



Fullerton Tax & Planning

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"Real People provide Real Service"

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Sleeping through a disaster!

May set new records in amount of stock market drops and stock prices. Recovery is the only positive thing that can come out of this period. We have seen this volatility in the past, but it is always good to remind those with equity exposure, to hold to the strategy and the long term will bring better returns than May ended with.

Speaking of recovery, someone was caught asleep at the wheel. Before we ask for more government intervention, we need to place the blame in the right direction. BP, Transocean and Halliburton really put a spin on the Gulf of Mexico spill. And we are concerned about our government officials? This smells like, no pun intended, Wall Street's financial rescue all over again.

Meanwhile on a brighter note, we came across an investment advisor with a strategy broad enough to make everyone happy.

Seven steps to the investment process,

- One, determine the rate of return
- Two, Determine the risk tolerance
- Three, Determine the overall allocation
- Four, Create an investment Policy statement
- Five, Select the specific investments
- Six, Implement the Portfolio
- Seven, Monitor the Portfolio.

Meanwhile the Markets for May did

Index	May-10	QTD	YTD	Description
S&P 500 Index*	-8.2%	-6.8%	-2.3%	Large-cap stocks
DJIA*	-7.9%	-6.6%	-2.8%	Large-cap stocks
Nasdaq Comp.*	-8.3%	-5.9%	-0.5%	Large-cap tech stocks
Russell 1000 Growth	-7.6%	-6.6%	-2.3%	Large-cap growth stocks

Russell 1000 Value	-8.2%	-5.8%	0.5%	Large-cap value stocks
Russell 2000 Growth	-6.6%	-2.7%	4.7%	Small-cap growth stocks
Russell 2000 Value	-8.5%	-2.0%	7.8%	Small-cap value stocks
EAFE	-11.4%	-13.2%	-12.1%	Europe, Australasia & Far East Index
Lehman Aggregate	0.8%	1.9%	3.7%	U.S. Government Bonds
Lehman High Yield	-3.6%	-1.3%	3.2%	High Yield Corporate Bonds
Calyon Financial Barclay Index**	-1.5%	0.0%	2.1%	Managed Futures
3-mo. Treasury Bill	0.0%	0.2%	0.1%	
<p>All returns are estimates as of May 28, 2010. *Return numbers do not include dividends. ** Returns are estimates as of May 27, 2010.</p>				

The Investment Advisor mag for May indicated that financing is starting to loosen up in sectors, just not banking. One proposal would be to buy up the banks, go to credit unions for financing, or look for venture capital firms.

Eventually, banks will get back to the business that they were chartered for. Don't hold your breath for lower credit card rates or higher certificate of deposit rates. Best medicine for banks, long term, cancel your credit cards, double up your payments on loans or refi elsewhere.

A Few Quirky Tax Breaks That Aren't Going Away

Surprise: Not all taxes are going up. On April 15, the House of Representatives passed a tax exemption for employer-provided cellphones and smartphones.

It's a bigger deal than you might think. Under the current rules, cellphones and PDAs are taxable fringe benefits, something like corporate jets. Taxpayers who have employer-provided phones should pay tax on personal use. That, of course, would be a tracking nightmare. In theory, "You should log every call, then figure what percentage of total use is personal," says Melissa Labant, an expert with the American Institute of CPAs.

Before last June, these rules were mostly ignored and little enforced. Then the Internal Revenue Service proposed a safe harbor of 25% personal use for employer-provided phones a change that would have dispensed with record keeping but raised taxes for millions. It sparked an uproar until the IRS backed away a few days later, asking Congress to change the law instead.

Assuming the bill becomes law it is now before the Senate the cellphone exemption will join a long list of quirky tax breaks that have so far escaped the chopping block. Here are some others.

The "Masters exemption." Homeowners who rent out their property for 14 or fewer days a year may pocket the income tax-free. This break has given homeowners near the Augusta National Golf club a sweet deal on income over the years, in some cases up to \$20,000, from short-term rentals during the Masters tournament each April.

The property doesn't have to be a first home, but the exemption can be taken only once a year, says CPA Douglas Stives of Monmouth University. It can be taken on more than one property, according to the IRS.

Employee awards. Employers can make awards to workers valued as much as \$400 a year for good attendance, safe driving, years of service and so on. The criteria must be objective and fair, but the awards aren't taxable to the employee and are fully deductible by the employer.

Gift-tax exclusion. One of the best estate-planning options remains the \$13,000 annual gift-tax exclusion. Anyone may give anyone else up to that amount per year in cash or property, free of gift tax. One partner of a married couple can double the gift and the exemption. So a couple with three married children and six grandchildren could give away over \$300,000 a year, tax free.

This provision has some twists. Donors to 529 college savings plans may bunch up to five years of annual gifts as President Barack Obama and his wife, Michelle, did for their daughters a few years ago. If circumstances change, the donor can withdraw the money with little or no penalty, says Donald Tobin of Ohio State University.

Frequent-flier miles. If you earn frequent-flier miles on ticket you buy, the miles aren't taxable. But miles earned for business travel should be, in theory. After a 2002 brouhaha, the IRS said it wouldn't tax miles unless taxpayers convert them to cash. Ever notice how perks important to Congress escape the tax man's heavy hand?

The State of Illinois has a true budget crisis Who is going to solve it? Look in the mirror for the answer.

Where a great number of things in our lives come from Springfield, Washington and the above, your financial destiny is not one of them. It's one that requires personal involvement.

So it's your decision. How much of your future do you wish to rely on outside benefactors, and what percentage do you wish to be master of your own financial destiny? A meeting with your financial advisor now can help you focus on how much money you'll have to spend in retirement.

Remember it's not the day you retire that counts it's the size of the check when you do.

Baby Boomers

In the final years of what has been one of the worst decades this century for stock-market investors, a growing number of baby boomers like Dr. Palanisamy have reshaped their attitudes about risk and return. The turmoil of the past 18 months, coming on the heels of the bear market of 2000 to 2002, has created a heightened sense of fear and uncertainty among these investors. Many of the 80 million boomers between the ages of 44 and 63 are retiring already, and they need to stretch their savings to cover the rest of their long life expectancies. Any dip in the value of those nest eggs could prove devastating. Even those still in the work force realize they have less tolerance for investment missteps and less time to regain lost ground with every year that passes.

What does this mean in practical terms? While some boomers still chase performance, a growing number are no longer demanding that their financial advisers trounce the broader stock market year after year. Instead, they say they will be satisfied with a modest single digit return that matches what they need to earn to meet their retirement needs and keep pace with inflation.

Financial Advisers Try New Tactics

Frank Armstrong, president and founder of Investor Solutions Inc., an independent financial advisory firm in Miami that still practices buy-and-hold investing.

The changes come at a time when financial advisers are coming under pressure from clients who are tired of paying fees only to watch their savings evaporate. Advisers have "a lot of cranky clients," says Mr. Armstrong. "They want to see something happen," he says.

Certain advisers have long placed small tactical bets on sectors, countries or regions they expect to outperform the broad market. Many have also placed a small portion of clients' portfolios into alternative investments, such as commodities and real-estate investment trusts.

"Asset allocations built on stocks and bonds are best suited to secular bull markets," says Louis Stanasolovich, founder of Legend Financial Advisors Inc. in Pittsburgh. "But the past nine years have proved that nontraditional thinking makes more sense in secular bear markets."

There is some evidence that advisers who practice the traditional buy-and-hold philosophy are losing clients to managers trying new approaches. Jeff Porter of North Canton, Ohio, left his buy-and-hold-oriented planner last year and moved his account to Brenda Wenning of Newton, Mass. Ms. Wenning had been a financial adviser for years at a firm that practiced a buy-and-hold approach, but started actively managing clients' money in part by using leveraged ETFs when she opened her own practice in May 2008.

"I realized when I saw the market starting to change that the old buy-and-hold strategy just doesn't work," says Mr. Porter, whose account was already down 20% last year by the time he went to Ms. Wenning. She immediately shifted his investments to cash a move he calculates saved him about \$80,000. Since then, he says, Ms. Wenning has been slowly moving back into the markets. His old adviser hadn't bought or sold a single investment in his account last year.

"You're paying these people a fee to manage your money," Mr. Porter says. "They're really not earning their keep."

The Long and Short of Collecting Survivor Benefit

I am a 63-year-old man who plans to delay taking my Social Security benefits until age 70 in order to maximize my now 53-year-old wife's survivor benefit. If she takes her Social Security retirement benefit when she turns 62, how will that affect her survivor benefit?

Does the answer change depending on whether she takes her early-retirement benefit on my record or hers? (She qualifies on her own, but for less than she would receive on mine.)

While I hope to delay my Social Security benefit until age 70, what happens to her survivor benefit if I die before I turn 70 having never take benefits? Will her survivor benefit be based on my benefit calculated at age of death? Full retirement age? Age 70?

Our discussion last week about survivor benefits sparked a lot of email from couples who are trying to work through various scenarios involving each spouse's retirement and survivor benefits from Social Security.

The reader above is doing the right thing, says Elaine Floyd, a certified financial planner and retirement and life planning director for Horseshoof LLC in New York, which provides information and support to financial advisers. Managing survivor benefits is "extremely important" for married couples, she says, because odds are good that at least one spouse will be long-lived. "One of the best ways to maximize income at later ages is for the high earner to delay retirement benefits to age 70."

In the case above, the reader's wife could take her own retirement benefit as early as age 62, at a reduced level, and then, after her husband dies, switch to the larger survivor benefit. The timing of when she takes her own retirement benefit doesn't affect the survivor benefit, says Cynthia Edwards, a spokeswoman for the Social Security Administration in Baltimore.

Whether the wife had taken an early retirement benefit based on her earnings record or her husband's record wouldn't affect her survivor benefit either, Ms. Floyd says.

What does affect the survivor benefit is the widow's age when she starts taking it. First, the widow would have to determine her "full retirement age," as defined by Social Security. Here matters get a bit sticky. Depending on when you were born, your full retirement age may or may not be the same for Social Security retirement benefits and survivor benefits, Ms. Floyd notes. If the reader's wife was born in 1956, her full retirement age for taking retirement benefits is 66 and four months but for survivor benefits, it's 66.

You can look up your own full retirement age for each type of benefit at ssa.gov/retire2/agereduction.htm and ssa.gov/survivorchartred.htm.

Getting back to our couple: If the widow already has reached her full "survivor" age when she files for a survivor benefit, she generally is eligible for her deceased husband's full benefit.

(This assumes, as the reader says, that this benefit would be larger than the one she gets based on her own earnings history.) She could start collecting a survivor benefit as early as age 60, but at a reduced rate.

We hope our reader lives a long and happy life. But if he dies before his full retirement age of 66, having never taken Social Security retirement benefits, his widow's survivor benefit would be based on his full retirement benefit at age 66. If he dies after age 66, the survivor benefit includes any delayed credits he accrued, Ms. Floyd says.

The Social Security Administration has publications at its Web site to help explain survivor benefits, including Publication No 05-10084, "Survivor Benefits" at ssa.gov/pubs/10084.html, as well as Publication No 05-10127, "What Every Woman Should Know," at ssa.gov/pubs/10127.html.

Watch Out for Hidden Tax Traps Inside ETFs

Does ETF stand for "esoterically taxed fund"?

Many investors may just have finished wading through the tax reporting on commodity or currency funds for the first time and found it a slog. They also may have learned that an investment's taxation can by itself make the difference between a winner and a loser.

Exchange-traded funds, or ETFs, are bundles of assets that resemble a mutual fund but trade on an exchange like a stock. Their structure has enabled many of them to avoid distributing taxable capital gains, earning a reputation for minimizing tax bills.

But the mad dash in ETFs lately has been into "alternative assets" like currencies and commodities. The investment researchers at Morningstar track 108 such ETFs with a total of \$80 billion in assets: 42 are less than two years old. These funds are taxed so differently, and at such higher rates than traditional investments, that many investors now wish they had looked before they leaped.

"As ETFs have gone farther afield from stock indexes," says Robert Gordon of Twenty-First Securities, "their tax efficiency and simplicity are getting left behind." Analyst Mariana Bush of Wells Fargo Advisors has estimated that commodity ETFs can be taxed in six different ways and currency ETFs in eight.

Commodity and currency ETFs often aren't "funds" at all, but trusts or limited partnerships that pass income and gains through to their investors. The income or gains may come from foreign currencies or physical commodities but also from money-market instruments, swap agreements, futures contracts or other derivatives. There, the tax treatment may be utterly alien to investors who are used to paying 15% on qualified dividends and long-term capital gains.

U.S. Oil Fund, for instance, trades oil futures. The Internal Revenue Service requires open positions in futures contracts to be "marked to market" at year end. That means investors can owe capital-gains taxes on holdings the fund hasn't unloaded yet "regardless of [whether they] sold their shares during the tax year or not," says U.S. Oil Fund's chief investment officer, John Hyland.

The fund is far from alone. At Many other commodity and currency ETFs, paper profits are taxed at a blend of short-term and long-term capital-gains rates. That amounts to 23% for taxpayers in the highest federal bracket on gains you haven't even received. Under IRS rules, you may even be liable for taxes on mark-to-market gains booked by the fund as long as 30 days after you sold it.

Or consider SPDR Gold Shares.

The fund holds nearly 37 million ounces of gold, so the IRS taxes your capital gains at the 28% rate for collectibles even if you have held your shares for more than one year. "We try really hard" to make sure investors are aware of that higher tax rate, says James Ross of the fund's sponsor, State Street Global Advisors.

Any gain when you sell is also taxed on ordinary income, not at the lower capital-gains rate. "We have not gotten any negative feedback" from investors, says Christine Hudackso, a spokeswoman for iPath, because "we take care to highlight the different tax treatment."

You shouldn't invest in commodity or currency ETF at all unless you "thoroughly understand what type of income the transaction will generate and what your tax rate will be," says Robert Keebler, a CPA at Baker Tilly Virchow Krause in Appleton, Wis. That means plowing through the "Income Tax Considerations" section in the ETF's prospectus.

If necessary, get a tax adviser or someone at your brokerage house to explain it. With tax rates on the rise, you can't afford not to know whether you are getting into a can of worms.

From Standard & Poor's Outlook comes.....

TOP TEN PORTFOLIO

COMPANY / TICKER	‡QUALITY RANKING	*RISK	STYLE	P/E RATIO	CURRENT PRICE	12-MONTH TARGET PRICE
American Tower / AMT	B	High	Blend	42.6	40	57
Applied Materials / AMAT	B-	Medium	Blend	13.0	13	17
DreamWorks / DWA	NR	High	Growth	13.0	29	55
Flextronics Int'l / FLEX	NR	High	Foreign	7.1	6	11
General Mills / GIS	A-	Low	Blend	15.4	71	82
Gentex / GNTX	B+	Medium	Growth	20.2	19	26
Int'l Business Machines / IBM	A	Medium	Growth	10.7	123	167
Noble / NE	B	Medium	Growth	5.4	31	60
Teva Pharmaceutical / TEVA	NR	Medium	Foreign	11.7	54	75
Textron / TXT	B	High	Value	43.5	20	28

THE DAYS OF 'BUY-AND-HOLD' HAVE GONE AND WENT

A Financial Planning Industry that has been nurtured for decades on a steady diet of buy-and-hold investing arguments is now expressing a growth preference for more active strategies in light of last year's market meltdown.

While many financial advisers still prefer terms such as "tactical investing" over such phrases as "market timing." The bottom line remain that more professionals are questioning the value of buy-and-hold strategies.

"It's time for the industry to wake up and realize that retail investors don't have a long-term risk tolerance, and I would think if you were a buy-and-hold firm last year, you don't have many client left," said Robert Levitt, president of Levitt Capital Management LLC, which has \$400 million under management.

My recommendation for the short term is to minimize your exposure to European funds. The fallout is still not over, and if you are in an asset allocation, have the advisor shift to Asian exposure. The long term outlook is much brighter.

Meanwhile, have a great month. Here's more housing sales, better interest rates, and don't forget the income estimates due on June 15th. For Kim and Betty Ruth, Go Sox!



Timothy T. Fullerton, Sr.



Mary Ahart

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