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Is Media Biased Toward Bad Financial News?

Headlines about the economy in July sounded dire. "IMF Says Doubt Weighs On Economy," reported *The Wall Street Journal.* "Economy Looks Weaker As Retail Sales Slump," said *The Boston Globe.* "Fiscal Cliff Could Trigger U.S. Recession: IMF Economist," according to a CNBC story.

While the U.S. economy indeed was not growing briskly this summer, it was growing, and gloomy headlines belied reasons for optimism. Here are counterpoints to bad news and recession-mongering, reasons to expect that a slow-growth recovery will continue.

Positive Earnings Outlook. Earnings drive stock prices. A key prop supporting stock prices is that big-company profits are holding up and earnings estimates have stayed strong. In July 2012, the consensus earnings estimate of Wall Street analysts for companies in the Standard & Poor's 500 Index stood at $105 per share for 2012 and $118 per share for 2013. In the short term, headlines can whip stock prices around, but corporate earnings are the basis for stock prices in the long run. If analysts are close to correct in their earnings estimates, it would support stock valuations. Plus, we are halfway through 2012, so achieving something close to the $105 target should not be a stretch.

New-Jobs Formation. It's erratic. But it is positive. Job formation was choppy in the months following the last recession. The jobs recovery that began in January 2002 went negative in early 2003 even as the economy surged. Don't expect new jobs to grow steadily, and remember that inconsistent does not mean a recession is around the corner.

Household Versus Establishment Jobs Survey. Release of monthly jobs survey data in May and June caused big one-day dips in stock prices. But that's partly because the media focus on the U.S. Labor Department's Establishment Survey data on job creation at large corporations and not the Household Survey, which includes jobs created by small business and agriculture. While the widely-followed Establishment Survey tallied 80,000 net new jobs in June, the Labor Department's less-referenced Household Survey, indicated 128,000 net new jobs were created. Over the past six months, according to independent economist Fritz Meyer, the household survey has registered 1.6 million net new jobs versus just 900,000 by the Establishment survey --a significant difference. Yet big media seem generally unaware.

ADP Jobs Survey. ADP, which processes data for small businesses nationally, does its own survey of job creation. While over time, it tracks closely with the government survey data, in recent months it has shown a material difference. ADP reported more than twice the number of new jobs created in May and June than did the Labor Department's Establishment survey.

Auto Sales. Three years into the recovery, a return to the historical mean of about 16 million sales of American

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Dividend-Paying Stocks Good Bet Despite New Taxes

We believe that dividend-paying stocks are an important part of your overall asset allocation. Increasing dividends often signals strength in corporate earnings, and stock volatility tends to decrease as dividends increase. Dividends also are a great barometer as to a company's future earnings.

As we move closer to the election, there is much talk about increasing taxes on dividend income. The tax rate could be as high as 43.4%, which includes the new healthcare tax.

Yes, these taxes will be detrimental to investors; however, even with this additional tax burden the dividend yields on dividend-paying stocks are generally higher than you can obtain in bank certificates of deposit and treasuries. Dividend-paying stocks have performed exceptionally well (compared to their non-dividend counterparts) in periods of higher tax rates on dividend income.

The negative sentiment against dividend-paying stocks as a result of potential tax increases may suggest a buying opportunity for income-focused investors.

Dividends provide a wonderful source of income. For most investors, stocks and stock mutual funds that pay dividends should be considered as part of your overall asset allocation.

Best Personal Regards,

Donald N. Hoffman, MS, CPA
President

Two Investment Principles In Tandem

Diversification and asset allocation are twin building blocks of a solid investment foundation. Though the concepts are closely related, understanding each rather than just mixing them together can help you make the most of both. Consider these basics:

Diversification. This is the method of spreading out investment dollars among different categories, or "baskets," in order to reduce your overall risk. For instance, even if you're 99% sure that a particular stock is about to take off, you don't want to invest your life's savings in only one stock. There's still a chance it will tank, leaving you in a financial hole you may never get out of. Similarly, you want to avoid putting all of your investment dollars in a single basket—stocks, bonds, or copper, say—no matter how fundamentally sound the category may seem.

Diversification may work because different kinds of investments tend to rise and fall at different times. If you hold a variety of investments, some may do well when others stumble. Additional benefits can come from diversifying within categories—by spreading your stock investments over many industries and also holding shares in foreign companies. By the same token, you'll probably want to own different kinds of bonds with various maturities. Yet while broad diversification may help your investments weather a worst-case scenario, it can't protect you from losses, especially in a declining market.

Asset Allocation. Closely related to diversification, asset allocation goes a few steps further. Here, you seek to divide your holdings among major investment categories based on a set percentage for each category. Because each group has a unique combination of historical risks and returns, it's expected that each also will perform differently in the future.

This is diversification with a little more science. Because it's likely that if one category loses value, another may be on the upswing while a third holds steady, devoting an appropriate percentage of your portfolio to each can keep your portfolio in balance.

Yet there's also a lot of art involved in asset allocation. Choosing the best percentages for your circumstances requires looking at several variables, such as your objectives, age, health status, amount of assets, and tolerance for risk. And because your goals are likely to shift, allocations need to be reevaluated and adjusted periodically. Typically, your choices will become more conservative as you near or reach retirement.

Asset allocation provides a rigorous method for achieving diversification in your investment portfolio. Having the two ideas working smoothly together can help you move closer to your financial goals. ●

Avoid Five Pitfalls In Refinancing

Mortgage interest rates are at historic lows, but does that mean you should refinance an existing mortgage? A "refi" may pay off, but you should consider all of the relevant factors, including these five potential problems:

1. You're back to square one. Starting over is hard to do if you're close to paying off a mortgage. For instance, if you take out a 30-year loan, the monthly payments in the first seven years will reduce your principal by only 5% or so, with the rest going to interest. Instead of beginning to make a dent in their principal debt, homeowners who refinance after seven years are effectively starting from scratch. Figure out how much you're really saving if you shave only a percentage point or less off your current rate.

2. Closing costs can pile up. Depending on how long you stay in a home, the expenses of a new loan can outpace the savings. Figure on closing costs equal to about 1.5% of the mortgage amount. Then calculate your monthly savings to see how long it will take you to break even on the cost of the mortgage. For example, if you refinance a $300,000 mortgage, closing costs will run about $4,500. If the new mortgage interest rate is 1 percentage point lower than your current rate, you will save $178 a month and will need just over 25 months to recoup your closing costs. So if you're not planning to stay in the house for more than two years, you could end up losing money. Reduce these costs by paying the prepaid items out of pocket. You'll get that money back when the escrow accounts on your old loan are paid back to you.

3. Terms can be confusing. With refis so popular now, they can take a long time to process, and it may not be clear when you should stop paying your current mortgage. If you inadvertently fall behind, it could

Impact Of The New Ruling On Health Care Law

On June 28, 2012, the U.S. Supreme Court handed down its long-awaited decision on the controversial health care law implemented by President Obama, the Patient Protection and Affordable Care Act of 2010 (PPACA) — widely known as "Obamacare." With the exception of an expanded Medicaid requirement on states, the nation's top court upheld the constitutionality of the law. So where do we go from here?

Certain PPACA provisions are in effect already and several important tax provisions become effective in the months ahead. Here's a roundup of key changes on the way:

Individual Coverage Mandated. Beginning in 2014, anyone ineligible for Medicare or Medicaid and who is uninsured must obtain minimum essential health insurance coverage or pay a nondeductible penalty. The annual penalty will be $95, or 1% of income, whichever is greater. It rises by 2016 to $695, or 2.5% of income, for individuals. Families face a maximum penalty of $2,085, but will owe 2.5% of household income if that amount is greater. The law also authorizes subsidies for low-income individuals and creates a reinsurance program for employer-sponsored early retiree coverage.

Employer Coverage. Beginning in 2014, an employer failing to offer minimum essential coverage in any month for an eligible full-time employee will owe a special tax. The tax is equal to one-twelfth of $2,000 times the number of all full-time employees in the company. This penalty applies only to employers with 50 or more workers, but the first 30 workers are excluded from the calculation. For example, an employer with 50 employees will pay the required tax based on only 20 employees. An employer also may be assessed additional tax if the employer imposes waiting-period restrictions. Furthermore, if an employer provides minimal essential coverage to employees, it must file information returns with the IRS.

Medicare Surtaxes. Beginning in 2013, some high-income taxpayers will be liable for one or two new Medicare surtaxes.

- Beginning in January 2013, a 3.8% surtax will be levied on single taxpayers with modified adjusted gross income (MAGI) exceeding $200,000, and married couples filing jointly with adjusted gross income (AGI) exceeding $250,000. The surtax applies to the lesser of net investment income or MAGI exceeding $200,000 for individuals ($250,000 for married couples filing jointly). Net investment income includes interest, dividends, royalties, rents, gains from dispositions of property, and income from passive activities. Tax-free interest and payouts from qualified retirement plans and IRAs are exempt.

- Beginning in January 2013, an additional Medicare payroll tax of 0.9% will be applied to individuals with AGI exceeding $200,000 and married couples filing jointly with more than $250,000 of AGI.

Health Care FSAs. Currently, there's no limit on the amount an employee can contribute to a flexible spending account (FSA) used for health care expenses. (A $5,000 limit applies to dependent care expenses.) Contributions to FSAs are made on a pre-tax basis, so you're able to pay for qualified medical expenses with pre-tax dollars. Beginning in 2013, the new law limits annual contributions to health care FSAs to $2,500, but that figure will be adjusted for inflation.

Medical Deductions. Currently, you can deduct qualified medical expenses in excess of 7.5% of your adjusted gross income. Beginning in 2013, however, the new law generally raises the "floor" to 10% of AGI. However, an individual (and spouse) who is age 65 or older is temporarily exempt from this increase for tax years beginning after 2012 and before 2017. The medical-expense AGI floor for alternative minimum tax (AMT) purposes, which is already 10%, remains the same.

Pre-Existing Conditions. Under a provision that took effect in 2010, children under the age of 19 with pre-existing conditions can't be denied access to their parents' health plan nor can insurers exclude treatments for these children. Beginning in 2014, this expanded coverage for pre-existing medical conditions will be extended to adults.

Medicare Donut Hole. Medicare beneficiaries who fall into the Part D coverage gap, known as the donut hole, began receiving a 50% discount on the cost of covered brand-name prescriptions in 2011. Additional discounts for brand-name and generic drugs are being phased in. The donut hole will be closed completely by 2020.

These changes are just the tip of the iceberg. Although the health care law still may be repealed or modified, it includes dozens of other provisions that could have a direct or indirect impact on you, your family and your business. We'll keep you posted on the new rules. ●

throw a monkey wrench into the works. Generally, lenders offer a two-week grace period after a mortgage payment is due and then charge a 5% penalty. Even worse, your credit score might plummet by 100 points or more if you're 30 days past due—and that change could affect your refi.

4. The appraisal may be too low. Before the refi is approved, the lender will require an independent appraisal to confirm the home's value. The numbers now are trending lower than expected for many homeowners, especially those who reside in areas hit by numerous foreclosures. If the appraised value is too low and you don't have enough equity in the home, the lender could raise the rate or deny the loan altogether.

5. You could pay hidden fees. Under federal law, lenders must provide a good-faith estimate of the fees needed to complete the refi, and that statement could reveal costs you hadn't expected. Also, some low-interest mortgages require you to pay "points," and each point is equal to 1% of the mortgage amount. That could delay your break-even point even longer. ●

Should You Consolidate Your IRAs?

Everyone's financial situation is different, but people at various stages of life often share similar concerns. Here's a question from a client we encountered under such circumstances:

"I am in my 60s and recently retired from my full-time job. Over the years, I've opened several traditional IRAs and a Roth IRA. Also, I have a 'rollover IRA' with funds from a 401(k) at a previous job. Should I consolidate all of these IRAs into one for tax purposes, or should I just leave things the way they are?"

While there is no real tax benefit one way or the other, there is a trap to watch out for if you do consolidate. Combining the assets of your traditional IRAs into a single IRA could provide a few advantages, however.

For starters, it may be more flexible and cost-efficient to have just one IRA, as well as relieving you of considerable clutter if you're still receiving paper statements from all of your IRA custodians. Also, if one IRA has provided better investment returns than the other or offers other advantages, it might make sense to shift more funds to the IRA with those advantages. (Of course, past performance is no guarantee of future results.) And you may find it easier to coordinate your plans for retirement, and focus on your main objectives, with a consolidated IRA.

Moreover, consolidating accounts might help you avoid a complication that can arise when you start taking "required minimum distributions" (RMDs) from your traditional IRAs. The law mandates that you begin taking RMDs no later than Apri1 1 of the year following the year in which you turn age 70½. These withdrawals from your account, the amount of which is based on life expectancy tables, must continue annually for the rest of your life. If you have several IRAs, you'll have to choose the source of your annual RMD. It can come from one or multiple IRAs. But no matter how you arrange the distribution, the IRS treats it for tax purposes as coming from all of your IRAs on a "pro-rata" basis.

Let's say you have four IRAs with a combined value of $500,000, and this year you withdraw $20,000 from one of them. The applicable percentage is 4% ($20,000 divided by $500,000), so it's calculated as if you had withdrawn 4% of the balance in each IRA. Consolidating your IRAs would eliminate any confusion.

Finally, be aware that you can't commingle the funds in traditional and Roth IRAs. This is the trap we alluded to earlier. Because Roths have an edge over traditional IRAs—qualified Roth distributions are tax-free and you don't have to take lifetime mandatory distributions—you wouldn't want to put them together anyway. Should you consolidate all of your Roth IRAs? Many of the same considerations that apply to combining traditional IRAs also are applicable to Roths. ●

Is Media Biased?

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vehicles annually is upon us. The average age of cars in the U.S. increased during the last recession, as people were foregoing new car purchases, but the average age now is decreasing, which bodes well for car sales. Ford's chief economist was quoted in *The Wall Street Journal* on July 3 as saying consumers are still eager to trade in aging vehicles for new, more fuel-efficient models equipped with the latest technology. In addition, she said, low interest rates and easier access to credit also are boosting auto sales.

Leading Economic Indicators (LEI). In its release of the June LEI, The Conference Board said the economy was growing modestly and pointed to a "relatively low risk of a downturn (http://www.conference-board.org/data/bcicountry.cfm?cid=1) in the second half of 2012." In addition, the six-month rate of change in LEI was not signaling a recession, as it has before previous downturns. According to economist Meyer, the six-month rate of change in the LEI dipped substantially below zero in advance of each of the last three recessions. The most recent numbers, however, show nothing of the sort.

Consumer Debt. Contrary to frequent press reports about consumers being tapped out and struggling under a mountain of debt, the Federal Reserve on June 22 said consumers' ability to meet monthly expenses has not been better since 1980. The Fed's financial obligation ratio, which measures consumers' fixed expenses compared to disposable income --a good measure of consumer debt on mortgages, credit cards, car loans, etc. --has recovered fully. At 16%, 84% of after-tax household income is available for other purchases.

Predicting the economy's next upturn or downturn is not easy and these optimistic signs could be quickly dashed if Europe slides into recession, if a war breaks out in the Mideast, or any of a myriad of bad scenarios becomes reality. Absent such a negative surprise, economic data support a continued slow recovery. But the bias of the media, toward selling newspapers and getting viewers of websites and TV shows, tends to elevate the importance of bad news. Good news doesn't sell, create urgency, or feed fear. Prudent long-term investors must try to keep that in mind. ●