Private Opportunities Club
Your Window Into the World of Wealth
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- Buying Munis in This Financial Environment
- Timing the Muni Market

Plus

- Be Aware of Muni Bond Safety Nets
- An Estate Planning Dream Come True

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This month's password is: gold

(Please remember to use lowercase letters.)

Gold: The Smart Move Now

By Forrest Jones

Investors should stick with gold this year.

Not because it's due to keep rising, as all the drivers behind it would suggest, but because how it will rise — or at the very least remain stable — makes it solid for the long term.

Gold is growing increasingly uncorrelated to stocks, behaving in such a way that makes it the perfect anchor to other asset classes in their portfolios, experts say.

For years, gold didn't shine so much, trading around $300 an ounce or even less over a decade ago before soaring — breaking $1,900 an ounce in 2011 — as loose monetary policies were cheapening paper currencies and creating inflationary fears.

Today, there are three drivers affecting gold, which has long served as a hedge, or insurance policy play, against inflation.

Those drivers include ongoing economic uncertainty, loose monetary policies, and the search for diversification, says Abraham S.H. Bailin, an ETF analyst at Morningstar.

Uncertainty isn't going to end.

Europe remains mired in its debt crisis, and although European leaders recently agreed to a $172 billion bailout package for Greece, underlying problems plaguing the European economy aren't going anywhere any time soon.

China has cut its growth targets, and it's anyone's guess when the U.S. picks up the pace of its recovery and unemployment rates begin to fall at a meaningful clip.

"If I were to pick any given word to describe the markets these days, the word 'certain' would not be in my vernacular," Bailin says.

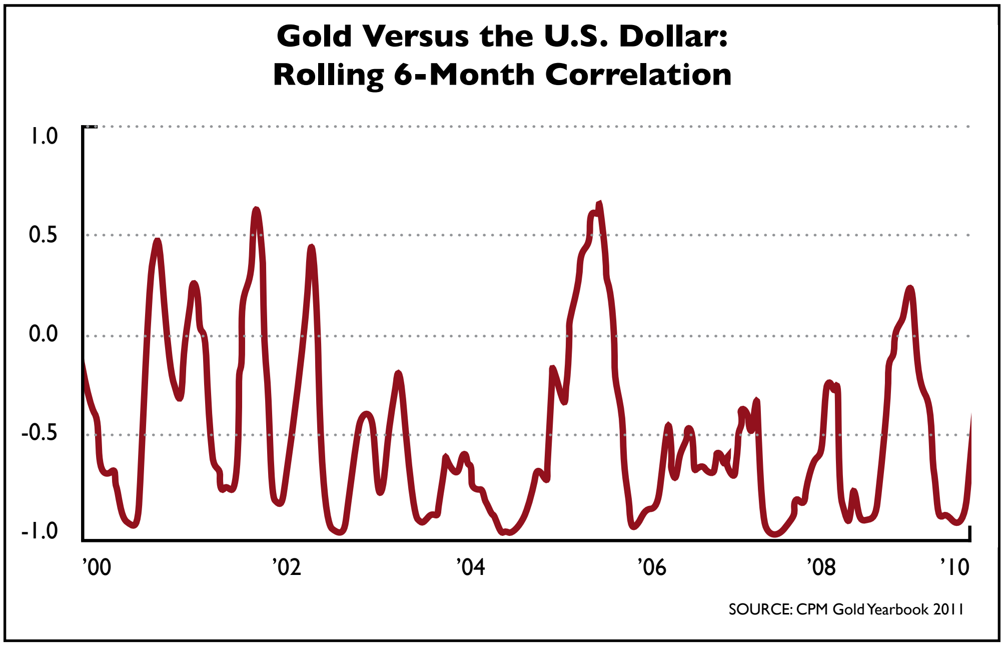
Loose monetary policies aren't going to change either.

The Federal Reserve and other central banks have pumped vast amounts of liquidity into their financial systems to steer their respective economies away from crippling deflationary downturns.

On top of keeping interest rates low, the Federal Reserve has launched two rounds of quantitative easing, asset purchases from banks, known widely as QE1 and QE2, pumping $2.3 trillion into the economy in the process.

QE1 saw the Fed acquire $1.7 trillion in assets from banks, mainly mortgage securities, while QE2 saw the U.S. central bank snap up $600 billion of Treasury bonds, the latter round ending in June of last year.

Critics say the policy weakens the dollar, stokes inflationary pressures, and hasn't done much to better the economy anyway, as unemployment remains high and consumer spending and growth lackluster.



Lately, indices that are heavily weighted in Treasurys are showing negative correlations against the S&P 500, including the Barclays Aggregate Bond Performance Index.

That's what known as the risk-off trade in the media. When people sell stocks and run for safety, Treasury bills are popular.

On the flip side, the Russell 2000 small-cap index is showing a positive correlation, meaning when S&P 500 shares rise, so do shares in the smaller companies that make up the Russell 2000.

The problem with buying into those shares is that when an investor does so, he's really not diversifying.

If S&P stocks go down, they'll likely follow suit.

That's where gold becomes a nice anchor due to its zero correlation with large-cap stocks, meaning it doesn't necessarily behave in lockstep or aversion to the S&P 500, as many factors dictate its movements.

In other words: it's not just a simple hedge against inflation anymore but a necessary anchor for portfolio, as no matter what, it's going to offset declines in something.

"We actually see that the correlation of gold to the broad equity market is virtually zero, which is certainly a positive for gold."

— Abraham S.H. Bailin

"Gold is literally at zero over the last year. So when you talk about that diversification benefit, that's where it is," says Bailin, adding "you need the next asset in your portfolio to do well when everything else is not doing well. That's where that diversification benefit comes in."

So stick with gold, because there will be a demand for it as long as portfolios need an anchor.

Supporters say the policy steers the economy away from deflation and aims to boost hiring via keeping interest rates low and stock prices high.

All that liquidity has made gold more attractive as the dollar weakens and inflationary pressures — or concerns of such — arise.

The Fed has not ruled out rolling out a QE3 due to continued weakness in the labor market and in the economy as a whole.

Even if the Fed doesn't roll out QE3, it hasn't mopped up all the liquidity from QE1 and QE2, which further supports gold.

Lastly, correlations are getting interesting, which brings portfolio diversification into play.

Gold is showing a near zero correlation to the broad Standard & Poor's 500 stock index, which is pretty rare.

Gold the Perfect Anchor in This Economy

Correlations illustrate how assets move in relation to one another.

When two assets show a correlation of 1, they move in lockstep, meaning if an asset has a correlation of 1 with the S&P 500 broad stock index, if the S&P 500 goes up 5 percent, the other goes up by 5 percent.

Others show a negative correlation, meaning if the S&P 500 and an asset have a correlation of -1, when the stock index goes up 5 percent, the other goes down by 5 percent.

"We actually see that the correlation of gold to the broad equity market is virtually zero, which is certainly a positive for gold."

Supply-side drivers look good for gold as well.

New mines aren't rushing to come on line and dump gold onto the market — the very nature of the mining industry prevents as such.

"Have we seen supply-side change? Not to a great degree, and the fact that the supply side does not change overnight, it's not something that's quick to change because opening up new mines is not easy — even ramping up production at existing mines is not easy. It's because of that gold is able to be such a safe haven," Bailin says.

Correlations tend to remain tight during times of financial crises, other experts point out.

In 2008 during the collapse of Lehman Brothers, everything fell.

That's something to consider, as correlations can change.

"A lot of the traditional factors are still at play. Also the fact that not just gold but with all assets, the correlation between various assets is not fixed, it can change over time," says Greg McBride, senior financial analyst at Bankrate.com.

"Particularly in times of financial crisis, correlations tend to increase. That's what we saw in the fall of 2008, when literally, every asset class with the exception of U.S. Treasuries plunged in value. Any time there's a financial crisis or the prospect thereof, you're going to see the correlation between assets increasing but that doesn't mean that that's a permanent state but a reflection of overall fear in the marketplace."

Getting Started in Gold Investing

So how does an investor get involved in gold? Exchange-traded funds are one good option.

They're accessible and cost-efficient, McBride says.

Some investors opt to buy stocks in the mining companies themselves.

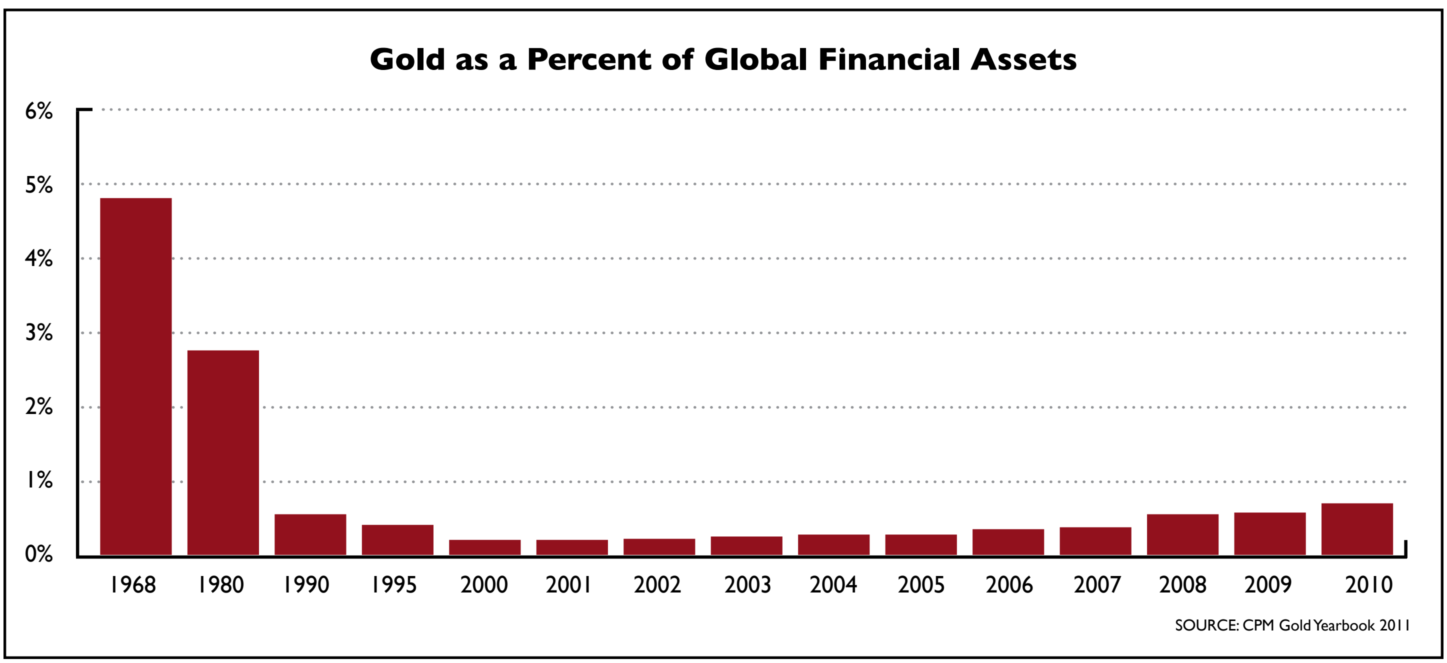
After all, if gold rises, the mine is probably going to earn more money.

Be careful, McBride says, as stock prices can jump around with swings in the stock market.

"The thing about investing in companies that mine — whether you do that in the specific companies themselves or through a dedicated mutual fund or ETF — is that it's a bit of a leveraged play on the precious metal itself," says McBride.

The mining company must also clear its production costs before the profits roll in.

"When the price of gold goes up, their stock price can go up significantly faster than the price of gold just because once they've covered their production costs, everything else is pure profit. But it works the same way on the way down," McBride says.



So how much gold should an investor have in his or her portfolio?

"Gold, specifically, I think 5 to 10 percent is most appropriate. Anything more than that, I think clearly you are getting into speculation," McBride says.

For those who like stocks and want to invest in companies that produce the yellow metal, there's good news: stocks often lag behind the metal itself.

While gold bullion itself has soared, mining companies have yet to catch up.

"If you look at what gold miners have done in the past year versus the physical metal, there's been a huge difference. That alone has a lot of people excited," says Janet Yang, an analyst on gold funds at Morningstar.

"Though the end of 2011 the SPDR Gold Shares gained 11.2 percent but the FTSE Gold Mines Index, an index of gold miners, actually lost 15.9 percent."

That gap should come back together soon, which would leave many to believe shares in gold mining companies are due to rise.

"Most people are thinking that it should come back together, in terms of their movements," Yang says.

"Either the miners will rise to meet gold or gold will fall to meet the miners."

A lot of factors that pushed up gold in the first place are still in play: Loose monetary policies and demand from central banks around the world will boost bullion and possibly with it, shares in gold mining companies.

"Those concerns aren't going away any time soon," Yang says.

Central Banks Stocking Up on Gold

Others agree, pointing out that physical demand is going to push up prices increasingly more in the future.

China and India are rising economic powerhouses with growing middle and upper classes that are eager to buy gold.

"They hold gold probably in higher esteem than we do," says Scott Weingarden, an associate vice president of Raymond James in Miami, Fla.

"The growth of China and India in the last decade in just wealth, and we hear about how much money there is, how many billionaires and all those things — there it holds a different place in the culture than it does here."

"If you look at what gold miners have done in the past year versus the physical metal, there's been a huge difference. That alone has a lot of people excited."

— *Janet Yang*

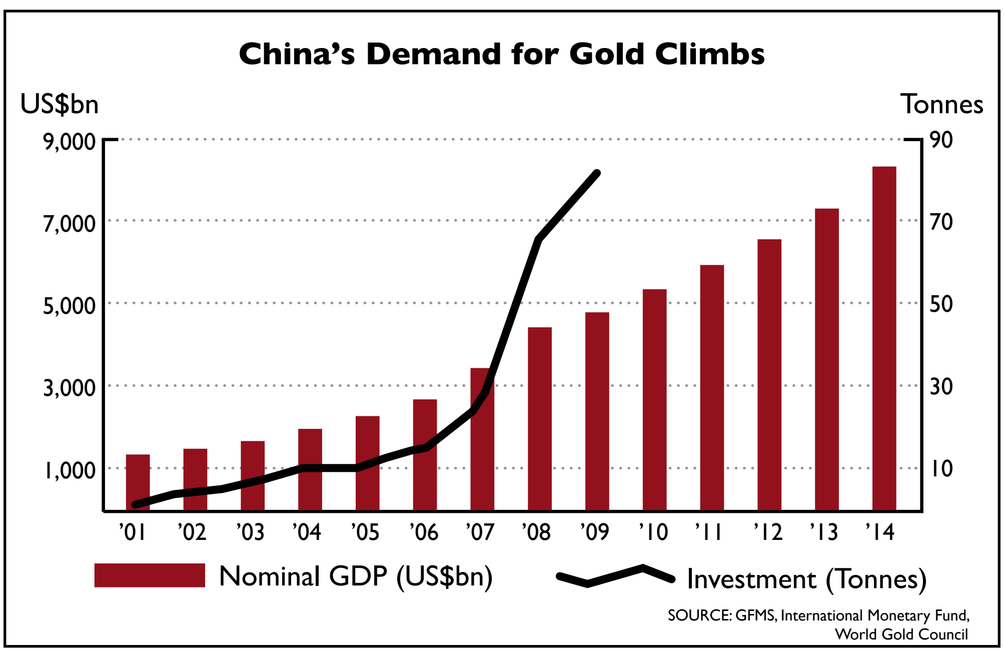
Central banks in China, India and elsewhere have been stocking up on physical gold as well.

Plus the word is out that gold is hot, as evidenced by the advertisements popping up on television and on the Internet.

In other words, investing in gold is not just the talk of hedge fund managers, although many of whom remain long on gold.

"Some very, very successful investors like George Soros and John Paulson have made a huge bet on gold, and I don't think they've made it for one year," Weingarden says.

"I think they've made it for five or 10 years." ■



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Do I Buy Munis in This Environment?

By Greg Brown

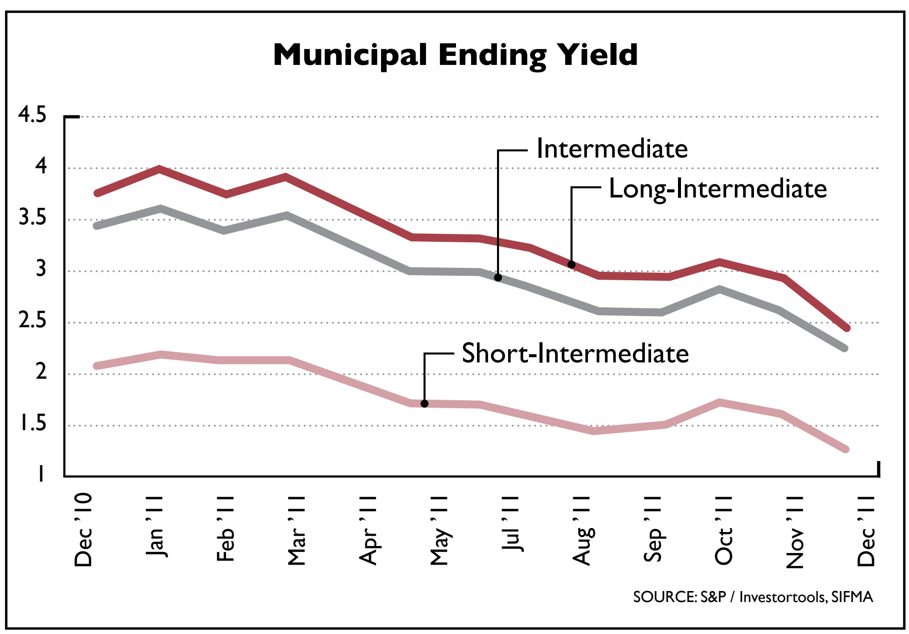
As sleepy fixed-income markets go, it was the shot heard ’round the world. Former banking analyst Meredith Whitney, who had been widely praised for her early, prescient call on the credit crunch, had a new warning: Municipal bond markets were in deep trouble.

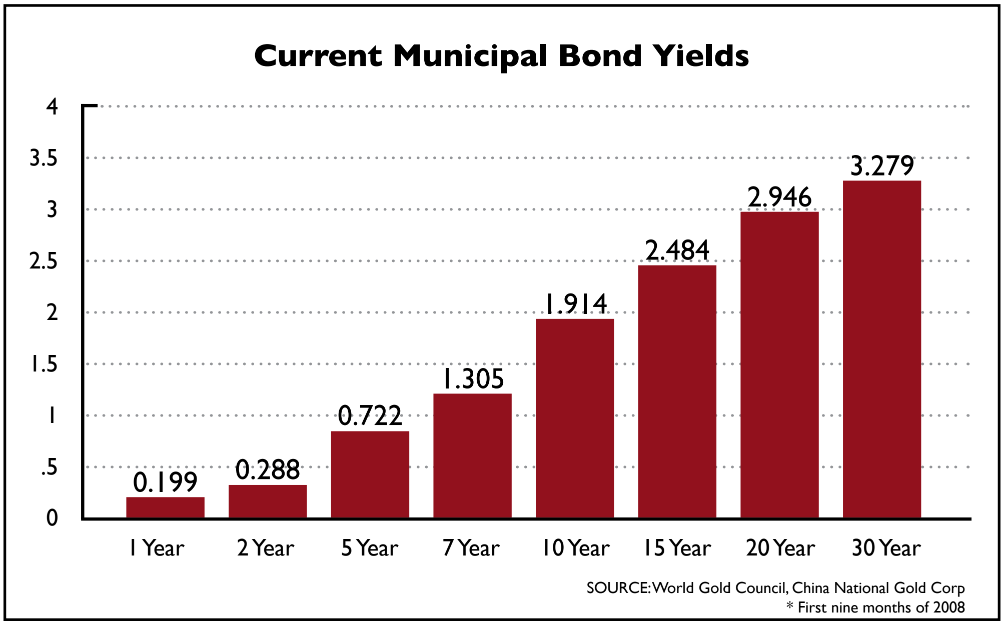
Appearing on the CBS News program “60 Minutes” in December 2010, Whitney predicted an alarming rise in municipal bankruptcies and nothing less than chaos to follow in the bond market. She told journalist Steve Kroft to expect a huge increase in defaults, probably during 2011.

“There’s not a doubt in my mind that you will see a spate of municipal bond defaults,” Whitney told Kroft. “You could see 50 sizable defaults. Fifty to 100 sizable defaults. More. This will amount to hundreds of billions of dollars’ worth of defaults.”

Certainly, the market already knew a lot of the bad news and it seemed to be baked in: Budget problems in California and Illinois, outsized debts piling up in Harrisburg, Pa., and Jefferson County, Ala. What was new, investors wondered?

The bond rating agencies seemed unconcerned as well, but Whitney said the rating agencies had got it wrong again, just like with the banks. “When individual investors look to people that are supposed to know better, they’re patted on the head and told, ‘It’s not something you need to worry about.’ It’ll be something to worry about within the next 12 months,” she said then.





What happened next could be added to the increasingly crowded list of startlingly bad calls by financial stars, such as hedge fund giant John Paulson's awful bets on banking stocks and gold, despite getting the housing collapse just right, or bond guru Bill Gross's outlier call to dump Treasurys, one which later forced him to walk back, to his chagrin, as investors fled his Pimco funds left and right.

Through it all, the municipal bond market performed well over 2011, judging by yields. Long, short and intermediate bond yields fell in lockstep (bond prices rise as yields fall as higher demand allows for cheaper financing). Whitney had her doubts (and still does), but investors seemed ready to ignore all that and buy just the same.

Timing the Muni Market

Should investors buy now? "The question is a good one, especially with the level of uncertainty we have seen," says Andrew Aran, CFA, a partner at Regency Wealth Management in Midland Park, N.J.

There were defaults after Whitney's prediction, Aran notes, but fairly few — 118 issuers defaulted on $12.8 billion worth of bonds in a $3.7 trillion market. Most of the defaulters, however, were not rated at all, Aran says, the bond market equivalent of a large red label that says "Poison, Do Not Drink."

The muni bond market strengthened through the second half of the year, Aran says, and for two reasons. First, the volume of issues declined. "Second, as I think Meredith missed, these cities and counties are not static," Aran says. "They can react, by cutting services and raising taxes. And they did." California, he points out, is now on watch for a credit upgrade. Its 10-year bonds yield 2.7 percent, down from 5 percent not long ago.

Can municipals stay the course? As the saying goes, the trend is your friend till the end. But when the end does arrive, it won't be pretty.

"The biggest risk to investors is duration risk," Aran says, that is, the risk is increasing of owning a long-term bond with no potential buyers. Short bonds yield less but allow an investor to trade up as rates rise. However, there is precious little demand for long bonds in a rising rate environment. You can hold them to maturity but little else. Meanwhile, inflation turns your real return sharply negative.

"It is infrequent in the world that a person can buy something with less risk and yet higher yield. And yet that opportunity exists in the municipal bond arena."

— *Donald Cumming*

Aran figures that 10-year paper could lose 23 percent of its value if rates go to 5 percent. Thirty-year paper would lose 37 percent of its value if rates rose to north of 6 percent. "Long-term municipal investors are probably not focusing on that type of risk, they focus on political risk," Aran says. Yet "if it's a general obligation bond, the default risk is insignificant."

If and when the economy improves, rates will go up, Aran notes. "Back in 2004, Fed rates were at 1 percent and within 18 months they were at

5 percent. This time it might take longer because of the employment and housing picture, but they will go up. Once the Fed doesn't have to be so accommodative, they will stop buying. In fact, they will start selling."

Choices Abound to Assure Safety Net

If you must put money into municipals and still worry about default, there are choices, says Donald Cummings, managing partner at Blue Haven Capital, a fee-only money management firm in Geneva, Ill.

"It is infrequent in the world that a person can buy something with less risk and yet higher yield. And yet that opportunity exists in the municipal bond arena. I have always been a fan of escrowed and pre-refunded municipal bonds, as opposed to straight municipal credits," Cumming says.

When rates fall, Cummings explains, cities are required by law to refinance. Like a homeowner who gets a better mortgage rate, the cost of debt thus declines. Unlike the homeowner's extinguished mortgage, however, the previous bond continues to exist. Its payments come out of an escrow account from the sale of the previous debt, an account that usually consists of Treasurys.

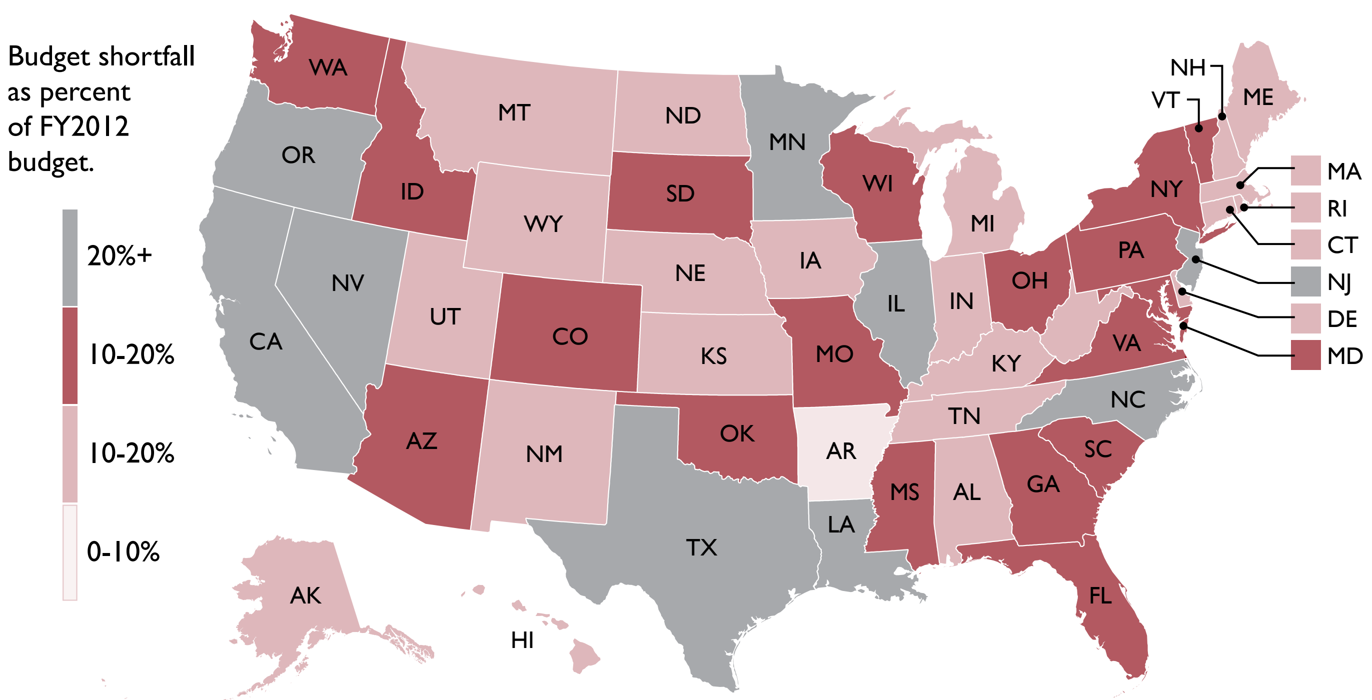
"You are no longer being paid by the municipality but are being paid off by U.S. Treasurys, so you have the safety of Treasurys but the tax advantage of the municipal bond," Cummings points out.

Watch out for callability, Cummings says. Also, the federal government is considering limiting the tax break high earners get from holding muni bonds. But "all things being equal," there are absolutely good investments to be made in the muni space, he says.

"I think the risk is out there, but there's some hysteria out there, too. People say 'You're going to get slaughtered if you are in municipal bonds. You're going to get murdered.' Very few people in the media have quantified what happens to that bond if interest rates go up," Cummings says.

If people were to quantify the income, they wouldn't hesitate to buy 7- or 10-year bonds, Cummings contends. But, "they would hesitate to buy 30-year bonds," he warns. "There's a lot of hurt in that end of the curve." ■

More Than 40 States Are Projecting Billions of Dollars in Budget Shortfalls for Fiscal 2012



SOURCE: Center on Budget and Policy Priorities, Center for Retirement. Research at Boston College, National Conference of State Legislatures.

An Estate Planning Dream Come True

By Julie Crawshaw

Estate taxes are always a major concern for those with high net worth. The bad news is that if the Bush tax cuts expire at the end of 2012, estate taxes will rise. The good news is that there's a kind of trust about which few people know that can make the estate tax problem go away.

According to Carlos H. Lowenberg Jr., ChFC, and CEO of Lowenberg Wealth Management Group in Austin Texas, the Beneficiary Defective Inheritor's Trust (BDIT) is good for everyone who has wealth to protect.

"A BDIT is the most elegant solution there is in trust planning right now," says Lowenberg. "BDITs offer the most effective disposition of assets with the least possible diminution in wealth, plus long-term, dynasty-type asset protection against creditors, divorcing spouses, and estate taxes."

"A BDIT makes you a trust fund kid and protects your assets at the same time."

Normally, the grantor in a trust is the family wealth holder. But when members of the younger generation are creating the wealth, their parents can make them trust fund kids simply by starting a BDIT with a few thousand dollars. After that, the children, who are both beneficiaries and trustees for the BDIT, can house assets or start new businesses inside of the trust while retaining access to those assets.

Like an Intentionally Defective Grantor Trust (IDGIT), a BDIT is a flow-through entity unrecognized by the government for income tax purposes. Transactions between the trust and the beneficiary are income tax-neutral, as if the trust did not exist, as are "in-kind" payments using appreciated assets.

Any income taxes due on assets held within a BDIT must be paid by the beneficiary. So, if you hold $1 million in assets outside of your BDIT, and the assets inside your trust are costing you $50,000 a year in income taxes, that $50,000 comes out of the $1 million you hold outside of the trust, providing a "tax burn" that reduces the size of your taxable estate by $50,000.

"If you do the math, tax burn winds up being a big deal for estate tax planning purposes, and almost no one thinks about it," says Lowenberg. "Everybody thinks about the leverage you get by discounting an asset and selling it, but the tax burn is typically a bigger deal."

BDITS are also favored by Las Vegas estate planning attorney Richard Oshins. "Payment of income tax by the beneficiary on income earned by the trust is the functional equivalent of a gift to the trust of the tax paid, but not a prohibited transfer for gift tax purposes which would expose the trust to transfer tax or creditors," Oshins says.

Though these trusts cost only a few thousand dollars to set, getting the assets valued when you sell assets into the trust can be expensive.

"Say you own an apartment building that's earning $500,000 a year," Lowenberg says, and you want to sell it to your BDIT, for which you are both the trustee and beneficiary. In order to have the arm's-length transaction the IRS requires, you have to have someone appraise the building in a defensible way, which might cost $10,000. Put five such assets into your BDIT and you could easily be looking at $50,000 or more in appraisal fees.

Also, even you can actually start new businesses inside a BDIT, if you've got a big asset you want to house inside it, the trust has to have enough financial substance to be able to buy it.

"The transaction can't be just for tax planning purposes; it's got to have some economically defensible substance behind it," Lowenberg says. "Moreover, determining what is necessary for a down payment or a guarantee of performance for an asset can be tricky. Making sure the guarantees around that purchase are reasonable in the eyes of the IRS is where the BDIT complexity lies."

Lowenberg says that finding an attorney qualified to set up a BDIT is not to be taken lightly. "When you find someone who says they can, ask how many BDITs they've done, how long they've been doing them and what they feel is appropriate for guaranteeing," he says. "If they can't discuss this, they haven't done it." ■