



Second Quarter 2009

Time for a Reality Check

Put aside the newspaper, turn off the television and take a moment to get the current financial situation back into perspective. Yes, the crisis is real and yes, it's global. That alone makes it very different from prior financial meltdowns. This isn't just a tech stock slide, or an Asian crisis. It's worldwide and it is going to change our lives. But it isn't the end.

There is cyclical to everything - from life with its inescapable move from birth to death, to the financial markets with their unending cycles of bull and bear, to economies and business cycles. It seems as if we need those cycles to advance and to change. The good news is that if you look back throughout history, periodic crises catalyze a whole new epoch for society.

And by and large those catalysts bring positive changes.

In the U.S., despite the erosion of net worth from declining values in homes and investments, we have tremendous resources to pull us through this crisis. Indeed, our greatest worry isn't what happens here at home, but what happens around the world where safety nets are thinner, or perhaps don't exist at all.

What should you do personally to get through this period? It sounds trite, but just do your best. Decide what matters the most to you and focus on keeping those elements whole and healthy. Personal relationships should be a priority. This is not the time to let stress destroy families, friendships

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Wealth Distribution on Your Terms

The current administration and Congress have made it pretty clear that wealth needs a bit of redistribution. The exemption for estate taxes is to be frozen for now at \$3.5 million. Effective 2011, taxes will rise for single individuals earning \$200,000 and more and couples earning \$250,000 and over. The *Wall Street Journal* reports this will generate \$656 billion over 10 years.

The problem is that isn't enough. The current economic stimulus plan exceeds \$780 billion in less than three years. And that's before we start talking financial bailouts. President Obama's plan to finance increased

deficits with increased taxes on the wealthy is going to fall short even if the tax rate is raised to 100% according to many analysts. There just aren't enough people earning above \$200,000 (or \$250,000 for couples), and their numbers are falling with the economy.

Payoff plans under the proposed federal budget also rely on some fairly rosy economic forecasts. The White House budget assumes that the economy will decline only 1.2% this year, growing 3.2% next year. By 2010 to 2013, budget expectations are that the economy will average 4% a year.

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Spotlight on Fraud

At the very least, the current financial crisis is shining a very bright light on investment fraud. With more Ponzi schemes surfacing and the list of advisers on the lam growing, Warren Buffett's comment in his 2002 shareholder letter is coming true "...you only find out who is swimming naked when the tide goes out."

2009 Distributions NOT Required

The 2008 Worker, Retiree and Employer Recovery Act provides a one-year suspension of retirement account Required Minimum Distribution (RMD) rules in 2009. This allows people 70½ or older to skip taking distributions from IRAs and defined contribution retirement plans (such as 401(k) and 457(b) plans). It also applies to after-death distributions.

Waiving the 50% excise tax penalty imposed if minimum withdrawals are not taken after age 70½ is designed to ease requirements for pension plans that are having problems meeting funding requirements in the current economic crisis. But it can work to the advantage of individuals as well.

The main reason to skip a minimum distribution in 2009 is to give your retirement account more time to recover from the past 18 months. If you want to be able to pass retirement assets on to your beneficiaries, minimizing withdrawals from retirement accounts is a good strategy. Because distributions from tax-deferred accounts are taxed as personal income, withdrawals may be subject to higher tax levels than other income sources and could impact your tax bracket.

Questions to Ask Before You Take Early Social Security

With many retirement portfolios reduced by the market's continual decline, individuals considering retirement are facing two conflicting levels of advice. The first says, postpone your plans for retirement, keep working a little longer and put as much as you can aside to rebuild your retirement portfolio. The second says with jobs scarce, your best option is to take early retirement and start receiving Social Security. At least that way you will have income coming in and less need to tap your savings.

A survey by Fidelity Investments, conducted in August of 2008, found that nearly half (45%) of 61-year-old Americans expect to tap into Social Security at age 62, their first year of eligibility. Given rising unemployment levels since August that number may be even higher today.

But before you opt to start collecting early Social Security benefits, there are a few facts you need to understand about the system and some questions to answer.

Your Social Security benefit depends on your earnings, or those of your spouse, on which Social Security

taxes have been paid, averaged over your working lifetime. Generally, the higher your earnings, the higher your Social Security benefit. If you served in the military after 1956, you paid Social Security taxes on those earnings. Since 1988, inactive duty service in the Armed Forces reserves (such as weekend drills) has also been covered by Social Security.

You can start your Social Security benefits as early as age 62, but your benefit amount will be reduced based on the number of months you will receive checks **before** you reach full retirement age. *This reduction is permanent. Benefits will not go up when you reach full retirement.*

Receiving your full Social Security benefit requires postponing benefits until your full retirement age. This varies based on the year you were born, shown in the chart. (Widows and widowers can begin receiving Social Security benefits at age 60 (or age 50 if disabled) on the deceased spouse's account.)

Postpone receiving Social Security benefits until after your full retirement age and your benefit will increase by a certain percentage for each additional year you work until you either start taking your benefits or reach age 70.

If you work while receiving early retirement Social Security benefits, your benefits will be reduced if your earnings exceed the current earnings limit. In 2009, for every \$2 over \$12,960, \$1 will be withheld from benefits. This increases to a limit of \$34,440 for the year you reach full retirement age, at which time, for every \$2 over the limit, \$1 is withheld from benefits.

Once you are past your first year of full retirement, there is no reduction in Social Security benefits for working. For more information on your benefit and rates, visit www.ssa.gov.

Which brings us to the questions you need to answer:

1) Is the value of the benefits you receive early worth the tradeoff

in lower benefits for the rest of your life?

2) Do you plan to continue working in early retirement?

If so, will you earn enough to trigger a reduction in your current benefits?

Weigh your alternatives carefully before using Social Security as a stop-gap source of income between jobs.

Cash in hand now may not be worth the permanent reduction in long-term benefits.

3) How long do you anticipate living?

If your health is such that you don't anticipate collecting benefits for the long term, by all means retire early.

If your family history indicates the potential for living into your 80s and 90s, this needs to be taken into consideration

4) Do you expect Social Security to remain viable or become a needs-based system?

This is the tough one. If you foresee a day when you will not be eligible for Social Security benefits, now may be the right choice, allowing you to conserve other assets for later in life. On the other hand, the more likely you are to need Social Security benefits to meet daily living requirements in retirement, the more important it may be to maximize those benefits later in life by waiting to retire.

Remember, Social Security was never intended as a full retirement plan, but rather as supplemental income to keep older citizens from abject poverty in what was assumed to be a relatively short retirement life. When Social Security was originally passed, few workers reached the age of 65.

Before you make any decisions about early retirement, it makes sense to sit down with a financial adviser and determine exactly what your resources and financial needs will be in retirement and how you can best enjoy those years.

Retirement Age for Full Social Security Benefits

1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Note: Persons born on January 1 of any year should refer to the full retirement age for the previous year.

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That's optimistic even within the federal government. In mid-February, the U.S. Energy Information Administration reported that the U.S. real gross domestic product (GDP) is expected to decline 2.7% this year.

If you don't have a lot of assets, wealth redistribution by the government probably sounds pretty good. If you do have assets, however, or family income above \$250,000, you might want to start looking at your own redistribution plan while you still have an 18-month window. Being one of the "wealthy" in America looks like it will not be a very exclusive class when the bills come due.

With values down for many investment classes, this could also be a good opportunity to transfer assets at a lower value, minimizing tax implications.

Before you do anything, identify how much you can afford to transfer. You don't want to jeopardize your lifestyle needs. Second, decide how much control you would like to retain over the assets. If you want to help finance a child's education, an outright gift might not be the best way to do so. There are other ways to transfer assets that give you more control over the use of those funds.

The Tax-Free Gift

Use tax-free gifts first to transfer wealth. There are three ways to do so: (1) the annual exclusion gift per recipient – currently \$13,000 transferrable to as many beneficiaries as the donor wishes, (2) the \$1 million lifetime gift-tax exemption per donor free of gift tax (this will reduce the amount of your estate that can pass free of taxes) and (3) certain gifts earmarked for educational and medical expenses.

If you pay someone's medical or education expenses directly to the provider, the gift is not included in your annual exclusion amount. With a 529 Qualified Tuition Plan, a grantor can elect to use five years of annual gift-tax exclusions at once as a contribution for a beneficiary.

Trusts and Other Tools

A number of types of trusts can help transfer wealth free of gift taxes while avoiding probate and reducing estate taxes. Make certain you work with a qualified attorney or tax adviser in establishing a trust, however. You want to know your trust will stand up in court and in the face of the IRS. Some trusts to consider include:

- Generation Skipping Trust / Dynasty Trust
- Grantor-Retained Annuity Trust
- Charitable Lead Annuity Trust
- Qualified Personal Residence Trust
- Irrevocable Life Insurance Trust
- Uniform Gifts to Minors Act Account
- Section 2503(c) Minor's Exclusion Trust

Other tools for wealth transfer are:

- Family Limited Partnership
- Private Annuities
- Asset sales/loans to family members.



Redistribution of assets and income on your own terms assures that your money goes where you feel it best serves.

In addition to passing through as much value as possible to your beneficiaries, with little or no tax cost to the grantor, wealth transfer allows the future income and appreciation of the transferred

assets to escape transfer taxes.

The big caution we would like to make is that you need to work with qualified advisers when establishing wealth transfer plans. This is going to be a topic of increasing concern with wealthier individuals and unscrupulous advisers are virtually guaranteed to appear promising the latest and greatest wealth transfer scheme. Not all will be legal.

If you are interested in ways to transfer the wealth you have accumulated in ways most likely to benefit people and causes you want to help, we welcome an opportunity to discuss your goals and some of the best ways they might be accomplished. Just call and let's talk.

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or working relationships. In fact, these relationships are typically your greatest source of support and happiness.

This is a good time to be financially conservative, but remember that crises create opportunities. Rather than acquiring the latest, greatest toys, look for possessions with lasting value and ways you may be able to create wealth in the future with your spending. Try to set as much money aside as you can so you are positioned to take advantage of opportunities.

Like it or not, we are all being jolted out of the comfortable ruts

we've traveled for the last 20-30 years. And the change can be very good if you take the time to rethink your life. We welcome the opportunity to talk with you, to explain our view of the future and where the financial markets might be headed. If your circumstances have changed, it may be time to change your investment approach. Perhaps there are ideas you would like to bounce off of us, or investment opportunities you would like to consider. As always, please feel free to call us with any questions or concerns.

The Fallacy of Index Funds and Fees

Wondering whether your financial adviser is at a loss and just guessing what you should do next? If you are being told the best place to invest is to buy and hold index funds with the lowest expenses, your adviser is clueless.

Investing solely in index funds is equivalent to throwing up your hands and saying there's no point in trying to think your way into better returns.

Index funds are a broad representation of the market. Their returns are completely relative to the industry they represent and the general economy. If the economy is in the pits and the industry is reporting losses, the index fund is going down. Having the lowest fees just means it may go down fractionally less. If the economy recovers, the index will recover, but only to the extent that the market segment it represents recovers. If, as many economists project, the U.S. economy is in for a period of little growth and lots of problems in sectors such as automotive, an index fund that represents the broad market is in for the same fate.

Can you think of any activity in life where passivity is the path to success? It doesn't exist. In sports, work, and even relationships, getting what we want

takes action. It takes thinking, planning, anticipating where the opportunities are, making decisions and being prepared to change our minds if the results aren't what we anticipated. And, it takes preparing for disaster, because sometimes things go wrong no matter how much we prepare.

Passive investing in index funds is easy and you can always blame the market if you fail. But, it's not good investing. If you are looking for ways to rebuild your retirement portfolio, to regain financial security, you need active management. That's where our firm is different. We are actively looking for opportunities. Opportunities to avoid losses and achieve profits regardless of market circumstances.

We know that at every point of the business cycle there are segments that do better than others. The reasons are often obvious. Sometimes it takes a bit of research. Among businesses doing well in the first half of 2009, for example, were movie theaters. Escapism? Perhaps. What matters is that they are reporting profits. With an active approach, seeking out profitable companies and market segments is part of the job.

While actively managed accounts pursue strategies that are intended to outperform passive investing, there can be no assurance that the strategies or their pursuit will be successful. Before purchasing an index fund, request a prospectus and read it carefully to understand the fund's investment directive, fees and risks.

Medical Identity Theft Rising

Identify theft has taken a new twist with the theft of medical identity numbers and patient information. Armed with this information, a thief can get care or make false claims for medical insurance. In addition to the financial liability, the potential for corrupted medical files presents a real danger to the insured if treatment is based on the imposter's medical history. Victims could also find they hit their insurance caps, or become uninsurable or unemployable based on someone else's medical problems.

Make certain you carefully review your medical and insurance documents and move quickly to counter any you think might be fraudulent.



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