REAL WORLD MONEY TIPS

Life and Money in Concert

February 2011

Quote of the Day: "The difference between the right word and the almost right word is the difference between lightning and the lightning bug." Mark Twain

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Overseas news commanded the attention of investors in February, as revolutions spreading across North Africa and the Middle East threatened to send oil prices into an upward spiral and curtail U.S. economic growth.

Estate Planning: The Rules Change Again

In the past four years, the estate tax exemption has performed a jitterbug, making it difficult for Americans to finalize their estate plans. Here's a summary of what's changed since 2010.

The 2010 Tax Relief Act: Something Old, Something New

With the specter of the Bush tax cuts about to expire during one of the worst recessions of the last century, Congress at the 11th hour acted to extend the tax breaks -- and added a few extra sweeteners for American taxpayers.

Four Tips to Surviving the "New Normal" Economy

While the "new normal" doesn't sound particularly promising, a sluggish economy doesn't have to derail your financial goals. There are some simple things you can do to help protect yourself from whatever the future holds.

A Closer Look at Inflation-Indexed Bonds

Examining the potential benefits of inflation-indexed bonds.

The S&P 500 and Dow Jones Industrial Average hit two-and-a-half year highs in the middle of the month, and the Nasdaq reached its highest level in more than three years.

February 2011 Market Recap

(For the month ended February 28, 2011.)

Unrest overseas played a role in the stock market's initial rise in February, but later helped cause a reversal of fortune that briefly sent prices into a downward trajectory. Each major U.S. equity market index posted gains during the month. Early in February stocks climbed higher in the wake of news that Egyptian President Hosni Mubarak had stepped down. Despite the spread of unrest to other countries in the region, positive domestic earnings and manufacturing data helped stocks continue their ascent. The S&P 500 and Dow Jones Industrial Average hit two-and-a-half year highs in the middle of February, and the Nasdaq reached its highest level in more than three years. The subsequent outbreak of violence in Libya raised fears of higher oil prices, and stock prices dropped for three consecutive days before moving higher again in the final trading sessions of the month. Bond yields generally fell as investors embraced the relative safety of U.S. government debt.

Through 2/28/11*	**February**	**YTD**	**1-Year**	**3-Year**	**5-Year**	**Closing Value**
S&P 500	3.2%	5.5%	20.2%	-0.1%	0.7%	1,327.22
Dow Jones Industrials	2.8%	5.6%	18.4%	-0.1%	2.1%	12,226.34
Nasdaq Composite	3.0%	4.9%	24.3%	7.0%	4.0%	2,782.27

Source: Standard & Poor's. The S&P 500, Dow Jones Industrials, and Nasdaq Composite are unmanaged indexes. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

*Price only. Does not include dividends.

Milestone ahead? The S&P 500 closed the books of February within striking distance of a major milestone in the stock market's post-bust recovery. If the index can manage to close above 1,352 it would represent a doubling of the March 3, 2009, closing level. Only 8 of the prior 15 bull markets since 1932 doubled their bear market closing low. It took them a median 49 months to advance 100%.

Housing still weak Many market watchers believe it may be difficult to sustain a long-term economic and stock market recovery without improvements in the nation's housing market. Unfortunately, February didn't bring a lot of good news. For example, Case-Shiller data showed a 3.9% drop in home prices during the fourth quarter - and a 4.1% annual decline. In addition, the average interest rate on a 30-year mortgage briefly exceeded 5% for the first time since last spring. Rising rates could convince potential buyers - many of whom are still concerned that prices will keep dropping - to stay on the sidelines even longer.

From the Fed In his February 9 testimony before the House Budget Committee, Fed Chairman Ben Bernanke sounded somewhat more upbeat about the economy, though he acknowledged that "the job market has improved only slowly." He also seemed a bit more concerned about inflation, noting that "we have recently seen increases in some highly visible prices," but blamed these mostly on demand from outside the United States together with supply problems or fears. The testimony suggested that the Fed might consider tightening a bit earlier than some analysts had been expecting. Much of the testimony focused on fiscal policy. Bernanke said that "even after economic and financial conditions return to normal, the federal budget will remain on an unsustainable path." But he also said, "A self-sustaining recovery in consumer and business spending may be taking hold."

Treasury notes Bonds benefited from the less certain economic outlook, and yields fell overall as prices rose. The yield on 10-year Treasuries fell from 3.48 to 3.43. The yield on 30-year government bonds dropped from 4.62 to 4.50.

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While the current estate and gift tax exemptions render certain trust arrangements redundant for many, be sure to consider state tax considerations when drawing up your estate plan.

Estate Planning: The Rules Change Again

The federal government isn't making it easy for Americans to feel confident about their estate plans. In the past four years, the estate tax exemption has performed a jitterbug -- jumping from $2 million with a 45% top tax rate in 2008, disappearing completely in 2010, and ratcheting up to $5 million with a 35% top rate in 2011.

The $5 million/35% threshold will remain in place through 2012, but after that, all bets are off. The current law expires at the end of 2012, and unless Congress acts again to extend or change it, the exemption may revert down to just $1 million, while the top tax rate could rise to 55%.

Estate Taxes: A Moving Target

Year	Exemption	Top Tax Rate
2008	$2,000,000	45%
2009	$3,500,000	45%
2010	Estate tax repealed	0
2011	$5,000,000	35%
2012	$5,000,000	35%
2013	???	???

With so many changes over the years and so much uncertainty for the future, it's a good idea for anyone with an estate in excess of $1 million (both individuals and couples) to meet with financial and tax professionals to map out their estate planning needs.

Gift Tax Exemption: Act Before It's Gone?

As part of the new tax act, the gift tax exemption has increased from $1 million to $5 million. Couples can transfer $10 million. But, as with the estate tax exemption, this "gift" is set to expire at the end of 2012.

One important item of note: While the current estate and gift tax exemptions render certain trust arrangements redundant for many, be sure to consider state tax considerations when drawing up your estate plan. Currently, nearly 20 states impose their own estate tax exemptions that can differ widely from federal law. For example, New Jersey allows an exemption of only $675,000. Be sure to check with your advisors to see if your state imposes taxes on estates and if a trust may still be applicable to your situation.

When you do meet with your estate planning professionals, you should also ensure your overall plan includes the following pieces:

- **Durable power of attorney** -- This document allows you to designate to one or more individuals access and control over your financial assets in the event you are incapacitated or unavailable.
- **Living will and health care proxy** -- A living will spells out your wishes in the event you need life-sustaining medical treatment. A health care proxy is similar to a durable power of attorney, but in this case, it allows your designee(s) to make medical decisions for you when you are unable to do so.
- **Business succession plan** -- Business owners should leave clear instructions as to the transfer of ownership of their entities upon their death or incapacitation. If you have a trust, be sure your succession plan complements your trust provisions.

The information in this article is not intended to be tax advice and may not be applicable to your situation. Please contact your tax advisor for information relevant to your own situation.

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Under the new law, the estate tax, which was repealed entirely in 2010, would be reinstated for two years at a maximum of 35% that would impact only those estates worth more than $5 million.

The 2010 Tax Relief Act: Something Old, Something New

With the specter of the Bush tax cuts about to expire during one of the worst recessions of the last century, Congress at the 11th hour acted to extend the tax breaks -- and added a few extra sweeteners for American taxpayers.

Here's a breakdown of the some of the key pieces of legislation from the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 for investors and business owners. Note that most of these provisions are set to expire either at the end of 2011 or 2012 unless Congress acts again.

What's Staying the Same ... for Now

- **Income tax rates** -- The current individual income tax rates will stay in place, with the highest bracket topping out at 35%.
- **Investment income** -- The rate on long-term capital gains for investments held for 12 months or longer will remain at 15% through December 31, 2012, as will the tax rate on qualified dividends.
- **Alternative minimum tax** -- The bill offers a two-year "patch" that essentially keeps the AMT exemption at current levels. If left unchecked, the AMT would have affected 21 million more American taxpayers in 2011.
- **Tax credits/deductions for working families** -- The bill renews the $1,000 Child Tax Credit, expands the Earned Income Tax Credit, and extends the American Opportunity Tax Credit, which provides college students a credit of up to $2,500 toward the cost of tuition. Several other education benefits were also extended through 2012, and deductions for expenses teachers incur were extended through 2011.
- **Charitable gifts from IRAs** -- The law allowing IRA owners over the age of 70 1/2 to donate distributions of up to $100,000 from their accounts tax free to qualified charities was extended for another year.
- **Business tax credit** -- The bill includes an extension of the current research and development tax credit.

What's New

- **Reduction in Social Security payroll taxes** -- The bill will reduce the standard 6.2% employee's portion of FICA payroll tax by two percentage points, to 4.2% for just the 2011 tax year. This reduction will apply to the first $106,800 of pay per worker. This measure would provide a maximum savings of $2,136 per worker. For a worker earning $50,000 annually, the tax cut would amount to a savings of $1,000 for the year.
- **Extension of unemployment benefits** -- The bill promises to extend unemployment benefits at their current level for an additional 13 months, through December 31, 2011.
- **Business expensing** -- A measure proposed by President Obama in September 2010 that would temporarily allow businesses to write-off 100% of their investments in 2011 and 50% in 2012 was included in the final agreement.
- **Estate tax exemption** -- Under the new law, the estate tax, which was repealed entirely in 2010, would be reinstated for two years at a maximum of 35% that would impact only those estates worth more than $5 million. In addition, for the first time the same exemption threshold -- $5 million per individual, $10 million per couple -- will apply to estate, gift, and generation-skipping taxes, thereby simplifying the gifting of assets during an individual's lifetime. These exemptions are set to sunset after 2012.

The information contained in this article is not intended to be tax advice and should not be treated as such. Each individual's situation is different. You should contact your tax professional to discuss your personal situation.

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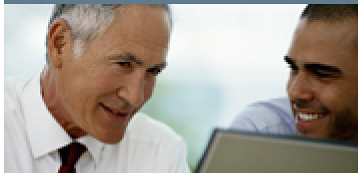

Four Tips to Surviving the "New Normal" Economy

Rebalancing your portfolio is generally a good idea, but it shouldn't be done simply to chase gains or as a knee-jerk reaction to a negative event.

Slow economic growth, higher unemployment, more market volatility: Welcome to the "new normal" economy.

That's what pundits have dubbed the landscape in the wake of the Great Recession. While the "new normal" doesn't sound particularly promising, a sluggish economy doesn't have to derail your financial goals. There are some simple things you can do to help protect yourself from whatever the future holds.

Tip 1: Expect a Bumpy Ride

There is no such thing as a financial crystal ball -- even the most savvy industry insider can't predict when the next market decline will happen. But, using history as a guide, the only thing we can be reasonably sure of is that another crisis will upset the markets at some point.

It's not a new phenomenon -- stock market declines are more frequent than you might imagine. According to Standard & Poor's historical data, there have been 18 corrections (including the current one) since 1946 that posted average declines of 14%. The latest one was a biggie -- arguably the most significant market downfall since the Great Depression. Couple that drop with a slower-than-average recovery and tremors in many foreign markets, and you've got a recipe for a prolonged ride of extreme highs and lows.

Tip 2: Don't Follow the Herd

All that volatility and uncertainty is making investors nervous. From January 2008 to July 2010, they pulled nearly $250 billion in assets out of stock mutual funds.[1] Where did those assets go? Much of it went into bond funds, which recorded a whopping $375 billion inflow in 2009 alone, as investors searched for "safer" havens and better returns.[1]

Rebalancing your portfolio is generally a good idea, but it shouldn't be done simply to chase gains or as a knee-jerk reaction to a negative event. Before you make any big changes in your investing strategy, be sure to think about your reasons for making them. Your ideal asset allocation will evolve over time, but it should be a gradual, not sudden, shift.[2] Flocking to a "hot" investment is rarely a good idea, especially if it compromises your risk tolerance or causes your portfolio to become too heavily weighed in a single asset or asset class.

Tip 3: Continue to Boost Savings

For years, the savings rate in America hovered near zero. With rising home equity to tap and access to other loan options plentiful, consumers had little need to save for a rainy day. That is, until 2008, when the mortgage bubble burst, housing values plummeted, the stock market nosedived, and millions of Americans were left jobless in the fallout.

Now saving is in again. According to the Bureau of Economic Analysis, the average personal savings rate in the United States has climbed to over 5% since the fourth quarter of 2008, peaking at more than 7% in the second quarter of 2009. The irony here is that while Americans are finally embracing the type of responsible saving habits financial professionals have urged for years, many economists and government officials are looking to consumers to help "spend" the country out of its funk.

Finding a comfortable middle ground between saving and spending may help Americans be better prepared for the next downturn. Funding an emergency account is also a smart idea. Many financial professionals recommend saving at least three to six months' worth of living expenses. But with unemployment expected to be higher than normal for the foreseeable future, a cushion of 6 to 12 months may make more sense.

Tip 4: Keep Paying Down Debt

Another silver lining of the market crash has been a renewed focus on paying down debt, especially high interest rate loans such as credit cards. According to the Federal Reserve, Americans cut their credit card debt by 9% from the second quarter of 2009 to the second quarter of 2010. While that's great news, Americans still owe over $800 billion on their cards. That adds up to an average debt of about $15,800 per household. With average interest rates hovering over 14%, it's a balance many consumers should strive to reduce.[3]

[1]*Source: Investment Company Institute, Mutual Fund Fact Book, August 2010.*

[2]Asset allocation does not ensure a profit or protect against a loss.

[3]Source: *CreditCards.com*, September 2010.

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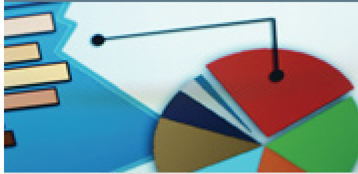

Are these bonds a good bet for the average small investor? The answer depends on how you intend to use these bonds and your outlook on inflation.

A Closer Look at Inflation-Indexed Bonds

Government bonds are a mainstay of many savers and long-term investors because they carry the full faith and credit of the U.S. government.[1] However, government bonds can pay low returns relative to other investments, and risk being outpaced by inflation.

In an attempt to remedy this situation and encourage more people to increase their savings, the Treasury Department issues inflation-indexed bonds in 5-, 10-, and 20-year maturities with a return linked to the inflation rate. These issues are available for purchase in $1,000 increments through financial advisors, banks, and Treasury Direct (www.treasurydirect.gov).

Benefits of inflation-indexed bonds include:

- Rate of return is guaranteed to exceed the rate of inflation.
- Principal is indexed to the Consumer Price Index (CPI).
- Semiannual interest payments are based on the interest rate applied to the inflation-adjusted value of the principal.
- Guaranteed return of the principal even if the rate of inflation drops, so that the indexed value is below the value of the bond when it was issued.

Best Purchased in Periods of High Inflation

Are these bonds a good bet for the average small investor? The answer depends on how you intend to use these bonds and your outlook on inflation.

If you purchased a $1,000 bond and the CPI rose 3%, the principal value would rise a corresponding 3% to $1,030. Assuming the interest rate on the bond was 3%, you would receive interest payments of $30.90 twice a year. If, a year later, the CPI had risen by 4%, the principal of your indexed note would then be adjusted from $1,030 to $1,071.20, and your interest payment would be 4% or $42.85, paid twice a year.

How do these bonds compare with the ordinary variety? Assuming the inflation rate is 3%, and the yield of an unindexed $1,000, 10-year Treasury note is 6.3%, the real yield of this note would be 3.3% (6.3% minus the inflation rate). After a year that ordinary bond would be worth $1,063; but you'd lose $30 of that gain to the effect of inflation, leaving you with a note that's worth $1,030. Clearly, it makes sense to purchase these bonds only if you expect a major uptick in inflation.

Although the interest that inflation-indexed bonds pay is exempt from state and local taxes, federal income taxes apply. You are required to pay taxes on the interest and any increase in principal on an annual basis.

[1]Bonds are subject to market and interest rate risk if sold prior to maturity.

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