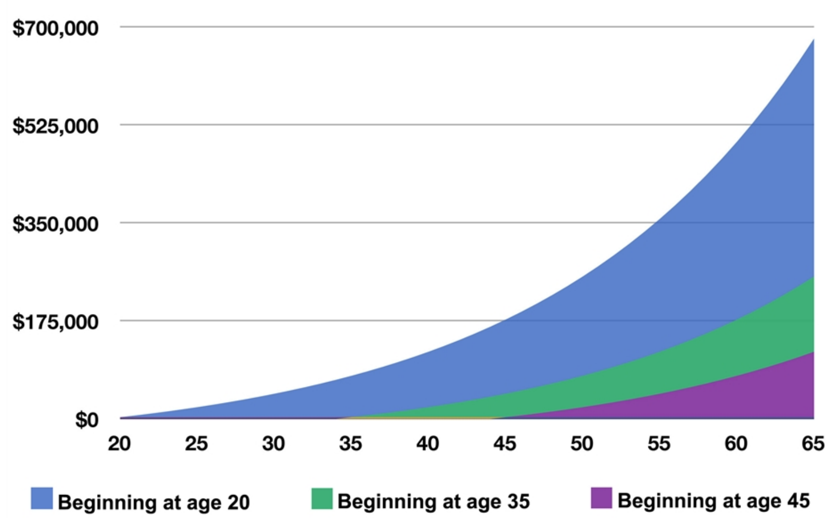
But how long do I have to wait?

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



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I refinanced my mortgage loan last year. Can I deduct any of the costs associated with refinancing the loan?

Now more than ever, homeowners are taking advantage of historically low interest rates and refinancing their mortgage loans. Did you pay points to your lender when you refinanced your loan? If so, you may be able to deduct them.

Points are costs that a lender charges when you take out a mortgage loan or refinance an existing mortgage loan on your home. One point equals 1% of the loan amount borrowed (e.g., 2 points on a $300,000 loan equals $6,000).

In order for points to be deductible, they must have been charged by your lender as up-front interest in return for a lower interest rate on your loan. If the points were charged for services provided by the lender in preparing or processing the loan, then the points are not deductible.

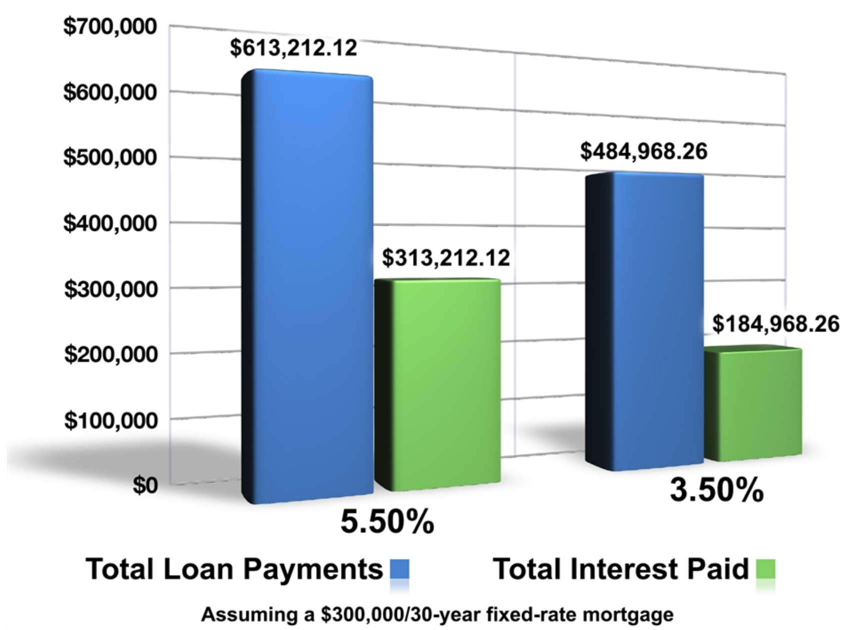
When deducting points, keep in mind that unlike points paid on a loan used to purchase a home, points paid on a refinanced loan usually cannot be deducted in the year that you paid them. Instead, the points may need to be amortized over the life of the loan.

For example, assume that you refinanced to a $300,000/30-year mortgage loan and paid $6,000 in points. You would be able to deduct 1/30 of those points each year over the 30-year loan period, or $200 per year.

The one exception to the amortization rule is if part of your refinanced loan is used to make improvements to your primary residence. In that case, you may be able to deduct the portion of the points that is allocable to the home improvements in the year that the points are paid. In addition, if you choose to refinance again or sell your home in the future, you can generally claim the entire unamortized deduction that remains. For more information on the deductibility of points, you can refer to IRS Publication 936.

As for other costs you may have incurred from refinancing, such as recording, title search, appraisal, and attorney's fees, they are not deductible. Furthermore, unlike costs associated with a home purchase, costs associated with a refinance cannot be added into the cost basis (value) of your home for income tax purposes.

The Potential Benefits of Refinancing Your Mortgage



This is a hypothetical example and does not reflect all of the costs that may be associated with refinancing. Actual results may vary.