

William Baker

& ASSOCIATES, INC.

Securities offered and supervised by Wilbanks Securities, Inc. Member FINRA/SIPC Investment Advisory
through Wilbanks Securities Advisory 4334 NW Expwy, Suite 222 Oklahoma City, OK 73116 405-842-0202

William H. Baker, CIMA/CIMC
President & CEO

400 Galleria Parkway • Suite 1500 • Atlanta, Georgia 30339
770-956-4073 • bbaker@wmbaker.com
www.wmbakerinvest.com

Investment Insights

May/June 2011

THE DILBERT DUNKER

Once upon a time, during flight training, I strapped into a training cockpit that was rigged to roll down steep-sloped rail tracks, crash into the water, and flip upside down. We called this water-crash trainer the Dilbert Dunker.

As I recall, a buzzer sounded that was loud enough to put the fear of God into anyone and then the instructor pushed a button. Almost instantaneously, Voila, whoosh, crash, splash, there I was upside down in the water, disoriented, and as I recall not overly enthusiastic about the whole thing. Still strapped tightly into my cockpit, I had nothing to breathe in but water, which fortunately I did not. We had been very thoroughly briefed as to what to expect and what to do. After the initial shock, and after the bubbles had dissipated, I unstrapped my seat belt, unplugged my helmet cords, grabbed onto the canopy frame and pulled myself down, pushing, kicking and swimming out of that cockpit. I then shot to the surface as fast; I'm sure, as a Polaris missile launched from a submarine. I was very happy that that training session was over!

Just-in-case training such as this is very valuable in that it better prepares you to handle situations in real life. Planning ahead and being prepared for worst-case scenarios is important to pilots. It's also important in the business and practice of investing. Complacency, inattention, or lack of preparedness and a lack of appropriate action can do significant damage to an investment portfolio when things go bad. And, in the capital market place, things can happen very quickly.

For instance, in the short space of about six weeks the S&P 500 gave back most of its gains for the year, down about 7% between the end of April and June 15th. Part of our job is to be prepared to manage both the upside and the downside in our client portfolios, both the opportunity for returns, and the risk of losses. In earlier newsletters, I mentioned that, by a number of measures, the market risk had been very high and that stocks were overpriced. The recent market pullback brought prices down some and currently the S&P is testing a floor at about the 1250 level.



Roughly, the S&P is now trading in a range between 1250 and 1350. 1250, the floor, may either turn into a launch platform for a rally or it may turn out to be thin ice, which if broken through could mean more downside toward the 1150-or-below level.

To manage in a constant state of uncertainty we corroborate fundamental (macro and micro-economic) and technical (capital market supply and demand) research to help us assess opportunity vis-à-vis risk. While both bodies of research suggest caution there have also been some recent positive signs.

One area that we monitor is what the insiders are doing. Insiders have to report their stock transactions. Usually when one or more insiders are buying their own stock at market price it suggests that they think the stock price will be going up. Information on insider selling is usually not as valuable because they could be selling to diversify, or because they just need the money. Recently, our insider research has indicated that a bottom may have (repeat may have) been put in place recently. In other words, there has recently been a preponderance of insider buying at market price and a significant reduction in insider selling.

Over the past few months, many of our individual security exit prices were triggered causing us to sell. By doing that we avoided most of that 7% drop in the market and now have begun to put that cash back to work. *(continued)*

May / June 2011

William Baker & Associates, Inc.
CIMA/CIMC
Investment Management and
Financial Planning Specialists
400 Galleria Parkway, Suite 1500
Atlanta, GA 30339

Phone: 770-956-4073
Email: bbaker@wmbaker.com

www.wmbakerinvest
.com

S&P 500 Look back

2000	-9.11%
2001	-11.89%
2002	-22.10%
2003	+26.68%
2004	+10.87%
2005	+ 3.00%
2006	+13.62%
2007	+ 3.52%
2008	-38.5%
2009	+18.9%
2010	-11.33%

NASDAQ Look back

2000	-39.18%
2001	-20.78%
2002	-31.25%
2003	+50.76%
2004	+9.14%
2005	-1.4%
2006	+7.87%
2007	+ 9.27%
2008	-40.5%
2009	+30.5%
2010	+14.46%

YTD thru 6/30/11

S&P500	+5.01%
NASDAQ	+2.72%

10/11/2007 HI thru 6/30/11

S&P500	-15.41%
Mar 2000 HI thru 6/30/11	
NASDAQ	-45.06%

*There is no risk-free investment! Investment portfolio values fluctuate and past performance is never a guarantee of future results. "Do no harm" translates into structuring and managing an investment portfolio to conform to a client's risk tolerance and time horizon. Proactive asset allocation, diversification within asset classes, and continual monitoring and risk management of each position are methods we use in structuring and managing portfolios. Our approach includes corroborating fundamental research, with capital markets supply-and-demand research, also called technical research. At times we will use conservative hedging techniques to limit downside risk.

(continued)

We continue to maintain tight stops on our holdings in case that floor turns out to be thin ice instead of a launch platform.

Our own analysis still pegs a fair value for the S&P 500 to be 1050-1100, about 15% or more lower than the present level. There is no way however to time the market so all we can do is deal with what is. Continual due diligence and assessment of opportunity and level of risk, constant improvements in our research and technology, and excellence in execution we believe are hallmarks of our practice. Our investment management mantra remains "**Do no harm and make money.**"* (please read the sidebar) We work every day to be amongst the best in our industry and to be and do the best for our clients.

Client referrals are one mark of a successful business. Please let us know if there is someone you know that might be in need of our wealth management services which include investment management as well as an array of financial planning and insurance services.

The Income Tax Planning Landscape: 2011



At this time last year, income tax planning was particularly challenging. Several tax deductions had already expired, and significant changes, including new, higher income tax rates, were scheduled to take effect at the end of the year. Legislation passed in mid-December, however, hit the "reset" button, reinstating already-expired deductions, and extending major tax provisions--including lower rates--for an additional one to two years.

As a result of the December legislation, 2011 tax planning takes place in an environment characterized by something that was missing last year--a relative degree of certainty. That being said, here are some things to keep in mind as you consider your current tax situation.

Tax rates/calculation

- ▶ **Federal income tax rates** --The same six federal income tax rates that applied in 2010 will continue to apply in 2011 and 2012. So, depending on your taxable income, you'll fall into either the 10%, 15%, 25%, 28%, 33%, or 35% rate bracket. Remember, though, that all of your taxable income is not necessarily taxed at that rate--instead, the rate at which you pay tax generally increases as your income increases. For example, if you're a single individual with 2011 taxable income of \$100,000, you fall into the 28% tax bracket. However, your first \$8,500 of taxable income is taxed at 10%, your next \$26,000 of taxable income is taxed at 15%, and your next \$49,100 in taxable income is taxed at 25%. Only \$16,400 of your taxable income is actually taxed at 28%.
- ▶ **Rates for long-term capital gains and qualifying dividends** --As in 2010, long-term capital gains and qualifying dividends continue to be taxed at a maximum rate of 15% through 2012; if your income (including any long-term capital gains and qualifying dividends) puts you in the 10% or 15% income tax brackets in 2011 and 2012, a special 0% rate will generally continue to apply.
- ▶ **Alternative minimum tax (AMT)** --While regular income tax rates and the maximum rates that apply to long-term capital gains and qualifying dividends were extended through 2012, the latest AMT "fix" (in the form of increased AMT exemption amounts) is effective only through 2011. So, if you think you may be subject to the AMT this year, the good news is that you know ahead of time what the relevant exemption amounts are (\$74,450 for married individuals filing jointly, \$48,450 for unmarried individuals, \$37,225 for married individuals filing separately); the bad news is that the AMT situation for 2012 remains up in the air. You can probably expect another AMT fix later this year, but as it stands now, AMT exemption amounts will drop significantly in 2012, dramatically increasing the number of taxpayers ensnared by this parallel tax system.

(continued on next page)

Temporary payroll tax reduction

Available for 2009 and 2010, the Making Work Pay tax credit was a refundable tax credit equal to the lesser of 6.2% of earned income or \$400 (\$800 for married couples filing joint returns); the credit was phased out for those with higher incomes. The tax credit was not extended to 2011, but the December legislation created a new one-year 2% reduction in employee Social Security payroll taxes (the 2% reduction also applies to the self-employment tax paid by self-employed individuals).

So, if you're an employee, 4.2% of your 2011 wages (up to the 2011 taxable wage base of \$106,800) is being withheld for your portion of the Social Security retirement component of FICA employment tax instead of the 6.2% that would normally be withheld. If you're self-employed, the 12.4% you would normally pay for the Social Security portion of your 2011 self-employment tax is reduced to 10.4%. So, if you earn \$100,000 in wages, you'll have an extra \$2,000 in take-home pay for 2011. Consider opportunities to take advantage of this extra income by, for example, increasing your retirement savings; applying the extra money toward a long-term goal could extend the benefit of this temporary tax reduction beyond 2011.

Other considerations



- ▶ **IRA qualified charitable distributions** --Unless Congress passes additional legislation, 2011 will be the last opportunity for individuals age 70½ or older to make qualified charitable distributions (QCDs) of up to \$100,000 from an IRA directly to a qualified charity. These charitable distributions can be excluded from your income, and count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA for 2011.
- ▶ **Depreciation and IRC Section 179 expensing** --If you're a business owner or self-employed individual, you're allowed a first-year depreciation deduction of 100% of the cost of qualifying property acquired and placed in service during 2011. The "bonus" first-year depreciation deduction drops to 50% for property acquired and placed in service during 2012. Additionally, the maximum amount that can be expensed under Internal Revenue Code (IRC) Section 179 for 2011 is \$500,000; in 2012, the limit is currently scheduled to drop to \$125,000.
- ▶ **Small business stock** --Generally, you can exclude 50% of any capital gain from the sale or exchange of qualified small business stock provided that you meet certain requirements, including a five-year holding period. For qualified small business stock issued and acquired in 2011, however, you'll be able to exclude 100% of any capital gain from income if the qualified stock is held for at least five years and all other requirements are met.
- ▶ **Energy efficient improvements** --Though not as generous as it has been the last two years, a credit is still available to individuals who make energy-efficient improvements to their homes. You may be entitled to a 10% credit for the purchase of qualified energy-efficient improvements, including a qualifying roof, windows, skylights, exterior doors, and insulation materials. Specific credit amounts may also be available for the purchase of specified energy-efficient property: \$50 for an advanced main air circulating fan; \$150 for a qualified furnace or hot water boiler; and \$300 for other items, including qualified electric heat pump water heaters and central air conditioning units. There's a lifetime credit cap of \$500 (\$200 for windows), however. So, if you've claimed the credit in the past--in one or more tax years after 2005--you're only entitled to the difference between the current cap and the total amount that you've claimed in the past. That includes any credit that you claimed in 2009 and 2010, when the aggregate limit on the credit was \$1,500.