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MENTOR
CAPITAL

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Mentor Monthly Missive

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A tax break from your investment advisor

One of the many benefits of having a fee-only advisor manage your investments is that transaction costs are low or non-existent. Instead of paying high commissions, you pay a management fee based on the value of your account. Advisors who use this method are invested with you: As your investments rise, their compensation rises too. Such a shared goal establishes a strong basis for an effective long-term partnership.

Another benefit of using a fee-only advisor is that amounts paid for investment management services may be tax-deductible. Commissions are never tax-deductible; they simply add to the cost basis of your investment.

Fees paid for management of taxable investment accounts are listed on Schedule A under "Job Expenses and Certain Miscellaneous Deductions." You can clearly see where the IRS allows you to deduct investment expenses.

However, your ability to enjoy tax savings for fees paid to manage taxable accounts depends on three factors. First, you must itemize deductions. Second, Schedule A provides tax savings only to the extent that your miscellaneous deductions, including these fees, exceed 2% of your adjusted gross income (AGI). Third, miscellaneous deductions are a "tax preference item" for purposes of calculating the alternative minimum tax (AMT). If the AMT applies to you, some or all of these deductions could be disallowed.

Fees paid to manage investments in regular IRA accounts also receive a tax benefit, and they're not subject to the miscellaneous-deduction limit or AMT restriction listed above. A custodian can pay management fees to an advisor from an investor's regular IRA without triggering any taxes. In effect you are paying your investment fees with money that's never been taxed. Fees paid to manage taxable accounts cannot be withdrawn from IRAs, however.

For more information about the deductibility of investment management fees, give us a call or consult with your tax advisor.

'I did nothing illegal!'

How's that excuse going to play when your spouse catches you in bed with your neighbor?

It's what Berkshire Hathaway's David Sokol said when confronted with an allegation that he improperly profited from his company's recent move to buy Lubrizol Corp.

In January Sokol bought $10 million of Lubrizol stock. He then pitched his boss, Warren Buffett, on buying the company, adding that he owned shares but not disclosing how many or when he had bought them. On March 13 Berkshire's board voted to buy Lubrizol for $9 billion at a price that gave Sokol a $3 million paper profit.

After the situation was disclosed, Sokol resigned from the company. He later said, "I don't believe I did anything wrong or unethical." He said he would "do it again tomorrow."

The SEC will determine whether charges should be brought against Sokol. But Buffett, known for being normally honest and upfront, has to ask himself whether he did all he should have done when he learned that his aide owned Lubrizol stock. He also should have made stronger statements against this type of activity, whether or not it's illegal.

Markets review – Q1 2011

March 31 marked the end of the best quarter for the U.S. stock market since 1999. Measured by the Dow Industrial Average, stocks rose 6.4% for the period. Small-caps again outpaced their large-cap cousins, with the Russell 200 index advancing 7.6% on the quarter. For the 12 months ending March 31, the average was up 13.5%.

Since the U.S. stock market hit bottom on March 9, 2009, the industrial average has risen 88.17%.

March saw a fair amount of stock-market volatility, with natural disasters and political strife dominating the headlines.

Treasury yields were up slightly over the three-month period, putting pressure on bond prices. The yield on the 10-year Treasury ended the quarter at 3.454, after opening the new year at 3.342.

Elation about stock-market gains was tempered for anyone who drives a car, as the cost of gasoline again approached $4 a gallon. Other losers included those who hoped to travel to a foreign country, as most currencies strengthened against the dollar. The U.S. Dollar Index (which measures the greenback against a basket of foreign currencies) declined 3.8%. This was generally good for exporters, however.

We are sticking to our investment management strategy, which continues to prove effective in generating superior returns while managing risk:

- Basing our approach on the timing of client goals and their risk tolerance;
- Using passive, low-expense index-based funds when appropriate, to capture the characteristics of a particular market;
- Seeking out asset classes that have low risk and return correlations, thereby smoothing out volatility;
- Rebalancing when client goals change or when positions exceed their targets by pre-set proportions.