RED HILLS CAPITAL

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Welcome back to the Red Hills Newsletter! I hope everyone is having an enjoyable summer and that we have all thanked Mr. Willis Carrier for his invention of air conditioning.

As promised, the newsletter is back with some observations about the market and economy – not all of which are dire – as well as a few articles about changing financial rules and maybe a useful (or at least interesting) note about HSAs.

We look forward to putting this information in your hands and please let us know what you think!

IN THIS ISSUE

Red Hills Capital is a Registered Investment Adviser based in Tallahassee. Since 2001, Red Hills has offered independent advice and individualized solutions to people, businesses, trusts, and non-profits.

From IRAs, stocks, mutual funds, bonds, and more, we craft individual solutions for your individual situation. Contact us today and let us build a solution for you.

Let's Make a Deal!

There were times during the debt ceiling debate that I thought Monty Hall's game show was more dignified than the process in Washington. In the end, as expected, a deal was struck, handshakes were exchanged, opinions were spun. Now the final votes have been cast and the debt deal has been approved and signed by the President, we can move on to how this deal and the rest of the economic world may affect your investments.

There are two major questions to be answered. First, will the USA lose its AAA credit rating for the first time? Second, is the global economy slowing into a second recession? First things first, there are multiple reasons to believe that a ratings downgrade is deserved. The US is in a more precarious financial position than at any time in recent years and the debt continues to grow even with the cuts planned by Congress. A downgrade could have an impact on the interest rates that affect you and I. However, none of our debt situation comes as a shock to the marketplace. The markets are aware of the downgrade risk and there has been little to no reaction in the interest rate markets. The 5-year Treasury bond pays slightly more than 1.3%. Think about that for a second ? people are willing to lend their money to the United States Government for five years and only want 1.3% in return. This number alone tells us that the global fear of the US falling into fiscal chaos is very low.

As to the second question, there have been recent data releases suggesting the global economies are slowing again. The US economy has grown at a much lower than expected rate during the first half of 2011; the European situation is not resolved; oil prices (and gasoline prices) have affected consumer spending to a degree. Despite these signs, I am not ready to throw in the towel on this recovery.

There is still life in corporate America, and there is plenty of cash waiting to be deployed into investment and expansion projects. The economy is like a patient that is no longer near death, but has a long road to recovery. There will surely be setbacks along the way.

On a brighter note, corporate earnings continue to come in nicely. These earnings have been the driver behind the market's improvement over the last 12 months (some 1500 Dow points). The outlook for earnings remains generally good and an improvement in market values between now and the end of the year seems very plausible. We reiterate our long-term view that the world has 6.5 billion people and is making more every day! The demand in markets like India and China (a combined 2.3 billion people or roughly seven times the population of the US) continues to increase. These increasing numbers of middle class workers will want better food to eat, better means of transportation, and more things in their homes. This belief underpins our focus on food, agriculture, energy (oil and gas), and basic materials (copper, aluminum, steel) companies. What happens over the next few years is anyone's guess, but the population realities should push those commodity-type stocks higher over the longer term.

Beyond the stock market itself, corporate bonds continue to perform well. Our focus continues to be shorter-term maturities as the interest rate risk may be significant. Should rates move higher, you can redeploy your bond funds at maturity in the higher interest rate environment. It seems unlikely that interest rates would move lower especially given that the shortest-term rates are effectively zero. In general, one would expect less volatility holding corporate bonds versus common stock. If the stock market is causing you any loss of sleep, let us know so we can revisit your allocations and overall objectives. Don't lose sleep over this stuff - that's what you hire us for!

See disclaimer on final page

The New Face of Socially Responsible Investing

Though past performance is no guarantee of future results, you should make sure your expectations (both financial and social) are realistic and in line with what you hope to achieve.

Feeling strongly about the societal benefit or harm your money might be supporting doesn't mean you have to forgo pursuing a return on your investments. Socially responsible investing allows you to further both your own economic interests and a greater good.

The concept of putting your money where your mouth is first gained widespread attention during the 1970s, when such highly charged political issues as the Vietnam War and apartheid in South Africa led some investors to try to make sure their money didn't support policies that were counter to their beliefs. Since then, a wide variety of investment products, such as socially conscious mutual funds, have been developed to help people invest in ways consistent with a personal philosophy. However, individuals aren't the only ones to adopt responsible investing principles; many colleges and universities, government pension and retirement funds, and religious groups do so as well.

There are many approaches to what may also be known as mission investing, double- or triple-bottom-line investing, ethical investing, socially conscious investing, green investing, sustainable investing, or impact investing.

Screening potential investments

This is perhaps the best known aspect of socially responsible investing: evaluating investments based not only on their finances but on their social, environmental, and even corporate governance practices. The process may be negative, eliminating companies whose products or actions are deemed contrary to the public good. Examples of companies that are frequently excluded from socially responsible funds are those involved with alcohol, tobacco, gambling, defense, and those that contribute to environmental pollution or that have significant interests in countries considered to have repressive or racist governments.

However, as socially responsible investing has evolved, the screening process has become increasingly positive, using screens to identify companies whose practices actively further a particular social good, such as protecting the environment. For example, green technology that can help address environmental problems has attracted the interest of many investors who see not only a social good but an opportunity for profit.

Shareholder activism

Both individual and institutional shareholders have become increasingly willing to pressure corporations to adopt socially responsible practices. In many cases, having a good social record can enhance business, making a company more attractive to investors. Shareholder advocacy can involve filing shareholder resolutions on such topics as corporate governance, climate change, political contributions, environmental impact, and labor practices. Such activism got a boost from the SEC when it adopted the so-called "say on pay" rule as part of the Dodd-Frank financial reforms. As of April 2011, companies over a certain size must allow shareholders a vote on executive pay at least once every three years. Though the vote is nonbinding, it could give institutional investors a stronger hand in advocating for other interests.

Community investing

Still another approach involves directing investment capital to communities and projects that may have difficulty getting traditional financing. Investors provide money that is then used to make or guarantee loans to organizations that help traditionally underserved populations with challenges such as gaining access to affordable housing, finding jobs, and receiving health care.

Impact investing

A recent development focuses not only on investment returns and social benefit, but on measuring and managing performance in both of those arenas. So-called "impact investing" aims not only to minimize negative impact and enhance social good, but to do so in a way that maximizes efficient use of the resources involved, using business-world methods such as benchmarking to compare returns and gauge how effectively an investment fulfills its goals. In fact, some have made a case for considering impact investing an emerging alternative asset class, since such investments may not be highly correlated with traditional assets such as stocks or bonds.

Know your goals

When investing for the greater good, make sure your expectations are clear and realistic. "The public good" may be defined differently by every investor. Also, many socially responsible funds achieve solid financial returns; others may not.

***Note:** Before investing in a mutual fund, carefully consider its investment objectives, risks, fees, and expenses, which can be found in the prospectus available from the fund; read it carefully before investing.*

Deciphering Health Savings Vehicles

Beginning January 1, 2011, for HSA, MSA, FSA, and HRA programs, a drug or medicine is considered a qualified medical expense only if it is obtained with a prescription, or is insulin.

Effective January 1, 2013, contributions to a flexible spending account will be limited to $2,500 per year, increased annually by cost-of-living adjustments.

Health savings accounts (HSAs), Archer medical savings accounts (MSAs), health reimbursement arrangements (HRAs), and flexible spending arrangements (FSAs) are all personal health accounts that may help you control your health-care costs. But trying to figure out what's what can be confusing. Here's a brief description of each type of account, including some of their major features and benefits.

MSAs/HSAs

As of January 1, 2008, the MSA program expired and no new MSAs can be established, although if you already participate in an MSA, you can continue to receive contributions. HSAs have generally taken the place of MSAs because of their greater flexibility and options. In fact, in most instances you can roll over an existing MSA into an HSA. MSAs and HSAs are set up in a trust account with a financial entity. Contributions made through your employer are pretax dollars (or you can contribute to the account directly and deduct the contribution), no tax is due on funds in the account, or on any earnings until withdrawn, and if funds are used for qualified medical expenses, the withdrawals are not taxed. However, account withdrawals that aren't used for qualified medical expenses are subject to a tax penalty of 20%, in addition to regular income tax. Your account is portable, meaning if you change employers or leave the workforce, you can keep the account. To be eligible, you must be insured by a high deductible health plan (HDHP) that you maintain (if self-employed) or that's provided through your employer.

However, there are also differences between MSAs and HSAs. Generally, anyone with an HDHP can participate in an HSA. But to qualify for an MSA, you must have been either an employee of a company that employs 50 or fewer people, or be self-employed (or the spouse of such an employee or self-employed person). With an HSA, contributions can be made by you, your employer, or anyone else on your behalf within the same plan year. But MSA contributions can only be made by either your employer or yourself, but not both, in the same plan year. Contribution amounts also differ. In 2011, maximum HSA contributions are limited to $3,050 for single HDHP coverage and $6,150 for family HDHP coverage. MSA contributions can be up to 75% (65% if you participate in a self-only plan) of the annual deductible of your HDHP, but no more than your annual earnings from employment.

FSAs

If you don't participate in an HDHP, you still can set money aside for uninsured medical expenses through an employer-established FSA. Unlike an HSA, you must be an employee of the employer providing the FSA in order to participate (self-employed persons are not eligible and certain limitations may apply if you are a highly compensated participant or key employee). Pretax contributions can be made by either you, your employer, or both of you (except employer contributions used to pay long-term care premiums must be included in income). You determine how much money you want deposited each year up to the plan's maximum dollar amount or percentage of compensation; funds in the account are not subject to tax; and distributions are tax free if used to pay for qualified, unreimbursed medical expenses you've incurred (no advance payments for anticipated expenses). Unlike HSAs, if you leave your employer, you can't keep the money in the account or take it with you to another employer (it's not portable). Also, what you don't spend on medical expenses by the end of the plan year is forfeited and not available the following year (i.e., you must use it or lose it).

HRAs

Like FSAs, HRAs are only available to employees, not to self-employed individuals. And HRAs must be funded solely by an employer; you can't contribute directly to the account. The terms of the HRA are generally determined by the employer. For example, your employer's plan may or may not require you to have health insurance in order to participate. The plan sets the maximum amount of contributions, and determines whether a credit balance in the account can be rolled over from year to year, and if so, how much of the account can be rolled over. But contributions and reimbursements for qualified medical expenses are tax free. Reimbursements can be made to current and former employees, including spouses and dependents of employees and deceased employees. However, if the plan allows for any distribution to you or anyone else (e.g., spouse, dependent, estate at your death) for other than reimbursement for qualified medical expenses, then any distribution, whether for qualified medical expenses or not, is included in gross income.

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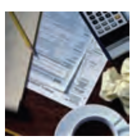
Ask the Experts

Can I make charitable contributions from my IRA?



Yes, if you qualify. The law authorizing "qualified charitable distributions," or QCDs, has recently been extended through 2011.

You simply direct your IRA trustee to make a distribution directly from your IRA (other than a SEP or SIMPLE) to a qualified charity. You must be 70½ or older, and the distribution must be one that would otherwise be taxable to you. You can exclude up to $100,000 of QCDs from your gross income in 2011. If you file a joint return, your spouse (if 70½ or older) can exclude an additional $100,000 of QCDs in 2011. But you can't also deduct QCDs as a charitable contribution on your federal income tax return--that would be double dipping.

QCDs count toward satisfying any required minimum distributions (RMDs) that you would otherwise have to take from your IRA in 2011, just as if you had received an actual distribution from the plan. However, distributions that you actually receive from your IRA (including RMDs) that you subsequently transfer to a charity cannot qualify as QCDs.

For example, assume that your RMD for 2011 is $25,000. In June 2011, you make a $15,000 QCD to Qualified Charity A. You exclude the $15,000 of QCDs from your 2011 gross income. Your $15,000 QCD satisfies $15,000 of your $25,000 RMD. You'll need to withdraw another $10,000 (or make an additional QCD) by December 31, 2011, to avoid a penalty.

You could instead take a distribution from your IRA and then donate the proceeds to a charity yourself, but this would be a bit more cumbersome, and possibly more expensive. You'd include the distribution in gross income and then take a corresponding income tax deduction for the charitable contribution. But the additional tax from the distribution may be more than the charitable deduction, due to IRS limits. QCDs avoid all this by providing an exclusion from income for the amount paid directly from your IRA to the charity--you don't report the IRS distribution in your gross income, and you don't take a deduction for the QCD. The exclusion from gross income for QCDs also provides a tax-effective way for taxpayers who don't itemize deductions to make charitable contributions.