GLOBAL
WEALTH ADVISORS LLC
Registered Investment Advisor

INSIGHTS

Michael J. Krencicki, MSF, CFP® March 2010 James M. Knaus, MSM, CFP®

Best Of Times Often Have Followed Worst Of Times

These have been tough times for strategic long term investors. While it may seem logical to stay the course through the market's inevitable ups and downs—taking advantage of stocks' tendency to deliver strong returns over very long periods—that logic was little comfort during the bear market, when some portfolios lost more than half their value. Wouldn't it have been better to bail out in, say, late 2007, replacing stocks with cash or with bonds, which have outperformed equities during most of this decade?

Of course it would have been better, but myriad problems stand in the way of executing a successful market timing strategy, which calls for getting out of investments before they swoon and getting back in when they're ready to rise. To investigate market timing's feasibility, Donald Bennyhoff and Yan Zilbering at the Vanguard Group recently examined the performance of the Standard & Poor's 500 stock index from 1928 through 2008 and reported their results in a research note, "Market-Timing: A Two-Sided Coin." Looking only at prices—they left aside dividends because of a lack of data on daily total returns before 1980—Bennyhoff and Zilbering found that the index had returned an average of 5% a year during that 81-year stretch. A clairvoyant investor who had managed to be out of the market on just the 20 worst trading days—avoiding an average loss on those dark days of 9.2%—would have gained 7.5% annually. Anyone who had missed the 20 best days, on the other hand, would have gained only 2.6% a year. That amounts to a 50% swing, up or down, in portfolio performance.

No one could ever hope to forecast all of the market's best and worst days. But given that infinitesimally small changes—being out of the market on just 20 of 20,340 trading days during the 81 years the researchers considered—can have a profound impact, it may seem worthwhile to try to identify some of them. What if, for example, you got out of the market after it had a particularly bad day, or got in after a really good one? Wouldn't more of the same be likely to follow?

Often that's not the case, according to Bennyhoff and Zilbering. Frequently the best and worst days happen within shouting distance of one another, and some of the best days have been particularly likely to follow hard on the heels of some of the

(Continued on page 4)

10 Worst Days for S&P 500 Index and Returns for Five and 20 Trading Days Following

Date	Return	Next 5 days	Next 20 days
10/19/1987	-20.5%	1.2%	9.6%
10/29/1929	-16.1%	4.6%	2.5%
5/14/1940	-10.3%	-11.1%	-3.8%
11/6/1929	-9.9%	-14.3%	8.9%
10/15/2008	-9.0%	-1.2%	-6.1%
12/1/2008	-8.9%	11.5%	9.1%
7/20/1933	-8.9%	1.0%	1.8%
9/29/2008	-8.8%	-4.5%	-23.3%
7/21/1933	-8.7%	8.1%	9.6%
10/26/1987	-8.3%	12.3 %	6.7%
Average	-10.9%	0.8%	1.5%

Source: Vanguard

A Personal Note From Global Wealth Advisors

Our lead article this month is admittedly chock-full of statistics, but gives support to the comments we've made in prior quarterly newsletters: Market timing simply doesn't work. A properly constructed portfolio involves a blend of different asset classes based on the client's needs, objectives, and risk tolerance. Suitable asset allocations are maintained through periodic rebalancing, which essentially forces an individual investor to buy low and sell high.

In addition to the other articles relating to national savings rates, income tax, gift strategies, and financial planning in general, we are closely watching developments concerning possible changes in the estate tax. For now, the Federal Estate Tax and Generation Skipping Transfer Tax have been repealed as scheduled under prior tax law.

However, as we write this, Congress is considering whether to reinstate these taxes retroactively to January 1, 2010! Such an obviously unfair tactic may nonetheless succeed, even after constitutional challenges. Our advice is for you to review your estate planning documents with your attorney to assess your risks. Please let us know if you'd like us to join you.

Finally, thanks for your continued trust and confidence. We appreciate your business and referrals.

Jim Knaus Mike Krencicki

A Welcome Spike In Personal Savings

Are you looking for something good that may have come out of the recession? As a result of the economic downturn, Americans have generally been spending less and saving more. The savings rate in U.S. households in 2009 reached a high point of 6.9% of after-tax personal income in May. Even though the savings rate has slipped slightly since then, the watershed mark was the highest rate since 1992, when savings peaked at 7.7%.

While it's not an exact measure of fiscal health, the savings rate is the percentage of household disposable income that is put into savings rather than consumed. Mortgage payments are not considered savings, but retirement plan allocations (not capital gains) are. Although a sub-7% savings rate isn't much to brag about in most parts of the world—the annual percentage in other countries routinely hits double digits—it marks a dramatic shift in our personal financial habits. During recent years, the percentage of savings actually dipped below 1%, bottoming out at 0.4% in both 2006 and 2007. In 2008, the saving rate was still only 1.8%.

What's behind the trend towards more savings? During the preceding two decades, rising stock market values and home prices had enticed consumers into thinking they had money to burn, and they became less and less inclined to save for retirement and other needs. Even retirees were encouraged to spend like there was no tomorrow.

But the recent precipitous decline in household wealth ended the wild spending spree. Real estate values around the country have dropped by an estimated 35%, and during the past two years, U.S. household wealth has been reduced by a whopping 140% of annual disposable income. That's a total of $14 trillion.

Faced with daunting economic news, people have been forced to rein in spending, while increasing their efforts to prepare for a secure retirement. For instance, instead of buying goods with their checks from the economic stimulus package or taking advantage of other tax incentives, many people have chosen to hold on to the money. And it doesn't look as if things will change radically anytime soon.

How long will the latest trend last? Most economists predict a slow, steady climb back to better times rather than a quick return to another financial boom. But cutbacks in domestic consumption will also slow down the economic recovery. In the meantime, the savings rate is expected to rise gradually until it hits the 10% mark at some point during the next 10 years. Other financial experts believe the recovery period could last even longer.

Of course, an increased savings rate is to be applauded, especially after it had plummeted dangerously close to zero. Americans will have to adjust to a lower standard of living compared with the heyday of 2007. But if forgoing a few luxuries is the price you have to pay for protecting your financial future, that's probably a trade-off you'd be willing to make. ●

IRS Report Pinpoints Key Tax Trends

The IRS recently released its Fall 2008 Statistics of Income (SOI) Bulletin, which provides key statistics about federal income tax returns filed for the 2006 tax year. In general, the SOI Bulletin reflects increases in income and deductions over the previous year, clear signs of an economy and investment markets that were then still thriving. The tax trends seen in 2006 have likely been reversed during the more recent tax years, when wealth-building has taken a major hit.

Consider these noteworthy statistics from the 2006 tax year:

• Taxpayers filed 138.4 million returns, an increase of 3% from 2005. The collective adjusted gross income (AGI) on these returns totaled a staggering $8 trillion, 8.2% higher than in the preceding year. Taxable income also increased, by 8.6%, to $5.6 trillion.

• Several income items jumped significantly, a byproduct of the bull market in stocks that was in full force at the time. Taxable interest rose 37.1%, ordinary dividends were up 19.7%, and net capital gains were 16.7% higher.

• Total income tax paid rose to $1 trillion in 2006, up 9.5% from 2005. That marked the third straight year in which total income tax increased.

• For the fourth consecutive year, taxpayers saw higher alternative minimum tax (AMT) bills. Total AMT paid rose 23.8% from $17.5 billion to $21.6 billion. But the number of returns with AMT liability decreased 1%—the first decline in AMT numbers since 2001.

The 2006 tax year also saw several changes related to itemized deductions—again, largely a sign of an economy and financial markets that were still flourishing.

• Total itemized deductions increased for 2006 to $1.23 trillion, a rise of 9.6%.

• The largest itemized deduction, for interest paid, rose 16% to $470.5 billion.

• The second largest deduction—taxes paid—increased by 8.1% to $432.8 billion.

Help Loved Ones With Tax-Free Gifts

Today's severe economic crisis is taking its toll on virtually every segment of the population. Young newlyweds are finding it difficult to set aside funds for the down payment on a home, despite the now lower prices. Middle-aged parents are struggling to make ends meet and still squirrel away cash for their children's college costs. And older workers and retirees have seen their nest eggs eroded by the recent stock market downturn.

If you've been fortunate (and foresighted) enough to escape major damage to your own finances, you may want to consider helping family members overcome economic hurdles. Providing tax-free gifts could improve their situations while benefiting your own estate planning as well. If you stay within tax law boundaries, you don't have to pay gift tax on cash or property transferred to relatives or any other recipient. At the same time, the gifts will reduce the size of your taxable estate.

The value of the latter benefit depends on the future of the federal estate tax, which remains uncertain. The estate of an individual who died in 2009 could shelter up to $3.5 million of assets from federal estate tax. That's an increase from a $2 million exemption in 2008, as stipulated by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which calls for the outright repeal of the estate tax in 2010. But that provision of the legislation expires at the end of 2010, and in 2011, pre-EGTRRA rules return. The estate tax exemption is scheduled to revert to just $1 million, and the estate tax rate will rebound to 55% from the current 45% unless Congress acts to change the law.

While a legislative compromise on the estate tax is likely, the tax will almost certainly continue in some form. And that likelihood only increases the appeal of making gifts now to help loved ones hurt by the recession. In 2010, you can provide tax-free gifts of as much as $13,000—in any combination of cash and property—to as many recipients as you choose. (A periodic inflation adjustment resulted in an increase in this exclusion amount from $12,000 in 2008.) You don't even have to file any tax forms or otherwise inform the IRS about such gifts (if those are the only gifts made and unless gift splitting with a spouse is elected).

The chance to provide unlimited numbers of tax-free gifts could multiply the benefits not only for recipients but also to your estate plan. For instance, if you have two children and three grandchildren, giving each of them $13,000 in 2010 adds up to a total of $65,000. If your spouse also makes such gifts (or consents to a joint gift by filing a gift tax return), that exemption jumps to $26,000 per relative and a total of $130,000 for five, all without gift-tax consequences. Continue this gift-giving program for five years and you'll have cut the value of your estate by $650,000 while providing generous assistance at a time when it may be sorely needed.

If the recipient is in a lower income tax bracket, gifting shares of stock, mutual funds, or other assets that have appreciated will save you from paying capital gains taxes. But if you have assets with unrealized losses that you want to give, it's better to sell them first so that you can deduct the loss on your tax return and give your gift in cash.

If you exceed the annual limit on tax-free gifts, you still won't necessarily owe money to the IRS. But larger gifts would count against your lifetime $1 million gift-tax exemption, which might be put to better use in funding trusts or for other estate planning purposes. Plus, you'll have to file a gift tax return—or potentially two gift tax returns if you're married.

Meanwhile, there are two special situations in which the normal giving limits don't apply. The first involves money you provide directly to an educational institution on behalf of a student. The second is for direct payments to health care providers.

The unlimited exemption for education payments means you won't owe gift tax if you cover college costs for children or grandchildren. Suppose your granddaughter is attending an Ivy League institution and the annual bill for tuition is $50,000. You can pay that amount directly to the university and still give her an additional $13,000 gift (or $26,000 with your spouse) that won't be subject to gift tax.

If children or grandchildren are still years away from college, an even better approach might be to fund a Section 529 college savings plan that names the child as beneficiary. Income earned by plan investments won't be taxed, and withdrawals to pay qualified educational expenses will also be tax-free. Plus, a special provision allows five years' gifts to be sent to a 529 plan in one fell swoop. That means you and your spouse could immediately provide $130,000 to jump-start a 529 plan without gift-tax consequences (provided you file a gift tax return to elect to front-load the gift). ●

• Deductions for casualty and theft losses declined dramatically to $5.1 billion from a record high of $15 billion the prior year, likely constituting a return to normal after Hurricane Katrina and other natural disasters had devastated personal property in 2005. Also, with higher AGIs, the opportunity for casualty deductions was limited since you can only take the deduction to the extent that the amount exceeds 10% of AGI.

Reducing The Tax Bite

Selected itemized deductions on U.S. returns in 2005 and 2006. Deduction amounts are expressed in millions of dollars.

Itemized Deductions Before Limitation	2005	2006	Percentage Change
Medical expenses*	67,354	70,704	5.0%
Taxes paid**	400,390	432,774	8.1%
State and local income taxes	227,581	246,382	8.3%
State and local sales taxes	17,271	18,924	9.6%
Interest paid***	405,718	470,475	16.0%
Home mortgage interest	383,733	443,152	15.5%
Charitable contributions	183,391	186,647	1.8%
Casualty and theft losses	14,984	5,136	- 65.7%
Miscellaneous deductions	76,183	76,666	0.6%

* After applying 7.5% AGI limit

** Includes real estate taxes, personal property taxes and other taxes not shown separately

***Includes investment interest and mortgage interest not shown separately (e.g., points)

Finally, the report on the 2006 tax year also provides valuable data about corporate and partnership returns.

To see those and other revealing statistics, download the SOI Bulletin at www.irs.gov/pub/irs-soi/08fallbulintax.pdf. You can comp are your own situation to that of the nation's taxpayers as a whole—and find a picture of a U.S. economy that may not soon return. ●

Not Having A Plan Is A Costly Mistake

Your deadlines at work are impossibly tight. Your to-do list gets longer every time you turn around. And with constantly shuttling the kids to Little League and piano lessons, it's no wonder your financial life gets short shrift. Yet, however good your excuse, failing to plan your financial future is a costly mistake.

Most Americans lack a formal financial plan, according to a recent survey by the Certified Financial Planner Board of Standards. Yet the same survey finds those with a written financial plan are more satisfied with how their finances are managed, more confident about their financial decisions, and less worried about being financially secure at retirement.

Financial planning doesn't start with deciding where to invest your money, and those who arrive at the door of a financial planner asking "Where should I invest?" are likely to be greeted with two words: "Slow down." You need to step back, assess your current financial situation, identify short- and long-term goals and your risk tolerance, and figure out your timetable—what will you need, and when will you need it?

You also need to consider asset protection—though again, don't rush to buy insurance until your financial plan is in place. It can help you decide what coverage you really need, and which options and riders make sense. Beyond pointing to the obvious homeowners and automobile coverage, your plan will guide you to the right life, health, umbrella liability, and disability policies and look at any unique liabilities associated with your work or your participation in community activities or corporate boards.

By presenting a broad view, your financial plan helps you understand how each financial decision affects other areas of your finances. For example, suppose you receive an inheritance and use it to pay off your mortgage. That frees up more of your earnings to put into your retirement plan. But your taxes rise because you've lost your mortgage interest deduction, and your expanding net worth means estate taxes could become a problem. Like a compass, your financial plan keeps you pointed in the right direction even as your life inevitably changes. What's more, the comprehensive nature of financial planning should help you avoid major mistakes—from choosing a high-flying mutual fund with no regard for its risk to overestimating how much you can safely withdraw from your nest egg.

Developing a plan takes time, but often, simply articulating your values, hopes, and dreams can increase your motivation to save. Your plan also enables you to chart your progress. Review and regularly revise it as needed, and it will be a road map that can last a lifetime.

The sooner you get on the planning road, the better. As Yogi Berra once said, "If you don't know where you are going, chances are you will end up somewhere else." ●

Best Of Times Follow Worst

(Continued from page 1)

worst. In dramatic turnarounds, eight of the 20 best days occurred within 10 trading days of one of the worst 20 days. On October 29, 1929, the S&P sank by 16.1%; the next day, it soared 12.5%. In 2008, a 7.6% loss on October 9 was followed by an 11.6% gain on October 13.

Post-plunge rebounds often last more than a day, with the market frequently recouping, during the next few weeks, a significant fraction of what it has lost. For example, the worst sell-off in the Vanguard study—on October 19, 1987, when the S&P 500 lost 20.5% of its value—was quickly followed by a lot of buying. Within 20 trading days of Black Monday, the market had rebounded by 9.6%. A similar thing happened during the 1929 crash; after that 16.1% free fall on October 29, the S&P stabilized temporarily, regaining 2.5% during the 20 trading days that followed. And in 2008? Twenty days after December 1, when the market fell 8.9%, it had regained 9.1%. Looking at the S&P's performance following all 20 of the worst days, the market regained an average of 2% during the next 20 trading days.

For would-be market timers, those tendencies make a difficult job virtually impossible. While it may be feasible to anticipate broad market shifts and to make tactical adjustments to a portfolio based on certain metrics like price-to-earnings ratios, any attempt to time a wholesale market entrance or exit will probably fail. Few people expected the stock market to surge when it did in the spring of 2009, or to advance as much as it did during the next several months. Investors who had cashed out their portfolios during the market rout almost certainly missed some (if not all) of the rally.

The recent volatility of the S&P 500—from day to day, week to week, and month to month—only reinforces how unlikely it would be for anyone to get in or out at just the right time. Rather than try to time the market, which almost always backfires, most investors would do better to stick with a well-diversified portfolio with regular asset allocation rebalancing to keep volatility in check and increase potential long-term gains. ●

Performance data quoted represents past performance and does not guarantee future results. Indices are unmanaged and do not reflect the payment of fees and other expenses associated with an investment. Investors cannot directly invest in an index.