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**Special points of interest:**

- Updated Privacy Notice enclosed
- Markets Closed July 3 and September 7 (Labor Day)
- Summer Vacation weeks: July 27-31 and September 8-11.
- Friend or family need our help? Starting July 1 Schwab is offering a commission waiver on all equity trades for up to one year for new-to-Schwab advisor accounts.

## Market Commentary— That 70's Show

Whether you are a Democrat, Independent or Republican, whether you think Congress is on the right track or asleep at the wheel, one thing can't be denied – if you want to understand Wall Street these days you really need to figure out Pennsylvania Avenue.

I'm from the school of what "is", not what I'd like, or want, or idealize, but the reality of what the thing or the situation actually is. I think that's a healthy Alma Mater to hail from when I deal with the cynical inhabitants of Wall Street and especially when I'm responsible for your money. So I think that we should look at both ends of Pennsylvania Avenue right now and ask ourselves "what is the reality" because it has tremendous ramifications for the business world and your investments.

Let's take a look at the reality right now and try to hit just the big items.

1. The Obama Administration believes that the Federal Government *can* and *should* solve social and economic problems including healthcare, tobacco, the military, financial oversight, taxation, education, and global warming.
2. These changes will cost money and lots of it – a trillion plus on healthcare alone according to



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the OMB. The inherited banking and auto troubles and the stimulus plans add an additional 1-2 trillion to that. The Treasury will need to borrow all of that— mostly from the Chinese.

3. The Democratically controlled Congress is largely in agreement with the President so the outlook for implementation of these plans is likely.
4. Recently passed legislation has been marked by shades of populism/protectionism. There are the "buy American" provisions of the

*Continued on page 2*

## Second Quarter 2009 Market Wrap

<u>Market Indexes</u>	<u>% Change from 3/31/09</u>
S&P 500	+15.2%
DJIA	+11%
NASDAQ Comp	+20%
MSCI EAFE	+23.8%
Russell 2000	+20.2%

<u>Mutual Fund Yardsticks</u>	<u>% Change YTD</u>
Equity Income	+2.14%
Large Cap Growth	+11.13%
Balanced	+6.93%
Gen US Taxable	+10.55%
Intermediate Inv Gr Bond	+5.41%



## Market Commentary—That 70's Show (cont)

stimulus bill, the rescission of the NAFTA accords regarding Mexican trucking, the lack of a vote on the Columbia Free Trade Treaty, and various trade spats with Canada, Mexico, Europe and China.

5. The Federal Government now owns two car companies, a large piece of the banking system, and the two largest mortgage companies in America. In this role both the Executive and Legislative branches have been increasingly involved in "suggesting" how the companies should be run and who should run them.

The conclusions that investors and business owners have drawn from this are not surprising. The Federal Government is in control. They will run up trillions of dollars of debt implementing these plans. Busi-

nesses will be regulated more stringently and at an increased cost to business owners. The country will issue protectionist policies. And, lastly, we will need to raise a vast amount of taxes to balance the books. The economic fallout of this will be higher interest rates, the possibility of higher inflation down the road, a weakened dollar, slower international growth of trade and more regulation. These policies have the effect of putting on the economic brakes.

These times remind me very much of the 1970's with the high taxes, inflation, energy crisis and unpopular/costly war. I think there's money to be made, but it will be made in different ways and in different places than before. We will need to look elsewhere to find faster growth industries and higher GDP countries to invest in. Our current political policies may

effectively cede economic leadership to the emerging economies of the world- China, India, Brazil, Southeast Asia and we can profit from that through direct investment as well as through US multinationals that focus in these regions. (It is ironic that China provides a better role model for capitalism than we do right now!) Lower US growth rates may mean that stock dividends and bond income become relatively more important than capital gains in the total return picture. Twenty percent returns in the US are so 1980's, but those kinds of growth rates may be available elsewhere. Additionally, these emerging market economies require raw material input and other building blocks of a prosperous economy. Perhaps we should look to technology, metals, and mining companies to fill those inputs.



I believe that the new frugality by the US consumer may be here to stay, so think perhaps Costco and Genuine Parts (NAPA) rather than Saks and Mercedes. Also, the "basics" companies (i.e. consumer non-durables) like food, personal products, and beverages – many of which also pay good dividends – may become the "go to" companies to capture what consumer dollars are spent.

There is always a profitable place to invest longer-term. I think that if we realistically assess the "70's show" nature of our current environment new investment themes can be formulated to avoid the slow spots and accentuate the positives.



*"The only thing we learn from history is that we learn nothing from history."  
Friederich Hegel*

## Bernie Madoff...and you

Bernie Madoff was sentenced yesterday to 150 years in prison for perpetrating the biggest Ponzi scheme in history. I only wish he were younger than his 71 years to more fully enjoy the fruits of his crime.

The Madoff scandal was enabled by one central fact that runs through every other scam and/or Ponzi scheme that I can recall and is very easily protected against. **Madoff ran both sides of the deal, acting simultaneously as manager and reporting custodian.** Every one of these fraudulent schemes requires that the "manager" and the custodian are in cahoots or at the very least that the manager can hide the real statements from the custodian and print his/her own fraudulent ones. In order to steal the money the theft needs to be hidden by a bogus custodial statement otherwise the "investor" might notice the significant hole in their assets.

The very simple solution that would prevent nearly all of these

schemes before they start is for the investor to be sure that his/her funds are held in their own name at a reputable custodian completely separate and independent of the investment manager's business. You can't steal what you can't hide.

I hope you have already gotten my point; our relationship with you, our clients, is set up in exactly the proper way I just described. Your funds are held in your name by a very reputable custodian, Charles Schwab, who sends you confirmations of every trade and a monthly statement completely independent of us. Everything we do for your portfolio is reported to you by both us, and independently of us, by Schwab. The relationship is transparent and verifiable and there are checks and balances. We watch Schwab, they watch us, and we encourage you to watch us both by reviewing your Schwab statements and our Quarterly Reports diligently.

## MARKET TALK

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*We are pleased to have guest columnist, CPA Russell Blodgett provide this article on the American Recovery and Reinvestment Act.*

*Russ is a fellow professional working at 3240 Shelburne Rd, Shelburne, Vermont. A CPA since 1987, Russ focuses on individual and business taxation and provides accounting and financial management consulting services for a number of small businesses. Russ can be reached at 802-985-5570.*

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## Tax Relief? by Russell M. Blodgett

On February 17, 2009 President Obama signed the American Recovery and Reinvestment Act of 2009 which was enacted by our 111<sup>th</sup> United States Congress. This Act was based primarily on proposals made by the President and his advisors intending to provide stimulus to the economy in the midst of a severe downturn. The Act includes federal tax relief, expansion of unemployment benefits and other social welfare provisions. Other items in the \$787 billion package include domestic spending in education, health care, and infrastructure. I am sure we have all heard of the mind numbing dollars involved and share astonishment when learning of the recipients. I also believe that we all question how we are going to pay for this spending, when it will be paid, and how many generations will be affected by the fallout.

The Act refers to federal income tax relief. As usual, how much of this relief we experience will generally depend on our *incomes* and *personal circumstances*. The changes in the tax laws for 2009 are too numerous to discuss in one sitting so I have identified several areas that have generated questions from most of my tax clients over the years.

### Alternative Minimum Tax

For many of my clients that have been stung by AMT the question is always, "What are you talking about?" I offer my best explanation of the tax code pertaining to AMT and in most cases my client's eyes glaze over following shortly thereafter with a shake of their head.

The AMT rules were established in the 1960's to act as a second income-tax system that runs parallel to the regular individual income tax. It was established to target a small group of high-income taxpayers who had managed to avoid taxes through whatever exemptions, deductions, credits, etc. that their wealth afforded them. When computing AMT, after exceeding a certain amount of income, many of these exemptions, deductions and/or credits, known in the AMT

world as "preference items" are not allowed or change, and the recalculated income is generally taxed at 28%. The taxpayer then pays a total tax equivalent to the higher of the original income tax or the AMT.

This is a very simplified explanation of a fairly complex issue but each year more taxpayers have been subject to AMT because the AMT exemption amount was never indexed for inflation. Income tax cuts made in 2001 and 2003 also made millions more taxpayers vulnerable to AMT. This will continue to be a problem as most incomes have risen dramatically over the years. Efforts to repeal this section of the code have not been successful as the Treasury Department estimates the loss of tax revenues would exceed \$150 billion by the 2014 tax year.

Fortunately Congress has enacted several annual "patches" to the code which increased the AMT exemption amount. For 2009 the AMT exemption amount increased to **\$46,700 (\$70,950 if married filing jointly or qualifying widow(er); \$35,475 if married filing separately)**. This represents a modest increase over 2008 amounts of \$46,200 (\$69,950 if married filing jointly or qualifying widow(er); \$34,975 if married filing separately).

### "Stealth" Taxes

Taxpayers with adjusted gross incomes above a certain level experience a phasing out of their itemized deductions and personal exemptions. The effective results are higher income taxes without actually raising the official tax rates. Known as stealth taxes this phenomenon is often complex and difficult to detect.

For 2009, taxpayers with adjusted gross incomes in excess of **\$166,800 (\$83,400 if married filing separately) will begin to lose some of the value of these itemized deductions.**

## Tax Relief? (cont.)

The 2009 personal exemption deduction is increased to \$3,650 from \$3,500. However, taxpayers with adjusted gross incomes in excess of \$125,100 for married filing separately, \$166,800 for single individuals, \$208,500 for heads of households, and \$250,200 for married persons filing jointly or qualifying widow (er)s **will begin to lose some of the value of these personal exemptions.** For 2009, each exemption cannot be reduced to less than \$2,433.

### A Few Other Items of "Relief"

They say that timing is everything and nowhere has that been more evident than with the first time homebuyer credit. For the 2008 tax year, first time homebuyers who purchased a principal residence after April 8, 2008 could claim a tax credit of 10% of the price of the home up to a maximum of \$7,500. This was a fully refundable credit that essentially equated to a non-interest bearing loan from the IRS that is required to be repaid over 15 years beginning with the 2010 tax year.

The 2009 American Recovery and Reinvestment Act expanded the **first-time homebuyer credit** by increasing the credit amount to **\$8,000** for purchases made in 2009 before December 1. For a principal residence purchased in 2009, the credit does not have to be paid back unless the home ceases to be the taxpayer's main residence within a three year period following the purchase.

For 2009 the maximum amount of contributions to a **401(k) plan** has increased to **\$16,500**. For those taxpayers over 50 an **additional amount of \$5,500** is allowed. The maximum contribution that can be made to a traditional or Roth IRA remains the lesser of **\$5,000** or the amount of your taxable compensation for 2009.



If you are 50 years of age the maximum contribution remains the lesser of \$6,000 or the amount of your taxable compensation for 2009.

**The basic federal estate-tax exemption increased to \$3.5 million from \$2 million in 2008.** This should result in a decline in the number of estates subject to the tax for 2009 and mean significant tax savings for many larger estates that are affected.

**The Residential Energy Credit** that expired at the end

of the 2007 tax year has been reinstated. **A tax credit of up to 30% to a maximum of \$1,500** may be allowed for qualified 2009 expenditures for home improvements items such as heat pumps, air conditioning, water heaters, windows, doors, insulation products, certain roofs, and stoves that burn biomass fuels.

Unemployment compensation up to **\$2,400** received in 2009 is exempt from income.

The maximum amount of earnings subject to Social Security taxes rose to \$106,800 from \$102,000.

For those taxpayers who use their vehicles for work the standard mileage rate is **55 cents per mile**. Those who use their vehicles for medical purposes or as part of a deductible move can deduct **24 cents per mile**, and those who use their vehicles for

charitable purposes can deduct **14 cents per mile**.

One last noteworthy change in 2009 is a **decreased estimated tax requirement for qualified individuals with small businesses.** To be a qualified individual more than 50% of your gross income has to be from a business that had an average of fewer than 500 employees in 2008 and your adjusted gross income in 2008 was less than \$500,000 (\$250,000 if you are filing married filing separately for 2009). If you qualify you are eligible to make smaller estimated tax payments equal to the smaller of **90% of the tax shown on your 2008 tax return or 90% of the tax shown on your 2009 tax return.** Previously the general requirement was the smaller of 90% of your current year's tax or 100% of your previous year's tax. For those taxpayers with adjusted gross income of over \$150,000 the requirement was 90% of your current year's tax or 110% of the previous year's tax, whichever was lower.

There are many more changes to the income tax code for 2009 relative to individual, business, and fiduciary issues. If you have questions please seek professional guidance.