

# Investor Insights & Outlook

January 2011

Vol.2 No. 1

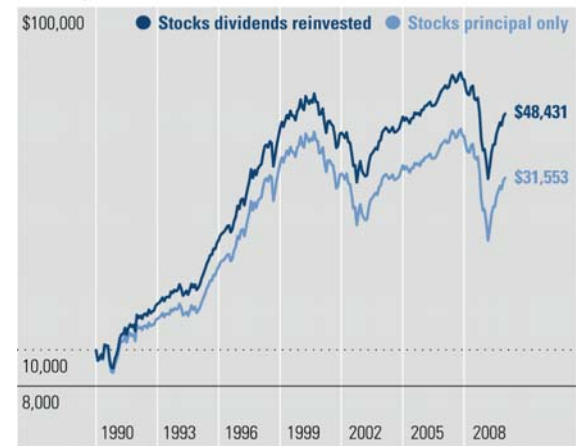
HALLETT ADVISORS

## Dividend Discussion

For many investors, the only reward that matters is an increase in share price. But if you look beyond capital gains, you might find a dividend offering significant benefits. A dividend can (1) provide regular income, (2) grow over time through reinvestment opportunities, and (3) offer significant tax benefits. Prior to the 2003 Tax Act, dividends were taxed at ordinary income-tax rate levels, which could be as high as 35%. Now investors pay significantly less taxes, ranging from 5% to 15%.

Despite these advantages, dividends seem to be an often overlooked component of total returns. The image below illustrates the impact that reinvested dividends have on investment returns over time. These paying investments can add value to a portfolio, but keep in mind that it is possible to lose money by investing in them, and that companies cannot always guarantee their dividend payments.

Growth of \$10,000:  
Principal Versus Reinvested Distributions



This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed.

Source: Stocks with dividends reinvested—Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general; Stocks principal only—Standard & Poor's Capital Appreciation.



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### Advisor Corner

Thank you for the opportunity to serve as your advisor. We appreciate your trust and confidence. Here's to a prosperous 2011.

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# What the New Tax Law (Might) Mean for You

## PLANNING TIPS:

- ▶ Meet with Jim and determine what your marginal tax rate is likely to be in 2011. Let this number help guide your investment activities during the year. But don't let the tax tail wag the investment dog. Always consider the investment merits first.
- ▶ If you have a child or grandchild in college, you may be able to claim a tax credit for qualified tuition and related expenses. If you will be writing checks for school expenses talk with Jim.
- ▶ If you are over 70 1/2 talk to your favorite charities about setting up an ongoing program of direct contributions from your IRA.
- ▶ Now that we have clarity on the estate tax - for a couple of years at least - estate planning can be done with more confidence. Don't put it off.

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, informally known as the 2010 Tax Relief Act (H.R. 4853) or the Obama compromise plan.

If you work, pay taxes, own investments, have a child in college, are over 70 1/2 or anticipate a death in 2011, the new tax law has something for you.

## MAIN PROVISIONS OF THE NEW LAW

\* Continuation of the 2010 individual tax rates for 2011 and 2012 \* Continuation of 2010 capital gains and qualified dividend rates for 2011 and 2012 \* Extension of the American Opportunity Tax Credit through 2012 \* Extension of tax-free distributions from IRAs to charity, for 2010 and 2011 \* Employee payroll tax cut from 6.2% to 4.2% for 2011 only \* Estate tax exclusion of \$5 million per person. The maximum estate tax rate is 35% for 2011 and 2012.

## EXTENSION OF TAX RATES

If you are contemplating an investment that pays ordinary income, you'll know how much federal income tax you will owe on that additional income. Conversely, if you are considering a tax-saving strategy, such as contributing to a qualified retirement plan, you will know how much that strategy will save you in taxes. For example, if you are in the 33% tax bracket and contribute an additional \$10,000 to a qualified retirement plan, it will save you \$3,300 in taxes. Investors also got some clarity on capital gains tax rates. The 15% rate on capital gains and qualified dividends was extended through 2012. For investors in the 10% or 15% tax bracket, the capital gains tax rate continues to be zero.

By the way, do not forget that the tax act also permits the continuation of IRA charitable rollovers. For those over 70 1/2 this can be a great tax saving opportunity.

## SOMETHING NEW

If you work and pay into Social Security, your paycheck will go up in 2011. For one year only, the employee's share of the payroll tax will be reduced by 2% to 4.2%. This tax is assessed on earnings up to \$106,800 in 2011 and does not affect the 1.45% Medicare tax, which is assessed on all earnings.

The government will make up the lost income by transferring an estimated \$120 billion from the general Treasury to the Social Security trust fund. This is the first time in the history of Social Security that a transfer will be made from the general Treasury; up to now Social Security has always been completely self-financed. Franklin Roosevelt insisted upon this from the very beginning in order to keep Social Security from being perceived as a welfare program. He wanted workers to feel a legal and moral right to collect benefits based on the contributions they had made over their working lives.

## REINSTATEMENT OF THE ESTATE TAX

People who died in 2010 didn't have to pay any estate taxes, even if they left billions to their heirs. For 2011 and 2012 the estate tax comes back. The exemption amount is \$5 million per person, and the top tax rate is 35%. The new estate tax also comes with what is called portability, which will be advantageous to husbands and wives. If one spouse dies without using up his/her entire \$5 million exemption, the remaining amount may be added to the surviving spouse's exemption amount. This may eliminate the need for a bypass trust to accomplish the same objective.

## Staying in Style

Most financial professionals agree that the asset-allocation decision is one of the most important factors in determining both the risk and the return of an investment portfolio. Asset allocation is the process of combining asset classes such as stocks, bonds, and cash into a portfolio that will meet your goals. Taking this process a step further means selecting mutual funds to represent a certain segment or style for your overall portfolio (large stocks vs. small stocks, growth stocks vs. value stocks, etc.).

This can be a challenging task, and once the process is complete and the portfolio of mutual funds built, you'll need to consider something else: style drift. Style drift occurs when actively-managed mutual funds deviate from a particular investment style over time in an effort to potentially improve performance. While improved performance might not seem like a bad thing, a shift in style can be hazardous because it alters your risk exposure and return profile.

For example, let's say you held a large percentage of your portfolio in a large-cap stock fund. Now, at a certain point in time, this fund's manager got convinced that small stocks would benefit due to certain market conditions. Acting on this belief, he shifted the strategy of what was supposed to be a large-cap stock fund by buying an unusual amount of small stocks. This not only unnecessarily increased the risk of your overall portfolio, but also potentially set you up for large losses if small stocks were not going to behave the way this manager expected.

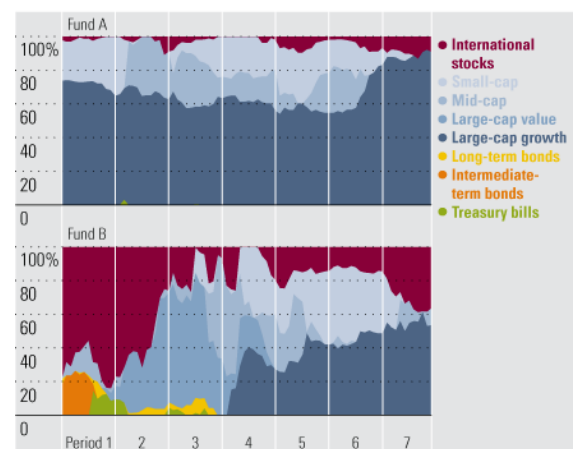
Style analysis is a technique used to understand investment style and identify the behavioral characteristics of a fund. It matches the returns of a fund to a mix of asset-class benchmarks that best describe the fund's behavior. This process can aid investors and advisors in the selection of funds to assemble a diversified portfolio.

The graph shows the rolling style analysis over time of two hypothetical mutual funds with the same stated objective. Although these two funds have the same objective, their style and

consistency differ greatly. Look at international stocks, for example: In Period 1 and Period 2, Fund B had a much higher exposure to international stocks than Fund A. Such style drift can indicate that your manager is not following the fund's stated objective.

If you notice your fund manager jumping on the bandwagon of past trends, he may be trying to save his own hide. Remember, the goal is to buy low and sell high, not jump in late and hope for the best. It takes real discipline to stick to a set of stated investment objectives. So always keep an eye on your investments and evaluate funds periodically to make sure they fit your asset allocation appropriately.

### Understanding Fund Behavior: Some Funds Do Not Behave as Advertised



The percentages illustrated in the image are based on each hypothetical fund's returns-based style analysis results using 36-month rolling periods. Style analysis represents the best combination of benchmarks that match the variation in fund returns over the time period. It does not represent actual holdings.

# The Asset Allocation Puzzle

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Possessing a considerable amount of knowledge about stocks, bonds, and cash is only a small part of the investment planning process. Many investors are under the false notion that the greatest determinant of portfolio performance is the specific investment choices that they make. In reality, the biggest decision you will make is how much to allocate to different investment categories. Asset allocation is all about finding the mix of investments that is right for your situation. Goals, time horizon, and risk tolerance are some of the key factors that should be taken into consideration when allocating assets.

**Goals:** Determining what asset allocation is appropriate depends largely on the goals you seek to achieve. Are you saving for retirement, college education for your children, or a vacation home? Each goal must be considered in creating the appropriate asset mix.

**Time Horizon:** Time horizon is the length of time your portfolio will remain invested before withdrawals need to be taken. If your average investment horizon is fairly short, you will most likely want a more conservative portfolio—a portfolio with returns that do not fluctuate too much. If your investment time horizon is longer, you can most likely invest more aggressively.

**Risk Tolerance:** Everyone has a different emotional reaction to sudden changes in their portfolio value. Some people have trouble sleeping at night because they are too busy worrying about how their portfolio is performing. Other investors are unfazed by fluctuations in the market and can endure the uncertainty associated with more risky investments.

As you can see, the asset allocation decision is not an easy one and it may be best to work with an investment advisor who can piece together a plan that is right for you.

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