The Thoughtful Investor™

James W. Olsen, CFP® | Legacy Investment Strategies | First Quarter 2012

New Year's Resolution – Put Your Financial House in Order

2012 is upon us with continued market turbulence, a presidential election, the ongoing European financial crisis, high unemployment, expanding US government debt and more issues than we care to list. What's an investor to do to cope? Start by making certain you have your financial house in order. With that advice, we offer a list of **Financial Resolutions for the New Year.**

1. **Know where you are with respect to your personal finances.** If you don't have one, create a personal net worth statement. If you have one, update it. A personal net worth statement itemizes your assets and liabilities. It provides you, in one glance, an understanding of what you are worth, where your assets and debts are concentrated, and how your personal net worth has changed from prior years.
2. **Create a rough budget for the year ahead.** This budget should include non-discretionary spending as well as discretionary spending. On the non-discretionary side are loan payments, utilities, insurance, property taxes, memberships, etc. These are costs that it would be difficult to eliminate. Discretionary includes costs you could cut back on if necessary.
3. **Assess the strengths and weaknesses of your financial position given your budget.** Play "what if." What if real estate values continue to decline? How will this affect your financial security? What if interest rates increase, or inflation

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Cycles and the Economy

My postal carrier recently returned from vacation in Italy and reported that the most reassuring part of her visit was the realization that civilization is a long cycle of rise and collapse and that through it all, people rebuild.

The predominance of cycles and the regularity with which they repeat throughout recorded history is indisputable. Russian economist Nikolai Kondratiev, using data from the late 1700s through 1920, identified three phases in an average 50-year cycle: expansion, stagnation, recession. His work was published in 1925 in the book *The Major Economic Cycles*. Unfortunately, it earned him a sentence to a Soviet forced labor camp and eventual death for what Joseph Stalin took as criticism of the planned Soviet economy. According to Kondratiev, the stagnation phase is characterized by a lack of good investment opportunities that leads to low interest rates and lowered credit standards, which creates a speculative boom and high debt levels, followed by a crash and financial crisis. Sound familiar?

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Will 2012 Follow the Presidential Cycle?

There are limits to presidential power and to the ability of the party in power to influence the economy. But there is also a strong incentive for individuals in power to do all they can to influence financial markets and the economy to support their re-election. Thus, actions that might have a negative impact on the markets are taken early in the term, followed by actions to support strong market prices the closer to the next election. This thesis certainly seems to fit the Presidential Cycle, which has seen rising stock markets in advance of every U.S. Presidential election since 1952 until 2008, when markets fell along with the incumbent president's party and nominee.

Stock Market Changes from Oct. 1 of the 2nd year of Presidential Term through Dec. 31 of Election Year

1952	+35%
1956	+45%
1960	+16%
1964	+52%
1968	+39%
1972	+40%
1976	+70%
1980	+32%
1984	+37%
1988	+19%
1992	+38%
1996	+60%
2000	+34%
2004	+33%
2008	-27%
2012*	8.1%

*(with one year to go)

S&P 500 data from Yahoo Finance. Past performance is not indicative of future returns. The S&P 500 is an index. One cannot invest directly in an index.

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begins to have a greater impact? What returns can you expect from your investments in different scenarios?

4. **Set up a meeting with your financial advisor.** You should meet at least once a year with your advisor to review your financial situation, but this year it's particularly important. Review with your financial advisor where your assets are invested, expectations for 2012, and where opportunities and pitfalls may exist in the year ahead. If there have been any changes in your life, such as a new job, new family member, loss of income or anything else that may affect your financial plans, you need to discuss these changes with your advisor.
5. **Review your estate plan in light of your updated net worth and any changes in your life.** Are beneficiaries up to date? Have your assets and their desired disposition changed? Have there been changes in your life that should be reflected in your will? Also, make sure you have a power of attorney and a living will to assure that your wishes are followed should you become seriously ill or incapacitated.
6. **Fund retirement accounts for 2012.** The reason for funding a retirement account early in the year is based largely on when the market tends to realize its greatest gains — the period from December through May. If your employer provides a matching contribution, you want to put those funds to work for you as soon as possible. Retirement contributions can also help lower taxable income and build financial security. So pay yourself first by funding retirement plans early rather than later.
7. **Review your credit reports.** At least once a year review your credit report and make certain that the information on the report is accurate. You are entitled to do so without charge once a year. Request your free credit report at www.annualcreditreport.com, or by calling 877-322-8228. If you find inaccuracies in your credit report, talk with a representative of the credit bureau immediately to find out what needs to be done to correct the information. But don't stop there. Notify any creditors you don't recognize that there is a problem with the account. If you suspect identity theft, contact the fraud departments of the credit agencies and file a report with your local police at once.

Cycles and the Economy — *continued from page 1*

The global economy has undergone three significant expansions over the last century:

1. **1904-1929:** This period ended with the Great Depression (25 years).
2. **1947-1974:** This period was ended with the early 1970s oil crisis (27 years).
3. **1982-2007:** Has the current cycle reached an end? (25 years).

The pendulum ultimately swings too far resulting in every period of expansion followed by a period of adjustment. How often have you heard market commentators explain a fall in market values as a period of "digesting earlier gains?" Economies and politics do much the same. In our current downturn, a critical problem is digesting excesses of debt. Deleveraging at the personal level is painful, but at the government level problems are compounded by the "Somebody Else's Money" syndrome. Rather than accept that debt levels have become unsustainable, the impulse is to find more money by tapping someone else's assets.

Along with the economic cycles come shifts in public confidence. During the good times, people tend to not want to rock the boat. In difficult times, there is a tendency to look to government for answers. Destroy an economy and dictators rise to power more easily.

The lesson of cycles for investors is the realization that opportunities for profit change, and that the periods of change can last over a relatively long time period. Rather than cling to what *has been* waiting for it to recover, we need to move on to look for investment areas favored by the current cycle. For example:

Food manufacturers and retailers are somewhat protected from recessions. While demand for more luxurious or expansive foods may decline, everyone has to eat. Addictive substances such as tobacco tend to be a necessity regardless of costs. Medicine and medical equipment fall under the necessity category and are less impacted by economic cycles, as are utilities. While new construction may languish, repairs and refurbishments expand. Frugal nations also have their opportunity to shine.

If we are to look for any lessons on the cyclical nature of economies, it is not to expect quick fixes. Cycles take time to play out, but eventually economies recover. The key is to limit your losses, keep your capital intact as much as possible and look for opportunities that match today's market, not the market of five or even ten years ago. Within every long-term cycle there have been shorter cycles that offer opportunities for the agile investor.

The information cited in this article is not intended as investment advice. All investments have the potential for loss as well as gain. Work with your financial advisor to determine the appropriate investments for your financial situation.

Increased Limits for Retirement Plans

The IRS has acknowledged that the cost of living has indeed increased over the past year, triggering changes in 2012 contribution limits for 401(k), 403(b), Simple IRA, SEP-IRA plans and the federal government's Thrift Savings Plan. In addition, income levels under which individuals can qualify for tax deductible contributions to IRA plans or contribute to Roth IRAs have been increased.

Effective 2012, the contribution limits for 401(k), 403(b), and Thrift Savings Plans increase. Simple IRA total contributions in 2012 cannot exceed $17,000 with a $2,500 catch up contribution limit for employees who are at least 50 years in age. For SEP IRAs, the IRS has raised the employer's contribution limit.

Contribution amounts remain the same for IRA accounts, however, eligibility limits to deduct contributions to IRA plans or to participate in Roth IRA accounts increase as shown below:

2012 IRA Income Limit Caps		
	For Full Tax Deduction on Contributions	For Partial Tax Deduction on Contributions
Single	$58,000	$58,000-$68,000
Head of Household	$58,000	$58,000 - $68,000
Married	$92,000	$92,000 - $112,000

2012 Roth IRA Income Limit Caps		
	For Full Contribution Eligibility	For Partial Contribution Eligibility
Single	$110,000	$110,000 - $125,000
Head of Household	$110,000	$110,000 - $125,000
Married	$173,000	$173,000-$183,000

Individuals with income above the Roth IRA limits can still contribute to a Roth IRA in a roundabout fashion by contributing to a non-tax-deductible IRA and then converting those funds to a Roth IRA. Income limitations on Roth IRA conversions were eliminated in 2010 and have not been reinstated.

Type of Retirement Plan	Maximum Annual PERSONAL Contributions			
	2011		2012	
	Under Age 50	50 and Older	Under Age 50	50 and Older
Individual Retirement Plans*				
Traditional and Roth IRA	$5,000	$6,000	$5,000	$6,000
Employer-Sponsored Retirement Plans				
401(k), Roth 401(k), 403(b), 457 and SARSEP Plans	$16,500	$22,000	$17,000	$22,500
Small Business or Self-Employed Retirement Plans				
Self-Employed 401k (a.k.a., Solo-401k, Individual 401k, Roth 401k)	100% of compensation up to $16,500	100% of compensation up to $22,000	100% of compensation up to $17,000	100% of compensation up to $22,500
SIMPLE (Savings Incentive Match Plan for Employees) IRA or 401(k)	$11,500	$14,000	$11,500	$14,000
SEP IRA – employer contribution	25% of compensation up to $49,000	25% of compensation up to $49,000	25% of compensation up to $50,000	25% of compensation up to $50,000
SEP IRA – employee contribution	$5,000	$6,000	$5,000	$6,000

Always Contribute When there is an Employer Match

As a general rule, if you are eligible to participate in an employer sponsored retirement plan with matching contributions from your employer, participate. The matching contribution is the closest you will ever come to a risk-free return on your investment.

It also makes good sense to contribute to your retirement plan early in the year. Historically, the market's greatest gains have been experienced in the period from December to May. While past performance is not a guarantee of future results, you want to optimize your exposure to better performance periods.

Keep in mind there are a number of rules and conditions that impact retirement plan contributions, so talk with your financial advisor before contributing to make sure you maximize your benefits.

What I Wish I Knew

By Andre Orcutt

As a recent college graduate looking back over my life in the financial realm, I am somewhat struck by the fact that I was not given enough information, or perhaps the right information, for what I now consider as vital for financial success later in life.

Growing up in a middle class family, I had all the comforts I needed as a kid. I knew that mom and dad made decent money. My parents did instill a great deal of work ethic in me as a young child and teenager. I had to work for my weekly allowance and when I was 13, I began work in my parents' small town Sears store.

Although I am grateful for the sense of urgency and work ethic I gained as a young man, I wish I had instilled in me earlier the need to save and a greater understanding of the cost of credit. With the benefit of hindsight, I feel that once a child is old enough to spend his or her own money they should be educated on the importance of good credit, saving money, and long-term goals.

Bringing this back home to my situation, I am now 25, making minimum payments on three credit cards and a few student loans. With the economy in its current state, and my

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Is Inflation Inevitable for Europe?

It seems inevitable that to save the Euro the members of the European Common Market will ultimately resort to the one fix-all countries have overwhelmingly used to deal with excessive debt – inflate it away. Austerity measures are all well and good to control the source of the problem, excess government spending. But austerity tends to bring with it economic slowdown, limiting government revenues and the ability to repay debt. Add inflation and the picture changes with new winners and losers.

Debt is a clearly denominated number. A $500,000 debt stays a $500,000 debt. With 15% inflation, however, in five years that debt is cut in half in terms of real value. In theory, inflation contributes to rising government revenues as wages increase to maintain buying power of the individual. Sales taxes increase as the prices of goods increase. Values of real assets increase, as well as capital gains taxes when those properties are sold. In fact, under inflation virtually everything is potentially increasing in price with the exception of prior debts and the currency itself. The result is more money (albeit money with less value) to pay down old debts. This is good news for borrowers, but disaster for lenders, whose assets are steadily losing value.

There's also the problem that inflation's impacts rarely occur evenly across a population.

The segment hardest hit by inflation tends to be the middle class and individuals living on a fixed income, such as retirees. The poor typically have little wealth to lose while the rich are often able to get their wealth into investments not adversely impacted by inflation.

To date, Germany has held out against the printing of Euros to create inflation, which carries very bitter memories for the country. Inflation was at its worst in Germany in the second half of 1923, when prices rose more than fivefold each week. The social turmoil that accompanied the hyperinflation set the stage for the rise of Adolph Hitler, but it virtually eliminated all debts that existed prior to 1921. The value of German mortgages in 1913 measured in U.S. dollars was about $10 billion; in late 1923 these mortgages were worth only one U.S. penny.*

*A *Case of Inflation* by Robert Schenk, http://ingrimayne.com/econ/EconomicCatastrophe/HyperInflation.html

What I Wish I Knew — *continued from page 3*

own finances in limbo if you will, I have realized — hopefully not too late — the importance of financial knowledge and its benefits. When I was asked to write this article, I wanted to tell parents that the most important information they can share with their children is the cost of debt. Paying for an item on credit can mean paying double its price over time. As proof I offer one of my credit cards. With a $1,800 balance, making minimum payments of $45 (18% annual interest plus 1% balance), it will take me 14 years and $2,122.98 in interest to pay off my balance.

"We cannot always build the future for our youth, but we can build our youth for the future." Franklin D. Roosevelt (1882 - 1945)

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