

Current Observations

Ideas Worth Spreading *By Paul Sutherland, CFP®*

There are so many things in the world to be positive about – socially and economically. There are, of course, negative, awful things that happen. But as investors we don't have to go there. So in this article and Jeff's, we invite you to walk with us on the bright, refreshing, sunny side of the street.

And Now the Good News

I consider myself supremely lucky. In my world I get to hang out with creative and successful people and work with clients who are gifted, accomplished and concerned citizens. As investors we seek companies that have great businesses, in great industries, with management that anticipates competition, government regulations and views a slow economy as a challenging period during which opportunities are created.

Thankfully, except for the black swan global financial tsunami in 2008, we feel we have successfully been consistent about making money for our clients for more than 25 years. Actually, if a client had fallen asleep 10 years ago and woke up today to see their portfolio, they might ask, "What tsunami?"

I invite all FIM Group clients to our website – www.fimg.net – to view a publication that a typical prospective client might read in their quest to find an investment manager. Without pretense or eloquence the piece is titled "Investing Without Borders." Barry Hyman, Jeff Lokken and I also recently conducted a webinar titled "What Do You Own and Why," in which we presented our thoughts on the current economy, markets and investments. The webinar is posted on our site or can be ordered free of charge as a CD-ROM by calling our office.



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Opportunity in the Mayhem

At FIM Group we believe in transparency, and our statistics are reflective of that belief. For example, we don't cherry-pick accounts. Instead, we clearly show how we arrive at our performance statistics, all of which reflect amounts after fees, commissions and non-tax expenses have been deducted. The secret to our success is actually quite simple: We look for opportunity everywhere (*Investing Without Borders*). We don't get caught up in the short-term groupthink, or mental malaise, that plagues the average investor who succumbs to the "mass behavior" and ends up with disappointing investment results.

Darwin aside, humans are herd animals. And while the herd is quite often safe, especially from an emotional perspective, it can be quite damaging when it comes to financial or life success. The downside of herd behavior is illustrated in the news excerpt reprinted below:

Turkish shepherds stunned after flock of 1,500 sheep leaps off cliff.

ISTANBUL, Turkey (AP) – First one sheep jumped to its death. Then stunned Turkish shepherds, who had left the herd to graze while they had breakfast, watched as nearly 1,500 others followed, each leaping off the same cliff, Turkish media reported Friday.

Source: <http://www.zgeek.com/showthread.php/38285-Turkish-shepherds-stunned-after-flock-of-1-500-sheep-leaps-off-cliff>

We all know the real victims in 2008-2009 were the ones who "jumped off the cliff," sold everything and moved to the sidelines to watch passively as literally trillions of dollars were made by those who just stuck to their plan, held on or saw opportunity in the mayhem.

TED

For years I've attended the World Futurist Society's World Futurist Conference each summer, often as a speaker. This year, however, I attended the TEDGlobal event in Oxford, England. TED is a small nonprofit organization devoted to propagating "ideas worth spreading." TED started out in 1984 as an annual conference that brought together people from three industries: technology, entertainment and design. Since then its scope has broadened to include: economics, business, education, environment, psychology, health care and other disciplines at its conferences. TED has grown significantly, and a ticket to TED is coveted.

Despite all of my current obligations, I was encouraged by my wife, friends and colleagues to attend this year's conference, the theme of which was, "And Now the Good News" which demonstrated many others who see opportunities during mayhem. For that I am grateful, and I invite all of you to take the opportunity to attend TED if it ever presents itself.

Clients can hear TED talks by simply visiting www.fimg.net, under "client updates." You will find hundreds of discussions that will inspire, sadden, anger, challenge, enlighten, amuse and certainly entertain. For your convenience we have highlighted some of the chats below, including photos of the speakers.

INFORMATIVE



Bill Gates

"Bill Gates on Energy: Innovating to Zero!"

INSPIRATIONAL



Steve Jobs

"How to Live Before You Die"



Louise Fresco

"Louise Fresco on Feeding the Whole World"



Roz Savage

"Why I'm Rowing Across the Pacific"

Is it Still Winter?

By Jeff Lokken, CFP®, ChFC®

I am sitting on my couch writing this article, and it's July in Wisconsin. The trees and flowers are in full bloom, and the nuts are still growing on the trees, so those pesky squirrels need to raid my birdfeeders for nourishment. My neighbor just backed his RV out of the driveway to prepare for a family vacation. Yes, it is summer here in Wisconsin but apparently not on Wall Street. Individual investors and corporations continue to store up cash like squirrels burying nuts, readying for a harsh, cold winter. Are there signs of summer coming to Wall Street?

At the risk of overdoing my seasonal metaphor, may I observe that having so much cash invested in assets with miniscule returns and, in fact, losing purchasing power after the impact of inflation and taxation, is like wearing a winter coat in summer? That North Face parka is wonderful for fighting the cold winter wind in Wisconsin, but it becomes a major hindrance in July when pruning trees and working in the garden. It's time for investors and corporations to understand that summer is coming; they need to shed the fear and parka and put some of their piles of cash to work into investments that make real profits, grow wealth and create jobs.

The unwillingness of corporations and individuals to move from cash to "riskier" assets like stocks and real estate is limiting economic recovery and muting the performance of the stock market. According to a recent *Bloomberg News* article titled "Record Cash Weighing on U.S. Stock Market Returns" by Roben Farzad, U.S. companies accumulated \$1.84 trillion in cash on their balance sheets in the first quarter of 2010. The article further highlights that "as a percentage of company assets, cash is at its highest level in a century." In

his recent "Guide to the Markets," Dr. David Kelly of J.P. Morgan pointed out that an individual's portfolio of cash on the "sidelines" increased 30% from March 2007, through March 2009 and has dropped only modestly since. Now don't get me wrong, I like cash. I remember Warren Buffett talking at a recent Berkshire Hathaway shareholder meeting about how he gets his peace of mind by having several billion dollars in cash. Currently he has about \$30 billion in peace. However, as a shareholder in some of the cash-rich companies and as a capitalist, I expect more investment savvy from management than stashing away cash with no opportunity for return, like an obsessive squirrel burying more nuts that he can eat in October.

When are shareholders, hedge funds and boards of directors going to demand that management deploy some of this cash for higher returns instead of squirreling it away? When are individuals going to stop accepting negative real returns on "safe" bank assets and move to stocks? I don't know when, but it will happen. It is irrational to accept negative returns perpetually.

How can we know when summer is coming on Wall Street? Here are three categorical indications of the potential for summer to come to Wall Street:

1. An increase in flows of money out of cash assets like money markets to equities.
2. An increase in merger and acquisition frequency.
3. An increase in the number of corporations willing to increase dividend payments to shareholders.



The facts are promising when considering the flows of money by investors in mutual fund asset categories. According to the Investment Company Institute and J.P. Morgan, the net flows of domestic and world equity funds have gone from an outflow of \$233 billion in 2008 to a small inflow of \$14 billion through June 30, 2010. This may be an early indication that investors are leaving cash and low yielding bonds for higher potential returns in global equities. More demand to buy equities will eventually increase stock prices.

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In the merger and acquisition category, recent headlines note some indication of corporations' willingness to invest cash by acquiring other companies. At the risk of being a bit presumptuous, a search of financial news headlines shows a trend toward an increase in merger and acquisition activity. For example, Sanofi-Aventis recently indicated an interest in an informal acquisition approach to biotechnology drug maker Genzyme Corp. I am sure

Genzyme shareholders were pleased by the 15% increase in per-share value on this announcement.

A further scan of headline news illustrates the potential evidence of future increases of dividends by cash rich companies may be in play. On July 23, 2010, General Electric announced that because of a stronger than expected cash position, they were increasing their dividend 20%. GE also said they will restart a stock buyback. On the news, GE stock appreciated more than 3%.

It may still be winter on Wall Street as evidenced by high corporate and individual cash positions but there are a few early signs of investor willingness to put the cash to work. Individual and corporate investors should shed their winter parka of fear and begin allocating the piles of cash to investments that can provide good long-term investment returns. Those who see summer coming first will enjoy it the most.

Taxing Issues

By Jim Frye, CFP®

With 2010 more than halfway behind us, it is a good time to consider the potential for tax-planning opportunities. Unfortunately, in addition to opportunities, there are a number of uncertainties and changes that will impact many taxpayers. Here are a few things to keep in mind.

Roth IRA Conversions

This year is important for Roth conversions for several reasons. Starting in 2010, income limits have been eliminated on eligibility to make a conversion to a Roth IRA. There are a variety of reasons to consider a Roth conversion, including the ability to avoid mandatory distributions from your retirement account during your lifetime as well as pass a portion of your assets tax-free to your beneficiaries. This year taxpayers also have a one-time opportunity to choose to pay taxes on the converted amount in 2010 or spread the tax payments over 2011 and 2012. An important consideration for spreading out the tax payments over 2011 and 2012, as well as for determining if a Roth conversion is right for you at all, is whether you expect your marginal tax rate will be lower in 2010, in the next two years or in the future when you would begin to

take taxable distributions if you don't convert. One thing looks likely at this time – tax rates going up next year for taxpayers in the higher tax brackets ... which leads us to the next topic.

Marginal Tax Rates

Today there are six marginal federal income tax rates. Without additional legislation these will expire at the end of 2010. The lowest 10% bracket will disappear, and the remaining brackets will return to pre-2001 levels, as shown below:

MARGINAL TAX RATES	
2010	2011
35%	39.6%
33%	36%
28%	31%
25%	28%
15%	15%
10%	15%

Other Key Tax Rate Changes

The tax rates that apply to **long-term capital gains** are changing as well. This year if you sell a capital asset (like a share of stock) that you've held for more than one year, the gain will generally be treated as a long-term capital gain, taxed at 15% if you are in one of the top four marginal tax brackets or 0% if you are in the 10% or 15% tax brackets.

These rates are also scheduled to expire at the end of 2010. In 2011, a 20% rate will apply, except for taxpayers in the lowest marginal tax bracket who will pay a 10% rate on long-term capital gains.

Qualifying dividends are treated similarly to long-term capital gains in 2010, taxed at 15% for the top four brackets and at 0% for taxpayers in the 10% and 15% tax brackets. In 2011, they will be taxed as ordinary income.



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Of course FIM Group will continue to manage all of your accounts (taxable accounts, IRAs, etc.) to take advantage of the unique structure that each account offers in order to maximize tax efficiencies.

Looking ahead, new taxes related to the recent health care legislation will take effect in 2013. A new **Medicare payroll tax** of 0.9% will be assessed on wages exceeding \$200,000 for individual taxpayers and on combined wages exceeding \$250,000 for married

couples filing jointly. Also beginning in 2013 is a new **Medicare surtax** of 3.8%. Single filers with income exceeding \$200,000 and joint filers with income more than \$250,000 will be assessed the surtax on the lesser of: 1) net investment income, or 2) modified adjusted gross income (MAGI) in excess of the income thresholds. If either 1 or 2 is zero, there is no surtax. Net investment income includes taxable interest, dividends, capital gains, distributions from annuities, rent and royalty income, and passive-activity income. It should be noted that distributions from

a traditional IRA are counted in MAGI and could trigger the surtax, whereas Roth withdrawals will not.

Estate Tax

This year we saw the temporary repeal of the federal estate tax. Many expected Congress to move quickly to reinstate the tax, but to date we are still waiting. The chart below shows a summary of the changes, and as you can see the estate tax returns in 2011 to the pre-2001 level of \$1 million with a top tax rate of 55% unless additional legislation is passed.

Year	Estate Tax	Step Up in Basis	Gift Tax
2009	<ul style="list-style-type: none"> • 3.5 million exemption • 45% top tax rate 	<ul style="list-style-type: none"> • Full step up in basis 	<ul style="list-style-type: none"> • \$1 million lifetime exemption • 45% top tax rate
2010	<ul style="list-style-type: none"> • Repealed 	<ul style="list-style-type: none"> • First \$1.3 million gets full step up • Assets to spouse get an additional \$3 million step up 	<ul style="list-style-type: none"> • \$1 million lifetime exemption • 35% top tax rate
2011	<ul style="list-style-type: none"> • \$1 million exemption • 55% top tax rate 	<ul style="list-style-type: none"> • Full step up in basis 	<ul style="list-style-type: none"> • \$1 million lifetime exemption • 55% top tax rate

“I’m proud to be paying taxes in the United States. The only thing is – I could be just as proud for half the money.”

- Arthur Godfrey

All of this uncertainty makes it especially important to review your estate plan to ensure that it effectively carries out your wishes.

This summary covers some of the more significant federal tax opportunities, changes and uncertainties for your tax planning consideration. This is by no means an exhaustive list but rather highlights some of the changes that may affect many of our clients. The impact and applicability in individual

circumstances needs to be reviewed on a case-by-case basis. Please contact your FIM Group adviser if you would like to discuss any of these matters further.

We can’t predict what Congress will do, but as in recent years it is likely we will see additional legislation between now and the end of the year making it important to stay informed.

Congratulations to FIM Group's Suzanne Stepan

Suzanne Stepan, CFA, CFP®, Portfolio Manager at FIM Group in Traverse City, MI has been authorized by the Certified Financial Planner Board of Standards (CFP Board) to use the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and  in accordance with CFP Board certification and renewal requirements.

These marks identify those individuals who have met the rigorous experience and ethical requirements of the CFP Board, have successfully completed financial planning coursework and have passed the CFP® Certification Examination covering the following areas: the financial planning process, risk management, investments, tax planning and management, retirement and employee benefits, and estate planning. CFP® certificants also agree to meet ongoing continuing education requirements and to uphold CFP Board's *Code of Ethics and Professional Responsibility*, *Rules of Conduct* and *Financial Planning Practice Standards*.

We are all very proud of Suzanne's accomplishment and her tireless efforts to provide more services and expertise to FIM Group clients.



DISCLOSURE

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