STRATEGIC Wealth Advisors

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Wealth by Numbers

America has long been known as the land of opportunity and the promise of a better life to people from all over the world. Recently, however, many Americans feel robbed of opportunities and better lives by the top 1% of their own. This growing income inequality has led to problems and civil unrest, as demonstrated by the “Occupy Wall Street” movement.

The table presents household income distribution data from the U.S. Census Bureau. Given that the poverty threshold for a two-member household is around $14,000, it appears that approximately 13.7% of Americans are poor. At the other end of the income spectrum, 3.9% are rich, with household incomes higher than $200,000.

Household Income Distribution in 2010

Under $5,000	3.5%
$5,000 to $9,999	4.3%
$10,000 to $14,999	5.9%
$15,000 to $19,999	6.1%
$20,000 to $29,999	11.5%
$30,000 to $39,999	10.2%
$40,000 to $49,999	8.9%
$50,000 to $74,999	17.7%
$75,000 to $99,999	11.4%
$100,000 to $149,999	12.1%
$150,000 to $199,999	4.5%
$200,000 and over	3.9%

Source: U.S. Census Bureau, Current Population Survey, 2011 Annual Social and Economic Supplement. Poverty threshold also from the U.S. Census Bureau.

What's Happening at SWA

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We are currently upgrading all of our computers. Two issues that always come up with new computers are data backups and removing sensitive data from the old hard drives.

Imagine losing years worth of pictures, videos, important personal papers and music files to theft, fire, or a failed hard drive. It is vital that you frequently back up your data and store it off-site away from your computer should fire or theft occur. Using a USB external hard drive you can duplicate all important data files or store a complete image of your computer's hard drive. There are also online backup services such as Carbonite, Dropbox, and Mozy. Check them for security and file encryption.

To remove sensitive data, such as passwords, credit card numbers, and tax returns from old hard drives there are a number of data removal tools available such as DriveScrubber, Eraser, DBAN, and Free File Wiper. If you have no faith in software, using a hammer is a viable option!

Monthly Market Commentary

April employment numbers were low, but auto sales were near record levels, housing data continued to improve, and retail sales are moving ahead at a slow but steady pace.

GDP: First-quarter real GDP growth slowed down to 2.2% from 3.0% in the fourth quarter last year. The number would have been much higher if government-defense and business-construction spending hadn't fallen significantly. In perspective, the drop in GDP growth is not such bad news given all the offsetting factors, and Morningstar economists estimate that we seem to be on track for 2.0%–2.5% growth in 2012 and 2013.

Employment: April's employment report was definitely bad news, with only 115,000 jobs added, a disappointingly low number when compared with the recovery high of 275,000 we saw back in January. If interpreted as a trend instead of as a number, this could mean more bad months ahead. However, weather, the auto industry, and seasonal factors can affect month-to-month employment data, making the bad news seem worse than it actually is. Examining the data year-over-year can strip out seasonality and eliminate month-to-month anomalies such as strikes or weather-related fluctuations. Year-over-year job growth has been steadily trending upward, from 0.8% in May 2011 to 1.6% in February 2012, then slightly down to 1.4% in April 2012.

Morningstar economists believe that, even though we shouldn't expect high numbers like in January anymore, employment growth will continue and will vary greatly by sector. So far, the manufacturing sector has been performing above average, while government has been experiencing a sharp decline. When comparing current job growth numbers with the ones observed during past recoveries, it becomes apparent that things are a little worse this time around (1.4% employment growth on an annualized basis versus a 1.9% average for the recoveries from the 1982, 1990, and 2001 recessions). Government is the sector with the worst shortfall.

Auto sales: In April, the auto industry experienced its second-best month of the recovery. Sales were not quite as strong as in February, but they were better than in any other month of the recovery since 2009. Strength in the auto sector was a main driver in the recovery, contributing 1.1% of the 2.2% increase in GDP during the first quarter of 2012.

Consumer spending: Inflation-adjusted consumer spending only increased by 0.1% in March, following 0.3% and 0.5% increases in January and February, respectively. However, warm weather and the reduced use of utilities may have played a role in keeping the March number low. On the other hand, year-over-year employment data suggests wage income is up only modestly (maybe 0.5% to 1.0% after inflation), while consumption is growing faster (about 2% after inflation).

Housing: Improvement in this sector has been steady and dramatic, as demonstrated by the Case Shiller 20 City Index, the Federal Housing Finance Administration Report, and pending home sales numbers. With mortgage rates back down, affordability back at record levels, and inventories in several markets near historic lows, the prognosis for further improvement is excellent.

When economies diverge: Can the U.S. economy keep improving if the rest of the world slows down? The Eurozone economy declined by 0.3% in the fourth quarter of 2011 and now appears poised to fall even faster in the first quarter. Inflation in Europe also seems to be on the rise, driven primarily by oil prices. As Europe is China's largest trade partner, a European slowdown may not bode well for China's economy. The U.S. derives less of its GDP from exports and a weakening in this area has so far been offset by a powerful auto industry, but the consensus is for the trade deficit to increase in the months ahead.

Stay a Step Ahead of the Tax Collector in 2012

A good mantra for investing is to focus on what you can control. Although most people are inclined to put taxes into the "out of my control" bucket, that doesn't have to be the case. The key to cutting your tax bill is staying current on tax-law changes. Although there aren't any substantial changes to the tax code for the 2012 tax year versus 2011, here's a summary of recent and impending tax-law changes. Some of these changes have an impact only on those in very high tax brackets, while others affect individuals of all income levels.

Social Security Payroll Tax Holiday: Congress extended the Social Security payroll tax holiday through the end of February 2012, though many pundits believe the holiday will eventually be extended through year-end. Under the holiday, the Social Security withholding rate has dropped from 6.2% to 4.2%. As in the past, individuals won't pay Social Security tax on any earnings over a certain level, currently at $110,100. (One related provision that has gotten less play is that when Congress extended the payroll tax, it included an additional provision that levies an additional tax on high-income earners, specifically, a 2% tax on any income earned in the first two months of the year that's in excess of $18,350 and not greater than $110,100.)

Given that taxpayers are effectively receiving a pay hike, one idea is to divert that money to your own retirement fund, either your company retirement plan or an IRA. Bump up your 401(k) plan contribution to at least match the amount you're gaining during the tax holiday, and keep your contribution elevated if the holiday is extended for the full year.

Dividend Tax: Through 2012, the tax on qualified dividends remains at zero for taxpayers in the 10% and 15% tax brackets, and is 15% for all other taxpayers.

Long-Term Capital Gains Tax: Through 2012, taxpayers in the 10% and 15% brackets will not owe capital gains tax on the sale of assets they've owned for more than one year. Long-term capital gains tax rates remain at 15% for all other taxpayers. Short-term capital gains are taxed as ordinary income.

Estate Tax: The top estate tax rate is 35% for 2011 and 2012, and it only affects those who have amassed estates of more than $5 million. Those who inherit assets will also once again receive a step-up in the cost basis of those assets, meaning that the inherited assets are valued at their fair market value as of the decedent's death.

Gift Tax: The annual gift-tax exclusion stays the same as it was in 2011: $13,000. That means you can gift $13,000 apiece to an unlimited number of people this year without having to worry about a gift tax or even fill out the gift-tax paperwork. Say, for example, you and your spouse would like to help your daughter and her husband buy a new house. You could each gift $13,000 to both your daughter and son-in-law, for a total of $52,000.

Savers in 529 college-savings plans can actually gift $65,000 in a single year without triggering a gift tax, assuming they make no further contributions to the same individual's college plan in the subsequent four years. In that case, the IRS assumes that your contribution is spread over five years ($13,000 x 5 = $65,000). Married couples can actually contribute $130,000 to one child's college-savings plan in 2012, assuming they make no further gifts from 2013 through 2016. Also, if you're gifting to pay educational or medical expenses, you can circumvent the gift-tax system altogether by making payments directly to the educational or medical institution.

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In Case of Emergency

Nobody likes to think about the possibility of job loss, serious illness or other major expenses. But these are all possible in an uncertain world, and having an emergency fund in place can help if such situations arise.

An emergency fund is a money market, savings or checking account where you keep a specified amount of money to cover expenses. The important part here is that the money is stored in an investment vehicle that allows quick and easy access to funds. But you do not touch the money in this financially liquid account unless a real emergency pops up. No ifs, ands or buts.

Setting up an emergency fund is usually the first step toward building a solid financial plan. If you don't already have one in place, start building one as quickly as you can. It obviously takes perseverance to stash money from each paycheck into your emergency fund, but it may be well worth it one day.

How much cash should you put aside? Most financial advisors recommend to first aim to keep enough money in the fund to cover at least three months of expenses. However, as your take-home pay increases or your expenses grow, you may need to keep six months or even as much as a year's expenses in your fund.

Take it one step at a time. Once you've saved enough to cover three months of expenses, try for the six-month mark, and so on. Easier said than done, sure, but if you treat your emergency fund like any other must-pay monthly bill, it will undoubtedly grow over time.

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