



VANTAGE POINT ADVISORS

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The big picture is that the ship has turned and the employment anchor has been lifted. Full steam ahead.

-Robert Johnson, CFA, is an associate director of economic analysis with Morningstar.

“Society in every state is a blessing, but government, even in its best stage, is but a necessary evil; in its worst state an intolerable one.”

~Thomas Paine

As we reach the end of not just 2009, but the first decade of the new millennium, we are still enmeshed in an economic crisis the likes of which most Americans have never before experienced. It now appears the worst of it is behind us, but if history teaches us anything, it is that appearances can be deceiving and as soon as it appears the worst is behind us, it is time to be cautious.

Over the past year, Vantage Point Advisors have spent hours reviewing data and attempting to help our clients redefine where they stand financially speaking, and more importantly, where they stand on the issue of taking on risks to their portfolio values. This past year has seen a return to risk-taking in the markets in which we all must invest to achieve returns that allow us to maintain what some might now see as bloated lifestyles. There are still demands for exposure to higher risks to achieve higher returns, while we also see several instances in which clients have made some difficult choices to allow their lives to go on without a return to sleepless nights and anxieties brought on by daily events. Growth investments have substantially trumped higher quality investments over the past year. Today, you are offered a mere 3.5% to invest with our most sacred and secure investment, a ten year loan to the US Government. Can many of us come even close to sustaining our desired lifestyle over the next ten years on an income of 3.5%?

When this crisis first hit hard in the fall of 2008, Vantage Point Advisors immediately developed strategies that reflected whether a client was still accumulating new assets or whether they were already living off accumulated reserves, since the first group could conceivably better “stay the course” while the latter group could no more take on continued losses to principal than a drowning man could use a drink of water. We continue to focus in just this fashion, asking for whom are we planning and investing. And our recommendations are heavily colored by the answer. If you are still an accumulator, you should be invested for the longer term, willing to ride out the inevitable swings in market values to achieve higher returns over the next 10+ years. But if you are counting on your nest egg BEING THERE, why take the risk? Make other adjustments, but without a way to replenish the assets lost to the shorter term risks that are always present, why risk a future of a potentially diminished lifestyle?

To be sure, there are signs of an improving economy, and more importantly, there are signs the absolute worst is behind us. Banks continue to fail at an alarming rate, but the largest financial institutions that needed emergency taxpayer help are paying the government back. Our US economy lost just 11,000 jobs in November compared with a consensus estimate of 130,000 job losses. Because our economy employs more than 131 million, 11,000 jobs lost in November is statistically insignificant, especially when we consider the 741,000 jobs lost in January. Further evidence of improving joblessness is the 159,000 jobs added back in the government's revisions for September and October. Although reported unemployment still remains in excess of 10%, these are dramatic improvements, lagging indicators, which demand we adjust the prospects for growth in our economy and likewise our investment portfolios.

There are three drivers for our economy: the consumer, which has been the most dominant over many years; business and the government. Where do we stand now? The government has become the prime driver of our economic activity. Not only via bailout monies to the banks and the auto manufacturers, but to the States for road and bridge construction. Just recently, the government helped yet another industry by slapping huge tariffs, taxes, on imports of tires. We need to ask ourselves as we examine the potential for future economic growth if this driving force is sustainable. Can our government continue to stimulate our economic growth sufficiently until either consumers or business takes back over? Frankly, there is no other choice right now.

Is business growing? Not very much, really. Inventories are at historic low points but orders are not being placed. Businesses have been able to announce reasonably good profit and loss figures, but when those results are supported primarily by cuts in costs, layoffs of workers and other new "efficiencies", how long will those improved results be sustained? Gains in productivity have been the staple of American businesses for many years. We lead the world in ideas to make our companies work smarter and how we can get more out of less. But after decades of relying on the tools of increased productivity, such as outsourcing virtually everything to another company downstream, can those gains be sustained going forward?

How about the US consumer? Is the consumer ready to lead the charge back to full employment? Ask the luxury sellers of goods and services, those who always believed their markets were immune to a downturn. Now that government cash is no longer available to replace our cars, will consumers continue to crowd showrooms and keep autoworkers employed? GM's bankruptcy, we were told, would cascade down and create an abyss from which we would never be able to recover. Did that happen? We see a new paradigm of frugality among Baby Boomers that could result in serious long-term deflation. Baby boomers moving to sell their larger homes, trading down in the cars they buy, the clothes they reuse, the stay-cations they are taking. Not all, mind you, as the wealthiest of Americans are likely to remain a static group, but we are all affected by the broadest measures of consumer trends and they are not on the upswing so far.

We continue to assess that right now, while inflation remains virtually non-existent. Trying to guess *exactly* when to turn your portfolios toward inflation will be near impossible. Instead, we have kept inflation-protection in our portfolios to a minimum, but we are ready to shift to a new stance if we see good reason. Here are some examples to consider:

- * Bonds will perform miserably in an inflationary environment, so we are very mindful of *keeping durations and maturities shorter for more principal protection*. **“Bonds are Signaling A Stronger Recovery”** was the headline this week in the Wall Street Journal and it is important why this is so. When investors are dumping stocks and buying bonds or just sitting in money market accounts, interest rates are being driven lower. But this year, risk appetite has returned and now we are seeing the ten year US Treasury bond reaching new highs. For longer-term growth investors, there are few reasons to maintain a bond portfolio and they might embrace alternatives as their buffer against stock market volatility, a place bonds have maintained for quite a long time. Our exposure to high yield bonds is coming to an end as we seek other growth options and alternative non-correlating investments for the protection diversification is to provide.
- * Higher inflation remains currently non-existent, but because we can never hit the change exactly, we still retain anti-inflation hedges in our portfolios, including a commodity index, allocations to REITs in some models and equities, which are themselves protection from higher prices;
- * We have recently reintroduced the use of PimCo All Asset Fund, a hedge product targeting returns of inflation plus 5% because it will be positioned to deliver before we could actually know inflation has returned. Having these hedge products, “Alternatives” in our portfolio, are an important aspect of remaining properly diversified;
- * Despite the very real difficulties being faced by commercial real estate managers faced with terrible retail sales and a lack of demand for more office space, REITs will be a winner as higher inflation means higher land prices which in turn affect rents and all real estate; we intend to add REITs back and increase current positions;
- * Business will be slow to improve as higher prices get baked into everything from raw materials to labor. Commodities will increase in value as demand increases globally for raw materials, so our smaller commitment will increase too;
- * The equity managers will need to focus on different cyclical industries than they are focused on right now so we may need to rotate certain managers (funds);
- * Foreign securities could suffer as the US Dollar would be more valuable with higher domestic interest rates and rates will be increased to respond to inflationary pressures. This past week saw a huge surge in the value of the US Dollar, after months of decline against the rest of the world’s currencies. Our foreign equity managers hedge the currency risk, and now that Europe’s recovery is following our own, we want continued exposure to the rest of the world’s best companies. We see the greatest growth opportunities in smaller companies in developed countries and in emerging markets which economies have almost been completely sheltered from the recession.
- * Although the Federal Reserve has again indicated its willingness to keep interest rates low to spur borrowing and economic growth, eventually interest rates will increase to stem the inflationary tide. Higher rates slow growth enabling those companies who pay dividends and have real growth instead of just plans for growth, to prosper; think “value” over growth” in equities;

If investors need another sign of the changed economic landscape, they need look no further than Social Security. Largely because of the economic downturn and a decline in energy prices, inflation has been low and is expected to stay low for the coming year. As such, for the first time since 1975, Social Security recipients will not receive a benefit increase in 2010. Vantage Point continues to work with clients who are closing in on their decisions on exactly when it is best to begin collecting their benefits. This is a complex area, but we have found a great resource at the Social Security Administration who helps us work through a variety of options. We recently determined a client could begin collecting her own benefit *right away*, while continuing to delay collecting her much larger widow's benefit by waiting until she reached her "normal retirement age". That will lock in larger benefits for the longer-term. We also have helped clients implement a "buy back" provision in the law to actually pay back what they have been receiving as reduced benefits from collecting too early, only to thereafter qualify for substantially increased benefits from restarting at a higher age.

A bill introduced by Rep. Earl Pomeroy, a Democrat from North Dakota, that would extend the 2009 federal estate tax level to 2010 and make permanent the estate tax at a \$3.5 million exemption level and 45% maximum tax rate was approved along party lines December 3 by the full House of Representatives. Unfortunately, the Senate did not take up the estate tax situation and we are all awaiting the legal guidance we need to make sound plans into 2010. It is extremely irresponsible for our government to allow this estate tax issue to go unresolved, so here is what is set to happen: In another week or so, the estate tax will become non-existent, although Democrats have indicated some retroactive fix will occur in early January. Until then, estates will also not have the "stepped up basis" that now exists that keeps assets purchased years ago from being taxed for capital gains. Just think about that record-keeping nightmare for executors. And there are some who will challenge the retroactivity of any new law on Constitutional grounds. We think it remains prudent to expect some form of estate tax relief, but at this time, who really knows? Brenda Schafer, a tax expert at H&R Block's Tax Institute, called the entire scenario a nightmare for tax planners. "It's chaos," she said. "It is just crazy because you don't know what to do. The only thing we know for sure about the situation is that it is all going to get undone."

Tax Planning took center stage for us these past few weeks. For us, that means making certain 2009 gifts get completed to save estate taxes, making sure capital gains and losses are considered to reduce income taxes and finally examining the opportunities to convert traditional IRAs to ROTH IRAs for long-term tax savings. VPA completed an extensive review of all of our clients' 2008 tax returns, if we had them, and made several recommendations to remove IRA assets or convert them to ROTH status before the end of 2009. ROTH conversions will be all the rage in 2010 as the income limits that keep many from this conversion are removed. The choice to convert is not a slam dunk, but for many it will make great long-term sense to pay some tax now and none in return.

Karen McIntyre, CFP, our VPA Vice-President, recently accepted an invitation to speak at our local Sunrise Senior Living of Blue Bell as part of National Assisted Living Week. Karen is our in-house expert on long-term care issues and has made several important connections with Elder Care attorneys as well as gerontologists and other providers to the elder marketplace. If you have questions about Long Term Care Insurance, for yourself or your parents, Karen is ready to help.

As VPA looks to 2010, we are excited to have selected a new technology partner and we will be upgrading our computer server to make us all more productive. This new partner will also enhance our data security with offsite back-up storage. We have entered into an agreement with the Family Office Network to offer an online secure cyber vault to our clients and their outside advisors, into which we can store important documents for easy access. We are also bringing new technology onboard that will allow us to bring in data from accounts held outside of Schwab, such as 401K accounts, so they can be embedded into our portfolio performance reports and analyzed as part of the overall picture for which we most often have responsibility. We are advancing our plans to build a new headquarters in Horsham, a short distance away, and it looks as though next year's December letter may be written from our new digs. We are pursuing LEED certification for our new building and interiors, the most advanced standard for energy and sustainable environmental design supported by the Green Building Council. It is a very exciting project.

Finally, we are investing in our own staff members, attending conferences, advancing our education and our ability to serve you, our most important audience. We are grateful for the opportunity you have given us and we embrace the responsibility that comes with your trust and confidence and referrals of friends, family and colleagues at work. Keep 'em coming.

Best wishes for a happy New Year. We look forward to working together for years to come.

Respectfully,

Terry J. Siman, *President and Chairman*

Vantage Point Advisors Investment Committee