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THE SEIA REPORT

Successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

Year End Review, 2012 Preview

By Deron T. McCoy, CFA, CAIA, CFP®, AIF®
Director of Investment Strategy

2011 REVIEW: "PREPARE TO TACK"

Twelve months ago the US equity markets wrapped up 2010 with a 15% gain. Small caps and emerging markets fared even better with 20%+ gains. It appeared that Ben Bernanke's Quantitative Easing programs staved off recession and continued recovery and expansion were in store for 2011. Our year end review highlighted trades in the capital markets that would profit from this ongoing recovery.

Five months into 2011, it appeared that the "global growth" investment strategy was sound. World markets absorbed the Japanese earthquake/tsunami/nuclear tragedy establishing new post-crisis highs in early May. The S&P 500 gained nearly 9% from year-end, but in ironic fashion, topped at 1370 on May 2nd, the day of Osama bin Laden's capture. Signs were surfacing that the economy was slowing and the European debt-crisis was heating up. This time however, Europe's problems were not limited to small peripheral countries such as Greece and Ireland; by summer, the crisis spread into the larger core-European countries (Spain, Italy, and France) causing much more duress and heightened volatility. The July congressional budget battles and corresponding US debt downgrade in August only added fuel to the fire.

As such, our mid-year course correction (a "tack" in nautical terms) revised many of our global growth themes. In a weakening global economy more conservative equity sectors were favored. Although the US economy was slowing, globally speaking US Large Cap companies were the "cleanest shirt in the laundry." Throughout the year more attention was given to domestic blue chips. While the rotation was profitable, it could not overcome the severe bear markets in the rest of the world.

International investments usually serve as a great diversifier in a portfolio by lowering overall investment risk, but this was not true in 2011. China, the "best" performer of the large emerging markets (BRICs), was down more than 20%. While it was easy to avoid Greece this year (down 63%), the 2011 winners were harder to predict (namely Venezuela, Pakistan, Jamaica, and Botswana).

Country Stock Market YTD Performance

Country	YTD % Change
Venezuela	20.14
Ireland	11.37
Indonesia	9.30
Jamaica	5.96
United States	2.11
Britain	-6.12
Canada	-14.36
Japan	-16.21
France	-19.31
Germany	-20.05
China	-20.33
Russia	-20.95
Brazil	-24.85
Italy	-25.76
India	-37.97
BRIC Nations	
G7 Countries	

Fixed income allocations mirrored equity returns as the more aggressive credit-related bonds lagged US Treasuries in the flight-to-safety trade. And as seen in the chart below,

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Year End Review, 2012

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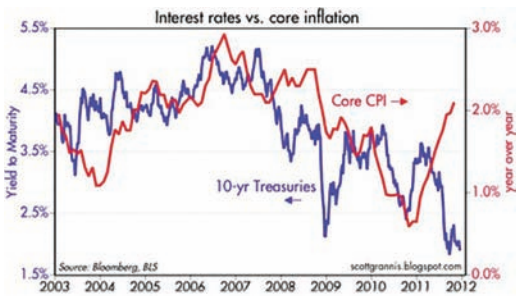
investors are willing to pay exorbitant prices (lowering yield) for Treasuries in view of their safe-haven status. The risk-free (default) status of Treasuries seems paramount and far outweighs the other risk (inflation). As seen in the chart below, the message for investors is that fear has reached extraordinary levels and current pricing is not sustainable in the long-term.



Although defensive in our equity sector allocations, at the height of the crisis with the S&P 500 near 1120, we commented in our special e-newsletter that stocks should not be sold if one had a sufficient time horizon. Simply put, equities looked attractive relative to other investments. At those price levels, a $100 invested in stocks returned about $8 in earnings. The same $100 invested in high-quality US 10-year Treasuries only returned about $2 in yield—a $6 difference and a spread level only reached once in the last 35 years in (the depths of the 2008/09 crisis when the S&P was around 700). The "stock over bond" argument is even more compelling when one considers the payout in ten years—stocks prices should be higher in 2022 as earnings and P/E multiples should rise from here whereas the 10-year bond will still be yielding 2% on cost and mature at par. Stocks in fact did stabilize and rebounded around 8% heading into the fall.

Although the global slowdown and volatility will most likely continue, there is some comfort in knowing that we are not in the high leverage days of 2007 nor the high valuation days of 2000—there is value in US stocks and it will be unlocked—it is only a matter of when.

2012 WORLDVIEW: "E.E.E."

As our 2011 predictions proved, it is difficult to predict fluid events 12-months out. Fortunately, last year can be a reminder that outlooks can change and any investment thesis needs to be constantly updated. Rest assured that if the facts change our investment strategies will follow suit—an idea that is all too important when tackling the top issue of 2012 and our first "E"—Europe.

Europe: The global investment outlook is almost entirely dependent on the outcome in Europe. While their problems have now been with us for 2 years, summit after summit has failed to produce a credible and sustainable solution. Headlines discuss profligate nations and outstanding government debt, but it is the tentacles of these issues that are of primary concern. Recall that the US crisis was primarily due to US banks loading up on debt of mortgagers that could not repay; the European crisis is similar in that European banks have loaded up on sovereign debt of nations that cannot repay. While the talk focuses on the balance sheets of Spain and Greece, the crux of the problem is European banks. The banks need to be recapitalized (perhaps in the same manner as US banks in 2009) but the ECB and others have yet to sign off. Adding to the mayhem is the fact that there is no unifying fiscal union to the experimental monetary Euro union (imagine the taxpayers of Virginia or Massachusetts (France/Germany) bailing out the homebuilders of Miami or Las Vegas (Italy/Greece)—all without Washington D.C. coordinating the effort). The goal of a closer and more enforceable fiscal union needs to be on the agenda, but its implementation would be several months (and summits) away ensuring ongoing volatility early in 2012.

If the crisis quickly unravels, contagion could spread causing financial conditions to tighten across the world, impairing global growth. A replay of 2008 could follow. However if the euro-zone debt crisis is contained within Europe, then comparisons to an earlier time may be more appropriate. In 1998, the U.S. stood at the outskirts as the Thai baht devaluation led to currency meltdowns, collapsed markets, a liquidity crisis, and economic contraction throughout Southeast Asia. The tentacles also included an ensuing oil price drop which triggered the 1998 Russian default which in turn led to the demise of Long-Term Capital Management. The period included a series of IMF bailouts and ultimately a Fed bailout to stop the contagion, with quick and successful results.

Preview

The market's current low valuations (low P/E multiple in equity markets and a below-inflation yield on the 10-year Treasury bond) seems to be pricing in extreme negative scenarios, such as a disorderly euro-zone default and the bankruptcy of some European banks. Debt-crisis fears will remain in early 2012 as a wave of sovereign bond auctions come to market—testing the ability and resolve of euro-zone governments and the ECB. All within the context of a weakening European economy—an economy that some seem to believe is already in recession. Europe is the largest trading partner with China and a deep recession would certainly hurt the world's second largest economy and our second "E" of 2012—Emerging Markets.

Emerging Markets: Last year, we outlined the enormous growth opportunities in countries such as Brazil, India and China. However, the problem in 2011 for emerging market stocks was that growth was too strong and inflation was surging. Continued interest rate hikes to fight inflation were too much to overcome for EM stocks. But the outlook in 2012 appears to be a 180-degree turn. Inflation pressures have begun to ease and global central banks are taking their foot off the brakes (in November, China's cut bank reserve requirements). Although it comes with a lag, the change in monetary policy could provide a tail-wind for global growth and provide support for commodities, industrial/ material stocks later in 2012. With Europe and Emerging Markets controlling international headlines, our 3rd "E" will dominate domestic headlines for the bulk of the year and culminates in November—namely Elections.

Elections: Although the situation in Europe is more dire than that of the US, politicians and leaders across the pond hold out some hope for a resolution. On the contrary, there doesn't seem to be much hope or positive news coming out of D.C. in the next eleven months. 2011 gave us two opportunities for Congress to come together and act decisively to address our government debts and deficits. Because governments tend not to act until a crisis looms, the manufactured crises of the July debt-showdown and November budget cuts had the potential to be game-changing bullish events. However in both instances the results failed to inspire. It can only get worse in 2012 as the November elections take center stage, dashing all hopes of positive legislation being enacted anytime soon. Favorable outcomes could result from the election but any market moving news is probably a year away.

2012 PREVIEW: "DEFENSE vs. OFFENSE"

Capital markets in 2012 may be may be shaping up like the NFL playoffs—the football team that wins the coin flip will choose to play defense first and defer offense until the second half. Investors should start the year with defense—seek out companies with strong balance sheets, healthy dividends, and predictable earnings. The risks overseas as well as weak leading indicators continue to point to sluggish growth in the months ahead including a possible recession. Worldwide, the countries of Japan, China, Brazil, Germany, France, and the UK have all recently posted negative growth numbers. Although 2012 is not 2008 (we now have lower levels of leverage, lower valuations, leaner corporations with larger cash balances, etc.) one must be cognizant of the fact that a recession reoccurring so soon and without full recovery from the last recession could have some severe consequences (i.e. budget cuts now would be harder and any federal stimulus would be smaller or non-existent due to the current quality of the government's income statement, etc.).

But some strong underlying trends are not getting the attention they deserve. In the years ahead, you may hear more about the renaissance of the USA, the "American Phoenix" rising from the ashes and once again leading the world. Consider the following…

- The economy is improving as Housing is bottoming
- The jobs market is improving as Weekly Jobless Claims are at the lowest levels since May 2008
- American innovation is changing the way we interact with each other (Technology: mobile, social, cloud)
- American innovation is changing the way we interact with OPEC (Energy: shale gas revolution). The US may soon be energy independent which would have far reaching affects.
- American innovation is helping to industrialize the Emerging Markets. In fact, US exports are at an all time high (Industrials: planes, tractors, engines). While old Europe is important, it is wise to keep in perspective the strength of Emerging Markets—China essentially "creates" a Greece every 6 months and the BRIC nations "create" an Italy every 2-3 years. These two countries have thousands of years of history and are being marginalized by the countries of the next century.

As the US recession question potentially gets answered in Q1, as European fears hopefully subside in Q2, global recessions wane in Q3, and the political rancor ends in Q4, investors will be able to switch to offense. We don't need much to get double-digit returns in the equity markets, simply a return to the fundamentals and historical valuations—meaning a stock market with a higher P/E and a bond market that yields more than core inflation.

We hope you had a wonderful Holiday Season. Happy New Year and here is to a prosperous 2012!

Extraordinary Estate & Gift Tax Planning Opportunities through 2012

By John P. Keenan, CFP®, AIF®

Once again, we have experienced a year of continued changes and planning possibilities as to federal estate, gifts and generation-skipping transfer (GST) taxes. You may remember that the Tax Relief Act of 2010 extended some tax breaks and expanded others. However, certain provisions highlighted in the box below– including lower tax rates – are set to expire at the end of 2012. In light of this uncertainty, minimizing taxes over the next few years will require smart planning and timely action.

Planning Opportunities to Consider Immediately

For the purposes of this article we have identified three planning opportunities to consider. We don't have room here to cover all tax law changes and strategies that may apply to you, so we strongly encourage you to consult your advisor about your best course of action.

Make Outright Gifts to Take Advantage of Increased Exclusion Amount

You now have a total of $5 million ($10 million for a married couple) that you can gift in the aggregate during your lifetime. The $5 million applicable exclusion amount is substantially in excess of the $1 million applicable exclusion amount for gifting that was previously available. Most experts do not anticipate this lifetime exclusion to survive past 2012. Thus, making gifts before the end of 2012 may provide significant transfer tax savings. In addition the growth on the gifted assets is currently not subject to estate taxes. For these reasons we feel that this is the biggest estate planning opportunity our clients should consider before the end of the year.

Many clients are uncomfortable transferring $5 million of their net worth before the end of 2012. There are however, solutions available that provide flexibility for use of those assets while taking advantage of the high current gifting limits. One such solution is a Spousal Access Trust which is a Trust that names your spouse as the primary beneficiary of the trust. Often, the spouse will serve as the Trustee of the trust. When your spouse is serving as Trustee, distributions must be limited to his/her health, education, maintenance and support. Spousal Access Trusts allow you to make gifts that will reduce the size of your estate for estate tax purposes without reducing your spouse's ability to access the income or principal of the trust if circumstances warrant. The assets of the trust will not be included in your estate or your spouse's estate tax purposes, and are often funded with a life insurance policy that can even provide a tax-advantage retirement supplement during your lifetime.

Grantor Retained Annuity Trusts (GRATs)

GRATs remain one of our most valuable planning tools for business owners with larger estates, particularly in this time of historically low interest rates. Because of the possibility that legislation may soon pass changing how GRATs may be structured and interest rates will eventually rise, GRATs should be considered as soon as possible.

A GRAT provides you with a fixed annual amount (the annuity) from the trust for a term of years (currently as short as two years). The annuity you retain may be equal to 100% of the amount you use to fund the GRAT, plus the IRS-assumed rate of return applicable to GRATs (which for gifts made in December 2011 will be 1.6%). As long as the GRAT assets outperform the applicable rate, at the end of the annuity term, you will be able to achieve a transfer tax-free gift of the spread between the actual growth of the assets and the applicable rate.

Charitable Lead Annuity Trust (CLAT)

Another very effective planning tool in a low interest rate environment is a CLAT, which combines philanthropy with tax planning. A CLAT is an irrevocable trust that pays one or more named charities a specified annuity payment for a fixed term. At the end of the charitable term, any remaining assets in the CLAT pass to the remainder, non-charitable beneficiaries. As with a GRAT, to the extent the assets outperform the IRS assumed rate of return (1.4% for November and 1.6% for December), those assets can pass transfer-tax free to whomever you would like.

With all of the turmoil within the government and the markets, it is certain that we will continue to see unprecedented change within our systems. The Estate Tax Laws will likely suffer the same fate. Current laws provide some unique opportunities for our clients who want to control the direction of their wealth. It has been said that your estate will go to one of three entities: your family, your charitable interests, or the government. Ultimately it is up to you and your family to determine what kind of positive change you want your wealth to have on your family and our society. We encourage you to think about this mission, and to develop or review your strategy with the appropriate professionals to stay up to date with current laws as well as your objectives and amend as necessary.

Current and Future Estate & Gift Tax

The 2010 Tax Relief Act (Expiration 12/31/12)
- Reunification of Estate & Gift Tax
- 35% Top Tax Rate
- $5,000,000 Exemption for Estate, Gift and GST

Annual Gift Tax Exclusion
- $13,000 per recipient in 2012 ($26,000 per recipient if your spouse elects to split the gift with you or you're giving community property)

Current Exclusions After 2012
- **40-55% Top Tax Rate**
- **$1,000,000 Exemption for Estate, Gift and GST**
- **$14,000 Annual Gift Tax Exclusion per recipient**

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SEIA Launches the Signature Fund For Giving

By Marshall Smith

Launched October 1, 2011, the Signature Fund for Giving was established to support the youth of Southern California while making a meaningful difference in our community and the world. Partnered with the Schwab Charitable fund, a charitable organization created to facilitate strategic giving, we at SEIA are raising money through contributions from Senior Partners, Advisors, Staff and clients to be distributed to local charities in order to help make a difference.

Our Signature Fund for Giving Select Fund will be contributing directly to three area non-profits; A Place Called Home (www.apch.org), Toberman Neighborhood Center (www.toberman.org) and Miracles for Kids (http://miraclesforkids.org). SEIA will be matching $.50 on the $1.00 for all contributions. For more information about these non-profits please visit each respective website.

Donors will also have the opportunity to donate to the Signature Fund for Giving Custom Fund in which contributions will be directed to a non-profit of the donors choice.

Since the recent launch of this division in October 2011, we have raised close to $20,000 for our local Southern California non-profits. With your help we can continue to add to this already outstanding number.

For more information on the Signature Fund for Giving and how to contribute please contact myself or Allison Crandall at 310-712-2323.

"Do not let what you cannot do interfere with what you can do." ~ John Wooden UCLA

SEIA believes that investment management and prudent portfolio allocation can be accomplished with an overall wealth management strategy.

Did You Know?

Did You Know?

Mark E. Copeland, Fritz Miller, Terence Da Cunha, Tom West and John P. Keenan recently received their Accredited Investment Fiduciary® (AIF®) designation. This specialized designation can be an invaluable resource to investment management clients, private foundations and ERISA retirement plans. The AIF® designation represents their knowledge of Global Fiduciary Standard of Excellence and their application of the global standard into their own practices.

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IRS Audit Red Flags: The Top Five

Provided by Kiplinger.com

Ever wonder why some tax returns are audited by the IRS while most are ignored? Well, there's a whole host of reasons to this age-old question. The IRS audits only about 1% of all individual tax returns annually. The agency doesn't have enough personnel and resources to examine each and every tax return filed during a year. So the odds are pretty low that your return will be picked for an audit. And of course, the only reason filers should worry about an audit is if they are cheating on their taxes.

However, the chances of you being audited or otherwise hearing from the IRS can increase depending upon various factors, including whether you omitted income, the types of deductions or losses claimed, certain credits taken, foreign asset holdings and math errors, just to name a few. Although there's no sure way to avoid an IRS audit, you should be aware of red flags that could increase your chance of drawing some unwanted attention from the IRS. Here are the 12 most important ones:

1. Failure to report all taxable income.

The IRS receives copies of all 1099s and W-2s that you receive during a year, so make sure that you report all required income on your tax return. the IRS computers are pretty good at matching these forms received with the income shown on your return. A mismatch sends up a red flag and causes IRS computers to spit out a bill. If you receive a 1099 for income that isn't yours or the income listed is incorrect, get the issuer to file a corrected form with the IRS.

2. Claiming large charitable deductions.

This comes up again and again because the IRS has found abuse on audit, especially with those taking larger deductions. We all know that charitable contributions are a great write-off and help you to feel all warm and fuzzy inside. However, if your charitable deductions are disproportionately large compared to your income, it raises a red flag. That's because the IRS can tell what the average charitable donation is for a person in your tax bracket. Also, if you don't get an appraisal for donations of valuable property or if you fail to file Form 8283 for donations over $500, the chances of audit increase. Be sure you keep all your supporting documents, including receipts for cash and property contributions made during the year, and abide by the documentation rules. And attach Form 8283 if required.

3. Home office deduction.

The IRS is always very interested in this deduction, primarily because it has a pretty high adjustment rate on audit. This is because history has shown that many people who claim a home office don't meet all the requirements for properly taking the deduction, and others may overstate the benefit. If you qualify, you can deduct a percentage of your rent, real estate taxes, utilities, phone bills, insurance, and other costs that are properly allocated to the home office. That's a great deal. However, in order to take this write-off, the space must be used exclusively and on a regular basis as your principal place of business. That makes it difficult to claim a guest bedroom or children's playroom as a home office, even if you also use the space to conduct your work. Exclusive use means a specific area of the home is used only for trade or business, not also where the family watches TV at night. Don't be afraid to take the home-office deduction if you're otherwise entitled to it. Risk of audit should not keep you from taking legitimate deductions. If you have it and can prove it, then use it.

4. Claiming 100% business use of vehicle.

Another area that is ripe for IRS review is use of a business vehicle. When you depreciate a car, you have to list on Form 4562 what percentage of its use during the year was for business. Claiming 100% business use for an automobile on Schedule C is red meat for IRS agents. They know that it's extremely rare that an individual actually uses a vehicle 100% of the time for business, especially if no other vehicle is available for personal use. IRS agents are trained to focus on this issue and will closely scrutinize your records. Make sure you keep very detailed mileage logs and precise calendar entries for the purpose of every road trip. Sloppy recordkeeping makes it easy for the revenue agent to disallow your deduction. As a reminder, even if you use the IRS' standard mileage rate to deduct your business vehicle costs, ensure that you are not also claiming actual expenses for maintenance, insurance and other out-of-pocket costs. The IRS has found filer noncompliance in this area as well and will look for this.

5. Taking higher-than-average deductions.

If deductions on your return are disproportionately large compared to your income, the IRS audit formulas take this into account when selecting returns for examination. Screeners then pull the most questionable returns for review. But if you've got the proper documentation for your deduction, don't be scared to claim it. There's no reason to ever pay the IRS more tax than you actually owe.