

WHAT THE GOVERNMENT ISN'T TELLING US

By Gregory R. Banner, CLU®, CFP®, CRTP

Over the past year John and I have been warning of a major correction we were expecting by spring time. As I write this article the market is down about 6% from its high of weeks ago. Recently a few developments have occurred around the world that lead us to believe the worst is still coming but has been delayed hopefully until next year. Those developments are a combination of the improving short-term fundamentals of the U.S. economy and the European debt crisis.

We believe the Federal Reserve (Fed) will stick to its previous comments about keeping interest rates low for quite some time. Low rates will continue to allow the U.S. economy to recover, help the banks remain profitable and sell some of their toxic debt, and most importantly for the Fed; give it the ability to pay back the interest it owes on the deficit with cheap dollars.

This artificially low interest rate is helping to address the short-term problems but at an unknown future cost. We believe that cost will be very expensive starting

next year as soon as interest rates go up.

When growing up did you ever play the game kick the can? That's what the government is doing, kicking the can to the future with the attitude that we will deal with it when we get there.

Right now the U.S. economy is continuing to grow and recover. This should drive the U.S. markets higher later this year after some of the rioting and Chaos stops in Greece.

The European crisis has been a saving grace for the U.S. economy because a lot of money has left Europe and come to the U.S. in a flight to safety to our currency and investment markets. Unfortunately, we believe Europe's problems will be a precursor to what may happen to the U.S. in the future as our own debt problems worsen.

What the government isn't telling us is what worries us. Let me explain: Recently the March consumer price index (CPI)⁽¹⁾ was released and came in at 0.1%.

The CPI gives monthly data on prices paid by consumers for a representative basket of goods and services. It is also used to decide if retirees are going to get cost of living adjustments in their social security payments each year. The problem is that the government decides what that basket of goods is comprised of. Several years ago the government decided that food and energy should not be included in that basket. I don't know about you but food and gas are a large part of my monthly expenses and they have gone up dramatically.

By way of contrast we cite the CRB⁽²⁾ Index which consists of 19 widely traded natural resources and minerals. From February through April that index was up approximately 8.5% - in just 3 months! You might ask how this impacts you. Well, through the process of hidden inflation, higher costs get passed on to consumers and essentially cause a confiscation of wealth through inflation.

This is also a major issue with holding dollar-denominated cash in the bank. Earning a measly 0.2% in interest while it costs you an extra 20% to purchase the same goods and services as the previous year is the road to ruin. It means that you just lost 20% of your purchasing power relative to the goods and services you could buy in the past.

This is the silent way to devalue the dollar over time without most people even realizing it. At the same time the government can pay back the deficit with cheap (depreciated) dollars at our expense!

Where are we going from here?

If we look at other countries around the world, many of the developed countries started raising interest rates last year as a way to protect their economies and currencies while the U.S. has kept rates artificially low. This causes other investors around the world to start looking for where they can make the most on their money with nominal risk.

In a recent Treasury auction where the U.S. sold Treasury Bonds, the U.S. ended up buying a large percentage of their own bonds as many other foreign countries were no longer interested in purchasing U.S. debt at auction.⁽³⁾ It is only going to be a matter of time before the Fed is forced to start raising interest rates to continue to raise capital and as a future means of protecting its currency. When this happens, it's our opinion that a string of events is going to be set off that could lead to another substantial market correction.

This also fits with our past comments that we are only partially through a long-term bear market that still has several years left before we see a recovery. We can never discount the possibility of a global event like the attempted bomb attack in the heart of N.Y. a few days ago, the riots in Greece or even possibilities of an attack on Middle Eastern oil facilities which could send the markets into a tailspin.

It is because of these factors that John and I have been implementing a new style of asset allocation the past

few years using much more than diversification by asset class. Please contact us if you are interested in better protecting your portfolio from another significant market drop.

- (1) www.bls.gov/cpi
- (2) www.theice.com
- (3) <http://www.treas.gov/tic/ticsec2.shtml#ussecs>

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Why 2010 is the Year You Should Pay Closer Attention to your Estate Plan

Estate planning is an essential part of anyone's personal finances -- no matter how wealthy you are. But even for those who have been diligent about planning for their spouses and heirs, this is a year when it may make particular sense to re-examine your strategy.

With the nonstop flurry of legislative activity in Washington, Congress has still not acted on the phase-out this year of the estate tax. If nothing is done this year, the heirs of any person who dies in 2010 won't be liable for any federal estate taxes, no matter how big the estate. (The carryover basis rules for 2010, however, may give rise to additional planning considerations.)

Yet the potential bad news will come next year when the estate tax is scheduled to return with a vengeance on all estates over \$1 million in size (the threshold was \$3.5 million for individuals in 2009) with a potential return to a 55 percent top tax rate..

It's worth a trip to your estate planner and your financial planner to help ensure your paperwork is in order and the previous plans you've made won't cause problems.

Family trusts – also called bypass or credit shelter trusts – are of particular concern. These trusts work this way: Individuals add what's known as a formula clause to their will or revocable trust that distributes up to the maximum amount of assets that can pass free of estate tax to the trust if the individual dies before their spouse. The creation of the trust helps ensure that once your spouse dies, neither these assets nor any appreciation on them will be subject to estate tax. But if you die this year, a failure to address the formula clause could potentially cause you to unintentionally disinherit your spouse.

The bottom line: It's worth making a call to a financial planner and your estate attorney to make sure your plans are still in order.

And what if you've never made an estate plan? Even if you're not particularly wealthy, you definitely need one. Here are some specific things you should do and make sure you have in place:

Make a financial plan: You can't have a very effective estate plan without a full grip on your finances. First, sit down with a financial planner to gain an understanding of all the various aspects of your finances from your income and investments to your debt. Add various facts about your family situation to the mix, and that's the starting point for an estate plan.

Make a will your first priority:

Unless you have a very complicated estate, a standard will with wording common to your state may be satisfactory to properly dispose of your assets, but it's generally a good idea to get feedback from an estate attorney to make sure your will fits you and your financial structure.

Create all necessary directives:

It's important to create a durable power of attorney to oversee financial issues and a healthcare proxy to appoint a trusted individual to oversee health-related decisions if you are unable to do so for yourself. Some states will allow you to appoint more than one individual in each role to allow for checks and balances, but it's particularly important to work with an experienced estate attorney to make sure things are done right.

Establish guardianship and financial directives for your children:

If you and your spouse were to die at the same time, who would take care of your kids? Based on your state's requirements, your decision may need to be written up as part of or an addendum to your will. It's also a good idea to name alternates in case the people you name have a change of heart for any reason, or if something happens to them. If your children are to inherit substantial assets or insurance

proceeds, it is also wise to make sure that their guardians are qualified to handle that money. If not, someone else should be legally named to do so.

Review all beneficiary information:

Make sure all your beneficiary designations on retirement accounts, insurance and other assets not distributed through your will or trust are current and clear.

Consider transferring IRA assets to a Roth:

You'll take a tax hit with the conversion, but converting traditional IRAs into Roth IRAs removes another headache for your heirs because no income tax will be assessed once the funds are withdrawn, assuming certain requirements are met.

May 2010 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by John L. Jenkins, AEP®, EA, CFP®, a local member of FPA.

Capital Gain Taxes Are Going Up, Way Up

"58 Percent Increase in Capital Gain Taxes is Coming"

TAX INCREASE #1 - 20% CAPITAL GAIN TAX IN 2011

On January 1, 2011, the capital gain tax reduction that was signed into law by President Bush under the Tax Increase Prevention and Reconciliation Act will "sunset." The tax rate will revert from the current 15 percent rate back to the former

20 percent capital gain tax rate that was in effect prior to 2003.

TAX INCREASE #2 - 3.8% MEDICARE TAX IN 2013

Beginning in 2013, the national health care reform legislation that became law in March, 2010, imposes a new 3.8 percent tax on certain investment income. The new tax will apply to single filers with incomes over \$200,000 and married taxpayers with incomes over \$250,000. Under the law, the investment tax provisions in Chapter 2A of the Internal Revenue Code are placed under the heading "Unearned Income Medicare Contribution." In general, this new Medicare tax will apply to investment income that is subject to income tax, which includes capital gains. Pursuant to IRC Section 1402 (C)(1)(A)(iii), the investment income to which this new tax applies includes "net gain" (to the extent taken into account in computing taxable income) attributed to the disposition of property that qualifies as a capital asset under Section 1221 (capital gains), as well as gains on other property that are considered part of ordinary income. Also of relevance for rental property owners, this new tax applies to a real estate investor's rental income if they have income above the \$200,000/\$250,000 income thresholds.

The net effect of both capital gain tax increases is a new 23.8 percent tax rate for higher earners—the highest rate for long-term capital gains since 1997. The Joint Committee on Taxation estimates the new Medicare tax on investments will cost taxpayers over \$30 billion annually. Additionally, the modified adjusted gross income

threshold at which this Medicare tax will apply will not be indexed for inflation, which means an increasing number of taxpayers will be snared by this tax provision.

Overall, the economic impact of these tax increases will be felt by the very investors who help promote long-term economic growth. In 2007, taxpayers with incomes greater than \$200,000 reported 47 percent of all interest income, 60 percent of all dividends and an amazing 84 percent of all capital gains.

THE COMING TAX INCREASES A COMPARISON

	<u>Current</u>	<u>January 2013</u>
Conventional Short-Term	35.0%	43.4%
Conventional Long-Term	15.0%	23.8%
AMT Short-Term	28.0%	31.8%
AMT Long-Term	15.0%	23.8%

How Your Personality Affects Your Financial Decision-Making

All investors are not created equal. That's why financial planners start their first client meetings with a discussion of money attitudes, goals and risk tolerance – the driver at the root of all investment decisions. Some planners do this by general conversation, others by detailed surveys they ask their clients to fill out.

The survey route can be a more valuable tool because it forces

clients to face their money issues, perhaps for the first time. Despite the difficulty in facing up to such key issues, individuals get a better idea of where their money strengths and weaknesses really lie. Often, the real difficulties lie in how money is spent.

The real value of answering a lot of questions about your risk tolerance is to tell you what you *don't* know – how the sources of your money, the way you made it, your money viewpoints and current methods of handling it will inform every decision you make about it in the future.

The most important thing a questionnaire can reveal is your true money priorities and behaviors. Trained financial advisers, such as CERTIFIED FINANCIAL PLANNER™ professionals – use both conversation and surveys to reach some firm answers that might surprise you.

Are there particular money types? In reality, you'll find quite a number of surveys out there that define money types in particular ways, but you'll find personalities that are common on the scale from conservative to liberal. Deborah L. Price, a Financial Planning Association member and founder and CEO of the Money

Coaching Institute, offers these scenarios in an article titled, "[What's Your Money Personality?](#)":

The Innocent: Price notes that innocents often live in denial, are easily overwhelmed by financial information and rely heavily on the advice and opinions of others. They tend to be the most trusting because they generally don't see people or situations clearly – which leaves them open to bad decisions at best and fraud at worst.

The Victim: She notes that victims are people who tend to live in the past and blame their woes on outside factors and situations they claim they can't control. These people may have been abused, betrayed, or have suffered some great financial loss, but they generally see life as a self-fulfilling prophecy that they can't change.

The Warrior: Generally seen as a successful person in the business and financial worlds, they will listen to advisors, but they make their own decisions. They tend to be great caretakers.

The Martyr: These people generally put other people before their own financial health. They use

Household tasks are easier and quicker when they are done by somebody else.
- James Thorpe

their money to rescue others based on their high expectations for themselves and the people they're rescuing, but these decisions may be costly in the long run.

The Fool: The Fool, explains Price, is a combination of the Innocent and the Warrior because they have no clue about what they're doing but they'll act fearlessly. They are financially adventurous and they act on impulse.

The Creator/Artist: These people often have a love/hate relationship with money. They're constantly struggling to make their finances work, but they often feel that caring about money means something bad.

The Tyrant: Price reports that this type hoards money and uses it to manipulate others. They may have everything they need, but they're never comfortable with their lives because they fear losing control.

The Magician: Price defines the Magician as the ideal money type. They're aware of their circumstances and responsibilities and can see situations very clearly.

A financial planner tries to see through the static to find out what you really need to create a solid financial life. But it might make sense to ask yourself a few questions before you and your planner sit down:

- How would you describe your financial status right now?
- What's important about money to you?

- What's your family history with money?
- What do you do with your money?
- If money wasn't an issue, what would you do with your life?
- Has the way you've made your money – through work, marriage or inheritance – affected the way you think about it in a particular way?
- How much debt do you have and how do you feel about it?
- Are you more concerned about maintaining the value of your initial investment or making a profit from it?
- Are you willing to give up that stability for the chance at long-term growth?
- What are you most likely to enjoy spending money on?
- How would you feel if the value of your investment dropped for several months?
- How would you feel if the value of your investment dropped for several years?
- If you had to list three things you really wanted to do with your money, what would they be?

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Workshops

All workshops take place at the Southern California Institute, 3636 Nobel Drive, Suite 450, San Diego, CA 92122 *unless otherwise noted*. **Please RSVP to Janet at (858) 455-1825 or janetsilva@asset-preservation.com.**

Entity Choices

will be presented by Alex Matuk, Esq., Strazzeri Mancini LLP & Gregory R. Banner CLU®, CFP®, CRTP on Thursday, July 1, 2010 from 2:30—4:00 PM.

Evaluating The Entities: Sole Proprietorships, Partnerships, Corporations, Limited Liability Companies. This course surveys each business entity option. Multiple considerations dictate which choice of entity, for example: What are the business goals of the owner(s)? How do ownership, liability protection, capitalization, management, sale of the business, estate planning, taxation, and owner and employee benefits affect the choice of business entity?

Income For Life -

with John L. Jenkins, AEP®, EA, CFP®, Asset Preservation Strategies, Inc., will take place on August 5, 2010 from 2:30 PM to 4:00 PM at the Southern CA Institute.

You're invited to a special presentation about Retirement Planning for the 21st Century.

Will you outlive your savings or will you have Income for Life?

- A 2008 study by the Vanguard Group Center for Retirement Research showed that fewer than one in ten investors age 55 – 75 appear to have a formal spending rule in place
 - A combination of estate and income taxes could leave your
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Referrals

Thank you for your Referrals

Most of our new clients come as a result of referrals from people like you. If you know a friend, family member or small business owner who might benefit from our services, please let us know. Be assured that anyone you refer to our firm will be treated with the same high standards of professionalism and confidentiality that we extend to you and all of our clients.

John to Perform with Guitar Orchestra at the La Paloma Theater in Encinitas

Friday, June 4th, 2010 at 8pm
Encinitas Guitar Orchestra performs an "Americana Theme" directed by Peter Popping, assistant director William Wilson

For tickets go to
www.lapalomatheatre.com

The Encinitas Guitar Orchestra will be performing a traditional American medley with the songs "Poor Way-faring Stranger, Turkey In The Straw, and Dixie" arranged by Keith Van Zandt. We have a second med-

ley arranged by British guitarist arranger Andrew Forrest called "Amtrad" which is a great arrangement of the songs Sacramento, Shenandoah and Oh Susanna. They are specifically arranged for guitar orchestra and lend themselves well to instrumental guitar. In addition to traditional American music we will explore popular folk music from the 20th century and some Irish tunes reflecting the influence of Irish music on American music.

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- What does retirement mean to you? Does it mean quitting work entirely and doing whatever you want to do or working in a new career full- or part-time?
- Do you want kids? Do you understand the financial commitment?
- If you have kids, do you expect them to pay their own way through college or will you pay for all or part of it.
- What kind of shape are you in to

afford their college education?

- How's your health and your health insurance coverage? What kind of physical and financial shape are your parents in?

One of the toughest aspects of getting a financial plan going is recognizing how your personal style, mindset, and life situation might affect your investment decisions. A financial professional will understand this challenge and can help you think through your choices. Your resulting portfolio should feel like a perfect fit for you!

December 2009 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by John L. Jenkins, AEP®, EA, CFP®, a local member of FPA.

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Income For Life

heirs with as little as 35% of your retirement accounts. *Source: Tax Facts 2008*

- Some retirees are paying tax on as much as 85% of their social security benefits unnecessarily
 - Many retirees are not taking income from their investments while they still have their health
- Are you one of them?

Join us for this unique and valuable presentation.

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