www.efallc.com

evergreen
FINANCIAL ASSOCIATES

Fourth Quarter 2010

Guide...Protect...Preserve

Now Is A Good Time To Reassess Your Risk Profile

The recent past has given investors an invaluable lesson in risk, which makes now an ideal time to reconsider your "risk profile," the amount of volatility you're willing to accept. From the happy heights of late 2007, the Standard & Poor's 500 stock index lost 55% of its value by March 2009, and much of the damage came sickeningly fast, with a 40% freefall between September and November of 2008. Then came a dizzying recovery, as the S&P rallied 60% between March and December 2009. Yet even after the comeback, the large-company index remained some 30% below its record high.

How your portfolio has fared during this remarkable period depends on how much risk was built into your investments, and on how you responded when conceptual risks became all too real. Many investors, lured into volatile areas of the market when most investments were rising, were shocked when numerous sectors suddenly dropped by more than half. Some of these investors watched helplessly, unable to sell as holdings kept plummeting, while others got rid of everything, determined to stick with cash for the foreseeable future.

Neither predicted outcome was good or anticipated. The purpose of determining your risk profile is to use it to build a portfolio that minimizes disruptive surprises. If you think you can handle a 15% annual loss but would be apoplectic if your investments dropped twice that much, then you need a portfolio that, in most economic and market scenarios, wouldn't dip by much more than that "comfortable" 15%.

But markets don't always behave as predicted. The recent financial crisis highlighted the reality that assets under duress can move together. All manner of stocks—from shares of enormous, normally rock-solid companies to those of small, fast-growing firms and stocks in once-hot emerging markets—headed down together. And while some bonds fared a little better, Treasuries fared the best as safety-obsessed investors bid up prices and caused yields to decline considerably. And alternative investments, including real estate, commodities, and hedge funds, had major issues of their own.

As a result, most investment portfolios did worse than expected, and that exacerbated the problems of investors who had taken on too much risk. Panicking, many sold when investment values were at their lowest point, and with losses locked in, they've missed out on stocks' historic rally.

Reassessing your risk profile now, and making appropriate portfolio adjustments, could help you prepare for the next financial upheaval. This process may involve several steps. The first is to understand how you really feel about risk. How did you react in September and October of 2008, when

(Continued on page 4)

In The Wake Of Financial Upheaval, Three Steps To Take

With nerves still frayed over the global economic crisis that began in late 2008 and more recent struggles in Europe, it's difficult to be optimistic. But it may be helpful to put the bad news about the American economy in perspective.

According to the International Monetary Fund, U.S. gross domestic product in 2009 totaled more than $14 trillion. That represented nearly a fifth of the world's total output of goods and services, even though we have less than one-twentieth of the world's population. America remains the world's dominant economic power.

And though much of the financial and economic news has been bleak, stock prices rose more than 70% from their March 2009 lows and the economy has slowly improved.

Where does all of this leave you? Here are three steps to take:

1. Be open to diversifying across asset classes that behave differently from each other, and to reevaluating your financial goals to ensure they are realistic.

2. Give more attention to your long-term financial plan—this is a time for proactive planning.

3. The recovery in stocks offers a chance to reassess your risk profile or to rebalance and sell some of your stock gains. If you learned during the market fallout that you can't tolerate as much investment risk as you thought you could, please call to make an appointment so we can consider changes to your portfolio.

Mary Jane Callaghan & Mitch Glicksman

The Right Way To Manage Money

In any relationship between financial advisor and client, trust is crucial. But in the post-Bernard Madoff era, it's not enough to sense that an advisor or a financial firm is reliable. Everyone trusted Madoff. His clients recommended him to their friends, who lined up for the privilege of having him manage their money. Yet all of those trusting clients ended up on the losing end of a $50 billion Ponzi scheme, and several other recent frauds have further shaken investor confidence. These days, trust requires proof, delivered regularly. Keeping your investments in the custody of a major financial firm can help provide that proof.

Madoff didn't use an outside custodian. Client funds were reportedly handled by a custodian at a remote storefront office that had few employees and no independent auditor. That left Madoff with unfettered access to clients' money and little or no accountability. It now appears he claimed to have made trades that never occurred and exaggerated returns from other transactions. But without reports or account statements from an independent custodian, there was no way for clients to know there was a problem.

Although Madoff's firm was a registered investment advisor, that kind of set-up is extremely unusual among RIAs, which are regulated by the Securities and Exchange Commission or the individual states. More than nine out of 10 RIAs serving individual clients work with independent custodial firms that have physical possession of client assets, monitor their value, and provide trade confirmations and account statements directly to clients, who can also check on investments by logging in to their account on the custodian's website.

Custodians, such as Fidelity, Schwab Institutional, TD Ameritrade Institutional, Pershing, and others, provide other kinds of security as well. Insurance from the Securities Investor Protection Corporation covers investors for up to $500,000 of losses of securities and $100,000 of losses of cash if a custodian becomes insolvent, and custodial firms often also purchase additional insurance. A common level of supplemental coverage is for up to $5 million of losses of securities. One company provides coverage for losses in securities accounts of up to $149.5 million and up to $900,000 in cash accounts. Moreover, most firms have automated systems to monitor client accounts.

To deter fraudulent activity, the SEC recently proposed a rule change that would require certain RIAs with custody of client assets to use an independent public accountant to conduct surprise audits of client accounts. But you don't have to wait for a new rule to protect your investments. We work with an independent firm that maintains custody of your assets, and you can easily compare the portfolio performance statements we provide with the custodian's account statements. This relationship is just one way we are working to prove that we deserve your trust. ●

Do You Know Estate Planning Basics?

With the future of the estate tax up in the air, you may be tempted to neglect estate planning. The federal tax on inherited wealth is currently scheduled to be repealed in 2010, only to return in 2011 under less favorable terms. Congress will most assuredly resolve this issue before year-end, perhaps exempting all but the wealthiest families from estate tax liability. Yet whatever the fate of the law, having a thoughtful, effective estate plan will continue to be crucial.

At a minimum, you need a legally enforceable will that lays out how you want your assets to be distributed. An accompanying, non-binding letter of instruction could further spell out your wishes. You may also want to establish one or more trusts designed to minimize taxes, manage assets for minors, provide asset protection for heirs, implement philanthropic plans, or protect assets from creditors. And a living will (or health care proxy) could provide valuable direction on end-of-life health care.

Are you familiar with estate planning basics? Use this quiz to test your knowledge.

1. Which of the following is true?

a) A will is legally valid only if drafted by an attorney.

b) You can transfer jointly owned property through a will.

c) A will may appoint a guardian for minor children.

d) Your property must go through probate if you don't have a will.

2. When can a will be changed and remain legally enforceable?

a) Only if the changes are recorded by an attorney

b) Only when the heirs named in the will provide their consent

c) Any time before your death or mental incompetence

d) Never

3. In 2009, the federal estate tax exemption was:

a) $1 million c) $3.5 million

b) $2 million d) Zero

The New Health Law & Business Owners

The massive new health care legislation passed last spring—the Patient Protection and Affordable Care Act of 2010—will have a long-lasting impact on businesses. Most companies will soon have to provide health insurance for employees, though some small businesses will be able to use tax credits to offset the cost of this benefit. And while some provisions take effect right away, others will be phased in over the next few years. Here are the likely new rules in several important areas.

Coverage requirements. After 2013, employers with 50 or more full-time employees will be subject to "play or pay" rules—if the companies don't provide "minimum essential coverage" to full-time employees, companies will have to pay a penalty. For this purpose, a full-time employee is anyone who works at least 30 hours a week. The monthly penalty will be based on an annual amount of $2,000 for every full-time employee, not just the ones without coverage, though the first 30 employees will be subtracted from the calculation.

Help for owners of small businesses. From 2010 through 2013, a business with 10 or fewer employees and average annual wages of less than $25,000 can claim a tax credit to offset the cost of mandated health coverage. A smaller credit applies to companies with as many as 25 employees and average annual wages of up to $50,000.

Health insurance exchanges. Beginning in 2014, state-based insurance exchanges and the Small Business Health Options Program (SHOP) will offer coverage to individuals and small businesses with up to 100 employees. States may allow companies with more than 100 employees to purchase coverage in the SHOP exchange after 2016.

Free-choice vouchers. Also starting in 2014, employers that provide minimal essential coverage must offer qualified employees a free-choice voucher to enroll in a state health insurance exchange. Qualified employees have household incomes that don't exceed 400% of the federal poverty level and a required contribution for health insurance premiums of between 8% and 9.5% of household income. The amount of the voucher, provided in lieu of a company's normal coverage, would equal what the employer would otherwise have to pay for an employee's insurance.

Automatic enrollment. Eventually—it's not clear when this provision will take effect—an employer with more than 200 employees will have to automatically enroll full-time employees in its health plan, though workers will be able to opt out of the coverage.

Minimum coverage. Effective in 2014, a health benefits package will have to provide a comprehensive set of services, cover a minimum of 60% of the actuarial value of benefits and limit employees' annual cost-sharing.

Provisions for "grandfathered" plans. Company-provided health coverage in effect on March 23, 2010, when health reform became law, is exempt from many requirements of the legislation. But these "grandfathered" plans must now extend dependent coverage to age 26, prohibit cancellation of insurance, eliminate waiting periods of more than 90 days, and stop excluding children with pre-existing conditions. The plans have until 2014 to get rid of annual and lifetime limits on coverage.

Retiree health insurance. Through 2013, an employer may offer a temporary health reinsurance program to retirees over age 55 that are not eligible for Medicare.

Flexible spending accounts. Beginning in 2013, companies will have to limit annual contributions to flexible spending accounts (FSAs) for health care to a maximum of $2,500. (Future increases to that cap will be indexed for inflation.)

Information reporting. Beginning in 2012, a business that provides minimum essential coverage to individuals will have to verify the terms of that insurance in annual information returns to the IRS. The information returns will identify who has insurance, the amount of coverage, and any premiums paid by the covered individual.

These are just some of the many business-related provisions of the new law, and further details about how and when particular parts of the law will be phased in are still to come. But it's clear that most companies will now have to provide health insurance coverage to their employees, and you'll need to factor that major expense into your business plan. We can help you calculate the likely impact on your company and discuss strategies for minimizing the financial impact of the new requirements. ●

4. In 2010, the annual gift tax exclusion shelters gifts to individuals of up to:

a) $10,000 c) $1 million
b) $13,000 d) Zero

5. For estate tax purposes, the value of assets is based on:

a) Their fair market value on the date of the owner's death (or six months from that date)
b) The amount received from the sale of those assets
c) The assets' original cost
d) The value stated in the owner's will

6. A "power of attorney" is best described as:

a) A bequest in a legally validated will
b) A document authorizing an agent to act on your behalf
c) A document allowing life support systems to be shut down
d) The use of a lawyer in estate planning matters

7. Which of the following is not true?

a) The value of your principal residence is excluded from your estate.
b) The value of property transferred to your spouse is exempt from estate tax at your death.
c) A testamentary trust takes effect when you die.
d) A will normally determines who will care for minor children.

If you have questions about estate planning or need to refine your plan, please give us a call. We can work with you and your attorney to make sure all of your needs are met.●

Answers: 1-c; 2-c; 3-c; 4-b; 5-a; 6-b; 7-a

Yield vs. Risk In Emerging Market Bonds

Stock markets around the world improved in 2009, but the spectacular growth came in emerging markets, which gained more than 75%, according to Barron's. Foreign stocks and bonds swept up a record $64 billion of American investor assets, with just more than half going into emerging market equities, $2.7 billion into emerging bonds, and the rest into developed market bonds. Meanwhile, U.S. equity mutual funds lost $40.3 billion in assets in 2009.

While the money flowing into emerging market bonds represented a small proportion of foreign investment, it was nevertheless a remarkable development. U.S. investors had paid little attention to those fixed-income securities until the global financial crisis reduced yields on U.S. government bonds to next to nothing. Because bonds of developing countries are considered riskier than U.S. Treasuries, they pay more—and recently, a lot more. Some emerging market debt now pays more than U.S. corporate high-yield bonds.

Emerging market bonds provide a good example of the trade-off between risk and return. U.S. Treasuries have historically been considered "risk-less" and pay little. Emerging bonds, which pay plenty, may bring considerable risks. The Dubai scare, when Dubai World announced in December 2009 that it had to renegotiate at least some of its $59 billion in debt, reminded investors of the 1998 crisis, when Russia defaulted on its bonds. Back then, some emerging market bond funds sported yields well into the double digits, as they did again in 2008, according to The Wall Street Journal.

Yet despite their volatility, emerging market bonds can serve as an effective tool for managing risk. They can squeeze a little extra yield out of the income portion of a portfolio while also decreasing risk, thanks to their diversification value, and may provide a hedge against the fluctuating value of the U.S. dollar, as long as the currency of the country issuing the bonds isn't pegged to the dollar.

The governments of many developing countries have received high marks for their handling of the global financial crisis, and if they can follow up with sensible policies as economic growth returns, investors may be more willing to hold their bonds. At the end of 2009, the "risk premium"—the additional return investors receive for putting money into less stable holdings—on developing world bonds, as measured by JPMorgan's Emerging Markets Bond Index Global, had fallen to just under 3 percentage points above Treasuries.

Many investment experts believe U.S. holdings should account for a smaller proportion of investors' assets than they have in the past, and increasing exposure to international markets could include buying debt in developing countries. We can talk to you about the risks and rewards of such investments and help you review your portfolio mix. ●

Reassess Your Risk

(Continued from page 1)

account balances slid lower almost every day? Were you able to take a long view, assuming that even this bear market would pass, or did you treasure safety above all else? Would you rather stick with less volatile investments even if that means accepting lower long-term returns?

Your answer to that last question depends in part on what you need your portfolio to achieve, and re-examining your financial needs is step two of this process. Perhaps the prospect of postponing retirement or spending a little less during your later years seems like a reasonable trade-off for the comfort of holding less volatile investments.

Once you've figured out how much risk you're willing to accept, and how much you need to reach your goals, the third step of the process is to incorporate your readjusted risk profile into a formal "investment policy statement." This document puts your strategy in writing and commits you to the discipline of a plan built around your financial objectives, risk profile, and investing timetable.

You'll also need to rebalance your portfolio, selling some holdings and buying others, first to get in line with your new risk profile and then to keep allocations steady as markets fluctuate. Finally, it's important to monitor your investments, periodically re-evaluating what you own in light of your evolving personal circumstances.

We have the tools, experience, and expertise to help investors successfully complete this crucial post-crash process, helping position investments for a potentially smoother ride through the next crisis and steady progress toward financial goals. If you would like to speak with us about your portfolio, please give us a call. ●

Evergreen Financial Associates, LLC • www.efallc.com
Mitch Glicksman • 8180 North Hayden Road, Suite D203, Scottsdale, AZ 85258 • Toll Free: 888.865.4449 • Phone: 480.951.6536 • Fax: 480.922.3007
Mary Jane Callaghan • 300 C Lake Street, Ramsey, NJ 07446 • Phone: 201.934.1818 • Fax: 201.934.4040