Condor Capital
Investment Management

Condor Capital

1973 Washington Valley
Martinsville, NJ 08836
(p) 732-356-7323
(f) 732-356-5875
info@condorcapital.com

Despite continued Eurozone worries, U.S. stocks rallied amid hope for a solution and solid domestic economic data.

High yield bonds rebounded as investors' risk aversion diminished.

Strong corporate fundamentals, attractive valuations, and a gradually improving labor market bode well for investors going into 2012.

...more than just an investment manager

Condor Capital Reviews 4th Quarter 2011

Despite a continued focus on events abroad, domestic stocks fared well during the final three months of 2011. A continued rise in sovereign bond yields in certain European nations and a tepid response to a German bond auction caused investors to worry that the debt crisis was deepening. However, encouraging domestic economic data, coordinated action by global central banks, and hope for a comprehensive solution in Europe allowed the S&P 500 Index to rise 11.82% for the quarter.

Overall, a turbulent and trying year for investors ended with the S&P 500 Index gaining 2.11%. Despite a strong showing in the fourth quarter, mid- and small-caps underperformed in the year, with the Russell Mid Cap Index and Russell 2000 Index falling 1.55% and 4.18%, respectively. Although growth-oriented companies outperformed value-slanted names in the large- and small-cap spaces, value outperformed growth by a slim margin in the mid-cap universe. Even though returns for domestic stocks were not spectacular, they easily outpaced the struggling international markets as the impact of the debt crisis in Europe took its toll. Against this backdrop, the MSCI EAFE Index fell 12.14%. As for developing markets, fears of continued inflation pressures, the potential for slowing growth, and investors' risk aversion caused the MSCI Emerging Markets Index to fall 18.42% in 2011.

An interesting dichotomy emerged in the fixed income markets over the past three months, illustrating the push-pull relationship between an improving domestic economy and negative sentiment regarding the situation in Europe. While government bond yields edged lower, hinting that investors remained cautious, a rally in high yield bonds indicated that investors' risk appetite increased. With that being said, the yield on the benchmark 10-year Treasury was 1.88% at year-end, down from 3.29% at the start of 2011. For the year, the Citi Corporate Bond Index returned 8.26%, while the CSFB High Yield Index rose 5.47%. Municipal bonds overcame some worries earlier in the year to deliver a strong performance, with the Lipper Municipal Fund Index gaining 10.96% in 2011.

While no changes were made to its interest rate policy during the quarter, the Federal Reserve participated in a coordinated move with central banks across the globe in order to lower the cost of U.S. dollar funding, which was aimed at improving liquidity in the European financial system. In addition to easing fears over the stability of EU banks, it also signaled that world leaders may be ready to take decisive action to prevent another financial crisis.

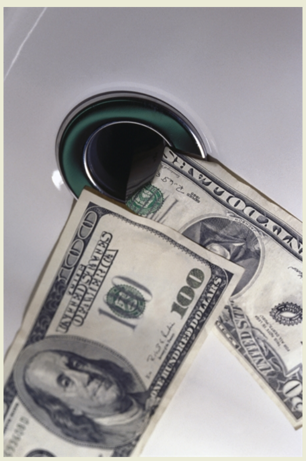
Outlook - With economic data continuing to improve, prior chatter of a second recession has abated. Furthermore, a steady decline in weekly jobless claims suggests that progress in the labor market may be picking up steam. Fundamentals at many domestic corporations also remain strong, with profit margins near all-time highs and S&P 500 companies collectively holding over $2 trillion in cash. We see the next year bringing increased confidence in the broader economy, which should result in an increased deployment of this record cash hoard in the form of share repurchases, dividends, and capital investment.

Despite strong underlying trends, equity valuations remain attractive, with stocks trading at a discount to historical averages. Emerging market stocks could also be in store for a strong year as easing inflationary pressures may allow for more dovish monetary policies. With regards to Europe, it is important to note that while we believe a sweeping agreement will be reached in the coming year, there may still be some bumps along the way as various nations and leaders engage in brinksmanship in order to advance their agendas. As for fixed income, we continue to favor corporate bonds over low-yielding government issues given the strength of corporate balance sheets. High yield bonds also appear attractive, as credit spreads remain elevated despite below-average default rates and a gradually improving economy. With many local governments taking the first steps towards getting their fiscal houses in order, municipal bonds also look appealing. Although negative sentiment remains pervasive, we believe there are sufficient catalysts to make 2012 a solid year for investors.

See disclaimer on final page

The Problem with Do-It-Yourself Estate Planning

The one-size-fits-all fill-in-the-blank forms that do-it-yourself estate planning sources provide may be attractive to some individuals because they cost a fraction of what attorneys typically charge. But is saving a few dollars worth the risk and potentially high cost of doing things incorrectly?



As the number of Internet websites and software packages have quickly multiplied, along with the many books and stationery store kits that have always been available, do-it-yourself (DIY) estate planning is on the rise. The one-size-fits-all fill-in-the-blank forms that these sources provide may be attractive to some individuals because they cost a fraction of what attorneys typically charge. But is saving a few dollars worth the risk and potentially high cost of doing things incorrectly?

Cheap, easy, and better than nothing?

Proponents of DIY estate planning typically have two arguments:

1. It's cheap and easy: A will, for instance, can be completed online in about 15 minutes for about $69. In comparison, working with an experienced attorney to create common estate planning documents (wills, trusts, health-care directives, and powers of attorney) may cost you anywhere from $800 to $3,000 or more, depending on the complexity of your estate.
2. It's better than nothing: The consequences of dying without estate planning documents are that the state will make important decisions for you, such as how your property will be distributed, who will care for your minor children, and what medical care you'll receive if you are unable to make your wishes known.

These points are valid; for those who cannot afford to pay an attorney, DIY may be the only economical alternative available. For others, a poorly drafted will is better than no will at all, especially where the naming of a guardian for minor children is involved. But the chances that DIY estate planning will effectively accomplish exactly what you intend is slim. Here's why.

It's too easy to make mistakes

DIY sources typically only handle simple estates, and can't deal with even the most common complexities such as children from a prior marriage, children with special needs, property that has appreciated in value resulting in capital gains, or estates that are large enough to be subject to estate taxes. And, DIY sources generally fail altogether to take advantage of sophisticated estate planning strategies because they typically can't account for an individual's unique circumstances.

Further, you may make an error by failing to understand the instructions or by following the instructions incorrectly.

The result is that the documents you create could be invalid, ineffective, or contain legal language having consequences you never intended. You might not know if that is the case during your lifetime, but at your death your loved ones will find out and may suffer the lasting consequences of your mistakes.

You're not getting legal advice

DIY sources provide forms but not legal advice. In fact, these sources clearly state that they are not a substitute for an attorney, and that they are prohibited from providing any kind of legal advice.

Estate planning involves a lot more than producing documents. It's impossible to know, without a legal education and years of experience, what the right legal solution is to your particular situation and what planning opportunities are available. The actual documents produced are simply tools to put into effect a plan that should be specifically tailored to your circumstances and goals.

Estate planning laws change

Laws are not static. They constantly change because of new case law and legislation, especially when it comes to estate taxes. Attorneys keep up with these changes. DIY websites, makers of software, and other sources may not do as good a job at keeping current and up-to-date.

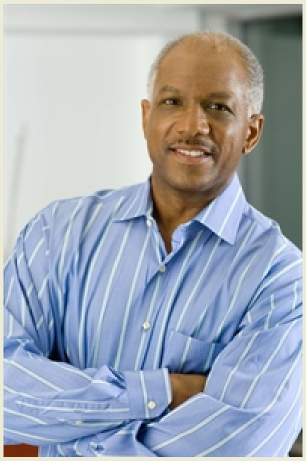
Fixing mistakes can be costly

As previously stated, estate planning documents can be obtained from a lawyer for $800 to $3,000 or more, depending on the complexity of your estate. But these costs are minor in comparison to the costs that your loved ones may incur if there are serious errors in your DIY estate planning. Many more thousands of dollars may have to be spent by your loved ones to undo what was done wrong.

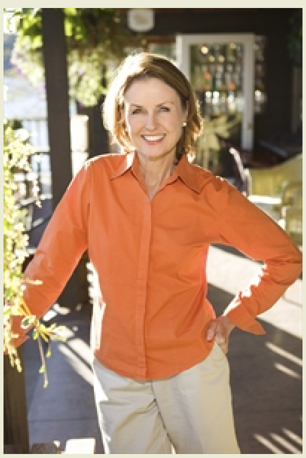
The bottom line

There are obvious savings in legal fees by using form wills and trusts, but there are also risks involved. One of them is that problems such as defective forms, violations of state law, or improper witnessing will not be apparent to you when the documents are signed. It may be only after death occurs many years later when the problems are discovered, and at that point it may be very costly, or even worse, too late to revise the documents.

How Much Do You Know about Social Security?



For more information, visit the Social Security website at www.socialsecurity.gov or call 800-772-1213.



Social Security is in the news more and more, as the first wave of baby boomers retire and economic pressures on the program increase. More than 90% of Americans are covered by Social Security,* but how much do you know about this important program?

How is Social Security funded?

Unlike many government programs, Social Security is funded primarily through the collection of payroll taxes. In 2010, 81.9% of funding came from this source, with the rest derived from interest earned on government bonds held by Social Security trust funds and income taxes paid on benefits.* That's why Social Security is known as a "pay-as-you-go" system. However, someone working and paying Social Security taxes today is not funding his or her own benefits, but is funding the benefits of someone who is receiving them now or in the near future--one of the reasons why Social Security is facing a potential funding shortfall. According to the Social Security Administration (SSA), the number of retired workers will double in less than 30 years, but there will be fewer workers paying into the system. And with life expectancies increasing, benefits will be paid for a longer period.*

How are earnings reported to the SSA?

If you work for an employer, your employer will send a copy of your W-2 form annually to the SSA. If you're self-employed, the IRS will report your earnings to the SSA annually after your federal income tax return has been processed.

What benefits are available?

Although Social Security is known as a retirement program, benefits are paid to people of all ages, including surviving family members and disabled individuals. In 2010, 5.7 million people were awarded Social Security benefits. Of those, 46% were retired workers, 36% were survivors or spouses/children of retired or disabled workers, and 18% were disabled workers.*

How do you qualify for benefits?

As you work and pay payroll taxes, you earn Social Security credits. Generally, you need to work 10 years to earn enough credits to qualify for retirement benefits--other benefits have different requirements. Contact the SSA if you have any questions about your benefit entitlement.

Do most people apply for early retirement benefits?

Yes. According to a report by the Government Accounting Office (GAO), 43% of people take early retirement benefits at age 62, while almost 73% of people apply for benefits before they reach full retirement age.**

How much more will you receive if you delay applying for benefits?

For each year past your full retirement age you delay receiving benefits, your Social Security benefit will increase by a certain percentage (8% for anyone who was born in 1943 or later). For example, if your full retirement age is 66 and you delay receiving benefits until age 70, your annual benefit will be 32% higher.

Can you receive benefits based on an ex-spouse's record?

You may qualify for divorced spousal benefits if you were married for at least 10 years, you haven't remarried, you are age 62 or older, and you don't qualify for a higher benefit based on your own work record.

Do workers with lower earnings receive more from Social Security?

A worker who has lower earnings will receive a lower monthly benefit than someone with higher earnings because benefits are based on average lifetime earnings (the highest 35 years of earnings are used in the calculation). However, the Social Security benefit formula is designed to ensure that workers with lower earnings receive a greater percentage of their preretirement earnings. For example, a worker with relatively low earnings may receive a benefit that is approximately 55% of his or her preretirement earnings, while a worker with relatively high earnings may receive a benefit that is approximately 25% of his or her earnings.***

Do you have to stop working to receive Social Security retirement benefits?

No. As long as you've reached early retirement age and meet eligibility requirements, you can apply for Social Security benefits even if you decide to continue working. However, if you're younger than full retirement age and earn more than a certain amount, your benefits will be temporarily reduced (once you reach full retirement age, your benefits will be increased to account for the money that was withheld).

***Source:** *Fast Facts & Figures About Social Security, 2011*

****Source:** *GAO-11-400, Retirement Income, June 2011, based on data compiled by the SSA Office of the Chief Actuary*

*****Source:** *SSA Publication No. 05-10045, 2011*

Ask the Experts

Condor Capital

1973 Washington Valley
Martinsville, NJ 08836
(p) 732-356-7323
(f) 732-356-5875
info@condorcapital.com

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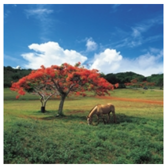

Are hobby expenses deductible?

So, you have a hobby that you enjoy. Lately, you have been viewing the hobby as a possible source of income. Of course, you will have to report that income on your income tax return. But can you deduct your hobby expenses?

If your activity qualifies as a business, you are able to deduct qualified business expenses, even if they exceed income from your business. However, there is a hobby loss rule designed to limit the deduction of losses when an activity is not carried on to make a profit. (The rule does not apply to C corporations.)

Whether you carry on an activity to make a profit is determined by all relevant facts and circumstances. However, your activity will be presumed carried on for profit if it produces a profit in at least three of the last five years (two out of seven for certain activities involving horses). The IRS can rebut this presumption.

When you first start out, it may be difficult to show a profit. You can elect to have the three out of five years (or two out of seven years) presumption made after you have the five (or seven) years of experience allowed by the test. You do this by filing Form 5213 (generally, within three years of the due date--determined without extensions--for filing your income tax return for the first year of the activity). Filing the form delays the IRS determination of whether your activity was carried on for a profit. It also extends the period of limitations for possible denial of hobby loss deductions until two years after the end of the five- (or seven-) year period.

If your activity is not carried on for profit, deductions from the activity are limited:

1. You can take any deductions that would be allowable for personal purposes, such as real estate taxes or home mortgage interest.
2. Deductions that do not result in an adjustment to basis can be taken, limited to the excess of income from the activity over deductions in (1).
3. Deductions that result in an adjustment to basis (for example, depreciation) can be taken, limited to the excess of income from the activity over deductions in (1) and (2).

Deductions claimed under (2) or (3) are miscellaneous deductions, which are allowable only to the extent all such deductions exceed 2% of your adjusted gross income.

Are business start-up costs deductible?

Generally, costs that you incur prior to the time that you actually begin operating a business are treated as capital expenditures, which are part of your basis in the business. However, certain start-up expenditures may be deducted, either in the first year of business or over time (amortized).

Such start-up costs must be incurred before the business begins operation and be ones that otherwise would be deductible as a normal business expense. Certain syndication costs of marketing or selling interests in a new business cannot be deducted, and must be capitalized.

You may elect to deduct your business start-up costs. If you make the election, you may deduct up to $5,000 of start-up costs in the taxable year in which you actively start the business. The $5,000 amount is reduced (but not below zero) to the extent that start-up costs for the business exceed $50,000. Thus, no first-year deduction is available if start-up costs exceed $55,000. The remainder of the start-up costs are amortized over a period of 180 months. If you do not elect to deduct your start-up costs, you must capitalize them.

You deduct amortized start-up costs in equal amounts over a period of 180 months. You take the total start-up costs, reduced by the amount you deduct in the year you start the business, and divide that amount by the 180 months in the amortization period. This figure is the amount deductible each month. If the business is terminated before the end of the 180-month amortization period, you may be able to deduct as a business loss any remaining start-up costs that have not been previously deducted.

Example: *You incur $52,000 of costs starting up your business before it begins operation and elect to deduct start-up costs. In the year your business actively starts, you can deduct $3,000 of start-up costs [$5,000 - ($52,000 - $50,000)]. You can also deduct the remaining $49,000 ratably over 180 months, or $272.22 a month for 180 months; your deduction for a year with 12 months of amortization would be $3,266.67.*

Tip: *You are deemed to have elected to deduct eligible start-up expenses unless you affirmatively elect to capitalize the expenses on a timely filed federal income tax return.*