GLOBAL WEALTH ADVISORS LLC
Registered Investment Advisor

INSIGHTS

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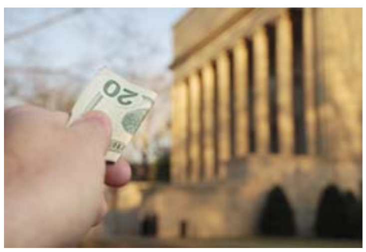
U.S. Government Bailouts Have A Mixed Record

The final cost of the U.S. government's still-evolving rescue plan for the nation's financial institutions may be impossible to tally. Beyond parceling out the $700 billion of the Troubled Asset Relief Program (TARP), the U.S. Treasury Department and the Federal Reserve are providing wide-ranging financing, loan guarantees, and foreclosure relief for homeowners. But whatever the price tag, and however much or little of its investment the government eventually recoups, the plan will ultimately be judged on whether it accomplished what it set out to do—avoid massive bank failures, thaw frozen credit markets, stabilize home prices, and just generally pull the nation out of its economic tailspin.



Those are ambitious goals, but this is hardly the first time the government has attempted to save threatened industries or companies. ProPublica, a public interest news organization, recently compiled a list of 15 U.S. bailouts that begins with the 1970 rescue of the Penn Central Railroad and continues through today's multiple efforts. Though some initiatives managed to stabilize important American institutions, the overall record has been decidedly mixed.

Typically, the government steps in only after its hand has been forced. In the case of Penn Central, for example, the railroad was nearly bankrupt when it asked for help from the Federal Reserve, arguing that support was vital because the railroad transported goods essential for national defense. But Congress balked and Penn Central, which had placed large bets on real estate and other non-railroad investments, declared bankruptcy to avoid repaying debts owed to numerous commercial banks. Fearing a chain reaction of bank failures, the Fed in 1971 provided almost $700 million in loan guarantees. In 1976, the U.S. merged Penn Central with five other rail carriers into Conrail, a national freight railroad company, and later sold the company to private investors. All told, the government spent almost $20 billion to keep Conrail running, then recouped about $4 billion on the sale.

Other transportation industries have needed their own bailouts. Defense contractor Lockheed, which made military aircraft, wanted to produce commercial jets as well, but problems with its first passenger plane left the company in dire financial straits. In August 1971, Congress passed the Emergency Loan Guarantee Act, and to save 60,000 jobs in California and avoid a threat to national defense, the government guaranteed $250 million in financing (more than $1.3 billion in 2008 dollars). Lockheed repaid the loans by 1976, according to ProPublica, and the U.S. actually made money on the deal,

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A Personal Note From Global Wealth Advisors

Following the pattern from last quarter, the equity markets have continued to rebound from their March levels. Economists generally agree that the economy seems to have bottomed out after 18 months of decline. While we hope (and many leading indicators show) that this is the turning point, only time will tell. In any event, we believe that capitalism and free markets will prevail.

Meanwhile, our congressional leaders face volatile reaction in many quarters to the proposed healthcare reform. Myths and mischaracterization on both sides of the debate do not help to propel the discussion to a rational and bipartisan program, but rather will tend to paralyze the process. We will continue to participate in the debate with our congressional contacts and encourage you to do the same.

You will also observe the customary variety of articles in this issue, ranging from investments to estate planning and college funding. The piece relating to the Madoff Ponzi scheme reinforces the wisdom of choosing an advisor who uses an independent custodian subject to stringent audit requirements.

As always, feel free to contact us if you wish to discuss any aspect of your financial and investment planning. Thanks for your continued confidence.

Jim Knaus Mike Krencicki

Red Flags Raised By Madoff's Scheme

The recent revelations concerning Bernard Madoff's "Ponzi scheme" have put the fear of fraud in investors. Even if you never came anywhere near Madoff Securities, you may sympathize with those who reportedly were bilked out of billions of dollars. And you'll probably wonder whether something similar could happen to you.

According to Madoff's indictment, his truly was a scandal for the rich and famous, who were drawn in not by a chance to make a quick killing but by rock-steady annual returns of 10% to 12% regardless of the state of the markets. Although there are no guarantees that any financial manager is on the up-and-up, a closer examination of Madoff's operation would have revealed several "red flags," giving investors pause.

The mere fact that he had an unwavering track record should have been the first and biggest warning sign. Normally, even the best-diversified portfolios will rise and fall with the markets; the hope is merely for a smoother-than-normal ride and better-than-average results. In addition, Madoff took the unusual step of assuming full custody of client assets, rather than using a nationally recognized custodian. That, too, should have set off alarm bells. But there were also other problems.

Madoff's books were audited by a little-known accounting firm. That's extremely unusual for such a major investment company. Normally, big investment managers use a Big Four national accountant or at least a prominent regional firm—and investors thinking about entrusting Madoff with millions of dollars in assets should have been wary.

The lack of information on Madoff's website and in his brochures was telling. There was nothing about the qualifications or designations of the firm's money managers, and scant information about Madoff's process for managing assets. If investors had compared these marketing materials to those of other, more forthcoming investment firms, they might have been more inclined to question Madoff's apparently remarkable results. Those who did try to decipher how Madoff worked his magic found they couldn't replicate his results—it just seemed impossible to deliver that kind of performance. It was.

There was no evidence of diversification. The kind of astonishingly steady returns Madoff used to attract investors, if feasible at all, should require broadly spreading assets over many kinds of investments and regularly rebalancing to keep investment risks under control.

As more details about Madoff's dealings emerge, investors may get a clearer picture of what went wrong. In the meantime, the scandal reminds everyone that there are no shortcuts to investment success, and that when results seem too good to be true, they almost always are. ●

Keep A Leash On Part Of Your Estate

It's standard practice for wealthy individuals to transfer much of their assets to one or more trusts. Handled properly, a trust can provide a stream of annual income until the assets eventually pass to the beneficiaries—typically, children or grandchildren—free of federal estate tax.

But these benefits come at a price that may seem particularly steep in some cases. In order for assets to be removed from your taxable estate, the trust generally must be irrevocable, and you have to give up control over all of its assets. Typically, you'll cede your power to a trustee institution or individual you designate. But giving up control can be a real sticking point, especially if a business interest represents the bulk of your estate.

One solution is to set up a "directed trust" that enables you to continue to exert influence without jeopardizing the estate tax shelter. It's like keeping a leash on your business interest.

The basic concept of a directed trust is relatively simple. The trustee of a trust holding your assets agrees to be "directed" by another party regarding how some or all of the assets are managed. In effect, this splits the trustee's duties, leaving some responsibilities to the trustee and others to a third party you designate. Directed trusts are sometimes used to provide investment management by an entity other than the trustee institution. But a directed trust could also separate the management of your business, with the trustee agreeing to have that job handled by another person or group of people. Often, the optimal choice to manage a business will be other family members already involved in the operation. If this is part of a succession plan for the business, there may be additional tax advantages.

In many cases, trustees are receptive to having someone else handle part of the estate. Managing a

College Savings Plans For A Grandchild

Let's say you've managed to reach retirement in great financial shape. Your home is paid for, you have plenty of money available to travel and enjoy your hobbies, and you've accumulated enough funds to provide security for the rest of your years. What's more, your children are out on their own and doing reasonably well. It may seem as if you've addressed all of your major financial obligations. Chances are, however, that your children could still use your assistance, especially when it comes time to pay for their offspring's college education.

According to the College Board, the average cost of tuition and fees at a private college for the 2008-2009 school year was $25,143, up 5.9% from the previous year. And the cost of attending many top private schools can be much higher. Moreover, with inflation in college expenses outpacing overall price increases each and every year, it's tough even to guess how much college will cost by the time your grandchildren matriculate.

But if you'd like to help with that major future expense, you don't have to wait until the tuition bills come due. You can set up a Section 529 college savings plan now that will pay some, most, or all of a grandchild's education costs. Every state offers these plans, and most are open to non-residents as well.

There are actually two types of 529 plans—prepaid tuition plans and investment plans. With a prepaid tuition plan, you pay for future tuition in today's dollars. Most of these cover costs at state schools; if current tuition is $10,000, for example, a contribution of that amount now will be guaranteed to pay 100% of a year's tuition whenever your grandchild enters school. But most grandparents opt for investment plans that offer greater flexibility, though without a tuition guarantee. If the plan investments perform well, the returns could potentially match or beat annual tuition increases, but they could also lose value if the underlying investments depreciate as they did in 2008 and early 2009.

Most plans offer multiple investment options that may include a target-date portfolio (based on the year a child will enter school) that gradually adjusts allocations from a stock-heavy mix during the early years to a more conservative strategy as freshman year approaches. Other state plans manage 529 money alongside state pension assets, while still others let you set your own asset allocations.

Each state establishes the contribution limits for its own college savings plans, but the caps tend to be generous, reflecting the high future cost of college. Also, though many people believe otherwise, plan beneficiaries aren't required to attend school in their home state. The full value of the account may be used at any accredited college and university in the country—and even at selected foreign institutions.

If you set up a plan for a grandchild who doesn't go to college, you can roll over the funds tax-free into an account for a different beneficiary, such as another grandchild. But distributions from the account must begin when the eventual beneficiary reaches age 30.

In all 529 plans, earnings accumulate tax free for both federal and state purposes, and distributions are exempt from federal and state income tax as long as the funds are used for qualified educational expenses. Many states also offer state tax deductions or credits to residents who choose their plans.

If plan funds are withdrawn for other uses, earnings on plan distributions will be taxed at ordinary income rates, and there will also be a 10% federal penalty unless the beneficiary has died, become disabled, or doesn't need the money because he or she received a scholarship. States may assess additional penalties.

Finally, though your contributions to a Section 529 plan are considered gifts, you may give up to $13,000 a year without gift tax consequences to one or several beneficiaries. And if you're married, your spouse can kick in another gift-tax-exempt $13,000 per grandchild. Moreover, special rules for 529 plans let you make five years of contributions in a single year. That's a total of $65,000 per spouse for each beneficiary. Want to establish 529s this year for three grandchildren? Together with your spouse you could give $130,000 per child, or a total of $390,000, without owing gift tax.

The bottom line is that helping with your grandchildren's college costs not only reduces the burden on your children; it also reduces the size of your taxable estate. That makes this option worth considering as part of your overall estate plan. We urge you to discuss your goals with us and also with your children so that funding college is a coordinated effort of all parties. ●

business may not be something the trustee is comfortable doing, and from your point of view, family members with experience in the company will be more likely to take the business in the direction you've set for it.

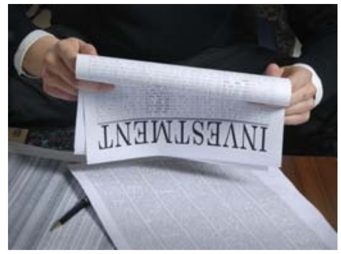
Some 30 states have laws encouraging the use of directed trusts. But banks and other trustees aren't likely to agree to a directed trust unless the trust holds assets worth several million dollars, and some institutions won't touch a directed trust with less than $25 million. Moreover, the trustee may assess fees based on the entire value of the trust, including the assets it isn't managing.

Also keep in mind that states impose varying standards of liability for trustees of directed trusts, with some states shielding trustees from accountability if any part of the trust is managed by someone else. We can work with you and your attorney to see whether a directed trust could work in your state and would serve your needs. ●

Rules Tightened On Indexed Annuities

The Securities and Exchange Commission (SEC) may regulate most equity-indexed annuities (EIAs) sold after January 12, 2011. An SEC rule approved December 17, 2008 is likely to move the lion's share of indexed annuities out of the realm of state-regulated insurance products, though state regulators, insurance companies, and agents are fighting the change, and the dispute may end up in court. If the regulatory shift occurs, it could bring increased scrutiny of EIAs, which are complex and may carry high costs and other characteristics that undercut their goal of providing guaranteed retirement income partly linked to stock market performance.

Equity-indexed annuities exist in a gray area between fixed annuities and variable annuities. Fixed annuities are insurance products, with an insurer typically promising a fixed rate of return on premiums and the annuity purchaser assuming no investment risk (only risk of default from the annuity provider). With a variable annuity, there is investment risk, because the premium is invested in securities that may lose value. EIAs, though regarded as a kind of fixed annuity, offer a link to the performance of a stock index such as the Standard & Poor's 500 that could boost returns. As investments, variable annuities are SEC-regulated, while fixed annuities—including, until now, EIAs—are regulated as insurance.



When markets rise, EIAs can deliver appealing returns, and they've become popular, with a total of more than $120 billion invested in EIAs at the end of 2008, according to the SEC. But the link between performance of an underlying stock index and investors' returns may be complicated, and annuity contract holders aren't credited with the index's full gain.

In down markets, EIAs may also be helpful, providing a guaranteed minimum return that varies according to state requirements. That positive yield, usually a few percent of a portion of premiums paid, is preferable to the double-digit losses most stock-and-bond portfolios racked up in 2008. In the early years of EIA contracts, there are surrender charges that could undercut returns, though those aren't likely to apply during retirement, when most contract holders make withdrawals.

The new SEC rule provides that an indexed annuity is an investment—and thus will be SEC-regulated—"if the amounts payable by the insurer under the contract are more likely than not to exceed the amounts guaranteed under the contract," according to SEC comments issued with the rule. How a particular EIA is defined will be decided before the annuity is sold, so investors will know whether they're buying an investment or an insurance product.

These tighter rules could help clarify the risks and potential benefits of EIAs. The best of the breed may belong in some investors' portfolios, and we can help you weigh the pros and cons. ●

Bailouts Mixed Record

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receiving $112 million in loan fees.

New York City and Chrysler Corp., in 1975 and 1980, respectively, also asked for and received federal bailouts. President Gerald Ford at first refused to help the insolvent city, but once New York had made efforts to save itself, he signed legislation that provided billions of dollars in loans and loan guarantees, all of which was eventually repaid. In 1979, Chrysler lost $1.1 billion and was on the verge of bankruptcy. Once again, Congress acted, and $1.5 billion in government loans, matched by commercial lending, saved the company. According to ProPublica, the U.S. netted more than $600 million on its bailout investments.

Several past bailouts involved financial institutions, including Franklin National Bank in 1974 and Continental Illinois National Bank and Trust Company in 1984. But by far the biggest previous rescue involved the savings and loan industry in 1989. In what was then the greatest collapse of financial companies since the Great Depression, more than 1,000 S&Ls failed. The Resolution Trust Corporation, formed as part of legislation passed in 1989, took over failed institutions and sold assets at an ultimate cost to taxpayers of $293 billion, according to ProPublica.

Current government efforts dwarf anything it has done before. Already, hundreds of billions of dollars have been spent to arrange for the sale of Bear Stearns, guarantee the solvency of Fannie Mae and Freddie Mac, rescue American International Group, Citigroup, and automakers General Motors and Chrysler, and inject capital into banks through TARP. It may take years to judge the success or failure—and add up the total cost—of this latest, greatest government bailout. ●

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