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Financial Planning Strategies for the Obama Years

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In July, readers of this publication were warned of impending disaster in our financial markets. Now, in the aftermath of that reality, three questions appear to dominate most investor's minds. First, "Have the markets hit bottom yet?" Second, "Is it time to re-enter the market?" And third, "How will Barack Obama's presidency impact my personal finances?"

Have the markets hit bottom yet? Just a few weeks ago, the markets finished one of the strongest weeks in history – all while digesting a series of bad economic reports. That would suggest that perhaps the markets have already anticipated most of the coming bad news. Over the last two weeks, however, the markets have been in free fall. Jobless claims are likely going to continue to climb in the coming months, and future economic reports may well indicate the onset of a recession. Have the markets hit bottom yet? Who knows? Investors should beware of anyone who claims to know the answer to that question. That being said, here are a few of the factors that could impact the direction of the markets in the coming months.

Nationwide, many experts believe that home sales will begin to grow and real estate values will start to stabilize during the first half of 2009. Some believe that unemployment will level off during that same period. The precipitous drop in energy prices has already gone a long way toward easing concerns about inflation, but geo-political uncertainty threatens to reverse that trend at almost any time. Based on these factors, the market has likely already taken into account many of the factors that would negatively impact it. That is not to say, however, that there won't be more declines in the coming weeks and months.

Is it time to re-enter the market? The answer to that question is dependent on a number of variables and is unique to each individual investor. So, as always, exercise caution and solicit advice that is specific to your unique situation prior to investing. That being said, most experts do not expect the markets to make a spectacular recovery in the next few months. If anything, markets will likely fluctuate above and below current levels for several months while the rest of the economy sorts itself out and the Obama administration establishes its policies - which leads us to the third question.

How will Barack Obama's presidency impact my personal finances? I typically try to avoid political discussions with clients and prospects. But, with an exchange of power in the Oval Office, it is an opportune time to examine financial priorities in light of the new administration's stated objectives. That being said, I will attempt to provide an unbiased observation of how investors may be impacted by the Obama administration's publicly stated policies and objectives. I will also provide some ideas on what investors can do to maximize their personal finances during the Obama years.

Income Taxes – Let's start out with some good news. If Obama holds true to his word, most of us can expect a reduction in our income tax bill. How much of a reduction remains to be seen. For those blessed enough to earn \$250,000 or more, prepare for a tax increase to pre-Bush levels. On a side note, despite Obama's stated plan to cut taxes for 95% of Americans, exit-polling indicated that 70% of Americans expect him to raise their taxes. In full disclosure, the numbers were almost identical for John McCain. These numbers would indicate that voters for both party's candidates actually voted for someone they perceived to be a liar – troubling, indeed!

Qualified Dividends and Capital Gains Tax Rates – Obama has indicated that he intends to impose a 15% tax on Qualified Dividends and Capital Gains for those making less than \$250,000. Those making more than \$250,000 will see their rate increase beyond the 15% rate. The Obama plan is not specific except to say that rates will not be more than 28%. Some previous versions of the Obama initiative have shown this tax rate as high as 40%.

Under current tax policy, the vast majority of investors pay no tax on Qualified Dividends or long-term Capital Gains. Taxpayers in the upper brackets pay a maximum of 15%. These increases (from 0% to 15% and from 15% to 28% plus) will have three undesirable effects. First, they will significantly erode the growth or after-tax return of portfolios. Second, for many seniors who rely on Dividend income to supplement their Social Security check, these changes will result in a reduction of income. And finally, increases in these rates will likely prolong the recovery of many portfolios that have suffered from the recent market collapse.

Estate Taxes – For 2009, the estate tax exclusion is set at \$3.5 million per individual. In 2010, the limit is scheduled to be uncapped. Then, in 2011, it is set to revert to the \$1 million level. Obama has publically called for a freeze of the exclusion at 2009 levels. Obama will likely face stiff resistance on this issue from many of his own party, however. Democrats have long called for higher estate tax rates and elimination of the exclusions. If Obama cannot reach an agreement with congressional democrats, look for Congress and the Oval Office to allow the higher exclusion rates to simply expire in 2011. If so, the result will be particularly burdensome to many Boomers who are beginning to plan for the distribution of their estates.

401(k) and Retirement Plans – While Barack Obama has not officially endorsed any changes to 401(k) and other retirement plans, at least two congressional committees are considering a number of changes that may be voted on during the next two sessions of Congress. One such proposal under consideration, seeks to remove the deductibility of both employee and employer contributions to retirement plans. Instead, the plan calls for mandatory employee contributions of 5% of pay into a federally-managed plan that would pay 3% interest annually. Proponents of this strategy claim that these retirement plans have created a large tax loophole for the wealthy. In reality, since the government collects billions of dollars in tax revenue every year on IRS mandated distributions from these same retirement plans, there is no loophole at all. It is not clear if congressional democrats would seek to retroactively apply this to existing monies inside retirement plans.

Other issues – While the impact of some policy is easily quantifiable, there are other factors that can impact our economy, but that simply cannot be assigned a value in terms of their impact on our individual nesteggs. As an example of our present reality, with any transition of political power, there is an increased risk of international or terror-related conflict. Naturally, any such test would have a disastrous affect on our already unstable markets. Investors should also know that how the new administration chooses to address other critical domestic issues, such as the growth of Medicare and Social Security entitlements, will also affect the economy and markets.

WHAT TO DO... For most investors, when you combine the impact of increased taxes on Capital Gains and Dividends with weak projected returns in the markets, the allure of market investing is grossly faded. At the same time, many investors have taken severe losses over the last few months and desire the opportunity to regain some of their losses – understandably so. The question becomes, where can investors turn for returns that should outpace bank CDs. For instance, those in or near their retirement years should take an objective look at their investment portfolios to determine if they are sufficiently recession-proof. Those same investors should also decide whether or not they can afford to take losses. If not, then allocating investment portfolios toward more conservative strategies should be the order of the day. For some, locking in guarantees may be appropriate. Others may need some degree of growth, but cannot afford to realize losses. Yet others may only need to re-allocate their portfolio in order to make it more recession-friendly. Some who have been conservative investors in bank CD's and government bonds may need to consider some safe money options that will allow them to beat inflation and maintain their purchasing power.

Regardless of your situation, *there are solutions to fit your needs.* If you would like to discuss your situation, Storehouse Advisory Group offers a free, no-obligation consultation to discuss your concerns. Just call **(865) 850-6529** to schedule your in-home appointment.

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