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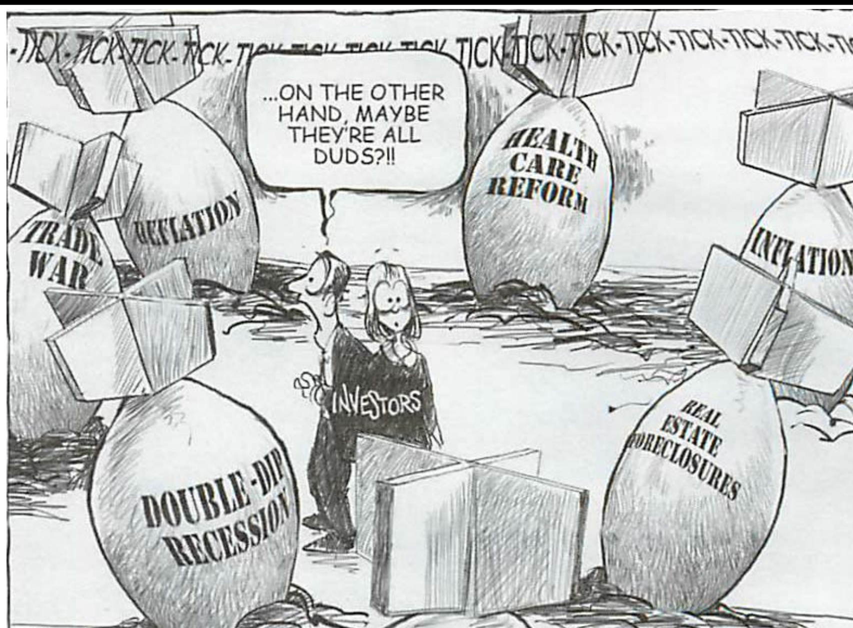
BFAS Money Line

Future?

Optimists point to excellent corporate profits and a slowly improving jobs picture as examples of a growing economy. Pessimists point to the exploding deficit, the decline of leading economic indicators, the foreclosure document scandal, and the continuing trade deficit as reasons there will be a double dip recession.

Optimists say the market is fairly valued at a Price to Earnings ratio of about 15 while pessimists say the price to trailing ten year average earnings shows the market overvalued by 40%. Add that to income and tax uncertainty, health care uncertainty, job uncertainty and foreclosure concerns, and you can see why **it is difficult to determine what the economy and the market are going to do.**

My sense is that the consumers, whose spending makes up 70% of the economy, are not going to increase spending until their debts are under control, they have some certainty about taxes and health care and they are not worried about their job or a foreclosure on their home. This will take at least two years and might take as long as five. At the end of that time, however long it is, the economy will take off along with the market.



In the meantime, slow growth is probably the best we can expect. Unfortunately, the clamor to "**do something**" can easily cause either political party to pander to those who would prefer that we weren't in a world economy. They would attempt to put artificial controls on world trade (currency restrictions, tax restrictions and government limits on companies seeking the lowest cost of production in order to maintain profitability like companies in other countries).

The world economy is not a "we win, they lose" situation. World trade is essential to everyone's economy. Things that attempt to limit it in one country affect all other countries. Each action to favor one nation will be countered by other nations, until we find world trade stopping and then we will be in a worldwide recession.

It will take farsighted leaders to avoid the clarion call to blame our troubles on others when most our problems are self-inflicted. Those same leaders should be making the hard decisions about **making entitlement programs sustainable over the long term**. These will be hard decisions that **should require all of us to sacrifice (less health care and social security) rather than resort to class warfare by raising taxes only on the wealthy**.

Current deficits would not be wiped out even if all income over $250,000 per year was "confiscated". We **can't tax our way to prosperity**, but spending cuts are very unpopular. I wish we had leaders in either party who would honestly tell the

American people that we cannot afford the promises made to everyone.

Politicians have punted to the Deficit Commission to avoid accountability. We'll see what the Commission has to say on December 1st. Unfortunately, the commission doesn't stand for office and face the wrath of voters who always want to protect their "pet programs". Everyone's ox must be gored to get us back on track.

Stocks are up over 11% so far this year and most of that gain was in September. The market has traded mostly between 10,000 and 11,000 this year. It started at 10k, rose to 11k by April, declined to 10k in June and is at 11k today. Recently, the market rise has anticipated the election results. However, we are now in a lame-duck session of Congress. Conventional wisdom is that Congress will kick the can down the road and make the new Congress address the huge income tax increase scheduled for January 1st.

The new Congress will likely have to tackle the estate tax issue. Also, while there are no estate taxes this year, next year estates over $1 million are taxed at up to 55%. If/when Congress does act; you should review your estate documents to see if they still reflect the best strategy to meet all your goals. Most attorneys I know are planning to be available this Christmas holiday to create new documents.

The Federal Reserve is now starting Quantitative Easing II (QEII). This $600 billion infusion into the economy is not likely to stimulate much economic growth but it will depress the value of the dollar. **For the next year or two, a falling dollar will make foreign stocks/bonds attractive**.

The Federal Reserve is also trying to fight deflation. The inflationary aspects of QEII have caused investors to accept a negative return on Treasury Inflation-Protected Securities (TIPS) as investors are willing to accept a small loss of principal to obtain inflation protection.

Asset Class	1 Yr Rtn (10/31/10)
S & P 500	+ 16.52%
NASDAQ	+ 22.61%
Lg Cap Gwth	+ 18.17%
Lg Cap Val	+ 13.93%
Mid Cap Gwth	+ 25.93%
Mid Cap Val	+ 23.02%
Sml Cap Gwth	+ 26.66%
Sml Cap Val	+ 24.34%
Foreign	+ 12.49%
Interm Corp Bds	+ 9.39%
Foreign Bds	+ 8.92%
Commodities	+ 11.82%

Odds and Ends

Income Tax Strategies – The impending tax increase to a top rate of 39.6% (from 35%) has some people contemplating accelerating their taxable income into 2010 to avoid the higher taxes next year. Some people are looking further ahead, looking at the deficit and thinking taxes in all brackets can only go up from here.

There will be titanic battles over tax policy in the next Congress. But, what if tax rates stay the same and Congress puts in a Value Added Tax (VAT) tax instead?

Typical strategies to accelerate income include taking bonuses in 2010 if possible. However, your additional income might eliminate the ability to make Roth IRA contributions.

Another issue for seniors who accelerate income is higher Medicare premiums. If your married adjusted gross income is higher than $170,000 ($85k single), you will pay higher Medicare premiums. These premiums could be as much as $243/mo higher for those earning over $428k (singles above $214k).

You can also **accelerate deductions by paying your January mortgage payment and state estimated taxes in December**. Be warned though, that you might get hit with a higher Alternative Minimum Tax (AMT).

If taxes do go up next year, charitable deductions could be worth more (unless the President's proposal to cap the deduction at 28% is passed). **Consider gifting appreciated stock or mutual funds to a charity instead of cash.** This allows the charity to sell the appreciated assets and pay no taxes while you deduct the fair market value of the asset.

Capital Gains Strategies – The capital gains rate is proposed to increase to 20% for those earning more than $250k next year. Or, if Congress extends the Bush tax cuts, the 15% rate may stay in place. Many have

wondered if selling assets with capital gains this year to pay the lower rate made sense.

If the lame-duck Congress raises capital gains rates on high income earners in 2011, I will likely recommend some selling in December to harvest gains at 15%.

On the other hand, most people have harvested tax losses in recent years. At current rates, these capital losses save you 15% on capital gains taxes. However, it the capital gains rate goes to 20% these carryover capital losses are now saving you even more. Thus, **those with carryover losses might want to hold onto them while those high income earners with no carryover losses might want to harvest gains**. You can see how this is a situation dependent decision. No one-size fits all!

Estate Tax Strategies – The expiration of the current estate tax regime means that next year estates over $1 million are subject to up to 55% estate taxes. This makes gifting even more important than ever. **Take advantage of the $13,000 annual gift exclusion.** You can gift up to that amount to anyone (children, grandchildren, in-laws, out-laws, etc.) If married, you can gift $26,000 to the above list between the two of you.

If you gift more than $13,000 in any one year, you just use part of your $1,000,000 lifetime exemption. **Some have advocated gifting a large amount this year; using the lifetime exemption and paying "only" 35% gift tax on the excess over $1 million rather than be subject to a 55% estate tax starting next year**. Of course the lame-duck Congress could extend the current estate tax law with higher exemptions but that is uncertain.

Many people have life insurance in their own name to cover cash needs in case of unexpected death. In the days of $3.5 million estate tax exemptions, this did not cause a problem in smaller estates. However, with an expected exemption of only $1 million, a small estate with a $500,000 house a $500,000 IRA and a $ 1 million life insurance policy will now be subject to estate tax.

One solution, if the estate tax exemption is not raised, is to put the life insurance policy into an Irrevocable Life Insurance Trust (ILIT). You must live three years after this act. Otherwise the life insurance will be brought back into the estate. However, once in the ILIT for the required time, the life insurance will pass without estate or income taxes. Note: if you set up the ILIT first, then purchase the life insurance from the ILIT, the three year rule doesn't apply.

Social Security - Most people apply for Social Security (SS) benefits at or shortly after reaching age 62. Unless they are in poor health or have minor children, that is probably not a good idea**. If you delay SS benefits to age 70, you will get an 76% more inflation-adjusted income for the rest of your life.**

Every year you wait after normal retirement age of 66, you receive 8% more income, 32% if you wait until age 70. Having an 8% guaranteed income increase is pretty tough to find anywhere else in today's investment environment!

Many families have one primary income earner and a spouse with much less earned income**. Using "file and suspend", they can start receiving spousal benefits for the low earning spouse but suspend benefits for the high earning spouse until age 70**.

For example, say the high earning spouse is entitled to $2,000 per month at normal retirement age of 66. The high earning spouse could file for SS benefits, and then suspend those benefits until age 70. Meanwhile the low earning spouse could receive $1,000 per month if 66 or older, $750 per month if not yet at full retirement age. The high income earner's benefit will be worth $2,640 per month at age 70, while the low income earner's will stay the same. However, if the high earner dies first, the low earner will receive the high earner's higher amount for life.

Another technique involves two spouses with similar income histories. In this case, **once both are at normal retirement age, one might take spousal benefits only while allowing normal retirement benefit to increase to age 70**. This means that at least one of a couple will be receiving maximum benefits for life.

Charities – With the charity season moving into full swing, please take the time to check out a charity before gifting. Here are some ideas:

Better Business Bureau – www.bbb.org

Charity Navigator – www.charitynavigator.org

Guidestar – www.guidestar.org

Trusts for Children with Disabilities

Primarily, families use Special Needs Trusts (SNTs) to fund a high quality of life for their children with disabilities. These **trusts can be funded while the parents are still living although most are funded at the deaths of the parents**. Trusts can be funded from family assets or by life insurance.

Setting up SNTs correctly is important. Most attorneys rarely draft SNTs and mistakes can occur (about 40% of the time in my experience). Try to locate an attorney who specializes in these trusts. Good websites to check are:
www.specialneedsalliance.com
www.specialneedsplanners.com
www.naela.com

Drafting SNTs typically costs thousands of dollars. In addition, you must decide who will be the trustee. Lots of people want family members (typically siblings) to be trustees to reduce trust costs.

While the sibling might be a wonderful person and have the beneficiary's best interests at heart, he may not have the expertise to invest the trust assets nor the knowledge of how trust distributions can be used to help the beneficiary without ruining the beneficiary's access to SSI and Medicaid.

Will the trustee know how to conserve the trust assets so that they last for the life of the beneficiary? Should it be invested in CDs, stocks, bonds, mutual funds, etc.? How much of the money can reasonably be expected to be used annually to meet the child's needs while preserving the long-term viability of the fund/trust?

As a trustee of the Virginia Beach Community Trust, our guideline is **no more than 5% should be used in any one year unless there are special circumstances**. Special circumstances might include not using any money for several years, then asking for a 10% withdrawal to fix a car or take a special trip

Corporate trustees have investment expertise but rarely knowledge SSI/Medicaid regulations. Moreover, most states have community trusts at costs much less than corporate trustees. Your best bet to find the one in your state is the local chapter or national website of your particular disability (e.g. www.thearc.org).

In the Hampton Roads area, you should consider using one of the free/low cost Community Trusts (Virginia Beach, Chesapeake, Norfolk, Hampton/Newport News). manage the money. These trusts pool the beneficiary money for investment purposes, but track each beneficiary's share individually. **Managed by volunteer trustees who hire low cost investment managers and authorize distributions to beneficiaries, these trusts are usually for small trusts of less than $100,000.**

For larger amounts, check out the **Commonwealth Community Trust in Richmond (888-241-6039).**

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