



PARTNERS

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What A Difference A Year Makes In 10-Year Returns

Would you invest in an asset that has been in the red for an entire decade? That's the question a lot of investors have been asking themselves lately. The stock market rout that began in late 2008 and continued in early 2009 has resulted in a negative average annual return for stocks during the past 10 years, and that's bound to make many people hesitate to commit the lion's share of their portfolios to such a seemingly underwhelming investment. But the future for stocks looks much brighter than the recent—and not so recent—past.

Ten-year returns don't exactly lie, but their story is much more complicated than you'd expect, according to a recent report from Vanguard Investment Counseling and Research—"The 'Lost Decade': Rational Expectations in Uncertain Markets," by Francis M. Kinniry Jr. and Christopher B. Philips. Kinniry and Philips point out that during the past decade, the stock market has gone through several extraordinary periods—first, the runaway bull market of the late 1990s, then the brutal bear of 2000 through 2002, and finally the vertigo-inducing dive during late 2008 and early 2009. For years, the great markets of the late '90s buoyed long-term performance numbers. But now, as they fall out of 10-year calculations, the results begin to look pretty bleak.

For the decade ending June 1, 2009, the U.S. stock market as represented by the Standard & Poor's 500 index returned a negative 3.32% a year—and that was after the market had rebounded almost 40% from its early March low.



That's worse than bonds, which had an average annual gain of 5.88% during the same period. But just a few years earlier, long-term stock performance looked much better, according to the Vanguard report. At the end of 2002, coming out of the most punishing bear market in 70 years, the 10-year average annual return for stocks was a respectable 8.74%, and just two years later, as 2004 came to a close, that average had risen to

11.92%. Three years later still, however, the average annual return for the preceding 10 years had plunged by almost half, to 6.29%. The reason? Returns from 1995 through 1997, three years during which annual gains averaged nearly 30%, had dropped out of the equation.

Those returns from the 1990s, though exceptional, came during a decade that saw average returns of almost 20% a year, according to the Vanguard report. That's starkly different from the 2000s, which may well produce average annual returns of less than zero. Looking at those numbers, you might logically conclude that owning stocks isn't what it used to be, and that you ought to pare back your portfolio's equities, perhaps replacing them with bonds, which have outperformed all other asset classes so far this decade.

But that would be the wrong conclusion, suggest Kinniry and Philips. There's nothing you can do about what has already occurred; what's important for investors is what's to come, and Vanguard, one of the world's biggest fund managers, is decidedly bullish on

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P&C Protection With PWM

During the current economic downturn, we have found that even our most risk-tolerant clients have become more focused on preserving and protecting their assets. With more emphasis—and anxiety—directed at declining investment balances, we are frequently called upon to help protect our clients' financial future in any way possible.

One critical means of providing that desired protection is by having sufficient liability coverage. With so much attention given to the market lately, it's easy to forget that a single serious loss can wipe out the benefits of a solid financial plan. Not only are assets at risk, but also future income. If not properly insured, clients stand to lose everything in the financial portfolio they've worked so hard to build.

You may not be aware that as part of our comprehensive wealth management services, PWM offers property and casualty insurance for all your personal and business needs. For all clients, we are recommending a review to assist in eliminating any gaps in coverage and to help ensure that you have adequate protection for all your assets. How much coverage is enough? Are you paying too much? Is it with the right company? Contact our office for a thorough risk management review!

Financial Plans Are Meant To Be Revised

One great benefit of a financial plan is that it gives you a feeling of certainty. Designed to take into account wide-ranging scenarios, it seemingly should be able to shrug off an uptick in inflation, a bear-market stretch for stocks, or a spike in interest rates. Yet there are some circumstances—such as the recent once-in-several-decades plunge of the economy and financial markets—that even the most carefully constructed plan can't fully anticipate. Such events, as well as possible changes in your own situation, mean that every financial plan, sooner or later, will have to be revised. Preparing a financial plan is a process, not a one-time event, and making smart, timely alterations is crucial.

Consider how that process works. A financial advisor takes stock of an investor's overall financial situation and asks questions about goals, comfort level with investment risks, and the timetable for using investment proceeds. Then, the advisor establishes a comprehensive plan designed to help achieve those objectives.

That requires several assumptions about how markets

and the economy will behave. For example, an advisor might base a plan on a projected inflation rate of 3%, an 8% average annual return for stocks, and 4% yearly gains for bonds. Though some or all of those assumptions might miss the mark, the idea is that, taken together, they should be close enough to be useful. Yet even small inaccuracies, left uncorrected for 20 or 30 years, will leave a plan seriously out of whack.

Think of a ship setting out from New York for, say, Lisbon. The captain charts a course that should take the ship across the Atlantic to Portugal. But what if he makes a small miscalculation? Even if he's off only 1%, that could be a problem, and unexpected changes in winds and currents along the way are likely to make things worse. If he sticks to his original bearings, he could end up in Africa—or Ireland.



But that won't happen, because every good sailor understands the need for minor but constant course corrections. And a financial plan requires similar adjustments. Look at the predictions of economists, market forecasters, or the government, and you'll see that no estimate extending more than a

year or two into the future will be even close. So a financial plan written to predict the feasibility of a retirement 30 years away won't—and can't—be accurate. But it can establish a starting point. Reaching your goals requires frequent adjustments to compensate for the winds and currents you meet along the way.

Once you understand that basic certainty, you can prepare by discussing how, and under what circumstances, your plan will need to be altered. We would be happy to review your plan with you to make sure it continues to move you toward your long-term goals. ●

A Better Estate Plan For Business Owners

If you own a small business, you're likely working around the clock to build your company. But you still need to find time for estate planning. Despite recent tax-law changes, federal estate tax remains a prime concern for successful business owners. For someone who dies in 2009, the federal estate exemption can shield from tax up to \$3.5 million in assets going to non-spouse beneficiaries (up from \$2 million for 2008). But any excess is taxed at the top 45% estate tax rate.

While the estate tax is scheduled to vanish in 2010, it is likely that Congress will not let that happen, as

current legislation proposes retaining the current \$3.5 million exemption, with a maximum tax of 45 percent. And whereas heirs currently can "step up" the tax basis of assets for capital gains purposes—calculating subsequent gains or losses based on the assets' value on the date of death of the person who bequeathed them—that provision is due to change in 2010, at which point there will be a limited step up in basis.

However, estate tax minimization is only one aspect of estate planning. Financial planners offer many other services to help clients meet their estate planning goals. Here are four

estate-planning tools a business owner might put to good use.

Buy-sell agreement. This legal document can establish the value of your business for estate tax purposes while ensuring there will be cash for your family upon your death. A buy-sell agreement spells out arrangements for purchasing shares from a deceased co-owner or partner. Typically, the buyout is funded with life insurance on the owners or partners.

Section 303 stock redemption. Under Section 303 of the tax code, your family can remove cash from the business with little or no tax

Finding Deep Value In Distressed Markets

Savvy investors know that big-league opportunities open up during tough times, and the global economic meltdown is just such a time. If retirement is still a few years away, one of the most promising strategies could be investing in “distressed” securities. Typically, this involves buying deeply discounted debt of troubled companies, but there may also be great values in beaten-down equities.

The financial crisis has left major corporations and entire industries in financial distress. Many companies will be compelled to raise money by offering deeply discounted prices on bonds.

Often, these companies are close to filing for bankruptcy, so reorganization is likely. Those who buy the bonds stand to gain if the company regains its health, and if the company liquidates, bondholders are first in line to get back some or all of their money. That’s the risk of distressed debt investing—that bondholders may not recoup their entire investment from companies that close down. That’s why a distressed debt strategy depends on diversification, on buying debt in various industries to spread the risk.

Distressed debt is currently concentrated in the financial and mortgage sectors, but all types of companies are feeling the impact of the global economic crisis. Here are four areas in which there may be good values:

liability by redeeming company stock. This special provision may provide funds to pay funeral costs, estate and administrative expenses, and federal and state estate taxes. To be eligible, the value of the company stock held by the estate must exceed 35% of the estate’s total value.

GRATs. With a grantor retained annuity trust (GRAT), you transfer company stock to a trust that pays out annual income for a specific term, with the assets ultimately going to the beneficiaries you designate. This planning technique enables you to freeze the current value of the business in your estate. The amount of associated gift tax depends on the value of the stock transferred, the

Commercial real estate is usually a “lagging indicator” during a recession, meaning it’s one of the later industries to be dragged down by mounting economic woes. There could still be time to watch the industry for companies that are ultimately likely to weather the storm.

Buying the debt of troubled mortgage and real estate firms at discounts offers the chance to reap outsized returns once the economy bottoms out and growth resumes, because growing companies will need new space. In many cases, investors who buy this discounted debt will be able to convert the investment into an equity stake as the company reorganizes; this holding should then start rising along with the revived economy.

Corporate bonds offer a great way to maximize returns and minimize risk while investing in the debt of troubled corporations. Consider General Motors. When talk of a bailout vs. a potential bankruptcy was swirling around the troubled automaker, investors could buy top-grade GM bonds for less than 50 cents on the dollar. If the company recovers, those bonds will be worth far more than investors paid for them. If it ultimately folds, bondholders will be first in line for repayment, and those who bought the bonds at a deep discount will be more likely than others to get back most of what they put in.

Asian equity markets offer huge

term of the GRAT, and the Section 7520 interest rate at the time of the transfer.

Installment payments. Another tax code provision allows your executor to spread out estate tax payments over 15 years. Among other requirements, the business interest again must comprise more than 35% of your overall estate.

Of course, every business owner’s situation is different. One important thing to remember is to always ensure liquidity or these techniques will not be successful. Therefore, adequate life insurance is essential. We can work with you to discuss strategies to best address your unique planning needs. ●

opportunities to value investors because stock prices ran up so high during the years prior to the credit crunch. As the crisis encircled the globe, the value of stocks in Asian firms quickly dropped. During boom times, Asian companies took on debt so they could continue to expand to take advantage of growing demand for their goods and services. Now, with demand stalled, investors in much of this debt will unload their investments at a great discount.

Private equity firms invest in privately held companies, and private equity has tended to enjoy its biggest profits during down years in the stock market as the managers of private equity funds troll for cash-starved ventures in which they can take major stakes. High-quality private equity firms may roll out new offerings as the economic crisis continues to depress values.

Distressed securities shouldn’t make up a large portion of a portfolio, but a small, well-diversified allocation to this deep-value strategy could contribute outsized returns when the economy gets healthy again. Possible holdings might include cheap municipal bonds, discounted closed-end funds, deeply discounted stocks in hard-hit industries, and distressed corporate debt. This isn’t about timing the market or investing at the absolute bottom. Large swaths of securities are trading well below historical valuations. Choosing carefully from among these relative bargains could be profitable, even if prices initially slump further.

We are monitoring today’s difficult markets and looking for opportunities, including those within the distressed securities markets, that might benefit your portfolio. If you would like to discuss how these investments might fit your needs, please give us a call. ●

The information provided is not specific financial advice or a recommendation to buy or sell. We must review your profile, needs and accounts specifically to determine what is right for you.

Risks of foreign investment include currency fluctuations, economic, political or social instability. These risks may be significantly higher in emerging markets.

Using Offshore Trusts For Asset Protection

Offshore trusts aren't only for spies, the super-rich, and movie stars. They're also for ordinary folks: doctors, lawyers, business owners, and real estate investors, among others, who are at risk of being sued and want to protect their assets.

In our litigious society, shielding assets from legal judgment is no more radical than insuring against fire, burglary, or auto accidents. It costs about \$30,000 to set up an offshore trust and \$3,000 a year to maintain.

Your need for an offshore trust has less to do with how much money you have than with your potential exposure to a liability lawsuit. A doctor with a family practice may feel less threatened than a plastic surgeon, for example, and a real estate investor who owns several apartment buildings may feel more of a need for asset protection than someone who owns farmland, even if the holdings are of equal value.

An offshore trust may come in handy during divorce proceedings,

too, and it could benefit a director on the board of a publicly held company or a business owner who sells his company. In any of these situations, a properly structured trust could save you from financial ruin.

All states except Alaska, Delaware, Missouri, Nevada, Rhode Island, Utah, and Colorado have laws saying a trust created for your own benefit is not shielded from a creditor's claims. You could establish a trust in one of those states and house your assets there. But if you're sued outside of those states and hit with a judgment, the courts where you were sued may not respect the trust laws governing your trust.

According to Gideon Rothschild, chairman of the American Bar Association's Asset Protection Committee, approximately 17 foreign jurisdictions now promote offshore trusts, some of which can be used for asset protection purposes. The Cook Islands in the South Pacific is most well known, but others

include Belize, Gibraltar, and Nevis.

Some of these havens do not recognize foreign judgments. So if a U.S. court finds you financially liable, these countries will not enforce the judgment. Some have short statutes of limitations. By the time a creditor locates your assets, it may be too late to sue you in one of these jurisdictions.

If you're uncomfortable about moving your assets to a faraway place, you could have the trust assets located offshore but managed by a U.S.-based manager. Or, the trust could invest in U.S. securities, with a foreign bank as custodian. You could even use a U.S. custodian to hold title of the trust assets until you need to move them offshore. However, maintaining the assets in the U.S. may compromise the protection against an extremely persistent creditor.

And watch for offshore trust scams, especially those great tax schemes. Genuine offshore trusts are generally tax-neutral. ●

Difference A Year Makes

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stocks. Though equities are indeed riskier than bonds, that's exactly why they tend to outperform fixed-income investments, and Vanguard's analysts believe the current market offers a generous risk premium—the amount by which stock returns should exceed the return on “risk-free” Treasuries.

Vanguard expects that during the next 10 years, stocks could potentially produce average annual real returns—net of inflation—of more than 9%.

The risk premium is based on the idea that for investors to take on stocks' higher risks, they need the motivation of potentially higher returns. And the market's recent volatility only drives home the point that stocks do bring real

risks, and that short-term returns often fall as well as rise. From 1982 through 1999, there was only one down year in the stock market. But that was an anomaly, a departure from the stock market's long history of producing a negative return one year in every four.

That fact, in turn, reminds investors of another truism—that to benefit from stocks' long-term returns, you have to be in the market long term. If you sell when stocks fall, you will have paid the price of investment risk but you won't be there for the gains that inevitably follow. To contain the risk of the market stumbling again before the next long-term bull market, a prudent strategy may be to



“average” into the markets over the next six to 12 months, meaning that you should keep adding to your investments over time, rather than all at once.

Vanguard's optimism about stocks is based on several factors. Even after the recent rally, price-to-earnings ratios remain relatively low, and though the economy may not recover quickly, the stock market typically rebounds well in advance of a return to economic growth. But there's also the fact that stocks, statistically speaking, are due for a nice run after such a steep fall.* Investors miss it at their own peril. ●

***Past performance is not a guarantee of future return.**