



360 Perspectives

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The First-Time Homebuyer Tax Credit

Recent changes to the first-time homebuyer tax credit mean you might be able to benefit from the credit, even if you're not actually a first-time homebuyer. To take advantage of the credit, however, you have to act by May 1. Here are the basics as they apply to home purchases in 2010.



- The credit is reduced if your modified adjusted gross income (MAGI) exceeds \$125,000 and is completely eliminated if your MAGI reaches \$145,000. If you're married and file a joint return, the credit is reduced if your joint MAGI exceeds \$225,000 and is eliminated if your MAGI reaches \$245,000.
- You can't claim a credit if the purchase price of your principal residence exceeds \$800,000.
- You can't claim a credit if you're under age 18 at the time of purchase (unless you're married and your spouse is at least 18), or if you can be claimed by someone else as a dependent.
- You can't claim a credit if you purchase a principal residence from someone who is closely related to you or your spouse.
- You can't claim the credit if you're a nonresident alien.

Qualifying for an \$8,000 credit

If you, and your spouse if you're married, haven't owned a principal residence in 3 years, you may qualify for a credit worth 10% of the purchase price of a home, up to \$8,000 (\$4,000 if you're married and file a separate federal income tax return). The home has to be your principal residence, and must be purchased before May 1, 2010. If you enter into a written binding contract before May 1, 2010, you can still qualify for the credit if you close on the home before July 1, 2010.

Qualifying for a \$6,500 credit

If you, and your spouse if you're married, have maintained the same principal residence for at least 5 consecutive years in the previous 8 years, you may qualify for a credit if you purchase a new principal residence. While the credit remains 10% of the purchase price of the new home, it's capped at \$6,500 (\$3,250 if you're married and file a separate federal income tax return). As with the \$8,000 credit, the home must be purchased before May 1, 2010 (or you must close on the home by July 1, 2010, after entering into a written binding contract before May 1, 2010).

Limitations

There are several limitations that apply (the same limitations apply to both the \$8,000 credit and the \$6,500 credit):

Payback requirements

Generally, if you qualify for the credit as a result of a 2010 home purchase, you won't have to worry about repaying the credit. There's one important exception, however: if the home ceases to be your principal residence in the 36 months following the purchase, you'll have to pay the credit back. (If you're married at the time of purchase, the home must remain the principal residence of either you or your spouse for the 36-month period.) If you have to pay back the credit, you'll do so on the tax return for the year in which the home ceased being your principal residence.

Treating a 2010 purchase as made in 2009

If you purchase a qualifying principal residence in 2010, you can elect to treat the purchase as if it occurred on December 31, 2009, allowing you to claim the credit on your 2009 federal income tax return.

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Understanding Mutual Fund Expense Ratios

Every mutual fund must disclose certain costs associated with running the fund. Those costs represent a fund's expense ratio, which is expressed as a percentage of a fund's assets. For example, a fund that has \$100 million in assets and annual expenses of \$1 million would report a 1% expense ratio (1% of \$100 million = \$1 million).

Why is a fund's expense ratio important? First, it can help you gauge how efficiently the fund operates. A high expense ratio reduces the amount that is paid to you as a shareholder. Second, a fund's expenses affect your net returns, particularly over the long term. For example, let's look at a hypothetical illustration (which doesn't reflect the performance of any actual security). Assume you have \$10,000 in one stock fund that earns a 5.5% return and \$10,000 in another stock fund that earns exactly the same return but that costs you an extra half-percent in expenses. The difference between 5.5% and 5% over 20 years means a \$2,645 reduction in your bottom line.

That's not to say that you should automatically reject a fund just because it has a high expense ratio if the fund's performance is worth the higher cost. However, you do need to take expenses into account, especially if you're investing for the long term.

Some general categories of funds tend to have higher expense ratios than others. For example, a stock fund that specializes in emerging markets may have to spend more on research than a fund that invests only in large-cap U.S. stocks for which a great deal of information is readily available. A fund that is actively managed may have higher expenses than a fund that mirrors an index.

Each mutual fund's prospectus must include a table in the front that you can use to compare the expenses of various funds. The table lists the fund's expense ratio as well as a breakdown of the costs included in it, which fall into three general areas: management fees, marketing costs, and administrative fees.

Management fees

Every fund has an investment management or advisor firm that manages the fund and makes investment decisions. Even an index fund, which does relatively little trading and whose investments basically duplicate those of an index, will have a firm or an individual who

handles any transactions. Management fees often represent the single largest portion of a typical fund's expense ratio.

Marketing costs

These costs also are known as 12b-1 fees, after the legal provision that permits them. They were originally designed to let funds recoup costs associated with distribution and advertising, on the theory that attracting new investors and additional assets would help make a fund more cost-effective for each investor. In recent years, there has been discussion of whether 12b-1 fees should be eliminated--especially for funds that are closed to new investors and therefore should have little need to market themselves--but they are still very common.

Administrative fees

This category of fees includes the cost of recordkeeping, custodianship, taxes, and legal, accounting, and auditing services.

What's not included in an expense ratio

Trading expenses represent the cost of buying or selling securities, and also can have a substantial impact on your net return over time. Trading costs, which include commissions paid by the fund when it buys or sells a security, aren't included in a fund's expense ratio. However, funds are required to report the per-share cost of their annual commissions; this can be found in a fund's annual report or Statement of Additional Information.

Also not included in the expense ratio is any redemption fee a fund might charge if you sell your shares before a specified time, or any sales charge the fund might impose at the time of purchase or sale.

Before investing in a mutual fund, carefully consider its investment objectives and risks as well as its charges and expenses. This information is available in the prospectus, which can be obtained from the fund. Read it carefully before investing.

Comparison shopping

The "Tools and Calculators" section of the Financial Industry Regulatory Authority (FINRA) website includes an online Fund Analyzer that lets you compare the impact over time of the fees and expenses of as many as three funds.

Running the numbers

To get a true picture of a fund's performance, you do not need to deduct a fund's expense ratio from the returns quoted in its prospectus. The figures that measure average annual and cumulative return have already taken both operating and trading costs into account.



"Some general categories of funds tend to have higher expense ratios than others."

Back to Basics: Reviewing Your Budget

Do you ever wonder where your money goes each month? Does it seem like you've gotten sidetracked when it comes to reaching your financial goals? If so, you may want to review and perhaps revise your budget. Doing so can help you determine how you're spending your money, and that might show you what you need to do to get back on track.

"Oh, we don't need a budget," you might be saying. "We have plenty of money." If that's true, great! But if you aren't reaching your financial goals, there's a reason for that. Reviewing (or simply creating) your budget might help you find out what that reason is.

Examine your financial goals

The first part of reviewing your budget should be an examination of your financial goals. After all, planning any trip's itinerary depends in part on knowing where you want to go! Make a list of both your short-term and your long-term goals, and prioritize them. How much will you need to save for each one, and how long will you have to reach them? Should you forestall some of lower priority to reach others of higher priority?

Keeping track

Budgeting is largely about tracking your income and expenses. You can do this with a pen and paper, or you can use one of the many software programs or web-based applications designed for this purpose. The most important element of this process is to do it consistently.

Should you count every penny? Not necessarily, although to some extent you can't control the dollars if you don't track the cents. But focus primarily on meeting the basic expenses of life and then allocating what it will take to meet your goals.

Income and expenses

Much of your income may come from your regular paycheck or (if you're retired) from government benefits such as Social Security, a pension, or retirement account distributions. But don't forget to include all forms of income, such as child support and/or alimony, and even irregular or seasonal income, such as tax refunds, dividends, or interest.

Expenses generally fall into two categories. Fixed expenses are the "have-to" basics: housing, utilities, food, clothing, and transportation. Discretionary expenses are "want-to" items: eating out, entertainment, vacations, and hobbies.

Irregular expenses can't be predicted, but they always occur: car repairs and home maintenance are good examples. Remember to include these types of expenses in your accounting. For example, if you buy tires for your car every 3 years, one-third of the total is your annual expense.

Caution: *While you may find it easy to use your credit card for irregular expenses, do so only as a convenience. Be prepared to pay off the credit card charge with funds you have set aside in your budget for these expenses.*

Finally, prioritize the funds you'll need to meet both your short- and long-term goals as regular expenses in your budget.

And the answer is...

Once you've added up your income and expenses, you'll need to compare the totals. Are you spending exactly what you're making? Congratulations, your budget is perfectly balanced! Even better, if you're spending less than you're making, you have a surplus. If that's the case, you can allocate that surplus to either reaching your goals faster or funding new investment opportunities.

But if you're spending more than you're making, you're running a deficit. You might not feel the pinch if you're very good at juggling or funding it with increasing credit card debt or a home equity line of credit. But even the best of jugglers drop the balls sometimes, and increasing your debt can be dangerous. If that's what you're doing, you're sidetracking your budget into a dead-end spur.

So, to balance your budget and get back on track toward meeting your goals, you'll have to either increase your income or reduce your expenses--or both. As you may have seen while tracking your expenses, it's often your discretionary spending that leads to a derailment when it comes to meeting your goals. Rather than shortchange your goals (you'll only be shortchanging yourself if you do), work on reducing discretionary expenses.

Staying on track

You'll need to monitor your budget to keep it on track. Remember that, like life itself, you'll need to keep your budget as flexible as your changing circumstances may demand.



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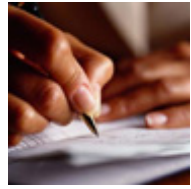
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Ask the Experts



What's an exchange-traded fund?

Like a mutual fund, an exchange-traded fund (ETF) pools money from investors to buy a group of securities. Though diversification alone

can't guarantee a profit or protect against potential loss, such an investment helps you spread your risk over many individual securities.

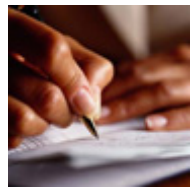
Most ETFs are passively managed. Instead of having a portfolio manager who uses his or her judgment to select specific stocks, bonds, or other securities to buy and sell, ETFs try to approximate the performance of a specific index, which can be either broad-based or narrowly focused. In this, they are somewhat similar to an index mutual fund.

However, there are some substantial differences between mutual funds and ETFs. Perhaps the biggest is the ability to trade ETFs throughout the day. Mutual funds are priced once a day after the market closes. If you buy or sell after that, you'll receive the next day's closing price. By contrast, ETFs are priced throughout the day.

Also, they can be bought on margin or sold short; in other words, they can be traded just like stocks. As a result, investors may use ETFs to actively trade a particular sector or industry.

ETFs typically have no minimum investment requirements or redemption fees for brief holding periods. And because most ETFs are based on an index, the administrative costs can be relatively low. However, ETFs must be purchased through a broker. Since you'll pay a brokerage commission with every transaction, ETFs may not be well-suited to a systematic investing program such as dollar cost averaging--transaction costs could quickly eat up any cost efficiencies.

Because the differences between one ETF and another can be dramatic, you should carefully consider a fund's investment objectives, risks, charges, and expenses, which are included in the prospectus available from the fund. Read it carefully before investing.



How can I use exchange-traded funds?

There are many ways an exchange-traded fund (ETF) can be used to help round out or supplement an existing investment portfolio.

Investing in a sector rather than an individual stock. An ETF allows you to invest in an industry or sector without relying on the fate of an individual company. If you have broad-based stock funds, you can give more weight to a particular sector by also investing in an ETF that focuses on a relevant index.

Minimizing taxes. ETFs can be relatively tax-efficient. Because a passively managed ETF trades relatively infrequently, it typically distributes few capital gains during the year. That means you won't incur the same tax liability as if you received significant capital gains. However, make sure you consider just how an ETF's returns will be taxed. Depending on how the fund is organized and what it invests in, returns could be taxed as short-term capital gains, ordinary income, or even as collectibles, all of which are generally taxed at higher rates than long-term capital gains.

Staying invested after selling stock for a tax loss. If you have sold a large stock position to realize a capital loss for tax purposes, but still believe that industry as a whole will soon experience a big short-term move, you can use an ETF to try to take advantage of that volatility. If you buy the same stock within 30 days, the tax-loss deduction will be disallowed. However, buying an ETF based on a relevant index as a proxy for that investment until you are able to buy the stock again allows you to preserve the tax deduction on the stock loss while staying invested in that industry.

Limiting losses. With an ETF, you can set a stop-loss limit on your shares. A stop-loss order instructs your broker to sell your position if the shares fall to a certain price. If the ETF's price falls, you've minimized your losses. If its price rises over time, you can increase the stop-loss figure accordingly. This strategy lets you pursue potential gains while setting a limit on the amount you can lose.