



Reality Check

Reality REAL SOLUTIONS FOR REAL PEOPLE
FINANCIAL
PLANNING SERVICES, LLC

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Planner's Perspectives

Happy New Year! Okay, so, I'm a month late with those well-wishes. One of my New Year's resolutions was to be more timely in writing these newsletters. Well, that one did not work out so well.

Probably the "Be more tolerant of stupid politicians" resolution won't work out so well either. After the onslaught of nasty political advertising prior to the Florida primary, it is a wonder that the mute button on my remote still works. Wow. One can only hope that that vitriol is not a foreshadowing of what will come in the Fall when the presidential campaign swings into full force. That, of course, is a very naive dream.

For sure, there will be any number of issues open for discussion. While the economy is recovering (based on the latest positive reports on GDP and unemployment), it is by no means where any reasonable person would want it to be.

There will be ongoing discussion of whether to continue to extend unemployment benefits and the

so-called "payroll tax holiday".

That latter issue is a great concern to me. The "tax holiday" is nothing more than reducing the collection of some payments that would otherwise go to fund social security. I wonder if once the public realized that we are just playing another round of "Rob Peter to pay Paul" that they would still want that extra few dollars in their paycheck. The social security trust fund is already in trouble. Does it make sense to continue underfunding it? While politicians like to say they are helping to fuel the economy by putting more money into our wallets now, when will they come up with a plan to replace it for those of us that would like assurance that adequate social security benefits will be available when we are ready to apply for them?

Expect major lip service regarding the "Buffet Rule", taxes on the very wealthy, and, most notably, the expiration of the Bush tax cuts (more on that later).

Expect a ton of finger pointing

and chest thumping - taking credit or laying blame - if the economy continues to improve (or turns negatively).

May need to check on replacement mute buttons for my remote.

On a totally different topic, the *Sun Sentinel* reported that a radio talk show host in South Florida was sentenced to more than four years in prison. Apparently, this guy provided investment advice on his radio show and "offered" his services to his audience. From his "years of studying the markets", he could advise people how to make money in any market. Allegedly he stole over \$1.56 million from his listeners that utilized his "expertise" in markets and real estate.

When will people ever learn? Just because someone is on the radio or writes a business column, no one should ever just "trust" that they are looking out for your best interests.

Tax Planning Does Not Get Any Easier for 2012 (and beyond)

Here we go again. Tax time is here and the scramble to get things in order to meet the April 17 tax filing deadline for your 2011 tax return.

However, tax planning for 2012 and beyond is fraught with uncertainty. I will get to that shortly.

There is some good news, though. The IRS announced cost-of-living adjustments for the 2012 tax year that increase the brackets, deductions, and other thresholds for inflation. A few examples of the most notable increases:

- The personal and dependent exemption increases to \$3,800, up \$100 from 2011.
- Standard deductions increase to \$11,900 for married couples filing a joint return; \$5,950 for

singles and married individuals filing separately; and \$8,700 for heads of household.

- Tax-bracket thresholds have increased for each filing status (see table).

2012 Tax Brackets

	Single	Joint Filers	Married Filing Separately
10%	\$0 - \$8,700	\$0 - \$17,400	\$0 - \$8,700
15%	\$8,700 - \$35,350	\$17,400 - \$70,700	\$8,700 - \$35,350
25%	\$35,350 - \$85,650	\$70,700 - \$142,700	\$35,350 - 71,350
28%	\$85,650 - \$178,650	\$142,700 - \$217,450	\$71,350 - \$108,725
33%	\$178,650 - \$338,350	\$217,450 - \$388,350	\$108,725 - \$194,175
35%	Over \$338,350	Over \$388,350	Over \$194,175

- Estate tax exclusions increase to \$5,120,000, up from \$5,000,000 for 2011. The annual exclusion for gifts will remain at \$13,000.

Several tax benefits are unchanged in 2012. For example, the additional deduction for blind

people and senior citizens remain at \$1,150 for married individuals and \$1,450 for singles and head of household.

At the end of 2012, we face greater challenges in the area of tax planning. To summarize the changes that could be coming:

- The Bush-era tax cuts are scheduled to expire.
- The estate tax exclusion is set to revert back to \$1,000,000.
- Capital gains and dividend income will revert back to their old levels. That is 20% for capital gains and dividend income will be taxed at ordinary income tax rates, potentially as high as 39.6%

(Continued on page 4)



GDF ↓ .15 HJK 1.25 ↑ RTY 1.23 IOP .05 ↑ BNM 12.0 ↑ XCV .20 ↑ QEW ↓ .65



Market Check

By now you have received your end-of-year statements and seen that Mr. Market, as measured by the S&P 500 did, pretty much, nothing for 2011. Oh, it started pretty well, then freaked out in August; only to recover with the big Santa Claus rally that made up the decline.

In 2012, Mr. Market has decided to get busy. By ignoring the "noise" from Europe (see the FPA Perspectives article), focusing on better-than-usual economic news, and good earnings reports from most of the larger companies. we have had a nice little 6% rally so far. Even the overseas markets are doing well - up almost 9% year-to-date.

One newsworthy event that may have missed your radar screen was Ben Bernanke, the chairman of the Federal Reserve's Open Market Committee, announcement to leave short term interest rates near zero "through 2014". Why is that significant? There is some thought that the 10-year Treasury note may soon trade for as little as 1.5% (they are currently at approximately 1.87%).



To put that in perspective, if you want to invest in the benchmark for "risk-free" assets and are willing to lock your money up for 10 years in the bond, you will have the pleasure of receiving a whopping 1.87% on that money. What a deal! Really? Considering the average yield on money market accounts (according to BankRate.com) is .13%, it does sound almost plausible.

What this latest announcement effectively does is make rates on the most conservative accounts

(ie., savings, money markets, and CDs) very unattractive. If you thought rates were abysmally low before, this latest Fed move now essentially ensures that banks will continue to pay squat (a very technical financial services term). In other words, it doesn't pay to be safe.

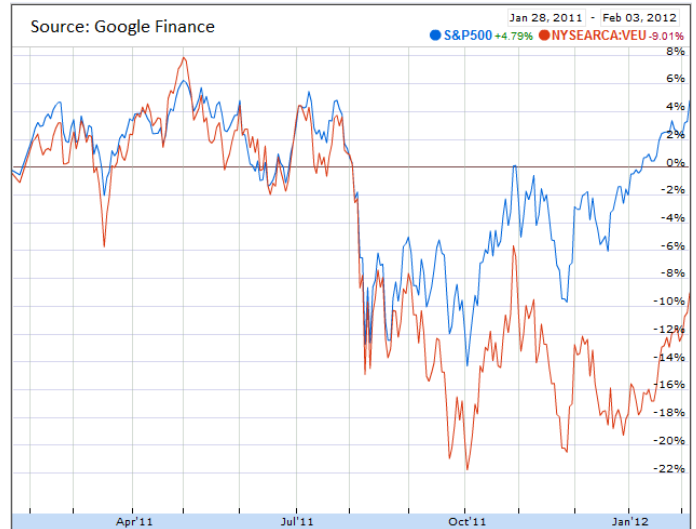
Mr. Market is now running around yelling, "Risk On". While the economic news is generally better, one could make a good argument that one of the reasons the market has been going up over the past months is the accommodative stance of the Federal Reserve.

I appreciate and applaud almost all of the efforts that Mr. Bernanke has made to resolve the economic crisis. And he certainly is a much smarter economic historian than I. However, it seems that he is telling even the most conservative of investors - seniors and retirees - that, in order to make any money, you may need to be willing to take on more risk than you may be comfortable in doing. While adding slightly more risky, market-based assets to a retirement portfolio may not be a bad idea in some circumstances, it bothers me that the most conservative folks have lost the ability to save risk-free if they want to keep pace with inflation.

Furthermore, it may actually create a "disincentive" to save money if you are not getting any return for doing so. Will that prompt people to spend more and, therefore, further stimulate the economy? At what price to retirement savings comes that stimulus?

And what if conservative investors did decide to ramp up the buying of riskier assets? Well, Mr. Market would certainly go up. But what happens when it goes back down - which it inevitably does? Do we want these folks wiped out in a market crash?

So, what are some options? Bonds may be an area to consider for some yield. Even the



forementioned 10-year Treasury bond becomes appealing when compared to a .05% savings account. However, the price of bonds and bond funds have been driven upward for the past three years. Inevitably, their associated yields will drop accordingly. Bonds are great for portfolio diversification and deserve an allocation in your portfolio. But, if Mr. Market continues to move higher, they may cause a little drag on that portfolio going forward. Now, before you abandon their consideration, remember that most bond funds outperformed Mr. Market last year.

Another option may be to look at stocks of well respected companies that pay a good dividend yield. Many very solid, blue-chip companies are paying attractive dividends well in excess of what "safer" investments are paying. For example (not an endorsement or solicitation to buy or sell), consider that AT&T - whose stock has done virtually nothing for over 3 years - is paying a dividend of 5.90%. But remember, even though a stock pays a nice divi-

dend, it is still subject to the vagaries (and volatility) of the market.

From my standpoint, it appears that Mr. Market is beginning to shake off a lot of the news from across the pond and focusing on the economic news on our own shores. So far this year, we have only had a handful of days where the Dow Jones Industrial Average has had a triple digit move. The VIX, a common measure of fear and volatility in the market, is showing very little movement. That is a sign that we are in a calmer phase of the market cycle.

As always, the lesson that Mr. Market (and prudent advisors) teach us is that our portfolios, conservative or otherwise, need to always match our long-term risk tolerance and capacity. Diversification does not guarantee success. But it may pay better than "squat". Savings rates will eventually rise. Until then, be sure that you regularly assess your risk tolerance. Unless your comfort level changes, there is no need to take unsuitable risk just to chase yield - always a bad idea.

"Knowing how to make money, and also how to keep it, either of these gifts will make a rich man." - Seneca



FPA

FINANCIAL PLANNING
PERSPECTIVES

Buying Time For Europe?

Last year, the S&P 500 Index was a hostage to the headlines, up one day and down the next, depending largely on events in Europe and questions about what they could mean for the U.S. economy. A prime example was the November 30 rally on the news that the Federal Reserve would lead an effort by six central banks to increase global liquidity and avert a credit crisis.¹

While the action was a welcome intervention following tense negotiations among heads of state, it is likely that the agreement will not address the root cause of the problem: a lack of confidence in European sovereign debt.²

Too Much Borrowing

Europe's challenges stem from a history of significant government borrowing by Italy, Spain, Greece, Ireland, and Portugal, among other countries. When the Greek financial crisis first erupted in 2010, questions about contagion led to borrowing costs that suddenly were unaffordable for Greece and many of its euro zone neighbors. A one-trillion-euro bailout fund was created in October 2011, but it quickly became apparent that the fund was not adequate. Standard & Poor's has put euro zone countries on credit watch, indicating their bond ratings may be lowered if the situation is not addressed.³

Looking Ahead: Slow Growth and Contraction

The Organization for Economic Cooperation and Development (OECD) anticipates that economic growth will be muted -- or it will potentially contract; with the United States in better shape than many countries within the euro zone.

Source: OECD *Economic Outlook*, November 2011.



What Investors Can Do

Although there are no guarantees, the following strategies may help to maintain a portfolio's value as events unfold in the euro zone:

■ **Diversify bond holdings.** Many sovereign nations, including the United States, maintain strong credit ratings and the capability to repay bondholders. That said, diversifying fixed-income holdings to include corporate and municipal offerings and being selective in your choices could make your portfolio less dependent on developments in one area of the bond market.⁴

■ **Investigate revenue streams outside of Europe.** Organizations that do a significant amount of business in North America or emerging markets may help to insulate your portfolio from the worst of Europe's problems.⁵

■ **Look for companies that generate cash.** Organizations with consistent profits may be in

a strong position to withstand a credit crunch if lending standards tighten.

Diversifying your bond holdings, looking for revenue streams outside of Europe, and identifying companies that generate cash may be beneficial strategies for mitigating the impact of euro zone developments on your portfolio.

Source/Disclaimer:

¹Source: money.cnn.com, "Dow Closes with Largest Gain Since March 2009," November 30, 2011.

²Source: Standard & Poor's Equity Research U.S. Sector Outlook, "Debt Drag," November 22, 2011.

³Source: Standard & Poor's, "Standard & Poor's Puts Ratings on Eurozone Sovereigns on CreditWatch with Negative Implications," December 5, 2011.

⁴Bonds are subject to market and interest rate risk if sold prior to

maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Interest income on municipal bonds may be subject to the alternative minimum tax. Municipal bonds are federally tax free, but other state and local taxes may apply.

⁵Emerging markets are generally more volatile than the markets of more-developed foreign nations, and therefore you should consider this market risk carefully before investing. Investors in international securities may be subject to higher taxation and higher currency risk, as well as less liquidity, compared with investors in domestic securities.



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"Financial planners who take commissions have a built-in conflict of interest – even with a disclosure, my choice would be a fee-only planner."
–Jane Bryant Quinn

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- ⇒ Investment strategies and management
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- ⇒ Estate planning

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REAL SOLUTIONS FOR REAL PEOPLE

Understanding and Managing a Bond Portfolio

(Continued from page 1)

These are all the same worries that we had to deal with in 2010 until a last-minute two-year extension was approved. Will that happen again? That is the big question that is unanswerable at this point given the rancor and political discord (not to mention inability of Congress to compromise).

Traditional income tax planning favors deferring taxable income to future years so that you put off paying the tax as long as possible. However, in a situation where it appears that the succeeding year's tax is going to be higher, pulling income into the lower tax rate year can be beneficial. That is even more critical if there is a change to the capital gains rules.

The Bush tax cuts were enacted in 2001. In case you have not appreciated these lower tax rates, let's review what the rates would be if we revert back to them: People in the 15% bracket and lower will experience no change (see the 2012 brackets on page 1). Higher income taxpayers will experience the following increases in their marginal tax bracket:

Bush Era Tax Cuts Impact of Expiration

2012 tax bracket	Bracket if cuts expire	Increase of
25%	28%	3%
28%	31%	3%
33%	36%	3%
35%	39.6%	4.6%

However, one should be cautious to not let the tax tail wag the investment dog. There is no point in accelerating income just for the sake of doing it. This becomes a planning opportunity.

And speaking of planning opportunity, be very aware of the other major tax expiration: the estate tax exclusion. That could impact more people than they may think. While home values have not appreciated significantly since The Great Recession, many investment portfolios have. Without realizing it, you could find yourself approaching the \$1 million exclusion very quickly. Estate planning attorneys will, no doubt, be very busy helping clients reassess their estate planning strategies (something everyone should be mindful of anyway). My gut feeling is that this issue will be addressed much more quickly than the expiration of the Bush tax cuts.

With the possibility of higher taxes on the horizon, be mindful of how your portfolios are constructed. The placement of different types of investments in taxable vs. tax-deferred account is going to become very important again.

Placing investments that yield high dividends and interest in tax-deferred accounts (such as IRAs) will save money over the long term since they will not be subject to income or Medicare taxes when earned. When the IRA distributions are subsequently taken, you will pay ordinary income on the amount taken, but not Medicare tax.

There is always the chance that the rates will not go up. At this point in the year, it is important to be aware and begin planning accordingly as we are, once again, held hostage by politicians.



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