Investing With Integrity

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The New Tax Package and Your Portfolio

On Dec. 16, 2010, Congress approved $801 billion in tax cuts and $57 billion for extended unemployment insurance. It includes other tax breaks, such as college tuition credit for some families, an expanded child tax credit, and the earned income tax credit. Here is how some of these changes may impact your portfolio.

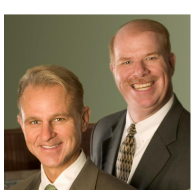
Social Security Tax: The one-year payroll tax cut would reduce the Social Security tax to 4.2% from 6.2%. Although this was intended to increase consumer spending levels and stimulate the economy, a better option would be to increase your contribution to your 401k plan to match your employer's contribution, at a minimum, if you do not need extra cash in the near future. The contribution limit for 401k plans remains at $16,500 for those under 50, and $22,000 for those age 50 or older.

Dividends/Capital Gains Tax Rates: Dividend and long-term capital gains taxes will remain at 15% for the next two years. Many had suggested selling securities in your portfolios that were projected to have huge capital gains before the end of 2010, since the capital gains tax rate was projected to increase to 20%. Now, you can sell your securities if your investment strategy dictates.

Estate Taxes: The new tax package sets new estate tax parameters with an exemption of $5 million per person, or $10 million per couple, and a maximum rate of 35% for the next two years. You should speak to your financial advisor about creating an estate plan that will detail how you would like your assets distributed after you are gone, and who should act on your behalf should you become disabled.

Dividends are not guaranteed and are paid solely at a company's discretion. Please consult with your tax professional for specific tax advice.

Advisor's Corner



Integrity Financial Planners
info@integrity-fp.com
541-469-4080
www.integrity-fp.com

Charles Blozinski, CFP and Thomas Goodwin, CFP, EA offer their clients the advantage of over 35 years of combined experience in financial services. They work as an interactive team to provide independent, unbiased financial advice in a fee-only environment. Integrity Financial Planners is a registered investment advisor in the State of Oregon.

The Many Faces of Inflation

Integrity:

- Current and future inflation expectations are important in determining how various types on bonds will perform within a portfolio. If higher inflation rates expected, treasury inflation protected bonds and floating rate bonds are expected to be among the top performers.

During the recent 2007–2009 recession, it seems all we've seen and heard about the economy was bad news: the housing market collapsing, 401(k)s suddenly being worth much less than before, a lifetime of savings almost disappearing in a few months, rising unemployment, and fluctuating prices. Now that the recession has officially ended in June 2009 and we're on the road to recovery, inflation may become a concern once again. In this uncertain economic climate, it may be helpful to learn about the different types of inflation and their immediate effects.

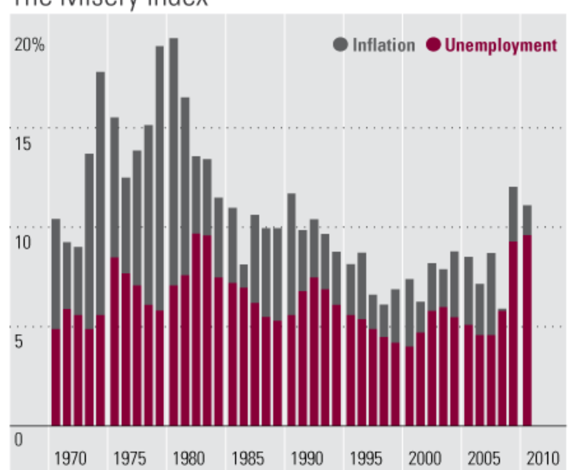
Inflation: Inflation is defined as a continuing rise in the general prices of goods and services. Simply put, if prices, on average, are going up in an economy, then you've got inflation. With a set amount of money in an inflationary environment, consumers are able to buy less and less over time. High rates of inflation can generate uncertainty, lower productivity and discourage investment. The leading measure of inflation in the United States is the Consumer Price Index (CPI). The government can change its monetary policy to control the money supply and keep inflation in check, although this is not the only variable affecting inflation. In November 2010, the Federal Reserve announced it would buy back long-term Treasuries in order to inject money into the economy, a policy called quantitative easing, which can trigger higher inflation.

Hyperinflation: Hyperinflation is extremely high, out of control inflation, caused by a steep increase in the money supply without a corresponding increase in the output of goods and services. Well-known examples include the German hyperinflation after World War I and the hyperinflation in Hungary after World War II. It appears that such an extreme phenomenon occurs mainly as a result of radical changes and prolonged economic instability.

Deflation: Deflation is the opposite case: a general decline in the prices of goods and services. In the U.S., deflation occurred as recently as 2008 and 2009: The change in CPI was negative in the third and fourth quarters of 2008 and in the fourth quarter of 2009, a clear indicator of deflation. The obvious positive effect here is lower prices—many argue that deflationary periods are good times to buy. The problem with deflation, though, is that consumers reduce spending and businesses stop growing, which is not good for the economy.

Stagflation: This is the worst-case scenario: high inflation and slow growth simultaneously. Normally, there is an inverse relationship between inflation and unemployment; if the economy is able to tolerate a higher rate of inflation, lower unemployment can be achieved, and vice versa. But during a stagflation period, both inflation and unemployment go up. An interesting measure for stagflation is the misery index, which, as illustrated in the image, combines the unemployment and inflation rates. The U.S. experienced severe stagflation in the 1970s, when unemployment and inflation reached a combined high of almost 20%. There has been talk of stagflation during the recent crisis as well, but the potentially encouraging news is that the misery index is not nearly as high now as it has been in the past.

The Misery Index



Source: Inflation is represented by the Consumer Price Index, and unemployment by the national unemployment rate, not seasonally adjusted, from the Bureau of Labor Statistics.

The Big Picture

Integrity:

- Each of Integrity's diversified portfolios includes a significant allocation in international equities. This allocation aids the stability of Integrity's portfolios throughout all market cycles.

The United States has long been the focal point of the global economy. However, investors should consider venturing beyond the U.S. for additional investment opportunities, growth potential, diversification benefits, and possibly an improved risk-and-return tradeoff, to name a few. International markets account for a large proportion of the world's available investments and offer a distinctly different set of investment opportunities than domestic markets. In addition, some international economies are growing at a significantly faster rate than the U.S. economy.

Despite the healthy economic growth of foreign markets, along with their outperformance when compared with the performance of the U.S. market, many investors still shy away from taking advantage of international opportunities. Consequently, they fail to experience the potential growth that is made possible through global investing. What many investors overlook is the possibility for overseas investments to bring stability and diversification to their investment portfolios.

The image presents the three best-performing developed-nation stock markets worldwide (out of a total of 23 countries) on an annual basis compared with the U.S. over the past 10 years. When compared with developed stock markets, the U.S. market has rarely been the top performer in any given year. In fact, the rank of the U.S. market has been toward the bottom during most of the years examined except for 2008 and 2010. For example, the U.S. ranked 7th in 2010 and 3rd in 2008, but 19th in 2009 and 18th in 2007. Actually, the U.S. finished in the top ten only three times during this past decade.

In fact, it seems that whenever the world equity markets generally experienced a prosperous year, the U.S. market was not among the top performers. With world equity markets down drastically in 2008, the U.S. actually ranked 3rd behind Japan and Switzerland, but fell to 19th place again as markets rebounded in 2009.

It is rare to find any single market that has performed consistently among the top markets. With it being nearly impossible to predict which markets will be top performers in any given year, it may be wise to hold a portfolio that is diversified across several countries. While all stock markets experience ups and downs, these fluctuations may occur at different times for different markets. Furthermore, the independent movement of global markets has provided considerable diversification benefits when held in combination with U.S. investments.

By looking at the big picture and taking advantage of op¬portunities abroad, investors may experience higher returns than if they were invested solely in the United States. However, holding a diversified portfolio (both in U.S. and international markets) may be the best way to protect against global market fluctuations and risk.

Growth Through Global Investing

	1st	2nd	3rd	USA rank
2010	Sweden	Denmark	Hong Kong	7th
2009	Norway	Australia	Singapore	19th
2008	Japan	Switzerland	U.S.	3rd
2007	Finland	Hong Kong	Germany	18th
2006	Spain	Portugal	Ireland	22nd
2005	Canada	Norway	Japan	19th
2004	Austria	Norway	Greece	22nd
2003	Greece	Sweden	Germany	22nd
2002	New Zealand	Austria	Australia	18th
2001	New Zealand	Australia	Ireland	8th

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. All returns were calculated in U.S. dollars. Returns and principal invested in stocks are not guaranteed. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards.

Source: Equities for each country are represented by Morgan Stanley Capital International Indexes and the U.S. stock market by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Developed countries in this analysis include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, United Kingdom, and the United States.

Chasing Performance

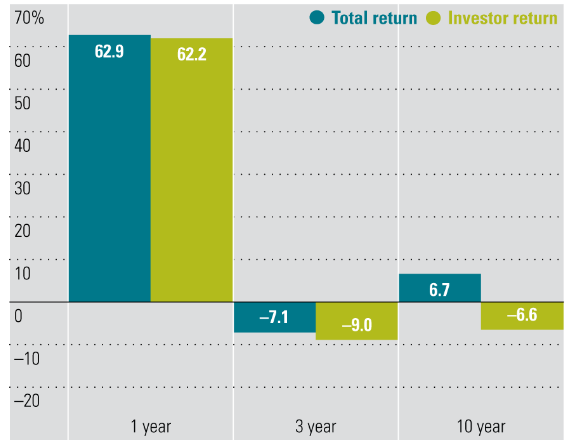
Integrity:

- In Integrity's investment selection process, we weight the 5 and 10 year performance of a fund significantly heavier that the short term performance to avoid these issues.

Investors often endure poor timing and planning as many chase past performance. They buy into funds that are performing well and initiate a selling spree following a decline. This becomes evident when evaluating a fund's total return compared with the investor return. Overall, the investor return translates to the average investor's experience as measured by the timing decisions of all investors in the fund.

The image illustrates the investor return relative to the total return for a given fund. Over the short term, both the total and investor returns were positive, with the investor return ending slightly lower. Over a 10-year period, however, total return greatly exceeded investor return. Investors who attempted to time the market ran the risk of missing periods of exceptional returns.

Comparison of a Fund's Return Performance Over Time



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. Returns and principal invested in stocks are not guaranteed. Morningstar investor returns measure how the typical investor in that fund fared over time, incorporating the impact of cash inflows and outflows from purchases and sales. It is not one specific investor's experience, but rather a measure of the return earned collectively by all the investors in the fund. Total return measures the percentage change in price for a fund, assuming the investor buys and holds the fund over the time period, reinvests distributions, and does not make any additional purchases or sales. Investor returns are not a substitute for total returns but can be used in combination with them. Data as of February 2010.

Source: The fund illustrated in this example was selected from Morningstar's open-end database.

Integrity Financial Planners
PO Box 4790
Brookings, Oregon 97415
info@integrity-fp.com
www.integrity-fp.com
Tel:541-469-4080