April 14th, 2010

Here is our newsletter for the 1st quarter of 2010.

There's Your Tax Bill on the Rise

If the headline seems familiar, remember the Credence Clearwater Revival song "There's a Bad Moon on the Rise". As sure as 2008 became a watershed year for changes in our economy and the markets, surely 2011 will be the same for taxation. Tax bills are on the rise.

For most of the last 40 years the highest federal marginal income tax rate has been going down. It was 90% in 1962. When John Fogerty's song topped the charts in 1969, all income over $200,000 was taxed at a rate of 70%. The top rate is currently 35% for all income over $375,650.

For lower earning families taxation has also gone down over the years. Only 47% of U.S. households will owe any Federal income tax for last year. An average family of four with $50,000 in income is the approximate cutoff point.

All is changing at the end of this year. Starting January 1st, 2011 the top income tax rate will go up to 39.6%. Rates in all the other brackets are going up from 3.0% to 4.6%, except that the 15% rate will stay the same. Also note capital gain tax rates are going up, with the top rate going from 15% to 20%. Note these changes were put into law between 2003 and 2005 when George Bush was president. So, if the President and Congress do nothing, taxes for all married couples making over around $68,000 will go up ($34,000 for singles).

Those that recognize this new reality can profit by acting now. Here are some strategies we are putting in place for our clients.

1. Tax deferral has less value. Don't automatically put all your investment contributions in tax deferred IRAs or company retirement plans.
2. Convert tax deferred IRA and company retirement plans to Roth IRAs. You can convert any IRA or company retirement plan except inherited IRAs and Education IRAs. This year and next the income limits for doing a Roth Conversion have also been eliminated, so those making over $150,000 can do a conversion.

We did several Roth Conversions last year for clients and will undoubtedly do more this year. We have two tools to determine the timing and size of the conversion. First, we use our comprehensive financial planning software and analyze a conversion while doing a comprehensive plan. Second, we have what I would call a quick and dirty analyzer that can estimate the value of the conversion in a few minutes. The good part about this analyzer is it recognizes the value of the conversion not only for the account owner, but also for the second generation. If the kids inherit a traditional IRA, they also inherit the tax bill on all the assets. Passing a Roth IRA onto the kids enables them to have tax-free income for their lifetimes as well.

Health Care Reform

I've found several summaries of the new health care reform act and have posted the best one on my website at http://www.compfinancial.com/need-to-know.html. At thirteen pages the summary is pretty comprehensive. Most of you have probably heard about many of the provisions but I would like to highlight a few.

1. Require U.S. citizens to have health insurance starting in 2014 or face penalties.
2. Require employers with 50 or more employees to offer health insurance coverage starting in 2014 or face penalties.
3. Provides small employers with no more than 25 full-time equivalent employees and average annual wages of less than $50,000 a tax credit for providing health insurance coverage for the employees. These provisions go into effect immediately. This could offer substantial savings for small businesses.

Another little known detail about the bill is it included a 3.8% surtax applied on income over $250,000 (includes all social security and portfolio income).

The Markets

The stock bull market that started in early March of last year continued in the 1st quarter of 2010, with U.S. large-cap stocks rising 5.4% and International (developed and emerging) stocks rising 1.5%. The Vanguard Total Bond Index rose 1.7% for the quarter while High Yield (junk bonds) gained 4.8%.

For the quarter our equity-tilted portfolio composite gained 3.6%, matching our benchmark returns. Our balanced portfolio composite gained 3.0% vs. 3.1% for the benchmark. We did make one change in our portfolios during the quarter by adding TCW Emerging Markets Income to all but our most aggressive portfolios. This fund invests in fixed income instruments, primarily corporate bonds, in developing countries such as Mexico, Russia and Brazil. This addition continues our strategy of underweighting equities in favor of corporate bonds to manage the risk in our portfolios and provide better risk-adjusted returns for our clients.

Our Website Makeover

Our website has been updated recently. Check it out at www.CompFinancial.com. Nick Spence at The Marketing Department did the work and did a great job. On the home page there is a link to an article in Fortune magazine of June of 2006, where I was quoted in the "Where does my home equity fit into my plan?" section of the article. I warned homeowners about taking on too much debt.

> "People now want to buy bigger or second homes in retirement and take on more debt," says fee-only planner Stan Johnson from Durango, Colo. Crazy talk. Instead, stay put or pick a smaller house that you can buy with no mortgage or a low one, and use any leftover cash to pay off other debt and pad savings.

After all that has happened in the last four years I'm amazed that home buyers are still being encouraged to put down only 3% to buy a home, backed up by the implicit guarantee from us taxpayers. Our country's new reality is our financial challenges are far from over, primarily due to the huge debt overhang that will take many years to deal with. Simply transferring that debt from the private sector to the public sector does not solve the problem.

I saw a quote from Charlie Munger just this week that seems appropriate. He is Warren Buffet's long time partner and co-chair at Berkshire Hathaway, one of our top holdings in our portfolios. "Recognize reality even when you don't like it: especially when you don't like it." Those that can recognize our new reality and face up the challenges will survive and thrive.

Thank you for your continued interest and let me know if I can be of service to you or a friend or relative.

Sincerely,

Stan Johnson, CFP(R)
Comprehensive Financial, Inc.
Registered Investment Advisor