Mentor Monthly Missive

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Intriguing facts about capital assets

So you're thinking about selling that Merck* stock your grandfather gave you in 1970. You've been reinvesting dividends for 42 years, and what started out as 100 shares has become 8,000, worth enough to buy the summer home you've always wanted.

Of course you check with your financial adviser, who tells you that you'll have to report the stock sale to the IRS. She says your taxable gain will be the difference between what was paid and what you receive in the sale. Unfortunately, you have no idea what was paid.

Does that mean you can forget the idea of the summer home? Not really, but this scenario does illustrate the importance of keeping track of tax basis in capital assets – even if it's for 30, 40 or 100 years.

*Merck is used for illustrative purposes only.

Here are some facts from the Internal Revenue Service about the tax nature of capital assets. Some may surprise you:

1.) Almost everything you own and use for personal purposes, pleasure or investment is a capital asset.

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MENTOR CAPITAL

Meet our Wealth Managers

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Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.

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Intriguing facts about capital assets (cont. from page 1)

2.) When you sell a capital asset, the difference between the amount you sell it for and your basis – which is usually what you paid for it – is a capital gain or a capital loss.

3.) You must report all capital gains to the IRS.

4.) You may deduct capital losses only on investment property, not on property held for personal use.

5.) Capital gains and losses are classified as long-term or short-term, depending on how long you hold the property before you sell it. If you hold it more than one year, your capital gain or loss is long-term. If you hold it one year or less, your capital gain or loss is short-term.

6.) If you have long-term gains in excess of your long-term losses, you have a net capital gain to the extent your net long-term capital gain is more than your net short-term capital loss, if any.

7.) The tax rates that apply to net capital gain are generally lower than the tax rates that apply to other income. For 2012, the maximum capital gains rate for most people is 15%. For lower-income individuals, the rate may be 0% on some or all of the net capital gain. Special types of net capital gain can be taxed at 25% or 28%.

8.) If your capital losses exceed your capital gains, the excess can be deducted on your tax return and used to reduce other income, such as wages, up to an annual limit of $3,000, or $1,500 if you are married filing separately.

9.) If your total net capital loss is more than the yearly limit on capital loss deductions, you can carry over the unused part to the next year and treat it as if you incurred it in that next year.

10.) Capital gains and losses are reported on Form 8949, then transfered to Schedule D, and finally end up on line 13 of Form 1040.

11.) The basis of a capital asset received as an inheritance generally is the value of the asset on the date of the decedent's death.

Returning to the Merck illustration: Your basis is what was paid for those original 100 shares plus what was paid for all the shares purchased with the reinvestment of dividends. If you sell only part of your 8,000 shares, your basis in that part is the basis of the shares purchased earliest, calculated with regard to the five Merck stock splits that have occurred since 1970. Alternatively, you can specifically identify the shares you are selling to achieve the best tax result. You cannot use average cost as the basis on individual securities. This method is reserved specifically for shares of open-end mutual funds.

In many cases – but not all – the institution where the stock was held will have information on tax basis. In many other cases, especially where the stock was moved from account to account, establishing basis will be difficult and perhaps impossible. In the latter, the taxpayer must make his or her "best effort" to establish tax basis in the shares sold.

For more information about reporting capital gains and losses, see the Schedule D instructions, Publication 550, Investment Income and Expenses or Publication 17, Your Federal Income Tax.

Monthly Market Commentary

Although several bellwether stocks, such as Intel, Texas Instruments, FedEx, Norfolk Southern, and Caterpillar announced earnings warnings, investors mostly shrugged-off weaker fundamentals and placed their hopes on growth through coordinated easing. Investors were not disappointed, as additional quantitative easing (QE3) was announced on September 13th. Riots in Spain caused markets to react negatively, durable goods orders took a dive because of airline orders, and income and consumption numbers were hit hard by a quick spike in inflation rates. However, year-over-year data for almost every report continued to look a lot better than the volatile month-to-month statistics.

GDP: Second quarter real GDP growth was unexpectedly revised downward in September to 1.3%, after initially being revised upward to 1.7% from 1.5% in August. Adjustments were across the board, which included a slowdown in personal consumption, inventory growth, and negative net exports.

Employment: The recent jobs report revealed a surprise drop in the unemployment rate to 7.8%, down from 8.1% in August. In September, 114,000 jobs were added, but more importantly, the job numbers were revised substantially higher for July (+40,000 jobs) and August (+46,000 jobs). These revisions are likely to produce meaningful increases in both personal income and consumption growth.

Housing: Housing data was mixed as house prices rose but pending home sales seemed lighter than expected. The Case-Shiller 20 City Index rose 1.2% sequentially and is now 7% to 8% above lows reached this spring. The relatively consistent improvement in prices over the past few months should help the appraisal process that has kept many pending homes that went under contract from actually closing. Consistent price increases, along with near-record low mortgage rates and skyrocketing rents, could push potential buyers off the fence.

Manufacturing: New orders for durable goods were down a whopping 13%. A major air industry show in July often causes a huge boom for airline orders in that month, followed by a collapse in August. If volatile categories such as airliner orders and other transportation equipment are ignored, new orders were down a modest 1.6% in August. Morningstar economists believe that while the export news looked particularly bleak, a combination of ramp-up in jetliner productions from Boeing and continued improvements in the auto industry (auto sales hit a new recovery high in September) should prevent a rout of the manufacturing industry in the U.S.

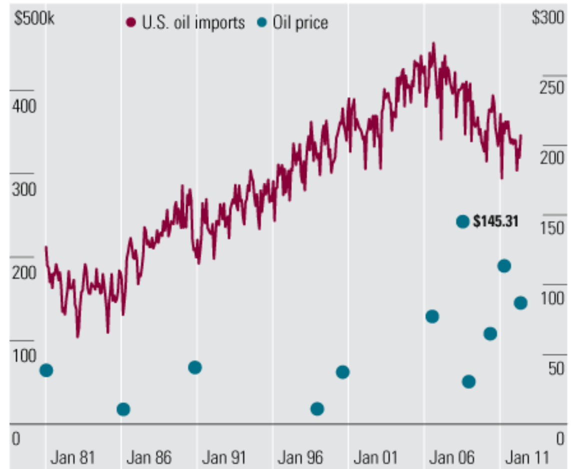
Quarter-end insights: The initial fears at the end of the second quarter that the U.S. would be pulled back into a recession because of slowdowns in Europe and China, has not come to pass. Markets were surprisingly strong in the third quarter, mainly from actions by central banks around the world that drove markets higher. Although the housing recovery has been improving for most of 2012, it has yet to have any significant impact on overall economic activity since residential housing only represents 2% to 3% of GDP. This excludes spending that typically follows home purchases, such as new furniture and landscaping. Morningstar sector analysts' quarter-end outlook highlighted lackluster fundamentals that showed no definitive signs of either a collapse or a boom. During the third quarter, cyclical and more economically sensitive stocks generally did well while more staid industries, such as utilities, generally underperformed the market. There is also concern of a stronger dollar undercutting sales growth with a general fear that the higher dollar may likely depress margins in the months ahead. High margins and conservative capital spending have resulted in higher levels of cash at major corporations, which is finding its way into the mergers and acquisitions space. Much of the merger and acquisition activity as well as general corporate growth stories continue to be built around emerging-markets growth, despite near-term pressures in some of those markets.

The Politics of Oil

With prices reaching $4 at the pump, the oil problem will probably be a major factor during the 2012 election season. In March 2012, the White House published a report showing how U.S. oil imports have dropped from 57% of total consumption in 2008 to 45% in 2011, a powerful argument for when president Obama needs to defend his energy policy.

In fact, oil imports (measured in thousands of barrels) have been dropping since 2006, but prices continued to climb, reaching a high of $145.31 per barrel in 2008. A more important question that comes to mind is whether the decline in imports is indeed due to more efficient domestic production or simply to decreasing demand caused by escalating prices.

U.S. Oil Price and Import Trends



This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. Report cited: "The Blueprint for a Secure Energy Future: Progress Report," March 2012, The White House, Washington, D.C.

Oil prices: West Texas Intermediate Crude in U.S. dollars per barrel. U.S. oil import data from the U.S. Energy Information Administration.

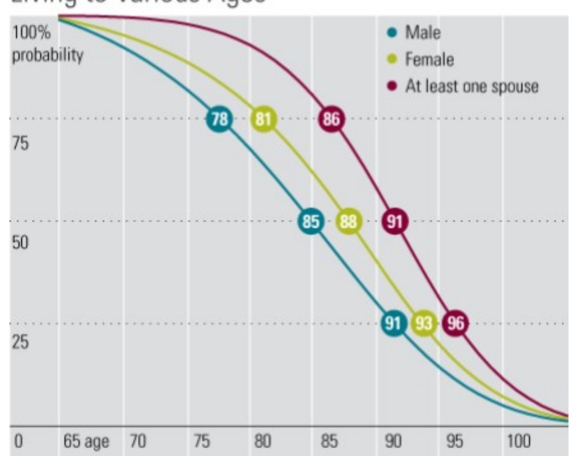
Bittersweet

The dictionary defines "bittersweet" as something pleasant, alloyed with pain. The word can describe retirement. The sweet part is that people are living longer thanks to better healthcare. The bitter reality is that when people live longer they risk outliving their assets.

Longevity risk is the possibility of outliving your retirement savings. While longevity is generally good, its risks are becoming a major concern for individuals entering retirement.

Longevity risk can be managed through proper planning, which considers when you'd like to retire, years you anticipate in retirement and desired income level. Mentor Capital's advisors have the tools and expertise to help you manage longevity risk. Call for a consultation.

Probability of a 65-Year-Old Living to Various Ages



Source: Annuity 2000 Mortality Tables—Transactions, Society of Actuaries, 1995–1996 Reports.

Like A Fine Wine

Like a fine wine, a portfolio only gets better with age. Well, not exactly, but the longer your investment time frame is, the greater the chance that your portfolio will be able to build more value. This happens because of a little phenomenon called compounding: the ability of an investment to generate earnings from previous earnings, accelerating the growth of your assets over time. For example, if you invested a sum of money on January 1st this year, you will get interest on your money at the end of the year. Next year, you will get interest on your money and interest on the interest and, if this happens over many years, you have a chance of ending up with a portfolio as delicious as a bottle of perfectly aged Chateau Margaux.

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