



FIRST QUARTER PERSPECTIVE January 12, 2010

The Markets

2009 closed with most asset classes posting sharply positive returns for the year:

Index	Tracks	2009 Return	3 Year Annualized	5 Year Annualized	10 Year Annualized	15 Year Annualized	Standard Deviation (10 Year)
Russell 3000	Broad US stock market	28.34%	-5.42%	0.77%	-0.20%	8.13%	16.50
S&P 500	US large cap stocks	26.46%	-5.63%	0.42%	-0.95%	8.04%	16.13
Russell 2000	US small cap stocks	27.17%	-6.07%	0.51%	3.51%	7.73%	21.54
MSCI EAFE	Foreign stocks	27.75%	-8.66%	0.85%	-1.07%	2.85%	17.71
Dow Jones US Select REIT	Real estate stocks	28.46%	-13.65%	-0.07%	10.67%	9.87%	25.70
Dow Jones - UBS Commodity	Commodities	18.91%	-3.83%	1.96%	7.13%	6.23%	17.42
Barclays Capital Aggregate Bond	Investment grade taxable bonds	5.93%	6.04%	4.97%	6.33%	6.80%	3.83
3-month T bill	Ultrashort govt debt (proxy for cash)	0.16%	2.13%	2.95%	2.88%	3.66%	0.57
Consumer Price Index (through Nov)	Inflation	2.68%	2.24%	2.53%	2.56%	2.50%	1.21

Source: Morningstar Principia

When we mail your performance reports later this month, most of you will see that these market returns have clawed back a major portion of the losses you saw in 2008. So far, history has repeated itself: we know that past severe bear markets were followed by big stock market rallies, and that's what we saw this year.

For our year-end review, we're sharing a piece by Bob Veres, a journalist whose newsletter for financial advisors is a must-read. Bob is a staunch supporter of the fee-only model of financial planning, and a great writer; his summary of the year speaks to what we want to communicate. We hope you find it useful.

Best wishes from the three of us for a happy, healthy, and optimistic year ahead. -- Karen, Joe, & Therese

Quarter-end, Year-end, Decade-end Market Report

2009 was an interesting investment year by any standard you want to apply. When it began, the global economy and international banking industries were still reeling from a free-fall in the markets that would continue on to a major low on March 9. All of the major Wall Street firms that sold toxic assets to their customers were receiving multi-billion dollar transfusions of taxpayer money, and AIG (the world's largest insurer), Fannie Mae and Freddie Mac--and, soon, General Motors--were effectively owned by the U.S. government. We would later learn that the economy had slipped into a recession over a year earlier.

Much of the first quarter felt like a free-fall; the index dropped to 676.53 at the close of March 9, and the world markets were awash in gloom. The S&P 500 finished the first three months of the year down 11.7%; its sixth consecutive losing quarter. Industrials were down 21.8%, financials had fallen 29.5%, and wherever you looked abroad, the news was even gloomier--Japan down 36%, the UK off more than 48%, Germany down 50.6% in dollar terms, China and India down 34.7% and 52.3% respectively.

None of us in the financial planning community knew what was coming; the most we knew was that markets eventually rise after a hard fall, and that the rise would inevitably come earlier than anybody expected. As it turns out, we didn't have long to wait. The S&P 500 index rose 15.93% in the second quarter and 15.61% in the third, marking the best back-to-back quarterly rally in decades. High-yield corporate bond indices posted double-digit returns and outperformed Treasuries by some of the biggest margins ever recorded. International stocks rose 26.74% and 19.52%.

The gains were more subdued in the 4th quarter, but still strong. The S&P 500 gained 7.5% in the last three months of the year, posting an extraordinary 26.46% gain for the year. The Russell 3000--a close proxy to the entire U.S. stock market--was up 5.89% for the last quarter of 2009, finishing up 28.34% for the year. The Russell 1000--a proxy for large cap U.S. stocks--gained 6.98% for the quarter and 28.43% for the year. The Russell 2000 (a proxy for small cap U.S. stocks) gained 3.87% for the quarter and was up 27.17% for the year, while the Nasdaq composite finished the year up 43.9%.

Around the world, the EAFE--a broad index of large cap stocks in developed economies--finished the year up 27.75%, and the EAFE Emerging Markets index posted a startling gain of 74.14%. China's key stock index was up 80% and Brazil was up 83%. An international index of Latin American stocks ended the year up 98%. Japan's Nikkei index was up 19%. The Financial Times European index gained 25.4%.

Commodity prices were also up, with copper rising 139% for the year, silver up 48% and gold up 24.8%--the precious metal's largest gain in three decades. Oil finished the year above \$79 a barrel, up 78% in calendar 2009.

Perhaps the biggest recovery of all investments came in real estate investment trusts; the NAREIT index rose 24% in 2009, but that represents a 110% gain from the March low.

Not all investments finished the year in positive terms. A composite of Treasury bonds--the safest investments in a downturn--lost 3.5% of its value in 2009--which, when added to inflation, means a real-value loss of more than 5%. This represents the first annual loss since 1999, and only the fourth time Treasuries have lost money over a calendar year since 1978.

The question is: with all this good news in domestic and international stocks, REITs and high-yield corporate bonds, why aren't we feeling any better? For many of us, 2009 felt like we were getting some of our money back, and we didn't get all of it. By the perverse math of down and up markets, an investor who took the full brunt of the 37.31% decline in the Russell 3000 index in 2008 would have required a 59.6% return in the next year to break even.

In addition, there is unhappy evidence that most investors didn't participate in the upturn--and, therefore, didn't make ANY of their money back. In time-honored fashion, the average investor retreated from stocks after the downturn and watched the upturn from the sidelines. Statistics compiled by the Investment Company Institute show that investors across 25 developed nations (including the U.S.) had \$10.4 trillion of their wealth in stocks at the end of the second quarter of 2008. Money continued to pour out, so that by the end of the first quarter of 2009, while the rally was already underway, total stock exposure had fallen nearly in half, to \$5.9 trillion. In the U.S., much of that money went into Treasuries--just in time to catch a rare losing year in government bonds. Money market funds, meanwhile, surged \$444 billion in the fourth quarter of 2008 and another \$63 billion in the first three months of 2009--putting a significant amount of money on the sidelines just in time to miss the record stock rally.

Bigger picture, we are emerging from a historically bad decade for stock investors. If you managed to increase your wealth over the last ten years, then you deserve congratulations. A chart circulating among financial advisors shows that the Dow Jones Industrial Average was up roughly 50% in the 1900s and 1910s, up more than 100% in the 1920s, and up more than 200% in the 1950s, 1980s and 1990s. The index rose narrowly in the 1940s and 1960s and squeaked out a gain in the 1970s.

Only the Great Depression-era 1930s and our recent decade of the 2000s delivered negative stock performance. Meanwhile, on December 31, the S&P 500 index closed out its first decade ever with a total return loss--which means a loss even with dividends reinvested.

So perhaps this is a time to count our blessings. The recession that began two years ago is officially ended, and the TARP program officially ended its existence in the final months of last year. Your investments were not dangerously concentrated in one asset or security--the reason why Bill Gates reportedly lost \$7 billion in 2009. We can all be pleased that we weren't fully-invested in Citigroup, which fell 50.7% for the year, or the Royal Bank of Scotland, which lost 40.9%.

Or we could envy the greed that still seems to be rampant among those Wall Street firms whose reckless actions brought the markets and the economy to their knees. Brokerage house bonuses and stock options haven't yet been paid out for 2009, but a survey by eFinancialCareers.com found that most brokerage professionals are expecting higher compensation for their 2009 labors than they received in 2008.

To put this in perspective, in 2008, the top 100 executives at the 20 largest banks that received Troubled Asset Relief Program (TARP) infusions from the taxpayers--including Goldman Sachs, JPMorgan Chase and Bank of America--received an AVERAGE total one-year compensation of \$13.8 million. More than a third of the brokerage executives, traders and top salespeople who expect bonuses to be higher this time around said it would be due to 2008's abnormally low bonus payments.

A cynical attendee at a recent financial planning conference hit the nail squarely on the head when he observed that "Terrible investment advice, and bad performance, don't come cheap."

What's ahead? With so many surprises over the past two years, professional soothsayers and prognosticators are being unusually cautious this time around. Normally, the year after a recession brings a hard and fast recovery, with GDP growth in the 6-8% range over the following 12 months. But a recent survey of economists by the Bloomberg organization found a consensus expectation of just 2.3% growth in U.S. economic activity, largely because the deleveraging process--paying back debts on the federal, state, local, corporate and personal balance sheets--may continue far into the future. Fortunately, if this continues, it will lead to a thriftier, financially healthier economy--eventually.

Of course, those predictions are merely guesses, as are anything you hear about investment returns during the next year. There are positive and negative surprises in our future, changes that will help or hurt. But generally, over time, the positive influences always tend to outweigh the negative ones, which is

why we don't still live in caves or drive mules to work, and why the Dow is not still hovering around 43, as it did in the early 1930s. We don't know what the future brings, but it's a good guess that the trauma of 2008, and the first decade of the millennium, will be remembered as unusual detours in the longer-term upward march of the markets. -- Bob Veres

Shorts

- **Livingto100.com.** We'll remind you of this every New Year, as all our thoughts turn to resolutions. If you haven't tried estimating your life expectancy online, take a look at the calculator at www.livingto100.com. This calculator, which takes about 10 minutes to complete, asks a series of personal questions about lifestyle, diet, health, and family history, calculates your life expectancy based on your answers, and gives you a list of things you can do differently and how many years you could add if you do so -- all based on data collected by the New England Centenarian Study. Very revealing....
- **Staying Healthy In Retirement.** *The New York Times* reported recently on new research that indicates people who work after retirement have better health. The University of Maryland study collected information from 12,180 people over a six-year period. These people were aged 51-61 at the start of the study, and answered questions about their work history, work after retirement, and their health. The study found that post-retirement work had a distinct effect on health, and that's after controlling for health before retirement.

Two details of note: part-or full-time work didn't matter, but what kind of work did. People who worked in retirement doing a job related to their previous careers had the best mental health.

- **Morningstar Fund Managers of the Year.** The portfolio management team at American Funds EuroPacific Growth, which we use in most client portfolios, was named Fund Manager of the Year in the International category. Morningstar uses the awards to honor past achievements, looking for strong long term risk-adjusted performance, and for funds that have been good stewards of investor capital. The other winners: the managers of Fairholme Fund (domestic stock) and Loomis Sayles Bond (fixed income).
- **Staff news.**
 - Joe has been named the president-elect of the Financial Planning Association of Puget Sound; he'll assume the reins in 2011. As president, he'll lead the 550+ member organization of financial professionals; his goals include increasing the participation of members in leadership positions, and advocating for reform within the financial services industry.
 - Therese was quoted in *The New York Times* in an article on Roth conversions by Tara Siegel-Bernard. You can read the piece at <http://www.nytimes.com/2010/01/09/your-money/individual-retirement-account-iras/09convert.html?ref=your-money>.
- **Disaster Plan.** We've created a disaster plan -- more formally known as a business continuity plan (BCP). The purpose of the plan is to ensure we can continue operations in the event of a man-made or natural disaster; it outlines what steps we'll take depending on the nature and severity of an event so we won't be caught flat-footed. Enclosed in this mailing is a notice informing you of the plan, and giving you our alternate office locations and contact information. We'll certainly make our best effort to reach out to you in case of a disaster, but we want you to be able to contact us as well, so keep this notice in your permanent trueNorth files.