The Thoughtful Investor

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Is It Over Yet?

Has the bear market come to an end? You'll find a lot of opinions and talking heads with answers based on prior market declines and recessions, but before you take those answers for fact, consider that those opinions are often based on scanty data and what "has been." The only way we will know for sure is hindsight.

You can't count on historical averages applying to today's situation.

This market decline is different from those of the '70s, '80s and even the early 2000s. The bubbles that brought it on in the housing and credit markets did not involve just investors or corporations but rather a wide swatch of the population at all income levels. Unwinding the excesses will take years in the natural course of life. Government intervention to avoid widespread pain could prolong the recovery even longer.

With that said, one indicator that may offer the best clue of the direction of the stock market is the 200-day moving average.

The 200-day moving average is typically considered to be the dividing line between a stock or a market that is technically healthy and one that is not. It is based on the current trend of the market and does not attempt to interpret the market based on prior situations.

A simple moving average is calculated by adding the last 200 days closing prices and dividing by 200. Each day a new value is added, the oldest is dropped, moving it along the time scale. An exponential moving average

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Planning for Higher Tax Rates

A number of factors look to make higher taxes inevitable for many Americans. There's the incredible cost of the credit crisis bailout and all its peripheral costs. On January 1, 2011, the entire 2001 EGTRRA Act will sunset. Capital gains, income tax, the estate, gift, and generation-skipping tax rates will all automatically reset to their higher pre-EGTRRA levels unless Congress acts before then. Then there is the continuing impact of the Alternative Minimum Tax on more and more middle class tax-payers. The new Administration's desired program expansions and goals also come with considerable costs that will need to be met.

All of which brings up the need to structure your investments and assets to minimize your tax bite and optimize the earning potential of your investments. Below are some ideas you might want to discuss with your tax and financial advisers and put in place.

1. Optimize tax-advantaged accounts.

To reduce your taxable income, take advantage of any retirement plan contributions you can make to defer taxes. The table below shows employee contribution limits for 2008

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Protect Your Assets

Bernard Madoff's alleged Ponzi scheme is notable primarily in the size of the fraud – $50 billion – and its length – in excess of 20 years. But the story itself is all too familiar. Like many con artists, Madoff used a stellar reputation and connections in the financial and political arenas to avoid questions on how he managed to achieve profits when others faltered.

Whether Madoff's investment management services began as a legitimate business or as a fraud, we don't know. What we do know are precautions that could have kept his investors from losing so much:

- **Always have an independent, credible verification of account values and performance.** While we believe the vast majority of managers are honest, you need to have a means of verifying performance.
- **The better the performance, and the less you understand how it was achieved, the greater your caution should be.** The financial markets have a way of humbling everyone at one time or another. Problems arise when the manager is unwilling to admit to failing and turns instead to great risks in hope of recovering or even fraud to cover up losses.
- **Diversification is essential.** The investors hurt the most are the ones who trusted Madoff with virtually all of their investment assets. But, fraud isn't the only reason for diversification. All investment approaches have periods of underperformance. Diversification by strategy, asset class and individual investments gives you at least a measure of assurance that you won't lose everything to a bad decision, whether yours or the manager's.

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and 2009, including catch-up provisions for individuals over 50. There are income restrictions to be eligible for an IRA or Roth IRA, so check with your financial advisor prior to making a contribution.

Type of Retirement Plan	Maximum Annual Contributions			
	2008		2009	
	Under Age 50	50 and Older	Under Age 50	50 and Older
Individual Retirement Plans*				
Traditional and Roth IRA	$5,000	$6,000	$5,000	$6,000
Employer-Sponsored Retirement Plans				
401(k), Roth 401(k), 403(b), 457 and SARSEP Plans	$15,500	$20,500	$16,500	$22,000
Small Business or Self-Employed Retirement Plans				
Self-Employed 401k (a.k.a., Solo-401k, Individual 401k, Roth 401k)	100% of compensation up to $15,500	100% of compensation up to $20,500	100% of compensation up to $16,500	100% of compensation up to $22,000
SIMPLE (Savings Incentive Match Plan for Employees) IRA or 401(k)	$10,500	$13,000	$11,500	$14,000
Coverdell Education Savings Account*				
Per beneficiary under age 18	$2,000		$2,000	
Health Savings Account				
Individual Family	$2,900 $5,800	Between 5-64 $3,800	$3,000 $5,950	Between 5-64 $3,900

2. Roll over traditional IRA accounts into a Roth IRA.

With many IRA accounts below prior year values, this may be the time to roll those accounts into a Roth IRA. Withdrawals from Roth IRAs are exempt from federal income taxes, however, contributions are not deductible and come from after-tax income. As a result, you will need to pay income taxes on amounts transferred from a traditional IRA to a Roth. There are income limitations for Roth conversions, so check before you convert. Barring new legislation, these limitations are set to expire in 2010, when anyone can convert to a Roth without regard to income.

3. Avoid capital gains distributions.

Even when mutual funds decline in net asset value, you can still get caught with capital gains if the funds sell appreciated assets to meet withdrawal demand. To avoid the capital gains issue, place mutual fund investments in tax-advantaged accounts, or sell funds that have lost value prior to distributions for the year, typically in December. Remember you cannot buy back into the same fund or a fund with the same investment directive for 30 days without running afoul of IRS rules. This may also be the time to look at Exchange Traded Funds, which avoid distribution requirements.

4. Harvest your tax losses, but avoid wash sales.

When you realize capital losses, you can offset any capital gains with those losses. If you have more losses than gains, the IRS allows you to use up to $3,000 of net investment losses to offset income in the current year and carry over additional losses to offset future capital gains indefinitely. Just be aware that if you buy substantially identical replacement investments within 30 days after the sale — or within 30 days before the sale — you can't deduct your loss under the wash sale rule.

This wash sale rule can apply even if you don't acquire stock. If you enter into a contract or option to acquire stock, that's enough to make the wash sale rule apply, as can selling options at a loss. The wash sale rule has three consequences: 1) You are not allowed to claim the loss on your sale. 2) Your disallowed loss is added to the basis of the replacement stock. 3) Your holding period for the replacement stock includes the holding period of the stock you sold.

5. Consider tax exempt bonds.

Income from taxable bonds and bond funds is taxed at ordinary income-tax rates (as high as 35% now). This can make tax exempt municipal bonds or a municipal-bond fund a better investment for after-tax yields. To the extent that you own taxable bonds, particularly high-yield bonds that produce income, consider holding them in tax-sheltered retirement accounts.

6. Use alternative investments to avoid losses in positions with large capital gains.

If you are concerned that an investment with substantial gains could decline in value and you want to lock in profits, consider the use of alternative investments such as inverse funds, contra-Exchange Traded Funds (ETFs), and options that allow you to hedge your gains to avoid liquidating a position. Be careful of selling out of closed funds, where you might not be able to reinvest later.

7. Consider AMT liabilities before taking gains.

The alternative minimum tax (AMT) is impacting more and more middle-class and upper-middle-class taxpayers. Taking major gains, exercising stock options and simply realizing more income than prior years may entangle you in the AMT.

7. Get credit for your generosity.

If you itemize your deductions, you can deduct charitable contributions. Save receipts and canceled checks as proof. Strategic giving can lower your income and allow your money to go to causes you support rather than taxes.

The preceding ideas are for general information purposes only and should not be considered tax or accounting advice. Every individual's situation differs. Talk to your financial or tax adviser about ways to reduce your taxable income before implementing any of these suggestions.

Adding Perspective to "Missing the Best"

As financial markets headed down, investors worldwide have been deluged with articles espousing buy-and-hold investing as the only strategy that really works long term. At the root of their argument is typically the cost of missing the best days in the market. But before you take this too much to heart, you need to look at a more balanced perspective.

First, the experts are correct in that:

1) If you miss **only** the best days in the market your return will drop.
2) The best days in the market often occur during or in close proximity to market declines. If you move out of the market during a downturn, your odds of missing the best days of the market are high.

What they don't tell you is that you are better off missing the best days of the market if you are also able to avoid the worst days. The following study of the S&P 500 Index over a period of 25 years ending December 31, 2007 shows that the results of missing both the best and worst would result in better returns than a buy-and-hold position regardless of whether you miss 10, 20 or 40 days.

S&P 500 – 25 Years Ending Dec. 31, 2007

Average Annual Return 10.28%

	Miss the Best	Miss the Worst	Miss Both the Best and Worst
10 days	7.43%	12.87%	10.56%
20 days	5.84%	14.64%	10.63%
40 days	3.07%	17.53%	10.56%

Original study by Telephone Switch Newsletter. Updated through 2007 by Hepburn Capital Management.

Naturally there's a catch. The statistical odds of missing just the best or worst 10, 20 or 40 days indicate it is virtually impossible. What is possible is to sidestep the periods in which those returns are most likely to occur.

Market sessions with particularly good or bad returns do not occur randomly, but tend to be clustered together during periods of high volatility, documents Robert Engle, a finance professor at the Stern School of Business at New York University who was the Nobel Laureate in Economics in 2003 for his work along these lines.

By mid-September 2008, the Chicago Board Options Exchange volatility index (VIX) climbed to its highest level in five years. In the subsequent six weeks, 5 of the 20 biggest daily losses of the past decade occurred along with 5 of the decade's 20 biggest daily gains.

A volatility-avoidance strategy would move assets out of the market when the VIX climbs into a high volatility period. This has the potential to reduce portfolio risk, take advantage of the market's upward bias in less volatile times and, based on studies of prior markets, potentially improve returns over a buy-and-hold portfolio. The reason is the impact that losses have on a portfolio. A 20% loss requires a 25% gain to return to breakeven. Miss a 20% loss and you are still ahead even if you miss a 20% gain.

The most important aspect for many investors in sidestepping market periods of the highest gains and losses is lower emotional turmoil. Investors tend to sell when the pain gets too great, often at the market's bottom. By imposing a rational buy-and-sell discipline on the investment process, an active strategy may well miss the best days of the market, but it is more likely to keep investors in the market for the long term. And that means participating in upward moves that build value.

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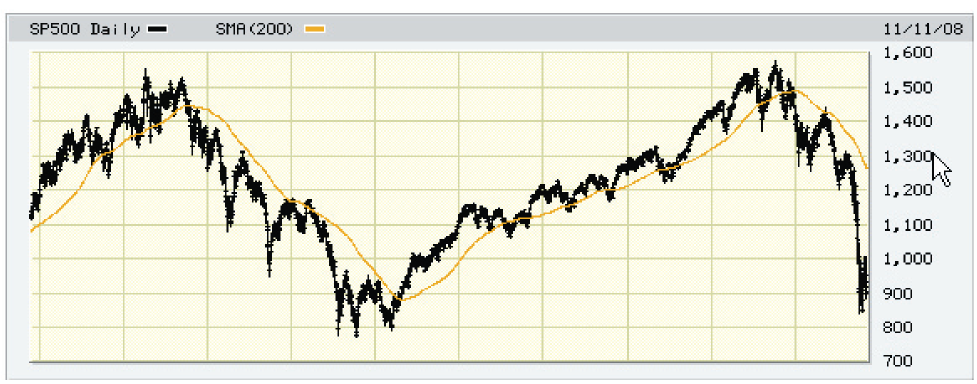
is much the same, but gives greater weight to later values.

As long as prices are above the 200-day moving average, the market is said to be in an uptrend. When values fall below the moving average, a downtrend is underway. Because a moving average lags the actual market, the turnaround in market direction always happens before the moving average signals confirmation.

The indicator is not perfect. In the chart below of the S&P 500 and its 200-day moving average over the last 10 years, you can see where brief whipsaws occurred when the market appeared to be changing direction only to revert to its earlier trend.

When the gap between the moving average and actual market values is at the widest, many analysts believe a change in market direction is indicated. But as the plot for the S&P 500 through December 31 shows, there can be no assurance as to how long that change might last.



Keep in mind that past performance is no guarantee of future market performance. Markets have a way of humbling investors at all levels, as 2008 has shown. The S&P 500 is an index and cannot be invested in directly

Make Dollar Cost Averaging Work for You

Ideally, you are continuing to make contributions to your retirement plans and setting aside money to achieve your long-term goals, whether an education for your children, a new business venture, a vacation home, or just the ability to relax in the sun. The problem is, what do you do with those assets when the market is falling?

The common advice is to keep investing in equities or your favorite mutual funds in a dollar cost averaging approach regardless of the market's direction. We beg to differ. There is nothing wrong with cash as an asset class if your alternatives are falling in value.

Declining markets are not the time to stop saving, but they are the time to pull back on new investments. Your goal should be to invest only in assets that are increasing in value. And, you should have an exit plan if they stop increasing in value, particularly if they start declining. Buy low and sell high only works if you sell when values are high so that you have the funds to buy when values are low.

Capital preservation is the most important aspect of successful investing. We don't know when the market is going to stop gaining value or when it will stop falling. What we do know is that markets move in cycles. They become overbought, fall below realistic values and then struggle back up.

Selling is typically the hardest part of investing. You want to let your winners run. As long as a position is rising in value, stay invested. But have a rule for when you are going to sell. There

are two elements on which to base that rule. The first is how much you are willing to lose, whether gains or principal. The second is the opportunity cost of having your money in an investment that isn't going anywhere.

Winners in a bear market are those who lose the least. That demands an active strategy. We welcome the opportunity to discuss our investment programs and how they have performed in the 2008 market decline with you and with any family members and friends who can benefit from an investment approach that recognizes the benefit of losing the least in bear markets and finding opportunities for profit in the carnage.

Avoid Paying Medical Debt with a Credit Card

Increasingly medical providers are offering customers the opportunity to pay for personal deductibles and non-covered/insured medical care by credit card. But before you do so, make certain you are very comfortable with the charges and your ability to pay the costs.

Once you convert medical debt to credit card debt it becomes more difficult to dispute questionable charges that make up the total bill. You've also eliminated your ability to work out a payment plan or negotiate reduced charges with the medical provider. Many medical providers hesitate to aggressively pursue low income patients for excessive unpaid balances because it can look bad from a pr stand. Credit card companies do not have the same concerns.

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