Tarheel Advisors Newsletter

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2011 Investment Outlook

The champagne is popped, your New Year's resolution is probably already broken, and the year that brought us the Flash Crash, Quantitative Easing II and Health Care Reform has come and gone. This also means another market year is in the books and it's time again for our annual market outlook. But first, how did we do in 2010?

Year in Review—Our thesis for the past year was that a global liquidity infusion was going to raise the prices of assets around the world. We predicted a 5 to 10% increase in the equity markets, and specifically recommended high quality fixed income and commodities. In addition we predicted a 10 to 20% correction would occur before year end. For those of you scoring at home here is how these predictions faired:

2010 Report Card

5 to 10% Return	B
10 to 20% Correction	A
Bond Outperformance	A-
Strong Commodities	A
Positive Returns for All Asset Classes	A

While we weren't perfect in 2010, we weren't off by much. The S&P 500 returned roughly 15% for the year, including a 17% correction back in the Spring. The Bond Market soared for the first 10 months of the year before reaching near bubble levels and selling off late in the year. Commodities, especially precious metals and agriculture related items, outperformed all asset classes by a broad margin.

2011 Outlook—Our predictions for the New Year are slightly different, but our underlying thesis is unchanged. Global liquidity and low interest rates will continue to drive up most asset prices, but unlike last year not all ships will rise with the tide. For decades the riskiest asset class was considered emerging market stocks. On the other hand, high quality bonds have been considered the least risky. In our view, this relationship has flip-flopped due to artificially low domestic interest rates and a steady expansion of the middle class in emerging markets.

So, how does one invest based on this backdrop? First, limit exposure to longer term fixed income maturities because they have the most negative exposure to interest rate increases. Camping out in bonds with maturities of 10 years or less will be the safest bet for the time being.

Contrarily, Emerging Market Equities should continue to outperform and we believe they, as well as Commodities, will surpass other asset classes in 2011.

As to US Equities, we are predicting another positive year with a similar target of 10%. We are not quite as optimistic as some of the Market pundits who cite the 3rd year Presidential cycle, or improving job growth as catalysts for much higher stock prices. Assuming Markets continue to move higher in an orderly fashion, we don't foresee another large drop in the in the immediate future. However, given the Fed's recent stance and loose monetary policy, there is a significant chance markets overheat in the first half of the year and we set ourselves up for another 10 to 20% correction around the second half of 2011.

Even though we are predicting above-average returns for 2011, we encourage everyone to approach the current bull market with pessimism. Current asset price increases should continue to be rented for the short term.

-Ryan Glover, CFP®

2010 Market Update

S&P 500	**+15.06%**
DOW	**+14.06%**
NASDAQ	**+16.91%**
MSCI World	**+8.95%**

Mortgage Rates

15-Year	**4.3%**
30-Year	**4.9%**
5/1 ARM	**3.5%**

Did You Know?

The best performer in the DOW for 2010 was Caterpillar which was up 64% for the year. The worst performer was Hewlett Packard which lost 18%

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Apple has surpassed Microsoft in market cap to become the 2nd biggest corporation in the world. Their $300 billion valuation trails only Exxon at $375 billion.

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Tax day has been postponed until Monday, April 18th due to the Emancipation Day holiday, which falls on Friday, the 15th this year.

New Year — New Tax Scheme

Our forefather, Benjamin Franklin once noted, "nothing is certain but death and taxes." And though those words may be very true, at least with the recent passage of the bi-partisan tax package, some measure of relief from both can be felt.

On December 17, 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 was passed. This mouthful of a title represents a compromise that will basically extend many of the Bush-era tax rates, including everything from income to capital gains to even the estate tax. Some of the other provisions include an extension of unemployment benefits, as well as dozens of temporary business and individual tax incentives. It would be difficult to cover every point of the Bill, so I will stick to highlighting some of the major aspects below.

In brief, the Act provides for:

- Extension through 2012 of the reduced dividends and capital gains rates
- Extension through 2012 of the 6 individual tax brackets ranging from 10-35%
- Extension of 50% bonus depreciation and small business expensing through 2012 and 100% deduction for certain property placed in service from September 2010 through 2011.
- Extension of unemployment insurance benefits for 13 months
- Reinstitution of the estate tax through 2012 with a $5 million per person exemption and rates up to 35%
- Portability of the estate tax exemption between spouses without the use of a marital bypass trust
- A one year, 2% reduction in the employee share of the payroll tax
- Extension of the American Opportunity Tax Credit, the Child Tax Credit, and the Earned Income Tax Credit for lower and middle income taxpayers

In summary: although the tax relief provided by the Act is significant, it is largely just a continuation of existing tax policies. Interestingly, with the passage of the pay-as-you-go budgeting law last year, the passage of this tax package became more difficult. The law states, with certain exceptions, that any tax cuts or spending increases must be offset by tax increases or spending cuts. Well, as you may have noted, there aren't any new measures in the bill to offset the revenue lost through the tax relief. But, leave it to Congress to find a loophole, which they did, by designating each provision under the act as a "emergency requirement" under the budget rules.

-**Walter Hinson, CFP®**

Provision	2010	2011	2012	2013
Rates for ordinary income	35.0%	NO CHANGE		39.6%
	33.0%			36.0%
	28.0%			31.0%
	25.0%			28.0%
	15.0%			15.0%
	10.0%			15.0%
Top rates for investment income				
Long-term capital gains	15.0%	NO CHANGE		20.0%
Qualified dividends	15.0%			39.6%
Marriage penalty relief				
Standard deduction	Deduction for married-joint filers is twice that of single taxpayers	NO CHANGE		Expanded deduction sunsets
15 percent bracket	Bracket expanded to twice that for single taxpayers	NO CHANGE		Expanded bracket sunsets
Child credit	$1,000	NO CHANGE		$500
Repeal of limitations on personal exemptions (PEP) and itemized deductions (Pease)	Repeal of PEP and Pease limitations in place	NO CHANGE		PEP and Pease limitations restored
AMT exemption	$47,450 Single; $72,450 Married	48,450 Single; $74,450 Married	$33,750 Single; $45,000 Married	
Payroll tax holiday	$400/800 Making Work Pay tax credit	2 percent cut in payroll taxes; maximum benefit per individual – $2,136	NONE	NONE
Estate tax				
Top rate	Estates can elect zero rate and carryover basis or law for 2011/2012	35%		55%
Exemption		$5 million		$1 million

The tax rate table and research for the article above was obtained through the publication *Staying in place: Congress extends the Bush tax cuts* prepared by the Tax Policy Group of Deloitte Tax LLP. The full report is available via the link below:

http://www.deloitte.com/view/en_US/us/Services/tax/9a075ce3644ec210VgnVCM3000001c56f00aRCRD.htm

The article does not constitute tax, legal, or other advice from Deloitte Tax LLP. Please consult a qualified tax advisor if you would like to know how the new tax laws will affect your

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