

SA-KG ADVISORS QUARTERLY



Best Of Times Often Have Followed Worst Of Times

These have been tough times for strategic long term investors. While it may seem logical to stay the course through the market's inevitable ups and downs—taking advantage of stocks' tendency to deliver strong returns over very long periods—that logic was little comfort during the bear market, when some portfolios lost more than half their value. Wouldn't it have been better to bail out in, say, late 2007, replacing stocks with cash or with bonds, which have outperformed equities during most of this decade?

Of course it would have been better, but myriad problems stand in the way of executing a successful market timing strategy, which calls for getting out of investments before they swoon and getting back in when they're ready to rise. To investigate market timing's feasibility, Donald Bennyhoff and Yan Zilbering at the Vanguard Group recently examined

the performance of the Standard & Poor's 500 stock index from 1928 through 2008 and reported their results in a research note, "Market-Timing: A Two-Sided Coin." Looking only at prices—they left aside dividends because of a lack of data on daily total returns before 1980—Bennyhoff and Zilbering found that the index had returned an average of 5% a year during that 81-year stretch. A clairvoyant investor who had managed to be out of the market on just the 20 worst trading days—avoiding an average loss on those dark days of 9.2%—would have gained 7.5% annually. Anyone who had missed the 20 best days, on the other hand, would have gained only 2.6% a year. That amounts to a 50% swing, up or down, in portfolio performance.

No one could ever hope to forecast all of the market's best and worst days. But given that infinitesimally small changes—being out of the market on just 20 of

20,340 trading days during the 81 years the researchers considered—can have a profound impact, it may seem worthwhile to try to identify some of them. What if, for example, you got out of the market after it had a particularly bad day, or got in after a really good one? Wouldn't more of the same be likely to follow?

Often that's not the case, according to Bennyhoff and Zilbering. Frequently the best and worst days happen within shouting distance of one another, and some of the best days have been particularly likely to follow hard on the heels of some of the

To Avoid Capital Gains Bite, Think About An Exchange

For 2010, the federal capital gains tax rate on a long-term gain remains at 0% for some taxpayers and 15% for others, before increasing to 15% and 20%, respectively, in 2011. For an individual selling property with a low cost basis, capital gains taxes can take a big bite out of profits.

It's possible, and often practical, to defer taxes by making a tax-free exchange. For example, a sale generating a \$50,000 long-term capital gain will incur a tax of \$7,500, assuming a 15% rate. If an exchange can be arranged, the \$7,500 can be invested in new property instead of going to Uncle Sam.

Both personal and real property can qualify for exchange. The asset can be used in a trade or business, or be held for investment. For personal property, the exchange must be for an asset of similar kind, i.e., a heavy truck for another heavy truck. With real estate, the rules are more lenient. For instance, acreage can be swapped for an apartment building.

If a seller cannot arrange a simultaneous transfer, the law allows a deferred exchange. The sale proceeds can be held in trust, and a replacement can be acquired later.

Our staff will be happy to discuss your particular situation and how you can benefit. Simply give us a call and we will arrange a meeting.

10 Worst Days for S&P 500 Index and Returns for Five and 20 Trading Days Following

Date	Return	Next 5 days	Next 20 days
10/19/1987	-20.5%	1.2%	9.6%
10/29/1929	-16.1%	4.6%	2.5%
5/14/1940	-10.3%	-11.1%	-3.8%
11/6/1929	-9.9%	-14.3%	8.9%
10/15/2008	-9.0%	-1.2%	-6.1%
12/1/2008	-8.9%	11.5%	9.1%
7/20/1933	-8.9%	1.0%	1.8%
9/29/2008	-8.8%	-4.5%	-23.3%
7/21/1933	-8.7%	8.1%	9.6%
10/26/1987	-8.3%	12.3%	6.7%
Average	-10.9%	0.8%	1.5%

Source: Vanguard

(Continued on page 4)

Move Fast To Corral Emergency SBA Loans

The Small Business Administration (SBA) has announced details of its much-anticipated program to free up emergency loans for struggling businesses. The “America’s Recovery Capital” (ARC) program kicked off on June 15, 2009. The money, provided by private lenders but fully guaranteed by the SBA, may be available until program funding runs out or until September 30, 2010, whichever comes first. And with loans to qualifying businesses made on a first come, first-served basis, it makes sense to apply as soon as possible. If you’ve had trouble getting capital, this may be an opportunity you don’t want to miss.

Authorized by the American Recovery and Reinvestment Act of 2009, the ARC program is supported by \$255 million that Congress set aside to pay for loan guarantees and interest subsidies. But the actual funding will be higher, according to the SBA. That’s welcome news to entrepreneurs caught in today’s tight-money squeeze. The stimulus legislation encouraged lending to small businesses, raising loan guarantee ceilings and waiving fees on SBA-backed loans, and average weekly loan volume increased by

more than 25% percent in the spring of 2009. But that jump was from very low levels. The number of loans made by private lenders through the SBA’s popular 7(a) program

declined by 57% in the first quarter of 2009 compared with the same period a year earlier, and major lenders outside the program

have also reported tighter credit.

The ARC program provides business owners with short-term loans of up to \$35,000 that may be used temporarily to cover payments on existing debt. The SBA is subsidizing the loans, making them interest free to business owners. No repayments are required during the first year and you can take five years to repay the loan.

The loans are designed to help businesses experiencing “immediate financial hardship.” To qualify, you must have an established business, provide financial statements demonstrating your business was

profitable in at least one of the past three years, and be able to project sufficient cash flow to meet loan payments during the two years following loan approval.

Funds will be distributed to business owners during the six months following loan approval. The money may be used for paying principal and

interest on existing small business debt, including mortgages, term and revolving lines of credit, capital leases, credit card obligations, and notes payable to vendors, suppliers, and utilities.

ARC loans are made by participating banks, but with a 100% guarantee from the SBA. If a business owner defaults, the SBA will repay the loan’s full value to the bank. That feature should encourage plenty of lenders to offer ARC money, and owners of businesses hurt by the recession are lining up. Applying now could be wise. ●



A SCIN Is A Timely Estate Tax Strategy

If there’s a single, central objective of most estate plans, it’s to transfer property to younger family members while minimizing estate and gift tax liability. Among the many strategies and structures designed to accomplish that goal, one less well-known vehicle—a self-canceling installment note, or SCIN (pronounced “skin”)—may work particularly well with today’s depressed asset values and low interest rates.

With a SCIN, you sell real estate, a business interest, or other assets to one or more younger family members, such as your children, in

exchange for an installment note with a term shorter than your expected life span. That aspect is required; to realize tax benefits, the note’s term must be shorter than the seller’s life expectancy, according to IRS tables. But under the “self-canceling” feature of the note, your heirs’ obligation to repay the loan automatically disappears if you die before the end of the term.

A SCIN provides several potential tax benefits. If you die early and there’s an unpaid balance on the loan, that amount won’t be considered part of your taxable estate. Yet the property still ends up in the

hands of your heirs. And because the transfer is a sale for fair value, not a gift, there’s no gift or estate tax.

There’s also an advantage in using a SCIN to pass along property that has appreciated in value. Though you may owe capital gains tax on the sale, you can spread out that liability over the note’s term. (Note that if the assets’ buyers are family members, they must wait at least two years to sell the property in order for the capital gains to be prorated and deferred.) The longer term might help you avoid moving into a higher tax bracket, particularly if the term of the loan extends into your retirement

A Global View Of The Economic Crisis

The world economy is making a comeback from the depths of 2008, but the results will vary from country to country and rising inflation could rain on the party. The biggest winners emerging from the global recession will be national governments.

Those are insights from a recent interview with Stephane Garelli, director of the World Competitiveness Center at IMD, a Swiss business school that ranks nations according to their competitive strength.

Garelli's outlook matches that of the International Monetary Fund, which expects the global economy to expand 2.5% in 2010, a full 0.6% faster than it had forecast in early 2009. The IMF predicts that in the United States, economic growth will edge up to 0.8% in 2010, following a 2.6% plunge in 2009. That, too, is an improvement from early 2009, when the IMF predicted the U.S. economy would remain flat in 2010. The 2009 IMD World

Competitiveness Yearbook ranks the United States No. 1 among 57 nations in terms of international competitiveness.

First in, first out. Because the United States was among the first nations to enter the global recession, it should be among the first to lead the way out, Garelli said. While some smaller exporting nations—and possibly China—are expected to see the earliest real growth in 2010, recovery in the United States will provide the clearest message that the world economy is on the upswing, he said. Among the last to recover will likely be Japan, Germany, and Switzerland, because of their lack of economic flexibility.

Depression avoided. The risk of a worldwide economic depression has passed, Garelli said (a depression is defined as a 10% drop in gross domestic product or a recession lasting three years). “However, Iceland and the Baltic States may be exceptions,” he added. Deflation is also not likely to hit many countries,

although Britain, Japan, and Spain could suffer its effects, along with the automobile industry and a few industrial sectors.

Stimulating results. Garelli said the stimulus packages from national governments will work best in emerging economies,

because people there need consumer goods and are likely to spend the money. In developed countries, “people will save the money they receive,” Garelli said. “They can delay a purchase without a perceptible decline in their standard of living.”

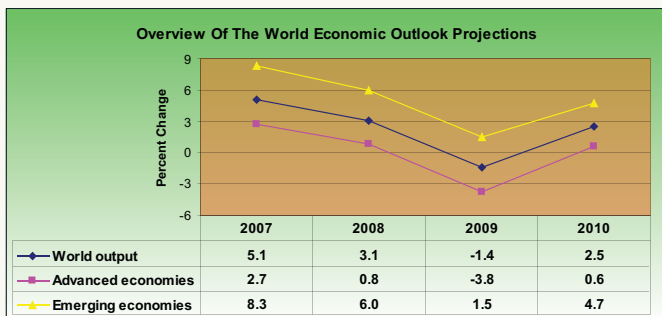
Jobless threat. Rising unemployment will remain a major barrier to economic recovery, because it has a devastating impact on public finances, Garelli said. As jobless rates surge, more government funds will be allocated to support the unemployed rather than create new jobs.

Tax havens hit. A side effect of stimulus legislation will be new attacks on tax havens, Garelli pointed out. In order to pay for stimulus spending, many countries plan to raise taxes on the wealthy. One way to do that would be to close tax loopholes.

Inflation looms. Global economic recovery will almost certainly bring a new round of global inflation. “It will be triggered by both an excess of money supply (especially dollars) and a rapid rise in commodity prices (fueled by the demand of emerging nations),” said Garelli. “Central banks will not react immediately to rising inflation so as not to impede recovery—and because inflation is an effective way to reduce the value of debt.”

Spending spree. Recovery also will trigger a rush by companies to spend billions in cash that has been set aside during the recession, Garelli predicted. The world's largest 100 companies have cash reserves estimated at a total of \$600 billion. “This money will be used to buy back shares,” Garelli said. “Acquiring industrial assets and companies will also be a priority.”

Winners take all. In the end, national governments will emerge as clear winners. “They have the ultimate power: printing money, making laws, and setting taxes,” Garelli said. “The multilateral world is on the decline, and it is again a brutal power game among big nations. But beware: In the words of Thomas Jefferson, ‘A government big enough to give you everything you want, is also strong enough to take everything you have.’” ●



years, when your income may be declining. Meanwhile, if the transferred property continues to appreciate, those gains will be outside your estate.

Because the self-canceling aspect of a SCIN is a risk to your estate, the note must include either an inflated market value for the assets or an interest rate that's higher than the applicable federal rate, or AFR. That can be a drawback of this estate planning technique. But interest rates now are exceptionally low, and the value of



most assets is well below what they may have been worth in recent years. As a result, the interest rate required for a SCIN may still be quite reasonable. And with asset values depressed, the principal of the note will be lower, and any rebound in prices will, again, occur outside your estate.

If you are interested in transferring property to your heirs, we can work with you and your attorney to consider whether a SCIN could help. ●

Best Of Times Follow Worst

(Continued from page 1)

worst. In dramatic turnarounds, eight of the 20 best days occurred within 10 trading days of one of the worst 20 days. On October 29, 1929, the S&P sank by 16.1%; the next day, it soared 12.5%. In 2008, a 7.6% loss on October 9 was followed by an 11.6% gain on October 13.

Post-plunge rebounds often last more than a day, with the market frequently recouping, during the next few weeks, a significant fraction of what it has lost. For example, the worst sell-off in the Vanguard study—on October 19, 1987, when the S&P 500 lost 20.5% of its value—was quickly followed by a lot of buying. Within 20 trading days of Black Monday, the market had rebounded by 9.6%. A similar thing happened during the

1929 crash; after that 16.1% free fall on October 29, the S&P stabilized temporarily, regaining 2.5% during the 20 trading days that followed. And in 2008? Twenty days after December 1, when the market fell 8.9%, it had regained 9.1%. Looking at the S&P's performance following all 20 of the worst days, the market regained an average of 2% during the next 20 trading days.

For would-be market timers, those tendencies make a difficult job virtually impossible. While it may be feasible to anticipate broad market shifts and to make tactical adjustments to a portfolio based on certain metrics like price-to-earnings ratios, any attempt to time a wholesale market entrance or exit will probably fail. Few people expected the stock market to surge when it did in the spring of 2009, or to advance as much as it did during the

next several months. Investors who had cashed out their portfolios during the market rout almost certainly missed some (if not all) of the rally.

The recent volatility of the S&P 500—from day to day, week to week, and month to month—only reinforces how unlikely it would be for anyone to get in or out at just the right time. Rather than try to time the market, which almost always backfires, most investors would do better to stick with a well-diversified portfolio with regular asset allocation rebalancing to keep volatility in check and increase potential long-term gains. ●

Performance data quoted represents past performance and does not guarantee future results. Indices are unmanaged and do not reflect the payment of fees and other expenses associated with an investment. Investors cannot directly invest in an index.

Reproduction of this material in whole, or in part, is prohibited without the express permission of Advisor Products Inc.



ADVISORS

Shannon & Associates, LLP

1851 Central Place S
Suite 225
Kent, WA 98030
253.852.8500

SA-KG Advisors, LP

701 Brazos Street, Suite 500
Austin, TX 78701
800.542.4916

info@kgadvisors.com