Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

Kane Company, P.C. 515-270-2727 Winter 2013

Will End Of Fed Easing Kill The Bull Market In Stocks?

The yield on a 10-year Treasury Note leaped a full percentage point over the one-year period that ended on June 30, 2013, and the stock market reacted. The S&P 500 stock index dropped, which during the quarter had hit a new all-time high, lost 3.8% of its value by the end of the quarter. What happened?

Ben Bernanke, Federal Reserve Chairman, reiterated his intention to end the central bank's easing program, which has kept interest rates low to fuel economic growth. If the economy continues to improve, Bernanke said on June 19, the Fed would start to slow its "quantitative easing" program for keeping interest rates low.

The big question for investors is whether the end of quantitative easing (QE) will abruptly end the stock market's long advance. How will stocks perform in 2014? In truth, no one can predict the future with certainty. But examining some likely scenarios is prudent.

The grey bands in this chart show when the Federal Reserve began and ended the different stages of its monetary easing program, known as Quantitative Easing One, QE 2 and Operation Twist. The easing program, which helped maintain lower interest rates, coincided with a strong rise in stock prices in the five years ended June 30, 2013.

You might conclude from this chart that the end of the easing program would bring higher interest rates and halt the bull market. But that may not necessarily be what happens.

The small green arrows point to four bull runs since 1994, and interest rates were rising during those bull markets.

Of course, that's not guaranteed to happen again now. Still, it is undeniable that rising bond prices have not derailed recent bull markets.

Despite the fact that rising interest rates have not spelled an end to bull markets in the past, you can expect to see some of Wall Street's "best minds" on TV saying that rising rates will be bad for stocks in 2014.

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The End Of Quantitative Easing: What's It Mean For Stocks?

Source: Standard and Poor's through July 1, 2013.

Kane Company, P.C. Partners with Community Foundation

We are excited to announce that Kane Company, P.C. is now a Charitable Investment Partner with the Community Foundation of Greater Des Moines. You may now designate Kane Company, P.C. as your preferred investment manager for any donor advised fund you have or will set up. This will assure that you maintain access to Dimensional Funds (DFA). Community Foundation donors receive maximum tax advantages including the 25% Endow Iowa Tax Credit, in addition to charitable deductions.

Commercial Property Owners: There is a new annual Business Property Tax Credit in Iowa available for commercial property. Contact your county assessor for instructions on how to complete an application no later than January 15, 2014 to have the credit applied to the 2013 assessment.

Reminders! December 31 is the deadline for Roth IRA conversions and College Savings Iowa contributions. We can assist in pension and IRA rollovers, or any required minimum distributions (RMDs) you may need to complete before year-end.

Our office hours will be extended January through April 15th: Monday through Friday from 8am-5pm & Saturdays from 8:00am-noon.

Thank you very much for your continued patronage and referrals. We wish all of you a happy and healthy holiday season, as well as a prosperous New Year!

Steven L. Kane, CPA/PFS, CFP®

Managing Your Tax Bracket Now Crucial

Four tax law changes that took effect in 2013 are driving high-income earners to manage their tax brackets more carefully.

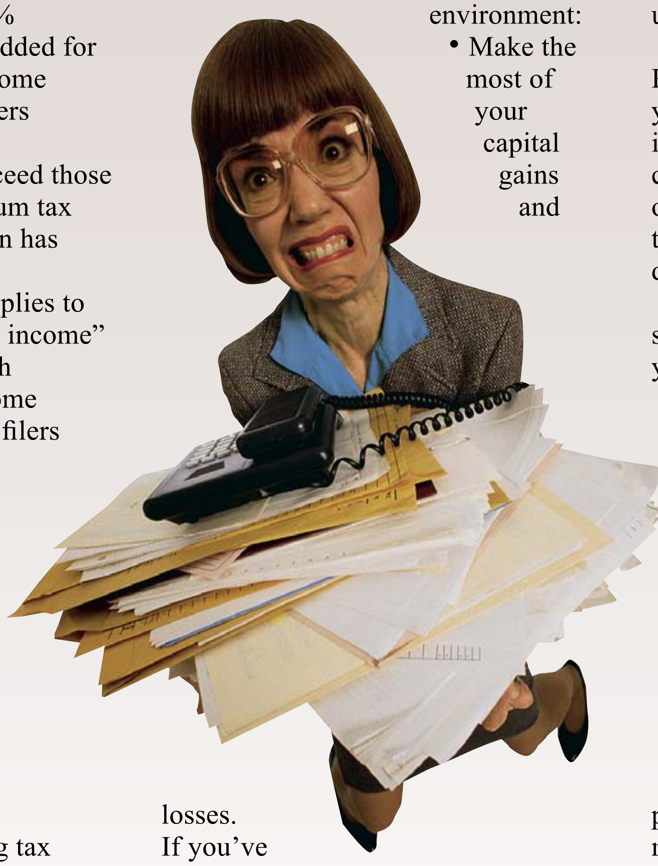
1. A new top income tax rate for ordinary income of 39.6% (previously 35%) has been added for single filers with taxable income above $400,000 and joint filers above $450,000.

2. For investors who exceed those same thresholds, the maximum tax rate on long-term capital gain has increased from 15% to 20%.

3. A new 3.8% surtax applies to the lesser of "net investment income" (NII) or the amount by which modified adjusted gross income exceeds $200,000 for single filers and $250,000 for joint filers. The definition of NII includes capital gains and dividends, but not payouts from retirement plans and IRAs.

4. The tax benefits available for itemized deductions and personal exemptions are phased out for taxpayers above certain income limits.

Faced with this changing tax landscape, you need to be especially vigilant to keep "bracket creep" in check. At the same time, it could make sense to realize year-end income up to the next bracket threshold. Here are several tax strategies to consider in this environment:



- Make the most of your capital gains and losses. If you've taken losses during the year, it could make sense to realize capital gains now, using those losses to offset extra income that could put you in a higher bracket or subject you to the 3.8% surtax. Or, if you have existing gains, taking capital losses could offset them and up to $3,000 of ordinary income.
- Convert a traditional IRA to a Roth IRA—but stagger the amount you convert each year to avoid rising into a higher tax bracket. The converted amount is taxable as ordinary income, but it may pay off in the form of future tax-free distributions.
- Stay in a lower bracket by shifting taxable income to the younger generation. For instance, you might give dividend-paying stock to a child in a low tax bracket. Just keep in mind that under the "kiddie tax," unearned income above $2,000 received by a dependent child in 2013 generally will be taxed at your top rate.
- Reduce your taxable income by making charitable gifts. The tax law generally allows you to deduct the fair market value of donated property that you've held for more than a year. However, deductions for charitable gifts are among those that may be reduced for upper-income taxpayers. ●

How To Avoid Bad Surprises In Roth IRAs

If you've been tempted to contribute to a Roth IRA, or to convert some or all of the funds in your traditional IRAs into a Roth, it's likely you've been influenced by the lure of future tax-free payouts. However, be aware this tax-favored treatment isn't automatic, by any means. What's more, if you're below a certain age limit, you may be slapped with a tax penalty on top of the regular income tax you'll owe.

At the same time, though, even if the Roth IRA distributions are subject to tax, the impact may be negligible or nonexistent under special IRS "ordering rules." That means that even "taxable" Roth distributions may be effectively tax-free.

Here are the basic rules for Roth IRAs. You don't get any tax break now for contributing to a Roth. But "qualified" distributions from a Roth IRA that has been established for at least five years are 100% exempt from federal income tax. For this purpose, qualified distributions include those made:

- After you reach age 59 ½;
- Because of death or disability; or
- To pay for qualified home buyer expenses (up to a lifetime limit of $10,000).

The rule that often trips people up is the one requiring the Roth IRA to be in existence for at least five years. To compound matters, if you withdraw funds before five years have elapsed and you're under the magic age of 59 ½, you'll have to pay a 10% penalty on the distribution amount.

But here's the silver lining: Under IRS rules, the money you take from a Roth IRA is treated as being distributed in the following order:

1. Roth IRA contributions. That money went in without any tax advantage to you, and you can take it out, for whatever reason, without any penalty or taxes.

2. Contributions made when you

It's Tough To Decide If You Should Retire Early

Whatever you do for a living, and whether you're an employee, work for yourself, or own a small business, one of the toughest decisions you'll ever face is when to retire. A number of factors will be at play in your decision-making process, including your age, your health, your retirement and insurance benefits, the cost of living where you live, the income-producing investments you may have, and your overall savings. But perhaps the biggest question underlying all of the others is whether you will be able to afford the kind of lifestyle you want after you are retired.

A journalist who opened a business-writing service in St. Petersburg, Florida, at age 50 and retired at age 60 offers his opinion on retiring early, or before retirement benefits and Social Security payments kick in.

"I don't regret retiring at age 60 because I simply burned out from working too much," he says, adding that as a small business owner he worked 60 to 80 hours a week, six and seven days a week, and was able to take only a single, one-week vacation during the decade that he operated the business.

"I enjoyed working for myself, being the boss, and making all of my own business decisions," he says. "I was lucky in that I was able to write business-related articles for two of the top national publishers of business and trade magazines. It took a lot of research and study, but I was able to break the Florida business community into five segments, identify the trade magazines that covered each segment, and develop a business model to provide coverage for each of the magazines."

He points out that he never qualified for pension benefits at any of the four metro daily newspapers where he worked. "I made a comfortable living working for myself, but I was not what would be considered wealthy by any definition," he says. "Comfortable, but not wealthy."

"I did two things—faithfully—that helped me retire two years before I got early Social Security benefits at age 62: First, I found a good, trustworthy attorney and, second, I hired an accountant. I never made a major business-related decision without consulting one or both of them. The accountant encouraged me to begin an IRA retirement fund. That was a lifesaver, especially since I had no other source of retirement income.

"The attorney saved me a lot of money when I decided to purchase a newsstand located next door to my business-writing office in downtown St. Petersburg. The owner of the newsstand told me that I didn't 'need to go to the expense of hiring an attorney' to handle the transfer of ownership of the newsstand from him to me. 'We can just use one of those standard bill-of-sale forms,' he said.

"Well, the title search ordered by my attorney turned up a lien against the newsstand that the previous owner hadn't told me about. It was for several thousand dollars. The lien was taken out of the previous owner's proceeds from the sale.

"Some people may feel that I retired without proper financial planning, and that may be true. One thing that I did do, however, was sell high and buy low in the real estate market, and this provided me with a comfortable nest egg to fall back on. I had eliminated all of my debt, except for car and house payments, and gotten on a cash basis before I retired.

"I used a large part of the nest egg to pay cash for a residence in a 55-plus community a few miles north of St. Petersburg and to buy a new economy car. I never have been extravagant and live, with my wife, on a strict budget. We have no debt now."

He added that he sold his writing business and newsstand when he retired and put the sale proceeds into his retirement nest egg.

"I would like to add a word of caution to those who may be reading this and thinking about retiring," he says. "I can't say that I retired too early, because I'm living and enjoying my longtime retirement, but when to voluntarily retire is an individual decision and should not be made lightly.

"One thing is certain: the future is uncertain. What's happening today may or may not be an indicator of what's going to happen in the future. But I can tell you this: growing old is bad for your health. When I retired at 60 my only health problem was sleep apnea. I since have developed high blood pressure, heart disease, and diabetes. I've had a heart attack and four angioplasties. I have 6 stents in my heart. But I'm now 82 and still kicking.

"Now that I'm older, and hopefully wiser, I would do ONE thing differently: I would hire a financial advisor before retiring!" ●

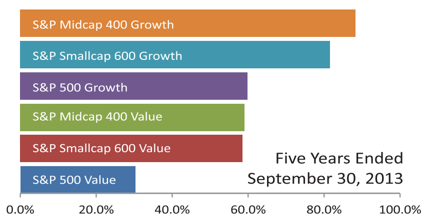
converted a traditional IRA into Roth status. These may be withdrawn tax-free even if they are part of a nonqualified distribution, but the 10% penalty tax generally applies to withdrawals within five years, unless you're age 59 ½ or older.

3. Contributions made when you converted nontaxable traditional IRA balances into Roth IRA status. Such contributions also may be withdrawn on a tax-free basis subject to the 10% penalty.

4. Earnings within the Roth IRA. These amounts are taxable when withdrawn unless they meet the definition of qualified distributions. In addition, the 10% penalty tax applies to withdrawals made before age 59 ½.

As you can see, federal income tax on a distribution doesn't kick in until you've gone through the first three categories. For many people with a sizable amount in a Roth, distributions won't be taxable at all, even if funds are withdrawn within five years of setting up the account. ●

Market Data Bank: 3rd Quarter 2013 ✤

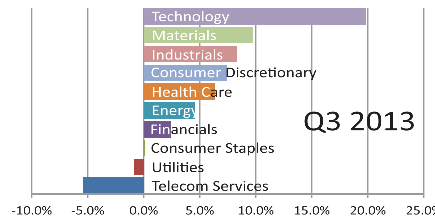


U.S. STOCKSBY MARKET CAP AND STYLE

A dollar invested in the S&P 500 stock index for the five years ended 9/30/13 appreciated in value to $1.60 — a 60% gain. Anyone smart enough to invest it all in mid-cap growth stocks gained 88.3%.

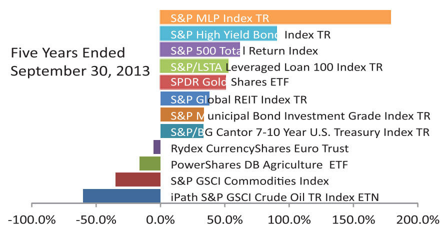
U.S. STOCKS

The five- and 10-year annualized return on companies — large and small, growth or value — is not too far below the seven-decade historical average of 10.5%. That's a remarkable comeback from the financial crisis.



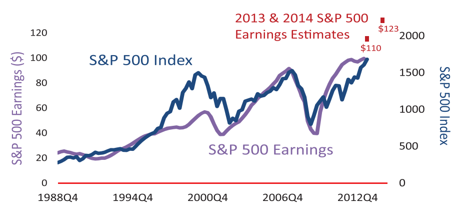
LARGE-CAPSTOCKS BY INDUSTRY

The tech sector in 3Q13 roared ahead of all other industries, but that is raising concerns that the sector is overvalued. The divergence in returns on the different sectors tells you why broad diversification is important.



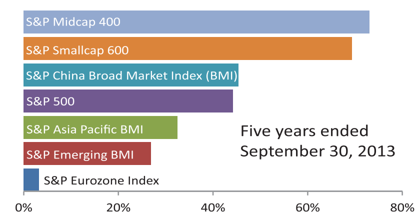
ASSET CLASSES ±

In the five years ended 9/30/13, four of 12 major asset classes lost value while eight posted positive total returns. Master Limited Partnerships, an asset class that did not exist a decade ago and mainly invests in oil and gas companies, trounced all asset classes in five-year cumulative returns.



S&P 500 INDEX VS. EARNINGS ¥

Estimated S&P 500 earnings per share as of 9/26/2013 was $110.18 for 2013 and $122.62 for 2014. The positive earnings outlook remained in place at the end of 3Q13. Unexpected events could derail earnings and prices, but fundamentals remained positive



FOREIGN VS. U.S. STOCKS

In the 5-years ended 6/30/13, U.S. stocks outperformed foreign stocks, as the U.S. economy far more resilient than most foreign markets. Ironically, that's made globally diversified portfolios look bad versus U.S. stocks. But that's a price you must pay for diversification.

✤ Past performance does not indicate future results. ± Indices and ETFs representing asset classes are unmanaged and not recommenda-tions for any specific investment. Foreign investing involves special risks, including political or economic instability and currency fluctuation. Bonds offer a fixed rate of return while stocks fluctuate. ¥Actual S&P 500 index data through 6/30/2013 and actual earnings through 3/31/2013. Estimated 2013 and 2014 S&P 500 earnings per share as of July 24, 2013. Sources: Yardeni Research, Inc. and Thomson Reuters I/B/E/S survey of consensus estimates; Standard and Poor's for index prices through 6/30/2013 and actual earnings data through March 31, 2013.

The Bull Market In Stocks

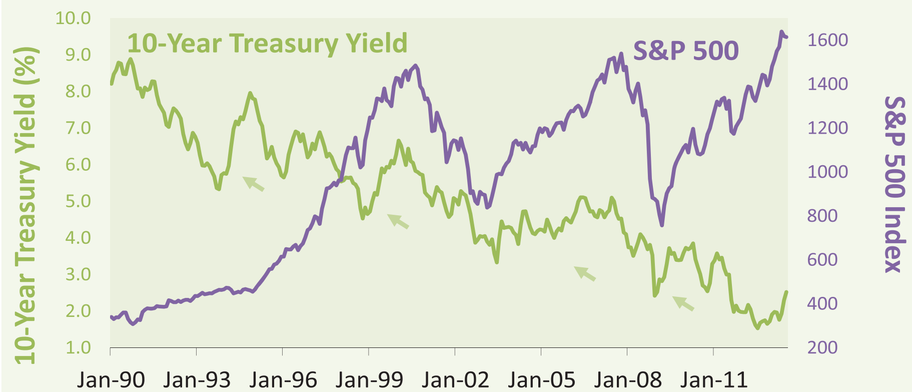
(Continued from page 1)

In the months ahead, it seems likely that the chatter will grow louder on financial TV stations and across the Web about how terrible higher bond yields are going to be for stocks. This has happened in previous periods of rising rates. Prognosticators are probably going to make three arguments:

One, that higher bond yields provide competition to dividend yields, which will make stocks less attractive. Secondly, that higher bond yields drive down the market's price-to-earnings ratio. And, lastly, that higher bond yields will choke economic growth, sending stocks lower.

Wall Street's talking heads have already been out in force in the media, warning that rising interest rates will hurt stocks. When you hear these forecasts, remember that many-- if not most--of Wall Street's prognosticators have a bad track record for predicting the market's next move. So when bond yields start to rise and you hear the refrain: "rising bond yields are bad for stocks," don't assume it's always true.●

Standard & Poor's 500 Versus Bond Yields



Sources: Standard and Poor's, Federal Reserve through July 1, 2013.
Past performance does not indicate future results.

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