Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

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When Times Are So Scary, Opportunities Emerge

As the nation struggles through a severe financial crisis, you're undoubtedly worried about your financial security and the safety of your nest egg. But this is no time to sell stocks or make wholesale changes to a well-balanced portfolio that is aligned with your goals and investment time horizon.

Remember that short-term volatility isn't a big worry when you are invested for the long term. And though stocks have underperformed bonds during recent years, over many decades equity investments have almost always come out on top.

Even if the nation is in a recession, there is a lot in the economy that is doing pretty well. Unemployment, though rising, hasn't exploded, interest rates are still low, and inflation remains under control despite higher energy and food prices. The economy is resilient and the federal government is taking steps to get past the credit crunch.

As for stock prices, much of today's and tomorrow's bad news already has been factored into the market. Selling stocks or mutual funds after a decline simply means getting out at a low point. Nervously entering and exiting the market heightens your risks and lowers your returns.

So what should you do? Stay the course and remain diversified, but ask your advisor about adjusting your portfolio to take advantage of investments more likely to produce solid returns during a bear market. Here are several potential opportunities:

- Before their recent declines, global growth trends had sent commodity prices soaring for energy, agricultural products, and precious metals. Now, lower prices can give volatility-tolerant investors a good entry point for gains once the economy stabilizes. Commodities can also serve as a hedge against inflation.
- Yields on Treasuries dropped as shell-shocked investors fled to the safety of government bonds. But the market fallout should reiterate the importance of broad portfolio diversification—and that includes low-yielding treasuries. Allocation back into stocks and corporate bonds, while prices are low is also important.
- Though not quite as safe as Treasuries, municipal bond funds can deliver income that's not subject to federal and, sometimes, state income taxes. Muni prices have fallen and yields have risen, in some cases nearing the yields of corporate bonds even before figuring in the munis' tax advantage. But tread with caution: there are concerns about the worsening financial health of local and state governments, along with municipal bonds' lack of liquidity.
- Yields on corporate bonds, too, may be attractive today, when companies must offer higher rates in order to get the financing they need. Though default risks are also high, taking well-considered risks can improve potential returns.

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The Stock Market Will Come Roaring BackTo Life!

Warren Buffett, the word's richest man, editorialized in the October 17 edition of the *New York Times* as follows: "Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month—or a year—from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before sentiment or the economy turns up. So if you wait for the robins, spring will be over."

Warren's point is clear: Do not panic but rather, continue to buy. And as you rebalance your portfolio, equities need to be the asset class purchased, because they have fallen the most.

Remember, conversions to a Roth IRA or a College Savings Iowa contribution also need to be completed by December 31. You may even transfer funds online at College Savings Iowa to beat the deadline.

We can also assist in any pension, IRA rollover, or required minimum distribution you may need to accomplish before year-end.

Please note: Our offices will be closed November 27 and 28 for Thanksgiving and December 25 and 26 for the Christmas holiday.

We thank you very much for your continued patronage and referrals and want to wish all of you a happy and healthy holiday season, as well as a prosperous New Year!

Steven L. Kane, CPA/PFS, CFP®

Five Year-End Moves To Cut Personal Tax

As the year draws to a close, there's still plenty you can do to reduce your personal tax liability for 2008. Consider these possibilities.

Manage your capital gains and losses. Losses realized on your investments can be used to offset capital gains (taxed for most people at 15%), and if you have more losses than gains, you can deduct up to an additional $3,000 against your ordinary income and carry forward to future tax years losses that exceed those limits. But resist the temptation to sell depressed holdings just to generate tax losses. One useful tactic is to sell a losing holding and move the money to another stock or fund in a similar sector or with a similar objective. That way you can harvest a tax loss but still keep your investment plan in place.

Avoid the kiddie tax. For taxpayers in the 10% and 15% brackets (your children, for example), 2008 brings the tantalizing prospect of a 0% rate on capital gains (instead of the usual 5%). But for 2008, investment income above $1,800 received by a child under age 19, or a child in school under age 24, is generally taxed at the parents' top rate (as high as 35%). This "kiddie tax" could make it counterproductive to give your kids appreciated investments to take advantage of their lower gains rate.

Minimize exposure to the AMT. Staying clear of the alternative minimum tax is more art than science, but in some cases year-end moves could make a difference. The AMT is a parallel tax system that excludes many items you could normally deduct, and exercising incentive stock options or taking large tax credits or deductions that aren't allowed under the AMT could make you subject to the tax. If your accountant thinks you're likely to pay the AMT, you may want to minimize those deductions and credits or try to defer them to the following year.

Get credit for your charitable donations. You can generally deduct the full amount of monetary gifts to charity, including donations made by check or credit card. But the tax law imposes stringent record-keeping requirements, and for each deduction, you'll need a receipt or other written communication from the nonprofit showing how much you gave and when. To beat the end-of-year deadline, you can charge a gift with your credit card in December even if you don't pay the bill until January or later.

Estimate whether you can deduct medical expenses. Doctor bills, prescription costs, and other expenses are deductible only to the extent the annual total exceeds 7.5% of your adjusted gross income. If you're at or near the 7.5% mark for 2008, you could schedule routine exams or other elective expenses in December to put you over the top. But if you have no shot at a deduction this year, you may as well postpone these expenses to January and try again next year. ●

Getting Old Is A Part Of Life You Can Plan For

For a couple, aging together can be wonderful, with each spouse looking out for the other. But once you reach your sixties, it's important to plan for what will happen if one of you should pass on before the other. Each spouse needs to know how the other feels about the use of life support, and older couples should consider creating a living will. This may be complemented by a durable power of attorney regarding all health care decisions. A lifetime of savings can be depleted in a matter of months if an elderly couple doesn't address this issue.

It's not enough simply to say to your spouse, "Do not revive me if I become very ill." This is a subject you need to discuss in considerably more detail, preferably with the help of your family physician and attorney. They should be able to provide a form for use as a living will.

Consider making your religious leader part of this dialogue as well. He or she can guide you through in-depth conversations in which you address important questions. For instance, do you want to remain alive with the help of feeding tubes? That's frequently an issue after a serious stroke, which can leave a patient bedridden indefinitely. Making well-considered plans about such things now will help your spouse make difficult decisions when the time comes.

Once you've completed your living wills, it may be wise to tell your children and other family members. Their support will be important when times get tough.

For spouses determined to ease the way for a surviving husband or wife, taking care of funeral arrangements also makes sense.

Fed's Unusual Moves In Credit Crisis

During the crisis of the nation's financial services industry, the Federal Reserve took several unprecedented steps to prevent an economic collapse. One of its most radical moves was to start accepting stock as collateral for the first time in its 95-year history.

Previously, only investment-grade securities were accepted as collateral under the Fed's six-month-old Primary Dealer Credit Facility, which lends money to securities firms. That limited the Fed's risk. But now, in order to provide the 15 or so companies eligible for the program—including Deutsche Bank, Goldman Sachs, Morgan Stanley, and UBS, among others—more access to capital, it's allowing them to use something they have plenty of—their own shares—to get the funds they need to stay solvent. The new policy also enables the firms to keep their holdings of U.S. Treasury securities, which strengthen their balance sheets. But if one of the borrowing companies later fails, the Fed might find itself holding the bag. "The Fed is taking on a lot of risk," says Edward J. Deak, professor of economics at Fairfield University in Connecticut. "This stock may not be worth very much."

Deak says that while the government must do what it can to provide liquidity for the financial system, loading its balance sheet with assets of dubious value may not provide that much help. "The problem is that the game is shifting from a market that needs liquidity to one that needs capital," Deak says. "Financial firms need investors, not lenders. This is a stopgap measure that keeps the companies going until they can either right their houses or liquidate themselves in an orderly fashion. You don't want to raise the Titanic and try to fix it: You want to try and keep it afloat."

Federal Reserve Chairman Ben Bernanke, a student of financial manias and crises, seems determined to avoid the mistakes of the past, and the decision to accept stock as collateral is only the latest of an unprecedented series of Fed actions. Earlier, the U.S. central bank had begun lending to investment banks as well as commercial banks, and it allowed financial institutions to swap illiquid mortgage-backed securities for Treasury securities, both for the first time.

On the same day the Fed started accepting equities as collateral, it also boosted the total amount of its Treasury securities lending program for bond dealers to $200 billion from $175 billion. The Fed also loosened the rules for loans between commercial banks and their brokerage affiliates.

"Bernanke understands the problems of the Great Depression and the failure to take extraordinary measures at that time," Deak says. "Now, with the global financial system so shaky, you can't afford to have the key players go belly up. You have no idea how much wealth would be lost." Still, Deak believes it's time for the government to overhaul the structure of the nation's financial system. "We need to rethink the level of regulation, the level of transparency, and the level of complexity," he says.

In the meantime, most of the Fed's moves have the same ultimate goal: easing the global credit crunch. After the subprime mortgage crisis drastically cut the value of mortgage-backed securities, leading to huge losses and the failure of several investment banks, financial institutions at every level began hoarding cash, unwilling to lend even to creditworthy businesses and consumers. With many fewer loans being made, companies have found it difficult to fund operations, putting earnings and jobs at risk and potentially deepening the economic downturn.

As the Fed made its moves, the U.S. Treasury Department helped organize a $70 billion loan fund involving 10 major financial firms, including JPMorgan Chase, Goldman Sachs, Citigroup, Bank of America, Barclays, Morgan Stanley, and others. Any member of the consortium can borrow up to a third of the fund. "These initiatives will be critical to facilitating liquid, smooth-functioning markets, and addressing potential concerns in the credit markets," said Treasury Secretary Henry Paulson.

All of these actions are expected to function as a prelude to increased government regulation of the financial industry. Frederic S. Mishkin, a member of the Federal Reserve Board of Governors, said the Fed plans to beef up regulation with stricter capital and liquidity rules, more disclosure requirements, and closer supervision of risk management. ●

Establish whether you want to be buried or cremated, and write down details about your funeral or memorial service. Dealing with such issues is much easier while you are still in good health.

Consider, too, what kind of social infrastructure will be there for a surviving spouse. A couple that is active in their community will have friends to help whichever of them outlives the other. Having a support group in place, whether through your house of worship, volunteer activities, or a hobby, will be a tremendous benefit as well.

Similarly, a couple should develop a network of trusted advisors to assist the surviving spouse. It's common for a husband to handle all of a couple's financial matters, and a husband is statistically more likely to die before his wife. This often forces a widow to make financial decisions she has never made before. Having a financial advisor, attorney, and accountant lined up to help is only prudent.

If you want to deal with all of these issues systematically, you may want to consider hiring a geriatric care manager, a new kind of professional who crosses over the lines between social work and medicine. For a referral, please call our office. ●

Year-End Tax Planning: Strictly Business

Most advice about year-end tax planning involves strategies for cutting personal taxes. But there are many moves that businesses, too, can make to reduce tax bills. Here are five possibilities that might work for your company.

Section 179 deductions. Under Section 179 of the tax code, a business can deduct, or "expense," the full cost of tangible assets (new or used) placed in service during the year. In 2008, thanks to a new law intended to boost economic activity, the maximum deduction has been increased to $250,000 (twice the 2007 limit of $125,000), provided that total purchases don't exceed $800,000. (For each dollar above that ceiling, your deduction is reduced by a dollar.) Just be sure to get any equipment up and running before January 1, 2009.

Bonus depreciation. The Economic Stimulus Act, which became law last February, also lets businesses claim a 50% "bonus depreciation" deduction for new (not used) business equipment bought and placed in service during 2008. You can also take a normal depreciation deduction for the remaining value of the equipment, and may be able to combine this with Section 179 deductions. Qualified assets must be deductible under the Modified Accelerated Cost Recovery System (MACRS) and have a depreciation recovery period of 20 years or less. Specified water utilities, computer software, and leasehold improvements also qualify. For some property with a depreciation period of 10 years or longer, the deadline for placing into service is December 31, 2009.

Bad business debts. If your business uses the accrual method of accounting and you're having trouble collecting from customers this year, you may be able to take some consolation by writing off the debts. The IRS lets you deduct unpaid bills during the year they become totally worthless, so consider stepping up collection efforts before the end of the year. You could send a series of dunning letters and follow up with phone calls and emails. Or you might hire a collection agency. Keep detailed records of all your activities.

Travel and entertainment. The tax law generally allows you to deduct 100% of travel expenses when you're away from home on business and 50% of business-related meals and entertainment. This can be especially helpful during the final months of the year, when you may meet with clients to plan for 2009 or take them out to thank them for their business. You could also host a holiday party for your staff and deduct 100% of the cost as long as everyone is invited.

Business supplies. Finally, don't forget you can deduct the cost of supplies for the office, ranging from paper clips to laser printer cartridges. Stock up on routine supplies you'll need soon anyway to increase your deduction this year. The cost is deductible on your company's 2008 return even if you charge it and pay the bill in 2009. ●

Opportunities Emerge

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- With the Federal Reserve likely to keep interest rates low, inflation could continue to be a concern, and Treasury Inflation-Protected Securities, or TIPS, can help insulate you against that risk. TIPS' principal increases in step with rises in the Consumer Price Index, and at maturity the buyer receives either the adjusted principal or the original principal, whichever is greater.

- Domestic stocks began their fall before international stocks and could be first to recover. Also, as overseas economies weaken, the dollar may resume its recent climb, reducing the value of foreign holdings for U.S. investors.
- European bonds may be a good bet as European countries drop interest rates in order to boost ailing economies. Declining interest rates favor bond holders.
- U.S. small-cap stocks may be preferable to large-caps because larger, multinational companies tend to have more exposure to international financial woes. Also, small caps tend to rebound first after a recession.
- Investing in surviving financial services firms might be worth considering, though only for those who can tolerate risk in a sector undergoing profound, unpredictable changes, and who have an advisor that has studied this sector significantly. ●

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