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The SIENA INVESTOR

A QUARTERLY PUBLICATION OF SIENA WEALTH ADVISORS

The Perception of Taxes

Taxes are often considered a necessary evil. The topic evokes strong emotions. How we perceive taxes and how we feel about paying them are complex issues. For investors, two significant situations to avoid when it comes to taxes are:

1) Focusing solely on how much of an investment gain could be lost to taxes
2) Worrying so much about taxes that it adversely affects decision making?

Eating Up Gains

Many (if not most) investors focus on the pretax value of their investments, even though they can only spend after-tax dollars. To see why this is so important, consider the 1993 study done by two Stanford University economics professors. They examined 62 stock mutual funds before and after taxes for the period 1963–1992. They found that each dollar invested would have grown to $21.89 in a tax-deferred account, but only $9.87 in a taxable account (for high-income investors).

Avoiding Taxes, Creating Other Problems

Such tax issues may leave some investors saying, "I'll just avoid paying taxes at all costs." However, avoiding tax bills could end up being a bad decision. For this, let's look at a hypothetical example.

In August 2004, an investor bought 200 shares of Google at $100 per share. This $20,000 investment was 5 percent of his total portfolio of $400,000, which was split evenly between stocks and bonds (meaning $200,000 in each). The stock skyrocketed, as Google crossed $700 about three years later. His stake in Google, now worth $140,000, represented about 25 percent of his portfolio, which had grown to $600,000. This also meant his stock allocation had jumped from 50 percent to 70 percent.

While seeing such an increase in the portfolio was a welcome sight, it also meant the investor's allocation had drifted far from where he started, meaning he was now taking on much more risk than before. However, rebalancing the portfolio would mean paying the tax bill on his appreciated shares. Assuming a federal and state tax rate of 20 percent, there would be $24,000 in taxes on the $120,000 gain. That bill was too much for the investor to swallow, so he decided against rebalancing.

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Siena News:

Roger L. Millbrook has recently been appointed to the Finance Committee of the Board of Directors of the LCC Foundation. The LCC Foundation is a non-profit, tax-exempt organization governed by a 27-member Board of community leaders. Each year the LCC Foundation helps hundreds of individuals realize the gift of education. The LCC Foundation supports Lansing Community College and its students financially through scholarships, program improvements, technological advancements, staff development and capital expansion.

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By January 2009, Google fell to $300, leaving his investment sitting at $60,000. Had he sold at the peak, the investor would have had net cash of $116,000 (the stock's $140,000 minus the $24,000 tax bill). Selling at $300 meant his tax bill dropped to just $8,000, leaving him with $52,000 net cash. He still saw a solid profit from his investment, but avoiding the $24,000 tax bill cost him $64,000.

Summary

Taxes are possibly the largest single expense that investors incur, even greater than management fees or commissions. Therefore, ignoring the impact of taxes is one of the biggest mistakes you can make.

However, it is also possible to become so concerned with taxes that you deviate from a prudent investment strategy to avoid the pain of paying them. You would be wise to remember that the only thing worse than having to pay taxes is not having to pay them.

For more on these topics, please contact a Siena advisor at 517-627-1412.

Maximizing Social Security

Life is all about balance. You want to enjoy life along the way, but it's also vital to plan for the resources for days that lie ahead. Mistakes made as you near retirement can be particularly damaging, in that you might not have the necessary time horizon to correct them.

Should you wait until full retirement age to take Social Security benefits? Should you instead take early benefits at age 62? What impact, if any, does your birth year have on the decision? Under which circumstances is it appropriate to wait until after full retirement (or perhaps until age 70), to take advantage of increased benefit payouts?

When addressing these questions, some of the factors to consider include:

1) life expectancy,
2) year of birth,
3) the level of benefits,
4) whether or not wages will continue to be earned,
5) the discount rate applied to future benefits and
6) issues related to a spouse.

Therefore, the decision is often a complex one.

Siena Wealth Advisors can you assist you with this decision through our complimentary social security analysis. Please contact an advisor for more information.

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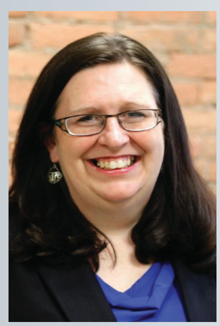
Stephen L. Hicks has been elected to the Board of Directors of the McLaren Greater Lansing Healthcare Foundation. The foundation's mission is to develop friends, raise funds and awareness for projects and services that provide quality patient care at McLaren Greater Lansing.



Susan K. Flynn has completed the steps to register as a wealth advisor for Siena Wealth Advisors. She has served as a Customer Service Specialist for Siena Wealth Advisors since 2000 and is the current Vice President of Operations with Siena Accounting, CPA, PLLC.

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