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"Real People provide Real Service"

January, 2014

Market versus Government

Lately the news has been focused on when the Federal Reserve will begin the "Taper" (Buying less bonds from the market) Sprinkled in the mix has been good reports on the overall economy. Granted there have been pockets of bad company reports, but generally the trends have been up.

The latest reports indicate that the economy has finally found its footing. Overall employment increases, actual unemployment drops and positive earnings all look up going forward. Even the end of the Federal Reserve bond program is firming up as being in March 2014.

What is missing in this picture? The trillion dollar piece called Congress. The latest Congress, Democrat, Republican and Independent together have introduced the least number of fiscal bills of any Congress on record. The record, 2 centuries of records.
So for your trillion dollars, you get nothing. This has the effect of creating a flow of laws to make this a market economy, then turning off the water.

Remember that Republican branch called "Tea Party"? They advocate less government and more social and economic freedom. Yet the very party that advocates less government spent your taxpayer dollars to make their point. Or rather, make no point. Because when you spread the blame around, passing the same bill 40+ times even though you know it will fail, is like sending lemmings to the sea. You know they will get to their destination, only to go off the cliff every time.

What was the point? Divert your attention from their tenure in an organization that has failed to accomplish anything except spend your monies? How about the fact that they get paid while gambling with your monies. The government got paid while shut down. Try to find that capability in any business laying off employees.

So, the overall summary is that the economy will continue to partner with the Federal Reserve until 2014, at which point the economy will be set free of controls. Think of the first time the training wheels were taken off the bike. However, rest assured, the Federal Reserve will be watching the progress on the economic front. Unlike the lemming approach of Congress.

As to that trillion dollar failure, Congress? What do you care? It's just your money, Detroit, Chicago, New York, Atlanta, etc. You obviously liked their personalities, their speeches, their good intentions. Oh, don't forget in November whose pensions will still be guaranteed. Especially, you Detroit voters. You guessed it, that trillion dollar failure, Congress.

Ouch!

Illinois lawmakers approved a landmark pension reform package Tuesday that would cut retirement benefits for teachers, nurses and other retired and current state workers.

The legislation comes after years of debate on how to fix the state's ailing retirement system -- considered the most troubled in the country.

The plan will reduce annual cost-of-living increases for retirees, raise the retirement age for workers 45 and under, and impose a limit on pensions for the highest-paid workers.

Employees will contribute 1% less out of their paychecks under the reform, while some will be given the option to contribute to a 401(k)-style plan.

Legislative leaders of both parties crafted the deal, which they say will save $160 billion over the next three decades -- savings desperately needed to help fill the state's $100 billion pension shortfall.

The bill will head to the desk of Governor Pat Quinn, who is expected to sign it into law. He said Tuesday the plan "addresses the most difficult fiscal issue Illinois has ever confronted."

Illinois unions, who have announced strong opposition to the deal, are expected to challenge it in court.

"Teachers, caregivers, police, and others stand to lose huge portions of their life savings," We Are One Illinois, a coalition of labor unions, said in a statement.

On the flip side, some argued that the reform doesn't go far enough.

Illinois, which has the worst credit rating of any state in the country, has set aside only 40% of the funds it needs to pay the pensions it promised current workers and retirees. Today, 20 cents of every tax dollar goes toward pension obligations -- up 400% from two decades ago, according to a recent report from the Pew Charitable Trusts.

Many cities and states across the country are struggling to keep up with pension bills. But most major pension reform in recent years has focused on cuts to new hires, not current workers and retirees.

Retired union workers facing 'unprecedented' pension cuts

In Illinois, one of the plan's biggest changes will significantly slow the growth of retirees' pension checks. Currently retirees receive 3% annual increases. So an initial $30,000 pension benefit would become $30,900 the next year, nearly $40,000 after 10 years, more than $50,000 after 20 years and so on.

Under the deal, the annual bumps will now only apply to a portion of pension payouts, based on a formula using years worked. For example, a retired teacher with 25 years on the job would receive 3% increases on only the first $25,000 of pension benefits, a base amount which would be tied to inflation.

Proponents say the reduced increases will help keep pensions in check, especially for higher-paid workers.

Unions counter that the cuts will significantly erode pension benefits over time and make it "impossible" for retirees to keep up with inflation. Many government workers are not eligible for Social Security and so rely heavily on their pensions.

A state nurse who retired with a $40,000 pension would lose more than $7,500 in the next five years, according to We Are One Illinois, while younger workers could see deeper reductions.

HIGH NET WORTH

By Martin M. Shenkman

Estate Planning Game Changer

The impact of the fiscal cliff tax deal is likely to be far wider and more complex than many planners have imagined. And many of these complexities will directly impact advisors.

What makes this deal such a game changer? A lot of it comes down to the estate tax. Not only is that $5.12 million exemption now permanent, it is also inflation-adjusted and portable between spouses.

The fear that drove waves of clients to engage in estate planning in the closing months of 2012 may never appear again. Outside the ultrahigh-net-worth sector, most clients will not fear the estate tax. Most will no longer care (although there may be some concern for state estate taxes). Estate planning has changed forever.

These changes also have implications for the income tax planning that planners are regularly involved in.

Higher Tax Rates

The backdrop for these changes is a change in the effective ax rates for the highest earners. The new law makes permanent the tax cuts enacted as part of the 2001 tax overhaul so that, for most Americans, the prior tax rates remain in effect. But higher-income clients, the mainstay of many planners; practices, face a tougher income tax regime.

A new 39.6% top marginal tax bracket has been restored for high earners. These same clients will also face a new higher 20% tax rate on dividends and capital gains. These rates are in addition to the 3.8% Medicare tax on investment income. And itemized deductions and personal exemptions are phased out on income of $250,000 for singles and $300,000 for married couples filing jointly. When all these factors are combined with state income taxes, affluent clients could face a combined tax rate of more than 50%

The immediate challenges will be ascertaining the real and often unexpected impact of the new laws on planning – and educating clients to deal with these new realities. What might you do to alleviate this painful new income tax burden? And how might your actions interact with a client's estate planning? There are a host of options, each with its own unique twists.

Harvesting Gains & Losses

For many high-income clients, an estate planning move has complicated harvesting of gains and losses. Obviously, planners prefer to have all assets in-house so that asset allocation and gain/loss harvesting can be controlled and best executed. Yet some clients have always insisted on maintaining some investment assets under a different roof. That obviously necessitates some coordination with whoever is managing these other assets.

In 2012, like no other year in the history of the estate tax, wealthy clients formed and made gifts to sophisticated irrevocable trusts. And many, perhaps most, of these 2012 gift trusts were structured as grantor trusts – in which the client who set them up retains a tax liability on the trust's earnings, even if the earnings remain in the trust and are not (or even cannot) be distributed. So before planners can harvest gains and losses, they'll have to determine who might owe taxes on the trust income (whether it is a grantor trust or not), and who is managing the investments of each of these trusts to coordinate overall asset allocations and gain/loss harvesting.

But the process may be even more complicated. Many of the 2012 gift trusts were also formed as directed trusts, meaning a designated person – an investment trustee or investment advisor – has the authority to make investment decisions, rather than the general trustee. So, harvesting gains and losses or modifying asset allocation or location decisions may require the coordination of several different trustees, trust investment advisors and managers. Planners should start asking clients who else they'll need to coordinate with come December.

Charitable Planning

Charitable contributions might be used to offset some gain, but the phase-outs for itemized deductions might negate some charitable planning. Charitable remainder trusts, through which the client can gift appreciated assets to be sold and defer capital gains tax, are another option. These trusts are not subject to the new Medicare tax on passive income, another advantage.

Life Insurance

Life insurance products have long offered a tax-favored envelope to protect investment dollars. But the new tax increases substantially enhance the benefit of investment buildup inside the protective skin of an insurance policy.

There are several new twists to life insurance planning in light of the new estate-tax laws.

Clients with wealth under the estate – tax threshold – potentially $10.24 million for a couple for 2012, and inflation indexed in future years – might skip the complexity and cost of a life insurance trust and merely own their policies directly. It's far from optimal from the perspective of protecting the assets. But the estate-tax rationale for insurance trusts now doesn't apply to most clients.

A planning technique that has been used over the years, but which most estate planners frowned upon, was purchasing life insurance inside a retirement plan – so pretax dollars could be used to fund premiums. Estate planners were generally worried about the inclusion of the insurance proceeds in the insured's estate. That has changed for clients under the large exemption amounts.

Assigning Title

It had been common for planners to work with clients' estate planners to divide assets into separate accounts and names so that both spouses would have sufficient assets to fund a bypass trust. This almost ubiquitous planning step has changed in many ways.

Many wealthy clients gave most or all of their $5.12 million exemption to trusts in 2012. If only one spouse made such gifts, the spouse who did not use up his or her exemption might consider holding all assets in his or her name to fund the bypass trust. For the vast majority of clients, unless state estate-tax planning requires asset division, title to assets may be irrelevant from a tax planning perspective.

Bypass Trusts

These trusts are designed to protect a surviving spouse by providing access to trust assets, but keeping them outside the surviving spouse's estate. They were the mainstay of many client plans, but the "new normal" of estate planning changes this.

Most clients will simply be far enough from the inflation-adjusted exemption amount that they will want to avoid the complexity of bypass trusts – titling assets, dealing with a trustee, filing trust income tax returns and so forth. Moreover, for clients who gifted most or all of their exemption amounts in 2012, setting up a trust for modest assets may not be cost effective.

Estate planners will, quite appropriately, endeavor to persuade clients that trusts are needed to address state estate tax, divorce/remarriage risk and more. And most wills and revocable living trusts mandate the funding of these trusts. But many clients will simply no longer tolerate the complexity.

For many of your high-net-worth clients, it's going to be essential to revise estate planning documents. Planners will face new challenges in coordinating with their clients' estate planners to ensure that planning is done properly and in a manner that best meets client goals.

2014 Predictions

Prediction 1: The Bears Declare Victory

At the first sign of a 5% correction, the market bears will announce the end of the stock market run. But like virtually all the warnings from timers over the last few years, stocks will regain their footing and embarrass the pessimists.

With the economy clicking and an accommodating Federal Reserve, we think equities will gain ground in 2014.

Prediction 2: Alts Get Even More Popular

If used properly, liquid alternative funds can potentially mitigate stock market risk, allowing advisors to create more diversified client portfolios.

Prediction 3: Look for More Leverage

With rates still historically low, companies are borrowing increasing amounts of money. That has caused a spate of credit downgrades, according to Bloomberg, even though 15% of bond offerings have been used to fund shareholder payouts instead of shoring up operations.

I expect balance sheet quality to decline, but the uptick in the economy should keep trouble from brewing, at least in the short term.

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www.SearchingForAlpha.com

Index	Dec-13	QTD	YTD	Description
S&P 500 Index	2.5%	10.5%	32.4%	Large-cap stocks
DJIA	3.2%	10.2%	29.7%	Large-cap stocks
Nasdaq Comp	2.9%	11.1%	40.1%	Large-cap tech stocks
Russell 1000 Growth	2.9%	10.4%	33.5%	Large-cap growth stocks
Russell 1000 Value	2.5%	10.0%	32.5%	Large-cap value stocks
Russell 2000 Growth	2.0%	8.2%	43.3%	Small-cap growth stocks
Russell 2000 Value	1.9%	9.3%	34.5%	Small-cap value stocks
EAFE	1.5%	5.7%	23.3%	Europe, Australasia & Far East Index
Barclays Capital U.S. Aggregate	-0.6%	-0.1%	-2.0%	U.S. Government Bonds
Barclays Capital U.S. High Yield	0.5%	3.6%	7.4%	High Yield Corporate Bonds
Newedge CTA Index*	0.6%	3.5%	0.7%	Managed Futures
3-month Treasury Bill	0.0%	0.0%	0.1%	

All returns are estimates as of 12/31/13
Return numbers include reinvestment of dividends.
*Returns are estimates as of 12/30/13

Dozens of popular tax breaks are on the verge of disappearing.

Credits and deductions benefiting everyone from teachers and students to homeowners are scheduled to expire at the end of the year, unless Congress extends them.

Here are eight of the tax breaks that will be missed the most, and how you can take advantage of them before it's too late.

1. Tuition and fees: A deduction for tuition and fees of up to $4,000 is currently available to parents and students paying for college. More than 2 million taxpayers claimed this break in 2010, saving more than $4 billion, according to the most recent data available from H&R Block.

If you want to take advantage of this tax break before it expires, you'll need to pay your spring 2014 tuition and fees before Dec. 31, said Lindsey Buchholz, lead research analyst at the Tax Institute of H&R Block. That way you can still claim those costs on your 2013 tax return.

2. Teachers' expenses: The Educator Expense Deduction aims to help teachers cover the cost of classroom supplies like notebooks, pens and paper that their school doesn't reimburse them for. Elementary and secondary school teachers can qualify for deductions of up to $250 per year, even if they don't itemize.

Nearly 4 million teachers deducted $915 million in school expenses in 2010.

"If you haven't bought all the supplies you need for your classroom, it might be worth doing that before the end of the year and taking advantage of this credit," said Greg Rosica, Ernst & Young partner and contributing author to the EY Tax Guide 2014.

3. Mortgage insurance premiums: Currently, homeowners are able to deduct their mortgage insurance premiums as residence interest. About 4.2 million taxpayers claimed the tax break in 2010, deducting a total of $5.6 billion in mortgage insurance premiums, according to H&R Block.

4. State and local sales tax: In states without an income tax, like Florida and Alaska, taxpayers have been able to deduct state and local general sales taxes instead of taking the income tax deduction -- but that won't be an option next year unless Congress intervenes.

In 2010, 57 million taxpayers claimed more than $16.4 billion in deductions this way.

If you live in a state without an income tax and are planning to make a big purchase next year, you may want to do it before the end of 2013 instead, said Rosica. That way, you can claim this deduction before it expires.

5. Donations through your IRA: Retirees older than 70-and-a-half have traditionally been able to make non-taxable charitable donations of up to $100,000 directly from their IRA disbursements. But once this tax break expires, they will need to take the disbursement first, meaning it will be considered part of their taxable income.

6. Energy-efficiency: It's your last chance to get a credit of up to $500 if you made energy-efficient home improvements this year -- including new windows and doors. To see if you qualify, visit EnergyStar.com or ask the company where you bought the items.

The break is only available for people who haven't already claimed received credits totaling $500 in past years (The credit has ranged in value since taking effect in 2006.).

7. Commuter costs: Currently, commuters who take mass transit like trains or buses to work are able to receive $245 a month (or $2,940 per year) in tax-free money toward those expenses. But this perk is scheduled to expire January 1, at which point commuters will only be able to write off just $130 per month -- $1,560 a year.

8. Mortgage debt forgiveness: A tax break that has been in effect since 2007 allows struggling homeowners to exclude any debt forgiveness they were granted from a bank when calculating their taxable income.

For the more than 6 million Americans who still owe more on their loans than their homes are worth, the expiration of this tax credit Jan. 1 is bad news. If they get a mortgage modification from their bank or do a short sale of their home after year-end, their tax bill could be thousands of dollars higher than if the modification were completed before year-end.

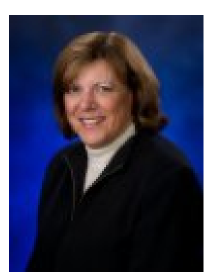
7 FLU-FIGHTING FOODS

By: Nissa Simon

The flu season is about to begin, and you know what that means – get a flu shot and do what you can to stay healthy. Drugmakers expect to produce nearly 140 million doses of vaccine this year, according to the Centers for Disease Control and Prevention, and officials warn that it's important for older adults to get their shot as soon as possible to give the vaccine time to take effect. To help cut down on illness, it's important that family members and those who work around people 65 and older get vaccinated. And don't forget to boost your body's immune system with these natural flu-fighting foods: *Black-Eyed Peas, Tea, Yogurt, Tomatoes, Mushroom, and Almonds.*
Source: AARP-Bulletin/Real Possibilities

Stay Healthy and where it gets cold, stay warm! Welcome to the New Year!

Timothy T Fullerton, Sr.



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