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INVESTMENT ADVISORY AND FINANCIAL PLANNING FIRM

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Don't Overlook The Tax Benefits Of Real Estate

Though it was a lesson learned the hard way, Scarlet O'Hara eventually realized the value of land in "Gone With the Wind." Of course, moguls such as Donald Trump—and many other wealthy investors—have long known the secret to turning rental real estate into profits, and even investors with much lower profiles can benefit from owning property.

What's more, with the federal income tax landscape changing dramatically in 2013, the tax benefits for real estate will become even more attractive than they have been. The higher tax rates that are coming will effectively increase the tax value of real estate investments, while the basic tax breaks remain intact. Let's take a closer look at the foundation for this traditional tax shelter.

Four tax pillars of real estate

1. Annual deductions. If you acquire real estate, you'll likely have to pay mortgage interest to a lender plus annual property taxes to local authorities. But these expenses are deductible and can offset the rental income you receive. Similarly, you can also recover the cost of investment property through an IRS-approved system of depreciation deductions. The cost recovery period is 27.5 years for residential property and 39 years for commercial property.

In other words, if you hold the property long enough, you'll get back most or all of its cost in the form of depreciation deductions. This is the backbone of the real estate tax shelter.

2. Capital gains on sales. Many of the rich get richer by buying and selling real estate properties. For 2012, the maximum tax rate on a long-term gain from the sale of real estate (that applies to sales of property you've held one year or longer) is generally 15% for high-income investors. Although the maximum tax rate for long-term gains is scheduled to increase to 20% in 2013, that's still better than paying tax at ordinary income rates.

Moreover, though there has been a recent slump in real estate values through most of the country, property has historically appreciated over the long term, enabling savvy investors to accumulate wealth.

3. Section 1031 exchanges. Instead of selling and buying real estate in separate transactions, you can arrange to trade a property you own. Assuming you meet the technical requirements for a like-kind exchange under Section 1031 of the tax code, there's no current tax on such a swap of properties. The tax is deferred until when and if you sell the new property. However, you will owe tax to the extent that you receive any "boot" in the deal, including cash or forgiveness of a mortgage.

Also, there are two key timing requirements for Section 1031 exchanges: The replacement property must be identified within 45 days of transferring legal ownership of the relinquished property. And title to the replacement property must be

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How Do You Plan To Approach The Year 2013?

It happens every year. We *make* New Year's resolutions and we inevitably *break* New Year's resolutions.

We see it in the gym more than any other place. We say to ourselves, "This is the year I am going to lose weight," or, "My goal is to watch what I eat and gain muscle mass."

We start off motivated to achieve our goals, yet we grow frustrated and quit when we don't see results immediately.

When we neglect to work out for a long time, it's going to feel painful both physically and mentally when we get back into the gym. And we seem to forget that what took years to build (weight gain, higher body fat, etc.) likely will take years to undo.

The same is true for your finances. If you have spent years accumulating debt, neglecting savings, or overspending, it takes time to change course and make better financial decisions in order to reach your financial goals.

You can't fix it overnight. So, instead of making an annual resolution to get in shape or fix your finances, change that by making daily resolutions. Make smart financial decisions on a consistent, long-term basis because contrary to popular belief, there is only one way to get rich and build wealth – slowly.

Sincerely,
USA Asset Management

The Benefits Of Working With An Advisor

People who work with a financial advisor are far more likely to understand the situation they will face after they retire, according to a recent survey by Franklin Templeton Investments.

Two out of three people who work with a financial advisor know the amount of retirement funds they will withdraw each year after they retire. That's almost twice the proportion of those who've never worked with an advisor who have that knowledge, according to the Franklin Templeton Retirement Income Strategies and Expectations (RISE) survey, taken in September 2011.

Volatile world markets and changes in the way people build retirement assets make it more important than ever for pre-retirees to understand their retirement picture, says Michael Doshier, vice president of retirement marketing for Franklin Templeton.

"Sixty-seven percent of respondents were more concerned about investment volatility than they were prior to the recession that began in 2008," Doshier said. "People's worries varied by age, gender, and income level, but from a general standpoint, some of their specific worries related to health expenses, Social Security, and simply running out of money.

"Our survey also showed, however, that working with a financial advisor can make a clear difference in how Americans think about retirement planning. By sitting down with a financial advisor, identifying and prioritizing one's retirement goals and concerns, and writing down a simple plan to address them, people can take meaningful steps toward confident action."

The RISE survey was conducted online among 1,020 men and 1,026 women. Here are other findings:

- 38% of respondents who never have worked with a financial advisor said Social Security will provide the most income during their retirement, compared with 19% of people who work with an advisor.
- Just 4% of people who never have worked with a financial advisor said IRA funds will provide the most income during their retirement, compared with 13% of people who work with an advisor.
- 35% of people who never have worked with an advisor said they do not think about how they will approach different sources of retirement income.
- Running out of money in retirement is the top concern of 35% of people who never have worked with an advisor, while 24% of those who work with an advisor cited it as their top concern.
- Of those respondents who never have worked with an advisor, 41% said they don't think they have enough money to need one, and 30% said they prefer to handle their finances on their own.
- 79% of Americans currently do not work with a financial advisor, but 47% of respondents said they would consider going to a financial advisor or switching their current advisor if the advisor prepared a written retirement income plan. ●

Will Your Retirement Assets Last?

If you've been scrimping and saving for retirement, you may be hoping to relax when that red letter day finally arrives. But recent developments—such as rock-bottom interest rates on fixed investments, the threat of higher taxes, and economic uncertainty—might give you pause. Could you outlive your assets in retirement?

Perhaps. According to a study by the Employee Benefit Research Institute, about 44% of those born between 1948 and 1978—encompassing most Baby Boomers and those in Generation X—haven't adequately prepared for retirement. Here are six steps to protect you:

1. Set aside funds for fixed expenses. Consider how much of your retirement money will go for necessities such as food and housing, transportation, health care, and utility bills. Then try to squirrel away enough in safe but liquid assets to pay those costs for three to five years. If you have that kind of cushion, you won't have to cash out of your other investments during a downturn.

2. Live long and prosper. Medical advances and other trends are helping people live longer than they did just a generation ago, and you'll need to plan accordingly. One possible hedge is to acquire long-term care insurance to cover at least part of the cost of an extended stay in a nursing home. But these policies vary, so proceed with caution. Another idea is to purchase an annuity that can provide steady income through retirement.

3. Don't be overly conservative. Naturally, retirement isn't the time to speculate wildly in the stock market, but relying too much on more conservative investments such as bonds can be detrimental, too. Retirees looking for increased yield may opt for long-term bond funds, but be careful about locking into an investment that could backfire if interest rates start to

Stimulus Of 2009 Worked, But Only Temporarily

Evidence is mounting that the American Recovery and Reinvestment Act of 2009 (ARRA), commonly referred to as The Stimulus, worked -- but only temporarily. It's likely that history will record this as an inconclusive episode in the ongoing debate over Keynesian economics, named for John Maynard Keynes, the famed English economist and writer who died in 1946.

In February 2009, just months after the failure of Lehman Bros. and the federal government's intervention in the nation's banking system, ARRA was enacted. It was a controversial legislative effort, with some saying the $787-billion stimulus plan would do little but temporarily shore up the economy and others arguing that the stimulus was too small.

ARRA authorized the federal government to spend on infrastructure, education, health, and energy projects. It expanded unemployment benefits and other social welfare provisions. The act also allowed for spending not directly related to economic recovery and other provisions specifically inserted by Congress, such as a limitation on executive compensation at banks that received federal aid.

ARRA thus presented this American generation's experiment with the Keynesian macroeconomic theory, which holds that, during recessions, the government should increase spending to save jobs and stop further economic deterioration. Such government spending aims to offset a recession-induced decrease in private spending, according to the theory.

Increasing government spending is always controversial, and increasing spending when the economy is weak raises even more controversy. Those who support more spending say temporarily increasing the federal government deficit is okay because it will stimulate economic growth and the government can cut spending after the economy is growing again.

On the opposite side are those who argue that the No. 1 priority should be strengthening the government's balance sheet. This side often is referred to as the Austrian school of economics tied to Friedrich von August Hayek, the 1974 Nobel Prize winner in economics, who argued that efficient allocation of capital is paramount to sustainable and optimal GDP growth. Government is inefficient, the Austrians would argue. Moreover, propping up failed banks with government aid prolongs a correction that free market forces must unleash for an economy to thrive, they add.

No simple answers can be drawn from ARRA, and the debate between Keynesians and the Austrian school is likely to continue. So far, however, job numbers generated by the economic stimulus package of 2009 do not look great for the Keynesians. What's gone wrong?

Much of the stimulus was intended to go into "shovel-ready" projects — rebuilding the nation's bridges, roads, and other infrastructure. However, economist Fritz Meyers says projects where ARRA funds could be deployed immediately simply were not available.

"The cash ended up getting funneled to states and municipalities and they spent it on lots of things other than shovel-ready construction projects," says Meyer. For example, local governments used ARRA money to sustain payrolls as local tax revenues shrunk in the economic slowdown.

"The stimulus was successful in the short term," says Meyer, "allowing states and municipalities not to embark on substantial headcount reduction as long as they were receiving federal grants in aid."

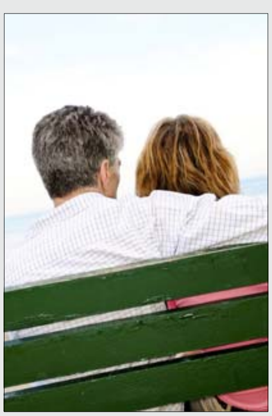
But the cash ran out. "It was a flash in the plan," says Meyer. "States and municipalities now find themselves in a budget crunch and they're right back to where they started in terms of having to lay people off," says Meyer. "So the stimulus in the longer term, I would say, was not successful because those were not sustainable jobs."

The multiplier effect, where spending by government stimulates more spending elsewhere in the economy, does not appear to have occurred. "If having a multiplier is your definition of a Keynesian success, the evidence of this most recent attempt to stimulate the economy with federal spending was that there was no multiplier, and the problem is you ended up by increasing the total debt by a material amount," says Meyer.

Does this prove the Keynesians wrong? No, because there were no shovel-ready projects in which to invest the stimulus funding. Since the execution of the government spending was flawed, you can't really know if the stimulus would have worked better if properly deployed. That likely will be a matter of study and debate in the years ahead. In the meantime, however, we do know the federal government is $1 trillion deeper in debt. ●

rise. Consider intermediate bond funds to complement your portfolio.

4. Remember the "i" word. Although inflation hasn't reared its ugly head in recent years, most financial analysts say it's only a question of when, not if, it will return in a big way. Take inflation projections into account when figuring out how much you'll need to sustain you through retirement.



5. Diversify your portfolio. Stock market volatility can be a nightmare for retirees living on fixed incomes. To keep your portfolio on a steadier course, follow the basic investment principle of diversification. And because overcompensating with ultraconservative investments may do more harm than good, seek alternatives that match up well with fixed-income investments and equities.

6. Reduce the tax bite. Although tax planning is especially difficult now, learn to adapt to changing rules and conditions. For instance, it may be sensible to convert savings from a traditional IRA to a Roth to secure future tax-free payouts. ●

Wealthy Investors Return To Alternatives

America's wealthiest investors are returning to hedge funds and other alternative investments in search of higher returns and other benefits.

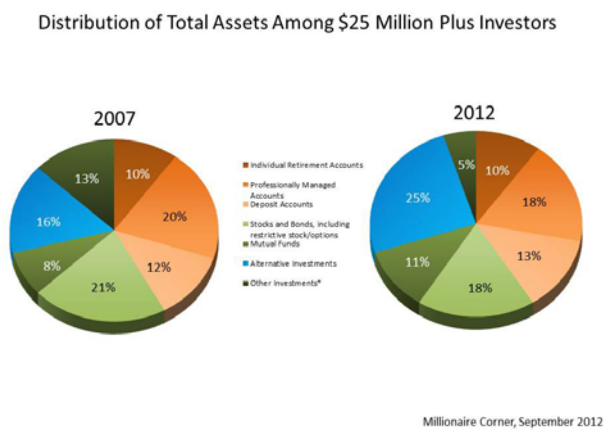
The ultra-wealthy (those with $25 million or more in net worth) are putting an average of 25% of their total investment assets in alternatives, compared with 20% in 2010 and 16% in 2007, according to Spectrem's $25MM+ Investor 2012 report. Nearly half of these households now own hedge funds, while stocks and bonds currently make up just 18% of their total investments—down from 20% in 2010 and 21% in 2007.

"One of the primary reasons the wealthy are investing in alternatives is because of their expectations for high returns," says Spectrem President George H. Walper, Jr., who noted that 60% of 201 respondents to a survey expect alternative investments to deliver annual returns of more than 9%. "These investors are able to manage their risk more effectively than other households because they have the assets to provide their own safety net," Walper adds.

Indeed, 55% of the respondents say it's more important to protect their principal than to grow their investments. Sixty-two percent also invest in individual stocks and 43% in money market funds and checking or savings accounts.

Fifty-five percent of the respondents are invested in private equity and 47% own hedge funds, while 45% own venture capital. Other alternatives mentioned include commodities, limited partnerships, and collateralized debt obligations.

Facing lagging market returns and likely tax increases, these wealthy investors hope alternatives can give them an edge. But should you adopt this strategy as well?



Even if your net worth is well below $25 million, alternative investments can play an important part in diversifying your portfolio. And you can get that diversification without hedge funds or private equity. Commodities-related investment vehicles may be more suitable, for instance, or real estate investment trusts. In helping you decide how to proceed, we will look at potential alternative investments within the context of your risk tolerance, goals, and overall financial situation.

Alternative investments have pros and cons that we'll help you factor into your choices. A chief benefit is that alternatives tend not to have a strong correlation with stock market results, so they may help buoy your portfolio when equities are sinking. But alternatives tend to have higher investment costs and to be less liquid than traditional assets. Alternatives also tend to be more complex, requiring specialized knowledge and more extensive research.

Let us help you navigate the complex world of alternative investments as you strive to make the most out of your investment dollars. ●

Don't Overlook Tax Benefits

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transferred within 180 days of the transaction or the due date of your tax return (plus extensions) for the tax year of the transfer—whichever comes first.

4. Step-up in basis at death. Under current federal tax laws, real estate inherited by the younger generation receives a "step-up" in basis upon the owner's death—that is, for capital gain purposes, the property's basis becomes its value on the date of death, rather than what it was worth when it was purchased. An inheritance of property will still be subject to estate tax, but it may be sheltered by the owner's estate tax exemption. (The exemption, $5.12 million for 2012, is scheduled to drop to $1 million in 2013, but that could be modified by Congress.)

The step-up in basis means there's no federal income tax on appreciation in a property's value during the time you owned the property. If your heirs then sell the property, they'll owe tax on only the difference between the selling price and the stepped-up basis.

Caution: Be aware of certain restrictions on the tax breaks for real estate owners. Most important, rules relating to "passive activities"—and that normally includes investor ownership of rental real estate—may limit the losses you can claim for such property. Generally, deductions are allowed only up to the amount of your income from that passive activity.

On the other hand, you may be in line for a complete or partial tax loss if you "materially participate" in a rental real estate activity (for example, managing tenants, arranging repairs, etc.), although this tax break is phased out for high-income taxpayers.

Investing in real estate is not for the meek. Usually, there's a large sum of money at stake. However, if you invest astutely, you may be able to benefit from a multitude of tax breaks as your fortune grows. ●

USA Asset Management, LLC
633 West 5th St., Suite 2600, Los Angeles, CA 90071 | Office: (213) 624-8886 | Toll Free: (888) 872-8898