THE H GROUP INC.
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

THE KELEMEN WAY
financial PERSPECTIVE

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Creators of The Planning Vision Process®

COMMENTARY BY:

Ron Kelemen, CFP®

Mary Way, CPA, CFP®

Between the Cracks—Back to the Basics

Over the past eight months, almost everyone has focused on the economy and the financial markets. Just about everything that can be said has been said. With this issue it's time to take a step back and look at some wealth management basics and some planning opportunities that have presented themselves because of changes in the law and the economic environment.

Loss Carry-Forwards

If there is a silver lining in the investment arena, this is it. An unrealized loss is a so-called "paper loss." A realized loss is an actual one where an asset is sold for less than its purchase price. Most investors have a mixture of both. You get to apply them against any gains. If you don't have enough realized gains, you can use $3,000 per return per year against your ordinary income. What is left over is carried forward indefinitely into future years until it is used up.

If you are contemplating the sale of other assets with long-term gains, such as real estate, a business, a stock or mutual fund, please let us know. In addition to your loss carry-forward, we may be able to identify certain assets with unrealized losses so that you can sell the appreciated asset with no taxable gain. This also makes portfolio changes easier without worrying about the tax consequences.

Roth IRA Conversions

A Roth IRA is an IRA where the withdrawals from it (after five years and age 59½) are tax free forever. To convert an existing IRA to a Roth IRA you pay the income taxes on the amount being converted. Since most IRA accounts have dropped in value over the past 18 months, this is an opportunity to consider converting your IRA at a time when you may have significantly less tax consequences. For 2009, your adjusted gross income (AGI) must be less than $100,000 to convert this year. In 2010, there is no income limit and the income tax bill can be spread over two years. **This is the time to start thinking about it, taking steps to minimize your AGI.** Any amount converted this year gets the five-year clock ticking so that you can start tax-free withdrawals sooner. Roth conversions aren't appropriate for everyone, so please consult with us before proceeding.

Mortgage Refinance

With mortgage rates in the 4-5% range now, it might make sense to refinance. But not always. According to a Bankrate.com survey, closing costs average $3,000. It takes a much lower interest rate and time to recoup that. And with the drop in home values, you may not have as much equity as you think. Here are some considerations:

Good Candidate for Refinancing	Probably Not Appropriate
Plan to stay in current home several years	Planning to move in 5 years or less
Have adjustable rate loan	Home equity is less than 20%
Current loan at least 1-2 points above today's market	Your mortgage balance is low, so that more of your payment is going to principal
Good credit score, 650 or more	Spouse lost a job, or your job isn't secure
Cash on hand to cover closing costs	Need to include closing costs in new loan balance
You want to switch to a shorter-term loan	You extend the length of your loan

And on a related note, some people want to accelerate their mortgage payments, even if it means taking funds out of their investment accounts. Their logic is that the financial markets aren't doing well now, so paying down a mortgage is a guaranteed rate of return. True, but you need to balance that with accumulating retirement assets. We've all seen what happens when people tie up too much of their net worth into illiquid assets. After all, can a sliding glass door buy a sack of groceries?

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(503) 371-3333
960 Liberty Street SE
Suite 210
Salem, OR 97302
www.planningvisionprocess.com

Five Safeguards to Protect Yourself Against Another Madoff

As if 2008 wasn't bad enough, the spectacular Bernard Madoff scandal and the Alan Stanford scandal are only making things worse. How can you protect yourself against these kinds of crooks?

1. Independence and Separation of Duties

Use a large <u>independent</u> custodian to hold the assets at arms length, as we do. We can only direct it to make buys and sells and to send you money. And when the custodian sends you money, it can only go to your address or to your bank account, not to us. Madoff created his own subservient custodian and brokerage company that took marching orders from his advisory firm.

Avoid proprietary investments, which are financial instruments manufactured by the advisory firm, brokerage firm, or insurance company of a financial advisor. While some of them may be very good investments, they may not pass the independence test and may have conflicts of interest. We don't use any. Period.

2. Transparency

Madoff's clients received irregular and fictitious statements that he manufactured. ***By contrast, you should receive a detailed <u>independent</u> statement every month, or at least every quarter. It should list all transactions, holdings, and the values of each.*** The data we use for our reports come from a computer download <u>from the custodian</u>. We use canned (but very expensive) software from an independent company that pension funds, mutual funds, and other institutional advisors also use. This makes it extremely difficult—if not impossible—to "cook the books."

You should receive detailed disclosures about your advisory firm and its practices when you open an account. This is called form ADV-II, which is on file with the SEC. We offer to give you an updated version every year. You can also view them at <u>www.adviserinfo.sec.gov</u>.

Finally, some investments are just more transparent than others. You pretty much know (or can learn) what you are getting with publicly traded stocks, bonds, and mutual funds. You can view audited statements prepared by large reputable accounting firms each year. You generally can't with hedge funds and private equity funds, which we don't use.

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Special Opportunities with Special Trusts

Grantor Retained Annuity Trusts (GRATs)

We have recommended GRATs to our clients over the years, but with today's low interest rates and low asset values we have never seen this strategy so attractive. A GRAT is a great way to give appreciating assets to your heirs without incurring a lot of gift or estate taxes, while retaining an income on the asset for a specified period, say, 10 years.

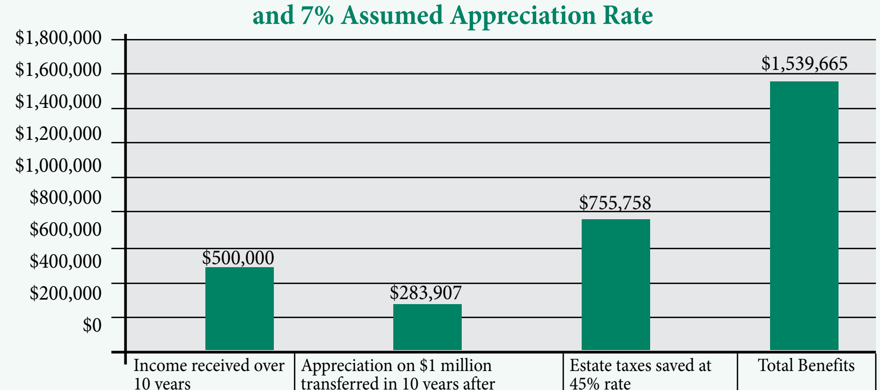
How does it work? Let's say you want to transfer a $1 million business interest, real property, or portfolio. Your estate planning attorney creates the trust and you transfer in the $1 million asset. Without a GRAT, that could potentially be a $1 million taxable gift. But with a GRAT, you retain an income interest of, say, 5% per year for a number of years. The IRS Section 2702 tables calculate the value of your retained interest using the "Applicable Federal Mid-Term 120% Rates" (AFR). The lower the interest rate, the lower your retained interest and taxable gift amount. In 1998, the AFR was 10%. Today it is a near-record low 2.47%. So to make this work, all the asset needs to do is appreciate faster than 2.47%.

Qualified Personal Residence Trusts (QPRTs) are similar, but they involve a personal residence or recreation property. This is a good way of reducing the size of your taxable estate while keeping a legacy property for your heirs. Instead of annuity payments, you retain the right to live in the residence, even after the term of years has expired. (At that time, you would pay rent to the heirs you transferred it to, but this is also another way of reducing the size of your taxable estate.)

Charitable Lead Annuity Trusts (CLATs) are also attractive at this time, especially for sheltering a high income tax year. (Maybe this strategy is only appropriate for "repo-men" this year!) With a CLAT, the annual payments go to charity, rather than to you. Each year, some of the assets are sold to make the annuity payments. But with a combination of assets with unrealized gains and losses, this is a highly efficient tax strategy this year. At the end of the term, the remaining amount goes back to you or your family.

We've only scratched the surface on the technicalities on each of these trusts. We can explain them in more detail and with customized illustrations if you think one of them may be appropriate for you.

Benefits of 10 Year 5% GRAT at 2.4% AFR and 7% Assumed Appreciation Rate



Source: Brentmark Software

New Limits and Opportunities of Interest

Social Security

The full retirement age (FRA) is 66 for those born between 1943 and 1954. The maximum benefit at FRA is $2,323. If you retire before your FRA, you may earn $14,160 before you forfeit $1 of benefits for every $2 earned over the limit. The limit for those reaching 66 this year is $37,680 before $1 is withheld for every $3 earned. **So, if you are 62 to 65, and planning to keep working, think twice about starting Social Security early.** In addition to this reduction, you'll also get a monthly payment that could be reduced by as much as 30%.

For those paying into the system, the combined employee and employer tax is 12.4% on amounts below $106,800 in earnings ($4,800 more than in 2008). The combined Medicare tax is 2.9% on all earned income.

Capital Gains and Dividend Taxes

The Federal tax on long-term capital gains and qualifying dividends is 0% for those in the 10% and 15% marginal tax brackets. For the higher brackets the tax remains at 15 % on most assets.

Estate Taxes

The annual gift tax exemption rises to $13,000 this year. Married couples may give $26,000 per beneficiary. The estate tax exemption rises to $3,500,000 per person, up from $2,000,000 last year. The gift tax exemption remains at $1,000,000. The top estate tax remains at 45%.

Education Tax Credits

The so-called **Stimulus Bill** signed into law on February 17 has many provisions, ranging from a home-buyer tax credit, AMT relief, COBRA health insurance assistance, energy tax credits, and much more. But one item affects a broad number of our clients for 2009-2010—**The American Opportunity Tax Credit** which temporarily replaces the Hope credit in 2009 and 2010. The amount of this new education tax credit is 100% of the first $2,000, plus 25% of the next $2,000 spent each year on tuition, fees, and course materials, for a maximum credit of $2,500. It applies to all four years of college. More people are now eligible, with singles at $80,000-$90,000 and married couples with $160,000 to $180,000 of Modified Adjusted Gross Income (MAGI).

Sources: IRS.gov; SocialSecurity.gov; Horsesmouth.com

Systematic Investing—When a Flat or Decreasing Market Can Be a Good Thing

We have numerous clients who invest in a systematic basis every month or quarter. They do it with contributions to their retirement plans (such as a 401-k) or from excess cash flow into taxable accounts. Some of them have wondered why they should keep doing this when they keep seeing the stock market and their account values decline.

If you are investing on a regular basis you should actually want the stock market to go down and stay down for awhile. Why? **Your objective is to accumulate as many shares as possible of stocks or mutual funds. When share prices of stocks or mutual funds go down, the same dollar amount invested each month buys more shares at lower prices per share.** Sooner or later the markets will turn around, and when they do, you will have more shares participating in the market appreciation.

You can also dollar cost average with automatic reinvestment of dividends. This strategy doesn't always work for investors with short time horizons in protracted down markets, but it can be an effective way to accumulate long term capital. It takes the emotion and second-guessing out of the equation. And investing today is certainly a better bargain than it was a year ago.

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The Team Advantage™

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 42 years of combined experience. They are members of The National Association of Financial Advisors (NAPFA), and as such work on a fee-only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over $400 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of three financial planning reference books. *Medical Economics* continues to list him as one of the 150 best financial advisors for doctors. He is President of the Rotary Club of Salem, chair of the Willamette Academy Advisory Board, and immediate past president of the Medical Foundation of Marion and Polk Counties. Ron is frequently quoted in the national press and professional journals.

About Mary Way, CPA, CFP®

Mary Way, CPA, CFP® joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She sits on the Investment Policy Committee of The H Group, Inc., is Vice President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation. She is also active in the Financial Planning Section of the Oregon Society of CPAs.

TEAM UPDATE

Much has happened since early March, most of it good. The financial markets tested new lows then came roaring back to their early January levels. Let's hope this holds! And the tough times help people realize that maybe they need professional help. So we've seen a nice increase of new financial planning and investment management clients.

The big team news is that after four years and a lot of professional growth with us, **Alex** took a position with a firm in Portland. Although Alex's valuable contributions and good sense of humor will be missed, he and wife Virginia have wanted to live in Portland almost since his first day with us. We wish them well. Until we reevaluate our needs and select a very highly qualified and credentialed replacement, feel free to ask for any one of us.

When asked about her activities for this section of the newsletter, **Lani** said, "It seems like I've spent the past two months either in the dental chair or on the chiropractor's table. And I've diversified into gold, in the form of crowns." Ouch!

Debbie helped get us through the extra reports, cash requests and retirement plan deposits of tax season. She's now relaxing in Kauai. As spring and summer approach, her spare time is spent helping husband Bob with his part-time wedding business.

Mary finished her Italian lessons and her work on the Rotary District Conference Committee, which was a huge success in Salem. She and husband Steve traveled to Minnesota to see his daughter's senior recital at St. Olaf College. The H1N1 Influenza (Swine Flu) situation has her pending vacation plans to Mexico on hold.

Ron's nose has been to the grindstone with our numerous client communications, and with his Rotary presidency, which is ending soon. The NAPFA Advisor magazine quoted him extensively about using mind mapping software for client problem solving and practice management. He's working on a mid-May presentation to the Central Oregon Estate Planning Council, sharing the program with Bill Gates, Sr. Ron and Kathy's new residential condo completion is finally moving along quickly. They hope to move Memorial Day weekend, but the operative word is hope.

Systematic Investing . . . continued from page 3

And speaking of systematic investing, here are the 2009 limits on contributions to retirement plans. If you are 50 and older you could voluntarily invest as much as $22,000 or $1,833 per month through an employer's 401(k) plan.

RETIREMENT PLAN CONTRIBUTION LIMITS	
Defined contribution plans	$49,000
401(k), 403(b), 457(b) elective deferrals	$16,500
Catch up limits for those age 50 or more	$5,500
SIMPLE plans elective deferral limit	$11,500
SIMPLE plans catch-up for those age 50 or more	$2,500
Traditional and Roth IRAs	$5,000
IRA catch-up amounts for those age 50 or more	$1,000

Source: IRS.gov

THE H GROUP, INC.
Independent Wealth Management Solutions
Ron Kelemen, CFP®
Mary Way, CFP®, CPA
Alex Sheppard, MBA, CFP®
The Kelemen, Way & Sheppard Financial Perspective
960 Liberty Street SE, Suite #210 • Salem, OR 97302
ADDRESS SERVICE REQUESTED

Five Safeguards . . . continued from page 2

3. Due Diligence

Madoff's and Sanford's scams did not pass the "sniff test" or due diligence of many endowments and advisors. **They diversified and followed a very strict investment selection process. You should do likewise by understanding your advisor's investment strategy and due diligence process before you sign on.** Ask questions—we really like well-informed clients. Many Madoff investors reported that they didn't ask questions. They were fearful that he would expel them from the fund. As long as the investment returns came in every quarter they adopted a "don't ask, don't tell" mentality.

4. Diversify

Some of Madoff's victims (including some hedge funds) invested their entire portfolio in one of his proprietary non-transparent funds. **There is a big difference between investing <u>with</u> one investment advisor and investing in only one <u>investment</u> offered exclusively by your advisor. Our clients use us to help them diversify into many transparent investments across different asset classes.**

5. Your Common Sense

This is the most important safeguard of all. **Many of Madoff's and Sanford's victims had one thing in common: greed blinded their common sense.** (Although some wanted to be a Madoff client more for the social status.) Madoff's promises really were too good to be true. High double-digit returns year in, year out simply are neither possible nor sustainable. As we have said many times before, nothing goes up forever, nor stays down forever. If your returns are very good in a down market, you had better go back to Step #3 and ask questions. **You should engage a financial advisor not only for investment advice, but also to help you manage risk.**