

Don't Panic Over Recent Stock Market Downturn

Until a few weeks ago, the major stock market asset classes had done very well this year – making many investors comfortable, if not happy. However, since the “high water” mark of May 9th, it's been a different story.

The table to the right summarizes how drastically the year-to-date (YTD) total returns of four major stock market indices decreased between May 9 and June 14.

Was this recent poor performance just a short-term blip, the beginning of a long-term slide, or something else? What is an investor to do at this point?

History has shown that stocks go up in value over the long run, but that over shorter periods of time – sometimes days, weeks, months, even years – stocks can lose value. Because *nobody* can consistently predict what the stock market will

Index	YTD thru 5/9	YTD thru 6/14
S&P 500 (U.S. large companies)	6.8%	(0.6)%
Russell 2000 (U.S. small companies)	16.4%	1.0%
MSCI EAFE (foreign developed countries)	19.3%	2.5%
MSCI EM (foreign emerging countries)	25.9%	(3.5)%

do, and studies have shown that trying to “time” the stock market is a loser's game, the best approach to investing is as follows:

- Determine an asset allocation strategy that is appropriate for you
- Diversify your portfolio among a variety of asset classes
- Periodically rebalance your portfolio when it strays from your desired allocation

- Stick to your asset allocation strategy through thick and thin

The moral of the story? Don't do something drastic because of the recent stock market downturn, such as selling your investments and sitting on the sidelines until you think the market is on its way back up again. Remember that investing is a *long-term* process that requires patience and discipline.

Many investors let their emotions get the best of them, causing them to buy and sell at the wrong times. At Mentor Capital, we maintain a disciplined and objective investment approach that helps our clients “stay the course” during the inevitable periodic downs *and* ups of the stock market. If you would like to learn more about our approach, and/or receive a complimentary analysis of your current portfolio, give us a call.

Paying yourself first can work like magic

How “paying themselves first” has resulted in the attainment of financial goals, personal fulfillment and accumulation of wealth.

During the 14 years that Mentor Capital has been in business, we have helped hundreds of people successfully save toward their financial goals. Whether it has been buying a new car or sending a child to college, the “paying yourself first” technique works like magic: Regardless of whether you think you can afford it, allocate a reasonable amount each month to your financial goal and watch as the goal comes closer, with little or no negative effect on your budget.

How can this be? A client once told me about working summers in a construction job and being amazed at how his fellow laborers' work expanded magically to fill the time available to perform it. There was no sitting around – those found loafing were fired – but somehow, even when there wasn't enough work, they kept busy.

It's the same with your cash flow: Somehow, spending magically grows to fill the income available to support it.

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Annual Gifting Limit Now \$12,000

Effective January 1, 2006 you can make annual gifts of up to \$12,000 each to as many people as you wish. The limit previously was \$11,000. If you wish to give more than the limit, you will need to file a federal gift tax return and may need to pay gift taxes as well.

Let's briefly review the IRS rules relating to gifts. Note that gifting and the estate tax are closely linked – the IRS does not want people to give away large chunks of property to avoid paying estate tax.

Exclusions

For IRS purposes, the following are not considered taxable gifts:

- Up to \$12,000 per donee per year (a married couple may double this)
- Gifts to a spouse
- Payment of someone's medical or school expenses, *if* paid directly to the service provider or school
- Charitable donations and gifts to political organizations

What is a gift?

The IRS definition of a gift is somewhat broader than

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Gifting

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you may think. Obviously, if you give somebody cash or property without getting something in return, that's a gift. Here are some other examples:

- You sell something at below the market price. The value of the gift is the difference between what you received and the fair market value.
- You forgive a debt.
- You give somebody an interest-free (or below market rate) loan.

What if you exceed the exclusion amount?

Now you need to file a federal gift tax return (Form 709). Here is how it works: Suppose you gave your alma mater a \$25,000 donation, your wife a \$15,000 fur coat and your son a \$50,000 Porsche for his high school

graduation. The donation can be deducted on your 1040 income tax return but has no gift tax consequences. The fur coat has no tax implications at all because your wife is the recipient of your largesse. That leaves the car. After subtracting the \$12,000 exclusion, you must report \$38,000 on Form 709.

But, assuming you made no prior reportable gifts, you don't owe any tax – yet. That's because there is also a \$1,000,000 lifetime exclusion, of which you have now used \$38,000. In future years whenever you exceed the exclusion amount you will need to file Form 709 to report the accumulated amounts. Once the total exceeds \$1,000,000 you will owe gift tax, which is quite hefty.

Estate tax connection

If you die before hitting the \$1,000,000 lifetime exclusion you will never pay any gift tax. But that doesn't necessarily mean you've gotten off scott-free. That's because your report-

able gifts also eat into your estate tax exclusion.

As always, it's best to consult a knowledgeable professional advisor such as Mentor Capital for help with both a gifting strategy and reporting, since the impact of making a mistake in this area can be sizable.

Paying yourself

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As financial planners we frequently hear complaints from clients that even though their incomes are rising, they are not increasing their savings. They feel like they're on a treadmill going nowhere.

By paying yourself first – either by electronic bank draft or religiously writing a check each month – you can sock away cash before you have a chance to spend it. In most cases your discretionary spending will adjust to make up for the additional expense.

Try it – it works!

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