Vision Financial Advisory Corp

ENHANCING YOUR VISION

Vision Financial Advisory

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Happy Spring... almost Summer!

The markets continue their pattern of historic volatility, so I've included an article about risk, as well as some information about historical stock market performance following recessions.

2010 is a unique year from a tax perspective, and many changes are likely around the corner. Some of that detail is included in this newsletter.

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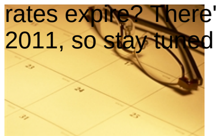
Thank you for your business, and the opportunity to help you reach your financial goals! Please call us any time with any questions you may have, or updates regarding your situation.

-John

June 2010

Dave Ramsey's Endorsed Local Providers

Will You See Higher Tax Rates in 2011?



The year was 2001. The top marginal federal income tax bracket was 39.6%, and the tax rate that applied to most long-term capital gains was 20%. Then came the Economic Growth and Tax Relief Reconciliation Act of 2001, followed two years later by the Jobs and Growth Tax Relief Reconciliation Act of 2003. By mid-2003, the top marginal tax rate was 35%, and the 20% capital gains rate had dropped to 15%. But this tax relief was designed to be temporary--the provisions that established lower rates were crafted to self-expire after a period of time. And now, in 2010, we're only months away from seeing those provisions expire.

Federal income tax brackets

Right now, there are six marginal income tax brackets: 10%, 15%, 25%, 28%, 33%, and 35%. For 2010, these brackets apply to married couples filing joint federal income tax returns in the following manner:

2010 Marginal Income Tax Brackets	
Married Filing Jointly	
Taxable Income	*Marginal Tax Rate*
Not over $16,750	10%
Over $16,750 to $68,000	15%
Over $68,000 to $137,300	25%
Over 137,300 to $209,250	28%
Over 209,250 to $373,650	33%
Over $373,650	35%

As it stands now, these marginal tax brackets will expire at the end of 2010. There would be no 10% bracket for 2011, and the remaining bracket rates would return to their original 2001 levels: 15%, 28%, 31%, 36%, and 39.6%.

Long-term capital gain tax rates

For 2010, if you sell shares of stock that you've held for more than a year, any gain is long-term capital gain, generally taxed at a maximum rate of 15%. If you're in the 10% or the 15% marginal income tax bracket, however, you'll pay no federal tax on the long-term gain (a 0% tax rate applies). That means if you're a married couple filing a joint federal income tax return, and your taxable income is $68,000 or less, you'd pay no federal tax on the gain.

However, these rates are also scheduled to expire at the end of 2010. Absent new legislation, in 2011, a 20% rate will generally apply to long-term capital gains. Individuals in the 15% tax bracket (remember, there won't be a 10% bracket in 2011) will pay the tax at a rate of 10%. Special rules (and slightly lower rates) will apply for qualifying property held for five years or more.

Finally, while qualifying dividends are taxed in 2010 using the same capital gain tax rates described above (i.e., 15% and 0%), in 2011 they'll be taxed as ordinary income.

Will Congress take action?

In the proposed 2011 budget submitted to Congress in February, President Obama asked for a permanent extension of the current 10%, 15%, and 25% marginal income tax brackets, and an expansion of the current 28% tax bracket. The current 33% and 35% brackets would be allowed to expire, resulting in the top two marginal rates for 2011 returning to 36% and 39.6%. The expanded 28% bracket would be calculated in a way that would allow individuals earning less than $200,000 (less the standard deduction amount and one exemption) and married couples filing jointly earning less than $250,000 (less the standard deduction and two personal exemptions) to escape taxation at the top rates.

The President also proposed making the current tax rates that apply to long-term capital gain (i.e., the 0% and 15% rates) permanent, but adding a new 20% rate for those in the newly reestablished 36% and 39.6% brackets.

Will Congress act, or will it simply let current rates expire? There's plenty of time before 2011, so stay tuned.

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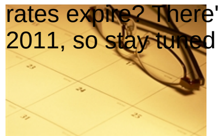

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"Understanding the nature and level of the risks you face can be critical in sticking to a long-term investing strategy."

Evaluating Risk in Your Portfolio

If you're like most people, you probably evaluate your portfolio in terms of the return it earns. However, as we were all reminded in 2008, returns aren't the only factor you should consider when determining whether your portfolio is allocated appropriately. Also important is the level of risk you take in pursuing those returns.

There are a number of ways to estimate the level of risk in a portfolio. The term "risk" is often used interchangeably with "volatility" (the tendency of a portfolio's value to rise or fall sharply, especially within a relatively short period of time). However, for most people, a portfolio is simply a means to an end--paying for retirement or a child's college tuition, for example. In that context, "risk" also means the risk of not meeting your financial needs.

Volatility measures

One of the most common measures of volatility is standard deviation, which gauges the degree of an investment's up-and-down moves. It shows how much the investment's returns have deviated from time to time from its own average. The higher the standard deviation of an investment or portfolio, the bumpier the road to those returns has been.

Another way to assess a portfolio's volatility is to determine its beta. This statistic compares a portfolio's ups and downs to those of a benchmark index, such as the S&P 500, and indicates how sensitive the portfolio might be to overall market movements. An investment or portfolio with a beta of 1 would have exactly as much market risk as its benchmark.

The higher the beta, the more volatile the portfolio. A beta of 1.05 means the portfolio involves 5% more market risk than the benchmark to which it's compared. If the benchmark rises 10%, a portfolio with a beta of 1.05 should theoretically rise 10.5%; a fall of 10% in the benchmark should mean a corresponding 10.5% decline in the portfolio.

A 0.95 beta means a portfolio has 5% less market risk than that index; in theory, the portfolio would rise and fall 5% less than the benchmark. (However, remember that investments also have unique risks that are not related to market behavior. Those risks can create volatility patterns that are different from the underlying benchmark.)

The risk of not achieving your goals

Another way to evaluate risk is to estimate the chances of your portfolio achieving a desired financial goal. In this case, "risk" means not volatility but the odds that your portfolio will succeed in meeting a specific financial liability. A technique known as Monte Carlo simulation uses computer modeling based on multiple scenarios for how various types of investments might perform based on their past returns. Though past performance is no guarantee of future results, such a projection can estimate how close your plan might come to meeting a future target amount.

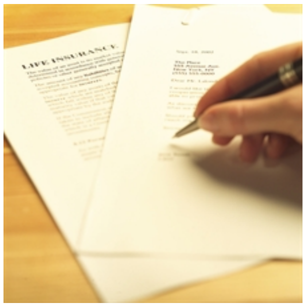
Let's look at a hypothetical example. Let's say Bob wants to retire in 15 years. A Monte Carlo simulation might suggest that, given his current level of saving and his portfolio's asset allocation, Bob has a 90% chance of achieving his retirement target. If he chose to save more, he might increase his odds of success to 95%. Or Bob might decide that he's comfortable with having an 85% chance of success in reaching his target amount if that also means his portfolio might be less volatile. (However, be aware that though a projection might show a high probability that you'll reach your financial goals, it can't guarantee that outcome.)

Are you getting paid enough to take risk?

Another approach to thinking about portfolio risk involves the reward side of the risk-reward tradeoff. You can compare a portfolio's return to that of a relatively risk-free investment, such as the inflation-adjusted return on a short-term (3 months or less) U.S. Treasury bill. Modern portfolio theory is based on the assumption that you should receive greater compensation for taking more risk (though there's no guarantee it will work out that way, of course). A stock should offer a potentially higher return than a Treasury bond; the difference between the two returns is the equity's risk premium. A small-cap stock that's relatively new should offer a higher risk premium than a well established, dividend-paying stock. While understanding risk premium doesn't necessarily minimize risk, it can help you evaluate whether the return you're getting is worth the risk you're taking.

Whatever your approach to portfolio risk, understanding the nature and level of the risks you face can be critical in sticking to a long-term investing strategy.

How Much Life Insurance Is Enough?



An insurance coverage review is a periodic reassessment of your insurance needs. The main objectives are to confirm that the level of insurance coverage you have is still adequate, to alert you to shortages in coverage that can occur due to changes in your life, and to ensure that any cash value policies are performing as expected.

Your life insurance needs often depend on a number of factors, including whether you're married, the size of your family, the nature of your financial obligations, your career stage, and your goals.

There are a number of approaches you can use to figure out how much insurance you should have. One method, called the "family needs approach," focuses on the amount of life insurance it would take to allow your family to meet its various financial obligations and expenses in the event of your death.

Family needs approach

With the family needs approach, you divide your family's financial needs into three main categories:

- Immediate needs at death, such as cash needed for estate taxes and settlement costs, credit card and other debts including mortgages (unless you choose to include mortgage payments as part of ongoing family needs), an emergency fund for unexpected costs, and college education expenses.
- Ongoing income needs for expenses related to food, clothing, shelter, and transportation, among other things. These income needs will vary in amount and duration, depending on a number of factors, such as your spouse's age, your children's ages, your surviving spouse's capacity to earn income, your debt (including mortgages), and whether you'll provide funds for your surviving spouse's retirement.
- Special funding needs, such as college funding, charitable bequests, funding a buy/sell agreement, or business succession planning.

Once you determine the total amount of your family's financial needs, you subtract from this total the available assets that your family could use to defray some or all of their expenses. The difference, if any, represents an amount that life insurance proceeds, and the income from future investment of those proceeds, can cover.

Example(s): *John and his wife, Wendy, are estimating the appropriate amount of life insurance to buy on John's life. They first estimate their immediate needs as follows:*

- *Final medical expenses: $5,000*
- *Estate settlement costs including funeral and burial expenses: $37,500*
- *Debts, including credit cards and mortgages: $317,000*
- *Emergency fund: $100,000*

Subtotal: $459,500

Next, they estimate ongoing income needs, such as:

- *Providing for their dependent children's needs for a period of time: $500,000*
- *Wendy's income needs until her retirement: $450,000*
- *Wendy's retirement income needs: $380,000*

Subtotal: $1,330,000

Adding the sub totals together, John and Wendy estimate that, should John die, their family would need $1,789,500. They then determine that assets available to offset their needs include:

- *Bank savings: $40,000*
- *Investments: $220,000*
- *Retirement assets: $250,000*
- *Existing life insurance on John's life: $300,000*

Subtotal: $810,000

The difference between their family needs ($1,789,500) and their available assets ($810,000) equals their life insurance need ($979,500).

Review your coverage

Trying to figure out how much life insurance is enough isn't always easy, and that amount will likely change with your changing circumstances. By examining your family's anticipated expenses during various periods after your death, you get a more realistic estimate of your life insurance needs.

Unfortunately, many people underestimate their insurance needs and are underinsured. Often, the purchase of life insurance is based on cost instead of what's needed. By the same token, it's possible to have more insurance than you need. You may have purchased a large policy during a particular point in your life, and then didn't adjust your coverage when your insurance need was reduced. Both of these circumstances are reasons to review your insurance coverage periodically with your financial professional. Doing so can reveal opportunities to change your levels of coverage to match your current and projected life insurance needs.

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How have stocks performed after a recession?

Mark Twain said it best: "History doesn't repeat itself; at best it sometimes rhymes." Past performance is no guarantee of future results, and history can be an uncertain guide in terms of what might happen with stocks this time around as the economy begins to stagger out of a recession.

That said, it's fascinating to look at how various subsegments of the stock market have behaved relative to one another. Particularly interesting is the comparison between the performance of small-cap stocks and that of large caps after each of the last six recessions. In each case, small caps led the way out of those downturns. During the 12 months after the recession came to an end, as declared by the National Bureau of Economic Research (NBER), small caps beat large caps every time.

The average difference over the six recovery periods was 14.5%. In some cases, the difference was dramatic; in others, small caps were barely ahead. Here are the percentages by which small caps beat the S&P 500*:

- December 1970-November 1971: 1.3%
- April 1975-March 1976: 23.2%
- August 1980-July 1981: 28.4%
- December 1982-November 1983: 14.4%
- April 1991-March 1992: 14.8%
- December 2002-November 2003: 5.2%

Will history rhyme this time? It's hard to say. Many economists feel the current recession ended sometime in summer 2009. Small-cap stocks have certainly done well since then, but some experts feel large caps are best equipped to navigate a credit crisis. However, until the NBER retroactively declares an official end to this recession, there's no way to know for sure. And don't forget that small caps historically have involved greater risk from market fluctuation, so a double-dip downturn could hit them hardest.

*Percentages calculated based on data from Ibbotson SBBI *Market Results for Stocks, Bonds, Bills, and Inflation* for small company stocks and the S&P 500 Composite Index.

How long does it take a bear market to end?

A bear market, typically defined as an overall stock market decline of at least 20% over an extended period, historically has lasted an average of a little over a year.* On average, bull markets tend to last almost twice as long as bear markets, but sometimes the differences can be even more dramatic. For example, the bear market that began in January of 2002 lasted almost nine months; it was followed by a five-year bull market from October 2002 to October 2007.

The shortest bear market on record lasted only about six weeks, from mid-July 1998 to the end of August. The longest? October 1939 through April 1942 (almost 30 months), beating out April 1930 to June 1932 (just over two years).

However, defining bear markets and subsequent recoveries from them isn't as straightforward as it might seem. For one thing, a long-term bear market can be interrupted by one or more shorter-term bull markets (or vice versa). For example, was the period between March 2000 and October 2002 a single 30-month bear market with a roughly 3-month "bear market rally" from September 2001 to the beginning of 2002, as some market technicians argue? Or was it two independent bear markets--one from March 2000 to September 2001 and a second from January 2002 to October 2002--that were separated by the shortest bull market since the Depression summer of 1932?

By definition, you only know you're in either a bear or bull market in retrospect, once the market has moved consistently in one direction or another. And the past isn't necessarily a good predictor of what will happen in the future. Since investing is about the future rather than the past, it may make sense to focus more on factors such as asset allocation than on the timing of a recovery you can't control.

*All time frames based on data from the *Stock Trader's Almanac 2010* on the Standard & Poor's 500, a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy.

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