

June 2009 Issue

In This Issue...

- [Is It Time to Rethink College?](#)
- [Get Familiar with the Financial Aid Process](#)
- [Taxes and Your Investments](#)
- [Stretching Your Salary](#)
- [Develop Good Investing Habits](#)



Is It Time to Rethink College?

College costs can seem staggering. For the 2008-09 school year, the average annual total cost was \$37,390 for a four-year private university and \$18,326 for a four-year public university, up 5.6% and 5.7%, respectively, from the prior year (Source: *Trends in College Pricing*, 2008). Over the past decade, average tuition costs have increased 4.2% annually after inflation at public colleges and 2.4% at private colleges (Source: *Trends in College Pricing*, 2008).

On top of that, many people's investments set aside for college have decreased substantially over the last couple of years. Add concerns about the current economic situation, and it's no wonder that students and parents alike wonder whether college is really necessary.

To help answer that, consider the median earnings by level of education for 2005 (most recent year available):

Professional degree	\$100,000
Doctoral degree	79,400
Master's degree	61,300
Bachelor's degree	50,900
Associate degree	40,600
Some college, no degree	37,100
High school graduate	31,500
Not a high school graduate	23,400

(Source: *Education Pays*, 2007)

It is estimated that college graduates will earn approximately \$1 million more over their working lives than high school graduates. In terms of paying back college costs, the College Board estimates the typical college graduate who started college at age 18 will earn enough to compensate for tuition and fees at the average four-year public university as well as for foregone earnings during those college years by age 33 (Source: *Education Pays*, 2007).

While that doesn't sound like a bad tradeoff - breakeven by age 33 and then earn substantially more for the rest of your life - keep in mind that those figures only include the cost of tuition and fees at a public university. Room and board adds another \$7,750 annually to the cost. And, if your student goes to a private university, the costs are typically double what you pay at a public university.

Those figures also don't consider how you pay for that education. If you pay for that college education primarily with student loans, it could take a lot longer than age 33 to breakeven.

That doesn't mean your child shouldn't go to college, just that you may need to reevaluate how much you want to spend on that education. Consider these strategies to reduce the cost of a college education:

- **Look for scholarships that are not based on need.** Generous merit scholarships are often available to students with outstanding high school grades and above-average entrance exam scores. Scholarships may also be available for athletes and for those with strong music backgrounds. If your student has qualities that a college is looking for, that college may be more willing to offer scholarships to attract him/her.
- **Apply to several different colleges.** Don't make the mistake of thinking that aid packages will be the same at all universities. You may be surprised at how wide the differences can be. Even if your child is set on one school, it is generally wise to apply to several different colleges. This is especially true in these economic times when more students are applying for aid and colleges have less aid available.
- **Talk to the university.** If the financial aid package is not sufficient, talk to the financial aid officers at the university. By explaining extenuating circumstances or showing the college offers from other universities, you may be able to increase your financial aid package.
- **Don't overlook state public universities.** Costs of public universities, especially in your state, are typically much more affordable than private universities.
- **Decide whether it makes sense to go to an expensive private college.** First, you need to evaluate how much financial aid your student would be entitled to, since many private universities offer substantial aid packages. If you are still left funding much of the cost yourself, consider whether your child's intended career makes it a good investment. If your child intends to

pursue a career with limited salary potential, you may not want to send him/her to an expensive college.

- **Consider starting at a two-year college.** Two-year colleges are often much cheaper than four-year colleges, especially when you consider that most students live at home while attending. For instance, for the 2008-09 school year, the average cost of tuition and fees at a public two-year college is \$2,402 compared to \$6,585 at a public four-year college and \$25,143 at a private four-year college (Source: *Trends in College Pricing*, 2008). Before starting, however, your child should determine which four-year college he/she will transfer to and make sure all of the credits from the two-year college will transfer to the four-year college.
- **Send more than one child to the same university.** Many universities offer discounts on tuition if more than one child attends at the same time.
- **Accelerate your child's studies.** You can save a significant amount of money if your child can complete a four-year degree in three years. Another alternative is to have your child take summer courses at a local community college. High school students may be able to take courses at a community college which will then transfer as college credits. Advanced placement courses may also count as college credit.

[Back to topics.](#)



Get Familiar with the Financial Aid Process

Over \$162 billion of financial aid was distributed during the 2007-08 school year, with an average award of \$8,896 per full-time student. Of that total, approximately 65% was in the form of loans and 32% in grants (Source: *Trends in Student Aid*, 2008). With so much money at stake, you should understand the financial aid process to maximize your share of financial aid.

The first step is filling out the appropriate forms so colleges can determine your financial need. After January 1 of the year your child enters college, you must complete the "Free Application for Federal Student Aid" form as well as any forms required by colleges your child applied to. These forms are used to determine your expected family contribution (EFC), which is the amount you're expected to pay annually toward college costs. If college costs exceed your EFC, financial aid officers try to fund that difference using grants, scholarships, work-study programs, and student loans.

Be prepared - most families are surprised by how much they're expected to contribute toward college. The calculation is based on a formula, not your actual expenses. After some adjustments, your EFC equals 2.6% to 5.6% of your eligible assets and 22% to 47% of your income, plus 20% of your child's assets and up to 50% of his/her income (Source: Savingforcollege.com, 2009). Your EFC is the same no matter how many children are attending college, so you can expect more aid if you have more than one child in college.

Consider these tips to help maximize your financial aid award:

- **Understand how the financial aid system classifies income and assets.** Your net worth, as defined by the financial aid system, includes bank accounts, stocks, bonds, and mutual funds, but not equity in your primary home, retirement funds, insurance, or annuities. However, individual colleges may have different criteria for certain assets. Loans against assets, such as mortgages, home-equity lines of credit, and margin loans, are deducted from your net worth, but consumer loans are not. Capital gains are also included in income, so you may want to time sales carefully.
- **Consider using your child's assets to pay school expenses before college.** For financial aid purposes, 20% of your child's assets are considered available for college expenses, while only a maximum of 5.6% of your assets are counted. You might want to purchase a computer or car for commuting to college with your child's money.
- **Apply to several colleges, evaluating each financial aid package.** Your awards can vary significantly among colleges, because financial aid officers use discretion when making awards. Some colleges use merit scholarships in addition to need-based financial aid to attract top students. Don't just look at the total amount of the award - evaluate the composition of that aid. Grants, which are not repaid, are more desirable than loans. Even the types of loans offered can make a big difference.
- **Don't automatically rule out more expensive colleges.** Your EFC will remain the same, whether your child attends a public, private, or Ivy League college. Many private and Ivy League colleges have more merit aid and discretion than public schools do when making offers.
- **Make sure to adhere to application deadlines.** Typically, colleges first evaluate applications submitted on time. Anyone filing late is evaluated later, after a significant portion of grants and work-study programs have been awarded.
- **Talk to the financial aid officer if you aren't satisfied with the financial aid package.** While financial aid officers don't like the word negotiate, they are often willing to reevaluate a financial aid package. If there have been significant changes in your financial situation since the forms were filled out, call and explain. If your child received a more generous aid package from another college, see whether this college is

willing to reevaluate its offer. Colleges will often increase a financial aid package, especially for a top student.

[Back to topics.](#)



Taxes and Your Investments

Ordinary income taxes on short-term capital gains and interest income can go as high as 35%, while long-term capital gains and qualified dividend income are taxed at rates not exceeding 15% (0% if you are in the 10% or 15% tax bracket). One way to help maintain your portfolio's growth potential is to invest in a tax-efficient manner. Some suggestions include:

- **Contribute to your 401(k) plan.** Contributions are made on a pretax basis, so you don't pay income taxes currently (Social Security and Medicare taxes are paid) and earnings grow on a tax-deferred basis until withdrawn. In 2009, you can contribute a maximum of \$16,500 to a 401(k) plan, although plans typically limit your contributions to a certain percentage of your pay to ensure the plan complies with nondiscrimination rules. Individuals over age 50 may be able to make an additional catch-up contribution of \$5,500 in 2009. Many employers also match your contribution.
- **Make contributions to an individual retirement account (IRA).** In 2009, you can contribute a maximum of \$5,000, plus those over age 50 can make an additional \$1,000 catch-up contribution. Investigate whether you're eligible to contribute to a traditional deductible IRA or a Roth IRA and then decide which option is best for you.
- **Carefully decide which investments to hold in tax-advantaged and taxable accounts.** Gains from investments held in retirement accounts, such as 401(k) plans and traditional IRAs, are taxed at ordinary income tax rates when withdrawn, rather than the lower capital gains tax rates. While it may make sense to hold investments that produce ordinary income or that you want to trade frequently in retirement accounts and investments that generate capital gains in taxable accounts, factors such as your investment period should also be considered.
- **Analyze the tax consequences before rebalancing your portfolio.** Portfolio rebalancing is a taxable event that may result in a taxable gain or loss. In general, avoid selling investments from your taxable portfolio for reasons other than poor performance. Bring your asset allocation in line through other methods.

- **Consider municipal bonds or stocks generating dividend income if you are in a high tax bracket.** Since municipal bond interest is exempt from federal, and sometimes state and local, income taxes, your marginal tax bracket is a major factor when deciding whether to include municipal bonds in your portfolio. Thus, you should determine how a muni bond's yield compares to the after-tax yield of a comparable taxable bond. Since qualified dividend income is taxed at rates not exceeding 15%, stocks that generate significant dividend income may be a good choice for high-tax-bracket investors.
- **Look into tax-advantaged ways to save for college.** If you are saving for college, look at education savings accounts (ESAs) and Section 529 plans. The annual contribution limit to ESAs is \$2,000. While you can't deduct the contribution on your tax return, earnings grow tax free as long as funds are used for qualified education expenses. With Section 529 plans, you can contribute up to \$65,000 to a qualified plan (\$130,000 if the gift is split with your spouse) in one year and count it as your annual \$13,000 tax-free gift for five years. Distributions from 529 plans to pay qualified higher-education expenses are excluded from income.
- **Consider owning a home.** Despite declining home values over the past couple of years, owning a home has significant tax advantages. Mortgage interest and property taxes can be deducted on your tax return, reducing the cost of owning a home. Mortgage interest is deductible on up to \$1,000,000 of original debt incurred to purchase a principal residence. Additionally, interest paid on up to \$100,000 of home-equity debt is deductible on your tax return. When you sell your home, significant capital gains can be excluded from income. You can exclude up to \$250,000 of gain if you are a single taxpayer and up to \$500,000 of gain if you are married filing jointly, provided the home was your primary residence for at least two of the preceding five years.

[Back to topics.](#)



Stretching Your Salary

In the current economic climate, many employers are cautious about increasing expenditures. That means your best bet for the near term is to make your current salary stretch farther. Some tips to consider include:

- **Deposit your paycheck directly into your bank account.** That way, you'll be less tempted to cash part of your paycheck and spend it.
- **Contribute to your 401(k) plan.** Not only will this help with your retirement goals, it can help with your current financial situation. Any contributions you make are deducted before income taxes (unless contributing to a Roth 401(k) plan), so you don't pay any current federal income taxes on your contributions. In addition, many employers match some portion of your contribution, which can substantially increase your 401(k) balance at no cost to you.
- **Check out your 401(k) investments.** Your job isn't finished once you make contributions to your 401(k) plan, since you are also responsible for investing those contributions. Make sure you are familiar with all options in your plan and review those options at least annually. Even if you only increase your rate of return by a percent or so, that can make a significant difference in your ultimate 401(k) balance over several decades.
- **Review your health insurance coverage.** If your employer offers more than one option, review those choices carefully to select the most appropriate insurance for the least cost. When your spouse also has coverage, review options from both employers and determine which is the best alternative for you.
- **Take a look at other fringe benefits offered by your company.** Many employers provide a variety of fringe benefits. Usually, you do not have to pay any income taxes on these benefits. Thus, carefully assess your company's fringe benefit package to ensure you are utilizing all appropriate ones.

[Back to topics.](#)



Develop Good Investing Habits

Good investing habits are needed to ensure that you follow through on your investment plan. Some tips to hone your investing habits follow:

- **Write everything down in a diary.** Every time you make a trade, write down why you did so and what was going on in the market to precipitate that trade. This will force you to organize your thoughts before making a trade. The diary will also be useful when evaluating your investment strategies.
- **Keep track of your portfolio's performance.** Don't get overzealous and review your portfolio's performance daily or even weekly. Monthly,

quarterly, or even annual reviews are adequate. The point is to assess how your investments have performed compared to a relevant benchmark. Evaluate all your investments, not just your retirement accounts or your taxable accounts.

- **Monitor the market and your investments.** You can't just purchase investments and then forget about them. While you don't have to read everything in print about your investments, make sure to set aside enough time to review quarterly and annual reports and other major news about your investments. You'll also want to read enough to have a general sense of what is going on in the market.
- **Evaluate your strategies.** Once a year, thoroughly review your investment strategies to make sure they are helping you reach your financial goals. The other habits will assist in this review. Pull out your diary and the analysis of your portfolio's performance so you can review all your trades and investments in detail. You're looking for trends and trying to analyze what you did right and wrong during the year.

[Back to topics.](#)