



## Fullerton Tax & Planning

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*"Real People provide Real Service"*

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So you are looking at the beach off of Spain, never assuming that this country is head over heels in debt. Great scape for getting away from one's woes.

Yet we have the same dilemma in the U. S. Great vacations but don't visit the East Coast for a month or so. Hurricanes and Rainfall exceeding records, while the Southwest is suffering the worst drought in history.

Now add to that the unemployment that started in 2008, the Wall Street worthless paper trail from the housing market and you have issues beyond your control.

Then we, the American people, decided it was time for change in 2008. Needed a little more excitement, did we? Drop in a relatively green politician to lead the pack, and then decide it was time to cut government support to everything under the sun.

Now we start the cycle over again. We look to Republicans to solve the problem that they caused in 2001-2008. Cut back the spending, lower taxes and lower the debt. Translated, cut back government spending, this will guarantee unemployment will go up, mostly in government employees. Lower taxes, this will make the rich happy, since they are about the only ones paying taxes. Lower the debt, hmmm, didn't we just propose to lower taxes? So if you are a business and you cut revenue, cut inventory, who pays for the existing debt?

Well, hang on, this next fourteen months is going to be interesting. But you need to prepare your storm cellar for supplies to weather this storm. Supplies? Okay, increase your emergency cash (we won't call it savings for the next two years) to 12 months. That's if you are working or on pension with excess income. Then look at your spending habits. Utilities need to be reduced, taxes need to be reassessed on real estate, and health insurance will need to be looked at next year, especially with the threat of restoring the Senior Drug costs, dropping children from the parent's insurance and closing competition on health insurance premiums. Credit cards need to be looked at in terms of rates offered. Financial planners are advising to keep the cards paid off but not closed. They haven't been paying attention to the havoc wreaked by the rating services on everyone's credit.

Finally, you need to trim your long term goals on stocks and bonds. That old Depression-born strategy to buy and hold for life is rapidly disappearing. Shorten your holding horizons. Look to Blue Chip and ETFs with dividends paying more than 2% to enhance that holding of Citigroup that you swear by. You need to be concerned about the next five years not the next decade. Most importantly, take your profits and move on. After all, the Republicans promise to eliminate all gain taxes. I would think eliminating taxes on Social Security income would be a greater boost to new business.

## Things Social Security Won't Tell You

1. "Long-term deficit? We can hardly afford our bills today."

Worried about the future of Social Security? You're far from alone. The Social Security Administration itself has said that unless something is done to reform the system, it will burn through its funds within the next few decades. Less talked about, perhaps, is the concern about the present: the program is having a hard time paying its bills. In 2010, the Social Security Administration collected less revenue in taxes than it needed to cover its benefit payments — the first time expenditures have exceeded income since 1983. As a result, the program had to tap its \$2.5 trillion trust fund, sooner than some had expected. The same is expected to happen this year. "The depth of the recession has slowed down revenues to the system," say Eugene Steuerle, an economist with the Urban Institute, a non-partisan think tank in Washington, D.C.

A Social Security spokeswoman points out that interest income from the Treasury bonds held in the trust fund will allow it to keep growing until 2022 — even if the agency has to siphon off some money to offset any shortages in tax revenue -- and won't be exhausted until 2036, when the first Gen Xers begin retiring. But that's already one year earlier than previous projections. After that, the agency says tax income under the current system will only cover about 75% of benefit payments through 2085.

2. "The more you make, the less you get back."

It's common to think of Social Security as an individual account of sorts — what you pay in, you get back, more or less. That's far from accurate. By design, the Social Security Administration says, the system is tilted in favor of lower-income workers who have fewer resources to save for retirement. In practice, that means that the more money you make, the less you get back, at least as a percentage of your salary. For example, a single, 66-year-old man who earned \$50,000 per year on average and retired in 2011 would get an annual benefit payment of about \$22,800, or about 45% of his annual salary. If he had earned \$150,000 per year, he would get annual benefits of about \$30,670 — just 20% of his annual salary. "People act like the percentage of benefits of your salary you get is the same for everyone and it really isn't," says Jo Anne Barnhart, former Social Security Commissioner.

## A RISK YOU SHOULD FEAR

### Playing It Too Safe

Of course, one way to avoid risk is just not to suit up for the game. But that puts you in danger of not having enough money in later years, and of missing major market advances.

"What you don't want to do is just focus on the risk and cap your upside," says Harold Evensky, a financial adviser in Coral Gables, Fla. "Returns come in short spurts. If you miss one, you'll never recover it."

- **YOUR BEST BET:** If the "sleep at night" factor is most important to you as an investor, then bank any money you might need over the next five years, Mr. Evensky says. That way, you won't be as tempted to unload assets when the going gets tough.

You still might feel queasy when markets gyrate, but that's the point. The late Peter Bernstein, a sage chronicler of financial-market history, once observed that "if you're comfortable with everything you own, you're not diversified."

His advice: "You hate bonds; you ought to own bonds. You hate gold; own some gold. You're scared to death own stocks because maybe things will have a happy ending."

So Standard & Poor's has downgraded U.S. Treasury debt and Washington is a fiscal and political mess. What does that mean for your retirement? Nothing good, for sure. But you can limit the damage with a calm, yet realistic approach. Here are 9 steps that should help protect your retirement.

1. Avoid panic selling. As Forbes columnist Richard Ferri suggests, don't make hasty moves when the stock market has a bad day — in reaction to an S&P downgrade or any other news. Instead, take the dog for a walk, see a dumb movie,

or go out to dinner and split a bottle of wine.

2. When calm, review your asset allocation. The idea is to find the mix of stocks and bonds that will maximize your odds of earning a good return while minimizing the risk that you'll require a second bottle of wine to avoid panic selling or that your holdings will have tanked just when you need money. (A longer time horizon generally argues for more money in stocks.) An old rule of thumb is to own your age in bonds. (So at 55, you'd have 55% of your money in bonds and 45% in stocks.) Many financial advisers believe that this simple rule gives too little weight to stocks, particularly considering today's longer life expectancies.

Fortunately, there are now some sophisticated web based tools that can help you come up with a smart asset allocation (adjusted for your age, assets and risk tolerance); determine whether your retirement plan is realistic; and even pick for you among individual mutual funds. You might have free access to one of these through your 401(k). For example, Financial Engines, the product of an independent advice company co-founded by Nobel Prize winner Bill Sharpe, is offered to employees from a laundry list of big companies, ranging from Alcoa to Kraft Foods to Xerox.

3. Play tax arbitrage. Review your IRAs and taxable accounts to see if you can at least wring some long term tax savings out of the market's recent decline. Now might be a good time to do a Roth conversion — or to undo one you did at the market's peak.

4. Maintain — or increase — your 401(k) contributions. Don't curb your contributions (or reduce your the amount you're putting into stock funds) just because the market is down. One advantage to investing the same amount each paycheck through a salary reduction plan is that you are cost averaging — you're buying more shares at lower prices and fewer at higher prices — thus minimizing the bad effects of market volatility or of poor market timing. If you stopped contributing to a 401(k) during the recession because your employer eliminated its match, check the current status of your plan. Many employers are restoring those matches and you don't want to lose out. You can contribute a maximum of \$16,500 to a 401(k) this year, plus an extra \$5,500 if you'll 50 or older in 2011.

5. Fund a Roth IRA. If you want to boost retirement savings but are worried about locking up too much money in a 401(k) in these uncertain times, a Roth IRA is the perfect solution. You can put up to \$5,000 a year (\$6,000 if you're 50 or older) in after tax money into a Roth, where it grows tax free for retirement. The key point here, however, is that you can take out your original contribution (not the earnings) at any time, without penalty. This allows you to stretch and put away more for retirement, without worrying about taxes and that nasty 10% early withdrawal penalty should you need the money sooner. (Warning: married folks with adjusted gross income above \$179,000 and singles with AGI above \$122,000, aren't eligible to contribute to a Roth if they have retirement plans at work.)

6. Get smart about Social Security. Most retirement planning programs plug in your promised benefits from Social Security under current law — but also give you the opportunity to fill in a lower number. If you're under 55, shave the number. (It's unlikely we'll see any cuts in starting Social Security benefits for those over 55, but inflation adjustments could well be trimmed for older folks too. In any event, you're just going to have to guess at the changes until warring politicians can come together on a plan to match Social Security's promises and revenues over the long haul.) Regardless of your age, a good way to offset any cuts is to delay claiming Social Security until at least your "normal" Social Security age — 66 to 67 for baby boomers.

7. Plan to work longer. The problem with this advice — which Forbes and others have been giving for years — is it's easier said than done. When older workers lose their jobs, they have a hard time finding new ones. Plus, many older workers find their jobs stressful. If you think your job might be at risk or you don't want to stay in your current position until full retirement age, consider transitioning to a second more satisfying (but probably less well paid) career. It's not easy, or an option for everyone, but it's worth considering.

8. Prepare for a "tax increase" in the form of higher Medicare premiums. True, Republicans seem determined to block all tax increases, even for the rich, no matter what S&P says. But even if the U.S. doesn't reduce its deficit in part through higher taxes, a big if, retirees are likely to face what is in effect, a marginal tax rate increase, in the form of Medicare premiums that rise with their incomes.

For 2011, singles with modified adjusted gross income of greater than \$85,000 and couples with income above \$170,000 are paying extra-income-based premiums for Medicare's Part B, which covers doctors' and outpatient hospital services, and for part D, which covers prescription drugs. At the extreme, couples with income above \$428,000 (for 2009), if they take the optional Part D drug coverage, will pay an extra \$8,203 this year for their Medicare benefits.

The income based Part B premiums were adopted by Congress in 2003 to help pay the cost of the Bush Administration's expansion of Medicare to cover prescription drugs. The extra Medicare Part D premiums were added by President Obama's 2010 health care overhaul to help finance a reduction in the notorious gap (or "doughnut hole") in coverage for seniors with high, but not catastrophic, drug costs. Significantly, last year's health overhaul also froze the \$85,000/\$170,000 cutoff for high-income Part B premiums at its current level through 2019, whereas previously it had been indexed for inflation. As a result, according to an analysis by the Kaiser Family Foundation, 14% of all seniors will pay extra income based premiums in 2019, up from 5% now.

And that's 14% of seniors paying income based premiums before Congress makes any changes to Medicare to reduce the deficit. A plan passed this year by House Republicans would turn all of Medicare (for those under 55) into a system of subsidies to buy private insurance and those subsidies would shrink as income rose. So through taxes, or premiums, affluent seniors will likely pay more. (Consider: while Democrats are determined to keep government run Medicare, they too have voted for income based premiums in the past.)

9. Make your adult kids pay rent. There's no question that today's young adults are having a rough go of it, between high student debt and a rotten job market. As a result, the number of adult children living at home has exploded. But you're not doing adult kids a favor if you sacrifice your own retirement security and then have to turn to them later for support.

### THE MONTHLY INDEX REPORT FOR AUGUST 2011

Index	August 2011	QTD	YTD	Description
S&P 500 Index	-5.4%	-7.4%	-1.8%	Large-cap stocks
DJIA	-4.0%	-5.9%	2.1%	Large-cap stocks
Nasdaq Comp	-6.3%	-6.8%	-2.2%	Large-cap tech stocks
Russell 1000 Growth	-5.3%	-6.2%	0.2%	Large-cap growth stocks
Russell 1000 Value	-6.2%	-9.4%	-4.0%	Large-cap value stocks
Russell 2000 Growth	-8.6%	-12.1%	-4.6%	Small-cap growth stocks
Russell 2000 Value	-8.8%	-11.8%	-8.5%	Small-cap value stocks
EAFE	-9.0%	-10.4%	-5.7%	Europe, Australasia & Far East Index
Barclays Capital U.S. Aggregate	1.5%	3.1%	5.9%	U.S. Government Bonds
Barclays Capital U.S. High Yield	-4.0%	-2.9%	1.9%	High Yield Corporate Bonds
Calyon Financial Barclay Index*	-1.0%	2.2%	-1.9%	Managed Futures
3-month Treasury Bill	0.0%	0.0%	0.0%	

*All returns are estimates as of 8/31/11; Return numbers include reinvestment of dividends.*

*\*Returns are estimates as of 8/30/11.*

### How to Help Keep Control

If grandparents want to retain more control on how funds are used, Ms. Muldoon advises setting up an irrevocable trust. This is a more costly route, and these trusts are usually set up by wealthy individuals or entrepreneurs. They can put cash or securities or property into these trusts, and can specify when the funds can be used.

Since these trusts are irrevocable, at the time of setting them up the grandparents ‘have to be pretty clear about what they want the purpose of the funds to be,’ says Ms. Muldoon. She advises never setting these up without the help of an estate lawyer.

Besides helping clients make financial-planning choices, Ms. Muldoon collaborates with her firm’s investment committee to pick investments for client portfolios.

Here, she shares a portfolio that she would use for a client with a moderate risk appetite. An actual client portfolio would differ depending on client needs and other factors.

The annual investment-management fee is typically 1% of assets under management, but would be lower for clients with more assets or more bonds in their portfolio. Carter Financials financial-planning arm, Carter Advisory Services Inc., charges a flat fee for financial-planning services depending on time and complexity involved of \$3,000 or more in the first year, and less for subsequent annual reviews.

## **A special-needs child must be eligible for government programs. Use a special needs trust to meet expenses the programs won’t cover.**

If you have special-needs children, here are a few assumptions that you should be considering. Will there be enough assets to provide for the special beneficiary? Is it time to juggle the planning to reflect the impact of the recent economic situation?

Unfortunately, a more basic issue is whether they have ever properly addressed the nuances of special-needs planning. Many clients haven’t. Special- needs planning is complicated and subject to dangerous misunderstandings.

### **COMMON MISCONCEPTIONS**

There are three planning misconceptions that can send the parents of special-needs children down the wrong road:

**Misconception 1:** “I should disinherit the special-needs child because they receive public benefits. “The misconception is that the government will provide for the child. It will, but only for food and shelter at the poverty level. There is also no assurance these benefits will continue. Proper planning, using a special-needs trust (SNT), is vital.

**Misconception 2:** “I’ll leave assets to my other children. They will take good care of their special-needs sibling,” What if the other children die first? Assets bequeathed to siblings are subject to divorce and creditor risks. What if a sibling opts for a new Maserati instead of helping his special-needs brother? Safer planning should be pursued.

**Misconception 3:** “We can afford to leave more than enough money to care for our special needs child.” Living costs and the expense of medical care for a special needs child or a seriously injured heir can erode even the most substantial estate or settlement. If Medicaid or other government benefits can cover some portion of these costs, then the funds might last for the child’s lifetime as a supplement to these government programs.

## **An Ear to the Ground on Metal Prices**

Metals, a normally volatile lot, have been even wilder during the past few weeks.

Prices for key commodities, including iron ore, copper and coal have risen between 22% and 52% in the first half of the year compared with the same period a year earlier. Most mining companies had been predicting that prices will stabilize at current high levels, making for a strong second half.

In spite of escalated concerns about the European sovereign-debt problems and potential double-dip recession in the U.S., the outlook remains relatively unchanged due to two basic fundamentals: Supply is constrained and global demand, while moderating, is still growing.

Indeed, slowdowns in the U.S. and European Union are expected to be offset by emerging-market demand, even amid monetary-policy-tightening initiatives in huge markets such as China. Weather-related production cutbacks, labor shortages and infrastructure bottlenecks, as well as labor strikes in Africa, have limited output for iron ore, copper and coal, likewise tightening supply and keeping prices firm for the medium and long term.

Spot prices have softened in some cases over the past few weeks, which could provide bargain opportunities for purchasing managers, who aren't dependent on quarterly contracts, and cause others to postpone purchases in anticipation of prices falling further. But the medium-and long-term price outlook remains strong. "The combination of strong demand growth and industry supply challenges gives us confidence that real long-term prices and margins for almost all the minerals and metals will continue at elevated levels albeit, of course, with heightened price volatility," **Rio Tinto** PLC Chief Executive Tom Albanese said during an Aug. 4 conference call, when the Anglo-Australian company said its first-half net profit rose 30%.

Of more concern are the pace of credit tightening in developing countries; rising costs of existing projects, due to labor and equipment shortages and infrastructure limitations; and uncertainty regarding efforts by governments to tax minerals, or secure ownership stakes in the mines and their profits. More than 25 countries either announced or implemented changes to tax and royalties, which is giving mining companies pause about new, longer-term commitments. "Resource nationalism is probably from a strategic standpoint, one of the largest sector challenges we face at the moment, and probably for the next few years," Mr. Albanese said.

China accounts for roughly 40% of iron ore and iron pellets for Brazilian mining giant Vale SA. Vale, which posted a 74% rise in second-quarter net income, said its average sales price for iron ore in the second quarter net income, said its average sales price for iron ore in the second quarter was \$145.30 per metric ton, up 58% from the year-earlier period, and that it expects iron-ore prices to stabilize at current high levels.

"Even if China demands moderated, growth in Indonesia and India is moving ahead," said Mike Elliot, global leader of Ernst & Young's mining and metals division. "Growth won't be as strong as we thought three or four months ago because of the European and U.S. situations, but we still see prices relatively buoyant."

Investors will be interested in any hints of softening prices, diminished demand outlooks, or changes in investment plans. The company spent close to \$17 billion this year taking over shale-gas producers in the U.S., and is spending more than \$9 billion in Australia this year on expansion projects.

In Australia, where mining accounted for 60% of exports in 2010, companies are placing a series of big bets that industrializing China and India will continue to fuel demand for resources such as iron ore and coal. The government is projecting a 33% increase in capital spending on resources and energy projects in the year to the end of June 2012. Much of the investment is directed to developing new mines or expanding production in sparsely populated Western Australia State, especially the dusty Pilbara region that accounts for 40% of the global seaborne trade in iron ore.

So, here's to a better September and a long Fall in the Midwest. By the way, you haven't noticed a milestone. We are in our 10th year as a separate entity. Time is flying. Have a great month, enjoy the colors and we will see you in October. You can find us on Facebook and Twitter.



Mary Ahart

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