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K & S Holiday 2009 Financial Fitness Newsletter "Movin' On Up"

I. Our view of the financial markets- We have experienced a substantial recovery since the stock market bottomed in March. The Dow Jones Industrial Average (DJIA) recently surpassed the 10,400 level after bottoming at 6500 earlier in the year. In light of this positive recovery, investor sentiment has changed from negative to positive. However, there are many investors who are understandably shell shocked from the tech and housing market booms and busts over the past decade who continue to remain skeptical about the recovery of the U.S. economy and stock market. We believe that the unemployment rate will slowly improve next year and the stock market will continue to slowly struggle higher and regain lost ground toward the 12,000 level on the DJIA. We expect this to occur within the next three years if not sooner.

II. Investment commentary from Wharton Business School Professor Jeremy Siegel-

Interest rates are expected to remain flat between now and the end of the year. If the economy gains steam during the first half of the year don't be surprised if the FED raises interest rates not as a response to inflation but to manage a potential 4 to 5% growth of Gross Domestic Product (GDP). Keeping interest rates at zero with this type of economic growth would cause the U.S. dollar to fall sharply which would cause inflation to rise. The dollar is expected to continue to decline as developing countries, which shifted assets into our currency as a flight to safety during the financial crisis, shift back into foreign currencies as worldwide economies recover. Since 1971 the dollar has depreciated by an average of 1.1% against the developed world's currencies and the U.S. has experienced about 1% higher inflation. Given

the looming government budget deficits, he expects U.S. inflation to be around 3 to 4% over the long term and for the dollar to continue to depreciate. A sinking dollar, moderate inflation, moderate labor costs may provide an attractive investment opportunity for investment in U.S. stocks. As the dollar depreciates, U.S. companies may seem like a bargain to foreign investors*.

** Investments in foreign securities may be affected by currency fluctuations, differences in accounting standards and political instability. These risks are more significant in emerging markets.*

III. Brandes Institute- "Gross Domestic Product: A Poor Predictor of Stock Markets Returns-"

With the economic adversity of the last two years, many investors and the financial media seem to focus on economic measures such as gross domestic product (GDP) in weighing investment timing decisions. Implicit in this interest is an assumption that an increase in GDP might signal when economic conditions are more favorable and more conducive to higher stock market returns. Investors should be aware that research indicates GDP has historically been a poor predictor of stock market returns, both in the U.S. and abroad. Market participants who wait for GDP levels to improve before investing may find themselves on the sidelines, missing out on remarkable opportunities in the stock market. Research by the Brandes Institute using FactSet data from 1929-2008 indicates that the coefficient of determination or the portion of stock market performance explained by GDP changes is only .0169. This is a very low correlation between the two factors.



Other researchers have come to the same conclusion. Elroy Dimson, Paul Marsh and Mike Staunton in 2002 examined the relationship between GDP and total real return for equities across global markets between 1900-2000. The authors concluded “we find no link between stock market performance and GDP growth.” As Jeremy Siegel noted in his book *Stocks for the Long Run*, “almost without exception, the stock market turns down prior to recessions and rises before economic recoveries.” We believe the results confirm that investors are best served by focusing on the valuation of stocks compared to their long-term profitability and earnings power. Perhaps Warren Buffett said it best: “you pay a very high price in the stock market for a cheery consensus.” Investors who wait for GDP and other economic measures to provide clear signals of economic health may miss robust stock market performance. To sum it up these wise individuals are subtly encouraging investors to tune out the media and short term economic data and to focus on the long term.

IV. Is it the right time to buy gold? For decades gold has been a haven for fearful investors in times of economic turmoil in the financial markets since it holds its worth if the dollar loses value. Since 2006, the price of an ounce of gold has risen from \$600 to over \$1200. As the U.S. dollar has depreciated in value the price of gold has appreciated. According to the November issue of *SmartMoney* magazine in an article titled “Should You Still Buy Gold?”, many investment professionals are using the 10-year Treasury bond as an indicator to evaluate gold’s prospects. Theoretically, both gold and the 10-year Treasury reflect what investors think about inflation and the state of the U.S. economy. Gold’s steep price indicates that many buyers are sure the U.S. government’s trillion dollar deficit will lead to rampant inflation and a potential collapse of the U.S. dollar. On the other hand, bond investors do not seem to be concerned about inflation at all. They continue to invest in securities at historically low interest rates. So which camp is right? The gold buyers who fear inflation or the bond investors who do not? Warren Buffett and others say that higher inflation is inevitable unless the government curbs spending. This is highly unlikely. In the short term, it appears that the bond investors

may be right. Even if the economy continues to recover, there are idle factories, excess inventory and ample supplies of goods such as cars and houses that should keep inflation at bay. This rationale trashes the logic for the most recent run-up in gold prices. According to Jon Nadler, senior analyst with commodities dealer Kitco Metals, based on supply and demand gold should be trading between \$680 and \$880 an ounce.

V. Tax Planning Moves for 2009 Here are some tips from the Kiplinger’s Personal Finance magazine December issue: 1. Go Green- The home energy tax credit is three times as large as 2007. If you add insulation or install energy-efficient replacement windows, doors or skylights in your primary residence by the end of the year, you’ll qualify for a tax credit equal to 30% of the cost, up to a maximum of \$1500. 2. Take Profits Tax Free- Taxpayers who are in the 10% to 15% tax bracket may have an opportunity to take advantage of the 0% capital-gains rate and sell assets for a profit tax-free. To qualify, your 2009 taxable income can’t exceed \$33,950 for individuals or \$67,900 for married couples filing jointly. This provision may enable retirees who are not required to take required-minimum-distributions (which have been suspended for 2009) from their IRA’s to sell appreciated investments tax free to lock in capital gains in their taxable accounts. 3. Give To Charity- The rules require you to have a receipt for a cash donation in any amount and an acknowledgement from the charity for a cash donation of \$250 or more. For non-cash donations of \$500 or more, you need a receipt from the charity. You must itemize to deduct a charitable contribution. Consider donating appreciated stock rather than cash to your favorite cause. This may enable you to deduct the full market value of your donation and you will avoid paying capital gains tax on the appreciation. In 2009, Seniors who are over age 70½ or older may donate money directly from an IRA to a charity tax free. However, they cannot double-dip and also claim a deduction for the amount of their charitable contribution. 4. Feed Your 401(k)- For most employees, the best way to reduce taxes is to maximize your contributions to tax-deferred retirement accounts. This year, you can contribute up to \$16,500 to your 401(k), 403(b) or Thrift Savings Plan. If you are age 50 or older you can



contribute an additional \$5500 catch-up contribution for 2009. For IRA investors the 2009 contribution limit is \$5000 or \$6000 if you are age 50 or older.

IV. Medicare Update- Medicare covers the majority of your medical expenses, while other out-of-pocket costs, prescription drugs, deductibles and co-payments are covered under supplemental medigap Part D plans, or Medicare Advantage all-in-one plans.

The average premium increase for 2010 is 7% for Part D plans and 22% for Medicare Advantage plans. You are able to compare details and prices of the Medigap and Medicare Advantage plans at www.medicare.gov/mppf and the Part D plan at www.medicare.gov/mpdpf. Switching to a new plan could provide you with better coverage and save you money. With Part D plans, there is an annual deductible that needs to be met (\$310 in 2010) before any drug costs will be covered. Many plans will not provide coverage in the doughnut hole (\$2,830 to \$6440 in 2010) and co-payments are rising. There are often pricing tiers, preferred versus non-preferred, which cover specific drugs or have varying co-payment structures. In 2010, almost 90% of Medicare beneficiaries will have access to the Medicare Advantage plan which charges nothing beyond the cost of Medicare Part B, however, you may have to pay out-of-pocket for certain medical expenses (i.e. chemotherapy, etc.) You can switch to another Medicare Advantage plan if yours shuts down or you are eligible to move back to traditional Medicare (this is only an option if your plan is terminated). If you choose to switch later on, the price of a new policy may be based on your health. We feel it is important to review all your alternatives before deciding on which plan to enroll in.

V. Health Update- "A tooth flossing a day..." Studies have shown a relationship between gum disease and its impact on your overall health: When gums bleed, the bacteria travel through the bloodstream and can cause problems in other areas of the body, including heart valves and arteries of the heart and lungs. These bacteria can also contribute to such complications of pregnancy as preterm deliveries and low-birth weight babies. There is a strong relationship between untreated

periodontal disease, diabetes, and unstable blood sugars. Periodontal disease affects nearly 80 percent of the adult population. One of the first signs that you may be at risk is seeing a pink streak of blood while you are brushing or flossing. In fact, bleeding gums are a sign of infection. Flossing can greatly reduce inflammation and bleeding in the mouth and promote a healthier body. Plaque forms both on the teeth and under the gums and returns every 24 hours. Many patients mistakenly think that there is no need to use dental floss because they don't trap food between their teeth. But that means you're leaving 40 percent untouched if you are not cleaning in between the teeth. The other two areas of the tooth that require cleaning. That 40 percent is where most problems arise- in between the teeth is where most people get cavities and bone loss.

Closing Comments- This Fall we have been distributing [asset allocation review reports](#) to make you aware of how much of your assets are invested in cash, bonds and stocks. Along with this report we have been including strategic advice on risk management. In mid-November we emailed to you two messages titled "[Risk Management I & II.](#)" We feel that these reports and messages are critical to your financial future. Please contact us if you would like to schedule an appointment to have us review this important information with you. We may be setting up teleconference calls in the near future to discuss this strategy with you as well.

We hope that you and your family are healthy, in good spirits and are enjoying a pleasant holiday season.

We look forward to talking to you soon.

Sincerely,

 

Andrew Krosnowski & Melissa Scott

P.S.- If you are looking for good reading material, you may want check out a book on the New York Times best seller list called "Three Cups of Tea." We believe that educating young Muslim women in south central Asia is one of the most intelligent approaches to combating terrorism in the world.

