



# Fullerton Tax & Planning

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*"Real People provide Real Service"*

**August, 2009**



Summer.....

Has been hot in much of the West, cool in the North and signs of recovery overall. Utilities are either complaining because of the weather or pouring on the power to keep up with the heat. Vacation spots like the Hawaiian beach above are down in footprints because of the economy. Jobs are still being dropped. But small bright spots like the Cash for Clunkers program have sailed.

So it is a mixed bag. Our Washington people are heading home on one of their many scheduled breaks, with promises of doing more work after Labor Day. At least they will be vacationing with their constituents' including the unemployed types. So August is a time for a slowing down process. Then it will be on to school sales, October sales for Christmas and hopefully more good news on the economy. Most analysts are predicting jobless numbers to drop and employment numbers to climb back into the black by the first quarter of next year.

As to portfolios from this last month and the second quarter, our reviews show positive returns from 6% to 28% depending of the assets in the mix. Even at 6%, that would translate into 24% for the entire year. So the markets have recovered some of the drop that incurred since last September. There is still a long way to go before this crisis comes full cycle.

Banks are lowering their rate offerings indicating that inflation is not a problem yet.

The rates locally and nationally are .....

Name	Term	Rate
Ally Bank (formerly GMAC)	1 Year	2.15
Discover Bank (online)	1 Year	2.00
Corus Bank	1 Year	2.25
PNC/National City	1 Year	2.00
Second Federal Bank	15 month	2.75

Stay short and stagger the maturities to take advantage of upcoming yield changes. If the money markets are close to the certificate of deposit rates, stay in money markets for the next six months.

The Markets according to the indices

## The Monthly Index Report for July 2009

Index	Jul-09	QTD	YTD	Description
S&P 500 Index*	7.4%	7.4%	9.3%	Large-cap stocks
DJIA*	8.6%	8.6%	4.5%	Large-cap stocks
Nasdaq Comp.*	7.8%	7.8%	25.5%	Large-cap tech stocks
Russell 1000 Growth	7.1%	7.1%	19.5%	Large-cap growth stocks
Russell 1000 Value	8.2%	8.2%	5.1%	Large-cap value stocks
Russell 2000 Growth	7.8%	7.8%	20.0%	Small-cap growth stocks
Russell 2000 Value	11.6%	11.6%	5.8%	Small-cap value stocks
EAFE	9.1%	9.1%	18.3%	Europe, Australasia & Far East Index
Lehman Aggregate	1.6%	1.6%	3.5%	U.S. Government Bonds
Lehman High Yield	6.1%	6.1%	38.4%	High Yield Corporate Bonds
Calyon Financial Barclay Index**	-1.2%	-1.2%	-5.7%	Managed Futures
3-mo. Treasury Bill***	0.0%	0.0%	0.2%	

All returns are estimates as of July 31, 2009. \*Return numbers do not include dividends.  
 \*\* Returns are estimates as of July 30, 2009.

### Neural Fair Value Portfolio

Company/Ticker	Risk	Style	Current Price
ADC Telecommunications/ADCT	High	Blend	10
Accenture/ACN	Medium	Growth	35
Allergan/AGN	Medium	Growth	52
BMC Software/BMC	Medium	Blend	34
Capella Education/CPLA	N/A	Growth	63
Check Point Software/CHKP	High	Growth	26
General Dynamics/GD	Low	Growth	53
Hanesbrands/HBI	N/A	Blend	17
Hanover Insurance/THG	Medium	Value	40
Herbalife/HLF	Medium	Growth	32
Hexcel/HXL	Medium		9
Hologic/HOLX	High	Growth	15
Immucor/BLUD	N/A	Growth	16
Integrus Energy/TEG	Medium	Blend	33
Int'l Business Machines/IBM	Medium	Growth	117
Lockheed Martin/LMT	Medium	Growth	75
Macy's/M	High	Blend	13
NetApp/NTAP	High	Growth	23

PetSmart/PETM	Medium	Growth	23
Polycom/PLCM	High	Growth	24
QLogic/QLGC	Medium	Growth	13
Symantec/SYMC	High	Blend	17
Tempur-Pedic Int'l/TPX	High	Growth	14
Tidewater/TDW	Medium	Value	47
Tyco Int'l/TYC	Medium	Blend	29

## 10 Financial Myths Busted

We can feed conventional wisdom into the shredder.

**Before the economic rout**, you could rely on certain iron laws of personal finance. For example, it was a given that house values didn't fall. Money-market funds never lost a dime. And no matter how ugly the market, expert mutual fund managers could protect you from drastic losses. Alas, in this Hydra-headed global financial crisis, another generally accepted principle of financial strategy or economic logic finds its way into the shredder almost every day. Here are ten truisms that no longer pass the test.

**Myth #1. There's always a hot market somewhere.** When U.S. markets began to blow up, you heard about "decoupling" and "the Chinese century." The idea is that Asia or Russia or Latin America can grow vigorously independent of the U.S. and Europe. Invest there and you'll offset losses at home. Instead, Chinese, Indian and Russian shares have crumbled. Net investment money flowing into emerging market economies fell 50% in 2008, to \$466 billion, and is forecast to sink to \$165 billion in 2009.

**The truth:** In this age of globalization, economic downturns and bear markets observe no borders.

**Myth #2. Real estate behaves differently from other investments.** Call it a bubble instead of a boom if you like, but it was supposed to be "proof" that real estate returns don't strongly correlate with the returns of stocks and other financial investments. The message: Rental properties or real estate investment trusts can make money despite drops in Standard & Poor's 500-stock index or the Nasdaq. Wrong. REITs lost 38% in 2008 because the credit crunch and overly aggressive expansion plans hammered profits and dividends. REIT returns used to have little correlation with the stock market.

**The truth:** Real estate won't overcome other risks when credit problems are harming all investments.

**Myth#3. Reliable dividend payers are safer than other stocks.** Companies recognized as dividend "achievers" or "aristocrats" because they could be counted on to increase their payouts regularly used to perform more steadily than most stocks. That's because shareholders seeking income tended not to sell. But now shares of dividend achievers can be as volatile as the overall market. One reason: more mass trading of blue-chip stocks in baskets, a la exchange-traded and index funds. Another factor: Banks, insurance firms and real estate companies can no longer afford to pay high dividends.

**The truth:** Companies aren't too proud to stop increasing dividends. If you want stable dividends, ignore the past and look for companies with lots of cash flow.

**Myth#4. Foreign creditors can drain the U.S. Treasury overnight.** Puny Treasury yields suggest that it's bad business for the rest of the world to lend so much money to the U.S. But think: What else would these investors do? And who has the power to impose this dramatic sell order? Nobody. Foreigners own \$3.1 trillion of Treasury debt. Of that, \$1.1 trillion is with private investors mainly pension funds, which cannot safely ignore a class of investment that is absolutely liquid and has never defaulted. Governments and institutional investors hold the rest. On occasion they have sold more U.S. debt than they have bought. But massive private buying has overwhelmed the modest pullbacks.

**The truth:** If what you want is super-safe bonds, the U.S. Treasury is the go-to-place.

**Myth #5. Gold is the best place to hide in a lousy economy.** In early February, an ounce of gold traded for \$910. That's just where it sat a year ago, when world economies weren't so bad off. But foreign and domestic stocks, real estate, oil and riskier classes of bonds have all tanked since, and now gold looks ahem as good as gold. However, gold does not typically benefit from a recession. As inflation slows, people buy less jewelry, industry uses less gold, and strapped governments sell reserves to raise cash.

**The truth:** Gold tends to rally in prosperous times, when you have inflation, easy credit and flush buyers (kind of reminds you of real estate.)

**Myth #6. Life insurance is not a good investment.** This canard spreads as 401(k)s and IRAs supplanted cash-value life insurance as Americans' most popular ways to build savings while deferring taxes. True, the investment side of an insurance policy has higher built-in expenses than mutual funds do. But two factors point to a revival of insurance as an investment. One is guaranteed-interest credits on cash values, which means that if you pay the premiums, you cannot lose money unless the insurance company fails. The other is the boom in life settlements. If you're older than 65, you can often sell the insurance contract to a third party for several times its cash value and pay taxes on the difference at low capital-gains rates.

**The truth:** A good investment is one in which you put money away now and have more later. Checked your 401(k) lately?

**Myth #7. The economic downturn dooms the dollar to irrelevance.** No question, the U.S. is deep in debt and going deeper while the economy contracts. History teaches that when a country can't pay its bills, lags economically and cannot control inflation, its currency loses value. That's why currencies in Argentina, Iceland, Mexico and Russia have all crashed within recent memory. The dollar does swoon, and it's lost punch in places as unexpected as Brazil and India. But and here's the surprise as recession gripped the U.S., the dollar got stronger. For one thing, there aren't many alternatives. For another, some other currencies were temporarily inflated by oil and commodities speculation.

**The truth:** The dollar has survived a tough test and remains the world's "reserve" currency.

**Myth #8. Mass layoffs reward investors.** In the 1990s, news of layoffs would boost a company's stock for several weeks. Stock traders lauded bosses for tightening their belts, so it was smart to buy or hold the shares. But mass firings no longer impress investors. Lately, firms as varied as Allstate, Boeing, Caterpillar, Dell, Macy's, Mattel and Starbucks have all announced enormous layoffs only to learn that, if anything, doing so spooks the market even more. For example, on the day in January when Allstate axed 1,000 of its 70,000 employees, its shares fell 21%

**The truth:** Don't buy a stock thinking that a layoff will help profits. More likely, trouble's brewing.

**Myth #9. It's crucial to diversify a stock portfolio by investing style.** Experts say a sound fund portfolio fills all "style boxes." Starting with growth and value. Growth refers to companies with expanding sales and profits. Value describes stocks selling for less than the business is worth. In 1998 and 1999, growth stocks soared and value stocks stalled. Then, for a few years, value rose while growth got crushed. But since 2005, the differences have been melting away. In the current bear market, both styles have been disastrous, and it's hard even to classify stocks as growth or value anymore. Many former growth stocks, such as technology companies, are so cheap that they act like value shares. Banks and real estate, once lumped into value, are a mess.

**The truth:** Pick mutual funds that are free to search for good prices on stocks, whatever their labels.

**Myth #10. A near-perfect credit score will get you the best loan rate.** Before the credit bust, if you could fog a mirror, you could get a mortgage. You know what happened next. But bankers still need to make a buck, so it sounds logical that if you can show a strong credit score, you'll win the best of deals on any kind of loan. Not so. Mortgage lenders prefer large down payments. Credit-card issuers are just as apt to reduce your credit line or raise your interest rate. And those 0% car loans? Often they last for only three years, which puts the payments so high you'll need to come up with more upfront cash anyway.

**The truth:** Credit is going to be tough to get for a while no matter what. So don't obsess over every few points of your FICO score.

## Beware company stock

Since your paycheck already depends on your employer, financial advisers say, your retirement account shouldn't depend on it, too. And given the tumultuous markets, it's especially important to be broadly diversified.

Yet many workers put all their eggs in the company basket. In defined-contribution plans offering company stock, about one-third of participants have more than 20% of their account balance in those shares, and 8% have a whopping 8-%

or more, according to Vanguard Group. The problem is exacerbated when the employer's contribution comes in the form of company stock.

"Short of not participating, company stock is the biggest mistake anyone can make," says J. Michael Scarborough, president and CEO of Scarborough Capital Management Inc., a firm based in Annapolis, Md. He believes that employer shares shouldn't be offered in 401(k) plans, partly because a single-stock holding can be far too volatile for a retirement account.

Fortunately, the Pension Protection Act gave workers greater rights to diversify their employer's contributions out of company stock. And thanks in part to worker lawsuits, more employers are imposing caps that prevent employees from amassing large positions in company shares.

## The Failure of Asset Allocation

**OVER 20 YEARS** ago, a landmark paper was published by Gary Brinson, Randolph Hood, and Gilbert Beebower. The paper attributed the variation in the total investment returns to three factors: asset allocation policy, market timing, and security selection. The study found that asset allocation was the overwhelming dominant contributor (91.5%) to the total return of an investment portfolio. Choosing the right stock or mutual fund was not the answer (4.6%), while market timing proved even more inept (1.8%). The dramatic results supported the notion that the asset allocation decision was the primary determinant of investment performance. These findings were subsequently confirmed by other major researchers, and the overall impact was groundbreaking. The study was especially embraced by our own industry. No longer would an advisor have to be an expert as a stock or mutual fund selector, but could now concentrate on the merits of asset allocation. Legions of advisors became asset allocation advocates. Glossy brochures and pie charts were developed to promote the new strategy. After the study's prominence was declared, an investor walking into an advisors' office was sold asset allocation as the ultimate cure-all.

By the early 2000s, asset allocation pie charts became quite robust, featuring no less than nine separate asset classes. Real estate investment trusts (REITs), foreign bonds, commodities, and precious metals started to become staples in a sample asset allocation plan. Many advisors thought that these more sophisticated asset allocation plans offered a stable level of return while reducing the chance of loss. Most important, they believed these new-age portfolios would sail through the worst markets.

During the 2000-2002 bear market, the asset allocation train steamed along, and those investors that followed their wise advisors that promoted asset allocation were heartily rewarded. As we came out of the 2000-2002 bear market, investors who had been burned in the Internet bubble suddenly became love-struck with appropriately diversified portfolios. Unfortunately, too many of us believed that these updated asset allocation plans were impervious to severe future stock market declines.

Of course, just when you think you have the capital markets figured out, they do something quite unexpected. The unexpected started in late 2007: a full-blown banking and liquidity crisis. As even the most sophisticated asset allocation plans did not account for such a Depression-era scenario, investors have suffered mightily.

In examining all the major asset classes over the past 52 weeks, only U.S. Treasury Bonds provided a positive return. The projected benefits of adding small cap and international stocks to a diversified portfolio have vanished during this market decline. With the collapse of real estate, REITs have not helped. Commodities and precious metals have also suffered dramatic depreciation. According to the experts, these asset classes were supposed to zig when the others zagged.

What went wrong? First, asset allocation, no matter how sophisticated, is no panacea. Asset allocation can explain past market performance, but not predict which allocation will work in the future. Although correlations of assets are fairly predictable over time, correlations can be extremely unpredictable over shorter time periods. For our own industry, it is a lesson to be learned. Our industry has preached and sold the merits of asset allocation for nearly 20 years. For the industry and its professionals, it is time for a frank discussion with clients on what asset allocation truly means: Not only what it can do, but more important, what it cannot.

## Goldman Buys Back Stock Warrants

**Goldman Sachs Group Inc.** has paid 1.1 billion to buy back the warrants for preferred stock that it granted to the U.S. government last year as part of the Troubled Asset Relief Program. The repayment

comes as fellow bank J.P. Morgan Chase & Co. is still bickering with the government over the warrants and their value. When combined with \$318 million in dividends that Goldman paid on its TARP infusion, the annualized return for taxpayers was **23%**, according to the company.

## **How to Give a Portfolio Once-over**

The way your investments are going (uh, down), you might be thinking you'd like an advisor to evaluate your strategy. A one-time checkup will run you \$180 to \$240 an hour-expect hours minimum. Here's how to find the best person for the job.

### **Step 1 START AT THE RIGHT SOURCES**

You want a planner who doesn't work on commission, who won't have a vested interest in selling you anything. The "fee-only" designation guarantees that. Search for fee-only planners at [garrettplanningnetwork.com](http://garrettplanningnetwork.com) or [napfa.org](http://napfa.org). Select five in your area to contact.

### **Step 2 GET THE FACTS**

E-mail them. Start by asking if they'll provide this one-time service for an hourly rate or a flat fee (some won't) and what the cost would be. Copy and paste the diagnostic questionnaire at [napfa.org](http://napfa.org), under Tips & Tools.

### **Step 3 DO AN INTERVIEW**

Evaluate the responses, choose one, then ask if he or she offers a no-obligation (no cost) initial interview. Use this to make sure you have rapport. Ask open-ended questions like, What's the biggest mistake you've made? "If someone says, 'I haven't made any,' they don't know themselves that well," says Brent Kessel, founder of Abacus Wealth Partners. "And the most important thing in selecting a planner is that you're willing to take the person's advice."

## **Cost of Doughnut Hole Drugs to Be Cut in Half**

In a surprise move that will please millions of Medicare beneficiaries, President Obama announced plans to slash the prescription drug expenses of Medicare beneficiaries who fall into the Part D coverage gap the doughnut hole. They'd pay only 50 percent of the cost of brand-name drugs in the gap instead of 100 percent they pay now. In an \$80 billion deal brokered by the White House and Senate Finance Committee Chairman Max Baucus, D-Mont., drug manufacturers agreed to donate half the cost of their brand-name and biologic drugs to people in the gap, at no cost to the government. The new benefit, expected to be part of health care reform legislation that Congress will consider in the fall, could take effect in July 2010.

In summary, do your homework on the markets, keep an eye out for bargains on the way up in the equity markets, and turn in that old "clunker" for the \$4500 credit on new car purchases. See you next month.



Timothy T. Fullerton, Sr.



Mary Ahart

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