CAPSTONE investment financial group, inc

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Living with Uncertainty

How can you do it, asked a client. How can you come into the office each day not knowing whether you are going to see the market fall in value again or not, and worrying how to etch out the gains we need to stay afloat?

The answer on our side is often as simple as, "Active management." Active management gives you a plan, it gives you tools to manage risk, and it gives you the ability to, if need be, move to cash. That is a tremendously liberating ability. Active management can't guarantee that there will be no losses, nor can it assure a profit. But it is infinitely better than standing in front of an oncoming train with a passive asset allocation and no ability to respond to changing markets.

There is also tremendous opportunity in today's market. And it is an opportunity many individual investors may miss. According to the *New York Times*, investors are fleeing equities in droves[1] withdrawing a staggering $33.12 billion from domestic stock market mutual funds in the first seven months of this year. Whether or not they return when the market recovers

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[1] "In Striking Shift, Small Investors Flee Stock Market," by Graham Bowley, THE NEW YORK TIMES, August 21, 2010.

Time Out for the Good News

Writing a financial newsletter can sometimes seem like one negative topic after another. Very few people really want to worry about their money or their future. They just want it to take care of itself. So with that said, it's time to look at some of the positives.

We are saving more. The real key to financial security both as individuals and as a nation is to have money in the bank that can be spent when needed not just the minute it is acquired. Individuals have gotten the message. Local and state governments are being forced to face the same reality. Next up, the federal government.

Necessity truly is the mother of innovation. Difficult times in the past have resulted in new innovations, new businesses, new realities. We can't wait to see what the current crisis will create.

Our environment is vastly improved from 30-40 years ago. It's hard to remember sometimes how very polluted our lakes, streams, air and grounds were just 30 years ago. In the United States, we have made tremendous changes in how we treat our environment and in doing so have set standards others throughout the world are striving to achieve. These changes have led to better technologies, cleaner energy and awareness of how small actions, good and bad, add up.

We are living longer, more active lives. 80 is not quite the new 60, but the potential is there.

Life is actually much less expensive than it was 10, 20, or 30 years ago. The

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When Averages Don't Add Up

One of the most deceptive claims in the investment industry is citing "average" returns. When it comes to growing assets, it's not an average that matters but the *when* and *how much*. For example, assume you had five years of returns including +8%, +18%, -24%, +6% and -3%. Your average return for the five-year period is 1%. Using that number, the value of a $10,000 investment compounded annually over five years would be $10,510. Reality, however, is very different. In the table below, average and actual returns and the growth of $10,000 are shown.

Growth of $10,000 @ 1% average annual return		
Year 1	1%	$10,100
Year 2	1%	$10,201
Year 3	1%	$10,303
Year 4	1%	$10,406
Year 5	1%	$10,510
Growth of $10,000 based on actual returns		
Year 1	+8%	$10,800
Year 2	+18%	$12,744
Year 3	-24%	$ 9,685
Year 4	+6%	$10,266
Year 5	-3%	$ 9,959

What happened when actual returns were considered? The realities of math came into play. It doesn't take 24% gain to make up a 24% loss, it takes a 32% gain. Before you accept the superiority of an investment approach based on average returns, you need to look at actual returns.

The mathematics of gains and losses is one of the reasons why a low volatility investment approach with lower annual returns can outperform a volatile approach that has years of higher gains, but also years with erosive losses.

Saving With Reduced Pain

Cannot people realize how large an income is thrift? ~Cicero

Creating financial security comes down to accumulating assets and investments that will see you through retirement, a college education, a family crisis, or even the start up costs of a new business. If you don't have the option of increasing savings from more income, you need to look at how you can increase savings by reducing spending. A natural starting point may seem to cut back on luxuries that add up, such as a latte a day. But before you eliminate the little pleasures that can make some days more fun, there are some big ticket items to consider.

Refinance

The largest single expense for most families is their mortgage. It may also be the easiest to cut given today's low rate environment. Interest rates for 30-year fixed-rate mortgages averaged 4.44% on Aug. 12, 2010, the lowest level recorded since 1970. Before you shake your head and say, but I couldn't qualify, find yourself a good mortgage banker. According to the *Wall Street Journal*, better deals can be found at smaller banks and credit unions than the national banks. These companies, along with mortgage bankers which originate loans for investors, may also be less "formula-driven" and have more flexible lending standards.

Monthly Payment for $200,000 Mortgage			
	30 Year Fixed Rate	20 Year Fixed Rate	10 Year Fixed Rate
7.5	$1,398	$1,611	$2,374
6.0	$1,199	$1,432	$2,220
4.5	$1,013	$1,265	$2,072

Source: www.bankrate.com mortgage calculator.

How much difference could 1.5% make in your payments? The table above shows payment amounts for 30, 20 and 10-year fixed-rate $200,000 loans. Depending upon your circumstances and how long you expect to be in your home, adjustable rates and other mortgage forms may save you even more. Just make certain you understand how much your costs could be if moving doesn't go according to plan.

If you have a second mortgage, a car loan or even outstanding credit card debt, refinancing could make a noticeable difference in your monthly expenses. Before you refinance, however, make certain you understand what your closing costs and final payment will be and that you will experience real savings.

Eliminate Unnecessary Fees

If you pay a fee, you should receive value for that fee. If the fee doesn't produce value, find out a way to eliminate it. Let's start with your mortgage. If you have more than 20% equity in your home, you do not need to pay private mortgage insurance (PMI) on a conventional loan. PMI averages $50-80 per month according to Mortgage Insurance Companies of America, but may be as much as $150 per month.

If you are paying a fee for your credit card, checking account or debit card, shop around. No-fee programs abound. Your current credit card company or bank may suddenly find a no fee program that fits your needs if you talk with customer service. Always look for credit cards with a 25-day grace period and make certain you pay off your balance each month. While credit cards offer a wide range of reward incentives for you to use your card, unless you have a specific goal in mind, cash back is the best reward.

Many companies will offer you discounts for consolidating your business with them. Insurance companies, banks, custodians, financial advisers and even the telephone/cable/internet company all have programs that reduce rates the more accounts or features you use. Again, talk to customer service or your adviser about these opportunities and combine services where it makes sense.

Shop Your Insurance Coverage

How long has it been since you priced your insurance policies? You may be passing up opportunities to save on auto, home, life, disability, personal riders and more. In addition to overall coverage, look at the difference increasing your deductible will make to your payments. Depending on your policy, you may be able to cover a higher deductible with the savings on your policy after just a few months. While insurance companies will offer better prices the more policies the company holds, sometimes it makes better sense to use an insurance company that specializes in the type of insurance you need. A life insurance specialist rarely has the most competitive auto policies.

Re-evaluate Monthly Services

If your family has cell phones for every member, it may be time to consider whether or not you need a land line for a telephone. A different cell phone plan may offer you the same benefits for less cost. With the computer taking over as the entertainment center for many families and digital TV expanding free offerings in major cities, cable television may not be a priority.

Look at all the bills you pay on a monthly basis and ask whether or not you still get the benefit you once had. If you want to continue the service, is there is a better way to do so? Talk to customer service. Ask if there is a better plan or a way to reduce your monthly costs.

Beware of little expenses; a small leak will sink a great ship. ~Benjamin Franklin

Time Out for the Good News *continued form page 1*

price of a loaf of bread may be more, but a transcontinental phone call, plane ticket, computer, telephone and many technology related conveniences are incredibly cheap in retrospect. The variety of clothing and household items that surround us today would have had our great-grandparents in awe.

Information is among the greatest riches of our lives today. The libraries and references of the world are open to anyone with a computer and internet access. This is such a completely transforming reality that it is hard to grasp. Can you remember the day when you couldn't look for a specific product you wanted online and find it? From a global yard sale to an intimate look into the lives of others, it's all there.

Thanks to technology, many people have the freedom and flexibility to work in the environment they choose. Investing is an excellent example of that. Thirty years ago, managing assets required access to information and people available only in the money centers - the New Yorks, Chicagos and other major cities. Today, some of the best money managers are located in what would have once been considered

the most unlikely locations. Moving away from the "herd" we believe leads to new and better ways of managing assets and the growth of active management approaches.

Your challenge – stop for a moment and think of all the positives in your life and then send us an email, so we can keep this list growing.

Living with Uncertainty *continued from page 1*

remains to be seen, but without an active investment strategy that return will most likely be late and costly.

Perhaps the best quote we have read lately comes from author and financial analyst John Mauldin:

"Recessions and tough times are God's way of telling you that you need to adjust a few things, both on a personal and business level – also nationally and globally. I am an optimist. I believe we will adjust and grow, not just in the US but as an emerging world. There are just so many opportunities."

John Mauldin
How We Get Through This Mess
August 20, 2010

There are many things we can't control in today's economy, but where we can make a difference, where we can use our tools, knowledge and judgment to the best of our abilities, we do so. And that keeps us going each day.

Putting Unemployment to Work

Unemployment is a terrible thing to waste.

The worst approach to unemployment is to fall into the time-killing entertainment muddle of surfing from channel to channel, playing endless computer games or wandering the vast stretches of YouTube. If you or someone you know is unemployed, it's time to think about reinvention. Learn new skills. Step outside of what has been to what might be.

All too often we define who we are by our job. It influences not only what we do each day, but our behavior, dress, the expectations of others and how we respond to those expectations. Remove the job from the equation and you have an opportunity to change how you view yourself and the way others view you. Reinvention starts with asking yourself what you really enjoy doing, what you are best at and how you might adapt those two parts of your life to a new you.

There's no better time to start learning. Educational loans are one of the few loans you can qualify for with no income or assets. If you can't afford tuition, you may find there's nothing to stop you from sitting in at the back of a college classroom and absorbing new ideas.

Volunteer opportunities can also be incredible learning experiences and open doors to jobs. Interested in construction? Volunteer to help build a Habitat for Humanity home. Thinking about becoming a veterinarian? Your local animal shelter would love to have your services as a volunteer. Local business won't hire you? Ask if they want an unpaid intern. Love to ski but can't afford a ticket? Train as a volunteer ski patrolman. Bored and want some excitement? Volunteer for the Red Cross. You could end up in the next natural disaster.

You never know where unemployment might lead if you give it a chance by seeking out new experiences, new opportunities, new ideas. Just don't waste it!

Will 2011 Bring the Largest Tax Hikes in History?

Being prepared is the best way to cope with changes. With that thought in mind, we need to look at taxes. Time is running out for Congress to address the expiration of the 2001 and 2003 Bush tax cuts. Without legislative action, effective January 1, 2011 the following changes will take place:

Personal income tax rates will rise:

- The 10% bracket rises to an expanded 15%
- The 25% bracket rises to 28%
- The 28% bracket rises to 31%
- The 33% bracket rises to 36%
- The 35% bracket rises to 39.6%

Itemized deductions and personal exemptions will phase out:

- The "marriage penalty" (narrower tax brackets for married couples) will return from the first dollar of income.
- The child tax credit will be cut in half from $1000 to $500 per child.
- The standard deduction will no longer be doubled for married couples relative to the single level.
- Dependent care and adoption tax credits will be cut.

Estate taxes will revert to a 55% top death tax rate on estates over $1 million.

The capital gains tax will rise from 15% to 20% in 2011.

The dividends tax will rise from 15% this year to a high of 39.6% in 2011 and increase another 3.8% in 2013.

And then there is the Alternative Minimum Tax. Created in 1969 to assure that the richest paid taxes, the AMT was never indexed to inflation. As a result, without legislative intervention an estimated 28.5 million families will be impacted by the AMT in 2011.

Coverdell Education Savings Accounts will no longer be exempt from capital gains taxes when used for primary or secondary expenses such as private school tuition, a new computer, or school supplies.

Other tax relief measures that expire this year include: Small business expensing of equipment purchases will be cut to $25,000. Larger companies will have to depreciate equipment purchases rather than expensing 50%. The "research and experimentation tax credit" will be eliminated along with others. Tax credits for education will be limited. Teachers will no longer be able to deduct classroom expenses. Employer-provided educational assistance is curtailed. The student loan interest deduction will be disallowed for hundreds of thousands of families.

If you haven't considered the impact of these changes on your finances, it may be time to talk to your tax adviser. Congress could still act, but contingency planning now is far better than realizing you need more than you anticipated for taxes next year and having to scramble to come up with the money.

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