



Will New Estate Tax Rules Lull You Into Inaction?

At long last, Congress passed meaningful federal estate tax relief at the end of 2010.

Among myriad other tax law provisions in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, there's a generous \$5 million estate tax exemption, and the top estate tax rate has been cut to 35%—the same as the top rate for ordinary income. The law also coordinates other estate tax breaks for wealthy families.

But there's a downside to these favorable estate law alterations—they're scheduled to expire after 2012. So there's only a small window of opportunity before the next crucial crossroads for estate planning, and because it's impossible to know what will happen next—or to guess what estate rules will be in effect at your death—the positive aspects of the new law could end up having a negative impact. Families whose wealth falls below the higher exemption amount may be lulled into doing nothing, but that's a risky approach.

It took Congress almost a decade to revisit the subject of estate taxes, and it only finally happened because *not* acting would have had a dramatic result. In 2001, the estate tax was repealed—but only in a very gradual way, and only temporarily. During the years that followed, the exemption level rose gradually to \$3.5 million and the top estate tax rate inched down to 45%. Then, in 2010, the tax was truly

gone, but only for a year. Without the 2010 law, passed as the clock wound down on a lame-duck session of Congress, 2011 would have reinstated

an exemption of just \$1 million and a top tax rate of 55%.

Finally, as part of an 11th hour tax compromise brokered by the Obama administration between congressional Republicans and

Democrats, the new two-year estate law came into being.

Though the \$5 million estate tax exemption and the 35% tax rate have gotten most of the attention, the new law also included other significant changes. The individual exemption is now “portable” between spouses, so that a surviving spouse can utilize any unused portion of a deceased spouse's exemption. That effectively lets married couples exclude \$10 million from estate tax liability—but only if both die before 2013. The new law also again gives heirs a “step-up” in the cost basis of inherited assets—an advantage they didn't have in 2010—and reunifies the rules for estate and gift taxes so that they share the \$5 million exemption. That amount in total can now be transferred from your estate either before or after your death without incurring either kind of tax.

With these changes in effect, estate planning may seem easier than it was before, particularly if you have less than \$5 million—or less than \$10 million, between you and your

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Retirement Saving Takes Time And Must Be A Priority

The bad news: If you're like most people, you haven't made adequate plans to ensure a comfortable lifestyle throughout retirement. The good news: You may still have time to do something about it.

According to a new study of almost 1,500 Americans by the National Bureau of Economic Research (NBER), many people lack essential financial literacy, and for most, prospects for a secure retirement may be even dimmer than feared. According to NBER:

- Fewer than one in 10 respondents was able to answer basic financial questions correctly.
- About 50% said they had trouble keeping up with monthly bills.
- Only about half had “rainy day” funds large enough to cover expenses for three months in case of lost income.
- Almost a third had done something resulting in an interest charge or fee for credit card charges.
- Only 42% said they have tried to figure out how much to save for retirement. Of those between the ages of 45 and 59, more than half said they hadn't calculated how much they'll need for retirement.
- Only 51% had a retirement account with an employer, and just 28% had another retirement account such as an IRA.
- During the past year, 9% of those with a 401(k), IRA, or another retirement account tapped the account prematurely.

The takeaway? Start now, during your working years, to get up to speed on financial matters and take steps to protect your future.

European Politicians Can Save The Euro

Although the United States' credit outlook has dominated recent headlines, the global credit crisis began in Europe and will not end until Europe resolves its problems. Investors need to know the issues.

The eurozone—composed of European Union member states that have adopted the euro—is the largest economy in history, accounting for 21% of global business activity. Yet all that power hasn't kept weaker members from drowning in a sea of debt while the strong dither over conditions for a rescue.

From the start, the shared currency was an experiment and a compromise. In theory, both the industrial powerhouses at Europe's center and the countries at the periphery—the insultingly dubbed “PIIGS” of Portugal, Ireland, Italy, Greece, and Spain—bought the idea that all were equal. But in practice, Germany and France kept a tight grip on the continent's monetary muscle, driving Greece and other less developed countries to borrow vast amounts at low interest rates in an attempt to catch up. But the global recession of 2008 eliminated these countries' access to easy credit and left them starved for revenue to manage \$8 trillion of debt.

Iceland melted down immediately. Greece, Europe's next most indebted country (measured by debt as a percentage of gross domestic product), ultimately had to accept a \$60 billion bailout from the EU and the International Monetary Fund in early 2010. If it hadn't been tied to the euro, Greece could have devalued its currency, making its fixed debt payments cheaper in real terms. But its bonds are denominated in euros, and Europe's AAA-rated countries had no inclination to wreck their shared currency to help a weak member.

During the past year, the cycle has continued as investors have fled sovereign bond markets, leaving Ireland, Portugal, Spain, and now Italy begging for relief. Even France—the second-biggest economy in the euro zone and the fifth-largest on earth—might soon have its debt downgraded.

Europe has more than enough financial firepower to fix the situation. Bailing out Greece, Portugal, and Ireland has cost roughly \$160 billion, leaving another \$460 billion allocated to rescue other countries. And even that huge sum amounts to just 2.8% of the eurozone's GDP.

But Europe's bankers have dragged their feet or imposed tough conditions—while raising interest rates on strong and weak eurozone members alike. And even now, many of the most powerful policymakers are vacationing



in Mediterranean villas while financial markets reel. They could put the euro on the right track. Waiting only makes the final cost harder to pay.

U.S. companies do a vast amount of business in Europe. European consumers and companies buy U.S. goods and America needs Europe to get back on track, for our own good as well as theirs. ●

Breaking Up Doesn't Have To Be Hard

Few divorces are friendly, and many are bitterly contested, with spouses fighting to the end over issues ranging from custody of the children to ownership of the summer cabin. But it doesn't have to be that way, and if you and your spouse intend to part amicably, you might consider a relatively new approach called “collaborative law.” Instead of slugging it out in the courts, both parties agree to work out a reasonable settlement with assistance from their attorneys.

The key is that both of you must sign a contract that prohibits you from going to court, and neither side

files for divorce until all the details have been ironed out. “The parties retain lawyers and sign an agreement that they're not going to litigate,” says Amy Shimalla, an attorney in Warren, N.J. and a leading proponent of collaborative law. “The two spouses and their attorneys all sit down together and work through the issues.”

The collaborative process accentuates the need for cooperation. Everyone is asked to check emotional baggage at the door, and the divorcing spouses are instructed to come to the bargaining table with goodwill and a genuine motivation to

achieve an equitable settlement. The attorneys adopt the same spirit. Their goal is to resolve the matter fairly and expeditiously so both parties can move on with their lives.

Shimalla notes that collaborative law provides certain advantages over traditional divorce law methods. “The matter is kept private—there's no public record—and you can move at your own pace,” she says. “And by avoiding court, you limit your expenses. This saves time and money.” She estimates that about 98% of divorce cases are settled before trial anyway, but that doesn't mean the normal process isn't long

Myths Can Distort Investment Outlook

Investors and analysts alike look to economic conditions and trends for clues to the direction of prices for stocks, commodities, and other investments. Often enough, however, what we think we can learn from the economy and what it actually tells us are two different things. Consider these widely accepted “truths” that turn out, on closer inspection, to be false.

High unemployment is a drag on the economy and the stock market.

For people who can’t find a job, high unemployment rates are a source of pain and anguish. However, for investors the jobless rate is one of the most misleading economic factors. That’s because unemployment is a lagging indicator when it comes to economic recovery.

After the recessions of 1990-1991 and 2001-2002, unemployment remained high for 15 months and 19 months, respectively, after the economy got back on track. That means if you wait to jump back into the stock market until jobs come back, you can miss out on rising returns by two years and more.

Manufacturing jobs pay more than service or public sector jobs.

When jobs start to come back after recessionary periods, critics often say too many are low-paying “service industry” jobs. They lament the long-term erosion of manufacturing jobs, which supposedly offer higher wages.

However, a check of payroll data at the U.S. Bureau of Labor Statistics gives the lie to this belief. Manufacturing workers rank sixth among the 10 basic categories of “private industry” workers, behind information, educational services, financial activities, “transportation and warehousing,” and “professional and business.” Bringing up the rear are workers in wholesale trade, “health care and social,” retail trade, and “leisure and hospitality.”

Americans are tapped out.

We spent all our money in the run-up to the global economic crash, failed to save for a rainy day, and now are out of work or working fewer hours. That may be the common perception, but data from the U.S. Bureau of Economic Analysis shows that Americans’ disposable personal income and personal spending are near record levels, while savings have rebounded. In fact, consumer liquidity (cash, checking, savings, and retail money market funds) is near a record, totaling 75% of annual personal income.

Core inflation isn’t an accurate measure because it leaves out food and energy prices.

The government says inflation remains low, yet we all see our grocery and gasoline bills rising. Because the government’s “core inflation” measure leaves aside food and energy prices (because they are volatile), critics consider the core inflation rate a bogus indicator.

But food and energy together make up just 13% of total personal expenditures, trailing housing/utilities and health care, and so not counting those outlays may still result in a relatively accurate assessment of where consumer prices are headed. Also, housing/utilities and health care costs have increased far more than food and energy costs since 1980.

Productivity is on a long downward slide because of the aging of the U.S. work force.

The oldest baby boomers hit retirement age in 2011, and millions of workers will leave the work force during the coming years. But there is an even larger group right behind the boomers that will more than replace them. People born between 1977 and 2008, known as “echo boomers,” account for 125 million Americans and outnumber the 117 million baby boomers.

As a result, the U.S. Bureau of Labor Statistics estimates the nation’s gross domestic product should grow 2.5% to 3% a year during the next 30 years. GDP drives corporate earnings, which in turn drive the stock market.

Demographic trends also favor the U.S. on the global stage. The only country expected to see higher growth rates in the population aged 15 to 64 between now and 2050 is India, according to United Nations projections.

Social Security will bankrupt the nation as the baby boomers age.

The specter of bankruptcy hovering over the nation’s Social Security system is exaggerated, according to Congressional Budget Office projections. The CBO forecasts that Social Security spending will actually decrease as a percentage of GDP during the next seven decades, because the “echo boomers” will be paying into the system.

The real threats lie in rising costs for Medicare and Medicaid and a coming explosion in the cost of paying interest on the federal deficit, according to CBO projections.

So the next time you hear a piece of received wisdom concerning the economy, stop and think twice. And please call our office if you want to discuss economic trends and how they might affect your investments. ●

and stressful.

The attorneys in a collaborative law proceeding don't always work alone. For instance, they may call in a neutral expert such as a forensic accountant to help determine the net worth of a business. Other professionals such as mortgage specialists can provide financial expertise. And the attorneys might utilize a health care professional or divorce “coach” in cases involving emotional turmoil.

Although Shimalla has also acted as a mediator in divorce proceedings,

she prefers this new approach. “I’m with the party I’m representing all the way through,” she says. In contrast, mediation requires an objective analysis as a third party without a connection to a client.

What happens if negotiations break down? The parties can still sue each other in court, but they have to use other attorneys. That has happened in only about one in 10 of the cases Shimalla has handled during the past two years. This new way of breaking up seems to work well and it’s easier to do. ●



Planning Ahead Doesn't End In Retirement

After working for many decades, buying a home, raising a family, sending children to college, and paying for a wedding or two, retirement probably seems like a just reward. Yet now is no time to sit on your nest egg. Even if you've been retired for several years, you need to keep planning for the future, which could extend beyond your 80s. In 2010, the average life expectancy for a U.S. citizen was 77.8 years. And if you've made it to age 70, the average rises to 87. Since many retirees can now reasonably expect to live into their eighties or nineties, retirement planning never really ends.

Of course, everyone's situation is different, but here are several areas that could have a major impact on your plans.

Investment portfolio. Most retirees tend to invest rather conservatively, and for good reason. When you're living on a fixed income, you need to make sure you have enough coming in to cover your basic expenses, and you may not have time to recover from steep market losses. Still, keeping too much of your

portfolio in bonds and other comparatively safe investments may backfire over a long life span, especially if higher inflation returns. Allocating a judicious percentage of your assets to stocks may enable you to maintain your standard of living when expenses rise.

Insurance policies.

Your coverage needs change with age, and a review during retirement of all of your policies can not only make sure you have enough insurance but also that you're not continuing to pay for coverage you may no longer need. Term life insurance may be an unnecessary luxury now, while long-term care insurance, to pay for extended care in a nursing home or in your residence could be a necessity. And while Medicare covers most doctor and hospital fees, you might need to buy additional supplemental coverage at a time that many employers are scaling

back health insurance for retirees.

Wills and trusts. Estate planning, too, tends to be a work in progress, and wills and trusts created several years ago will likely need to be updated to reflect your evolving circumstances as well as changes in estate tax rules. During the course of your retirement, for example, your children may become so successful that they no longer need to inherit as much of your wealth, while bequests or trust payments to grandchildren could help them buy a home or launch a business.

Weighing all of these factors and making sure that your retirement continues to unfold according to plan is a daunting proposition. But you don't have to go it alone. We are here to work with you and other advisors to help keep you on track regardless of where you are in your post-work life. Please call for an appointment to review your progress. ●



New Estate Tax Rules

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spouse—to transfer to your heirs. Doing nothing at all now may seem like a reasonable option. But the biggest problem, again, is that the new rules are guaranteed to hold sway only through the end of 2012. If Congress then reduces the exempt amount—and, in the meantime, your wealth has grown—you might have to scramble to get a new estate plan in place.

What can you do in the meantime? One effective strategy is to continue to take advantage of rules for yearly giving that can reduce the size of your estate. Under the annual gift tax exclusion, you can give anyone assets valued at up to \$13,000—\$26,000 if your spouse joins in the gift—and you

can make such transfers to as many people as you like each year. You can also avoid the issue of future estate tax rates by using your current \$5 million credit to transfer additional wealth while you're alive.

You can also pay attention now to estate issues that have nothing to do with taxes. It's important to decide how to divide assets among your children, for example, and how to protect your wealth from creditors. Making provisions for the care of a disabled child, perhaps by establishing a special needs trust, could also be crucial. Indeed, trusts of various kinds might help you support your family and

philanthropic organizations long into the future, regardless of what happens next to the political football of the estate tax laws.

For now, the latest big changes make this a good time to take stock of your estate plan, making any adjustments that may be needed in terms of how it is structured and in the

language of your will and other documents. And, until a long-term law is in place, it's a good idea to review your estate plan every year or two. We can work with you and your attorney to make sure you're taking advantage of today's opportunities. ●

