CYPRESS FINANCIAL REVIEW

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Cypress Financial Planning, LLC

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What to do with Your Tax Refund

As we are approaching the end of tax season, it is likely that you have recently or soon will become the recipient of a generous check from your Uncle Sam. Although this check is simply a reimbursement for all the money you had overpaid him in 2009, it is still cold hard cash on top of your regular income, and you want to make the most of it. According to the Internal Revenue Service, the average annual refund is $2,100. The following is a list of some thoughtful ways to ensure this money works hard for you.

1. Spend a portion of it on something extraordinary

Were you surprised to see this as the first recommendation? While the financial world constantly preaches save and invest, it is important to realize that the true value of money is its ability to provide the type of lifestyle that we desire. While I do not recommend blowing your entire refund down in Atlantic City, I believe that it is prudent to take a portion and purchase something that will improve your quality of life in the near term. Suggestions include a nice evening at a restaurant you have typically deemed out of your budget, an item you have been putting off purchasing, or the start of a summer vacation fund. While I will not recommend a specific dollar amount, the portion of your refund you choose to spend should hopefully be no more than one third of the total amount.

2. Pay down high interest debt

Now that you are enjoying the new home theater system you just purchased with a quarter of your tax refund, you are wondering what to do with the rest. The first thing on your list should be high interest debt. If you have outstanding credit card balances, automobile loans, or any other type of debt with an interest rate in the double digits, you need to wipe these out as quickly as possible, and your tax refund will help you accomplish this goal. Going forward, your monthly budget will look much better as you will have smaller interest payments which will free up your cash flow. Start with the highest interest rates first and work your way down.

3. Build an emergency fund

If you do not have any high interest debt and pay off your credit card bills in full every month, this refund can serve as an opportunity to build an emergency fund. At some point in everyone's life, there

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comes a time when you need a significant amount of cash very quickly. An unexpected car break down, a family member in need, a medical emergency, a home repair – these are all very realistic scenarios for most of us, and you may not have enough liquid cash to cover them. What would you do then? Likely fall into the trap we attempt to remedy in suggestion 2: take on some form of high interest, or high fee loan. This is not the ideal way to finance an emergency situation. I typically recommend 3-6 months living expenses available for emergencies. Consider a higher yielding savings account as a safe haven for this emergency fund. Although right now, "high yielding" means about 1-2%, this will not always be the case as interest rates are likely to rise in the near future.

4. Invest for future goals

If you are one of the fortunate few who has no high interest debt and a substantial emergency fund, now is the time to boost your savings for the future. If you are in the process of saving for retirement, you should make sure this money is allocated into a vehicle designed for that purpose. The easiest way to accomplish this is to put the money into a Traditional or Roth IRA. See the previous Cypress Newsletter for an analysis on which one is right for you. You have until April 15th to make contributions for 2009. When deciding on which type of investments to purchase, make sure your capital is allocated in a manner that aligns with your risk tolerance and the time horizon for the ultimate use of the money. Equally important, if you are considering a product being recommended by a "salesman", conduct your own due diligence to ensure that your best interests are the only ones being served by this advice.

What not to do

One of the biggest outcomes you should seek to avoid is unfortunately the one that happens by default: the refund gets deposited into your checking account. Under this scenario, you are not doing any of the four suggestions. You are clearly not paying down debt or investing. You are also not building an emergency fund in an effective manner because your checking account probably does not pay interest and is not segregated from your everyday cash flow. What will likely happen is that your spending level will increase because you have the money in your checking account. This increased spending will not be done in a thoughtful manner because you didn't specifically earmark the refund for something extraordinary. Worst of all, you will spend it all now instead of embracing the opportunity to allocate a significant portion to improving your overall financial well-being.

First Quarter Economic Review

We have closed the books on the first quarter of 2010. Let's explore some of the headline events that have impacted the economy and will continue to influence investors' portfolios as the year unfolds.

Market Performance

On the heels of a solid 26.5% gain in 2009, the S&P 500 US Stock market index continued its momentum into 2010. The equity market returned 4.9% in the best first quarter since 1998, thanks to a 5.9% jump in March. As the pendulum swings from fear to greed, riskier asset classes continued to outperform, with Small Cap US stocks surging 8.5% as measured by the Russell 2000 index. In the bond space, with government yields so low, investors are pouring assets into juicier bonds, with high quality corporate bonds up 3.6%, and lower quality returning 4.2%.

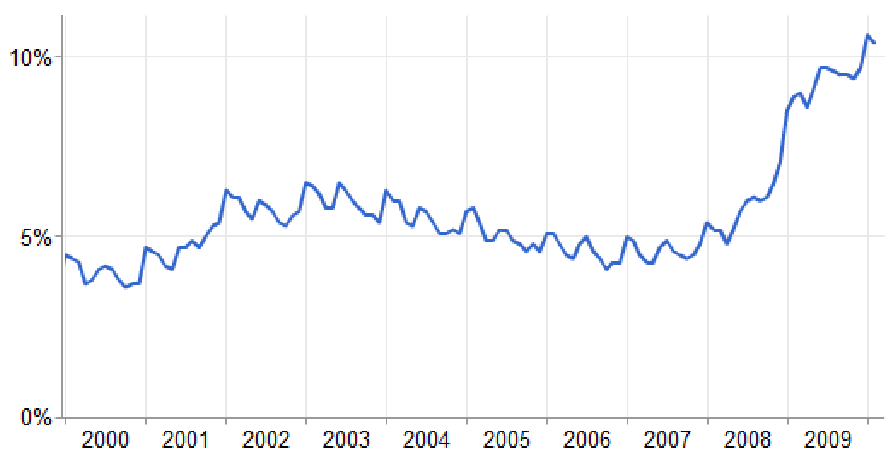
Actions by the Federal Reserve

The quarter has been punctuated by the Federal Reserve's intimate relationship with the mortgage market it has held since November of 2008. In an effort to encourage homebuying, the Fed began purchasing a substantial portion of the nation's outstanding mortgages, increasing its balance sheet from $874 billion to a current level of $2.31 trillion. The program has been effective at keeping mortgage rates at historically low levels, with the national average for a 30-yr fixed dipping below 5% at times. Many current homeowners have chosen to refinance their existing mortgages and a significant portion of the homebuying that has been taking place can be attributed to these lower costs of financing. Over the last week, the Fed purchase plan has been completed, and rates are creeping up as a result. The current debate amongst central bankers is when the Fed should begin selling all of these assets, risking further strain on the fragile housing market.

In addition to the significant national mortgage assistance, the Federal Reserve has also kept its benchmark rate target at a historic low of a range of zero to 0.25%. Economists agree that as the US continues its recovery from the Great Recession, this target rate will ultimately begin to rise to combat inflation fears. Were this to happen prematurely or unexpectedly, there is a significant risk of sending our economy tailspinning back into a recession. Ben Bernanke is keenly aware of this risk, and has continued to use the phrase "extended period" when referring to the amount of time rates will remain at current levels.

Employment Concerns

President Obama signed a bill on March 18 intended to provide an incentive to employers to help create more jobs across the country. The bill states that any employer who hires an unemployed person for at least sixty days will not have to pay their Social Security tax during that time. It also allows for a $1,000 tax credit if they keep that person in their employ for one year. This new legislation will serve as a boost to the increases in jobs seen so far this year. Employers added 162,000 jobs in March, the most in three years. Still, the unemployment rate remains close to a 26-year high at 10.4%. Particularly troubling is that 40% of the jobless have been out of work for at least six months, reducing their expected future income and employment prospects. In a recent speech to the Dallas Regional Chamber, Ben Bernanke believes that economic growth and stimulative monetary policy will slowly reduce the unemployment rate over the remainder of the year.



The percent of the labor force that is unemployed, not seasonally adjusted

Source: US Bureau of Labor Statistics

Auto Industry

As the Big Three automakers are struggling to achieve profitability at a time when consumers are reluctant to open their wallets for large purchases, a crippling series of vehicle defects struck Toyota late January and February. Toyota issued a global recall to fix sticking accelerator pedals as well as a separate problem with the braking system on various models. To get shoppers back to the lots, Toyota launched an aggressive sales campaign, offering free maintenance, interest-free financing and low-price leasing on popular models. The tactic worked, with sales rebounding in March to a 40% increase over the same month last year.

It is not all good news for Toyota however as Ford is expected to outsell Toyota in the US this year. Ford was the only automaker not to declare bankruptcy and the Toyota crisis has helped it regain ground in US sales. In February its sales jumped 43% primarily due to improvements in car quality. This year Consumer Reports recommended more Ford models than Toyota vehicles. Ford is still sitting on significant debt despite posting a $2.7 billion profit in 2009. Profits are expected to continue to grow but managing their debt burden remains worrisome.

Greece Debt Crisis

As the quarter came to a close, the debt crisis in Greece caught the attention of the European Union. Because investors are doubting that Greece will be able to pay their debts, they are commanding higher interest rates when Athens sells government bonds. According to Brussels economist Jean Pisani-Ferry, "Greece needs a crisis management regime". If one considers Greece alone, the impact of a default on debt is relatively insignificant as its economy is roughly the size of Massachusetts. However, investors consider many emerging markets and smaller European Union countries at a similar risk level to Greece, which is why global markets have acted so erratically as these events unfolded. Fortunately, the major powers of the EU, notable France and Germany, have vowed to step in and provide emergency assistance if conditions significantly worsen for Greece. The collective impact of this potential future bailout has caused the euro to hit a 10-month low against the US dollar in the third week of March.

Health Care Reform Plan Impact

For the last year, President Obama has been collaborating with the House and the Senate to craft an unprecedented healthcare overhaul intended to cut costs, give Americans more choices in their healthcare decisions, and reduce the number of uninsured. On March 23, the President signed into law the healthcare legislation that had been passed by the House earlier that week.

Impact on Working Middle Class

A major change introduced in this bill requires all employers with over fifty employees to provide healthcare coverage or pay a $2,000 fine per worker. If your employer currently does not offer coverage, it is likely that they soon will. Families who have healthcare plans through their place of employment will not have to change doctors or find their way through a new system. Instead, the government will be working with their doctors and insurance companies and putting in place regulations that will protect them from insurance abuse. Insurance companies will no longer be able to put a limit on how much coverage a person receives in a lifetime or keep someone from being insured because of a pre-existing condition.

Small Businesses

Owners of small businesses with less than fourteen employees have new opportunities through President Obama's healthcare reform plan. Under the new plan, insurance exchanges will be created to allow small businesses, uninsured individuals, and high risk patients to shop for plans, resulting in a more efficient market that will likely increase affordability. In addition, small businesses may be eligible for tax credits to encourage participation.

Aid for Seniors

The reform plan also includes help for senior citizens. The plan will be helping to cover prescription expenses that fall into what is known as "the donut hole" in Medicare expenses. Medicare stops paying for prescriptions after when the expenses reach $2,830 and starts paying again after they reach $4,550. The space in between can put a huge burden on the elderly who need more expensive medication. The healthcare reform plan will fill this gap, first by giving a rebate to all those impacted this year, and ultimately by capping the insured's copay at 25%, no matter the cost.

Plans to Finance New Legislation

The administration is promising expanded coverage and significant cost reduction on health care expenses for most Americans. They also claim this overhaul will reduce the deficit by $100 billion over the next ten years. These two conflicting goals are justified by the following measures:

- New 3.8% Medicare tax on unearned income such as capital gains and dividends as well as a 0.9% Medicare payroll tax increase for individuals earning more than $200,000 and couples earning more than $250,000
- Tax on "Cadillac" insurance plans with premiums over $10,200 for individuals and $27,500 for families
- A 6% reduction in the rate of growth for federal Medicare spending, resulting in $500 billion net savings

There is a widespread skepticism of these governmental projections, however, with a recent survey indicating that 81% of Americans believe that the reform plan will cost more than these estimates.