



Napa Wealth Management's The Sensible Investor

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Next Newsletter: April 2011

Current Outlook from TD Ameritrade's Chief Economist

By George P. McCuen, CFP®, President



Last month I attended TD Ameritrade's National Conference in San Diego. While there I attended a presentation given by Craig Alexander, Chief Economist TD Bank who gave his outlook on today's economic situation.

During his presentation Alexander stated, *"After the worst recession since the Second World War, the U.S. economy has now been growing for six quarters"*. Alexander went on to explain that when you're a year and a half into an economic recovery, you expect people and businesses to begin feeling good that we've made it to the other side of the valley. But it hasn't felt like that, right? There has been a lot of pessimism out there. The reason; when you have a financial crisis induced recession (e.g., banking crisis), the legacies of that environment are with you for a long period of time. It typically lasts twice as long as a normal business cycle recession, it's more than twice as deep and the speed of recovery is twice as slow.

Alexander believes that the housing market is going to remain weak for a *"very long period of time."* He points to the inventory of unsold homes, which is at an 8-month supply, as a key indicator. A healthy ratio is a 4 month supply, *"therefore we are 100% above where you should be"*, states Alexander. But, as Alexander pointed out, that understates how much of a supply overhang there is in the housing market. It doesn't include the number of homes that are going into foreclosure or are 90-days delinquent and on the cusp of going into foreclosure. If you included the latter two groups into the supply equation, it increases the inventory to 16-months of supply. The glut of housing supply weighs heavy on a recovery as it exhibits downward pressure on prices. His outlook is for several years of housing prices going sideways

and potentially single-digit declines.

The unemployment outlook is also lugubrious. Alexander points to a weak job market (we see this all around us). To put it in perspective, our economy needs to see an increase of 200,000 jobs a month to keep the unemployment rate from rising. Although the February unemployment rate dropped to 8.9%, the lowest since April 2009, it came with only 192,000 jobs added to the economy.

Alexander said that the rate is *"falling for all the wrong reasons. It's not falling because jobs are being created, but because people are leaving the labor market."* Alexander's point elucidates the under-reporting problem from the Labor Department. Simply stated, if you don't have a job and you are not seeking employment, you're not counted. This makes sense when you consider a parent who has left the labor market to raise a family or a college student, for example. They are not considered unemployed. But after a recession of the magnitude we recently experienced, where jobs are sparse at best, people have given up looking for employment. Another group to consider is workers who have gone from full-time to part-time work, but are still looking for full-time employment. When you take all data into account, the true unemployment rate is around 16%.

The good news; the unemployment rate is a lagging indicator. It tells you where the labor market has been, not where it's going. The stock market is a leading indicator. Investors will look at the unemployment rate and make assumptions about the stock market. That approach is tantamount to driving your car while looking through your rear view mirror – not a great way to get to your destination safely.

Alexander sees credit starting to flow from banks to business and consumers. It's not back to where it should be but progress is being made. That is comforting from an economic recovery perspective. The U.S. economy just went through the worst recession since World War II so we should expect some anxiety coming out of this economic period however

we are seeing a recovery. The outlook is becoming more favorable since credit is loosening. Alexander's forecast for U.S. economic growth for 2011 and 2012 is about 3 – 3.5%. To put this in perspective, in the past decade the best year for the U.S. in terms of economic growth was 2004 when we grew 3.6%. In 2008 we didn't grow and in 2009 we were down 2.6%.

Interest rates should remain low in this economic climate. With core inflation hovering around 1% (this is the government's number – not reality for most of us but a matrix that drives interest rate's moves by the Federal Reserve - Alexander indicated that he doesn't see the Fed raising interest rates until mid-2012. When you consider the impact that higher oil prices have on an economic recovery, you can appreciate that the Feds won't want to add any pressure by raising interest rates any time soon.

Alexander summarized his outlook by saying, *"Corporate profits will continue to increase and with dividends plus growth, company's profits should support high single or low double digit stock returns in North America and Europe. Stock dividend yield is attractive especially when you compare them to bond yields. A low inflation environment is positive for stocks. But volatility will remain a major theme for all asset classes and foreign markets"*.

Keep looking up,

George



Big Changes in the Estate and Gift Tax

By Jim Riley, CFP, EA



If you don't want to read all the details that's okay. Just so you know that the 2011 and 2012 estate and gift tax changes are huge and offer many, many planning opportunities to pass along assets and their future appreciation to children, grandchildren and more. You do not have to be ultra wealthy to take advantage of the new circumstances. For example, these changes might allow you to pass assets tax free

to grandchildren and for pennies on the dollar.

Okay. I got it out of my system. Here's a recap of the changes enacted by the Tax Relief Act of 2010:

1) The top estate tax rate is now 35% but the biggest change is that the estate tax exemption amount is now \$5,000,000 per individual. That means that a married couple can shelter \$10,000,000 against estate taxation. That is the highest amount ever. Furthermore each individual's exemption is portable. That means if Ozzie dies with an estate of \$3 million then Harriet may have an exemption of \$7 million provided an election is made at the time of Ozzie's death. This development effectively cancels the estate tax for all but the very wealthiest individuals. Bear in mind however that the facts I've described are only effective for individuals that die in 2011 and 2012 unless Congress extends them further.

2) The gift tax has undergone significant changes as well. There are two components of the gift tax. The first is the **annual exclusion** that states that any individual may give any other individual \$13,000 per year. Let me stress that this is an **annual** amount. This amount has not changed for either 2011 or 2012.

The second component is the **life time exemption** amount which has been \$1,000,000 for the last 10 years. For 2011 and 2012 this amount jumps to \$5,000,000. So now every individual may **annually** give \$13,000 to as many people as he or she wants **and** give \$5,000,000 over their **lifetime** without incurring gift tax.

3) There's more. The generation skipping transfer tax (GST) which allows inheritances to jump a generation or more has undergone much the same changes as the estate and gift taxes. For 2011 and 2012 each individual is allowed a \$5,000,000 GST exemption which makes giving to grandchildren and great-grandchildren easier than ever.

So, what do you do? At the very least, have a look at your estate plan. You'll want to make sure that any trust arrangements you've made will mesh with the new laws. Furthermore, it's become easier to pass assets to future generations and you might want us to discuss your options with you. These changes, as they stand now, are temporary and will end on December 31, 2012.