

The Sittenfeld, Stuard & Thornberry Group  
Private Wealth Management

23 April 2010

Dear Client:

### Economy

Recent economic data has been encouraging, but the recovery is too fragile to say we are out of the woods yet. Gross Domestic Product is estimated to have grown between 2.5-3.0% in the first quarter of 2010. That rate of growth may diminish as the fiscal stimulus wanes and inventories are replenished. The homebuyer tax credit has helped boost the housing market with pending home sales up more than 8% in February which is the largest gain since late 2001. Consumer spending rose in March although consumer confidence remains subdued. A small increase in hours worked was recorded for the first time since the end of 2007, and March marked some modest job growth.

Despite signs of improvement in the job and housing markets, unemployment and foreclosures remain challenges for the economy. Jobseekers are able to live on savings, but eventually the risk of foreclosure becomes a reality. Nearly half of those who have found work are earning less at their new jobs. This makes the mortgage and car payments that seemed manageable three years ago now a challenge. As longer term interest rates rise, which many analysts anticipate, the housing market will likely take another blow.

The inventory of homes for sale and vacant office space continues to constrain the pace of building activity. The restoration of consumer confidence is critical, and prolonged high levels of unemployment makes that difficult to achieve. In general, the economic data so far is indicative of a tenuous recovery at best. Stocks have rallied substantially since their lows just over a year ago, anticipating an economic recovery that hasn't been fully realized. Deleveraging of the consumer and the government has a long way to go for caution to be lifted. Optimists now suggest we may face a "canoe-shaped" economic recovery with flat to modest growth for an extended period before we see a meaningful turn upward.

### Markets

Large-cap stocks have lagged small- and mid-cap stocks, but they are positioned, certainly in terms of relative value, to stand out as the bull market matures. Low quality stocks led the rally of the past year, and, after a short pause at the end of 2009, these stocks have resumed leadership. Quality is measured by return on equity, profit margin, and debt-to-total-capital ratio. During a broad correction, low quality

Page Two  
23 April 2010

stocks most often lead on the downside. Some argue that the premium valuation that blue chips enjoyed in earlier years has diminished to the point of being at a discount to riskier assets. High quality stocks often are able to return a portion of earnings to shareholders in the form of dividends, and we believe this will play a greater role in total investment returns in the years ahead. Considering all these factors, we feel that sticking with a core of high quality, dividend growth stocks is an appropriate long-term strategy.

High quality stocks should only be one component of a long-term diversified investment strategy. In the last decade, it was possible to generate positive returns with broad diversification of assets, including bonds. An investment in an S&P 500 index fund for the past 10 years would have resulted in a slight loss, while adding a component of as little as 20% in an intermediate bond fund would have resulted in an annualized return of 1.5%. This isn't dramatic, but clearly shows the importance of diversification among asset classes. 2008 was one of the most difficult market environments ever; while most investments lost value, bonds lost considerably less. Having a diversified asset allocation helped buffer the losses during that period.

Incorporating bonds into a portfolio is a key element of investing, but bonds involve their own set of risks including default risk, inflation risk, and interest rate risk. When interest rates move up or down, bond prices move the opposite direction. The Federal Reserve tries to influence interest rates without disrupting the markets negatively. The Fed watches inflation indicators carefully and has been able to keep rate at historically low levels. With the exception of some upward pressure on commodity prices, inflation has not yet resurfaced. Accommodative policy by the Fed in the past has been stimulative to the stock market by pushing investors toward riskier assets in order to achieve higher yields. Treasury yields have remained low, and money market rates have hovered near zero. As Treasury issuance remains elevated and demand lessens, longer rates will likely move higher.

Foreign markets provide an increasing potential for growth, both from U.S.-based companies with foreign sales and from non-U.S.-based companies. With greater potential for growth comes greater potential risk. When the markets fell in 2008, foreign stocks were among the hardest hit. During the subsequent recovery, some international markets have performed better than others with some emerging markets regaining much of what was lost. European markets have reflected the credit concerns in Greece, Portugal, Italy, Spain, and Ireland. These countries do not control the currency in which their debt is denominated, so they depend on stronger members of the European Union to back their obligations. The stock markets of countries with a relatively strong credit base such as Australia and Canada will likely fare better in the near-term.

### **Next Steps**

Keeping a cushion of cash feels increasingly expensive with money market rates as low as they are, but it remains an important part of a diversified plan. Having a liquid reserve for expenses anticipated in the next couple years is important. Further, cash as dry powder to add to stock holdings if a market sell-off occurs may be prudent.

Page Three  
23 April 2010

Financial planning needs to look beyond the investment portfolio. We are in a period of flux when it comes to taxes, and policy changes could have considerable effects on planning decisions. The Estate Tax issue essentially remains in limbo. In 2009, the exemption was \$3,500,000 per estate which was estimated to shield all but about 6,000 estates from this tax. Currently, there is no estate tax through 2010, but heirs this year may not benefit from stepped-up cost basis on inherited assets. In 2011, the exemption is scheduled to revert back to \$1,000,000 per estate, where it was in 2002. At that level, it is estimated that 100,000 estates would be subject to the estate tax.

The pressing needs of supporting a fragile economy coupled with the growing budget demands of programs such as Social Security, Medicaid, and Medicare leave politicians with the daunting task of finding sources of additional revenue only months ahead of 2010 elections. Current tax cuts expire at the end of 2010. The maximum ordinary federal income tax rate is currently 35%, but that would revert to 39.6% without new legislation. Long-term capital gains tax rates currently at 15% could go to 20% for higher income taxpayers under President Obama's budget proposal, but could return to ordinary income tax rates if the budget is not approved. Qualified dividends, which presently receive preferential tax treatment of a maximum of 15%, could also be taxed at ordinary income tax rates. Presidential advisor and former Federal Reserve Chairman, Paul Volcker, has suggested a European-style VAT (value-added tax) which functions as a national sales tax affecting individuals of all income levels. With an estimated 36% of all those who file returns not currently owing any federal tax, the impact of a VAT could change meaningfully the level of consumer spending.

Planning for the future is challenging when such unknowns abound. Taxes not only can significantly erode income, but also have a compounding effect on suppressing asset growth. Looking at options such as Roth IRA conversions could be worthwhile, and there is still ample time to evaluate that possibility. Our goal is to keep in regular contact with you to help you make adjustments to your financial planning as needed. Please contact us if there have been changes in your personal situation of which we are not aware that may impact your financial planning. We continue to believe that your investment planning must be integrated as a subset of your overall financial planning. With that in mind, we are pleased to share some exciting news in the enclosed memo regarding our continuing commitment to our clients.

Sincerely,

Paul G. Sittenfeld  
Managing Director

Elaina C. Stuard  
Vice President

Jonathan E. Thornberry, CFP®  
Vice President

Enclosure