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Wealth Strategies
A Beautiful View To Your Financial Future℠

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Second-Quarter 2011 Market Review ~ Buy or Lease those New Wheels?

July 2011 - Despite a six-week losing streak spanning all of May and the first part of June, gains in April and a four-day rally at the end of the quarter left stocks mixed for the second period. Overhanging stocks was the ongoing Greek debt crises and fears of a European/Global contagion, as well as concerns that U.S. lawmakers would not meet an August deadline to reach a deal to raise the national debt ceiling.

Adding to the negative sentiment were varied economic statistics, including weak employment data and lower housing prices. Even with the after affects of the Japan earthquake, turmoil across the Arab middle-east, and an uncertain economic outlook, investor focus on corporate profits pushed major stock indices to finish the first half of 2011 by low to high single digits.

The close of the quarter brought an end to the Federal Reserve's $600 billion second round of Treasury-bond purchases. The "quantitative easing," began last fall and following a $1 trillion round initiated at the depths of the recession in 2009, was expected to increase the money supply and keep interest rates low, thereby stimulating the economy.

As the decline in stocks drove investors to the relative safety of bonds, Treasury-bond prices were bid up and yields dropped to levels not seen since the fall of 2010 (the 10-year Treasury note dipped below 3.0%). The Fed otherwise maintained its interest rate policy during their two meetings in the second quarter, leaving the Federal Funds and Discount Rate unchanged. At quarter end, the yield on the 10-year Treasury note was 3.16%, down 30 and 13 basis points for the quarter and first half of the year, respectively (the yield as of July 18th was 2.93%).

Bond prices advanced across the board. Staging a continued recovery from concerns about state and local government finances, Municipals lead the pack by jumping 3.9%. This was followed by U.S. Treasury TIPs, tacking on 3.7%, and International Emerging Markets, climbing 3.4%. All major bond indices advanced for the first half of 2011, ranging from 2.7% to 5.8%.

Below are rates of return for selected market indices for the second quarter of 2011, year-to-date 2011, and the three, five, and 10-year compound annual returns as of December 31, 2010.

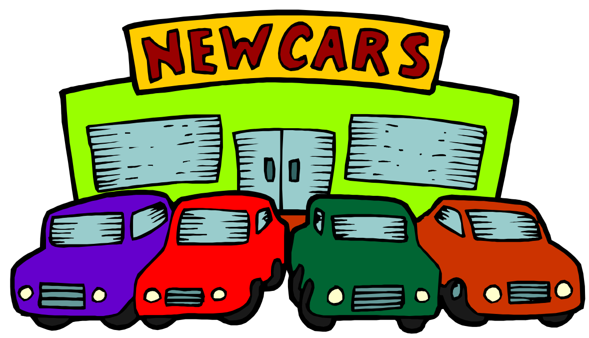
	2Q:2011	YTD-2011	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic Large Cap					
Russell 1000 - Growth	0.76%	6.83%	-0.47%	3.75%	0.02%
Russell 1000 - Value	-0.50%	5.92%	-4.42%	1.28%	3.26%
Russell 1000 - Blend	0.12%	6.37%	-2.37%	2.59%	1.83%
Domestic Small Cap					
Russell 2000 - Growth	-0.59%	8.59%	2.18%	5.30%	3.78%
Russell 2000 - Value	-2.65%	3.77%	2.19%	3.52%	8.42%
Russell 2000 - Blend	-1.61%	6.21%	2.22%	4.47%	6.33%
Real Estate (FTSE EPRA/NAREIT Global)	2.50%	4.59%	-4.67%	3.49%	NA
International					
MSCI EAFE Developed Large Cap	1.83%	5.35%	-6.55%	2.94%	3.94%
MSCI EAFE Developed Small Cap	1.03%	4.09%	-1.37%	3.17%	9.87%
MSCI Emerging Markets	-1.04%	1.03%	-0.03%	13.11%	16.23%

	2Q:2011	YTD-2011	3-Year	5-Year	10-Year
Fixed-Income (Bond) Indices					
Barclays Capital					
Global Aggregate	3.10%	4.38%	5.85%	6.72%	6.76%
U.S. Aggregate	2.29%	2.72%	5.90%	5.80%	5.84%
U.S. Treasury TIPs	3.65%	5.81%	4.97%	5.33%	6.90%
U.S. Corporate High Yield	1.05%	4.97%	10.38%	8.91%	8.88%
Municipal	3.89%	4.42%	4.08%	4.09%	4.83%
International Emerging Markets	3.38%	5.00%	8.89%	8.36%	10.49%

Source: russell.com, reit.com, msci.com, barcap.com

Buy or Lease those New Wheels?

With the summer driving season underway and lower gas prices tempting you to hit the open road, perhaps you are thinking about acquiring some new wheels. Following up from an October 2010 article about how to get the best price on a new vehicle (see *A Fighting Chance to Strike a Good Deal!* at http://www.kaloramawealth.com/docs/Q310.pdf), this will review the main factors you should consider in your decision whether to buy or lease.



In addition to a price that will stay within your budget, acquiring a new vehicle has both financial and non-financial considerations:

- Rapid depreciation in value - you will want to know how well the vehicle holds its value to avoid “negative equity,” which is when the amount owed on a loan is higher than the market value.
- Insurance - some vehicles are more expensive due to cost or special features.
- Maintenance and repair - history and costs vary widely.
- Personal preferences - dictate size, style, etc.

Another consideration is whether you will buy or lease to finance the acquisition. Buying will make sense for most if cash is available for the purchase or down payment. Leasing requires little or no cash for a down payment. If you have a good credit rating, you may be able to drive away with paying for the first month and security deposit on a credit card.

Purchasing works best financially if the vehicle will be kept for a long time, generally greater than four years or until it is ready for the junkyard. Once the loan is paid off, the only costs are for operations and repairs. The endless payments with a lease make leasing less economical in the long term.

Another reason to buy is if you expect to drive more than the mileage limit included in a lease. Most leases only allow 10,000 to 12,000 miles per year with an additional charge for each mile over the limit. If you exceed the limit, at a rate of 20 cents a mile, leasing can become very expensive.

Leasing may be the best option if low monthly payments are the goal. With a purchase, obviously you are paying for the entire car, figuring you will get some money back in the future when you trade it in or sell. The monthly payment is based on the amount financed above the down payment.

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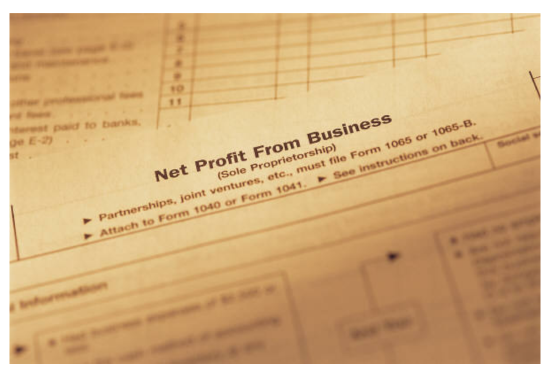
When you lease, the monthly payment is based on the agreed upon price, the estimated value at the end of the lease, and a money factor (interest rate). All you are paying for is the difference in the vehicle's value from the day you drive it off the lot until the day you return it (the depreciation), plus interest and fees.

Assuming the same time period for a lease and loan term for a purchase, the payment for a lease will be significantly lower, allowing you to drive a more expensive car for less money. Again, the drawback with a lease is that you will always have a payment. But, there are no trade-in hassles at the end of the lease.

Because there is no loan, a benefit of a lease is that you will always avoid “negative equity.” However, you will want to make sure the lease includes GAP insurance, which covers any difference between the amount owed on the lease and the vehicle's value if it is stolen or totaled in an accident. Leasing does not change the fact that the vehicle's value takes a hit the moment you pull off the dealer's lot. An auto insurance payoff will only cover market value, not the lease payments owed, thus the need for GAP insurance.

Leasing makes sense if you always want to have a new vehicle along with the latest safety and technology innovations. Manufacturers are continually upgrading with more air bags, anti-lock brakes, Bluetooth®, electronic stability control, traction control, and tire pressure monitoring systems.



Tax benefits may make leasing the preferred option if the vehicle is used for business. Whether buying or leasing, costs of operating a vehicle for business, such as gas, repairs, and insurance are deductible from business income for tax purposes. For a purchase, there is an additional deduction for depreciation, as well as interest if the purchase is financed. However, the amount of annual depreciation is capped (total of $22,460 for the first five years for a car purchased in 2010) and the depreciation is "recaptured" (included in income) if the vehicle is sold at a gain. The rest of a monthly payment is applied towards principal in a rapidly depreciating asset (a business owner may prefer to invest excess cash in the business).

For a lease, the entire lease payment is deductible, less an "inclusion" amount if the fair market value of the vehicle exceeds a limit stipulated by the IRS ($18,500 for cars in 2010). The inclusion amount, which has the effect similar to the limit on the depreciation deduction with a purchase, reduces the deduction for the lease payment by a small amount for each year of the lease. For example, the inclusion (reduction) for a $30,000 car leased in 2010 would be $28, $61, and $92 for the first, second, and third years of the lease, respectively. (Please consult IRS Pubs. 463 and 544 for further information).

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During the term of a lease, you are still responsible for maintenance costs, which should be minimal with a new car. The lease term should not be longer than the bumper-to-bumper warranty. Also, avoid any additional options such as undercoating or a security system; what's the point if you won't own the car?

You are also obligated to repair damages. In fact, another downside with a lease is that you will have to take care of the vehicle even better than if you owned it. When you return the vehicle at the end of the lease, they may ding your wallet for any dents and dings. Remember, the owner of the vehicle will then have to get the vehicle ready for resale. On the upside, if you need to get out of the lease before it ends, you can terminate by paying the difference between the remaining lease payments and value at termination, plus an early termination fee.

There are many variables to consider in the buy or lease decision. Please contact Kalorama Wealth Strategies if you would like to discuss which option might be best for your next vehicle. For more information on our investment advisory and financial planning services, please see our web site at www.kaloramawealth.com.

Thank you for your continued business and referrals. Please feel free to forward this newsletter to friends and colleagues who can benefit from information about investing and financial planning. If I can be of any assistance to you or anyone you know, please do not hesitate to contact me.

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Fee-Only Investment Advisory And Financial Planning

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