

# NAVIGATOR

The Newsletter for the Clients of TGS Financial Advisors



## Capitulation

by James S. Hemphill, CFP® ChFC CIMA

*“These are the times that try men’s souls.”*

Thomas Paine, The Crisis

These are tough times. The period since last September has been grim for investors around the world. At the recent low in March, the U.S. market was down almost 60% from the October 2007 high. In my lifetime, it has never been more frightening and painful for investors than it has been these last six months, from last September through early March.

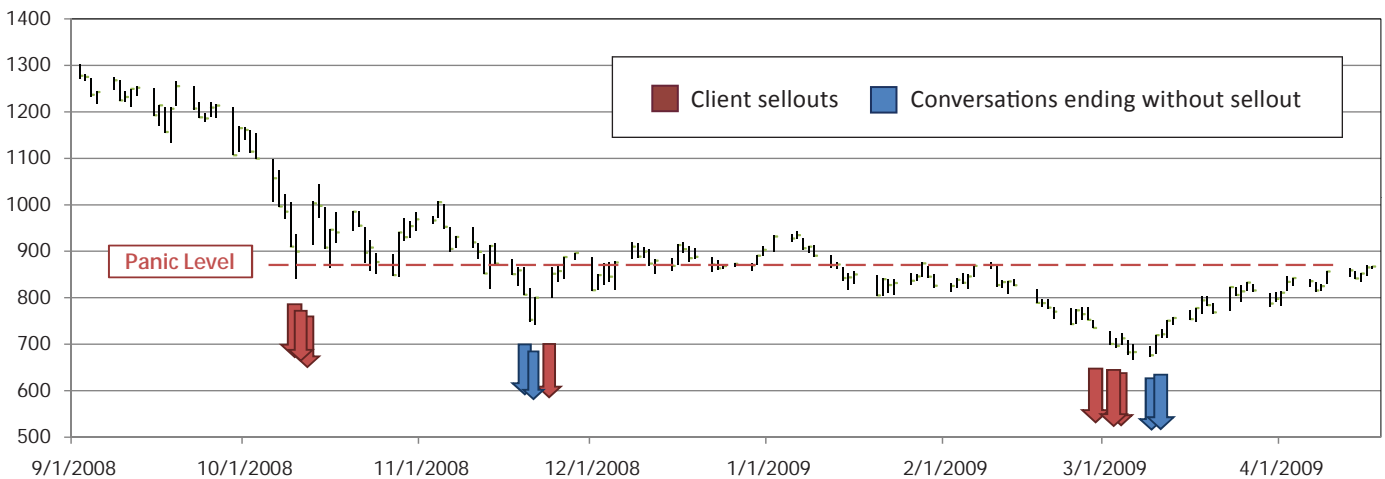
For a few of our clients, the pain of this bear market simply became too great. The phase of a bear market where investors finally panic, throw up their hands and demand to get out is called *capitulation*. This means, very simply, giving up. Between October 10<sup>th</sup> and March

10<sup>th</sup>, we have had seven clients sell out and go to cash, and we have talked another five clients out of doing so. The graph below shows the dates at which we executed those sellouts and had those conversations. (Red arrows for sales, blue arrows for conversations ending without selling.)

Contemplating this graph, we are forced to confront two of the central challenges we face as professional investors entrusted with other people’s money – the necessity of making prudent decisions amid uncertainty; and the tension between emotional sympathy and financial logic.

Our first challenge is that, as investors, we must always make decisions amid uncertainty. Today we face more immediate bad news, and more concerns about the future, than at any time since the dark days of the 1970s and early 1980s. Right now we must weigh some profound negatives (bad economic news, frightening

S&P 500 Stock Index: High/Low/Close



*Continued on next page*

government policy initiatives, and the likelihood of rising taxes) against some very real positives (low stock prices, high relative dividends, and massive liquidity on the sidelines).

In these scary times, we fully understand the urge to sell. Still, we must consider the question, were these sales wise? Every one of these sales decisions was made below the current market price. Each cluster of sales, or contemplated sales, was followed by a market rally of 10% or more. Those who sold in early March have missed a 20% rally.

We cherish every one of our clients, and we never stop thinking about those few who panicked, sold and left our practice. Among those who sold were friends of many years, folks we've broken bread with, families whose children and grandchildren we knew by name, even one man who came to my wedding. *We really miss these folks.*

Our sadness about losing these long-term relationships with wonderful people is compounded by our worry that these individuals have made a decision from which it may be financially impossible to recover. Consider: For someone who sold on March 9<sup>th</sup> and bought Treasury bills, the recent 20% rally has delivered more return in a month than that T-bill buyer will realize over the next *twenty years* at current rates.

David and I have both been advisors since 1978. We have seen clients panic and sell before, in 1982, 1987, 1991 and 1998. Not once have we seen such a sale benefit a single client. Not once did a panicked sale lead to a wise and well-timed re-purchase at a later date. We think stock sellers may be short-term psychological winners, but are almost certain to be long-term financial losers.

David puts it simply: "Once you sell, you are dead."

*In this environment of profound uncertainty, the information contained in the group psyche of investors may actually be our most powerful buy signal.* Every time over the last six months that we've witnessed one client sell everything, we've bought for five or ten other clients. Over time, we believe the cheap securities we've

purchased for the many clients who have stayed strong during these scary times will earn much higher returns than the Certificates of Deposit or Treasuries purchased by those few who panicked.

Yet we can't be sure. We can't ever know, whether a given buy or sell decision is correct, until long, long after the fact. Which brings us to our second challenge: What are we doing, and what should we do, to preserve the emotional well-being of each of our clients?

One of the most difficult tasks we face as advisors is a balancing act. We must weigh each client's emotional comfort and desire for control in a scary world against that same client's long-term financial security. *How should we balance immediate emotional comfort against long-term financial success, especially when we lack a crystal ball and possess imperfect information about the future?*

We are really struggling with this issue. We want our clients to be happy and sleep well at night today, when markets are scary. We also want them to have enough money to put food on the table and a roof over their heads twenty years from now. We worry that simply pushing hard against the panic that takes you permanently out of the game is not enough. We also need to help investors to re-build confidence in their lifetime financial security.

As we move forward, we plan to meet with each client to discuss how we can best structure a long-term investment portfolio to help that client to feel more confident about his or her immediate situation, without compromising the long-term growth each of us needs to reach our financial goals.

We are committed to helping you reach your financial goals. As fee-based advisors, our economic success is inextricably bound up with yours. Even in this market environment of extraordinary volatility and frightening economic losses, we find much for which to be thankful. Very high on our gratitude list is our relationships with our clients. We are, now and always, deeply grateful for your trust.

# The Death Tax May Cause Complications

by Vincent R. Barbera, CFP®

At your death, you are allowed an exemption from federal estate tax if your estate falls below a certain dollar amount. In 2008, that dollar amount was \$2 million; it has increased to \$3.5 million for 2009. From a federal tax perspective, this is good news that the exemption has increased but there are things that you need to be aware of from a state tax perspective.

## Brief History of State Death Tax

In the past, the federal tax system allowed a credit for state death taxes that were paid. Most states imposed a tax that was equal to the federal credit. In 2001, the law was revised to change it from a tax credit to a deduction. In response to this new law, many states “decoupled” from the federal system and began to impose their own death tax. Many of these states now only allow an exemption of \$1 million or less. So, even if your estate should fall below the federal estate tax exemption amount of \$3.5 million, you may still be subject to state death taxes.

## States of Interest: Pennsylvania and New Jersey

Let us review Pennsylvania and New Jersey. Both states decoupled from the federal estate tax in 2001/2002, with Pennsylvania having retroactively recoupled with the federal tax. New Jersey, on the other hand, has not

recoupled and the applicable exclusion amount stands at \$675,000. At death a New Jersey resident with an estate less than \$3.5 million but more than \$675,000 will owe state death taxes. Another local state with a decoupled tax system is New York. Their applicable exclusion amount is \$1 million.



## Estate Review

It is important to review your estate plan with your attorney in light of the potential complications caused by the decoupling of the federal and state death taxes. We can assist by reviewing, with you, the impact your state’s death tax may have on your estate plan.

# Warning:

## Leveraged ETFs and Long-Term Investing Do Not Mix

by David A. Burd, CFP®

As the old adage goes, you have to play big to win big, right?

Wrong (at least in this case). The dangers of leveraged and inverse ETFs, products that are designed to capture two or three times the market movement of a particular stock or index fund, became apparent last year. Many individuals lost big because they misunderstood the potential risks of these products.

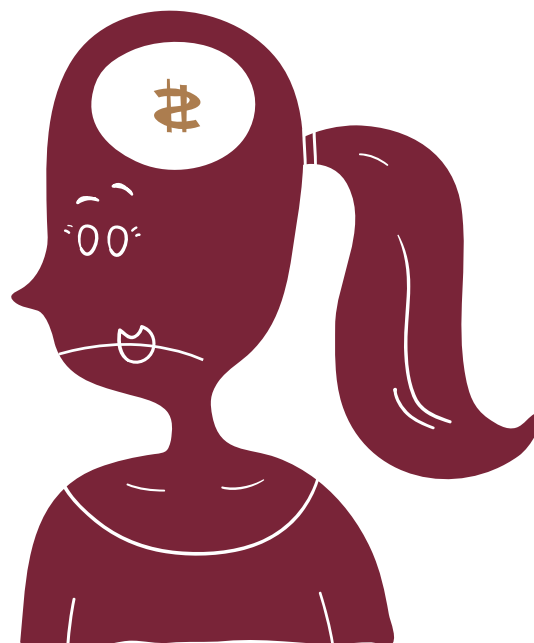
The catch is that these ETFs provide leverage on a *daily* basis. As a result the compounding effect can be detrimental over the long-term in a volatile market.

For example, let's say you decide to invest \$100 in a double-long leveraged fund. After one day the index returns 10%, the double-long index would be up 20% and would close at \$120 (20% of \$100 is \$20, \$20 plus \$100 equals \$120). The next day the index is down 10%, our leveraged index would end at \$96 (20% of \$120 is \$24, \$120 minus \$24 equals \$96). If we were to repeat this process (10% up one day and 10% down the next day) for six months your leveraged index would stand at \$2.54 — a 97.46% loss!

While some folks consider these ETFs appropriate for short-term tactical trades, they frankly scare us. *Buyer beware.*

# DO-IT YOURSELF: INVESTING DANGEROUSLY

by Marvin L. Barron III, CFP®



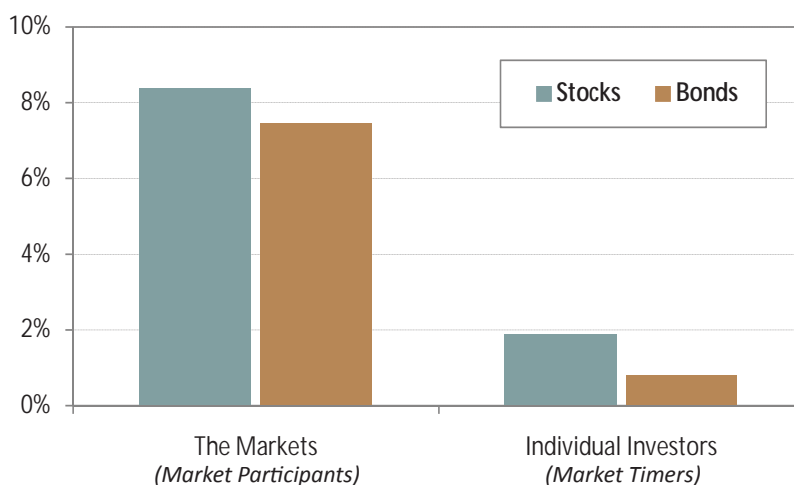
Spring is here! My favorite time of year. The NFL draft is next week, the Phillies are defending their title, and Dalbar, Inc. has just published its annual *Quantitative Analysis of Investor Behavior* (QAIB for short). This is the stuff dreams are made of. Well, my dreams anyway.

The QAIB is great because Dalbar has the best data on the behavior of individual investors. In particular, they are able to study the flow of money into (and out of) mutual funds over time. This allows them to re-create the average investor's portfolio and simulate it over time.

With this information Dalbar compares the average investor's portfolio with the actual market returns. That tells us whether or not individual investors have been making good decisions in moving their money around. It's like a yearly reality check for market timers (who move money from one mutual fund to an-

other) and market participants (who just keep chugging along). The results aren't pretty for the timers.

Average % Return per Year (1989-2008)



Two observations jump out of this chart:

First, it's been a close horserace between stock and bonds.

Over the last twenty years, bonds and stocks have deliv-

ered similar returns. Despite being mostly useless, this statistic has gotten loads of press. Of course bonds can be competitive – therefore we usually own both stocks and bonds. However, we have no reason to think that this is normal. We can only say this now that the stock market has tanked. Observations like this are good at making us feel bad, but are worthless for doing useful work (like predicting when bonds will be competitive before it happens).

Secondly, the jockey can make any horse look bad.

The gap in “stocks versus bonds” is tiny compared to the gap in “market participant versus market timer.” The gap between stocks and bonds was about 1% per year, whether you were a market timer or a market participant. However the gap between market timers and market participants was more than 6% per year, whether you were a stock investor or a bond investor.

To put that in perspective, at 1.3% per year (the average of what the stock and bond *timers* got), it takes 54 years to double your money. At 7.9% (the average of what the stock and bond *participants* got), it takes 10 years.

What’s going on? The QAIB hints at one reason. Individual investors hold onto a mutual fund for three years, on average, before switching to something else. Their timing couldn’t get much worse. The average credit cycle lasts seven years.

Why do they do it? Who knows? Most likely they saw another investment fund performing better than the one they owned, and they chased it. I’m guessing that these same investors don’t smash their light bulbs after ten hours of daylight, or burn their mittens after five months of warm weather. But they seem to systematically change their investment strategies halfway through the credit cycle.

The field of behavioral finance has launched careers in discussing why so many investors have this particular blind spot. It’s a topic I’ve covered in this space, many times. However, behavioral finance has little to

say about the role of the financial media in promoting such a short-term mindset. As useful as the QAIB is, you’ll never encounter it on cable news or read about in a popular financial magazines.

It’s unfortunate, but that’s how it goes. Your butcher doesn’t talk about cholesterol, your bookstore doesn’t issue library cards, and the IRS has never once accused anybody of overpaying.

In these cases, we know to be on guard (especially with the IRS). However, it is easy to forget that the financial media makes money by selling ads, not by improving our lives. This may not be in the strict realm of behavioral finance, but spending your hours watching CNBC might just be the most costly mistake of all.

## TGS FINANCIAL ADVISORS PRESENTS **SPRING EDUCATION SERIES**

We’re excited to announce the following upcoming events as part of our *Spring Education Series*:

### **Retiring After the Market Crash**

*How Much is Enough? What Should I Do Now?*

Thursday, May 14<sup>th</sup> @ 12:00 p.m.

Tuesday, May 19<sup>th</sup> @ 6:00 p.m.

### **Doctors: The Retirement Alternative**

*What delaying retirement for two years could do for your portfolio and your life*

Two sessions in June to be announced

### **How We Got GREAT Jobs**

Sunday, August 2<sup>nd</sup> @ 2:00 p.m.

All events will be held at our Radnor, PA office and will be limited in size. We will schedule additional meetings if needed. All events are open to our clients and their invited guests. Invitations will be mailed and e-mailed shortly. *To reserve your spaces, place call Shauna Mace at (610) 892-9900 or e-mail her at [shauna.mace@tgsfinancial.com](mailto:shauna.mace@tgsfinancial.com).*

SEC RANDOM AUDITS

The Securities and Exchange Commission (SEC) will begin contacting investors to make sure they have the assets their investment advisors are reporting.

The SEC will look to confirm that investors' account balances, as of specific dates, are consistent with records held by advisory firms and that all transactions are authorized.



# Quote FOR THE QUARTER

"The great proof of madness is the disproportion of one's designs to one's means."

Napoleon Bonaparte

## TGS Financial Advisors' TEAM NEWS

Vince and Jill Barbera welcomed Logan Diehm Barbera on April 3rd. He weighed 7 pounds and 9 ounces. So far his favorite hobbies are sleeping and watching the Phillies!

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In August of 2008, Marvin L. Barron III was promoted to Managing Partner. He joined the firm in 2000 as an intern.

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In April of 2009, Susan Mattero's son, Charles joined the TGS Financial team as an intern over his spring break.

Charles was recently recognized as an outstanding student by the Delaware County Principal's Association, a mix of Catholic and non-Catholic schools in Delaware County.

## Time to Refinance?

If you are locked into an adjustable rate mortgage (ARM) it's time to start shopping. In December of 2008 15-year fixed rate mortgage dipped below 5% and in January of this year 30-year fixed rates followed suit. As of April 17th, both the 15 and 30-year rates remain below 5%.

If you have an adjustable rate mortgage (ARM), we suggest that you get busy to ensure that you don't miss this opportunity. While there is no way to know how low rates might go, we fear that high inflation in coming years may push rates higher — perhaps significantly. At current rates many homeowners have an attractive opportunity to lock in historically low fixed rates.



# CLIENT Q&A

## **Why is TGS selling some of my investments at a loss?**

While we never like to see the value of your investments go down, there are tax benefits to be reaped during bear markets. Realizing capital losses can reduce your tax burden in two important ways: the losses can be used to offset capital gains realized that same year, and up to \$3,000 in excess losses can be applied to reduce your ordinary income.

## **What if my realized losses exceed the sum of my realized gains and \$3,000?**

Any unused losses can be carried forward to apply against future capital gains and/or ordinary income. They do not expire.

## **I see that you sold a mutual fund in my portfolio at a loss, then bought the same fund a month or two later. Why did you do this?**

When you sell an investment at a loss, you are prohibited from buying that same security back within 30 days. Such a transaction is called a “wash sale,” and losses realized are invalidated. When realizing losses, we like to use an alternative mutual fund or exchange traded fund in the same asset class to keep you fully invested during the “wash sale” period.

## **If I am carrying losses forward, does TGS want to know this?**

Absolutely! When your 2008 taxes have been filed, please contact us to let us know the amount of losses (if any) that you will be carrying into 2009. If you do not have losses to carry forward, we can look for opportunities to realize losses in 2009 to apply against ordinary income. If you do not know the amount of losses you will be carrying forward, your accountant should be able to provide you with the figure.

Thomas A. Rylko  
*Financial Planning Director*

## How to Find Unclaimed Property **WHAT ARE YOU MISSING?**

*by Rainey Rylko*

In a tough economy every little bit helps. Most states have an online Bureau of Unclaimed Property to help residents and former residents locate lost or forgotten assets. When property has not been claimed, or a company is unable to locate you, the assets are turned over to the Bureau. The state lists the names of the property holders on their site, in hopes that it will be claimed. I suggest that you check for your name. It is free, and you may be pleasantly surprised. I found my name on the Pennsylvania site.

To access your state’s web site type “bureau of unclaimed property” and a state name into your search engine. Be sure to select the government site. Companies will offer to do the search for you for a fee, but you can access the information yourself for no charge.

Check all mailing addresses in the state(s) that you have lived. If you find something that might be yours, click on it for more information. Remember to check it every year as the list is updated annually. Good luck!

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*"To hell with a balanced portfolio. I want to sell my Fenwick Chemical and sell it now."*

# The Markets at a Glance *(ending March 31, 2009)*

INDEX	VALUE	ANNUALIZED RETURN		
		One Year	Five Year	Ten Year
Dow Jones Industrial Average	7608.92	-36.0%	-3.6%	-0.4%
Standard & Poor's 500 Stock Index	797.87	-38.1%	-4.8%	-3.0%
Morgan Stanley Europe, Australasia, and Far East Index	1056.23	-46.5%	-2.2%	-0.8%
Barclays Capital Aggregate Bond Index	—	3.1%	4.1%	5.7%
Barclays Capital Municipal Bond Index	—	2.3%	3.2%	4.6%
Six Month Certificates of Deposit	—	2.7%	3.8%	3.7%
Inflation (Consumer Price Index)	—	-0.4%	2.6%	2.6%

*Inclusion of these indices is for illustrative purposes only. Keep in mind that individuals cannot invest in any index, and index performance does not include transaction costs or other fees, which will effect actual investment performance. Individual investors' results may vary. Past performance does not guarantee future results.*

## MARKET COMMENTARY

Last year the broad U.S. stock indexes plunged into true bear market territory. For the year ending March 31st, large company U.S. stocks are down 38.1%, and their foreign counterparts down 46.5%. The most striking feature of the broad, deep and frightening selloff of the last nine months was that there was simply no place to hide. Only cash equivalents and Treasury bonds have been any form of safe haven. Investors who bought U.S. stocks in January 2000 have earned a total return over more than nine years of -38%. Better in the mattress.

What the heck is going on? We believe we are witnessing one part rational discounting of a future economic scenario (a global recession lasting into late 2009 or beyond), one part sheer animal panic (terrified investors running for the exits), one part forced liquidation of

leveraged entities (i.e. hedge funds and private equity pools) and one part rational concern about the future direction of government fiscal and monetary policies.

Right now stock prices, based on trailing earnings, are cheaper than at any time since 1988. The S&P 500 Stock Index has a dividend yield of almost 4%, compared to less than 0.5% for a six-month Treasury bill. Compared to cash, common stocks offer higher income, the prospect of dividend growth over time, and a century-long history of prices rising every decade.

After years of predicting that long-term returns on investments would be depressed because of high valuations, we are now changing our tune. We believe we are in an environment where potential long-term returns are likely to be attractive, and where long-term opportunity exceeds risk.

*Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from TGS Financial Advisors. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.*

*Please remember to contact TGS Financial Advisors if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services. Please also advise us if you would like to impose, add or modify any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement discussing our advisory services and fees remains available for your review upon request. You should discuss any tax or legal matters with the appropriate professional.*