CMA Monthly News

Take your financial hat off and give it to us.

Capital Management Advisors, Inc.
Nicolina Stewart, CPA, PFS, CGMA, CLU, ChFC
President and CEO
5910 Post Blvd, Unit #110571
Bradenton, FL 34211
P: 941-320-1524
F: 941-296-7393
nstewart@cmaadvisors.net
www.cmaadvisors.net

Hello Everyone:

We are in the process of redesigning our website, so please bear with us if you visit our site and it is still under construction. We will have some great new features and content for you when it is complete!

In the meantime, please be sure to contact us if you need our help with taxes, financial planning or grant management. We are accepting new clients and would love the opportunity to work with you and/or your business!

~Nikki

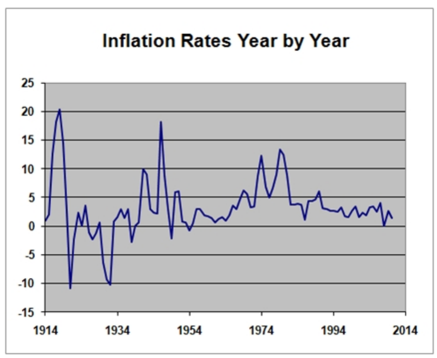
February 2013

Cost-of-Living Adjustments: What They Are and Why They Matter

The rising costs of food, gas, electricity, and health care can strain anyone's budget. The situation is even worse if your living expenses increase while your income stays the same, because your purchasing power will steadily decline over time. That's why cost-of-living adjustments, or COLAs, are especially valuable to retirees and others living on fixed incomes.

How COLAs work

A COLA is an increase in regular income you receive (such as a Social Security or pension benefit) that is meant to offset rising prices. It's important protection because price inflation has occurred almost every year in the last 40 years.



Data Source: *Bureau of Labor Statistics*

It's easy to think of a COLA as a "raise," but a COLA is meant to help you maintain your standard of living, not improve it. For example, let's say you receive a $2,000 monthly retirement benefit, and the overall cost of the things you need to purchase increases by 3% during the year. The next year, you receive a 3% COLA, or an extra $60 a month, to help you manage rising prices.

That 3% COLA doesn't sound like much, but without a COLA, inflation can seriously erode your retirement income. Assuming a 3% inflation rate, in just 10 years, the purchasing power of your $2,000 benefit would drop to $1,520, and in 25 years, the purchasing power of your benefit would be only $963, less than half of what you started with.

Who receives COLAs?

Social Security is the major source (and in some cases the only source) of inflation-protected retirement income for many Americans. Social Security COLAs are announced each October, based on increases in the average Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter of the last year a COLA was payable to the third quarter of the current year. For example, because the CPI-W rose 1.7% between August 2011 and August 2012, Social Security and SSI beneficiaries received a 1.7% COLA, beginning with December 2012 benefits. However, if there is no rise in the CPI-W, then beneficiaries will not receive a COLA.

COLAs are also commonly paid to retirees who are covered by state or federal pensions. However, most private pensions do not offer COLAs.

Less commonly, employers offer COLA increases as part of compensation packages. You may also purchase riders to certain insurance policies (such as disability income and long-term care policies) that ensure that benefits you receive keep pace with inflation.

Should you count on COLAs?

As important as COLAs are, they are still vulnerable to cutbacks. For example, pension plans that are underfunded may view reducing COLAs as a relatively simple way to cut costs, and some plans have attempted to eliminate COLAs altogether, although there have been legal challenges. Changing the COLA formula that the Social Security Administration uses has also been proposed as a way to save money and strengthen program reserves.

So while you should appreciate the value of COLAs, you should also take other measures to account for the effect of long-term inflation. These include using realistic inflation and investment return assumptions when planning for retirement, maintaining a diversified portfolio that reflects your time horizon and tolerance for risk, and considering investments that have historically held their own against inflation.

See disclaimer on final page

Looking Backward and Forward on Entitlement Programs

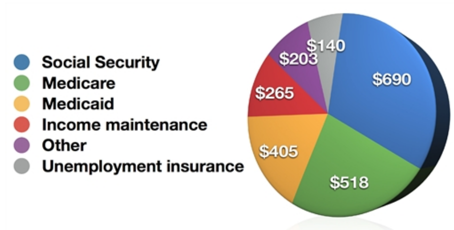
An unsustainable path

The bipartisan Bowles/Simpson Deficit Reduction Commission stated that "our nation is on an unsustainable fiscal path" in regard to entitlement spending.

Last year's presidential election, along with the more recent fiscal cliff and debt ceiling negotiations, have put the spotlight on our nation's tax policy, deficit, and entitlement programs. For some, entitlement programs are necessary--a social compact for America in an era of longer life spans, the decline of employer-provided pensions and health insurance in retirement, and a widening gap between the haves and the have-nots. For others, the current level of entitlement spending is jeopardizing our country's fiscal health and creating an "entitlement lifestyle." No matter where you stand in the debate, do you know the basic facts on our country's largest entitlement programs?

Where the money goes

All entitlement spending isn't created equal. The "Big Three" of Social Security, Medicare, and Medicaid account for more than two-thirds of all federal entitlement spending. Social Security and Medicare are primarily age-based programs, whereas Medicaid is based on income level. According to the U.S. Bureau of Economic Analysis, in 2010, the federal government spent a total of $2.2 trillion on entitlement programs, with the Big Three accounting for $1.6 trillion of this total. The largest expenditure was for Social Security ($690 billion), followed by Medicare ($518 billion) and Medicaid ($405 billion).



A history of growth

Alexis de Tocqueville, the famous French political thinker who traveled to the United States in the early 1830s and wrote about the uniqueness of our young nation's individual self-reliance in his famous book, *Democracy in America,* would likely be surprised to observe the growth in spending on entitlement programs that has occurred in the United States over the past 50 years. According to the Bureau of Economic Analysis, in 1960, U.S. government transfers to individuals totaled about $24 billion in current dollars. By 2010, that figure was $2.2 trillion, almost 100 times as much.

Current status

Let's look at our two main entitlement programs--Social Security and Medicare.

Social Security. Created in 1935, Social Security is a "pay-as-you-go" system, meaning that payments to current retirees come primarily from payments into the system by current wage earners in the form of a 12.4% Social Security payroll tax (6.2% each from employee and employer). These payroll taxes are put into two Social Security Trust Funds, which also earn interest. According to projections by the Social Security Administration, the trust funds will continue to show net growth until 2022, after which, without increases in the payroll tax or cuts in benefits, fund assets are projected to decrease each year until they are fully depleted in 2033. At that time, it's estimated that payroll taxes would only be able to cover approximately 75% of program obligations.

Medicare. Created in 1965, Medicare is a national health insurance program available to all Americans age 65 and older, regardless of income or medical history. It consists of Part A (hospital care) and Part B (outpatient care)--which together make up "traditional" Medicare; Part C (Medicare Advantage, which is private insurance partly paid by the government); and Part D (outpatient prescription drugs through private plans only). Medicare Part A is primarily funded by a 2.9% Medicare payroll tax (1.45% each from employee and employer), which in 2013 is increased by 0.9% for employees with incomes above $200,000 (single filers) or $250,000 (married filing jointly). In addition, starting in 2013, a new 3.8% Medicare contribution tax on the net investment income of high-earning taxpayers will take effect.

Looking ahead, Medicare and Medicaid are expected to face the most serious financial challenges, due primarily to increasing enrollment. The Congressional Budget Office, in its report *Budget and Economic Outlook: Fiscal Years 2012 to 2022,* predicts that federal spending on Medicare will exceed $1 trillion by 2022, while federal spending on Medicaid will reach $605 billion (state spending for Medicaid is also expected to increase). According to the CBO, reining in the costs of Medicare and Medicaid over the coming years will be the central long-term challenge in setting federal fiscal policy.

Reform

There has been little national consensus by policymakers on how to deal with rising entitlement costs. At some point, though, reform is inevitable. That's why it's a good idea to make sure your financial plan offers enough flexibility to accommodate an uncertain future.

A Business Plan Is Your Vision of Success

Business plans help key stakeholders share in your vision, but even if you don't have stakeholders, they can help you identify your strengths and weaknesses for strategic planning purposes. For more information, visit the Small Business Administration's new online resource.

What is your business's key to success? Unique products, flawless customer service, nimble operations--or something entirely different? As a business owner, you may instinctively know what makes your organization succeed in today's competitive marketplace. A business plan helps you share that knowledge with important stakeholders--including key employees and potential investors and lenders.

A good business plan tells the story of your company, illustrating where you are now and where you hope to be in three to five years. It provides a detailed description of your organization's current state and paints a picture of what it will look like in the future. Most important, it provides--in as few words as possible--the information others will need to make financial and strategic decisions, and is typically organized using the following sections.

Cover page and table of contents

The cover page is simply a title page for your business plan document. It should include the name of the company, address, phone number, owners' names, and contact information. It should also include the date on which the document was finalized and published.

The table of contents helps readers navigate through the document and identifies page numbers for each of the sections.

Executive summary

The executive summary is essentially your elevator pitch--an abridged version of the business plan that describes to readers why your business is worthy of their attention and possibly their investment. It should be no longer than one page, but should contain all pertinent details. (For this reason, it is often easier to write this section last.) It should answer readers' primary questions--i.e., are you looking for funding, is the document a roadmap for management, or both? As you draft your executive summary, keep in mind that many readers will decide whether the subsequent pages are worth reviewing based on this important section.

Business description

This section should provide more detail on the nature of your business. What product or service do you provide, and how is it produced? Who are your key advisors and managers, and how does their experience benefit your organization? What is your legal structure? Where are you located and why did you choose this location? You might also want to use this section to describe the genesis of your business--i.e., how and why you decided to launch the venture. Was there an industry gap you wanted to fill? A need you could meet? What makes your business idea worth pursuing?

Market analysis and marketing strategy

Perhaps the most influential section of your business plan, the market analysis is how you convince readers that your business will be successful. It should provide a specific and detailed analysis of your target market, including what you have done to maximize your opportunity within it. Who are your current and potential customers, and why?

Summarize any market research you have conducted to prove the viability of your business. How big is your potential market? Who are the major competitors, and what is your strategy for differentiating your company from them? If your business plan is intended for potential investors or lenders, this section will help convince them that you truly understand your market and are an expert in your industry. If your plan is primarily designed to educate key employees, it will provide the basic information they need to strategize.

This section should also summarize your marketing strategy, or how you will promote your products and services. Describe any planned advertising and communications tactics, as well as sales models.

Financials

This portion of the business plan is designed to help your readers understand where you are now, financially, and where you hope to be. You should include all current and projected (or "pro forma") financial statements. These should include cash flow and income statements, as well as a balance sheet and break-even analysis. This section will likely be scrutinized the most, so be sure it is completed carefully. Its purpose is to educate readers about the use of resources--including any debt and equity financing you hope to get--proving to them that your company can and will manage money effectively.

Take time and care

Many business owners--particularly entrepreneurs just starting out--loathe spending time writing business plans, preferring instead to jump into the more exciting arenas of creating, selling, and managing their business. However, a business plan represents a critical opportunity to draw key stakeholders into your vision of a future filled with success. Be sure to devote the time needed to produce an effective and engaging document.

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Capital Management Advisors, Inc.
Nicolina Stewart, CPA, PFS, CGMA, CLU, ChFC
President and CEO
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Bradenton, FL 34211
P: 941-320-1524
F: 941-296-7393
nstewart@cmaadvisors.net
www.cmaadvisors.net

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What is pet insurance?

For many, a pet is a full-fledged member of the family. And just as health-care costs for human family members have risen over the years, so has the cost of veterinary care. It's probably not surprising, then, that pet insurance has gone in a fairly short period of time from relative obscurity to something that more and more people are considering.

With pet insurance, you pay premiums to a pet insurance provider; in return, the provider agrees to pay for some of your pet's medical costs, according to the specific terms and limits detailed in the policy agreement. How much you pay in premiums and the coverage you receive vary widely by provider, and depend on factors that include breed and age.

If you are considering pet insurance, it's important to request quotes from several providers (a list of 12 pet insurance providers, along with some helpful information, is available at www.avma.org, the website of the American Veterinary Medical Association). After obtaining quotes from multiple providers, look carefully at the coverage details offered by each company.

With pet insurance, costs associated with "wellness" care (e.g., regular office visits and vaccinations) generally aren't covered. Pre-existing conditions are also generally excluded. Some providers also exclude certain hereditary or common conditions--for example, many pet insurance providers exclude coverage for hip dysplasia, a disease often associated with larger dog breeds.

In addition to comparing coverages, make sure that you understand your out-of-pocket responsibilities. You may be responsible for a co-payment. You're probably also responsible for a specified deductible amount before a policy will make any payment. And once you've satisfied any deductible, a policy is likely to pay only a certain percentage of covered costs. So, for example, you might have a policy that pays 80% of covered costs after you satisfy the policy deductible. Some providers also cap benefits on a per-illness, annual, or lifetime basis.

One final note--with your health insurance, your provider probably bills your insurance directly. That's generally not the case with pet insurance. Typically, you pay all costs up front, and then you submit claims to the pet insurance provider for reimbursement.

Is pet insurance worth the cost?

The last thing you want is to have to forgo lifesaving treatment for your pet sometime down the road because you simply don't have the money to pay for it. But that's a situation many pet owners eventually face. Pet insurance can provide some peace of mind, but is it worth the cost? That's a tough question to answer.

Let's say that you have a two-year-old Labrador retriever. You get quotes from all the major pet insurance providers, and after carefully comparing coverages and details, you decide on a policy that will pay 80% of covered costs after you satisfy an annual $250 deductible. Your cost for the policy is $40 each month. In most years, you don't have any reimbursable claims--just routine visits or claims that don't exceed the deductible. After six years, your lovable Lab swallows a sock, things go horribly wrong, and he needs surgery at a cost of $4,000. Good thing you purchased the insurance, right?

Remember, you have a $250 deductible, so you will have to cover that yourself. And, the insurance policy will only reimburse you for 80% of the remaining $3,750, or $3,000. Consider this: If, instead of purchasing the pet insurance policy, you set aside $40 each month into an account earning 3%, you would have a little over $3,000--the same amount you would receive from the insurance policy--saved by the time the operation was needed. Of course, this example assumes that you have the discipline to set money aside each month. And, of course, if the great sock catastrophe happened in year two instead of year six, the insurance might seem like a wise purchase.

The bottom line is that pet insurance companies are in business to make a profit, and that is how they set their rates. By purchasing a pet insurance policy, you're shifting some of the potential financial risk from you to the insurance provider, and you are paying for that as part of your premiums. That doesn't mean purchasing pet insurance is a bad decision; you just have to consider the numbers carefully. At the same time, you have to factor in that it's not all about the numbers--you may believe now that there's a limit to what you will spend to treat a pet, but if and when that time comes, emotions often have a tendency to trump logic.

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