Financial Alternatives Inc

integrated wealth management

Jim Freeman, CFP® / Chris Jaccard, CFP®, CFA

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Planning and Investing

We normally focus our January and July newsletters on investments and our April and October newsletters on financial planning related issues. Due to the recent market volatility we will briefly discuss market corrections as well as taxes in this newsletter.

Expect Market Corrections – They Will Never Go Away!

The week of October 6th through the 10th was an interesting one for the stock market. On Tuesday the 7th the Dow Jones Industrial Average dropped 273 points, on Wednesday the 8th it jumped 275 points, on Thursday the 9th it dropped 335 points and on Friday the 10th it dropped another 115 points to end the week down -2.7% overall.

This type of volatility gets people's attention, but is it really all that unusual? We have written often about the frequency of corrections in past newsletters and blogs but it's worth repeating here. According to Capital Research and Management Company from 1900 – 2010: 5% corrections occurred 3 times per year, 10% corrections occurred once per year, and 20% corrections occurred once every 3.5 years. That is a lot of corrections!

If you look at more recent history, corrections of 10% or more, including those that turned into corrections of 20% or more have occurred nearly every 1.5 years on average since 1957. The last time the market dropped more than 10% was in 2011 when it dropped 19% from the end of April to the beginning of October. It has been three years since this correction so you could say we are overdue for another one.

Should you worry about this? No! As long as you stay properly diversified and do not panic and sell your stocks during these very normal corrections, they will not hurt you in the long run.

Warren Buffet's View

Famed investor Warren Buffet colorfully expresses his view that you should ignore market corrections and media commentators making market predictions. We wanted to share some of his wisdom with you. The following excerpts are from Buffet's most recent shareholder letter.

- Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")

- Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments.

- Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of "Don't just sit there, do something." For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.

- During the extraordinary financial panic that occurred late in 2008. I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And, if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually

Executive Summary

- Don't be surprised by a market correction of 10% or more.
- "Forming macro opinions or listening to the macro or market predictions of others is a waste of time." – Warren Buffet
- "Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well." – Warren Buffet
- Stay properly diversified and do not panic and sell your stocks during corrections.
- Review your taxes with your CPA before the end of November.

disappoint, but as a group they were certain to do well. Could anyone really believe the earth was going to swallow up the incredible productive assets and unlimited human ingenuity existing in America?

Tax Planning

With only two and a half months left in the year we encourage you to review your taxes to see if there are any year-end tax planning moves you can make to reduce your tax bill. Below we've listed a few simple ideas to consider:

- Maximize your retirement contributions.
- Use Roth IRA conversions to fill up low tax brackets.
- Open up a self-employed 401k if you have consulting income or run your own business.
- Realize capital gains if you are in a 15% tax bracket as the tax will be 0% on these gains.
- If you are paying AMT tax, it may make sense to accelerate income into 2014 via Roth conversions, realizing capital gains or exercising stock options. Do the necessary tax projections with your CPA to deal with the complex AMT tax issues.
- Consider doubling up on schedule A deductions if you had higher income this year and doing so helps keep you out of a higher tax bracket (this can be done with property taxes, charitable donation, health care costs, estimated taxes, investment, financial planning & tax planning fees). Be sure this planning will not cause you to pay AMT taxes.
- Realize unrealized tax losses that can offset $3,000 of ordinary income and other capital gains.
- Try to keep your taxable income below $250,000 to avoid the 3.8% affordable care act tax.
- Make gifts of $14,000 to your children to remove these assets from your taxable estate.

There are many more strategies to be considered. We recommend calling your CPA before December to discuss any last minute tax planning you may be able to benefit from. Please feel free to call us to discuss this as well.

Summary

Market corrections are a part of stock market investing and they always will be. Falling markets create a tremendous amount of emotion and fear. If you have a well designed and diversified portfolio, it is best to do as Warren Buffet recommends and ignore the emotional forecasts and predictions and hang onto your stock funds—knowing that they represent ownership interests in business that will continue to grow over the years. And don't forget that, historically, stock returns have been negative roughly one out of every three years.

We also recommend reviewing your taxes with your CPA to see if there are any year-end tax moves you can make to reduce your tax bill.

Thank You for Your Referrals

As always we want to thank you for the referrals you continue to send us. We appreciate the confidence you have placed in us and we will work our hardest to make sure these new clients are happy and thankful that you sent them our way.

Financial Alternatives, Inc.

7734 Herschel Avenue Suite L
La Jolla, CA 92037
Phone: (858) 459-8289
Fax: (858) 459-8258

info@financialalternatives.com