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YBFP empowers its select clientele to make informed decisions regarding building, protecting, and distributing wealth by providing conflict-free independent management advice, comprehensive education, and service of the highest caliber.

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**YERBA
BUENA** 
Financial Partners, LLC

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The Outlook for 2010

Change Remains, "Advance & Protect" Awaits

The Constancy of Change

Rarely can financial planners say, "We see the future!" That's because too much of our practice involves uncertainty: of risk, of growth, of opportunity, contraction or recovery. If we've learned anything in the ten years since 2000 (also known as "The Lost Decade" because of the S&P 500's disappointing results), it's that the only real economic guarantee is economic change. Fortunately, the abilities to foresee and act gracefully amid continuous change separate successful financial planners from those of us who are phenomenal!

However, because not even we at YBFP can predict the future, it's our collective opinion that the following changes will occur in this new decade. Our responsibility is to prepare and provide strategies for managing and mitigating their effects on you:

1. Marginal Federal Income Tax increases for "affluent" Americans.
2. Recovery of the domestic stock market, but ever-more-frequent "boom" and "bust" cycles, "perfect storms," "tipping points," "black swans," and other low-probability, high-impact occurrences unpredictable in prospect, yet obvious when seen in retrospect.
3. Fewer "Negatively Correlated Assets," due in large part to greater globalization and past aggressive use of derivatives.
4. Greater demand for guaranteed insurance products, particularly in uncertain times.
5. Seismic shifts in financial regulation.
6. Modification or significant reformation of Social Security.

"Advance & Protect" Awaits

Financial-industry oversight and regulations may prohibit us from using the word "promise" to describe specific recommendations, but we promise our latest news and newest advancement is exciting for you and us. Now, in addition to the two key, tried-and-true investment-management tools we use to help define and work toward your financial goals,

we have in place a third and final supporting pillar in our portfolio-management structure.

We've thoroughly researched, developed, tested and synthesized this proprietary process, which we call "Advance & Protect." * In simple terms, A&P helps us advance your portfolio, making sounder future investments while protecting the assets you've accumulated already. Through A&P, we can provide even more nimble, active, tactical management of traditional equity and fixed-income portfolios.

The A&P system augments our traditional, hands-on analysis, global diversification and asset-allocation processes. The new "strength triumvirate" includes:

1. Increased insurance-based product use for guaranteed-income and distribution planning.
2. Greater use of "alternative" investments (assets not correlated to traditional equity and debt markets).
3. Portfolio-component analysis and consequent market-risk adjustment with strategic, diversified use of cash-versus-equity exposure, reducing your portfolio's overall risk exposure and encouraging better risk-adjusted returns. At this higher level, you benefit from clearer, more concise, non-emotional, rule-based analysis to guide your decisions to buy, sell or hold investments.

To illustrate this proprietary program, we back-tested this system with highly accurate statistical analysis of hypothetical YBFP portfolios' performances against historical data. The results are nothing short of amazing. Obviously, we'd love the chance to describe A&P in more detail and to demonstrate its abilities with and for you. Judging from results we've seen, A&P may help us shield your investments in a sounder way, reducing market risk and increasing future return.

Please call us to set an appointment. It's very possible your outlook for 2010 and beyond could become considerably brighter! And, as always, we thank you for the opportunity to be of service.

*No strategy can promise profit or protect against loss.

Retirement: Does Your Withdrawal Strategy Need a Second Look?

In its simplest terms, a withdrawal rate is the percentage you withdraw from an investment portfolio in any particular year. However, in retirement income planning, what's important is not just your withdrawal rate, but your sustainable withdrawal rate.

A sustainable withdrawal rate represents the maximum amount (expressed as either a dollar amount or a percentage) that can be withdrawn from your retirement assets each year with reasonable certainty that the portfolio will provide income for as long as it's needed (for example, throughout your lifetime).

A commonly expressed rule of thumb states that your portfolio should last for your lifetime if you initially withdraw 4% of your balance (based on an asset mix of 60% stock and 40% fixed income securities), and then continue withdrawing that same dollar amount each year, adjusted for inflation. However, this rule of thumb has been under increasing scrutiny, and like any rule of thumb, it may not apply to you.

Why is it important?

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money. You want to find a rate of withdrawal that gives you the best chance to maximize income over your entire retirement period.

Withdrawal rates are based on a number of assumptions, including your living expenses, projected lifespan, risk tolerance, projected rates of return and inflation, asset allocation, taxes, and whether you wish to leave a portion of your estate to others. As you progress in retirement, you'll have empirical data against which you can evaluate these assumptions. Plus, your investment horizon will be getting shorter. That's why it's important to periodically revisit your withdrawal strategy during your retirement to see if your assumptions are still accurate and whether your strategy needs to be modified.

Dealing with market volatility

If you're currently withdrawing a fixed percentage of your investment portfolio each year, the amount you receive will fluctuate with the performance of your portfolio. Small changes may not significantly impact your lifestyle. But what if your portfolio suffers a serious decline

due to a market downturn? Will you be able to meet your expenses with the reduced withdrawal amount you'll be receiving? If you're currently withdrawing a fixed dollar amount each year, you may be able to meet your expenses, but can your reduced portfolio continue to support that same dollar amount or will your assets be depleted much too soon?

The converse of this is also true. If your portfolio realizes a gain that's significantly greater than your assumptions, a fixed percentage withdrawal will provide you with more dollars than you had been taking. Do you need the additional income? If you're taking a fixed dollar amount each year, is it time to give yourself a raise?

Market volatility may also lead you to consider changes in your asset allocation. If your portfolio is down, you may be inclined to become more conservative to avoid additional losses; conversely, when your portfolio is up, you might contemplate becoming more bullish. But if your asset allocation is designed to produce sustainable long-term income, changes should be considered carefully and only implemented as part of a disciplined strategy.

Other factors to consider

When you review your withdrawal strategy, make sure you consider the following:

Inflation: Inflation erodes your buying power. If you've underestimated the inflation rate, you may need to increase your withdrawals. If your portfolio can't support additional withdrawals, you'll need to reduce your expenses, or find another source of income (e.g., part-time work) to maintain your lifestyle. If inflation is lower than you've anticipated, you may be able to withdraw less and prolong your portfolio's income-producing ability.

Lifestyle: You may find that your expenses during retirement decrease from your initial estimate as you travel less or downsize a home—or they may increase because of health care or other costs.

Legacy: A decision to increase or decrease the amount you leave to heirs or charities can have a significant impact on your withdrawal strategy.

Revisiting your withdrawal strategy will allow you to focus on changes that have occurred during your retirement and fine-tune your strategy going forward, helping to ensure your retirement will be a financially secure one.

A sustainable withdrawal rate is critical to retirement planning. Draw too heavily on your savings, especially in the early years, and you could run out of money too soon. Take too little, and you might needlessly deny yourself the ability to enjoy your money.



Retirement Issues to Watch in 2010

Recent years have seen a flurry of legislation impacting retirement plans. Here are some of the more significant changes that take effect in 2010.

Nonspouse rollovers must be permitted

The Pension Protection Act of 2006 allowed, for the first time, nonspouse beneficiaries to make a direct rollover of inherited funds from an employer plan to an IRA. While the provision seemed fairly straightforward at the time, confusion arose as to whether plans were actually required to allow these rollovers. Congress addressed this in the Worker, Retiree, and Employer Recovery Act of 2008--beginning in 2010, employer plans *must* let nonspouse beneficiaries make a direct rollover to an IRA if they so choose. The new law also clarified that prior to 2010 employer plans could, but were not required to, allow the rollovers.

IRA conversions for (almost) everyone!

Beginning in 2010, if you own a traditional IRA, you'll be able to convert it to a Roth IRA. The income limits and marital status requirements that previously applied to Roth conversions were repealed by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

In addition, if you convert a traditional IRA to a Roth IRA in 2010, you'll be able to report half the income on your 2011 tax return and half on your 2012 return. Or, if it's to your benefit, you can instead elect to include the entire amount in income on your 2010 return. It's up to you.

If you inherit a traditional IRA from your spouse, and you elect to treat that IRA as your own, you'll also be able to convert the inherited IRA to a Roth IRA in 2010, regardless of your income or marital status. Nonspouse beneficiaries, however, still can't convert an inherited traditional IRA to a Roth.

Note that the income limits for contributing to a Roth IRA haven't changed for 2010. If your income is high enough, your ability to make regular contributions to a Roth IRA in 2010 may be limited, or even eliminated. The ability to convert a traditional IRA to a Roth without income limits, however, provides a potential workaround--you can make your annual contribution to a traditional IRA, and then immediately convert that traditional IRA to a Roth. You'll have to aggregate all your traditional

IRAs when calculating the tax effect of the conversion, so speak with a financial professional first to make sure this strategy works for you.

Employer plan conversions for everyone!

Beginning in 2008, employees and beneficiaries were permitted for the first time to essentially "convert" employer plan distributions by rolling the funds over to a Roth IRA. This was allowed, however, only if the payee satisfied the income and marital status limits that applied to traditional IRA conversions. The elimination of those restrictions by TIPRA, described above, also applies to distributions from employer plans--so beginning in 2010, anyone who receives an eligible distribution of non-Roth funds from an employer plan can roll those funds over to a Roth IRA, regardless of income or marital status. This applies even to nonspouse beneficiaries--but only if the transfer to the IRA is done in a direct rollover.

Here comes the DB(k) ...

Beginning in 2010, "small employers" (those that generally employ at least 2 and no more than 500 employees) can adopt a DB(k) plan--a single plan that incorporates both a 401(k) plan and a defined benefit plan (including a cash balance plan). A single trust is used, but there is separate accounting for the defined benefit and 401(k) portions of the plan.

The plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements. In return, the plan will be exempt from top-heavy rules and certain 401(k) testing.

Because the DB(k) plan is one plan instead of two, it is expected that the plan will be simpler to administer and less costly than maintaining two separate plans. This, in turn, may provide an incentive for employers to begin offering defined benefit plans to their employees in addition to 401(k) plans. Whether this proves to be the case, however, remains to be seen.



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Ask the Experts



What is a Build America Bond (BAB)?

Investors have a new way to invest in municipal bonds. The American Recovery and Reinvestment Act of 2009 authorized a subsidy for local and state governments that issue what are known as Build America Bonds (BABs) before January 1, 2011.

Unlike most municipal bonds, the interest payments you receive on a BAB are taxable on your federal income tax return. However, the federal government subsidizes 35% of those interest payments. That subsidy is made in one of two ways:

1. As a direct payment to the governmental body that issued the BAB, or
2. Via a 35% federal income tax credit on the net coupon interest to the bondholder

The governmental body that issues a BAB determines in advance which type of subsidy it prefers; so far, most governmental bodies that have issued BABs have chosen to do so

using the direct payment method rather than offering the tax credit.

If you're interested in tax credit bonds, don't assume the credit automatically makes them more valuable than a fully taxable bond. Because both the bond's interest payments and the value of the tax credit will be included in your gross taxable income, the calculation depends not only on the coupon rate but also on your tax bracket. It's best to check with your financial professional to compare a BAB to both taxable and tax-free municipal bonds to determine which is the better choice for you. Any unused portion of a BAB's tax credit may be carried forward to successive years.

Before investing, make sure you know if a given BAB offers the 35% tax credit, and what it would mean given your tax bracket. Also, remember that even though the federal subsidy is designed to help lower local governments' cost of financing projects, it does not mean that the bond is guaranteed by the U.S. government, as Treasury securities are.

What is a refunded municipal bond?

In a time of falling interest rates, homeowners often try to refinance their mortgages to reduce their monthly interest payments. Issuers of municipal bonds often do something similar, issuing new bonds to pay off older debt.

The proceeds of the new bond or bonds can be used to replace a specific revenue source that was pledged to repay the interest and principal of older bonds (for example, a tax collected by the issuer or the revenues of a bond-funded project). The money received from issuing the newer bond is generally put into escrow and paid out over time as the older bond's obligations come due. Because the older bond no longer relies on its original funding source, but on the escrowed proceeds of the newer bond, the older bond is then considered a refunded bond.

Bonds that are refunded through their maturity dates are said to be "escrowed to maturity." The escrowed money is typically invested in or collateralized by U.S. Treasury securities timed to mature as the refunded bond's

interest and principal payments are due. If a refunded bond's original documents include a call provision that allows the issuer to pay off the bond before its maturity date, the bond is referred to as a pre-refunded bond.

Because refunding typically occurs after interest rates have fallen, refunded bonds generally offer a higher coupon rate than equivalent newer issues, and often sell at a premium to their par value. Also, because they are backed by escrowed money that is typically invested in or collateralized by U.S. Treasury securities, they are generally considered high quality bonds, much as Treasuries are.

However, even though it may be backed by Treasuries, a refunded bond itself is not guaranteed by the full faith and credit of the U.S. Treasury. Also, municipal bonds are subject to the risks associated with any fixed income security, including interest rate risk, credit risk, and reinvestment risk. Reinvestment risk is even greater if a bond is callable, meaning it could be redeemed prior to the maturity date.