

## Markets-First Half

The second quarter saw a decline in most equity markets as the European debt crisis worsened again and prospects for continued economic recovery in the US dimmed. For the quarter, the Dow Jones Index lost 1.85% while the S&P declined 2.75%. Other indices also fell. This pattern now seems to be a regular occurrence over the last few years: The markets start out strong in the first quarter but give back some or all of the gains in the second.

The volatility and uncertainty of stock price movements over the past few years center on key concerns about the future of the global economy. The markets continue to focus on three major themes: (1) The governmental budget deficits in Europe and their ripple effect on the Euro Zone and economic growth in Europe as a whole; (2) The political stalemate in Washington DC and its impact on business and investor confidence and the growth of the US economy; and (3) Concerns about the slowing global economy as it relates to the developing world, especially China.

Each of these topics has been in the news as this article is being written. The head of the European Central Bank, Mario Draghi, came out with a strong statement on July 26<sup>th</sup>, 2012 stating that the ECB will do "whatever it takes" to preserve the Euro. Markets surged early, but are already giving back some of the gains as investors digest this news. Actions speak louder than words and until some confidence and growth can be restored, we may see more reversals on possibly less-than-positive developments.

Here at home, the Senate and the House have each passed bills that reflect their respective majority party wishes. The House passed a bill to extend the Bush Tax Cuts to all taxpayers for a one year

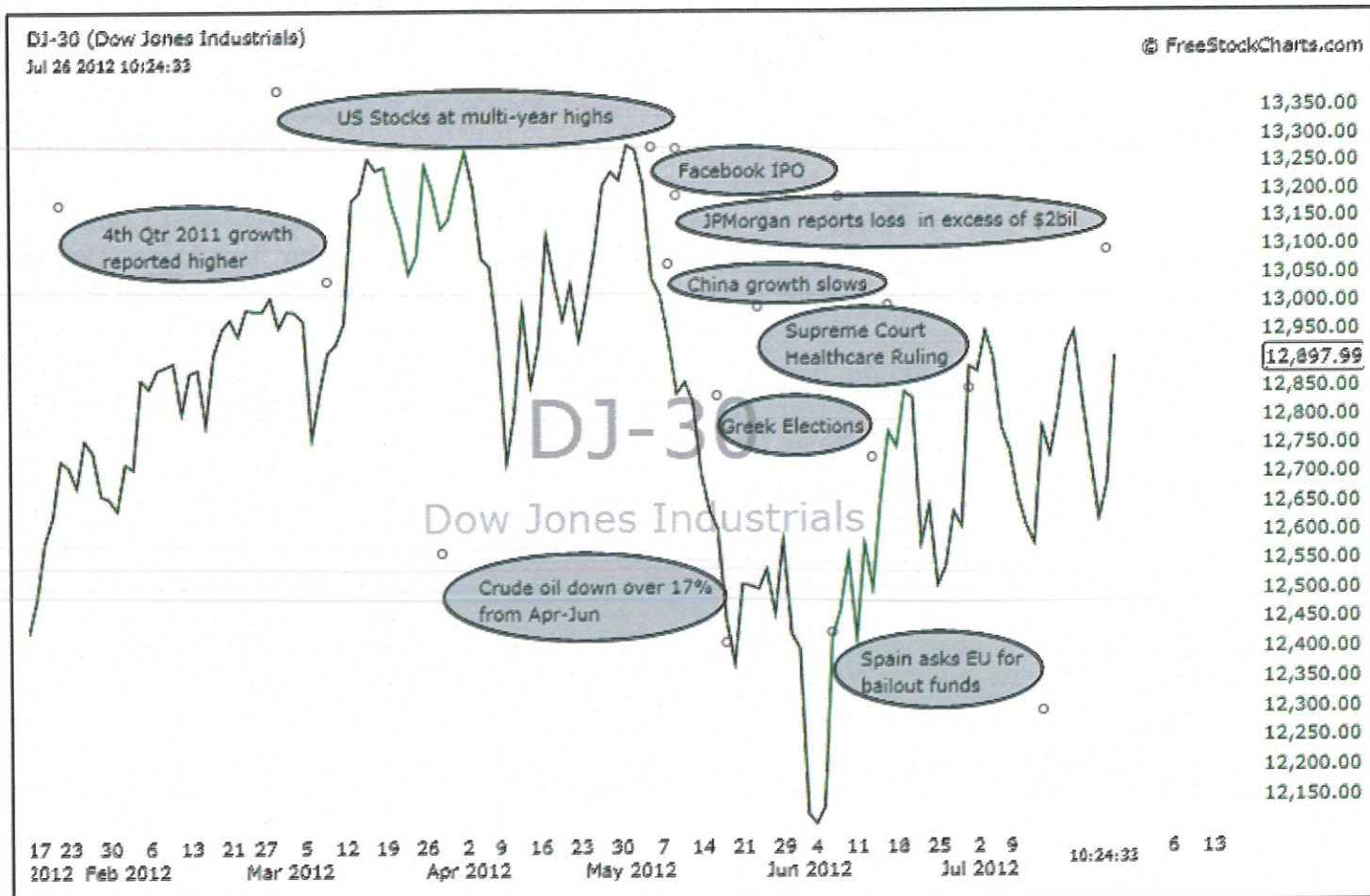
period through 2013, to give the next Congress the opportunity to do a major Tax Code Overhaul. However, the Senate defeated that version of the bill, but passed one which extends the current rates to all except those who earn over \$250,000. It is likely that this issue, as well as others affecting Tax Rates will not be decided until after the November election and possibly not until the new Congress takes office in January 2013. If that is the outcome, we should expect increased market volatility in the third and fourth quarters as investors do not like uncertainty.

China and the rest of the developing world economies are experiencing slower growth as the markets for their exports are stagnant to declining. Most of these economies do not have the luxury of significant domestic demand to offset such export losses so these countries will also see falling GDP. Although they may try to encourage demand by lowering interest rates (or through other actions), it takes time to change their consumer habits.

While these Macro Economic Factors have a negative effect on markets, the US economy continues to grow - albeit at a rate less than 2%. And on a positive note, a few disappointments notwithstanding, corporate earnings are doing reasonably well and productivity has continued to rise.

Unfortunately, the low growth has not allowed for job creation, thus keeping the recovery tepid at best. US disposable income remains sluggish as workers have not been able to command wage increases in this environment. Companies, sitting on a reported 2 Trillion in cash, are unwilling to invest in new ventures until the political and fiscal uncertainties are settled.





## Markets-First Half (continued):

A true “chicken and egg” scenario: Companies need to spend to create the jobs, but they are reluctant in the face of the uncertain growth prospects.

(Source of article: WSJ, Bloomberg, Yahoo finance.)

## IAA Investment Outlook:

During this first half we have generally remained in a defensive posture in both our Growth and Income Portfolios. We have made very few moves in the Income Portfolios choosing to stay in a relatively conservative stance with over 6% in cash, nearly 33% in Fixed Income, 50% in Hedged Mutual funds and almost 12% in the AMJ Oil & Gas Pipeline Index. We will consider changes in the allocations as more

certainty in market sentiment and direction are forthcoming.

In the Growth oriented Portfolios we did make some position changes in late April and allocated a larger share of the portfolio to both Equity ETF's and individual stocks, though still maintaining a number of “hedge” positions. Although the timing did not initially appear very good, the positions taken have all come back to near parity. Additionally, the dividend yields from these securities should help produce positive returns. Again, if the recent market direction continues we will likely reduce allocations to the hedging positions and adopt a bit more aggressive posture.



## **Independent Model = No Conflict of Interests**

One of the more frustrating aspects of working with the investment community is the absence of transparency. In a world of increasingly complex financial products, the idea that all fees, risks and compensation be disclosed to and understood by investors is regularly voiced by industry leaders, but more often rarely emphasized.

Recently another scandal broke, alleging that a large investment house was “pressuring” its brokers to sell its own mutual funds over investments of competitors—even when these other investment products may have been less expensive and better performing (NY Times, 07/12/12).

To be sure, conflicts of interest with clients abound on Wall Street. Customers who may be better served with buy and hold strategies face brokers looking to generate commissions, trying to justify short-term trading. Similarly, products with high charges compensating the broker may be sold to a client, although the returns on such investments seldom merit such an expense.

And as in the latest case, the company itself is being accused of “aggressively encouraging” the sale of its own mutual funds. Such funds may be laden with fees that the company itself charges and collects. As a popular analogy—“if commissioned to find a home for a buyer, should not the realtor present the most desirable and appropriate property instead of just one from its own inventory?”

In all the examples listed, the overriding theme is that the firms’ interests are being put ahead of the client. Should an investment or strategy be worthy of a higher cost to the purchaser, then it may make sense to explore. However, much of the time this is just not the case.

At Income & Asset Advisory, Inc., we are not limited in our range of investments or restricted by the type of investment we can offer clients. Our advisors have no sales quota to meet or any particular product that we are required to sell. Our interests are aligned

completely with our clients. (The cost of a trade ticket is what Pershing charges IAA. This is not a revenue source for IAA.)

This may sound cliché, however, in an industry that largely characterizes success by the amount of assets under management and the associated revenue a firm has, it becomes easy to see how client interests can be sacrificed in the name of sales and the derivation of fees. Under the independent advisor fee model, not only is our success based on our client success, but our fees are transparent, disclosed and always readily explainable. This is an important distinction and one which we are proud to highlight at every opportunity.

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## **What are 529 Plans?**

Over the years, 529 Plans have gained tremendous popularity--and with good reason. For those unfamiliar, a 529 plan is defined by the IRS as “a plan operated by a state or educational institution, with tax advantages and potentially other incentives to make it easier to save for college and other post-secondary training for a degree designated for a beneficiary, such as a child or a grandchild.” (IRS.gov)

The main advantage of such plans is that the earnings are not subject to federal tax and generally not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, books as well as room and board. More recently, supplies and equipment required for enrollment such as computer technology/internet access and related services have been added to the list of eligible qualified education expenses.

There are two types of 529 plans: prepaid and savings. Prepaid plans allow purchase of tuition credits at today’s rates to be used in the future. Currently, 12 states provide a prepaid tuition plan, which are administered by states or higher education institutions (sec.gov).

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## Happenings at IAA

IAA has completed its transition to American Portfolios as Broker Dealer and Pershing LLC as custodian of client funds. Although the process took a bit longer than expected and we encountered a few unexpected complications, overall it went well. The decision to move was not made lightly as we had had a similar experience several years ago but now that we it is completed we feel that it was worth it. The client costs to trade securities have been significantly reduced, the ability to trade and get better executions has been improved significantly and the back office administrative interactions have been streamlined. We have made improvements to the Albridge Quarterly Reports and will continue to look for ways to make those reports more user friendly.

We realize that getting used to the new Pershing Monthly Statements is a process after seeing only the NFS statements for many years. If you would like any assistance please let us know, we would be happy to go over the nuances with you.

### New Personnel at IAA:

As many of you already know, Derek Ralston joined us last fall and has proven to be a valuable addition to our staff as he has interacted with many of you already.



Derek

Derek's background is working with high-net worth clients both in trading and order execution, as well as in individual investment strategy and overall portfolio risk management. His experience is largely based in

equities and options, along with certain fixed-income products. Currently, Derek lives in northern New Jersey.

In March, three other Investment professionals joined IAA. Jason Waxler, Pam Muratore and Catherine Newman came to us from an RIA firm on Wall Street. Both Jason and Pam have extensive experience in various aspects of the Investment World and bring a wealth of knowledge to the daily

operation of our practice. Catherine Newman is a registered assistant who provides the administrative and operational support to this team and the office in general. Jason and Pam have brought with them an extensive roster of Advisory clients. They will also be working with many of our active 403b clients to broaden our services in that area.



Jason



Catherine

As all long term clients of IAA and J.P. McCauley & Co. know having a transition plan in place is extremely important for the clients as well as the practice.

I, Jim, have no immediate plans to retire or ride off into the sunset but am acutely aware of the need to have plans in place should the unforeseen happen. I am confident that the addition of Derek, Jason, Pam and Catherine will help to insure an orderly and uneventful transition when the time is right.

Eileen, Joe, Bryna, Michelle and Jim Law will continue to provide the excellent service that you have come to expect.

Eileen continues to service small groups of clients that she has worked with over the years. In her spare time Eileen enjoys playing tennis and golf and spending time with her grandchildren.



Pam

Joe continues to be in charge of our Trading, Reporting and ITT functions as well as the font of Institutional knowledge. Joe's three girls continue to blossom into beautiful young ladies.

Bryna's newest addition, Ellis, is 8 months old; he is trying to keep up with his three older brothers who are 8, 6, and 3. He is not quite up to shooting hoops in the backyard or kicking the soccer ball around



yet but will be soon. Bryna continues to work a shortened day, but is the Chief Operations Officer and Office Manager who keeps the office running efficiently.

Michelle got married in July and will be continuing her path to a Masters in Social Work; she will continue to work with us on part-time basis for the coming school year.



Jim Law

we are required to adhere to. His background as a Paralegal has served well to prepare him for his duties at IAA.

Jim Law joined us around the beginning of the year on a part time basis. He's had a baptism by fire coming aboard just as the transition started but is very quick to learn the intricacies of the forms, files and systems that

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## More than Advisory Services...

Handling estate matters resulting from certain events such as death, inheritance and divorce requires information be accumulated quickly and quantified accurately. Recently, we have been privileged to assist a number of clients facing these situations. We thought it would be a good time to let all our clients know about these services.

At Income & Asset Advisory, Inc., in addition to our traditional investment advisory services, we also provide a number of ancillary services which benefit our clients and help to reduce some of the administrative burdens that they encounter in situations as described above.

Re-registering account titles and stock certificates, shifting assets among transfer agents and clearing firms, as well as the other numerous inheritance/spousal transactions can be very complex and may seem quite overwhelming.

Our first goal is to gain a complete understanding of the client's situation and what particular circumstances are involved. This may be determined through one meeting or, more likely through several, as more facts and greater details become available. Once all the specifics are defined, we will review the information, consider the circumstances and present our recommendations accordingly.

Throughout the process, we try to work closely with any involved third-parties such as estate attorneys, tax accountants and/or transfer agents. In most cases, we can coordinate our efforts, reduce unnecessary information-gathering steps and provide updated progress and guidance to the clients.

As a fiduciary acting on our clients' behalf, not only do we have the familiarity and experience in such matters, but we have the resources to greatly expedite the overall process.

By taking an active, participatory role and interacting with the necessary parties, we may be able to:

- Assist in Cost Basis Calculations
- Analyze Death Benefits/Assets: Pension plans, IRA's, etc.
- Segregate assets and establish accounts for heirs or spouses, etc.
- Determine Re-Investment options for Insurance Settlements
- Conduct Lost Account/Property and Asset searches
- Consolidate Individual or Orphaned Accounts
- Register Stock Certificates with necessary transfer agents
- Locate and transfer assets in directly held accounts

If you should find yourself facing any of these situations, please feel free to call us for help.



## What are 529 Plans? (continued)

A 529 Savings plan is different in that all growth is based upon market performance of the underlying investments, which typically consist of mutual funds. Most 529 Savings plans offer a variety of age-based asset allocation options where the underlying investments become more conservative as the beneficiary gets closer to college age. Savings plans may only be administered by states; record-keeping and administrative services for many Savings plans are usually delegated to a mutual fund company or other financial services company. (sec.gov)

While most plans allow investors from out of state, there can be significant state tax advantages and other benefits for investing in your state's 529 plan; such as matching grants and scholarship opportunities, protection from creditors and exemption from state financial aid calculations.

A number of other issues to be aware of include, but are not be limited to:

- 1) Contributions are not necessarily tax deductible.
- 2) Non-qualified withdrawals are subject to income tax and a 10% penalty on the earnings portion of the withdrawal. (savingforcollege.com)
- 3) Unused contributions in a 529 Plan may be used for other qualified members of the beneficiary's family without incurring any tax penalty.
- 4) If a distribution exceeds qualified education expenses, a portion will be taxable to the beneficiary and will usually be subject to an additional 10% tax. (finra.gov)
- 5) The account owner can make changes to the investment options usually once per year. (savingforcollege.com)
- 6) Annual contributions of up to \$13k per year are allowed per plan (\$26k per married couple); maximum balance for all accounts for one beneficiary is over \$300k. (finra.gov)

- 7) Under a special election, up to \$65,000 (\$130,000 for married couples) can be contributed at one time by accelerating five years' worth of contributions (as gifts). The account owner will not incur federal gift taxes as long as he/she does not make any additional gifts to the same designated beneficiary for four years after the year during which he/she makes the one-time gift. In order to do this, the account owner must make an election on federal gift tax return for the year of the contribution. However, if the account owner elected to treat the gifts as having been made over a five-year period and dies before the end of the five-year period, the portion of the contribution allocable to the remaining years in the five-year period would be includable in computing the account owner's gross estate for federal estate tax purposes. The account owner should see tax advisor for more information regarding the gift and estate tax consequences of opening an account. (MFS)
- 8) No restrictions on beneficiaries, income or the number of plans you set up. (finra.gov)
- 9) 529 account plans are now treated as an asset of the account owner (typically the parent), meaning they have little impact on a student's eligibility for financial aid.
- 10) The donor maintains control of the account; with few exceptions, the named beneficiary has no rights to the funds. Most plans even allow you to reclaim the funds for yourself any time you desire. (finra.gov)

At Income & Asset Advisory, Inc., we advise our clients on many different 529 Plans for various states. If you have any interest in creating one for a family member, or if you have questions regarding an existing plan, please give us a call.

As college costs dramatically rise, the importance of saving now does as well.

## Market Activity

Market Indicator	Prices			Percent Changes	
	6/30/2011	3/31/2012	6/30/2012	Last Year	Last Quarter
1 Ounce of Gold ( <i>London PM Fixing</i> )	1483.00	1662.50	1576.25	6.3%	5.5%
Technology Oriented Stocks ( <i>NASDAQ Index</i> )	2816.03	3091.57	2914.88	3.5%	6.1%
Small Company Stocks ( <i>Russell 2000 Index</i> )	840.04	830.30	791.15	-5.8%	4.9%
International, Global Stocks ( <i>EAFE Index</i> )	1716.47	1553.46	1396.84	-18.6%	11.2%
Large Company Stocks ( <i>Dow Industrial</i> )	11808.79	13212.04	12706.63	7.6%	4.0%
Higher Yielding Stocks ( <i>DJ Utilities Index</i> )	439.03	458.93	475.25	8.3%	-3.4%
High Yield Bonds ( <i>M.L. High Yield Index</i> )	1183.86	1237.49	1206.29	1.9%	2.6%
Tax Free Municipal Bonds ( <i>Bond Buyer Index</i> )	112 4/32	123 3/32	125 28/32	12.3%	-2.2%
Long Term US Gov't Bonds ( <i>Lehman Index</i> )	1875.45	2214.68	2327.89	24.1%	-4.9%
Inflation ( <i>Consumer Price Index</i> )	226.50	229.80	229.50	1.3%	0.1%

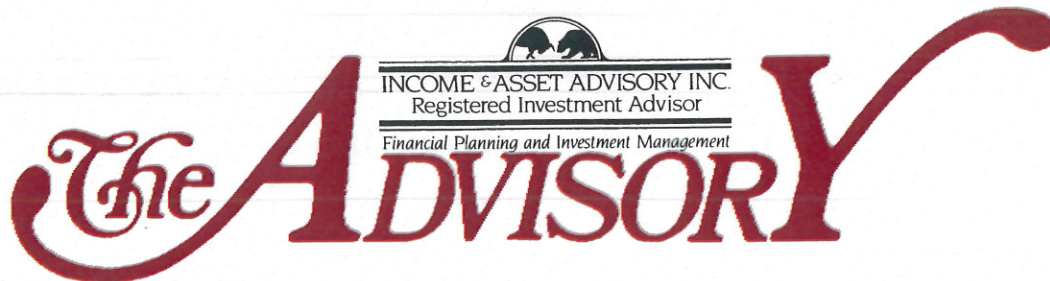
Source: Wall Street Journal, Barron's and Yahoo Finance. An Index is an unmanaged group of securities considered to be representative of the stock and bond markets in general. An index cannot be invested into directly and assumes dividends are not reinvested. In addition, past performance is not indicative of future results.



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In our efforts to go green, you can now receive *The Advisory* in PDF format via e-mail. If you are interested, please contact [Bryna@TheAdvisory.com](mailto:Bryna@TheAdvisory.com)



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