

# Investor Insights & Outlook

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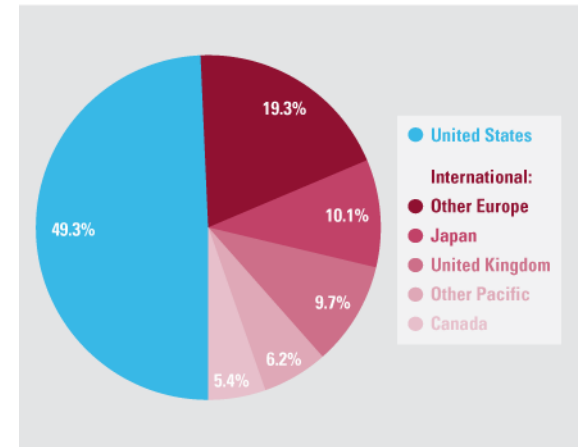
Investment Updates

## A World of Opportunity

As trade barriers continue to break down, the world economy has become a small neighborhood. Should investors seek to participate in this wave of globalization, or are they getting all they need here at home?

Historically, foreign investments have acted in a significantly different way from domestic investments. When the U.S. market slumped, various opportunities abroad have prospered. An American investor who put some money into foreign markets may have reduced risk while still attaining attractive returns. With the spread of globalization, this benefit decreases as companies across the globe are acting more like each other. However, as the image illustrates, an investor who doesn't take advantage of options outside of the United States is missing out on roughly half of the investable developed stock market opportunities in the world.

World Stock Market Capitalization  
Year-End 2010



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

Source: World Market Capitalization by Country is from the Morgan Stanley Capital International Blue Book™. The data is expressed in U.S. dollars.



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Advisor Corner

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# Tax Law Changes for 2011

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A good mantra, for investing and for the rest of your life, is “Focus on what you can control.” While most people are inclined to put taxes into the “out of my control” bucket, that doesn't have to be the case. Where taxes are concerned, it is always a good idea to consult with a tax professional. This article is intended only as a starting point to help you become informed about tax-law changes; it does not constitute tax advice. Some of these changes have an impact only on those in very high tax brackets, while others affect individuals of all income levels.

**Social Security Payroll Tax Holiday:** Social Security payroll taxes have dropped from 6.2% to 4.2% for 2011, giving an effective boost in pay to all workers. (As in the past, you won't pay Social Security tax on any earnings over a certain level—currently \$106,800.) This provision is designed to get people out there spending, but a better idea, assuming you can afford it, is to divert that money to another retirement fund: your own. Increase your 401(k) plan contribution as close as you can to the annual limit; in 2011, that limit remains \$16,500 for those under 50 and \$22,000 to those over 50. And if you're already funding your 401(k), 403(b), or 457 plan to the max—or if you would rather save outside the confines of your company plan—you can direct that money to an IRA instead. IRA contribution limits are also unchanged from 2010: \$5,000 for individuals under 50 and \$6,000 for those over 50.

**Alternative Minimum Tax:** Toward the end of 2010, Congress put in place a so-called patch to keep a new group of taxpayers from having to pay the alternative minimum tax, a parallel tax system that disallows many of the credits and deductions that taxpayers are entitled to under the conventional tax system. That's good news, but if you've fallen into the AMT zone in the past, the latest patch isn't likely to keep you out of it. However, by taking steps to control your AMT-subject income and managing your deductions, you may be able to reduce your AMT tax hit. Some key strategies that you can employ include carefully managing the exercise of stock options (a well-versed tax advisor should be able to help

with this) and watching out for private-activity municipal bond funds, which aren't taxable under the conventional tax system but are for the purposes of AMT.

**Dividend Tax:** Through 2012, the tax on qualified dividends remains at zero for taxpayers in the 10% and 15% tax brackets, and is 15% for all other taxpayers.

**Long-Term Capital Gains Tax:** Through 2012, taxpayers in the 10% and 15% brackets will not owe capital gains tax on the sale of assets they've owned for more than one year. Long-term capital gains tax rates remain at 15% for all other taxpayers. Short-term capital gains are taxed as ordinary income.

**Estate Tax:** Although the federal estate tax was set to jump to 55% for estates of more than \$1 million in 2011, last-minute Congressional maneuvering resulted in a much less onerous rate for people who die with a lot of assets. The top estate tax rate is 35% for 2011 and 2012, and it only affects those who have amassed estates of more than \$5 million. Those who inherit assets will also once again receive a step-up in the cost basis of those assets, meaning that the inherited assets are valued at their fair market value as of the decedent's death.

Given the more generous estate-tax limits, you may be assuming that a visit to your estate-planning attorney isn't necessary, but even if you don't anticipate that you will ever amass \$5 million in assets, there's more to creating an estate plan than sidestepping taxes. A properly crafted estate plan will detail how you would like your assets distributed after you are gone. **Gift Tax:** The annual gift-tax exclusion stays the same as it was in 2010: \$13,000. That means you can gift \$13,000 apiece to an unlimited number of people this year without having to worry about a gift tax or even fill out the gift-tax paperwork.

## Investing in Emerging Markets

Emerging-market economies offer tempting rewards and are becoming more standard among investors willing to take on additional risk. Commonly called developing-market economies, they are in transition but are beginning to see a substantial increase in living standards and income, rapid economic growth and a relatively stable currency. They can be small or large economies and can be found all over the globe. Examples include China, India, Korea and Thailand in Asia; Poland, Egypt, and Turkey in Europe and the Middle East; and Brazil, Chile and Mexico in Latin America. As of May 2010, MSCI Barra identified 21 emerging countries worldwide.

Since these economies are still developing, the risk of an emerging-market investment is higher when compared with a developed market. Some of these risks include currency fluctuations, foreign taxation and political, social, and economic upheaval. However, such added risk comes with the potential for higher returns.

Perhaps the easiest way to include emerging markets in a portfolio is to buy an emerging-markets mutual fund. This is a mutual fund that holds various investments in emerging countries, bringing you the added benefit of diversification. Make sure to read the mutual fund's prospectus very carefully before investing or sending any money.

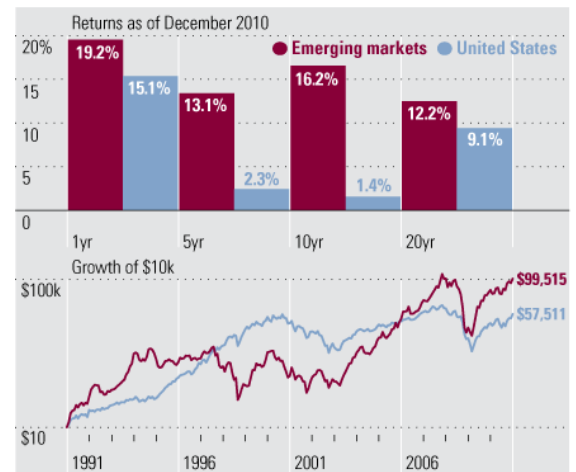
Another way to invest in emerging markets would be to buy stocks of foreign companies directly—much more difficult and risky to do on your own. You may also hear the term ADR connected with international investing. It stands for American Depositary Receipt, and it is an instrument allowing the stock of a foreign company to trade on a U.S. exchange. However, no matter how you decide to invest, always keep in mind the risks associated with international and emerging-market investments.

The graph illustrates the historical short- and long-term performance of emerging markets compared with U.S. markets. Emerging markets

posted very respectable returns, beating those of the U.S. market in every time period. However, these returns came with additional risk, as shown by the volatility of the line graph. A hypothetical \$10,000 invested in emerging markets would have grown to \$99,515 over this 20-year time frame, compared with \$57,511 for domestic investments.

While the emerging markets' ending wealth value easily surpassed that of the U.S. investment, it accumulated over a rather long time horizon. Note that emerging markets can experience a much greater upside and often a deeper downside in any particular year (2008, for example). Consequently, this type of investment is more appropriate for long-term investors who can handle potentially large fluctuations in returns.

### Undeveloped Opportunities: 1991–2010



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Emerging-market investments are riskier than developed-market investments. Liquidity is typically lower in emerging markets than in developed markets. An investment cannot be made directly in an index. Returns and principal invested in stocks are not guaranteed.

Source: U.S. stocks are represented by the Standard & Poor's 500® index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Emerging markets are represented by the Morgan Stanley Capital International Emerging Markets Index.

## Politics and Investment Performance

With the Nov. 2 elections come and gone, here's the result of an investigation into the relationship between the composition of the legislative and executive branches of the U.S. government and market performance. The data table displays the average annual returns for the S&P 500® and a 60% stock/40% bond portfolio in three different situations. The "unified" situation refers to years when the Senate, the House of Representatives, and the White House were all controlled by the same party. The "partially divided" situation represents years when the House and Senate were controlled by the same party, but the White House was held by a different party. The "completely divided" situation uses data from years in which the two houses of Congress were divided. Both the S&P 500 and the diversified portfolio averaged the highest returns during unified years, lower returns during partially divided years, and the lowest under completely divided years.

### Average Annual Returns 1926–2010

	S&P 500	Diversified portfolio	Number of years
"Unified" years	14.8%	9.9%	45
"Partially divided" years	11.1%	9.5%	30
"Completely divided" years	1.0%	6.8%	10

Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. The time period examined is 1926–2010, and the returns are average annual returns.

Stocks—Standard & Poor's 500 index, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds—20-year U.S. government bond.

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