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Often Wrong, But Never in Doubt A Review of 2010 Predictions

by Mike Palmer, CFP®

As we close the book on another year, it offers folks the proverbial “clean slate” with which to try and adopt better habits for the coming year. For me, the close of the year offers a chance to look back at stock forecasts and market predictions. While the mainstream financial publications aren’t shy about trumpeting headlines of the “Top Stock Picks for 2010,” rarely do they give equal billing to a post-mortem of how those predictions fared. Given our firm’s belief that market forecasting is a detriment to long-term investor success, we offer the following recap of some of the “best” 2010 predictions.

February Smart Money “Award Winning Funds”

The article picked several top funds in various categories, including “balanced funds.” Their selection in the Large Cap Equity category was Yacktman Fund (YACKX). Year-to-date through December 27 the fund returned 12.5% v. S&P 500 benchmark return of 15%. In the International Equity category their winner was Scout International (UMBWX) which returned 12% versus the MSCI World index which returned 15%. The only “winner” Smart Money picked was in the Real Estate category where Cohen Steers Realty Fund returned 26% versus benchmark return of 11% for the Dow Jones Select REIT Index. (The DFA Real Estate fund TCTS uses with clients returned 25% over the same period.)

Fortune December 21, 2009, “Ten Strong Stock Picks for 2010”

Here are the 2010 returns for each stock:

Amedisys (AMED)	-34%	Qualcomm (QCOM)	8%
American Tower (AMT)	17%	Quanta (PWR)	-5%
Baxter Int’l (BAX)	-13%	Renhe (RNHEF)	27%
Mastercard (MA)	-12%	Salesforce (CRM)	80%
Petrohawk Energy (HK)	-24%	Vornado (VNO)	19%



NOTABLE QUOTE

“There’s no chance that the iPhone is going to get any significant market share. No chance.”

– Steve Ballmer, CEO
Forum April 29, 2007

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Predictions, Resolutions and Gratitude

by Mitchell Paul, CPA

It seems that everywhere you turn in the final weeks of December someone's making a prediction about something for 2011. I ran across an investment "guru" who predicts "Apple (Apple Inc.) becomes *uncool* in 2011". I'll ask my three children about that – assuming they can break away from their many Apple devices to respond.

Rather than focus on trying to predict what is fundamentally unknowable (the future), let's take a quick look at the past and simply think rationally about the future. The Economist recently published a chart showing the growth of US Gross Domestic Product (GDP) in real (after inflation) terms. From 1870 to 2009, US per capita GDP grew from \$3,500 to \$45,000 in real, inflation-adjusted terms. Despite doom and gloom headlines, the US continues to be the world's largest industrial manufacturer, producing more than Japan and China *combined*. We produce this wealth with 1/5 the population of those two countries. For some reason, human nature seems to gravitate toward pessimism. It is hard to rationally believe our best days are behind us, when the facts so clearly demonstrate the contrary; remember this with gratitude and optimism.

Against this backdrop what should investors be asking themselves? We would contend it isn't which stock fund or asset class is likely to be the top performer in the coming year. As I become older and more "experienced," I realize that my sphere of influence is very small. This can be sobering or liberating depending

on how one chooses to view it. I, therefore, resolve to spend less time and mental energy over those areas I cannot influence (such as the equity markets) and more focus on those areas I can influence in a positive way. And by so doing, better prepare my family for the uncertainties and vagaries that are a part of life.

In our meetings with clients we ask them to consider the following:

- Is my portfolio positioned to meet long-term goals?
- Will my wealth provide the cash flow that I will ultimately need?
- Will I be able to gift as I desire to family members or charity?
- What loose ends do I still need to resolve? What areas do I need to revisit?

The answers will vary, but by putting the focus on somewhat more controllable planning-related issues we accomplish two things: we find clients are more secure about progress toward their goals (making them less emotionally reactive during periods of market turbulence) and they become grateful for their good fortune. Turning one's outlook from negative (fixing a poor situation) to positive (seeing progress toward goals) is frequently the result of our client meetings.

We hope you'll take some time in the New Year to enjoy the peace of mind that comes from an attitude of gratitude.



We're Moving!

Effective January 24 our office in Raleigh will move four blocks north to 3600 Glenwood Avenue, Suite 210, Raleigh, NC 27612. Our phone and fax numbers remain the same. We look forward to having you visit us at our new office!

Tax Clarity?

by John Slayton, CFP®

With the signing of *The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (TRA 2010)* into law by President Obama on December 17, 2010, we all received a Christmas present in the form of two years of tax planning certainty. The Bush income tax provisions remain in place as they have been and require little comment. The continuation of the 15% long-term capital gain tax rate should eliminate the need for realizing capital gains before 2011. We will focus, instead, on the new estate tax provisions. The two-year effective period of the *TRA 2010* has provided us a brief window of extraordinary wealth transfer planning opportunities.

First, the estate tax exemption has been raised to \$5 million for every individual (\$10 million per married couple) and the maximum estate tax rate is 35%. Under previous rules, if one spouse did not own enough assets titled in his/her name at death, their exemption amount might have been wasted, as the surviving spouse could not use any unused portion. The new law permits “portability” of the exemption, allowing for the full use of both exemptions for a married couple no matter who owns the assets at death. The surviving spouse can utilize whatever exemption is not used by the first spouse to die. At least for the next two years, this provision should cure common estate planning busts in the titling of assets and alleviate some of the need for traditional bypass trust structures. The ability to pass on \$10 million free of estate taxes through portability should result in more than 99% of the estates in America remaining untaxed. The \$5 million individual exemption number was heatedly debated and may be decreased after two years, particularly in light of the increasing budget deficits. A chart summarizing the complex estate, GST and gift exclusions and rates follows:

Year	Applicable Exclusion Amount	GSTT Exemption	Gift Tax Exclusion Amount	Maximum Tax Rate	
				Estate/GST	Gift
2009	\$3,500,000	\$3,500,000	\$1,000,000	45%	45%
2010 ¹	\$5,000,000	\$5,000,000	\$1,000,000	35% ²	35%
2011	\$5,000,000	\$5,000,000	\$5,000,000	34%	35%
2012	\$5,000,000	\$5,000,000	\$5,000,000	35%	35%
2013	\$1,500,000	\$1,000,000	\$1,000,000	35%	55%

¹ and ² See discussion above for special options regarding 2010 decedents.

During 2010, we had no estate tax, but we also had carryover basis instead of stepped-up basis of appreciated inherited assets for income tax purposes. *TRA 2010* allows the executor of an estate for a decedent who died in 2010 to choose between two roads of administering the estate. The automatic road subjects the estate to the new 35% estate tax, with a \$5 million exemption and a stepped-up income tax basis for inherited appreciated assets. The alternative, by election of the executor, would apply the 2010 rules of no estate tax, but with appreciated assets receiving only a limited step-up in basis. The 2010 estate tax rules basically swapped capital gains tax on inherited appreciated assets for no estate tax. Clearly, estates under \$5 million should opt for the first road, with a \$5 million exemption and stepped-up basis. Large estates will require additional consideration.

Next, under prior law, an individual could make lifetime gifts of up to \$1 million without paying gift taxes, in addition to annual exclusion gifts (currently \$13,000 per person). Even when the estate exemption rose to \$3.5 million, the lifetime gifting amount was frozen at \$1 million. With *TRA 2010*, the “Unified Credit” is re-united for gift and generation skipping tax (“GST”) and, for the next two years, an individual can transfer up to \$5 million without incurring any gift tax. Conditions for gifting have never been better in modern times. Under *TRA 2010*, we have a \$5 million unified estate, gift and GST tax exemption and a 35% combined estate, gift and GST tax rate. Add to that historically low federal interest rates, relatively low asset values after the recent recession and no legislation at this time

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A portfolio equally-weighted with the Fortune picks would have returned 1% versus the S&P 500 return of 15%.

Kiplinger's Personal Finance January 2010, "Eight Great Stocks for 2010"

Kiplinger's did only modestly better than Fortune:

United Parcel (UPS)	15%
Paychex (PAYX)	0%
Kimberly-Clark (KMB)	-1%
Pepsi (PEP)	7%
Western Union (WU)	-2%
Sysco (SYY)	4%
Broadridge (BR)	-4%
Chevron (CVX)	18%

A portfolio equally-weighted with the Kiplinger picks would have returned 4.5%, again falling short of the S&P 500 return of 15%.

If one of your New Year's resolutions is to get your financial house in order, we'd advise caution in following an investment strategy outlined in one of the personal finance magazines. A recent report by Standard & Poors (S&P Persistence Scorecard November 2010) outlines the difficulty in trying to pick "winners" from past performance. "Very few funds have managed to consistently repeat top-half or top-quartile performance. Less than 5% of funds maintained top half ranking over five consecutive 12-month periods. Expectations of a random outcome would suggest 6%." It would seem that picking mutual fund winners is, as Samuel Johnson might say, the triumph of hope over experience.

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restricting the use of discount gifting structures (such as grantor retained annuity trusts ("GRATs")) and/or valuation discounts on gifts of family controlled partnerships. Gifting during the next two years should be seriously considered, as lifetime gifting removes the assets and all future growth from the estate of the giver. Regardless of how the rules are changed after the two-year term of *TRA 2010*, it is unlikely that tax treatment of gifts during the two years can be reversed. We are available to help you consider the advisability of various gifting strategies.

Third, the IRA charitable rollover is renewed, much to the relief of non-profit organizations. The ability to transfer up to \$100,000 directly to charity for those over 70 1/2 is renewed for two years. For those who are charitably inclined, making direct rollovers of IRA assets makes sense, because it eliminates both the income and estate taxes on the assets, and it satisfies the annual Required Minimum Distribution ("RMD") for those who do not need the additional income resulting from RMDs. As a bonus, IRA owners can make the IRA charitable rollover in January 2011 and still count it on their 2010 tax returns and 2010 RMD.

Throughout 2010, we have puzzled over what tax treatment would be in place in 2011 and thereafter. Long term planning was not possible because we had no certainty regarding either income or estate taxes. *TRA 2010* provides at least two years of planning certainty and represents a welcome achievement of the recent lame duck legislative session. Feel free to contact us with any questions.



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