

ALBITZ/MILOE & ASSOCIATES, INC.

REGISTERED INVESTMENT ADVISER

FINANCIAL NEWSLETTER

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THE CRYSTAL BALL

Here are the two questions that matter regarding the financial markets: Is the country still in a recession, or is an economic recovery underway? We know that from the technical definition of a recession (two successive quarters of negative GDP), we are out of it. Even the stock market says that. However, the stock market's "big brother" (i.e. the bond market) is telling a different tale. Yields are so low that you can't help but conclude that the economy is still on life support. For goodness sake, the 10-year treasury recently yielded a paltry 2.50%, telling everyone there is no robust recovery.

With regard to the stock market, this market is a dream come true for a stock trader and a headache for a true investor. Volatility is high on a daily basis, causing nervousness and worry among many. In most cases the worry is unwarranted but understandable considering we are inundated daily with doom and gloom from the financial press.

So what do you do? Here are a few suggestions that might help you deal with the uncertainty of the markets now. Realize that for the first time since 1962, the yield on the Dow Jones Industrial Average exceeds that of bond yields. With that in mind and at this point it doesn't make sense to think that you are immune from losing money when holding and buying bonds. Buy low and sell high is the oldest adage regarding investments and bonds are not at low price levels, no matter how you look at it. Risk premiums (the difference between the earnings yield of the S&P index and the 10-year U.S. note) are at the highest level since the beginning of the modern era's bull market that began in the early 1980s. This bodes well for selective stocks. Further, nearly four-fifths of the companies contained in the S&P 500 index possess earnings yields that are greater than bond yields. And many offer (growing) dividend yields that are similar to their own bond yields.

What about a double dip recession? Recession/depression...it is really a matter of semantics. Judging by economic indicators, the economy is slowing down to a crawl, but not going negative. We are in the camp that there will not be a double dip recession. Slow yes, negative no. Don't spend any time worrying about it because it doesn't help. And with regard to the stock



market, zero interest rates insulate the markets from crashing any time soon; flagging economic data and chronically high unemployment guarantee that we are not blasting out to the upside either. We will be in a trading range until something precipitates a move out of the range. It might be something economic, it might be something geopolitical, it might be anything, but for sure, whatever it is, it will make you say, "Wow." And one comment about "flash crashes": We saw a flash crash back in May when liquidity dried up and the market fell 1000 points in 15 minutes. That could happen again but don't only remember the big drop, also remember how quickly prices recovered. Stuff happens.

SAVE THE DATE!

– November 13th –

Saturday morning, November 13th, we are having a seminar for all of our clients, their families and their guests. We will cover several important and timely topics. These are some of the presentation subjects.

- How may the November elections affect the economy and the stock market?
- What to watch out for when you finally decide to retire and call it a career.
- What can be done to combat the coming increase in taxes?
- How to transition to Medicare and what you need to know about annual decisions for Medicare Part D (drug plan)
- What is Concierge Medicine? - Medical guidance before and after retirement
- Question and answer session

We'll be sending out a special invitation in October and we hope to see you there. Please consider bringing a guest. Our seminars are generally very informative, and we always appreciate new clients. Thanks.

SHOULD RISING INCOME TAXES + WORRIED MONEY = TAX-FREE MUNICIPALS?

It is no secret that income taxes are going up and that includes taxes on dividends and interest. At the same time, people are afraid to move their money out of savings into investments, especially into real estate (RE) and/or the stock market. [True, this is probably the time to buy RE and stocks, as prices are fairly low, but that does not change the fact that people are concerned.]

How about this suggestion that addresses both of the problems above? Use a stepping stone approach and gradually begin leaving low interest savings, and putting your money to work in tax-free municipal bonds. Unlike taxable savings accounts and dividends, where you have to pay Federal and State taxes, munis allow you to avoid this taxation and keep what you earn. You can use a state specific muni fund, a national muni fund, or for those who are willing to absorb a little more price/fluctuation risk, you can use a high-yield muni fund. Noting that yields change every day, roughly speaking, here are the current yield ranges at press time for this newsletter: California intermediate term muni 3.85%; National intermediate term muni 3.53%; National high-yield muni 5%+. Call us to discuss your personal situation. Want to learn more about "high yields"? Call us and ask for the brochure called Municipal High Yield 101, a primer for understanding the basics of the municipal high yield market by Timothy Pynchon of Pioneer Investments. Bond prices are not "cheap" right now, however a dollar cost average or bond ladder approach to buying bonds still make sense, even today.

MEDICARE TRANSITION: YOUR HEALTHCARE AND POCKETBOOK

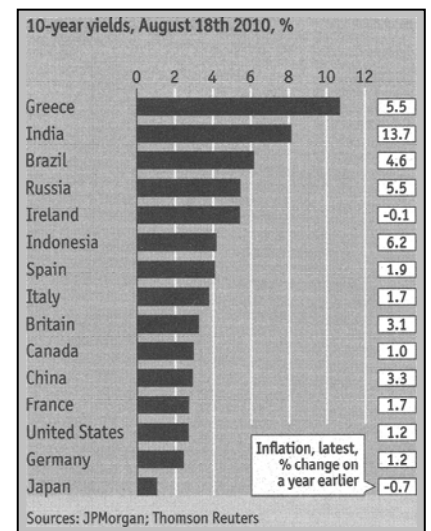
When I (that's Chris) turned 65, I was not prepared for the transition to Medicare. Included with this Newsletter is a brief guidance piece about retirement, healthcare planning, and the complexities of Medicare. The article starts out: "The process of transitioning yourself from your individual or employer based insurance coverage to Medicare, at one time a fairly easy process, is now a nightmare activity fraught with costly pitfalls, where plain ignorance or a simple mistake can carry financial and medical consequences throughout your retirement life years." We will cover this topic, specifically the need to annually select your Part D drug coverage in our forthcoming Seminar meeting on November 13th.

WORRIED ABOUT DEFLATION?

The latest worry in the financial markets is that the United States is entering a Japanese-style deflation. While we don't think that is going to happen, it can't be denied that there is some deflation here in the U.S. (e.g. house prices, payrolls, consumer prices). Fed chairman Ben Bernanke has pledged he will do whatever is necessary to avoid deflation. But what if he can't and what if the vicious cycle really has started?

Here's what to do. Find safe, dependable sources of income. Believe it or not, bond prices could go even higher than they are now. Treasury Inflation-Protected Securities should work in an inflationary or deflationary scenario. They won't make you rich, but they should hold their own. Cash would be nice if the plan was to use it when opportunity beckons. Gold might even work, if only because it could claim to be a monetary asset of limited supply. The stock market would be mixed. Companies with a lot of debt would be impacted because their debts don't deflate with everything else. Glamour stocks would likely fall in price. However, underpriced, good quality, value stocks that pay sustainable dividends could potentially be winners in this type of environment. Stick with blue chips. Personal debt is bad in deflationary times. Try to pay it off, if possible. We do live in interesting times. No one can predict the future with any accuracy but it doesn't hurt to look into different scenarios and have a plan of action in case they happen to unfold.

YIELDS & INFLATION THROUGH- OUT THE WORLD



PAYING FOR HEALTH CARE REFORM

Under the Health Care Act of 2010, new taxes will be implemented and existing laws will be changed. While many focused on the larger debate over health care, the final bill contained ways to help finance this major overhaul of our system. For example, in 2011, individuals taking non-qualified withdrawals from their Health Savings Accounts will face a penalty of 20% instead of the current 10%.

Then, in 2013, the Medicare payroll tax will increase over 60% from 1.45% to 2.35% for individuals with income over \$200K (\$250K for joint filers). Then, there's the Unearned Income Medicare Contribution – a 3.8% surtax on “unearned income” for members of these same income groups. Unearned income includes taxable interest, dividends, capital gains, annuity income, rental and royalty income. Fortunately, IRA and qualified plan distributions along with passive income from a trade or business would be exempt. Also, the threshold for deducting medical expenses will rise in 2013 from 7.5% to 10% (unless you have attained age 65, in which case the limit will remain at 7.5% through 2016).

Anyone who owns an IRA should be concerned because while their withdrawals will not be subject to the 3.8% surtax, the increase in taxable income attributed to their withdrawals may push total income above the limit where other interest, dividends, and capital gains get hit.

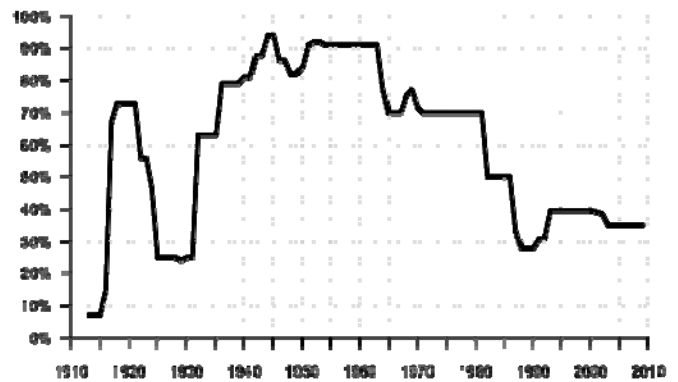
Many are finally reading this 2000+ page bill and finding out what is really in it. We see the bottom line this way: The bill has to be paid for and we all have to pay in some way. That's life.

DO YOU NEED IT?

Factoring Long Term Care (LTC) into your financial planning is crucial. We are placing more and more emphasis on reminding our clients of the importance of LTC. Policies continue to evolve and benefit options continue to be enhanced, and all the while, premiums continue to rise.

When you get over age 50, some consideration should be given to buying a long-term care policy. The reason is that each year you delay making the decision, potential increases in cost occur and there is a chance that a change in your health could leave you uninsurable later. With the advances in health care, the reality of devastating your asset base due to a LTC situation cannot be ignored. Tax law changes in 2010 have facilitated new options for financing LTC via “1035 exchanges” from life insurance policies and annuities. We are qualified to discuss LTC with you. Consider setting aside some time to review your options so you can relieve the anxiety around wondering what would happen if something were to happen to you.

YOU THINK IT IS BAD NOW?



**Top U.S. Federal Marginal Income Tax Rate
from 1910 to 2010**

Even though we can see from the chart that the marginal federal tax bracket has been much higher in the past, we are still inundated with taxes. Here's a quick list of additional taxes we might pay: Accounts Receivable Tax, Building Permit Tax, Capital Gains Tax, Cigarette Tax, Corporate Income Tax, Court Fines (indirect taxes), Dog License Tax, Federal Unemployment Tax (FUTA), Fishing License Tax, Food License Tax, Fuel Permit Tax, Gasoline Tax, Gift Tax, Hunting License Tax, Estate Tax (soon to reappear), Inventory Tax, IRS Interest Charges (on top of tax), IRS Penalties (tax on top of tax), Liquor Tax, Local Income Tax, Luxury Taxes, Marriage License Tax, Medicare Tax, Payroll Taxes, Property Tax, Real Estate Tax, Recreational Vehicle Tax, Road Toll Booth Taxes, Road Usage Taxes (Truckers), Sales Taxes, School Tax, Septic Permit Tax, Service Charge Taxes, Social Security Tax, State Income Tax, State Unemployment Tax (SUTA), Telephone Federal Excise Tax, Telephone Federal Universal Service Fee Tax, Telephone Federal, State and Local Surcharge Taxes, Telephone Minimum Usage Surcharge Tax, Telephone Recurring and Non-recurring Charges Tax, Telephone State and Local Tax, Telephone Usage Charge Tax, Toll Bridge Taxes, Toll Tunnel Taxes, Traffic Fines (indirect taxation), Trailer Registration Tax, Utility Taxes, Vehicle License Registration Tax, Vehicle Sales Tax, Watercraft Registration Tax, Well Permit Tax, Workers Compensation Tax... Don't you think that's enough?

PERSONAL NOTES

Edie L. -- Can't wait to see your Cuba book.

Ernie N. -- Happy 95th... you sure have a great family.

Clete and Chrissy -- Congratulations on the wedding. May the future hold your greatest joys.

CONVERT YOUR NON-DEDUCTIBLE IRA CONTRIBUTIONS TO A ROTH NOW

Exceptions abound when considering the advantages of a Roth IRA conversion. One situation exists where you should convert your non-deductible IRA to a Roth IRA immediately:

- Your basis (contributions to the non-deductible IRA) is lower than the current account value.
- You have no other IRAs in place (including SEP, SIMPLE and Traditional) and will not have any in place by the end of the year.

If this situation applies to you, you will not owe any taxes upon conversion, and will create an account that will grow tax free for the rest of your life. Remember, in 2010, Congress has eliminated the adjusted gross income limitations for Roth IRA conversions, effectively making everyone eligible to convert. Feel free to call us if you need assistance or have more detailed questions about your specific situation.

QUOTE . . .

“One of the disadvantages of wine is that it makes a man mistake words for thoughts.”

Samuel Johnson

A NICE STORY

An elderly mother who had just moved into a new building was giving directions to her son about how to find her apartment . . .

“So when you get to the lobby, you’ll need to look up our last name and press the button next to it with your elbow. . . Then when you get onto the elevator, come up to the 5th floor by pressing the button with your elbow. . . When you exit the elevator, make a right to apartment 503 and press the doorbell with your elbow.”

“Ma!” exclaimed the son, “What are you talking about? Why should I be pressing all these buttons with my elbow?”

“What?” replied the mother with a look of surprise, “You mean you are coming over empty handed?”

Albitz’s Opinions and Judgments...



On Financial Planning . . .

The problem with making plans is that things change.

The key to financial planning is to adjust when things that are out of your control change. Over the past 30 years, we here at Albitz/Miloe have seen plenty of change in the markets and we are good at adapting.

On Negativity . . .

If someone says something with enough certainty, many people will believe what that person said is a *certainty*. This is the case even if it is impossible for the person to be certain about what he said. Remember that the next time you hear someone talk so confidently about the doom and gloom that’s ready to befall the United States.

On Wishes . . .

On Bob Dylan’s Theme Time Radio Hour, he once played a song called “A Pretty Girl, a Cadillac and some Money” and said, “That sounds like three pretty good wishes.” Well, here’s three things I wish... I wish I could neatly iron a dress shirt, I wish I could nicely giftwrap a present, and I wish I could tell you what the stock market will do tomorrow. That’s not asking much, is it?

On the California elections . . .

Brown vs. Whitman and Boxer vs. Fiorina... if California voters really want change, it is clear who the winners will be.

On the Greatest Investment Adage . . .

Some say “buy low and sell high” is the greatest. That’s not bad, but I think the greatest investment adage is this: “Sell when you can, not when you must.”

Until next time,

Phil Chris Paul Clete Sylvia

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