The Financial Navigator – March Newsletter

In this issue we point out a few last minute tax tips that could cut your tax bill, and discuss the accuracy of market predictions that saturate the financial press these days. We include this latter section as we are often asked about what the latest talking-head on CNBC said last night and how one should react to his or her latest prediction.

Sincerely,
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Some last minute tax tips

Below are listed a few ideas that you may find useful to reduce what you owe Uncle Sam. Note that all the credits mentioned have income and timing limitations, please consult with your tax advisor about your specific situation and the details prior to taking the credit on your tax return.

1. Are you paying for college? If so you may be able to qualify for an American Opportunity Tax Credit. This credit expanded its predecessor (the Hope Credit) by making it larger and applicable to all four years of an undergraduate education instead of just the first two as the Hope did. It also raised the income limits so more people qualify.

The American Opportunity Tax Credit returns 100% of the first $2,000 you spend on undergraduate tuition, related fees, and course-related books in 2009 plus 25% of the next $2,000 you spend. The maximum credit would be worth $2,500 in 2009 for a qualifying student or parent. Income limits do apply and these limits can reduce or eliminate the credit for higher earners.

2. Did you buy a new car in 2009? You may be able to deduct the state or local sales or excise taxes as the 2009 economic stimulus law allows you to deduct the sales tax or excise tax paid on a new vehicle purchased after February 16, 2009, and before January 1, 2010. A new car, light truck, or motorcycle (all of which must weigh 8,500 pounds or less) or a motor home all qualify.

You can get the deduction whether or not you participated in the Cash for Clunkers program. The deduction is limited to the sales and excise taxes and similar fees paid on up to $49,500 of the purchase price. In states without a sales tax—such as New Hampshire, Montana, and Oregon—you can deduct other fees and taxes collected on automobile sales by state or local government. As always there is a catch, the credit begins to phase out at higher income levels.

3. Did you buy a home? Then you may qualify for the home buyer's tax credit. There were actually two versions in effect at different times in 2009. Originally intended only for first-time home buyers, the credit was renewed and expanded in late 2009 to also cover repeat home buyers.

Version 1: Qualifying first-time home buyers can claim a tax credit of 10% of the price of a home purchased at any time in 2009 up to a maximum of $8,000.

Version 2: Qualifying longtime residents who purchased a home between November 6, 2009, and January 1, 2010, can claim a credit of 10% of the price up to a maximum of $6,500. To qualify as a longtime resident, you must have owned or lived in your previous home for at least five consecutive years of the eight years before you bought your new primary residence.

The tax credit remains in place for qualifying home buyers who sign a sales contract by April 30, 2010, and settle by June 30, 2010. You can claim it for homes purchased in 2009 on either your 2008 (for those of you a year behind on filing your taxes) or your 2009 tax return. For homes purchased in 2010, you can claim the credit on either your 2009 or 2010 tax return. Income limits can reduce or eliminate the credit, and vary depending on the timing of the home purchase.

4. Can you claim the Making Work Pay Tax Credit? It's worth up to $400 to single taxpayers or up to $800 if you're married and file a joint return. You've may have been benefiting from the stimulus package bonus since spring 2009, when tax withholding tables were adjusted to give workers a little extra take-home pay in each paycheck. To keep those extra payments, you'll need to claim them on your 2009 tax return by filling out the new Schedule M and filing it with your federal return. It shouldn't be hard; tax-preparation software can lead you through the process automatically. Of course the Making Work Pay Tax Credit phases out for higher-income earners, and you cannot take the Making Work Pay Tax Credit if you are claimed as a dependent on someone else's return; so, for example, teenagers working at their first job may not benefit.

5. Did you make your home more energy-efficient? If so then you might qualify for a tax credit of up to $1,500. There have been various versions of energy-saving legislation over the years, but it lapsed in 2008. Reborn and expanded in 2009 like the home buyer's tax credit, these savings come in two flavors:

Version 1: You can receive up to $1,500 back in the form of a tax credit for the cost of qualifying insulation, energy-efficient windows, doors, or heating and air-conditioning systems installed in your personal residence. The credit is equal to 30% of the cost of the new materials placed in service in 2009 and 2010, up to a total credit of $1,500 for both tax years combined.

Version 2: A related 30% tax credit also is available on purchases of alternative energy sources such as solar electric systems, solar water heaters, geothermal heat pumps, wind turbines, and fuel cells. For these expenses, the $1,500 credit maximum is waived, except in the case of a fuel cell. If you install a qualifying alternative energy system in your home, the cost of labor may qualify toward the tax credit as well.

Note that no portion of the credit can be issued in a tax refund.

'It's tough to make predictions, especially about the future' — Yogi Berra

2009 proved to be unusually rewarding for equity investors around the world, with returns in excess of 25% in 41 out of 45 countries tracked by Morgan Stanley Capital International (MSCI). Emerging markets did especially well; total return for the MSCI Emerging Markets Index (expressed in US dollars) was 79.02%, the highest since inception of the index in 1988. US markets also turned in superb returns with the large cap sector producing a 26% return as measured by the S&P 500, and small cap stocks returning 27% as measured by the Russell 2000.

But for many investors 2009 was also the most challenging experience of their financial lives, and the ability to maintain one's investment strategy was constantly challenged by the dominance of dire predictions in the press, especially around February-March of last year. It is useful once in a while to look back on the so-called experts' forecasts for a reality check on their expertise, and to assess how much credence should be given to them.

What follows are excerpts from various economist, professional investors, and prognosticators made in 2009. As you read them remember where the stock market was a year ago, Dow Jones Industrial Average at 6,500, and where it is today, DJIA at 10,800. To start is one of my favorites, and although it is not recent, it still illustrates the fundamental nature of the financial press - it exists to sell magazines and newspapers, not to provide actionable, competent, and prudent advice.

- 'You make more money selling advice than following it. It is one of the things we count on in the magazine business-*along with the short memory of our readers.*'
  Steve Forbes, Publisher Forbes Magazine. Excerpt from presentation at The Anderson School, University of California, Los Angeles, April 15, 2003.

- "Concern about the economy flared after billionaire investor Warren Buffett said in an interview on CNBC television that the economy has 'fallen off a cliff' and the World Bank said that the global economy is likely to shrink for the first time since World War II."
  Peter A. McKay and Rob Curran, "Dow Drops to 6547.05 as Dim View Spreads Out," Wall Street Journal, March 10, 2009.

- "Some optimistic experts are now saying that though this will be a turbulent year for global markets, the worst of the financial crisis is behind us. Would it were so. We believe that 2009 will be tougher than many anticipate....The world's first global recession is just getting started."
  Ian Bremmer and Nouriel Roubini, "Expect the World's Economy to Suffer Through 2009," Wall Street Journal, January 23, 2009.

- "Don't be fooled by bear market rallies. It's way too early to get back into U.S. stocks...Expect meltdowns in securities backed by credit card debt, home equity, student and auto loans as well as commercial real estate.... Avoid emerging markets, especially China. China's fiscal bailout contains lots of smoke and mirrors, and social unrest is mounting."
  Gary A. Shilling, "Field Day for Short-Sellers," Forbes, February 16, 2009.

- "The current recovery has propelled the S&P 500 a third above its March low in just 60 days, convincing many skeptics that a new bull market has begun...It was a fairly typical sucker's rally and bear markets often need more than one to create sufficient disillusionment for a definitive bottom."
  Spencer Jakab, "On Wall Street: Beware of the Sucker's Rally," Financial Times, May 8, 2009.

- "Just how low can stocks go?... As earnings estimates are ratcheted down and hopes for a quick economic fix fade, the once-inconceivable notion of returning to Dow 5000 or S&P 500 at 500 looks a little less far-fetched... According to Goldman data, the bottom of the 1974 bear market had a forward P/E of 11.3. At the trough in 1982, it was 8.5. Put a multiple of 10 with estimates of $40 or $50 a share and the S&P 500 comes out at 400 and 500." [The S&P 500 index closed at 683.38 the previous day.]
  Annelena Lobb, "Dow 5000? There's a Case for It," Wall Street Journal, March 9, 2009.

- "When searching for a floor, the risk is that the roof caves in on top of you. The current broad market rally has spawned renewed talk of inflections, turns, and bottoms...Upbeat comments on profitability from the likes of Citigroup Inc. kicked things off. Speculation that mark-to-market accounting might be suspended also helped. Neither is convincing....Even if investors think it can't get any worse, the underpinnings of a sustained, healthy rally aren't in place yet."
  Liam Denning, "Rally Driver Wanted for Stocks," Wall Street Journal, March 17, 2009.

- "The most credible drivers of this rally are hints of an economic bottom. But even these tell of a bottom at a very low level, not necessarily a quick recovery....While this bounce might not mirror November's it still has the hallmarks of a bear-market rally."
  Mark Gongloff, "It's Starting to Look a Lot Like November," Wall Street Journal, April 6, 2009.

- "The rare nature of this recession precludes a cyclically normal recovery. Instead, we are consigned to a slow, painful climb-out, as are nations such as Japan and Mexico that depend on US demand."
  Roger Altman, former deputy Treasury secretary. "Why This Will Not Be a Normal Cyclical Recovery," Financial Times, April 6, 2009.

The point of this little exercise is that when times are dire, March 2009, or seemingly fantastic, think the late nineties, the press fills the pages of magazines and newspapers, and the airwaves with expert market predictions. However, as simply illustrated above, their records are for the most part abysmal. Therefore, you might consider viewing all of it as what it is; profit driven noise that is irrelevant to your long-term goals. Thanks to the team at Dimensional Fund Advisors, www.dfaus.com, for tracking and collecting the above predictions.

If you have any questions on this topics, or need some help with other financial issues you are facing give me a call at (603) 373-8793.