



The Mint Edition

from Yerba Buena Financial Partners, LLC

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Hello YBFP Clients and Family!
Happy New Year!

We have two reminders for you:

1) It's almost tax time! Your **1099 income tax** forms will be coming to you soon, **in the mail, from your institutions of financial investment**. The outside of the envelope will likely read "**Important Tax Information Enclosed**". Please watch for those envelopes, and keep them handy for your accountant.

2) If you haven't already scheduled your 2010 YBFP annual review, please get in touch with us. We always look forward to seeing you, updating you on the progress we've made, and looking ahead to 2011. Thank you for your trust in us.

Yerba Buena Financial Partners, LLC

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THE OUTLOOK for 2011

From all of us at YBFP, Happy New Year! Our wish is for all your hopes and dreams to become reality. Whenever we look at the economy, the markets, and how we hope to find the optimal manner in which to deploy your hard earned and saved capital, we do so with great humility, as we firmly believe no one knows what is coming. The landscape of market prognosticators in the finance business is littered with forecasts from people who act as if they know our future - care to guess at their track record? At YBFP we manage assets through LPL Financial under a process called Advance & Protect, which enables us to be nimble with your money and to be quick to change course if we are wrong. So please look at this article as a view of the trends we are watching for in 2011; not a prediction.

Given a lack of any "game changers" from the President's recent State of the Union address, our outlook for 2011 is very similar to what our outlook was for 2010. We believe that 2011 will see an encouraging first half, but will face headwinds in the second half. Corporate profits have been strong; we expect that trend to continue in 2011. Tax rate stability, immediate depreciation of capital expenditures, along with a social security tax holiday for employees, should enable consumer and corporate spending to be on par, if not grow, over 2010 levels. Additionally, the proposal for a reduction in corporate tax rates could offset some inflation and help spur growth.

The global headwinds we are navigating relate to continued high unemployment, constrained consumer spending, low corporate capital expenditures, reduced state spending, global inflation, Emerging Markets' bubble, geo-political challenges, and the potential for more constrained Federal Reserve policy. According to the Bureau of Economic Analysis the two largest contributors to U.S. GDP are 1) Consumers and 2) State & Local Gov't. We are all too familiar with what has been going on in the housing market and the realization that this will continue to be a multi-year work-out.

Something not widely discussed in the media is the schedule of mortgage resets in 2011 - folks, it is substantial. According to Credit Suisse, most of the subprime mortgages have already reset, but there are still many of those to reset also. However, the vast majority of current resets are mortgages that go from their initial low teaser rates, or other favorable initial terms, to fully amortized adjustable rate mortgages. The National Association of Mortgage Brokers states the average increase in monthly payments will be \$1,000. Some folks predict this new round of resets will be the 2nd wave of real estate defaults and their related consequences. With unemployment hovering around 9.5% (plus those who gave up looking), and state/local municipalities running out of federal funding, the prospects of a meaningful sustainable growth rate throughout 2011 are questionable.

As we review analyst reports and some of the predictions coming in for 2011 we see huge ranges from certain Armageddon to an unattainable Nirvana - as we like to say, "There is a medium in there somewhere." The current trend for S&P 500 growth is positive; our equity models are currently in Advance mode to take advantage should that growth trend continue. The bond market, however, is showing signs of concern; thus the current mode in YBFP bond models is Protect. Of course we monitor the models on a daily basis and, as warranted, will make weekly adjustments with the goal of taking advantage of opportunities, as well as do our best to mitigate volatility.

As you all know, in order for a business to thrive it must grow. We thrive and grow when we're researching, analyzing and working hard to help our clients pursue their goals - and to grow we ask you this: Who do you know who could benefit from an introduction to Yerba Buena Financial Partners? Please feel free to put us in touch in whatever fashion makes you most comfortable. As always we thank you again for the opportunity to be of service.

**No strategy assures success or protects against loss



Estate Tax Update

Once again, Congress waited until the eleventh hour to extend, patch, and reinstate old tax laws, and once again, they made most changes temporary (generally, for two years). The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Tax Act), signed into law on December 17, 2010, dramatically changes the federal transfer tax landscape. The biggest news: the estate and generation-skipping transfer (GST) taxes have been reinstated for 2010. And, to the delight of some and great disappointment of others, for 2010 through 2012, the estate tax exemption equivalent amount is increased to \$5 million (indexed for inflation in 2012), and the top estate tax rate is set at 35%. Here is a brief summary of all the changes.

For 2010

For 2010, the federal gift tax is unchanged by the 2010 Tax Act. The gift tax remains in force with an exemption equivalent amount (called the "applicable exclusion amount") of \$1 million and a top tax rate of 35% (also, remember that if you file as single, you can exclude gifts of up to \$13,000 per recipient, or if you're married and file jointly, you can exclude gifts of up to \$26,000 per recipient).

The estate tax has been reinstated for 2010, with a "basic" exclusion amount (the name has been changed from the "applicable" exclusion amount) of \$5 million. That translates into a tax credit of \$1,730,800. The top estate tax rate is 35%.

The 2010 Tax Act gives estates of decedents dying after December 31, 2009, and before January 1, 2011, the option to elect to apply (1) the reinstated estate tax with a step-up (or step-down) in basis, or (2) no estate tax with a modified carryover basis. The modified carryover basis allows an increase in basis of \$1.3 million, plus an additional \$3 million for property that passes to a surviving spouse.

The GST tax (a separate tax on assets transferred to grandchildren and lower generations) has also been reinstated, but at a rate of zero percent.

Note: *The 2010 Tax Act provides an extension of sorts to pay estate taxes for decedents dying after December 31, 2009, and before the date of enactment of the 2010 Tax Act. The due date for filing an estate tax return, paying estate taxes, or disclaiming an interest in property passing to a beneficiary from a decedent's estate is nine months after the date of enactment of the 2010 Tax Act.*

Note: *IRS Form 8939 is necessary to allocate the \$1.3 million basis adjustment allowed for any heirs and the additional \$3 million basis adjustment allowed for surviving spouses of decedents who die in 2010. Originally, the form was due on the same date as the decedent's final income tax return (April 18, 2011). The 2010 Tax Act also extends this deadline to nine months after the Act becomes effective.*

For 2011 and 2012

For 2011 and 2012, the gift tax is reunited with the estate tax. There is a lifetime basic exclusion amount of \$5 million (which will be indexed for inflation in 2012). The top tax rate is 35% (for taxable gifts/estates in excess of \$500,000).

The basic exclusion amount is portable (new in 2011). That means a surviving spouse can use that portion of the exclusion that was left unused by a deceased spouse. This "deceased spousal unused exclusion amount" (DSUEA) is available only from the estate of a spouse who dies in 2011 or 2012. For gift tax purposes, the DSUEA is available for an unlimited number of deceased spouses. But there can be only one DSUEA at a time. For gift tax purposes, the DSUEA is determined on the last day of the year using the DSUEA of the last deceased spouse as of such date. For estate tax purposes, however, the DSUEA is available only from the last deceased spouse as of the date of death of the surviving spouse. Thus, the DSUEA can change if the surviving spouse remarries, and is then widowed for a second time.

Note: *An election is required on the estate of the first spouse to die in order to preserve the ability of the surviving spouse's estate to use the DSUEA.*

The GST tax rate for transfers made after 2010 is equal to the highest estate tax rate in effect for the year. The GST exemption for 2011 is \$5 million, which will be indexed for inflation for 2012.

Note: *The GST tax exemption is not portable.*

For 2013 and beyond

If there is no further legislation, the changes described above will sunset after 2012. The transfer tax rules that were in effect in 2000 will apply for 2013 and beyond. That means a gift and estate tax exemption equivalent amount of \$1 million and a top tax rate of 55%.

For 2010 through 2012, there is an estate tax exemption equivalent amount of \$5 million (indexed for inflation in 2012), and the top estate tax rate is 35%.

You can also make federal tax-free gifts by paying for someone else's medical expenses or college tuition. Payments must be made directly to the medical care provider or educational institution, and other requirements may apply.

Buy Term and Invest the Difference Isn't Always the Best Strategy

When it comes to life insurance, we've all heard the debate over whether to buy cash value life insurance, or buy term insurance and invest the difference. While cash value life insurance provides a cash accumulation account, it typically costs a great deal more than a similar amount of term insurance. The "buy term and invest the difference" strategy involves using the amount you'd spend on cash value life insurance to buy a less expensive term policy for the same death benefit and investing the difference on your own.

Why "buy term and invest the difference"?

There are several reasons proponents consider this strategy instead of cash value life insurance:

- Your need for life insurance protection is often temporary (e.g., replacing income during working years, paying off a mortgage or other debt), so there may be no need for permanent cash value life insurance
- You have a greater variety of investment options to better meet your risk tolerance and savings goals
- By selecting your own investments, you have the potential of earning greater returns than may be provided by cash value life insurance
- You may have greater access to your savings, depending on the types of investment vehicles you choose
- You may be able to invest within tax-advantaged accounts such as IRAs, Roth IRAs, and tax-deferred annuities

Why cash value might be the better choice

Is your life insurance need permanent? Your need for life insurance may not be temporary. For example, you may want to leave a monetary gift to children or grandchildren, provide estate liquidity for taxes and other expenses including memorial and burial costs, or make a charitable bequest. You could use your savings to meet these goals, but what if you haven't accumulated enough? You may not be able to meet your financial goals at death, or you could fail to secure your surviving family members' financial future.

Will your term policy keep up with inflation?

Most term policies are purchased for a specific period of time, such as 20 years. Generally, the death benefit remains level for the entire term. However, rising inflation may actually eat

away at your death benefit, diminishing its value over time. Most cash value life insurance affords the opportunity to increase the death benefit in the future. For example, dividends from whole life insurance can be used to buy more death benefit (though dividends are not guaranteed), and some universal life policies allow excess cash accumulations to increase the death benefit.

How much savings will you have? Depending on your investment choices, you may not know how much your savings will be worth at a given point in the future. Recent stock market downturns exemplify how quickly portfolios and investment accounts can be reduced. If you haven't accumulated the amount of savings you anticipated and your term life insurance runs out, you may be forced to continue your term coverage. But your premium cost for term can increase significantly, simply because you're older. And if your health has deteriorated, it may cost you substantially more to renew your coverage, or you might not qualify for coverage at any price. Even if your policy is guaranteed renewable (i.e., the company has to renew your coverage regardless of your health), your premiums can still increase if the insurer does so for the entire class of policyholders, including you.

The advantage of many cash value policies is that you can usually predict the policy's death benefit and cash value throughout the life of the contract. Most cash value policies have a minimum or guaranteed death benefit that will remain in effect as long as premiums are paid (subject to the claims-paying ability of the insurer). And your premiums typically won't increase under any circumstances. Also, many types of cash value policies pay a minimum interest on the cash accumulation account. And some whole life policies may even pay a dividend that can be added to your cash value.

Will you invest the difference? If the buy term and invest the difference strategy is going to work, you have to "invest the difference." If you don't have the discipline to follow the course, you probably won't reach your accumulation goal. Cash value life insurance offers "forced savings," so it may be a good choice for individuals who are unable to save on their own.



In many states, the cash value of a life insurance policy is protected, at least in part, from claims of your creditors, providing a potential asset protection advantage over some other investment vehicles.





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Ask the Experts



Understanding the math of recovering from losses

Everyone knows the stock market has its ups and downs, but just what's involved in recovering from a serious downturn? If you lose 10% one year but your

portfolio returns 10% the next year, are you even again?

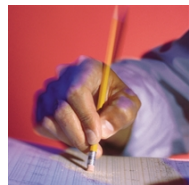
The short answer: no. The math of recovering from a loss isn't quite that symmetrical. You have to gain more than you lost to recoup all your losses. To understand why, let's look at a hypothetical example. Say you have a \$50,000 portfolio. In Year 1, you suffer a 10% loss and are down \$5,000. That leaves your portfolio worth only \$45,000.

In Year 2, the market rebounds and your portfolio rises by 10%. However, that 10% increase is based on a \$45,000 portfolio, not \$50,000. That means the 10% return adds only \$4,500 to your portfolio, not \$5,000, leaving you still \$500 down from where you started. You would actually have to earn a return of a little over 11% to get back to your original \$50,000.

The bigger the loss, the bigger that rebound needs to be to get you even. For example, if that \$50,000 portfolio had taken a 40% hit, as many did in 2008, you'd need almost a 67% increase to offset that \$20,000 loss and get back to the original \$50,000. That could take several years even if stocks perform well.

The challenge is compounded by investor psychology. Adjusting your asset allocation to aim for a higher return is one way to try to recoup losses faster. However, many investors find it difficult to take on additional risk after having watched their investments take a hit. And there's no guarantee that more risk will necessarily produce the desired result--at least not within the desired time frame.

The lopsided nature of recovery from market losses underscores why risk management is such a key component of successful portfolio management. Being realistic about the level of risk your portfolio involves and how much time you have to come back from potential downturns may help increase both your emotional and financial resilience.



Are you sabotaging your own portfolio?

Individual investors' returns typically fall short of those for the stock market as a whole. Why? Because their returns are affected by their own behavior. Many studies

have shown that individual investors tend to buy and sell at the wrong times. When the market goes down, they panic and sell. When the market rebounds, many gun-shy investors are reluctant to invest again and postpone getting back into the market. As they watch prices rise, they get increasingly anxious about missing out on those returns. However, by the time these investors are comfortable with buying again, prices often have risen to the point that they're almost ready to turn down again.

That kind of behavior can be costly over the long term. Dalbar's *Quantitative Analysis of Investor Behavior for 2010* compared the performance of the average mutual fund investor between 1990 and 2009 (as measured by fund inflows and outflows tracked by the Investment Company Institute) to that of the average index fund based on the S&P 500.*

The company found that returns for the average

investor trailed the S&P over that 20-year period by 5.6% because of investor behavior. Though there's no guarantee that the patterns of the past will continue in the future, previous studies also reached the same conclusion: that investors often earn less than a mutual fund's reported returns because of their own behavior.

How can you prevent self-inflicted portfolio sabotage? A disciplined approach to investing helps. Some techniques that can give you a framework for decisions that aren't based solely on emotion include establishing a target price based on fundamentals, dedicating specific pools of money to specific goals with defined time horizons, and rebalancing investments periodically. Also, understand your true risk tolerance. Knowing the type and level of risk involved in each of your investments and understanding how each has behaved relative to the overall market can help you stand firm despite losses.

*Based on the average return for all funds listed in Lipper's U.S. Diversified Equity fund category.