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Is It Different This Time Or Will The Gloom Subside?

If the financial news has you hanging your head, thinking about hiding your money under the mattress, turn off the TV, and take a deep breath. We've been here before.

Breathless talk of bank bailouts, the collapsing dollar, record oil prices, and mounting foreclosures has many investors nervously eyeing the safe haven of CDs, gold, and low-yielding Treasury bonds. Yet while a well-diversified portfolio might include some of those assets, overemphasizing them could carry a high cost in terms of lost opportunities and long-term losses.

It's hardly a secret that our current economic woes are linked to what had been a phenomenal rise in home prices that started during the late 1990s and gained momentum after the Sept. 11, 2001, terrorist attacks. Spurred by historically low interest rates and other factors, inflation-adjusted home prices rose 85% between 1997 and 2006, according to Yale University economist Robert Shiller, who developed the S&P/Case-Shiller Home Price Indices in the 1980s. It was the biggest national housing boom in U.S. history, and historic booms tend to be followed by historic busts. According to the S&P/Case-Shiller Home Price Indices, median home prices fell 8.9% nationwide in 2007, and that has sparked an explosion in foreclosures, a pervasive credit crunch, a slump in earnings for financial institutions, and plunging consumer confidence.

Financial stocks, now volatile and significantly off their highs, had been roaring ahead for years, helped along by the popularity of mortgage-backed securities. As home prices rose, mortgage activity soared, and banks repackaged bundles of home loans to sell to other investors.

By December 2006, the stock of financial companies had bubbled up to account for a record 22.3% share of the Standard & Poor's 500 stock index—almost 10 percentage points higher than in December 1999. But many of the bundled mortgages were of the notorious subprime variety. When the housing market cooled, defaults on those loans began, and soon financial institutions were swallowing huge losses. Their share prices plunged, and by April 2008, financial stocks were back down to a 17.2% share of the S&P.

As often happens when a bubble bursts, many investors found themselves over-concentrated in the hardest-hit sectors. Their financial holdings, which had been growing rapidly for years—and thus came to represent a disproportionate share of their portfolios—suddenly fell off the table. But the broader market has also suffered. The Dow Jones Industrial Average, after reaching an all-time high of 14,279.96 on Oct. 11, 2007, fell as low as 10,731.96 on July 15, 2008.

A similar chain of events occurred during the early 1980s. Energy stocks, which had comprised only 15.7% of the S&P in 1970, surged to a 28.2% weighting by 1980—and then fell to 11.6% in 1985.

That rise and fall was mirrored by

(Continued on page 4)

Confronting Your Own Mortality: It Isn't All About You

People tend to be either overly optimistic or pessimistic about the prospect of their own mortality, according to data collected by the National Bureau of Economic Research. Many people estimate their chances of living another 20 years at either zero or 100%, NBER says, with no middle ground. Furthermore, those with a relatively high life expectancy are too pessimistic about the chances of living, while those with a relatively low statistical lifespan are too optimistic.

While medical science continues to make breakthrough after breakthrough, sooner or later, we all die. This is obviously not something any of us want to hear, but that doesn't make it any less true. Nor does it absolve you of the responsibility of planning ahead for those you will leave behind.

In the financial planning profession, all too often you see how death comes as a total surprise. While no one can plan the day and manner of his passing, you can decide whether to leave your loved ones with a confused mess or an orderly estate that will continue to care for them after you're gone.

Keep your will up to date and review it annually. Store crucial financial documents where heirs can find them. Review life insurance coverage and beneficiary assignments on retirement accounts to ensure that they are correct and up to date.

If you need help dealing with this issue, we're here for you.

Sincerely,

Victoria Marrone

Ph.D., MBA, CSA, CFP®

They Don't Call 'Em Trusts For Nothing

Maybe you heard the story about the 60-year-old oil heiress who died and left everything to her husband. He was 71 and died just two months after remarrying a much younger woman, who inherited his first wife's fortune. The heiress' children got none of it. Or perhaps you heard about the man who left his son $500,000, which he used to buy a house with his wife. Two years later, they divorced, and she got the house in the settlement.

Then there's the one about a couple that inherited $250,000 from an uncle but received none of it because the IRS exercised its right to take the inheritance to satisfy back taxes.

Obviously, these aren't the kinds of stories that you want people to tell about your family. To avoid the possibility of such trouble, you may need to establish a trust.

A trust is an agreement in which you transfer ownership of property to a trustee of your choosing, who then manages it for the benefit of your loved ones. The trust can be funded during your lifetime or at your death if your will provides for it. Typically, it costs between $1,000 and $2,000 to set up a trust, although you might spend more depending on where you live, the legal advisor you use, and the complexity of the trust.

Life is full of surprises, but experts say that you can trust a trust

Trusts have long been used by the wealthy to reduce estate and income taxes, but more and more middle-class people are finding trusts can benefit them, too. Appreciation in real estate values over the long term, stock market gains for astute investors, and the slow march of inflation have thrown many middle-class individuals into higher income tax brackets and left them facing the prospect of estate taxes that could decimate the value of bequests to their loved ones.

A bypass trust can ensure that a married couple maximizes its combined estate tax exemption of $4 million (for 2008); a charitable remainder trust can reduce estate taxes while allowing you to do good for your community; and a life insurance trust can help guarantee the amount your heirs will receive. You can also use a trust to direct how the assets you leave behind will be managed, and to ensure that your bequests end up with the intended heirs.

The oil heiress, who had thought she was too young for estate planning and had feared that her 25-year-old son and 27-year-old daughter would squander the money, could have used a trust. She might have set aside some assets in the trust for her children until they were older, or she could have appointed a trusted friend or advisor as trustee to disburse the assets.

A trust also would have left the divorcing son in a better bargaining position to keep his house. Had his father left the money in a trust, allowing a trustee to buy the house for the son, the wife wouldn't have been able to get it. And the IRS could not have seized the assets in a trust established for the beneficiary with tax problems.

Life is full of surprises, but you can trust a trust. ●

Marriage Doesn't Mean Owning All Your Assets Jointly

Marriage is all about togetherness. Yet when it comes to owning assets, too much togetherness may not be financially healthy.

Owning assets jointly is more convenient than individual ownership, and it's the simplest way to avoid probate after a spouse's death. But couples often should consider separating their assets. Here's why:

Estate tax implications. Estate rules let spouses leave unlimited property to each other tax free. That's okay when the first spouse to die leaves everything to the second, but the second death could result in a whopping tax bill. Couples likely to have estate tax issues could acquire property individually to help maximize the value of each other's estate tax exclusion. While owning a house jointly is important for giving both spouses equal claim if they divorce, other assets can and should be held separately in roughly equal shares.

Dividing jointly owned property. How you take title also affects who can inherit your property. If you own it individually or jointly as "tenants in common," each of you may specify in your will that you want a particular asset or share of an asset to go to a designated heir. However, if you take title as "joint tenants" (with rights of survivorship) or "tenants by the entirety"—the most common form of ownership for married couples—you won't be able to say how assets are split. That may work if you and your spouse share the same beneficiaries. But it could be a problem if, for example, you're in a second marriage and want to divide assets among children from different marriages.

Consider John and Mary. Because they own their property as tenants in common, each holds 50%, and John

New Economic Stimulus Law: A Break For Businesses

No one's complaining about the much-hyped tax rebates the IRS sent out this year. But the real boost in the Economic Stimulus Act of 2008 is for businesses, not individuals. Companies get double-barreled tax relief for buying equipment and other assets in 2008.

If you were a single filer on your 2007 federal income tax return (and you meet income requirements), you should have already received a one-time tax rebate this year of $600. A couple filing jointly received $1,200. In addition, families received rebates of $300 for each child under age 17, with no limit on the number of qualifying children.

But not everyone was eligible to receive these checks. The rebates began to be phased out for individuals whose adjusted gross income (AGI) exceeds $75,000 and couples who earn more than $150,000. Above those levels, you forfeit 5 cents for every dollar of income. So if you're single with no children, the rebate phases out completely at $87,000 of AGI (5 cents x 12,000 = $600). A married couple with two kids and a combined AGI of $175,000 receives $550 (5 cents x 25,000 = $1,250; $1,800 - $1,250 = $550). There are also $300 rebates for taxpayers who have no tax liability but earned at least $3,000 last year.

Though much less ballyhooed than the rebates for individuals, two key business tax breaks were also included in the stimulus legislation. Like the rebates, the business provisions are temporary, but for business owners who qualify, the deductions can be much larger.

The first business provision involves Section 179 deductions. Normally, equipment and other business purchases must be "depreciated" over several years, with a portion of the cost deducted each year. Under Section 179 of the Internal Revenue Code, however, you can treat the purchase of qualified assets as a business expense, deducting, up to a specified limit, the cost during the year the assets are placed in service. Before the new legislation, the ceiling for 2008 was $128,000. And if the value of new business assets exceeded $510,000 in 2008, your deduction would have been reduced by $1 for each additional dollar of equipment put into service.

The economic stimulus law has made the Section 179 rules much more generous, almost doubling the maximum deduction, just for 2008, to $250,000. The law also hiked the threshold for reducing deductions to $800,000. So, this year, if your company buys $850,000 of qualified assets, your maximum Section 179 deduction is $200,000 ($250,000 minus the $50,000 by which the purchases exceeded $800,000). Unless Congress acts to extend this tax break, it will expire after this year, and Section 179 deductions will again be governed by the old rules.

The second business break involves bonus depreciation. Like the Section 179 changes, this also speeds up the timetable for deducting business equipment expenses. For qualified assets placed in service in 2008, you can write off 50% of the cost. Keep in mind, though, that this bonus depreciation deduction is available only for purchasing new qualified assets in 2008. It doesn't apply to used equipment.

For the purposes of this rule, "qualified assets" include the following:

- Property with a cost recovery period of 20 years or less
- Depreciable software that is not amortizable over 15 years
- Certain leasehold improvements (for example, tenant upgrades in a commercial building)
- Water utility property

One great thing about bonus depreciation is that you can claim it in conjunction with the enhanced Section 179 deduction and regular depreciation deductions under the Modified Accelerated Cost Recovery System (MACRS). IRS rules call for computing deductions in this order: 1) Section 179 2) bonus depreciation 3) MACRS.

Suppose your business buys a new computer system in 2008 for $300,000. First, you can write off $250,000 under Section 179. Second, the 50% bonus depreciation deduction takes care of half of the remaining $50,000, or $25,000. Third, you can take a first-year MACRS deduction equal to 20% of the $25,000 balance. That's another $5,000, giving you a total write-off of $280,000.

Other special rules, including limits on deductions for "luxury cars" used in your business, and the overall nature of most depreciation deductions as tax referral rather than elimination, may affect the size and benefit of your tax break. We can work with you to make sure your business takes full advantage of these temporary tax breaks. But remember, they are temporary, and go off the books after 2008. So you'll need to act quickly to reap the rewards. ●

can bequeath his share to children from a prior marriage. Mary won't automatically inherit John's interest.

But if they hold their assets as joint tenants or tenants by the entirety, the surviving spouse becomes the sole owner of everything the couple owned together. It won't matter that John's will names his children as beneficiaries; if he dies first, the title documents will govern, and Mary will decide how assets are divided when she dies.

Other considerations. Owning assets separately is especially important if your combined net worth is at or above the IRS estate tax exemption—$2 million in 2008 and $3.5 million in 2009. Once you approach those levels, it pays to consider ways to separate assets. Also, since joint-tenancy assets can be taken by creditors or lost in lawsuits once an individual's assets are exhausted, doctors or others who can be sued easily will want at least half of their assets in their spouse's name.

Deciding how to hold title to your assets is not a simple decision, as state laws differ and each situation is unique. We can work with your attorney to help decide what's best for you and your spouse. ●

Don't Wait Till The Last Minute On Taxes

Most people wait until the last couple of weeks in December to do year-end tax planning. By then, however, it's often too late to shuffle things around. It's like waiting till the day before Christmas to do your holiday shopping -- all the bargains are gone. Waiting until the 11th hour with your tax planning could mean missed opportunities, particularly when you need to get tax information from one professional to another. Consider acting on these four ideas before the end of the year.

Manage AMT exposure. The alternative minimum tax continues to affect millions of taxpayers in the middle and upper income tax brackets. When your tax bill under the AMT formula exceeds your regular tax, you pay your regular tax plus the excess AMT amount above your regular tax. Are you going to exercise incentive stock options, realize hefty capital gains, or take large deductions for state and local taxes, miscellaneous itemized expenses, or accelerated depreciation? If so, you stand a chance of being ensnared by the AMT.

When AMT applies, the tax rate is 26% for incomes less than $175,000; 28% if above, which may actually be lower than your regular income tax bracket. Once you know you're going to be caught in the AMT boat, you might actually save by pushing additional income into that year.

To manage your AMT exposure, you'll need to project your income and deductions over multiple years. You may want to shift income to years in which the AMT gives you a lower tax rate, while pushing deductions that would be lost under the AMT into non-AMT years. Deductions allowed under both tax regimes, such as charitable gifts, save you more the higher your tax bracket. Finally, if you know the AMT is coming, avoid private-activity municipal bonds, whose income is taxable if you owe AMT. The sooner you figure out if you'll be caught by the AMT, the better chance you have for planning around it to lower your taxes.

Don't miss a chance to deduct college costs. This year, more liberal rules apply to deducting payments for college tuition and fees. If you're single and make between $65,001 and $80,000 this year, or married and earning from $130,001 to $160,000, you may deduct the first $2,000 in costs. If your income is below those ranges, the first $4,000 in college costs are deductible; above the ranges, zilch. Don't let an extra dollar of income cost you. If you are close to the upper end of the income ranges, plan now for ways to defer income to maximize this deduction.

Plan business opportunities. Businesses may deduct the first $125,000 of assets purchased in 2007 ($128,000 for 2008). But buy too much and you'll save less, because the maximum deduction is reduced by each dollar of equipment purchased in excess of $410,000. And this deduction can't create, or add to, a business loss. However, you can deduct as bonus depreciation half of the cost of new property you don't write off.

Corporations, meanwhile, can stretch their cash flow this year. Only 80% of estimated tax for the third quarter is due by the usual September 15 deadline. The remainder may be paid October 1.

Review state tax changes. Not all moves reducing your IRS bill slice local taxes. Some states have declined to adopt recent federal tax breaks, while others have rewritten laws in response to fiscal crises. Examine your state's latest rules at the following website: www.taxsites.com/state.html. ●

Will The Gloom Subside?

(Continued from page 1)

the boom and bust of technology shares in the late 1990s. By August 2000, information technology stocks had risen to account for one-third of the S&P 500. When that bubble burst, that sector's weighting fell to 14.3% within a year.

While many investors suffered losses when these bubbles popped, the economy soon recovered, and it will happen this time, too. There's no way to know exactly when that will occur, but the point is to remain invested and diversified. That lets you take advantage of lower prices and puts you in position to benefit when the market inevitably turns upward.

Think about which investors had the best results during past bubbles. Was it those who panicked and fled the markets after the bubble burst—or those who made short-term adjustments but stayed invested and bought more while prices were low?

We're now in a transition from a market where growth and revenue reigned supreme to an era when a strong balance sheet will be most important to investors. When the economy is shaky and the market is well off its highs, it often makes sense to turn toward solid companies in steady industry sectors, such as consumer durables, and put less emphasis on high-flying prospects.

Sure, the stock market probably will remain choppy for a while, as the economy continues to recover from the nation's house-happy hangover. But savvy investors will see the situation as just another great, post-bubble buying opportunity. ●

Bubbles That Went Bust

Sector	Boom	Bust
Energy stocks	28.2% of S&P 500 in 1980	11.6% of S&P 500 in 1985
Internet-related stocks	33.6% of S&P 500 in 2000	14.3% of S&P 500 in 2001
Financial stocks	22.3% of S&P 500 in 2006	17.2% of S&P 500 in 2008

Source: Standard & Poor's

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