



Fullerton Tax & Planning

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"Real People provide Real Service"

August, 2010



August comes in as the "Dog Days" with record heat is upon us. So it is great to find someone in the cool during this time period. We got burned in the last quarter and rebounded nicely in July. Almost all accounts that got trimmed in May and June recovered more than 50% of the lost values.

We are in for some more rocky times. The Fed Reserve is replacing cash redemptions in its bad loan pool, with Treasuries. Banks are not lending, or offering good interest rates. So more bank failures will be coming in the next quarter. It's simple math on the recovery. Banks lend money to small to medium businesses for operations and hires. Businesses generate cash flow and income, consumers buy their goods, Then we have a recovery based on jobs and consumer purchasing power.

What is the status of the market sectors? In July the Food, beverage and tobacco, Furniture, Machinery, Nonmetallic minerals sectors were down.

What was the status of Bank 1 year certificate of deposits?

Discover Bank (online) was at 1.5%

Aurora Bank (online) was at 1.46%

Ally Bank (online) was at 1.46%

Bank of America was at .40%

For those of our clients in the preferred stock program the stocks paying in August and their annualized rates are:

Saturns 2005-3 Ltd

Ex Dividend 8/22 7.54%

Corporate Backed Callable Trust Cert	Ex Dividend 8/24	7.49%
Corts Trust J C Penney	Ex Dividend 8/24	7.65%
Preferred Plus	Ex Dividend 8/24	8.17%
Corporate Backed Callable Trust	Ex Dividend 8/29	7.48%

Overall Markets performed for July.....

Index	July-10	QTD	YTD	Description
S&P 500 Index*	6.9%	6.9%	-1.2%	Large-cap stocks
DJIA*	7.1%	7.1%	0.4%	Large-cap stocks
Nasdaq Comp.*	6.9%	6.9%	-0.6%	Large-cap tech stocks
Russell 1000 Growth	7.1%	7.1%	-1.1%	Large-cap growth stocks
Russell 1000 Value	6.8%	6.8%	1.3%	Large-cap value stocks
Russell 2000 Growth	6.6%	6.6%	4.2%	Small-cap growth stocks
Russell 2000 Value	7.1%	7.1%	5.4%	Small-cap value stocks
EAFE	9.5%	9.5%	-4.7%	Europe, Australasia & Far East Index
Lehman Aggregate	1.1%	1.1%	6.5%	U.S. Government Bonds
Lehman High Yield	3.6%	3.6%	8.2%	High Yield Corporate Bonds
Calyon Financial Barclay Index**	-1.7%	-1.7%	0.0%	Managed Futures
3-mo. Treasury Bill	0.0%	0.0%	0.1%	

All returns are estimates as of July 30, 2010. *Return numbers do not include dividends.
 ** Returns are estimates as of July 28, 2010.

Bank Wish No. 3 Deliver Real Service

Banks say they are focused on retail, which means they've spent a lot on sprucing up their lobbies. But you'd probably prefer to get helpful services instead of cushier seats.

BANKS THAT GET IT: Many are credit unions. In the most recent American Customer Satisfaction Index, they scored nine points more than banks on the index's 100-point scale. Credit unions also boast higher average rates than banks on checking, savings, and money market accounts, and many of them offer free financial counseling or seminars in money management. One of the best credit unions out there, the San Francisco Fire Credit Union, lets members get their FICO score free four times a year and deposit checks on an honor system: When a check is entered online or over the phone, it will be posted immediately to a customer's account (it just has to be mailed within seven days).

Create the Perfect Bond Portfolio

To get the safety you need from fixed income and earn decent returns, try this strategy.

You already know that to protect yourself against stock market meltdowns, you should devote more of your portfolio to bonds as you age. But as you may have discovered recently, the downside protection you get can vary dramatically

depending on the type of bonds you own.

Last year, for example, investment-grade corporate issues lost 5% while Treasuries surged 14% as fears of economic Armageddon led investors to flee from business debt and scramble into government securities. But this year the bond market has done a complete about-face. As the economic outlook improved, investors began unloading Treasuries and snapping up beaten-down corporates. Result: For the year through early September, Treasury bonds had dropped as much as 19%, while high-quality corporates were up 15%.

Clearly Gertrude Stein's dictum "A rose is a rose is a rose" does not apply to bonds. To ensure you get the security you need as well as a reasonable shot at decent returns follow these guidelines to create the bond portion of your portfolio.

BUILD A STRONG CORE

Unless you have mystic powers that allow you to divine bond market trends, the best course is to own a core portfolio that spreads your money among bonds from a broad range of issuers. As a practical matter, that mean you want to own everything from Treasuries and other government bonds to mortgage backed securities to high-quality corporate offerings. Diversifying that way ensures that your entire portfolio won't go south because one type of bond runs into problems

THINK SHORTER, NOT LONGER

Fear that issuers would default on their loans caused last year's havoc in the bond market. But a greater ongoing threat for bond owners is the risk of losses from a rise in rates. Bond prices and interest rates are like two ends of a seesaw, each moving in the opposite direction. So if the specter of higher inflation triggers an increase in rates hardly a stretch given projected federal budget deficits bond prices would fall.

While, you can't totally sidestep this risk, you can mitigate it by sticking to bonds with short to intermediated maturities; they tend to hold up better when rates climb. Get a good idea of a bond or bond fund's sensitivity to rates by checking out its duration, a statistical measure that looks at a bond's maturity, interest payments, and other factors to gauge how it will react to fluctuating rates. For example, the price of a bond with a duration of four years would drop roughly 4% if interest rates rise one percentage point and gain about 4% if rates fall by the same amount. To find a bond fund's duration, plug its name or ticker into the quotes box at Morningstar.com, then click on Portfolio.

You can create a well-diversified bond portfolio that offers reasonable protection from rising rates with a handful of different bond funds of varying maturities. An easier way: Invest in a total bond market index fund that gives you the entire investment-grade taxable bond market in one shot.

When Grandma Offers Tuition Help

Make sure the gift won't undermine your child's chance of getting financial aid.

Despite losses in their own investments, 65% of grandparents plan to help their grandkids pay for college, reports the College Savings Foundation. That may spell relief for parents squeezed by the economy. But handled incorrectly, such giving could hurt your child's chances for financial aid, says Joe Hurley of savingforcollege.com. Here are the best ways for Grandma to give.

CUT A CHECK TO THE PARENT

Any money given to a kid could be considered income, and by law must be reported on the Free Application for Federal Student Aid (FAFSA). The aid award could then be reduced by up to 50% of the gift, says Mark Kantrowitz, publisher of FinAid.org. A check sent to the school can similarly cut into a student award. (Yes, schools pay attention to who signs the checks.) Meanwhile, money given to the child's parent may be considered a parental asset, and that's far more favorable. There are significant exclusions on parental assets, and Mom and Dad are only expected to contribute up to 5.64% of the rest. Just advise Grandpa to keep his yearly contribution under the gift-tax exclusion \$13,000 per grandparent per beneficiary in 2010 to avoid taxes.

OPEN A 529 ACCOUNT

Grandparents can stash up to the gift-tax exclusion annually in a 529 college savings plan, or put away a lump sum of up to \$65,000 apiece using a special election on the federal gift-tax form. As long as the grandparent is the owner and the child is still a dependent, the account value won't count against federal aid. Also, distributions are considered student income, says Kalman Chany, author of *Paying for College*. So it may make sense to hold off using the funds until senior year.

Still, the 529 has benefits: Grandparents may get a state tax write-off. Plus, if the kid doesn't go to college, the grandparent can change the beneficiary or even reclaim the cash minus income tax and a 10% penalty on earnings. Visit savingforcollege.com for info on plans.

PAY OFF THE CHILD'S LOANS

Another option: Grandma could promise to pay off the child's student loans upon graduation. That won't affect the student's aid eligibility. And it provides an incentive to finish school. The downsides? The student will have to accept loans which, if the grandparent passes away before graduation, will be the child's responsibility. Also, if Grandma pays off more than the gift-tax exclusion in a year, she will owe the IRS.

Investment Strategies

Question: I have \$200,000 invested today that I would like to grow to \$800,000 over the next 24 years. What return do I need to earn on my investments for that to happen? -- Nancy, Quincy, Mass.

Answer: On the theoretical level, the answer to your question involves nothing more than some simple math. The kind of gain you're shooting for requires a 6% annualized return, assuming you'll reinvest your gains each year and that those gains will also earn 6% a year.

Of course, to earn 6% annualized you don't have to actually get 6% year in and year out. You could earn more in some years and less in others.

So, for brevity's sake, to use an example over a three-year span, earning 10% one year, -2% the following year and 10.5% the next year would also work.

Given the current low level of interest rates, I don't know of any investment around that will deliver that return guaranteed for 24 years. Investments that offer guaranteed returns -- CDs, Treasury securities held until maturity and such -- aren't paying anywhere near enough.

So as a practical matter, if you want a realistic shot at turning your \$200,000 into \$800,000 by the year 2034, you're going to have to put your dough in a diversified portfolio of investments, such as a combination of stock and bond mutual funds.

The key word here is "potential." When you invest in stocks and bonds, you may do spectacularly well some years (a 50-50 mix of equities and bonds earned 17.4% in 2009), fare poorly in others (the same blend lost 16.4% in 2008) and get so-so returns in yet other years (4.3% in 2005).

The point is that the return you will earn is uncertain. (In fact, recent research suggests that stock returns in particular may be even more prone to ups and downs than investors previously thought.)

So you really need to be thinking in terms of the probabilities of having a various amounts of money in the future. To get a sense of those probabilities -- and how they change if you invest more aggressively or more conservatively -- you can go to Morningstar's Asset Allocator tool.

So, for example, if you go to the tool and plug in the amount you have (\$200,000), your goal (\$800,000), the number of years in which you want to reach that goal (24) and then use the slider to create a simple portfolio of 50% large-company stocks and 50% bonds, you'll see that the tool estimates you have a 21% chance of achieving your goal in 24 years.

It also shows that you may do a lot better if the financial markets perform well. For example, you have a 10% chance of having almost \$1 million or more.

You'll find that you can significantly increase your odds of reaching your goal by investing more aggressively. For example, the odds of having \$800,000 in 24 years jump to 31% if you invest 70% in stocks and 30% in bonds, and your upside also climbs significantly. There's a 10% chance that you'll have at least \$1.3 million.

But there's also a risk that comes with investing more heavily in stocks. Your portfolio will experience more volatility and uncertainty. So while the tool estimates that a 50-50 portfolio has a possible three-month loss of roughly 8%, it figures a 70-30 portfolio could drop more like 11% over the same period.

There's also a potential long-term price to investing more aggressively. For example, the tool projects that even if the financial markets do very poorly over the next 24 years, with a 50-50 portfolio you have a 90% chance that your \$200,000 will grow to at least \$312,000. If the markets turn against you and you've invested in a portfolio of 70% stocks and 30% bonds, on the other hand, you have a 90% chance of having as little as \$290,000.

How you do in the real world will also depend on the investments you choose. Again, no guarantees here, but I think you can tilt the odds in your favor by sticking to low-cost investor-friendly funds like those that appear on our list of recommended funds.

That said, I think there's a value to going through the sort of exercise I just described. I've limited my examples to mixes of large company stocks and bonds. But you can use the tool's sliders to create portfolios with different combinations of large, small-mid and foreign stocks, bonds and cash. You can also very easily extend or shorten your investing time period and periodically invest new money to your portfolio if you wish.

By doing this, you'll come away with a better sense of how the investment world works. You'll see in actual numbers that the higher the returns you shoot for, the more volatility you must accept. More important, you'll see that while investing more aggressively may lead to greater rewards, it can also lead to much more meager ones if things go wrong.

Bottom line: whether you're investing for a goal like retirement that's decades away or something shorter-term, incorporate uncertainty and volatility into your planning.

Allow for the very real possibility -- indeed, the likelihood -- that you won't get exactly the return you're shooting for. Consider you may end up with something less. And then build in a cushion by saving more or giving yourself more time to reach a goal. Better yet, do both.

What Exactly Are 12b-1 Fees, Anyway?

Regulators fret that too many investors don't understand what they're paying. Here's where your dollars are going.

Mutual-fund investors paid about \$9.5 billion last year in 12b-1 fees and if you don't know what that is, you're not alone. The Securities and Exchange Commission worries that many people are unaware of or don't really understand these charges, which are subtracted from fund assets to pay for "distributions" and/or "services."

So will this be the year the regulators take action on 12b-1s?

SEC Chairman Mary Schapiro has made clear that's her intent, and she has asked the agency's staff for a proposal on 12b-1a this year. "We need to critically rethink how 12b-1 fees are used and whether they remain appropriate," she said in a speech in May.

But there's also a long history of SEC officials talking about overhauling or at least better disclosing 12b-1 fees, followed by no action. Sweeping change could be complex because these fees often 0.25% of assets a year, but sometimes as much as 1% are deeply woven into the intricate system for distributing funds to individual investors. Some in the fund industry also say there isn't any fundamental problem that needs to be fixed.

When 'Stop Loss' Trades Backfire on Investors

With a stop-limit order, traders typically enter two prices a stop price and a limit price, or the lowest price at which the

stock can be sold. People with stop-limit orders fared significantly better last week than those with regular stop-loss orders. (But a stop-limit order has risks, too: If a stock plunges and never comes back, a la Bear Stearns, the stock might not be sold at all.)

Another possible solution for investors trying to keep an eye on pieces of their portfolio: set an alert without a trade attached, says John Gabel, an exchange-traded fund strategist at Morningstar Inc. "I'm a fan of actively monitoring your portfolio," Mr. Gabel says. "You want to find out why it's moving."

Despite the many negatives, Ron Howard, a retiree who lives in Boca Raton, Fla., likes top-loss orders. He argues that stop-losses can protect profits, but recommends them only for sophisticated investors. "No matter how diligent you are as an investor, no matter how much homework you've done on what companies you have, the gods can still ordain that you can get hit," he says.

As for Mr. Pinder, he thinks of his stop-loss experience which vaporized a 10th of his net worth as "possibly another year added to our working lives." He explains: "When I first started working, I hoped to have the option to retire by age 50. The bursting of the dot-com bubble probably put us back to 55. The 2008-2009 crash put us back to age 60 or so. And now we'll maybe have to work an extra year, or just live with less money whenever we do retire."

Still, he is philosophical about how his stop-loss turned into a big loss: It's disappointing and annoying, but there are much worse things that can happen in life than this." Concludes Mr. Pinder: "I'm not sure setting a stop-loss would be a good decision to make again. Markets are markets, and we can't really control them."

S & P Forecasts

Attempts at a rebound following recent sell-offs is keeping trading choppy this month. Concerns that the global economic recovery is faltering were underscored by the recent disappointing U.S. June trade and budget deficit figures which prompted many economists to cut their Q2 GDP estimates. This news came a day after the Federal Reserve cut its economic outlook and announced the reintroduction of economic stimulus measures. The dollar spiked against the euro and the pound as investors took shelter in the currency safe haven. The yen came off its high, after Japan's Finance Minister Yoshihiko Noda said excessive foreign exchange movements were harmful to the nation's economy. Noda commented that he would seek to take appropriate action to curb such moves, but declined to elaborate, adding only that he would be working closely with the Bank of Japan.

Progress for the S&P Europe 350 (+0.4%) was stemmed by weak financial, material, and industrial stocks. Nonetheless, Prudential (PRU LN GBP5.66 ****) shares bucked the sector trend after unveiling interim numbers that were ahead of forecasts. The UK life insurer also attempted to appease investors by raising its dividend by 5%.

The consumer staples sector outperformed and made a serious attempt at offsetting losses. AB Inbev (ABI BB EUR 41 ***) shares topped the sector after the company posted consensus-beating Q2 earnings.

Meanwhile, have a great August, stay cool, especially in the Midwest and East and see you next month.



Timothy T. Fullerton, Sr.



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