Monthly Bulletin

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Diagnosis of a Decline

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OK, despite a title that runs contrary to the following claim – February's Bulletin will go light on alliteration - dampening down the didactic distractions and focusing on the facts. I promise.

January closed with a whimper as the first two weeks of cheery trading activity were unceremoniously side-swiped by a bearishly bad mood that fell upon both Wall Street and Main Street. Despite decent profit reports from many bellwether public companies and positive prognoses on the state of the economy-under-repair, the focus of the financial markets seemed equally distracted between domestic politics and foreign financial affairs.

Domestic Politics. On January 19th, the Massachusetts Senate seat held since 1962 by the late Ted Kennedy, a Democrat, was won in a special election by Scott Brown, a Republican. Seminal for supplying a filibustering 41st Republican vote, the legislative agenda of President Obama, and its attendant implications for specific industry sectors, (healthcare, manufacturing, financial services, etc.), veered off the fast-track. While there was a strong expectation that the market would rejoice in this advancement toward "productive" gridlock, the reaction was just the opposite, as on Wall Street: ambiguity = anxiety.

The following morning, in the face of a persistently declining approval rating, (January's final Gallup poll stood at 48% and, anecdotally, all "First-Family Portuguese Water Dogs" were marked down to half price at ***Build-A-Bear*** stores across the country), President Obama announced the Volcker Plan – a proposal to limit the size of financial institutions and the trading risks they are permitted to take with FDIC backing. The news conference introducing the prospective bank reform, inspired by former Fed Chief Paul Volcker, followed a record earnings release from Goldman Sachs – surreptitiously serving the public with its poster child for the speculative excesses that had battered the banks. Rather than providing comfort, the new proposed legislation fueled fears of forfeited financings, forestalling a meaningful economic recovery.

Foreign Financial Affairs. Focused on battling the domestic business cycle, the average investor could be forgiven for neglecting the fiscal fortunes of our foreign counterparts. January, however, provided two significant reminders of the extent of the international economic intertwinement that exists today. China and Greece grabbed headlines for dramatically different reasons embodying the imbalances that can germinate amidst global growth.

What happened in China? On January 20th, a government bank regulator requested that several Chinese banks restrain their lending, as concern had grown over the adequacy of their capital reserves.

Why did the stock markets around the world respond so negatively to this development? The growth of the Chinese economy, (current GDP level = 10.7%*), fueled by government-guided bank lending, has been a steady source of demand for the exports of many countries, not the least of which is the US. A disruption in the distribution of goods produced in our country could, (in an extreme scenario), increase idle capacity, elevate unemployment, reduce domestic spending and lower corporate profitability. Every recovering economy possesses heightened sensitivity to prospective trip wires and selling may ensue at the first scent of susceptibility to stalling. Despite the intentions of the Chinese bank regulators to control, *not constrict growth*, the realignment of expectations served to set the market back a bit.

What happened in Greece? After a late-December downgrade of their sovereign debt, the severity of the country's credit issues spiked in mid-January. The country's debt amounts to 113% of GDP, and its budget deficit has risen to 12.7% of GDP, well above the 3% ceiling allowable for countries in the European Union (EU).

Why did the stock markets around the world respond so negatively to this development? Concern about the EU catching a cold from an Athenian sneeze spread faster than H1N1. Immunization from the problems of their sister country proved difficult and European stock indexes fell considerably more than those in the US. In addition, bond prices dropped dramatically across the countries in the EU, making borrowing costs higher for governments and corporations, requiring a greater allocation of revenue to service debt, ultimately robbing the bottom line of its expected enhancement.

So, despite the steady improvement in the underlying fundamentals of the US economy and stock markets, January started 2010 on a sour note. Politics and international episodes served as a reminder of the primacy of psychology in pricing. Our hope is that the current obstructions give way to opportunities and that the markets strike the appropriate balance between quantitative and qualitative factors in setting prices as we move through the year.

*Source : Bloomberg

Market Statistics

Index	MTD*	YTD*
Dow Jones	-3.45%	-3.45%
S&P 500	-3.69%	-3.69%
Nasdaq	-5.36%	-5.36%

Index	12/31/09	1/31/10
Gold	1097.60	1083.80
Oil	79.36	72.89
10yr Bond	3.83%	3.58%

Statistics as of 1/31/10, Source: Bloomberg
**Performance figures do not include reinvested dividends*

Estate Planning Corner—2010 Estate Taxes

The year 2010 is posing quite an interesting challenge in the world of estate planning. This is the year in which estate taxes were supposed to, per the Economic Growth and Tax Relief Act of 2001, vanish for an entire year. This seemed far-fetched to most, as both jokes and serious discussions arose regarding the creative ways in which people might say "goodbye" in 2010 in order to dodge taxation on their hard-earned estates. However, the year 2009 closed with the House passing the Estate Tax Reform Bill on December 3, at which point it was sent on to the Senate for a vote, but a decision has yet to be made.

This means that there is currently no estate tax. In a time where people are more aware of their assets than they have been for generations, and where the government is looking to facilitate some alleviation of the dilemma of heightened national debt, Obama and his administration have been working to come up with a way to deal with this estate planning anomaly.

Before 2010, the law defined a maximum federal estate tax rate of 45% and a per-person exemption of $3.5 million, which may be transferred to heirs, free of estate taxes. A husband and wife may, together, transfer as much as $7 million. These laws expired at the start of 2010, and will return in 2011 at their pre-2001 levels of 55% and $1 million, barring legislation that would provide otherwise.

Some think that the initial decision, outlined above, will remain, and we will pass the remainder of the year free of estate taxes. Some think that the administration will reinstate the tax law at the 2009 levels, and make this decision retroactive to January 1, 2010, while others argue that such a decision would be unconstitutional.

Please contact our team with thoughts and questions, and we will continue to correspond as we await a precise and pragmatic decision.

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