Third Quarter 2012

# Knopinski & Fauver
## Financial Advisors

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# Is Media Biased Toward Bad Financial News?

Headlines about the economy in July sounded dire. "IMF Says Doubt Weighs On Economy," reported *The Wall Street Journal.* "Economy Looks Weaker As Retail Sales Slump," said *The Boston Globe.* "Fiscal Cliff Could Trigger U.S. Recession: IMF Economist," according to a CNBC story.

While the U.S. economy indeed was not growing briskly this summer, it was growing, and gloomy headlines belied reasons for optimism. Here are counterpoints to bad news and recession-mongering, reasons to expect that a slow-growth recovery will continue.

**Positive Earnings Outlook.** Earnings drive stock prices. A key prop supporting stock prices is that big-company profits are holding up and earnings estimates have stayed strong. In July 2012, the consensus earnings estimate of Wall Street analysts for companies in the Standard & Poor's 500 Index stood at $105 per share for 2012 and $118 per share for 2013. In the short term, headlines can whip stock prices around, but corporate earnings are the basis for stock prices in the long run. If analysts are close to correct in their earnings estimates, it would support stock valuations. Plus, we are halfway through 2012, so achieving something close to the $105 target should not be a stretch.

**New-Jobs Formation.** It's erratic. But it is positive. Job formation was choppy in the months following the last recession. The jobs recovery that began in January 2002 went negative in early 2003 even as the economy surged. Don't expect new jobs to grow steadily, and remember that inconsistent does not mean a recession is around the corner.

**Household Versus Establishment Jobs Survey.** Release of monthly jobs survey data in May and June caused big one-day dips in stock prices. But that's partly because the media focus on the U.S. Labor Department's Establishment Survey data on job creation at large corporations and not the Household Survey, which includes jobs created by small business and agriculture. While the widely-followed Establishment Survey tallied 80,000 net new jobs in June, the Labor Department's less-referenced Household Survey, indicated 128,000 net new jobs were created. Over the past six months, according to independent economist Fritz Meyer, the household survey has registered 1.6 million net new jobs versus just 900,000 by the Establishment survey --a significant difference. Yet big media seem generally unaware.

**ADP Jobs Survey.** ADP, which processes data for small businesses nationally, does its own survey of job creation. While over time, it tracks closely with the government survey data, in recent months it has shown a material difference. ADP reported more than twice the number of new jobs created in May and June than did the Labor Department's Establishment survey.

**Auto Sales.** Three years into the recovery, a return to the historical mean of about 16 million sales of American

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## *Wait For November For Clarity On 2013 Tax Policy*

Now that the "payroll tax holiday" has been extended through the rest of 2012, can we expect other significant tax legislation from Congress? Not before the national elections.

Although our nation's lawmakers may still act to keep several other expiring tax provisions, it seems unlikely Republicans and Democrats will reach consensus on the best tax policy for the country before November. Once voters have been heard, Congress will probably get down to business.

Their task is daunting. Several key tax law breaks are scheduled to be scaled back in 2013 if there's no congressional action.

- The two top tax brackets for ordinary income in 2012 are 33% and 35%. Absent new legislation, the two top rates in 2013 will rise to 36% and 39.6%, respectively.
- Currently, the maximum tax rate on long-term capital gains and qualified dividends is 15%. These "Bush tax cuts" are set to expire after 2012 when the capital gains rate will jump to 20% and dividends will be taxed at ordinary income rates.
- For 2012, the maximum estate tax exclusion is $5.12 million, and a surviving spouse may take advantage of any leftover exclusion of the spouse who died. But that "portability" is scheduled to end next year, and the exclusion will revert to $1 million.

We still could see wholesale changes in these tax rules . . . but not until later in the year.

Colleen & Rob

# Entrees For The "Sandwich Generation"

Bob and Marcy Tannenbaum both have hectic lifestyles. Bob, who is 45, works in the city for a public relations firm. He commutes from the suburbs each day. Marcy, who is employed closer to home, is the director of a nonprofit organization. She'll turn 43 before the end of the year. They're making ends meet, but haven't set aside nearly as much as they'd like for their future needs.

The couple's three children are 15, 12, and eight. Getting them to soccer practices, dance recitals, and religious-education sessions keeps their parents hopping—especially Marcy, who bears the brunt of the carpooling.

As if things weren't complicated enough, Bob received a panicky phone call last week from his mother. Bob's 70-year-old father had been hospitalized after taking a spill. His mother wanted Bob to come "home" immediately, but "home" is 1,000 miles away. And he can't just leave his family and job behind—not to mention the economic ramifications if he did.

This kind of scenario is all too familiar to those stuck in the middle of helping elderly parents and raising their own children. These people have come to be known collectively as the "sandwich generation." And if you're not careful in these situations, the challenges can swallow you.

Nevertheless, you may be able to minimize potential problems with advance planning. Consider these four basic steps:

**1. Get all the facts.** Job one is to avoid unpleasant surprises. Talk to your parents about their financial situation and their plans if they become ill or incapacitated. At the same time, examine your own finances. If you haven't already done so, figure out how much you'll need to save for retirement and college for the kids. What will you have left for emergencies?

**2. Seek "the power."** In case of a dire emergency, you'll have to act fast on behalf of your parents. The best approach is to have a durable power of attorney in place. This allows you to make decisions regarding their financial considerations. For more protection, supplement a power of attorney with a health-care proxy and a living will relating to medical decisions.

**3. Face up to long-term needs.** The cost of an extended stay at an assisted-living facility or nursing home can be a financial back-breaker for families. Check to see what coverage, if any, your parents would receive from long-term care insurance. If they don't have policies, examine your options. Of course, the longer someone waits to buy such a policy, the more it will cost per year.

**4. Don't forget about yourself.** As much as you want to help your parents, you can't ignore your own needs. It usually doesn't make sense to erode a college savings or retirement fund to support your parents. Stick to your priorities and develop a plan that incorporates all of these factors. ●

# Compare Traditional IRAs And Roths

While traditional IRAs and Roth IRAs share several common traits, there are some stark tax differences between the original IRA and the alternative version that made its debut in 1998.

First, let's look at the traditional IRA. Subject to annual limits, contributions may be wholly or partially deductible, depending on your modified adjusted gross income (MAGI) and whether you participate in an employer-sponsored retirement plan. There's no tax on earnings until you receive distributions. However, if you make a withdrawal prior to age 59½, you must pay a 10% penalty on top of regular income tax. Also, you must begin taking annual "required minimum distributions" (RMDs) in the year after turning age 70½.

Now, let's quickly examine the Roth. As with traditional IRAs, earnings are tax-deferred, but that's pretty much where the tax similarities end. Unlike contributions to traditional IRAs, money going into a Roth is never tax-deductible, but qualified distributions from a Roth in existence at least five years are completely tax-free. And you don't have to take lifetime RMDs.

Test yourself with these questions about the two types of IRAs:

**1) The contribution limit for traditional IRAs is:**

a) The same as the limit for Roth IRAs.
b) Higher than the limit for Roth IRAs.
c) Lower the limit for Roth IRAs.
d) Unrelated to Roth IRAs.

**2) Traditional IRA distributions are taxed at:**

a) Ordinary income rates.
b) Capital gains rates.
c) Special retirement plan rates.
d) Alternative minimum tax (AMT) rates.

**3) Assets in a traditional IRA can be:**

a) Rolled over tax-free to a Roth.
b) Rolled over tax-free to a 401(k).
c) Withdrawn tax-free upon retirement.
d) Withdrawn tax-free upon death or disability.

**4) Which of the following is NOT a**

# Manufacturing Is On Its Way Back To America

A combination of new technologies, low natural-gas prices, and the promise of a third industrial revolution are fueling hopes that the U.S. economy may emerge stronger than ever from the worst recession since the 1930s. Among the evidence that this revival already has begun are steady increases in the monthly Purchasing Managers Index (PMI), which has been improving month to month since late 2011. Prior to a slight dip, the manufacturing sector recorded its 33rd consecutive monthly expansion in April 2012, and the U.S. economy grew for the 35th month in a row.

Much of the recent good news for manufacturing, largely overlooked amid worries about other economic indicators and fallout from the ongoing sovereign debt crisis in Europe, can be traced to new technologies that are making it possible to drill oil and natural gas from shale rock formations. Petroleum geologists used to write off shale as a resource because there was no way to gain access to the oil and natural gas trapped in the formations. Now, technologies such as horizontal drilling and hydraulic fracturing (or fracking) have made it possible to extract oil and gas from these resources. This has caused a glut in natural gas supplies, which in turn has reduced prices to their lowest levels in 10 years.

These developments are having a snowball effect in the larger economy. Natural gas is used to generate much of the nation's electricity, so the decline in natural gas prices is trimming consumer bills for electricity as well as for heating. And the boom in oil and gas exploration is creating jobs not only for drilling companies but also for energy supply companies, the steel and plastics industries (heavy users of oil and natural gas), the paper industry, and the broader services industry. With more oil being produced in the U.S., the country also is less dependent on foreign sources.

Other new technologies have reduced labor costs for U.S. manufacturers in the transport, computer, fabricated metals, and machinery industries, all of which had outsourced much of their work to China. Now, with labor expenses dropping as a percentage of overall costs, U.S. companies are bringing jobs back home, gradually reversing the trend that had moved so many manufacturing facilities overseas. Being able to locate manufacturing plants near U.S.-based product designers also helps companies cater to increasing consumer demand for customization.

A U.S. manufacturing boom will have a significant impact on economic recovery. During the past five years, the boost in energy production alone has created 158,500 new jobs, and according to a recent Boston Consulting Group estimate, U.S. manufacturing output could be increasing at an annual rate of $22 billion to $55 billion by 2020.

Digitalization of manufacturing, lower labor costs, and cheaper access to clean energy could combine to create what some are calling a third industrial revolution. The first two, in the 19th and early 20th centuries, culminated in mass-production technologies that have remained the model for manufacturing ever since. Now, however, emerging technologies, such as 3D printing, are turning that model on its head. Today, rather than needing to raise enormous amounts of capital to build huge factories, entrepreneurs can use relatively inexpensive web-based services to cater to a variety of consumer demands. And whereas the first two industrial revolutions created individual wealth and industry titans, the third should benefit a much broader spectrum of society.

New technologies will help create jobs in the private sector while they also help revitalize industries that suffered during what has been dubbed the Great Recession. For example, the new oil- and gas-drilling capabilities are drawing workers to areas where housing is in short supply. That, in turn, is a boon for the prefabricated housing industry, and it's enabling companies in that and other industries to rehire workers they were forced to let go during the recession.

Digital technology is beginning to blur the lines between the manufacturing and services sectors. And as it continues to draw jobs back to the United States, it could provide enormous economic stimulus, stabilizing the recovery. As independent economist Fritz Meyer notes, even in the face of competition from China and other emerging economic powers, the United States has remained the world's largest manufacturer. This growing resurgence will only increase U.S. dominance and help sustain economic expansion despite temporary disappointments. ●

**qualified distribution from a Roth?**

a) Made after age 59½.
b) Made because of death or disability.
c) Used to pay for qualified higher education.
d) Used to pay for a qualified home purchase.

**5. Annual contributions to a Roth IRA are:**

a) Available to anyone who earns compensation.
b) Increased for low-income taxpayers.
c) Phased out for high-income taxpayers.
d) Limited if you participate in a retirement plan.

**6. Which of the following statements is true?**

a) You can't contribute to a Roth IRA before age 59½.
b) You can't take distributions from a traditional IRA before age 59½.
c) You can't contribute to a traditional IRA after age 70½.
d) You can't take distributions from a Roth after age 70½.

**7. Which of the following statements about Roth distributions is true?**

a) Pre-age 59½ distributions are 100% taxable.
b) Post-age 70½ distributions are 50% taxable.
c) Distributions within five years are 25% taxable.
d) Nonqualified distributions may be partially tax-free.

**Answers:** 1-a; 2-a; 3-b; 4-c; 5-c; 6-c; 7-d

# Avoid Five Pitfalls In Refinancing

Mortgage interest rates are at historic lows, but does that mean you should refinance an existing mortgage? A “refi” may pay off, but you should consider all of the relevant factors, including these five potential problems:

**1. You’re back to square one.** Starting over is hard to do if you’re close to paying off a mortgage. For instance, if you take out a 30-year loan, the monthly payments in the first seven years will reduce your principal by only 5% or so, with the rest going to interest. Instead of beginning to make a dent in their principal debt, homeowners who refinance after seven years are effectively starting from scratch. Figure out how much you’re really saving if you shave only a percentage point or less off your current rate.

**2. Closing costs can pile up.** Depending on how long you stay in a home, the expenses of a new loan can outpace the savings. Figure on closing costs equal to about 1.5% of the mortgage amount. Then calculate your monthly savings to see how long it will take you to break even on the cost of the mortgage. For example, if you refinance a $300,000 mortgage, closing costs will run about $4,500. If the new mortgage interest rate is 1 percentage point lower than your current rate, you will save $178 a month and will need just over 25 months to recoup your closing costs. So if you’re not planning to stay in the house for more than two years, you could end up losing money. Reduce these costs by paying the prepaid items out of pocket. You’ll get that money back when the escrow accounts on your old loan are paid back to you.

**3. Terms can be confusing.** With refis so popular now, they can take a long time to process, and it may not be clear when you should stop paying your current mortgage. If you inadvertently fall behind, it could throw a monkey wrench into the works. Generally, lenders offer a two-week grace period after a mortgage payment is due and then charge a 5% penalty. Even worse, your credit score might plummet by 100 points or more if you’re 30 days past due—and that change could affect your refi.

**4. The appraisal may be too low.** Before the refi is approved, the lender will require an independent appraisal to confirm the home’s value. The numbers now are trending lower than expected for many homeowners, especially those who reside in areas hit by numerous foreclosures. If the appraised value is too low and you don’t have enough equity in the home, the lender could raise the rate or deny the loan altogether.

**5. You could pay hidden fees.** Under federal law, lenders must provide a good-faith estimate of the fees needed to complete the refi, and that statement could reveal costs you hadn’t expected. Also, some low-interest mortgages require you to pay “points,” and each point is equal to 1% of the mortgage amount. That could delay your break-even point even longer. ●

## Is Media Biased?

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vehicles annually is upon us. The average age of cars in the U.S. increased during the last recession, as people were foregoing new car purchases, but the average age now is decreasing, which bodes well for car sales. Ford’s chief economist was quoted in *The Wall Street Journal* on July 3 as saying consumers are still eager to trade in aging vehicles for new, more fuel-efficient models equipped with the latest technology. In addition, she said, low interest rates and easier access to credit also are boosting auto sales.

**Leading Economic Indicators (LEI).** In its release of the June LEI, The Conference Board said the economy was growing modestly and pointed to a “relatively low risk of a downturn (http://www.conference-board.org/data/bcicountry.cfm?cid=1) in the second half of 2012.” In addition, the six-month rate of change in LEI was not signaling a recession, as it has before previous downturns. According to economist Meyer, the six-month rate of change in the LEI dipped substantially below zero in advance of each of the last three recessions. The most recent numbers, however, show nothing of the sort.

**Consumer Debt.** Contrary to frequent press reports about consumers being tapped out and struggling under a mountain of debt, the Federal Reserve on June 22 said consumers’ ability to meet monthly expenses has not been better since 1980. The Fed’s financial obligation ratio, which measures consumers’ fixed expenses compared to disposable income --a good measure of consumer debt on mortgages, credit cards, car loans, etc. --has recovered fully. At 16%, 84% of after-tax household income is available for other purchases.

Predicting the economy’s next upturn or downturn is not easy and these optimistic signs could be quickly dashed if Europe slides into recession, if a war breaks out in the Mideast, or any of a myriad of bad scenarios becomes reality. Absent such a negative surprise, economic data support a continued slow recovery. But the bias of the media, toward selling newspapers and getting viewers of websites and TV shows, tends to elevate the importance of bad news. Good news doesn’t sell, create urgency, or feed fear. Prudent long-term investors must try to keep that in mind. ●

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