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Hi Everyone,

We at EDFS would like to wish you and your families a safe and healthy Spring.

Steve, Brittany & Angel

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April 2008

## It's Not What You Earn--It's What You Keep

You work hard for your money. So why shouldn't you try to keep as much of it for yourself as you can? Here are some ways to pay less tax and keep more of your hard-earned dollars.

### Tax deferrals rule

Take advantage of tax-deferred retirement plans, such as 401(k), 403(b), and 457(b) plans, offered by your employer. They all allow you to make pretax contributions of up to \$15,500 in 2008 (\$20,500 if you're age 50 or older), and 403(b) and 457(b) plans may also have special catch-up rules that might let you defer even more. The tax savings can be significant. For example, if your marginal tax rate is 28% and you defer \$15,500, you'll save \$4,340 in current taxes. Your \$15,500 contribution will generate tax-deferred earnings for you until you withdraw the funds from the plan, when you may be in a lower tax bracket. And, if your employer matches your contributions, the deal is even sweeter.



Another common way to use tax deferrals to save more of what you earn is by setting up a health-care flexible spending account (FSA) at work. Your contributions reduce your taxable income, saving current taxes, and the funds you set aside can be withdrawn tax free to pay a wide variety of health-related expenses that aren't covered by your health plan. See IRS Publication 502, *Medical and Dental Expenses*, for a list of qualifying expenses.

And don't forget traditional IRAs. If neither you nor your spouse is covered by a retirement plan at work, and you're not yet 70½, you can make a deductible contribution of up to \$5,000 to an IRA in 2008 (\$6,000 if you're age 50 or older). Even if you or your spouse is covered by a plan, all or part of your contribution may be deductible, depending on your income.

### But tax free is even better

If you're an income-oriented investor, consider investing in municipal bonds. The income generated is free from federal income taxes and, in some cases, state income taxes as well. (Be sure to compare yields between taxable and tax-free securities, and keep in mind that certain municipal bond income may be subject to the alternative minimum tax.)

Another way you can generate tax-free income is by contributing to a Roth IRA, Roth 401(k), or Roth 403(b) plan. Unlike pretax deferrals, Roth contributions don't reduce your income, so there's no current tax savings. Because you've already paid tax on your contributions, they won't be taxed again when you withdraw them from the plan. But what really sets Roth contributions apart, and makes them so appealing, is that all earnings are also tax free if you satisfy a five-year holding period and certain other requirements are met.

If you have children, don't pass up the tax incentives offered by Section 529 plans and Coverdell education savings accounts (ESAs). Again, your contributions to these plans aren't tax deductible, but your savings grow tax deferred and withdrawals are tax free at the federal level (and typically at the state level too) when used to pay qualifying educational expenses. You can contribute up to \$2,000 to a child's Coverdell ESA in 2008, and most 529 plans let you contribute more than \$300,000 over the life of the plan.

### Think long term--for capital gains

Long-term capital gains tax rates are currently very attractive--a maximum of 15% through 2010. Short-term capital gains, on the other hand, are generally taxed at ordinary income tax rates--currently as high as 35%. To qualify for long-term capital gains treatment, make sure you hold your securities and other capital assets for more than one year before selling them.



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## How Well Are You Navigating the Efficient Frontier?

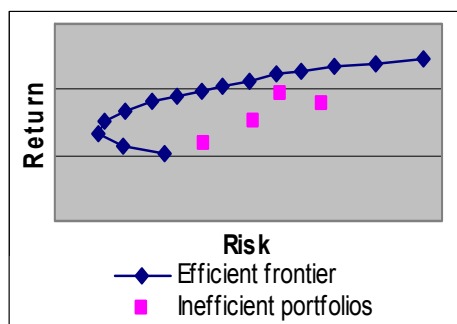
Investing isn't just about achieving the highest return possible; it's also about the tradeoff between return and risk. Modern portfolio theory (MPT) is based on a key assumption: No rational investor wants to take more risk than is necessary to achieve the desired return. The concept was outlined by Harry Markowitz in a pioneering 1952 *Journal of Finance* study titled "Portfolio Selection," which argued that you can manage the type and level of risk you take by combining investments that tend to behave very differently from one another.

### Different strokes for different folks

Modern portfolio theory tries to create portfolios that maximize return for a given level of risk—or alternatively, that minimize risk for a given level of return. MPT compares a portfolio's standard deviation—how much its return may vary from its statistical mean return over time—to its returns. An efficient portfolio navigates the risk/reward tradeoff by combining investments based on their level of risk, their expected return, and their correlation with other investments in the portfolio. MPT argues that a portfolio that doesn't do so isn't optimized—in other words, it takes too much risk for the return it provides.

### Efficiency is in the eye of the beholder

Even with a limited number of securities, the ways to combine them into a portfolio are practically limitless. For any group of assets, there may be multiple efficient portfolios, each of which combines those assets differently. Collectively, they represent what economists and financial professionals call "the efficient frontier." On a chart, the efficient frontier is a line that represents all optimized portfolios for a given group of assets. That line is actually a series of points; each represents a portfolio that provides the best return for whatever risk you are comfortable taking.



The efficient frontier represents all of the combinations of a given group of assets *that combine risk and return most efficiently*, expressing that tradeoff in graphic form. In a sense, the efficient frontier functions like a global positioning system (GPS) for investing, showing the most efficient way to get to your goal. Each GPS user may choose a different destination, but in each case, the GPS suggests the most effective way to get there.

### So what is risk anyway?

Risk has traditionally been measured by volatility; an asset whose price varies dramatically is considered riskier than one that is more stable. However, some experts have begun to question whether a portfolio can be better optimized by focusing on downside risk, arguing that such an approach more closely matches the way investors tend to think.

Unlike MPT, this so-called "post-modern portfolio theory" concentrates not on how an investment's return deviates from its statistical mean—its ups and downs—but on how often its returns fall below an individual investor's minimum acceptable return, how far below that figure they fall, and the potential worst-case scenario possible for that investment. Outlined in *Managing Downside Risk in Financial Markets* by Frank Sortino and Stephen Satchell of the Pension Research Institute, this approach attempts to combine portfolio theory with behavioral finance, hoping to more closely reflect the human decision-making process.

Depending on how risk is measured—by volatility or by downside risk alone—the efficient frontier may look very different, even for the same group of assets.

### The balance is up to you

Whichever approach is taken, the efficient frontier still doesn't tell you which assets are right for you, or in what combination. Only you can decide where you want your portfolio to be along the efficient frontier, and what type and level of risk you're willing to take.

Though past performance is no guarantee of future results, it can help serve as a guide when developing an appropriate asset allocation. Using data about past and anticipated returns of various assets as well as estimates of their volatility or downside risk, your financial professional can position your portfolio at the point along the efficient frontier that makes sense for you.

## Will You Pay Taxes on Your Social Security Benefits?

Did you know that you might have to pay federal income tax on your Social Security benefits? If Social Security was the only income you had during the year, then your benefits generally won't be taxable. However, if you or your spouse worked and had any earned income during the year, or if you had other substantial income (such as investment income), then a portion of your Social Security benefits may be taxable.

### Gather information

Your benefits are taxable if one-half of your Social Security benefit plus your other income (called your "combined income") exceeds a certain amount (called the "base amount"). To determine if your benefit is taxable, you need to know three things: (1) how much you received from Social Security during the year, (2) your combined income, and (3) the base amount for your filing status.

### Find out how much you received from Social Security

Each January, the Social Security Administration (SSA) will send you a Social Security Benefit Statement (Form SSA-1099) showing the amount of benefits you received during the previous year. You'll need to use this information to figure out whether any of your benefit will be taxable.

### Calculate your total income

Once you know how much you've received from Social Security, it's time to calculate your combined income. This figure includes the following:

- One-half of Social Security benefits received
- Other income including wage income, and taxable interest and dividends
- Tax-exempt interest income
- Income that's normally excludable-- interest from qualified savings bonds, employer-provided adoption assistance, foreign earned income or foreign housing, and income earned by bona fide residents of American Samoa and Puerto Rico

The IRS has a worksheet you can use to calculate your combined income and determine whether or not your Social Security benefits are taxable. You can find this worksheet and more information about the taxation of Social

Security benefits in IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*.

### Compare your combined income against the base amount for your filing status

Once you've calculated your combined income, you must compare that against the base amount for your federal income tax filing status. If your total income is less than the base amount, then your Social Security benefits won't be taxable. If your combined income is more than the base amount, then part of your benefits will be taxable. Base amounts aren't indexed for inflation, so they're the same year after year.

Your base amount is:

- \$25,000 if you file as single, head of household, qualifying widow(er), or married filing separately and you lived apart from your spouse for the entire tax year
- \$32,000 if you file as married filing jointly
- \$0 if you file as married filing separately and you lived with your spouse at any time during the tax year

For example, let's say your combined income for the year was \$30,000 and you file your taxes jointly with your spouse. Because your combined income is less than the base amount for your filing status, \$32,000, your benefits won't be taxable.

### How much of your benefit is taxable?

Even if your combined income exceeds the base amount for your filing status, you won't have to pay taxes on the entire amount of benefits you've received. Generally, up to 50% of your benefits will be taxable, but if your combined income is more than \$34,000 (\$44,000 if you are married filing jointly), or if your tax filing status is married filing separately and you lived with your spouse at any time during the tax year, up to 85% of your benefit will be taxable. Again, see IRS Publication 915 for worksheets you can use to figure your taxable benefits.

Keep in mind that taxation of Social Security benefits can be complicated. Different rules apply to certain U.S. citizens and nonresident aliens living abroad and in other situations. If you have any questions, consult your tax professional.

### Did you know?

*Social Security benefits were not subject to federal income taxation until 1984. They became taxable as a result of the 1983 Amendments to the Social Security Act.*



### Tax withholding

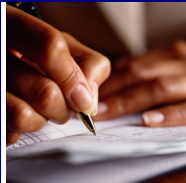
*You can have federal income taxes (but not state income taxes) withheld from your benefits if you so choose. Complete IRS Form W-4V and select the percentage that you want withheld (7%, 10%, 15%, or 25%), then return it to your local Social Security office.*

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## Ask the Experts



### What can we learn from the subprime mortgage mess?

The collapse of the subprime mortgage market and the jitters it's sending through the entire economy contain lessons for us all.

Here are a few:

*If it sounds too good to be true, it probably is.* Based in part on wishful thinking ("housing values will always appreciate") and in part on misleading information ("that's a great rate"), many homebuyers became convinced they could afford mortgages they later found they really couldn't. Similarly, many investors were led to believe that mortgage-backed securities were all about huge rewards with minimal risk. So, the lesson here is: When faced with what appears to be a rosy best-case scenario, always remember to ask "But what if ...?"

*Experience counts.* When seeking a mortgage broker, loan originator, investment firm and/or fund manager, check out their credentials, and look for those with lengthy experience who are respected within their fields.

*Read (and understand) the fine print.* Many people, both homebuyers and investors, got burned in the subprime mortgage mess because they didn't know the details of the contracts they entered--and the devil is always in the details. Review all mortgage documents and/or investment prospectuses carefully before you make a commitment. If you don't understand the ramifications of what you've read, seek assistance from an unbiased qualified professional.

*The best regulation is self-regulation.* Federal regulations designed to protect the consumer cover many loans resold to quasi-government agencies like Freddie Mac, and loans insured by the Federal Housing Administration also carry strict guidelines. But oversight of these loans is not always as diligent as it should be. What's more, many mortgages are now originated by unregulated nonbank lenders. As a result, you shouldn't assume that governmental and/or institutional regulations will always protect you from getting into financial trouble. Only you can do that.