The
FINANCIAL UPDATE

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An International View Of The Economic Crisis

The world economy is making a comeback from the depths of 2008, but the results will vary from country to country and rising inflation could rain on the party.

Those are insights from a recent interview with Stephane Garelli, director of the World Competitiveness Center at IMD, a Swiss business school that ranks nations according to their competitive strength.

Garelli's outlook matches that of the International Monetary Fund, which expects the global economy to expand 2.5% in 2010, a full 0.6% faster than it had forecast in early 2009. The IMF predicts that in the United States, economic growth will edge up to 0.8% in 2010, following a 2.6% plunge in 2009. That, too, is an improvement from early 2009, when the IMF predicted the U.S. economy would remain flat in 2010. The 2009 IMD World Competitiveness Yearbook ranks the United States No. 1 among 57 nations in terms of international competitiveness.

First in, first out. Because the United States was among the first nations to enter the global recession, it should be among the first to lead the way out, Garelli said. While some smaller exporting nations—and possibly China—are expected to see the earliest real growth in 2010, recovery in the United States will provide the clearest message that the world economy is on the upswing, he said. Among the last to recover will likely be Japan, Germany, and Switzerland, because of their lack of economic flexibility.

Depression avoided. The risk of a worldwide economic depression has passed, Garelli said (a depression is defined as a 10% drop in gross domestic product or a recession lasting three years). "However, Iceland and the Baltic States may be exceptions," he added. Deflation is also not likely to hit many countries, although Britain, Japan, and Spain could suffer its effects, along with the automobile industry and a few industrial sectors.

Stimulating results. Garelli said the stimulus packages from national governments will work best in emerging economies, because people there need consumer goods and are likely to spend the money. In developed countries, "people will save the money they receive," Garelli said. "They can delay a purchase without a perceptible decline in their standard of living."

Jobless threat. Unemployment will remain a major barrier to economic recovery, because it has a devastating impact on public finances, Garelli said. As jobless rates rise, more government funds will be allocated to support the unemployed rather than create new jobs.

Tax havens hit. A side effect of stimulus legislation will be new attacks on tax havens, Garelli pointed out. In order to pay for stimulus spending, many countries plan to raise taxes on the wealthy. One way to do that would be to close tax loopholes.

Inflation looms. Global economic recovery will almost certainly bring a new round of global inflation. "It will be triggered by both an excess of money supply (especially dollars) and a rapid

(Continued on page 4)

When To Take Social Security Is An Important Decision

You've been paying Social Security tax your entire career, so it's only natural to look forward to the promised "payoff" in retirement. But Social Security isn't like other promises from the government. The benefits you're entitled to receive are actually a unique asset and should be considered in your investment planning.

The full retirement age for those born from 1946 through 1954 is age 66. It gradually increases to age 67 for those born between 1954 and 1960. If you choose to start receiving Social Security benefits at age 62, you'll get your money sooner, but the monthly benefit will be reduced by 25%. On the other hand, if you wait until age 70 to start receiving benefits, the amount is increased by up to 8% per year, in addition to annual cost-of-living hikes.

Let's say your monthly benefit at the full retirement age of 66 is $1,000. Taking early retirement benefits at age 62 results in a permanent decrease to $750 a month. But waiting until age 70 would produce a monthly benefit of $1,320, a 32% increase.

Waiting to begin benefits isn't the best approach for everyone. Whether you should or could do it depends on numerous factors, including your current and anticipated cash needs, your health status and family history, if you plan on working during retirement, other sources of retirement income, and the projected amount of your Social Security benefit. We'll consider all these factors and help you decide how best to utilize this asset.

A Welcome Spike In Personal Savings

Are you looking for something good that may have come out of the recession? As a result of the economic downturn, Americans have generally been spending less and saving more. The savings rate in U.S. households in 2009 reached a high point of 6.9% of after-tax personal income in May. Even though the savings rate has slipped slightly since then, the watershed mark was the highest rate since 1992, when savings peaked at 7.7%.

While it's not an exact measure of fiscal health, the savings rate is the percentage of household disposable income that is put into savings rather than consumed. Mortgage payments are not considered savings, but retirement plan allocations (not capital gains) are. Although a sub-7% savings rate isn't much to brag about in most parts of the world—the annual percentage in other countries routinely hits double digits—it marks a dramatic shift in our personal financial habits. During recent years, the percentage of savings actually dipped below 1%, bottoming out at 0.4% in both 2006 and 2007. In 2008, the saving rate was still only 1.8%.

What's behind the trend towards more savings? During the preceding two decades, rising stock market values and home prices had enticed consumers into thinking they had money to burn, and they became less and less inclined to save for retirement and other needs. Even retirees were encouraged to spend like there was no tomorrow.

But the recent precipitous decline in household wealth ended the wild spending spree. Real estate values around the country have dropped by an estimated 35%, and during the past two years, U.S. household wealth has been reduced by a whopping 140% of annual disposable income. That's a total of $14 trillion.

Faced with daunting economic news, people have been forced to rein in spending, while increasing their efforts to prepare for a secure retirement. For instance, instead of buying goods with their checks from the economic stimulus package or taking advantage of other tax incentives, many people have chosen to hold on to the money. And it doesn't look as if things will change radically anytime soon.

How long will the latest trend last? Most economists predict a slow, steady climb back to better times rather than a quick return to another financial boom. But cutbacks in domestic consumption will also slow down the economic recovery. In the meantime, the savings rate is expected to rise gradually until it hits the 10% mark at some point during the next 10 years. Other financial experts believe the recovery period could last even longer.

Of course, an increased savings rate is to be applauded, especially after it had plummeted dangerously close to zero. Americans will have to adjust to a lower standard of living compared with the heyday of 2007. But if forgoing a few luxuries is the price you have to pay for protecting your financial future, that's probably a trade-off you'd be willing to make. ●

Build Up IRA Now For 2010 Roth Conversion

Thinking about converting a traditional IRA to a Roth IRA? Now in 2010, new rules permit anyone to make that move. But before you empty your traditional IRA, you might consider building it up, including using non-deductible contributions. The more money you convert, the more you'll be able to tap during retirement through tax-free Roth IRA distributions, but it's important to note that your Roth IRA conversion doesn't need to be an all-or-nothing event—you can do partial conversions. Just keep in mind that a little-known rule may affect the taxation of non-deductible contributions during a Roth conversion.

High-income taxpayers generally don't qualify for deductible contributions to a traditional IRA, but they can still contribute on an after-tax basis. The contribution limit for 2010 is $5,000 ($6,000 if you're age 50 or over). Distributions of deductible contributions and earnings are taxable at ordinary income rates.

A Roth IRA uses a different formula. Though contributions are never deductible, distributions from a Roth established at least five years ago are completely tax-free. Contribution limits are the same as they are for traditional IRAs. But here, too, high-income taxpayers may be shut out. For the 2009 tax year, Roth IRAs were off-limits to joint filers with an adjusted gross income above $176,000 ($120,000 for single filers), and to convert a traditional IRA to a Roth your AGI had to be no more than $100,000 during the year of the conversion.

But starting in 2010, anyone, regardless of income, will be able to convert a traditional IRA to a Roth. And though you'll owe income tax on converted money that hasn't previously been taxed—in other words, all deductible contributions and earnings—if you make a conversion in 2010, you can pay the resulting taxes during 2011 and 2012.

Help Loved Ones With Tax-Free Gifts

Today's severe economic crisis is taking its toll on virtually every segment of the population. Young newlyweds are finding it difficult to set aside funds for the down payment on a home, despite the now lower prices. Middle-aged parents are struggling to make ends meet and still squirrel away cash for their children's college costs. And older workers and retirees have seen their nest eggs eroded by the recent stock market downturn.

If you've been fortunate (and foresighted) enough to escape major damage to your own finances, you may want to consider helping family members overcome economic hurdles. Providing tax-free gifts could improve their situations while benefiting your own estate planning as well. If you stay within tax law boundaries, you don't have to pay gift tax on cash or property transferred to relatives or any other recipient. At the same time, the gifts will reduce the size of your taxable estate.

The value of the latter benefit depends on the future of the federal estate tax, which remains uncertain. The estate of an individual who dies in 2009 can shelter up to $3.5 million of assets from federal estate tax. That's an increase from a $2 million exemption in 2008, as stipulated by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which calls for the outright repeal of the estate tax in 2010. But that provision of the legislation expires at the end of 2010, and in 2011, pre-EGTRRA rules return. The estate tax exemption is scheduled to revert to just $1 million, and the estate tax rate will rebound to 55% from the current 45% unless Congress acts to change the law.

While a legislative compromise on the estate tax is likely, the tax will almost certainly continue in some form. And that likelihood only increases the appeal of making gifts now to help loved ones hurt by the recession. In 2009 and 2010, you can provide tax-free gifts of as much as $13,000—in any combination of cash and property—to as many recipients as you choose. (A periodic inflation adjustment resulted in an increase in this exclusion amount from $12,000 in 2008.) You don't even have to file any tax forms or otherwise inform the IRS about such gifts (if those are the only gifts made and unless gift splitting with a spouse is elected).

The chance to provide unlimited numbers of tax-free gifts could multiply the benefits not only for recipients but also to your estate plan. For instance, if you have two children and three grandchildren, giving each of them $13,000 in 2010 adds up to a total of $65,000. If your spouse also makes such gifts (or consents to a joint gift by filing a gift tax return), that exemption jumps to $26,000 per relative and a total of $130,000 for five, all without gift-tax consequences. Continue this gift-giving program for five years and you'll have cut the value of your estate by $650,000 while providing generous assistance at a time when it may be sorely needed.

If the recipient is in a lower tax bracket, gifting shares of stock, mutual funds, or other assets that have appreciated will save you from paying capital gains taxes. But if you have assets with unrealized losses that you want to donate, it's better to sell them first so that you can deduct the loss on your tax return and give your gift in cash.

If you exceed the annual limit on tax-free gifts, you still won't necessarily owe money to the IRS. But larger gifts would count against your lifetime $1 million gift-tax exemption, which might be put to better use in funding trusts or for other estate planning purposes. Plus, you'll have to file a gift tax return—or potentially two gift tax returns if you're married.

Meanwhile, there are two special situations in which the normal giving limits don't apply. The first involves money you provide directly to an educational institution on behalf of a student. The second is for direct payments to health care providers.

The unlimited exemption for education payments means you won't owe gift tax if you cover college costs for children or grandchildren. Suppose your granddaughter is attending college and the annual bill for tuition is $30,000. You can pay that amount directly to the university and still give her an additional $13,000 gift (or $26,000 with your spouse) that won't be subject to gift tax.

If children or grandchildren are still years away from college, an even better approach might be to fund a Section 529 college savings plan that names the child as beneficiary. Income earned by plan investments won't be taxed, and withdrawals to pay qualified educational expenses will also be tax-free. Plus, a special provision allows five years' gifts to be sent to a 529 plan in one fell swoop. That means you and your spouse could immediately provide $130,000 to jump-start a 529 plan without gift-tax consequences (provided you file a gift tax return to elect to front-load the gift). ●

Even without current year deductions, it could make sense to contribute to your IRA on a non-deductible basis before you convert. For example, you have until April 15, 2010 to make an IRA contribution of up to $5,000 for the 2009 tax year ($6,000 for older participants). When you then convert that traditional IRA to a Roth, the portion of the account attributable to those non-deductible contributions may be exempt from tax.

However, for purposes of a Roth conversion, the IRS looks at the overall split between deductible and non-deductible contributions in all of your retirement accounts to determine how much of a converted amount won't be taxed. Suppose you have one IRA with $10,000 in non-deductible contributions and another with $190,000 in deductible contributions and earnings. Because only 5% of your nest egg is represented by non-deductible contributions, if you convert the $10,000 IRA, you still must pay tax on 95% of the distribution, or $9,500. If you convert the entire $200,000, you'll be taxed on $190,000.

Astute planning can reduce the tax bite on Roth IRA conversions. For more information, please call our office. ●

Do You Really Need That Inheritance?

Sometimes it pays just to say "no thanks" to a generous bequest—even from your own spouse. There may be estate planning benefits to having the assets go directly to contingent beneficiaries named by the decedent. If those beneficiaries are your children, this strategy could help them keep more of the bequest.

Officially declining an inheritance involves executing a legal document known as a "qualified disclaimer." This refusal, which can apply to all or part of a bequest, must be executed within nine months of the donor's death and before you've received the inheritance. While this is generally a reactive measure, similar results can be obtained setting up a disclaimer trust as part of your estate plan.

One factor in deciding whether to refuse an inheritance is the uncertain future of the federal estate tax. Repealed for 2010, it will be revived in 2011 under unfavorable conditions.

The amount of an estate that's exempt from federal tax, which was gradually increased to $3.5 million for those who died in 2009, will drop back to $1 million for 2011, unless Congress enacts new legislation.

Also, after gradually being reduced to 45%, the top estate tax rate will return to 55%. The Obama administration and Congress will likely adjust the rules or change the timetable, but most experts expect the estate tax to continue to exist in some form. A qualified disclaimer or a disclaimer trust could help you prepare for whatever comes.

Suppose that under your current will, all of your assets are to go to your spouse if you die first, and vice versa. Then, at the death of the surviving spouse, the remaining assets will be divided among your children. With this arrangement, there's no estate tax due after the first death—because a spouse can inherit an unlimited amount tax free—and the surviving spouse's estate can be reduced, for tax purposes, by whatever individual exemption is in effect at the time.

But this wastes the exemption of the first spouse to die. Instead, the surviving spouse could disclaim an amount equal to the estate tax exemption, passing it directly to contingent beneficiaries. The first spouse's exemption relieves the heirs of any current estate tax liability, and later the surviving spouse's own exemption can be used.

Before disclaiming any assets, one's current and future potential need for the disclaimed assets needs to be carefully analyzed by a financial planner, since this is an irrevocable decision. We can work with you and your attorney to consider whether turning down an inheritance might make sense for you, and help you follow the rules that govern the process.

Also, if your net worth nears or exceeds federal estate tax exemption limits, we can discuss how setting up a disclaimer trust now can benefit your heirs. ●

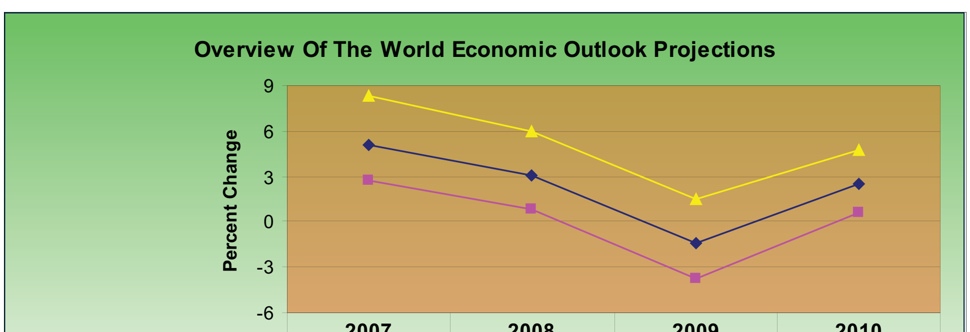
View Of The Economic Crisis

(Continued from page 1)

rise in commodity prices (fueled by the demand of emerging nations)," said Garelli. "Central banks will not react immediately to rising inflation so as not to impede recovery—and because inflation is an effective way to reduce the value of debt."

Spending spree. Recovery also will trigger a rush by companies to spend billions in cash that has been set aside during the recession, Garelli predicted. The world's largest 100 companies have cash reserves estimated at a total of $600 billion. "This money will be used to buy back shares," Garelli said. "Acquiring industrial assets and companies will also be a priority."

Winners take all. In the end, national governments will emerge as clear winners. "They have the ultimate power: printing money, making laws, and setting taxes," Garelli said. "The multilateral world is on the decline, and it is again a brutal power game among big nations. But beware: In the words of Thomas Jefferson, 'A government big enough to give you everything you want, is also strong enough to take everything you have.'" ●



	2007	2008	2009	2010
World output	5.1	3.1	-1.4	2.5
Advanced economies	2.7	0.8	-3.8	0.6
Emerging economies	8.3	6.0	1.5	4.7

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