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Will New Estate Tax Rules Lull You Into Inaction?

At long last, Congress passed meaningful federal estate tax relief at the end of 2010. Among myriad other tax law provisions in the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, there's a generous $5 million estate tax exemption, and the top estate tax rate has been cut to 35%—the same as the top rate for ordinary income. The law also coordinates other estate tax breaks for wealthy families.

But there's a downside to these favorable estate law alterations—they're scheduled to expire after 2012. So there's only a small window of opportunity before the next crucial crossroads for estate planning, and because it's impossible to know what will happen next—or to guess what estate rules will be in effect at your death—the positive aspects of the new law could end up having a negative impact. Families whose wealth falls below the higher exemption amount may be lulled into doing nothing, but that's a risky approach.

It took Congress almost a decade to revisit the subject of estate taxes, and it only finally happened because *not* acting would have had a dramatic result. In 2001, the estate tax was repealed—but only in a very gradual way, and only temporarily. During the years that followed, the exemption level rose gradually to $3.5 million and the top estate tax rate inched down to 45%. Then, in 2010, the tax was truly gone, but only for a year. Without the 2010 law, passed as the clock wound down on a lame-duck session of Congress, 2011 would have reinstated an exemption of just $1 million and a top tax rate of 55%. Finally, as part of an 11th hour tax compromise brokered by the Obama administration between congressional Republicans and Democrats, the new two-year estate law came into being.

Though the $5 million estate tax exemption and the 35% tax rate have gotten most of the attention, the new law also included other significant changes. The individual exemption is now "portable" between spouses, so that a surviving spouse can utilize any unused portion of a deceased spouse's exemption. That effectively lets married couples exclude $10 million from estate tax liability—but only if both die before 2013. The new law also again gives heirs a "step-up" in the cost basis of inherited assets—an advantage they didn't have in 2010—and reunifies the rules for estate and gift taxes so that they share the $5 million exemption. That amount in total can now be transferred from your estate either before or after your death without incurring either kind of tax.

With these changes in effect, estate planning may seem easier than it was before, particularly if you have less than $5 million—or less than $10 million, between you and your

(Continued on page 4)

Headwinds Remain

Concerns over the European debt crisis, extent of a possible global economic slowdown and continued political gridlock in the U.S. and abroad converged to produce one of the most difficult quarters for the equity markets in decades. The S&P 500 lost approximately 14%, while the Russell 2000 index of small companies and MSCI EAFE international index lost 21.9% and 19.6%, respectively. Emerging-market stocks fared even worse, losing 24% for the quarter. Investors running from riskier assets flooded into Treasuries, forcing yields to record lows. The quarter was marked by significant volatility, with many trading days experiencing large intra-day market swings. These short term swings could continue for some time into the future as macro challenges produce market moving headlines on a daily basis. Uncertainty is not a friend to financial markets and often drives investor behavior. As we head through the fourth quarter, looking at the glass half full, we continue to see strong U.S. corporate earnings and a sense out of Europe that they realize the scope and magnitude of what must be done in relatively short order to avert a more damaging scenario from unfolding.

On a planning note, as year-end approaches, a reminder to coordinate with your advisors to address tax planning; including any charitable giving, tax loss harvesting or IRA distributions, if applicable. As always, please contact us with any questions or concerns. We appreciate your continued confidence and wish you a wonderful holiday season.

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Modern Portfolio Theory Is Alive And Well

For more than 50 years, Modern Portfolio Theory, or MPT, had been an article of faith for investors. The basic idea was that you could keep investment risk and reward in balance by choosing a diverse mix of assets. But then came the bear market of 2008 and 2009, during which nearly every kind of stock, bond, and most alternative investments plunged simultaneously. That led some analysts to pronounce Modern Portfolio Theory dead. What good is diversification, they asked, if everything sinks together?

But Modern Portfolio Theory never asserted that asset classes couldn't fall at the same time. Moreover, a look back over the past decade shows that investors who stayed diversified, continuing to rebalance during the downturn, enjoyed healthy returns. In fact, the market meltdown has proven a powerful validation of MPT.

MPT asserts that the best way to maximize returns while minimizing risk over the long term is to allocate your money among diversified classes of investments and periodically rebalance to keep the proportions in line with original targets.

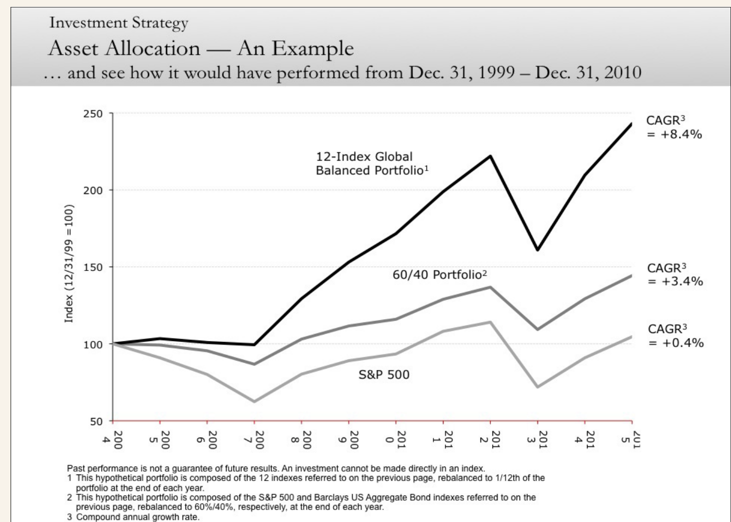
MPT attempts to build a portfolio of asset types that won't necessarily move together in response to changes in the economy. The hope is that when one portion of your portfolio—say, large-cap stocks—falls in value, another part—commodities, for instance—will rise. Rebalancing lets you "buy low and sell high," because to keep allocations at proper levels you end up selling assets that have gained in value and buying others that have lost ground.

For long-term investors, one of the most distressing aspects of the 2008 economic crisis was the unprecedented way that nearly all asset classes—bonds, stocks, commodities—lost value at the same time. The notion that diversification ensures gains in some sectors despite losses in others seemingly lay in tatters. But diversification can't, in fact, ensure that outcome, and MPT never suggested it could. It can merely increase the likelihood of that result.

And even when, inevitably, there are times when every part of a portfolio loses value for a while, MPT has great potential value. According to economist Fritz Meyer, a global portfolio using 12 asset classes managed according to MPT principles would have earned a compound annual growth rate of 8.4% during the volatile decade ending in 2010, compared with a 0.4% gain for a portfolio holding only stocks (represented by the Standard & Poor's 500 index).

The secret is in the rebalancing, Meyer says, because disciplined rebalancing forces you to ignore macroeconomic considerations and keep emotions out of the process.

As we embark on another decade of economic and market uncertainty, we will continue to design portfolios that are properly diversified and regularly rebalanced, allowing MPT to work for you.



Rising Tide: Emerging-Market Consumers

A wave of new consumers is building in the world's developing nations, a trend that offers great promise to U.S. investors.

Though developing countries face economic threats from political turmoil, inflation, and other challenges, Brazil, China, India, Russia, and many other nations in Asia, Latin America, and Eastern Europe have rapidly expanding middle classes hungry for electronic gadgetry, cars, and other consumer goods. Serving those booming markets has become a primary focus for multinational corporations such as Citigroup, whose CEO Vikram Pandit noted in his annual letter to shareholders that "emerging markets are growing consistently faster than developed economies, in some cases by many multiples." Pandit named "the rise of an emerging market consumer" as the No. 1 global trend and said that Citigroup's top priority was to increase its share of emerging market business.

For individual investors, rapid growth in developing markets could translate into strong investment returns, and making emerging markets one part of a balanced portfolio can help manage the risks of volatile regions. The key to tapping this new consumer demand is to understand where the growth is and the shifting opportunities and challenges of different regions. When conditions change, assets can be rebalanced among multiple emerging markets.

For example, stocks in Russia

Where The Growth Is
(Year over year % change in economic output)

	2009	2010	2011 (proj.)	2012 (proj.)
Advanced economies	-3.7	3.1	1.6	1.9
Emerging economies	2.8	7.3	6.4	6.1

Source: International Monetary Fund World Economic Outlook Update, Sept. 2011

11 Planning Tips For The Rest Of 2011

How are you faring financially so far in 2011? Now is a good time to assess your situation and consider changes. Consider these 11 tips.

1. Spend only what you can afford. It seems simplistic, but many people, even those with substantial incomes, ignore this basic financial principle. If you have more money going out than you have coming in, it's a recipe for eventual disaster. To get things in balance may require trimming your spending or earning more. Are you being paid what you're worth? Can you get an additional, part-time job? Do you have entrepreneurial ideas that could bring in extra income? Making a few thousand dollars more each year could add up to a significant sum over your lifetime.

2. Make a budget and stick to it. This tip dovetails with the previous one. Regardless of how much you earn, it's important to know what you're spending and where the money goes. Track your expenses by keeping credit card receipts and noting cash payments. You may be surprised at how much you spend on certain items and monitoring your outlays could help you find easy ways to economize.

3. Avoid mounting credit card debt. One of the worst financial traps is to make large purchases on credit and then fail to pay off the full amount each month. Despite recent legislation to reform rules on credit cards, your issuer can still impose double-digit interest rate charges on unpaid balances, sending your debt higher and higher and making it increasingly difficult to retire. If you have a large balance or two, consider consolidating your debt and putting away your plastic until you catch up.

4. Pay yourself first. This idea also needs to be coordinated with previous tips. But the main point is to set aside perhaps 5% to 10% of your income on a regular basis—before it gets spent. It may help to have the money automatically deducted from your paycheck and deposited into a separate account.

5. Invest your savings. It's not enough just to save money; you also have to put it to work for you. It's important to have an investment plan that considers your savings goals, when you'll need the money—for your kids' education, your retirement, or another objective—and how much investment risk you're comfortable taking. We can help you devise and implement an effective portfolio strategy.

6. Maximize employment benefits. Taking advantage of on-the-job benefits such as employer-sponsored health, dental, and life insurance could mean substantial savings. If your company offers flexible spending accounts, you can arrange to use pre-tax dollars to pay for unreimbursed medical or dental expenses—and save as much as a third on those outlays.

7. Salt away money in retirement plans. Most employers let you participate in a 401(k) plan or another tax-favored retirement account. With a 401(k), you can defer part of your salary on a pre-tax basis to your investment account, and your company may match a portion of your contribution. Outside of work, both traditional and Roth IRAs can also help you build your retirement nest egg.

8. Convert to a Roth IRA. One downside to traditional tax-deferred retirement accounts is that you'll be taxed on distributions at a time when you may need all the income you can get. A Roth IRA, in contrast, doesn't let you deduct contributions but can deliver tax-free payments in your 60s, 70s, and beyond. You can convert traditional plans to a Roth, paying tax on the converted amount now to avoid liability during retirement. And because a Roth IRA doesn't require withdrawals, you'll have the option of preserving the account to pass along tax-free income to your heirs.

9. Review insurance policies. Don't make the mistake of being under or over-insured. For most people, the need for life and disability insurance is greatest during peak earning years and when there are children at home. But you'll need adequate insurance coverage even during retirement.

10. Create or revise your will. Your will is the road map to your estate plan, and if you don't have one, creating one is an absolute necessity. And an existing will may need to be updated, especially in light of the generous $5 million estate tax exemption ($10 million for married couples) available for 2011 and 2012. It's also important to have a power of attorney document drawn up in case you are unable to manage your own finances.

11. Get organized. Finally, make sure to keep accurate records and know where they are located. Developing a system for monitoring your finances should prove helpful for years to come. ●

became more expensive after the recent political turmoil in the Middle East and North Africa. Investors poured money into Russia because it's the world's largest exporter of energy, and oil prices were headed higher. In light of Russia's suddenly loftier valuations, an investor could have reduced investments in Russia, taking profits after the market's rise, and redeployed capital to a region with more affordable equities.

We follow these trends closely, and our analysis can help you find suitable ways to invest in global consumer growth. Consider these approaches for putting investment dollars at work in dynamic developing markets.

- Mutual funds and exchange-traded funds. Many mutual funds and ETFs are designed to give U.S. investors easier access to foreign companies, countries, regions, and industry sectors. Many overseas funds invest a portion of their assets in consumer-related local companies as a way to capitalize on consumer growth trends. Another variation is to invest in ETFs or mutual funds that concentrate on small-cap overseas companies, because such firms tend to benefit from growth in consumer buying power.
- U.S.-based multinational firms. A number of U.S. corporations are marketing more products and services overseas. When you invest in these companies, you tap their expertise in knowing which emerging markets will generate the strongest demand for consumer goods and services. ●

Correction Creates Buying Opportunity

The stock market's midsummer swoon took investors on a harrowing ride, culminating in several days of triple-digit losses, a few days of triple-digit gains and an overall performance that, in the process, pushed the Dow Jones Industrial Average into negative territory for the year. The reasons behind the downturn were many, but largely focused on the following:

- Washington legislators lack of unity sorely worried investors. Congress and the administration argued and dithered for weeks before finding an eleventh-hour, short-term fix to the nation's deepening long-term debt woes.
- Rating agency Standard & Poor's responded by downgrading U.S. government debt (from AAA to AA+) for the first time in history.
- And much of the economic data released in the days before the market's roller coaster ride not only reinforced the fact that the current recovery is feeble but also fed fears that a double-dip recession could be on the horizon.

While investors of all stripes endured paper losses amid the downturn, the decline gave rise to good news for those with cash in reserve and a long-term investment horizon of five years or more. Stocks, as represented by the Standard & Poor's 500 index, are now selling at levels not seen since the market meltdown in the autumn of 2008. What's more, dividend yields on the shares of many high-quality, well-established corporations now compare favorably to the scant yields on 10-year Treasury securities.

Whether you are investing for retirement or a child's college education, or you would simply like to build wealth for an undetermined long-term goal, market downturns of this magnitude create investment opportunities to purchase stock at prices that are typically available only once every few years, though past performance is no guarantee of future success.

Indeed, there's no near-term guarantee that the summer market troubles won't continue into 2012. After all, Washington politicians have yet to find a solution to the damaging debt crisis, another downgrade of U.S. government credit by S&P or another ratings agency remains a possibility (though at this juncture seems unlikely), and few seasoned market observers believe the country's economic troubles will reverse course soon. Unemployment remains very high and consumer confidence is shaky.

The best advice now may be to revisit your investing plan and overall strategy to identify opportunities that have emerged that could help you achieve your long-range objectives. If the market downturn has been unsettling for you—as it has been for almost everyone—we could also revisit the risk exposure in your portfolio to ensure that it fits your personal comfort level. ●

New Estate Tax Rules

(Continued from page 1)

spouse—to transfer to your heirs. Doing nothing at all now may seem like a reasonable option. But the biggest problem, again, is that the new rules are guaranteed to hold sway only through the end of 2012. If Congress then reduces the exempt amount—and, in the meantime, your wealth has grown—you might have to scramble to get a new estate plan in place.

What can you do in the meantime? One effective strategy is to continue to take advantage of rules for yearly giving that can reduce the size of your estate. Under the annual gift tax exclusion, you can give anyone assets valued at up to $13,000—$26,000 if your spouse joins in the gift—and you can make such transfers to as many people as you like each year. You can also avoid the issue of future estate tax rates by using your current $5 million credit to transfer additional wealth while you're alive.

You can also pay attention now to estate issues that have nothing to do with taxes. It's important to decide how to divide assets among your children, for example, and how to protect your wealth from creditors. Making provisions for the care of a disabled child, perhaps by establishing a special needs trust, could also be crucial. Indeed, trusts of various kinds might help you support your family and philanthropic organizations long into the future, regardless of what happens next to the political football of the estate tax laws.

For now, the latest big changes make this a good time to take stock of your estate plan, making any adjustments that may be needed in terms of how it is structured and in the language of your will and other documents. And, until a long-term law is in place, it's a good idea to review your estate plan every year or two. We can work with you and your attorney to make sure you're taking advantage of today's opportunities. ●

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