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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, over emphasizing them could carry a high cost in terms of lost opportunities and potential 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 had come to make up a disproportionate share of those investors' 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 14,164.53 on Oct. 9, 2007, fell to below 11,745 by March 10, 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 whopping 28.2% weighting by 1980—and then plunged to 11.6% in 1985. That rise and fall was mirrored by the boom and bust of

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Let's Get Ready For 2009

Is tax planning on your mind? This is a good time to look at your investment holdings for candidates for repositioning.

This is a unique year in that those in the 10% or 15% federal income tax bracket are able to take advantage of a 0% (yes, that is a zero) federal long-term capital gains rate. Those in higher tax brackets are generally subject to a 15% federal long-term capital gains rate. Of course, there may be state capital gains taxes to consider depending on where you live and work. Since we may see different—read higher—federal tax rates in 2009, let's talk soon.

Another income tax reducing strategy to consider involves pre-tax contributions to retirement plans and IRAs. These accounts grow tax-deferred until money is withdrawn in retirement. While contributions to Roth IRAs offer no current tax deduction, these accounts grow tax-deferred and are not taxed when money is withdrawn in retirement. Also, Roth IRAs have no mandatory withdrawals at age 70 ½.

Let us team with your tax preparer or accountant to help you keep more of the money you've made in 2008.

On a slightly different note, thanks to you and your generous referrals, our business continues to grow in this difficult market environment. We wouldn't be here if it weren't for our clients. Thank you!

Judy

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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

Five Financial Ideas For Grandparents

Spoiling your grandchildren with extravagant gifts may be fun, but you're not really doing them—or yourself—any favors. Instead, it may be wise to look for ways that help your grandchildren but that also make financial sense for all of you.

Your experience handling money matters is one invaluable gift you can pass along. Sharing your savvy not only helps grandchildren develop healthy financial habits but also to understand family and cultural values. So tell them about your first job, how you started a business, and financial goofs you've made, such as spending too much or getting suckered into bad investments. "There's a big legacy gap," says Nathan Dungan, author of *Prodigal Sons and Material Girls: How Not to Be Your Child's ATM.* "Grandparents aren't having these conversations with the grandchildren."

But don't leave your own children out of the loop. Make sure your advice and giving strategies don't conflict with their plans or guidance for your grandchildren. Here are several ways you might help:

Leverage your gifts. A grandparent can now give as much as $12,000 a year tax-free to each child and grandchild. If you have a large family and make such gifts for several years, you could substantially reduce your taxable estate. But rather than simply putting cash in the grandchildren's pockets, consider creative alternatives. For example, you might open a custodial savings account for a grandson and match what he saves. Or you could establish a brokerage account and use your contributions to help your grand-daughter learn about investing. But stick to broad mutual funds rather than individual stocks. Choosing the wrong stock could lead to deep losses and discourage your would-be Warren Buffett.

Take care of college. Setting up a state-sponsored 529 college savings plan for your grandchild brings benefits for both of you. Start early and kick in the annual gift-tax-free maximum, and your grandson or granddaughter should be in fine shape when tuition comes due. Money in 529 plans grows tax free and withdrawals for qualified college expenses aren't taxed, either. And, if you want to accelerate giving, you can make five years' gifts—a maximum of $60,000—all at once. Moreover, because you control the plan, you don't have to worry about a spendthrift scion squandering the money. And, if you didn't get around to starting a 529? Consider sending a tuition check directly to your grandchild's college. It won't count against your $12,000 annual gift-tax exemption.

Put a roof over their heads. First-time homebuyers often earn enough to qualify for a mortgage but lack cash for a down payment and closing costs. Your gift could make up the shortfall. But there are other options, too. You could make a low-interest or interest-free loan, though that may raise complicated tax issues. Or, if qualifying for a home loan is a problem for your grandchildren, you could co-sign a mortgage. Some financial companies offer programs allowing grandparents to pledge securities as collateral for a grandchild's mortgage, so you can lend a helping hand without the expense and tax implications of liquidating personal holdings.

Guide with your gifts. One alternative to direct giving is to fund one or more types of trusts, which can be customized to fit many financial and personal situations. An incentive trust, for example, could be instructed to distribute funds to your grandchildren in installments at specified points in their lives and may tie payouts to your grandchild's accomplishments—reaching a certain income level, for example, or getting a college or graduate degree. But tread carefully, warns Dungan. "You need to help a grandchild develop healthy financial habits before trust distributions start," he says. And be careful about the kinds of hurdles you set up. "You want your grandchildren to be connected to their life passions, not yours, so don't strive for too much control," he suggests.

Encourage philanthropy. There are several options for helping your grandchildren learn the value of charitable giving, and many of these vehicles also offer estate tax advantages. For example, you could transfer assets from your estate into your own family foundation; though to be effective, a family foundation needs an initial commitment of as much as $1 million. Your grandkids could get involved by helping screen grant applications or serving on the foundation's board. A less expensive alternative is a donor-advised fund, which also lets grandparents and grandchildren confer about what charities to support. "This is like having your own foundation to support causes you believe in, but without the hassles and paperwork that go along with operating one," Dungan says. ●

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. ●

Will The Gloom Subside?

(Continued from page 1)

technology shares in the late 1990s. The high point came in August 2000, when information technology stocks accounted for a full one-third of the S&P 500. Then that bubble also burst, and the weighting for those stocks plummeted to 14.3% by September 2001.

While many investors suffered losses when those 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 in which growth and revenues reigned supreme to a time during which investors are most impressed by a strong balance sheet. 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, while putting 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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