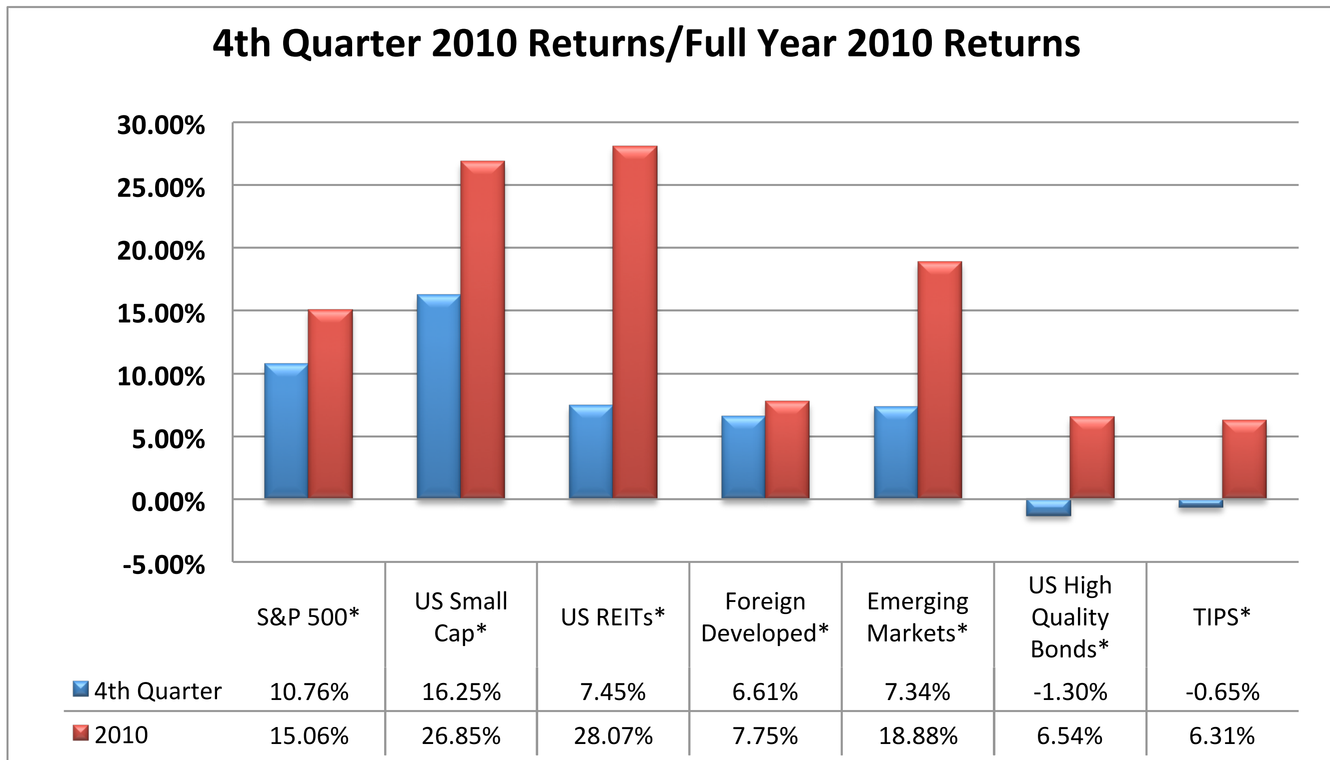
INTEGRAL FINANCIAL SOLUTIONS, LLC

Investment Management and Financial Planning

4Q10 Markets Summary and 2011 Outlook

By late December 2010, the Standard & Poor's 500 Index, a US large cap benchmark, met and surpassed its September 2008 level. This was the level at which Lehman Brothers went bankrupt, clearing a major psychological hurdle, especially for institutional investors.



** Benchmarks: S&P 500; Russell 2000 (US Small Cap); Dow Jones US Select REIT Index, MSCI EAFE (Foreign Developed) – US dollar, net dividend; MSCI Emerging Markets - US dollar, net dividend; Barclays Capital US Aggregate Bond Index (US High Quality Bonds); Barclays Capital US Treasury Inflation Protected Securities (TIPS)*
Source: Dimensional Fund Advisors

All stock and bond funds that we track advanced in 2010 despite difficulties that dragged markets lower during the second quarter. This drop in the stock markets lasted for several months and did not abate until a series of positive economic reports were released at the end of the summer. Ironically, it was also anticipation over further government stimulus spending (quantitative easing through the Federal Reserve) that drove markets higher starting in September.

In November, the Federal Reserve announced an additional round of quantitative easing (QE2) that is intended to keep rates low for the short term to stimulate borrowing. Despite QE2's program of buying $600B of US Treasury bonds between November 2010 and summer 2011, the rates on US bonds spiked after the mid-November announcement (driving their price down), finally leveling off in mid-December.

Economic variables

Throughout much of 2010, the US unemployment rate remained close to 10%. The California unemployment rate remained at 12.4%, the third highest state rate in the country. Despite these gloomy numbers, expectations are that in 2011 the unemployment rate will continue to decline slowly. GDP growth is slowly increasing; the consensus of economists is that growth needs to continue at 3.5% before the unemployment rate starts to noticeably decline.

Housing is the other major factor that will drive the US recovery. The current rate of sales is an annualized 4.68 million (12/2010), still short of the pre-recession trend of 5.50 million. On average across the US, home prices are stabilizing, but in the hardest hit states (CA, NV, AZ, FL), the change from 3Q09 – 3Q10 was -6% to -10%. Lenders continue to be cautious as the delinquency rates were at their highest (and expected to peak) in 2010 for both home and commercial real estate lending.

Inflation in the US remains low at around 1%, but it is creeping up in other countries. China recently raised its borrowing rate. The US is likely to raise rates once the recovery is more firmly established. Because rising interest rates adversely affect bond prices, we are keeping a close eye on developments.

Economic reports are just one factor that influence stock and bond market performance. Below is GDP data for a number of countries, including several emerging markets to make the point that strong GDP growth does not necessarily guarantee a strong year in the stock market. Instead, as you will hear from us frequently, we recommend a diversified portfolio across both stock and bond funds that contain all of these countries.

Country	GDP	2010 Stock Market Return (S&P 500 - US, MSCI - other countries)
USA	3Q10 2.6% (as of 12/22/10 revision) 4Q expected 3.4%	15.1%
Brazil	7.5%	6.5%
India	8.5%	20.9%
China	10.1%	4.6%
Germany	3.3%	8.4%
UK	0.7%	8.8%
Japan	3.6%	15.4%

Sources: CIA World Factbook, Union Bank, Financial Times, World Bank

Outlook for 2011 and Beyond

We are optimistic about the year ahead. The world economic and financial situation should continue to improve following the devastation of what economists now call the “Great Recession.” GDP growth rates are expected to be higher in emerging market countries which post-recession have stronger balance sheets than the debt-laden developed markets. The US and many developed countries are also expected to have positive GDP growth rates with a 2011 forecast of 3.3% in the US, although economists continue to keep a close eye on the peripheral European

countries (Portugal, Ireland, Italy, Spain, Greece) that continue to have problems managing and refinancing their debt loads.

We expect to see the economy continue to pick up as the overall jobs market continues to improve and real estate begins showing some positive signs; most observers predict US growth of approximately 3%. Positive factors include the accumulation of excess funds for investing in the growth of businesses and housing. Corporate earnings are steadily improving and, despite the approximately 15% increase in the U.S. broad market (as measured by the S&P 500) in 2010, equity valuations seem reasonable to us when compared against the 20-year average (source: Robert Shiller homepage: Cyclically Adjusted Price Earnings Ratio).

We want to remind clients to be patient with the recovery and to not expect miraculous improvements in 2011. These positive trends do not mean that the markets will appreciate quickly. The recession from which we just emerged was especially severe. Going forward governments, especially in developed markets, will need to wean themselves off stimulus spending. Housing will not fully recover until lending institutions demonstrate a greater willingness to loan the cash they have accumulated and only after unemployment drops significantly. Accordingly, we do not expect a full recovery for several years and, as the markets appreciate we expect continued volatility.

The uncertainty of our economy as compared with the performance of the markets since late 2007 demonstrates that there is still a place for both equity (stock) and fixed income (bond) funds in a diversified portfolio. For example, diversified portfolios of 60% equity /40% fixed income are approaching breakeven levels with the market peak in October 2007 and more conservative portfolios, i.e. those with more high quality fixed income allocations, are well past their October 2007 peak. By comparison, a 100% equity portfolio is still down over 10%.

At IFS, we remain committed to leading our clients through this uncertainty and will continue to recommend you stay with your long-term portfolio allocation unless there is a major life event that justifies a change.

New Tax Law – Income and Estate Taxes

In late December, after much confusion over income and estate taxes, the tax cuts [enacted under President Bush in 2001] were extended for two more years (2011 and 2012), with some modifications that modestly reduce the amount of Social Security withholding and significantly change the federal estate and gift tax rules. Following is a summary of the major provisions of the tax package:

Reduced Social Security Withholding
For individuals earning wages subject to social security withholding (FICA), the new tax law includes a social security tax savings of 2%. For example, for individuals with employment income of $106,800 or more, the tax break will provide $2,136 in additional cash.

Income and Capital Gains Taxes
The existing income tax rates and capital gains rates will be extended for another two years. For most taxpayers, this will not have an impact on year-to-year tax planning unless there are significant changes in the amount or sources of your income during 2011 and 2012. Nevertheless,

the tax extension can impact decisions to be made by taxpayers who made Roth conversions last year.

Roth Conversions
Beginning in 2010, taxpayers were allowed to convert funds from their traditional IRAs, 401(k)'s (in some cases) or other qualified plans to Roth IRAs, regardless of income. For individuals that elected to make a conversion last year, you have the added bonus of being able to choose between either paying all the income tax on the converted amount in 2010 (based on 2010 rates) or splitting the tax bill evenly over 2011 and 2012. The problem in the past was not knowing what the tax rate would be in 2011 and 2012.

Due to the extension of the current tax rates through 2012, it will make sense for most taxpayers to spread and recognize the income from a Roth conversion over two years, 2011 and 2012. You do not have to make the final decision until you file your 2010 tax return (as late as October 17, 2011 if you file for extension). If you believe your income was significantly lower in 2010 than it will be in 2011 and 2012, then we recommend that you speak with your accountant to see if it would make sense to pay the tax bill when you file your 2010 return.

Capital Gains
If you have highly appreciated assets, such as real estate or stocks, you may want to take advantage of the continued capital gains rates. At 15%, federal capital gains rates remain relatively low through 2012. Assuming the rate increases after 2012, you will pay less in taxes on gains you realize over the next two years.

Alternatively, gifting highly appreciated assets is still a good tax savings strategy.

New Tax Law - Estate and Gift Tax Exemptions

2010 Tax Relief Act
Effective for 2011 and 2012

Estate Tax Exemption:	$5 million
GST Tax Exemption: (Generation Skipping Transfer)	$5 million
Tax rate (estates over $5 million):	35%
Annual Gift Exclusion:	$13,000
Lifetime Gift Tax Exemption:	$5 million

Estate Tax Exemptions
For the next two years, estates for a single person of $5 million and less will be exempt from estate taxes ($10 million for married couples- there is now a provision allowing for portability between married couples to take advantage of the entire $10 million).

In 2001, when the Bush tax cuts were passed, the estate tax exemption was $675,000 per person, increasing incrementally through the decade to $3.5 million per person in 2009 and no estate tax

in 2010 with the possibility of the estate tax reverting back to estates greater than $1 million per person in 2011 if Congress did not act.

In 2011 and 2012, for estates greater than $5 million for a single person and $10 million for a married couple, the new estate tax rate is 35%, lower than the 45% rate that was in place in 2009 and 55% that would have been the new rate if the Bush tax cuts had been allowed to expire.

Gift Tax
The gift tax is now unified with the estate tax, so you can give away up to $5 million of appreciating assets like stocks and real estate (keeping the future appreciation out of your taxable estate) over the next years without paying a federal gift tax. This can be on top of cash gifts that take advantage of the $13,000 annual exclusion and on top of cash gifts to directly pay college tuition or medical expenses. If you make gifts that chip away at your $5 million federal gift tax exemption, your $5 million federal estate tax exemption is reduced dollar-for-dollar.

Beyond 2012

By extending the tax cuts in 2011 and 2012, the government has added another $858 billion to the federal budget deficit. Not surprising, the extension was well received by the American public and the securities markets. *Who doesn't like a tax break?* At the same time, there is not a consensus whether this decision will help our economy.

There's an old adage, fill a room with economists and you will never get agreement. In this instance, some economists would argue that we cannot afford to increase our national deficit, while others would argue that this is not the time to increase taxes.

Either way, Congress has managed to "kick the can down the road" until 2013. What happens in 2013 and beyond will probably depend on how the 2012 election turns out. If Congress does not act by the end of 2012, these tax cuts will expire, resulting in higher taxes for all income tax brackets, a higher capital gains rate and a reversion to an estate tax exemption of only $1 million and a maximum estate tax rate of 55%.

We recommend that you meet with your estate planning attorney and discuss your current estate planning documents. Having said that, depending on what transpires in 2012, you may have to update your estate planning documents again to reflect the rules that will apply for 2013 and beyond.

We remind our clients that we are not accountants or attorneys. If you have tax related or estate planning questions, we recommend you contact your accountant or attorney. If you need a referral, we are always happy to provide the names of accountants and attorneys. Recognizing that tax planning and estate planning are integral to financial planning and investment management, we work closely with a strong network of professionals, making it a point to understand their practices so we can make referrals based on your individual circumstances. In addition, as part of our practice we will work with your accountant and attorney on your personal financial planning needs.

Thank you for your continued confidence in our firm.