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Crisis Investing: Keeping Your Head

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Crisis Investing: Keeping Your Head

When a crisis creates uncertainty, markets often become volatile, especially when the scope of the disaster isn't clear. A crisis is like Janus, the Roman god with faces that looked forward and back. For some investors, it may represent a threat; for others, it may spell opportunity. Not every crisis requires a reaction; sticking to a long-term plan is still the best strategy for most people.

Here are some examples of factors that investors sometimes overlook when considering which face of Janus to focus on during a crisis.

Watch the global supply chain

Companies and economies increasingly operate in a global context. The more heavily an industry or company relies on global partners, the more it might be affected by crisis conditions. Think not only about companies that are affected directly by turmoil, but about other companies that rely on them.

For example, China has become in many ways the world's factory floor, and many information technology services are now outsourced to India. How would a crisis in either country affect global supply chains or communications infrastructure? Might competitors not affected by the crisis pick up at least some of the slack? How might a particular industry be hit by shortages of parts or raw materials? Is a large multinational so geographically spread out that a crisis in one part of the world may have little impact on its overall operations? Oil is perhaps the most obvious example of how a crisis can affect global supply chains. A perceived threat to supplies can affect prices of other assets.

Consider currency fluctuations

Currency fluctuations are another factor to consider. Crises in one part of the world can affect that region's currency. That in turn can affect companies located elsewhere. The 2010 panic over potential default by several eurozone countries strengthened the dollar, and though that may sound like good news, a stronger dollar can hurt U.S. exports.

Currency issues are also important because of what's called the "carry trade." This happens when investors use money from a country where interest rates are relatively low--the Japanese yen and the U.S. dollar have been prime examples in recent years--to invest elsewhere at a better rate of return. However, if the cheaper currency suddenly increases in value, the carry trade can reverse as investors put their capital back into the so-called funding currency. That can affect assets denominated in other currencies. For example, the yen soared as investors anticipated that money would be repatriated to deal with Japan's earthquake/tsunami/nuclear disaster. Some investments denominated in other currencies suffered when investors sold them to invest in yen.

Think both long term and short term

Nothing lasts forever. A crisis could create opportunities that eventually peter out, or challenges that later seem trivial. Or it could have little short-term impact but mean profound change over a period of years. When considering whether a crisis represents a challenge or an opportunity, think both short term and long term.

A crisis with potentially long-term opportunities or harmful consequences may mean you may be able to take more time with a decision. If the window of opportunity is smaller or the potential devastation more short term, remember that there are alternatives to an all-or-nothing approach. For example, you could take a small position and see how your investment thesis plays out before committing more. Even if the window of opportunity slams shut, new opportunities often emerge during even the worst of times; missing one now doesn't mean you won't find others later. If you're worried about a potential downturn, you could use other investments to hedge your exposure while retaining a long-term stake, or take profits to protect part of your holdings but leave some money invested in case the crisis is short-lived.

Note: *Any investment approach involves some type of risk, including the possible loss of principal, and there's no guarantee any strategy or technique will be successful.*

See disclaimer on final page

Medicare and Medicaid: Do You Know the Difference?

Medicaid, not Medicare, is the primary payer of nursing home care in the United States. Although Medicare pays for short-term skilled nursing or rehabilitative care in a skilled nursing facility, it does not pay for extended care in a nursing home or for other custodial long-term care. Custodial care is help with daily activities such as eating, bathing, dressing, and using the bathroom. Some individuals need both short-term and long-term care; for example, someone who has suffered a stroke may receive rehabilitation services in a skilled nursing facility, but may later be admitted to a nursing home in order to receive custodial long-term care services.

For more information, visit the Centers for Medicare & Medicaid Services website at www.cms.gov.

Medicare and Medicaid were signed into law 36 years ago to protect older and poorer Americans against the high cost of health care. Ironically, it's the high cost of providing health care through these programs that now threatens federal and state budgets, leading to calls for Medicare and Medicaid reform. Although these programs are often lumped together, they function quite differently. Here's a look at the coverage each provides.

What is Medicare?

Medicare is a health insurance program funded and run by the federal government that guarantees health coverage to older Americans. Medicare is not income-based. People who have paid Medicare taxes on their earnings are automatically eligible at age 65, but some people with disabilities qualify for Medicare coverage earlier than age 65, and people with end-stage renal disease qualify at any age.

Medicare offers three main types of coverage. Part A covers inpatient hospital care, as well as short-term skilled nursing care, hospice care, and home health care under certain conditions. Part B covers medical services such as doctor's visits, outpatient care, and laboratory tests. Part D covers prescription drugs. If you or your spouse has paid Medicare taxes while working, you generally won't pay a premium for Medicare Part A coverage, but you'll pay a premium if you want to enroll in Part B or in some (but not all) Part D plans. You'll also need to pay certain out-of-pocket costs such as deductibles, co-payments, or coinsurance costs, depending on the types of coverage you have.

What is Medicaid?

Medicaid is a health insurance program funded by both the federal government and state governments to provide coverage to Americans of all ages who have low incomes and no health insurance. States administer their own Medicaid programs under federal guidelines. They must cover individuals on public assistance, but they may also opt to cover other groups and establish eligibility requirements. Children, families, people with disabilities, and older individuals may all receive Medicaid.

If you're eligible for Medicaid, you may have to pay a small co-payment when receiving medical services, but most of your health-care costs will be covered.

Can you be eligible for both Medicare and Medicaid?

Yes--if you're eligible for both programs, you're known as a "dual eligible" beneficiary. Generally, individuals who are eligible for both programs are older or disabled (or both) and need help paying their Medicare costs because they have very low incomes. Medicaid covers premiums, deductibles, co-payments, coinsurance, and other Medicare costs and provides some health benefits that Medicare does not. Individuals in nursing homes are often dual eligible beneficiaries, and that's partly behind the misconception that Medicare pays for nursing home or other long-term care (it does not--see sidebar); instead, Medicaid is the primary payer of nursing home bills. Because many older individuals cannot afford the high cost of nursing home care and exhaust their savings, they eventually become eligible for Medicaid.

Medicare	Medicaid
Primarily age-based; individuals age 65 and older qualify, along with some individuals with disabilities	Primarily means-based; individuals of any age with low incomes who meet eligibility requirements may qualify
The federal government runs Medicare, and the program is the same for all Americans	State governments run programs under federal guidelines, so programs vary from state to state
Financing comes from federal funds; partly financed through payroll taxes and premiums	Financing comes from federal, state, and local revenue
Medicare Part A provides coverage for hospital stays; Medicare Part B covers the cost of doctor's bills, laboratory costs, and some outpatient costs; Medicare Part D covers some prescription drug costs	Broader coverage of health costs than Medicare, including inpatient and outpatient care, prescription drugs, laboratory costs, family planning, and nursing home care (types of coverage may vary from state to state)
Medicare beneficiaries may pay deductibles, co-payments, coinsurance costs, and premiums	Medicaid generally pays all approved charges, though a small deductible or co-payment may be required

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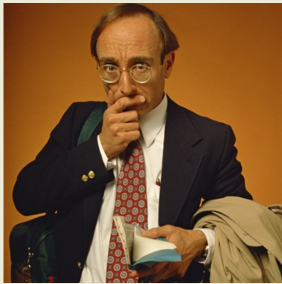
Deciphering Health Savings Vehicles

Beginning January 1, 2011, for HSA, MSA, FSA, and HRA programs, a drug or medicine is considered a qualified medical expense only if it is obtained with a prescription, or is insulin.



Effective January 1, 2013, contributions to a flexible spending account will be limited to $2,500 per year, increased annually by cost-of-living adjustments.

Health savings accounts (HSAs), Archer medical savings accounts (MSAs), health reimbursement arrangements (HRAs), and flexible spending arrangements (FSAs) are all personal health accounts that may help you control your health-care costs. But trying to figure out what's what can be confusing. Here's a brief description of each type of account, including some of their major features and benefits.

MSAs/HSAs

As of January 1, 2008, the MSA program expired and no new MSAs can be established, although if you already participate in an MSA, you can continue to receive contributions. HSAs have generally taken the place of MSAs because of their greater flexibility and options. In fact, in most instances you can roll over an existing MSA into an HSA. MSAs and HSAs are set up in a trust account with a financial entity. Contributions made through your employer are pretax dollars (or you can contribute to the account directly and deduct the contribution), no tax is due on funds in the account, or on any earnings until withdrawn, and if funds are used for qualified medical expenses, the withdrawals are not taxed. However, account withdrawals that aren't used for qualified medical expenses are subject to a tax penalty of 20%, in addition to regular income tax. Your account is portable, meaning if you change employers or leave the workforce, you can keep the account. To be eligible, you must be insured by a high deductible health plan (HDHP) that you maintain (if self-employed) or that's provided through your employer.

However, there are also differences between MSAs and HSAs. Generally, anyone with an HDHP can participate in an HSA. But to qualify for an MSA, you must have been either an employee of a company that employs 50 or fewer people, or be self-employed (or the spouse of such an employee or self-employed person). With an HSA, contributions can be made by you, your employer, or anyone else on your behalf within the same plan year. But MSA contributions can only be made by either your employer or yourself, but not both, in the same plan year. Contribution amounts also differ. In 2011, maximum HSA contributions are limited to $3,050 for single HDHP coverage and $6,150 for family HDHP coverage. MSA contributions can be up to 75% (65% if you participate in a self-only plan) of the annual deductible of your HDHP, but no more than your annual earnings from employment.

FSAs

If you don't participate in an HDHP, you still can set money aside for uninsured medical expenses through an employer-established FSA. Unlike an HSA, you must be an employee of the employer providing the FSA in order to participate (self-employed persons are not eligible and certain limitations may apply if you are a highly compensated participant or key employee). Pretax contributions can be made by either you, your employer, or both of you (except employer contributions used to pay long-term care premiums must be included in income). You determine how much money you want deposited each year up to the plan's maximum dollar amount or percentage of compensation; funds in the account are not subject to tax; and distributions are tax free if used to pay for qualified, unreimbursed medical expenses you've incurred (no advance payments for anticipated expenses). Unlike HSAs, if you leave your employer, you can't keep the money in the account or take it with you to another employer (it's not portable). Also, what you don't spend on medical expenses by the end of the plan year is forfeited and not available the following year (i.e., you must use it or lose it).

HRAs

Like FSAs, HRAs are only available to employees, not to self-employed individuals. And HRAs must be funded solely by an employer; you can't contribute directly to the account. The terms of the HRA are generally determined by the employer. For example, your employer's plan may or may not require you to have health insurance in order to participate. The plan sets the maximum amount of contributions, and determines whether a credit balance in the account can be rolled over from year to year, and if so, how much of the account can be rolled over. But contributions and reimbursements for qualified medical expenses are tax free. Reimbursements can be made to current and former employees, including spouses and dependents of employees and deceased employees. However, if the plan allows for any distribution to you or anyone else (e.g., spouse, dependent, estate at your death) for other than reimbursement for qualified medical expenses, then any distribution, whether for qualified medical expenses or not, is included in gross income.

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I'm buying a laptop online--will I have to pay sales tax?

There are currently five states that do not have a sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon. If you live in one of the other 45 states, or in the District of Columbia, you're probably legally responsible for paying some form of sales or use tax on your laptop purchase. And, to complicate matters even further, many municipalities assess a sales tax as well.

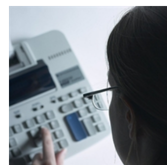
That doesn't mean an online merchant will collect the tax on your purchase from you, though. States can only force a merchant to collect state sales tax if the merchant has a significant enough physical presence in the state (think stores, distribution centers, corporate offices). This isn't unique to online merchants--the same rules apply to any out-of-state company that you purchase goods from.

So, it's entirely possible that you could order a laptop online from Company A, a company with an in-state sales staff, and have to pay sales tax as part of the purchase, but order the same laptop online from Company B, a company with no in-state connection, and not have to pay sales tax as part of the transaction. Of course, a merchant can voluntarily collect sales tax for a state, even if they're not required to do so.

Just because the merchant doesn't collect sales tax doesn't necessarily mean that you're off the hook, however. Most states that impose a sales tax also have a related use tax. Essentially, a use tax means that if you should have paid sales tax on a purchase, but didn't because the merchant wasn't required to collect the tax, you're responsible for reporting the purchase yourself and paying the appropriate amount of tax.

The details vary from state to state--some states include the use tax calculation on state income tax returns, while others use separate forms. Of course, because the use tax relies on individuals self-reporting their purchases, and states have a limited ability to enforce compliance, it probably isn't surprising that many consumers simply do not report their online purchases.

Can I deduct state sales tax on my federal income tax return?



If you itemize deductions on Schedule A of IRS Form 1040, you are generally able to deduct state and local taxes, including income tax, real property tax, and personal property tax. For 2011, if it works to your benefit, you can elect to deduct state and local general sales tax in lieu of state and local income tax. One thing to keep in mind: if your total itemized deductions don't exceed your standard deduction amount (for 2011, as an example, a married couple filing a joint federal income tax return would typically be able to claim a standard deduction of at least $11,600), you generally won't get any additional tax benefit from deductions you claim on Schedule A.

When claiming a deduction on Schedule A for state and local sales tax, you have two options. You can deduct the amount that you *actually paid* in sales tax, as evidenced by receipts that you have accumulated showing amounts paid. Alternatively, you can use tables published by the IRS that are based on average consumption in each state, and factor in modified adjusted gross income and number of exemptions. Even if you use the optional tables, you're still generally able to deduct the sales tax on certain specified items, like cars and boats.

One caution here: special rules apply to married couples who file separate federal income tax returns. If both you and your spouse elect to deduct state and local sales tax in lieu of income tax, and your spouse elects to use the optional state sales tax tables, you'll have to use the tables as well.

Things can get a little more complicated if you lived in more than one state during the year, or if the sales tax rate for the state in which you live changed during the year. Currently, the ability to deduct state and local sales tax in lieu of income tax expires at the end of 2011. And, if you're subject to the alternative minimum tax, the AMT rules may limit the deductions available to you, including the deduction for state and local taxes.

For additional information, talk to a tax professional, and see IRS Publication 600, *State and Local General Sales Tax,* and the instructions for IRS Form 1040, Schedule A.

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