



## VIEWPOINTS

4<sup>TH</sup> QUARTER 2008

ADVISORY NEWSLETTER

MARKET COMMENTARY

FREDRIC W. WILLIAMS

### *Shelter From the Storm...*

It goes without saying that for a variety of reasons, 2008 was a year for the record books. From the residential real estate market, to energy and commodity prices, to the U.S. presidential elections, last year will be remembered as both tumultuous *and* historic. For many investors, though, the past 12 months in the stock and bond markets will best be viewed like a bad stretch of road in the rear view mirror – something that was driven through and which we hope won't appear in the windshield again. From failed financial institutions and home foreclosures, to the collapse of oil prices and almost of a country (Iceland), surviving 2008 may become a sign of relative accomplishment as we navigate our way out of this recession and back towards more prosperous times. Many a participant in the capital markets can empathize with Bob Dylan's travails from his (appropriately named) 1975 Blood on the Tracks album:

*I was burned out from exhaustion, buried in the hail,  
Poisoned in the bushes an' blown out on the trail,  
Hunted like a crocodile, ravaged in the corn.  
"Come in," she said,  
"I'll give you shelter from the storm."*

There weren't many safe places to get out of the weather last year, as the credit and real estate crisis conspired to bring down almost all asset classes as a result of global deleveraging and forced liquidations. Despite this, it's important that prudent long term investors use disciplined criteria and proper perspective to make sure rational, rather than emotional decisions are made going forward.

As we pointed out previously in this space, we were less than sanguine about the markets' climb through the increasingly rarified air of '06 & '07, allowing cash to accumulate in our portfolios as we attempted to reconcile what appeared to be occurring. And although it would be presumptuous of us to infer that "we saw this coming", we do feel that the dry powder we can now gradually put to work in the markets will be amply rewarded over the longer term. Just as we thought the upside was overdone late in 2007, so too do we think the downside may have been overshot, as well, almost a year later in 2008. Whether the markets are efficient or not, we consider them to be tools to use in addressing the long term needs of our

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clients – and right now the markets may well be inefficient as a result of investors being overly emotional. Along that vein, we'd like to revisit some themes that those who are prudent and rational should consider employing in the coming years.

Time horizon, perspective, goals – call it what you will, but the basis for any investment in the capital markets is long term given the correlation between market prices and the growth of our country's GDP – where the trend is, appropriately, tortoise like. Despite the “rapid money” segment of a certain financial network, or the rantings of certain commentators on said network, true investing is *not* trading focused, nor does it require input from the elevated voices of a panel of egomaniacs trying to compete based on decibel level. Over the long run corporate profits, even when accounting for the business cycle and recessions, will grow with the expansion of our economy. Although we are advocates of actively managing our participation in that dynamic to effectively meet our clients' needs, a focus on daily changes in the price of a company's securities is not, in and of itself, the catalyst for any reasonable decision making process. Resolution number one for the new year, presuming that these types of broadcasts may not be able to be recognized for purely their “entertainment” value, could be to keep the television in off mode.

One also needs to recognize that even if you retired *today*, your time horizon should reflect not just the receipt of your first Social Security check, but more likely your remaining time on the planet, which could be another 25 to 30 years. Using this as an example, retirement does not mean that price increases will cease, or that the balance of your existence is going to be defined by time in the rocking chair on the porch. You'll want to continue to do the things that fulfill and enrich your life – spending time with your family, traveling, teaching – whatever you would want to do during the coming “golden years” that you have on your personal “bucket list”. As such, you'll need to have an income and capital base that will provide the purchasing power security *over time* to meet your current and *future* needs. Moving totally to short term depository investments during this timeframe would not effectively meet ones longer term objectives. And in this environment, such an emotional move would be the antithesis of “buy low – sell high”.

Whether or not Albert Einstein actually referred to compound interest as the eighth wonder of the world, investors could benefit from focusing more on the cash flow derived from investments in the capital markets, rather than their day to day price changes. Although exposure to both depository and investment assets is the basis for any complete wealth management plan, there sometimes can be confusion surrounding their attributes. The return from depository assets (savings accounts, for example) is a function of the daily balances on account – assuming a fixed interest rate, the larger the balance the larger the return, as well as vice versa. Investment assets (stock, bonds, for example) have their dividend and interest payments, by and large, determined as a function of the *number* of shares or bonds, not their daily *price*. This is important because, absent extenuating circumstances, the *amount* paid in dividends or interest is not affected by the daily changes in price of the securities in question.

Although important within our disciplined approach to portfolio management where the regular receipt of reinvestable income can provide additional opportunities to compound the growth of assets, this trait is even more important to retired investors. With their investment

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assets viewed as producers of supplemental income, the fact that dividends are not paid based on share price, but based on the number of shares owned (or interest on the number of bonds owned), can provide partial solace to income oriented investors over the last year. Likewise, gradually deploying cash at these market levels can provide the opportunity for compelling dividend and interest current yields not seen in more than a decade.

Lastly, the focus on “calling the bottom” is nothing more than an academic exercise in frustration. Focusing on trying to discern that inflection point is like trying to hit a can of tuna with a BB gun at 100 yards – not an effective use of ammo. Our belief is that a gradual “dollar-cost-averaging” approach to adding cash back to the capital markets over the next several months may provide a greater likelihood for success – much like a shotgun blast when the can of tuna is moved to 10 yards out.

Additionally, given that the markets are leading indicators of economic activity, one can understand that investment prices may move before apparent changes in the condition of the underlying economy. Remember that the markets peaked in late 2007, before many of the economic fissures were fully realized. We would expect that the monetary and fiscal stimulus that is being deployed will eventually have an impact – probably by late '09 or early '10. And the economy may likely get worse before it gets better – since the release of the relevant data is often times a lagging, rather than leading, indicator. But by focusing on the current income that can be garnered from investments at these levels, and recognizing that the market is a discounting mechanism, patient investors could be well served over the next 5 to 10 years.

## **EQUITY MARKET OVERVIEW**

**INVESTMENT POLICY COMMITTEE**

### ***No Place To Hide...***

The credit crisis morphed into forced liquidations as the world's capital markets continued their deleveraging in the 4<sup>th</sup> quarter, driving equity prices lower around the globe, and culminating in a year of negative superlatives. As a variety of asset prices, from financials to commodities and real estate, continued to decline in the early part of the last quarter of the year, collateral calls from the lenders to over-leveraged entities (a.k.a. hedge funds and investment banks) unleashed a torrent of forced selling in the domestic and overseas equity markets.

Absent anyone willing to try to catch the falling knife, stock indices succumbed to an abundance of sellers and a lack of buyers, touching a closing low of 7392.27 in the DJIA on November 21<sup>st</sup>. A measure of the magnitude of the quarter's developments was seen in the dramatic daily price swings:

*“Volatility was startling. In October, the Dow enjoyed two of the six biggest one-day percentage gains in its 113-year history, and then gave back all the gains and fell to new lows. Four of the 20 biggest daily percentage declines in Dow history happened in the last four months of 2008. Early in October, the Dow Industrials suffered their worst calendar-week percentage decline on record. Analysts blamed the swings on fast moving hedge funds*

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*and the heavy use of borrowed money, as stocks sometimes soared one day and collapsed the next.”*

WSJ 01/02/09

With the investing public stunned by the unheard of price swings, and traumatized from the daily drama being narrated by the media's talking heads, it's no surprise that wholesale liquidations may have emanated from a shorter term emotional perspective precipitated by a visceral reaction to their morning java being overshadowed by the financial networks' headlines that greeted their morning ritual.

Although the domestic indices recovered a bit from their November lows by the New Year, the numbers for the quarter and year stacked up to something that every investor would just as soon forget. The Dow Industrials lost 15% during the 4<sup>th</sup> quarter to close out an unpleasant 2008 down 33.8% - and as had been pointed out in the press ad nauseam - the index's largest decline since 1931. Likewise from the historical time line perspective, the S&P 500 dropped 16.7% in the quarter, finishing the year off 38.5%, while the NASDAQ slid 17.8% during the quarter, down 40.5% for the year, its worst performance in the index's 37-year history.

The rest of the globe's bourses were not spared the forced liquidations brought on by the tsunami of deleveraging circling the planet. London's FTSE 100 dropped 8.3% during the quarter to close down 32.4% for the year, Frankfurt's DAX was down 15.8% (off 43.5% for the year), the Paris CAC 40 slipped 14.4% (a decline of 42.6% for 2008), while Tokyo's Nikkei was off 16.2%, finishing 2008 down 42.6%. The developing world's markets, which had been the relative stars as oil and commodities rode their moon shot in the first half of the year, sustained the proverbial double whammy as both the financial *and* commodities markets came back to earth during the last two quarters of 2008. The BRIC countries were emblematic of the retreat, with Brazil off 41.2%, Russia down 72.4%, India dropping 52.4% and China 65.4%.

As we've commented in the past, fear and greed in the capital markets tends to push the extremes on both ends of the spectrum. Just as we were less than enthusiastic in 2007 as the markets pushed inexorably higher in the face of our aforementioned structural issues within the economy, we now feel that emotion has gotten the better part of this retreat and rational investors need to prudently, and gradually, begin to take advantage of the opportunities which have now become available.

*“At some point, experts agree, the stock market will hit bottom and move higher. Some people believe it happened in November, when stocks hit multiyear lows and then began an upswing. Others think stocks will sag again and won't bottom out until later, perhaps some time in 2009...”*

*“In other words, stocks do rebound sharply after a bad fall, but the trick is figuring out when they are done falling. Whether stocks indeed turn up in 2009, as is widely expected, depends in large part on how successful policy makers are in stabilizing the economy and credit markets, and getting banks to lend again.*

*“As the year ended, with the Fed pumping billions of dollars into credit markets, there were initial signs of thawing in things like interbank lending and demand for the highest grade of corporate bonds and other securities.” WSJ 01/02/09*

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We're not focused on having to pick the absolute bottom in the markets. We're far more interested in taking advantage, over a period of time (somewhat akin to dollar cost averaging), the values that are presenting themselves after this downdraft. Adhering to our long term asset allocation discipline compels us to evaluate income producing investments that can enhance cash flow. We believe that when the bathwater is followed out the window by not only the baby, but the sink, fixtures and most of the plumbing, patient investors should scour the landscape on the other side of the recession "valley" to find opportunities they can begin taking advantage over the near term.

## **BOND MARKET OVERVIEW**

## **INVESTMENT POLICY COMMITTEE**

### ***Pushing On a String***

After shaving the Fed Funds rate 3 times in late 2007, the F.O.M.C. got "serious" in 2008, taking out the machete and slashing the benchmark interest rate 7 times, the last in December which lowered the stated target rate to "0-0.25%". In conjunction with the discount rate being lowered to one half of one percent (levels not seen since the 1940's), and a commitment to continue their passel of newly minted lending programs and securities purchases, the Fed's statement on 16<sup>th</sup> of the month said it all:

*"The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability."*

As was pointed out later the same day by President-Elect Obama, it would take more than just the Fed reducing rates to get the domestic economy back on its feet again – an obvious foray into promoting his administration's upcoming stimulus proposals:

*"We are running out of tradition that's used in a recession, which is to lower interest rates. They're getting to be about as low as they can go. And although the Fed is still going to have more tools available to it, it is critical that the other branches of government step up."*

In more "normal" times we typically see the bond market being perceived as a "follower" in the world's capital markets – something that was dramatically turned around in the last year:

*"The credit markets led stocks and the U.S. economy down in 2008, setting records along the way as prices of corporate and mortgage bonds sank to new lows and yields soared to sky-high levels.*

*The new year probably won't bring declines of the same magnitude, if only because many bonds and loans already are at depressed levels and the pace of deleveraging -- the selling of assets by financial institutions and investment firms -- is likely to slow.*

*Multiple efforts by the Treasury Department and Federal Reserve to spur lending by banks and finance companies to individuals and businesses could help heal battered credit markets, or at least cushion the blow to the economy."*

WSJ 1/2/09

Oblivious to the U.S. government's efforts to encourage lending by the banks, and despite the fresh cash on their balance sheets, the credit markets remained dysfunctional during the

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4<sup>th</sup> quarter of 2008 and banks were reluctant to push any of the dollars provided to them back out to consumers or businesses – regardless to their size. Surplus reserves at the Fed (deposits from member banks) continued to grow significantly during the last quarter of the year as banks focused a return *of* their cash, rather than a return *on* their cash.

Although a variety of credit spreads improved modestly after the Fed's December moves, the reality is that even the spreads between investment grade corporate debt and Treasuries continue to be at historic levels given the developments during the 2<sup>nd</sup> half of 2008. This ongoing frost in the bond market continues to impede the extension and continuation of the credit necessary for businesses and consumers to effectively address this economic downturn, thereby extending the recovery timeline.

*“Other credit spreads have also narrowed sharply since the Federal Reserve took its key target interest rate to nearly zero and suggested it would keep rates low for a while.*

*“Such spreads are a closely watched measure of how much risk investors and banks are willing to take when extending credit. Lower spreads typically mean they're more willing to lend. That's good news for corporations that want to borrow, and in turn helps economic growth and stock prices.”*

WSJ 12/29/08

The investment impact has been an extraordinary flight to perceived quality whereby Treasuries may have become the newest asset class bubble. As funds poured into government bonds, short term T-bill rates dropped close to zero and even the 10 year T-note dipped briefly below a 2% current yield. Similar duration investment grade debt hardly moved as fretful investors discounted the security of anything other than sovereign debt. When 10 year investment grade municipal bonds pay 200 to 300 basis points more than comparable Treasuries, it's a sign of ongoing dysfunction in the credit markets.

These dynamics may be presenting opportunities for patient bond investors to realize equity type returns as the capital markets slowly recover into the future. With non-government backed debt priced for financial Armageddon, it would appear that investment grade debt, both within the corporate and municipal markets, could offer attractive risk-reward characteristics. The absence of bids for these assets has driven their current prices down, and current yields up, to the point where the convexity of some bonds is as attractive as it has been in decades. With prices at these levels, these issues will react favorably to relative interest rate reductions, while being relatively insulated from rate increases – thereby being described as highly convex debt in their reaction to interest rate changes.

With the likelihood of increasing interest rates on the horizon, given the massive government stimulus both here and abroad, it would appear the downside risk profile from Treasuries at these levels would warrant some concern:

*“Many investors argue it's dangerous to buy Treasuries with such low yields. While a holder can expect to get repaid in full at maturity, the price of longer-term Treasuries could fall sharply in the interim if yields rise. The 30-year T-bond, for instance, would drop 25% in price if its yield rose to 4.35%, where it stood as recently as Nov. 13...The chief risk to the Treasury market stems from the potentially inflationary impact of both the Federal Reserve's super-accommodative monetary policy, which has dropped short rates close to zero, and the*

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*enormous looming fiscal stimulus from the federal government. It also may take higher yields to attract investors -- particularly foreigners -- as the Treasury seeks to fund an estimated deficit of \$1 trillion or more in the coming year."* *Barron's 1/5/09*

In this environment we will continue to focus on the opportunities in floating rate issues that will provide the benefit of adjusting to rising interest rates going forward, as well as the hedging benefits from government backed inflation protected securities. Employing both dollar denominated issues, along with those in other currencies, will help insulate against future reductions in purchasing power that could result from increasing rates of inflation and interest rates. Combined with the select opportunities that present themselves in other corners of the bond market, we feel the evolving recovery over the intermediate term will be rewarding for prudent longer term investors.

## **WEALTH MANAGEMENT UPDATE**

**TRACY W. ROGERS**

### ***Planning Opportunities for 2009***

We want to highlight two significant tax law changes for 2009 that will require some strategic planning. The first is an adjustment in the regulations for mandatory Required Minimum Distribution rules. This will provide some flexibility for retirees and retirement plan beneficiaries. The second act repeals income limits for Roth IRA conversions, which presents wealthy Americans with an outstanding lifetime-and-beyond tax break

**Required Minimum Distribution Basics.** Participants in "qualified plans" and individual retirement accounts are normally required to begin taking distributions no later than April 1 of the year after they reach age 70½. The amount is based on the account balance as of the end of the prior year divided by a distribution factor derived from the uniform lifetime table published by the IRS. Failure to make an RMD triggers an onerous 50 percent excise tax.

**New Law.** The 2008 Recovery Act provides a one-year suspension of the RMD rules, allowing retirees to keep more money in retirement accounts in 2009. RMDs for 2008 are not affected and still need to be made before December 31, 2008. Specifically, no minimum distribution is required for calendar year 2009 from Individual Retirement Accounts and defined contribution retirement plans (such as Section 401(k) plans). This also applies to Section 457(b) eligible deferred compensation plans – which are available for governmental and certain non-governmental employers. The next RMD will be for calendar year 2010. This applies to life-time distributions to employees and IRA owners and after-death distributions to beneficiaries. A taxpayer who reached age 70 ½ in 2008 but chose to wait until April 1, 2009 to receive his 2008 RMD will still be required to make that distribution. However, he does not have to make the required RMD for 2009.

The 2008 Recovery Act's suspension of RMDs for 2009 helps retired taxpayers who are well-to-do and do not need to rely on their RMDs for living expenses. By not making the RMD for 2009 (or withdrawing less than the RMD) from their qualified plan accounts and/or IRAs, they will wind up with less taxable income for 2009. This could help avoid or mitigate

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the effect of AGI-based phase outs of tax breaks. They will also have more tax-sheltered assets to leave to their beneficiaries. Older recipients will benefit the most because their table-life expectancy factors would otherwise require large RMD payouts in 2009.

Taxpayers that can afford to not take an RMD in 2009 will have the opportunity for their investments to recover (if the market rebounds over the next 12 to 24 months) before having to sell assets in order to make withdrawals. The new law does not benefit those taxpayers who must make regular withdrawals (sometimes in excess of the RMD) from their retirement plan accounts and IRAs in order to get by each month. For the past year or so, those with a substantial portion of their retirement funds invested in stocks or mutual funds have been forced to take payouts from constantly dwindling account balances. They are likely to continue along that difficult pattern in 2009, barring a dramatic market turnaround.

**Roth IRA Conversion Changes.** The May 17, 2006 tax act, titled the *Tax Increase Prevention and Reconciliation Act* (or TIPRA) removed the income limit for Roth IRA conversions for tax years after 2009. Starting in 2010, wealthy Americans will qualify for a Roth IRA conversion regardless of their income. Previously, taxpayers with a modified adjusted gross income of \$100,000 or more were not permitted to make Roth IRA conversions. Individual IRA owners who have modified adjusted gross incomes of more than \$100,000 will be eligible for a potential windfall by taking advantage of the opportunity to convert their traditional IRA to a Roth IRA.

If you make the Roth IRA conversion in 2010 you will be given the option to pay all the taxes on the conversion in 2010 or average the taxes owed on the conversion over two years. It is important to be aware that 2010 is the last year for the current low income tax rates. Current law provides for an increase in tax rates in 2011. Therefore, if you were to choose to average your tax payments over the two year period in 2011 and 2012, you might be hit with higher tax rates.

**What Happens When You Make a Roth IRA Conversion?** When you make a Roth IRA conversion, you pay income tax on the amount you choose to convert. When you take advantage of this provision you will pay income taxes “now” on all or a portion of your traditional IRA. While the standard advice “to pay taxes later” still applies to the majority of successful long-term plans, this may not always be the case with respect to Roth IRA conversions. Each case needs individualized analysis on the merits of the conversion, but it may be better for many individuals and their families to pay taxes now.

The critical feature of the Roth is that once the initial taxes are paid on the conversion, income taxes will never be due on its growth, capital gains, dividends, interest or withdrawals of principle. This will be particularly advantageous to high-income taxpayers as marginal tax rates increase. For the very high income family, the benefit of a Roth IRA conversion is potentially phenomenal. An estimate is that a taxpayer’s family could *benefit by as much as twice the amount converted.*

**Should you do it?** Even with the higher tax bill, there are some big advantages to doing a Roth IRA conversion:

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- Many are concerned that income-tax rates will go up sooner or later. If the current low rates still apply in 2010 then converting lets you lock in those low rates and avoid higher taxes later.
- If you convert during 2010, you can spread your tax liability out across the 2011 and 2012 tax years. In subsequent years, you have to pay tax the same year.
- Unlike traditional IRAs, Roth IRAs don't force you to take money out if you don't need it. That opens the door to a very effective estate-planning technique, where you can pass on your Roth IRA to your heirs who can then enjoy tax-free distributions throughout their lives.

It's that last point that's the most powerful. You enjoy tax-free growth for the rest of your lifetime. Then, if you leave your Roth IRA to your kids or grandkids, *they* won't pay income tax, either -- they just have to take withdrawals based on their life expectancy. As always, these are general guidelines and each client's needs are different and individual. Please schedule an appointment to discuss how these changes may benefit your planning.

## INSIDE THE MARKETS

FRANCIS J. DAVIES III

### *Fin de Siècle*

Literally French for the end of a century, “fin de siècle” has a subtler meaning; suggesting both dreariness at the end of an age of extravagance and an eager anticipation for a new, saner era. The fourth quarter of 2008 saw the end of easy access to borrowed money. Without this endless borrowing, our asset-based economy could not continue. The credit markets froze solid and brought on the extinction of the mammoth investment banks, unable to survive without massive lines of credit. This was the ruination of the Wall Street culture that has shaped my work life reality since my first day in the business in May of 1982. The financial engineering, outlandish compensation and vulgar arrogance will not be missed.

Essentially any firm that sponsored a golf tournament is either dead or wounded. Lehman is gone along with their legendary fixed income desks. Morgan Stanley and Goldman are now bank holding companies offering toasters to new customers. Poor old bumbling Merrill Lynch, the butt of every Wall Street joke, is now part of Bank of America, a fate worse than death. No word yet on the toasters. All of this is good news. It is clear that unbridled greed is not only bad morals; it is also bad economics. Greed caused a fixation on short term results; a cut and run mentality that violated the trust the public had that the investment industry would at least pretend to safeguard our money. Now we will pick up the pieces and soldier on.

At the end of the third quarter, I wrote of the still developing bailout plan, “... it has an essential flaw. It tries to maintain the status quo... We cannot afford what we have. The plan should really be to shrink the economy back to a sane level. Shrink the massive debt down to a level where earned income can support it.” As always, government band-aids were no match for the will of the market. The global economy is now in the midst of a massive deleveraging. This painful step is essential for the return to an economy based on real productivity. It will be easier to accomplish this without the huge investment banks lobbying against it every step of the way. That is one small silver lining.

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The belief in the infallibility of long-term investing also ended in 2008. For years, investors were told that all they had to do make money in the equity markets was buy and hold. The longer they held, the lower the risk and the higher the return. Unfortunately, nothing is that simple. The relative value of the investment when purchased matters much more than length of time of ownership. Financial advisors also love to tell their clients, “No one can time the markets.” This is the coward’s way of admitting they cannot judge whether an investment is cheap or expensive, therefore there is no way they can help you to “buy low and sell high,” which is the most misused cliché in investing. So the client is left to ride the waves of the market – up, down, sideways and hope for the best.

We stress preservation of capital at IMCG precisely because the economy moves in cycles and cycles eventually end. What is important is that we profit from the growth periods and be patient in times of economic contraction. The only true test of a portfolio manager is performance during these difficult times. Anyone can make money in a bull market. Not many can hold on to those gains. To preserve capital, one must be able to sell at the right times. When valuations are stretched, assets must be reallocated to cash. This is why we were raising cash in May and putting that cash back to work in December.

A year like 2008 reveals much. The S&P 500 dropped 39%, a disaster only topped by the 43% decline in 1931. The year got off to a bad start for equity investors and went down from there. The S&P 500 never closed above where it had ended 2007. Only 29 stocks in the index finished the year in positive territory. As the market crashed, newspapers and television were jammed with salespeople dressed as advisors offering useless clichés. They warned that it was not the time to sell and they stressed that it certainly was no time for panic. Of course, none of them had ever recommended selling. A suggestion to raise some cash when the S&P 500 was hanging around 1400 in November of 2007 would have been useful advice. However, a year later, with the index now at 800 and portfolios in flames, implying that anyone selling stocks lacked nerve was less than useless. But it did take a lot of nerve.

Passive buy and hold leads nowhere. Look at the recent history of the S&P 500: it first broke 800 in April, 1997 and traded above 1500 for most of 2000. The tech crash pushed it back below 800 in the spring of 2002, completing a round trip that took roughly 5 years and yielded nothing. The index got over 800 once again in March, 2003, reached 1500 in May 2007 and was back below 800 in November of 2008. Another round trip, although this one took a little longer. More importantly, for the first time since the bull market started in 1982, the S&P 500 now has a negative return for the previous 10 years.

In real life, this means if you had put \$10,000 into an S&P 500 index fund in December of 1998, maybe as a present for a new baby; the child is now 10 years old and his college fund is worth exactly \$10,000. There was no reward for assuming market risk for 10 years. You would have been better off buying Treasuries. That is hard to take. What is even tougher to take is that the account was worth \$13,000 in March of 2000, \$7000 in October 2002 and got back to \$13,000 last October.

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Buying is the easier part of the process. Market lows are fairly simple to identify - it is when the pain is unbearable. A low is when the S&P 500 is below 900 for the first time in over 5 years. But to buy at the lows, one must have cash from having sold at higher prices. The reptilian brain knows when the market is low, recognizing the highs takes some insight. It is the ability to look out at the clear blue sky and perfect conditions and realize that if the environment is perfect, it cannot get any better and therefore it is time to take profits.

The best description of this mindset that I have seen in my 30 years of investing comes from F. Scott Fitzgerald. In 1936, he wrote a brilliant essay for *Esquire*. In it he said:

*The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function. One should, for example, be able to see that things are hopeless and yet be determined to make them otherwise.*

As Fitzgerald knew, life is not composed of simple, black or white, good or evil choices. The same is certainly true for investing. It is a nuanced process that requires subtle shifts. Improving the performance of a portfolio does not demand calling the exact top or bottom, or selling everything at once or becoming fully invested on a whim. But it does require some proactive thinking.

The reduction of leverage has significant consequences for the future of investing. There is no longer the mass of hedge funds and private equity concerns out there chasing the same companies. Both the economy and investing will have to return to the fundamentals. This will lower risk adjusted returns. Risk has been redefined from the fear of missing the next rally to the fear of losing everything. The US will likely see its first trillion dollar deficit in the next few years.

On the plus side, the last few weeks have seen an ebbing of the extreme volatility we experienced in October. Mutual fund redemptions reached a crescendo and will not exert as much pressure on the markets. Much of the uncertainty has been removed. The problems have not been solved, but at least they have been identified. The equity market has gone through the wringer, the most severe peak-to-trough bear market since the Depression, so we have discounted the most severe post-war recession. Valuations matter. 40% off is a sale worth investigating.

A telling sign of a bottoming process was the market's performance in December. It managed a small gain despite the Madoff story. When stocks stop going down on bad news, we pay close attention. But, as we know, buying is the easy part. Knowing when to sell is more challenging and more important.

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## **IMCG NEWS**

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### IMCG PROMOTIONS:

We are pleased to announce the promotion of *Ms. Camille Shiffler* to Operations Director for the firm. Having joined IMCG 3 years ago, she previously managed the Client Service Team and its Associates. To those responsibilities she will now add oversight of our custodial and technology interfaces, as well as be part of the Management Team. Additionally, *Mr. Travis Spencer* has been promoted to Portfolio Manager Associate from his previous role as a Client Service Team member. Having also successfully completed his Series 65 testing for the investment advisor registration he has joined IMCG's *Retirement Plan Team* consulting to employers and employees with regard to their qualified retirement plans.

### IMCG SEMINARS & EVENTS:

**JANUARY 28<sup>TH</sup>** – *THE BLACK BEAR INN, ORONO* (along with Portland and Sanford dates to be announced for February and March): **“Volatility...Can Lead To Opportunity”** – A discussion about the economy and capital markets, focusing on what prudent long term investors should do to properly align their portfolio allocations and financial plans with the current environment. Seating is limited so please reserve space by calling 800.605.6552 or via e-mail to [admin@imcgrp.com](mailto:admin@imcgrp.com).

**FRED WILLIAMS** – While meeting with clients on the east coast, Mr. Williams will be attending the Morningstar Ibbotson Conference in Orlando March 5<sup>th</sup> & 6<sup>th</sup>. This event will continue Ibbotson's tradition of bringing academic theory to industry practice, with thought leadership on asset allocation, investment research, and portfolio strategy. Additionally during the quarter he will travel to Louisville for The Dream Factory's Executive Committee and National Board Meeting March 27<sup>th</sup> through 29<sup>th</sup>.

### SAVE THE DATES:

**16<sup>th</sup> Annual Child's Play Golf Benefit** – The Dream Factory of Maine's annual event to raise funds for its mission of granting dreams to the critically and chronically ill children of Maine. Scheduled for Friday June 5<sup>th</sup> at Sable Oaks and starting at noon, The Dream Factory grants dreams for critically and chronically ill children nationwide, is based in Louisville, and has 2 chapters in Maine. Additional information can be found at [www.dreamfactoryofmaine.org](http://www.dreamfactoryofmaine.org).

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***Fore The Kids Golf Classic*** – Big Brothers Big Sisters of Southern Maine’s annual fundraiser will be held June 29<sup>th</sup> at The Woodland Club. Additional information on this popular two-ball/best-ball event can be found at [www.SoMeBigs.org](http://www.SoMeBigs.org).

***Greg Francoeur Memorial Golf Tournament*** – The 6<sup>th</sup> annual event to benefit the scholarship fund managed by the Maine Community Foundation which provides support to students enrolled at Carrabassett Valley Academy who would not be able to take advantage of educational and training opportunities without financial assistance. Contact Gary Francoeur at [garyfrancoeur@comcast.net](mailto:garyfrancoeur@comcast.net) for more information about the event to be held Friday morning July 10<sup>th</sup> at the Val Halla Golf Course in Cumberland, Maine.

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