Blue Bell Private Wealth Management

April 2010 **Spring Newsletter**

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Would You Ever Want To Lose Money?

On the surface, this question seems silly and counterintuitive, but there are times when you want to lose small amounts of money on certain investments. When the loss position or investment is a hedge against a larger investment or portfolio, losing money on the hedge position is a positive because you make more money on the underlying position.

What is the textbook definition of hedging?
Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security.

Hedging is a core component of our management style. We believe that hedging provides several advantages over both the short and long term. Hedging, when done properly, will reduce the overall volatility of a portfolio. One benefit is simply an emotional one. Volatile portfolios tend to produce volatile investors; investors can become too aggressive after large gains in the market and become too risk adverse after significant market drops. A 2003 Dalbar study found that from 1983 - 2002, the average equity mutual fund investor underperformed the S&P500 by a cumulative 183.35%. Dalbar's conclusion to this study was: "Motivated by fear and greed, [individual] investors pour money into equity funds on market upswings and are quick to sell on downturns. Most investors are unable to profitably time the market and are left with equity fund returns lower than inflation." In our opinion, a reduction in volatility tends to produce less emotional investors. This emotional response has been especially evident in the last year. From the market low on March 09, 2009 through the end of the year, there remained a cumulative net outflow of $12billion from equity mutual funds.

The advantages of hedging in a down market are obvious but what is somewhat less obvious is the advantage of losing less once the market turns around. Here is a hypothetical example: investor 1 lost 50% and needs a 100% return to get back even. Investor 2 hedged and lost 25% and needs a 33.3% return to get back even. Using this same example, if investor 1 does make 100% and gets back even and investor 2 only makes 50% (does half as well in the up market), investor 2 would not only be back even but would actually have an overall positive return of 12.5%.

In 2009 as the market hit the March lows, it is our belief that managers, like ourselves that hedged, performed well as the market recovered. This was due not because they outperformed the market during the recovery, but because they started at a higher levels (lost less as explained above) and remained invested in the market. In many ways, hedging gave us and our investors the confidence to remain invested.

Our hedging techniques include using structured products, writing covered calls, buying protective puts as well as others. Structured products served us well during the market downturn, albeit because we lost less. They remain an important component of our management style and we believe they will continue to be beneficial as we move forward. Covered call writing is a strategy that we have used for years and is once again becoming a larger percentage of our portfolios, due to the current risk/return potential this strategy produces. A 2004 Ibbotson Associates study investigated covered call writing. They examined the previous 16 years and concluded that S&P 500 investors that would have written covered calls against that position would have slightly outperformed the S&P500 with 1/3 less risk. These are the kind of returns that we attempt to produce for our investors and have found them to be extremely valuable over the long-term.

Protect Yourself From Early Retirement Scams

The stock market volatility and uncertainty of the last 2 years has invariably led investors to search for a "silver bullet" that will protect their principal, grow their retirement funds, and/or reduce their tax liability. While on their search, many of these investors come across "crash proof retirement" strategies and equity-index annuities (EIAs). According to the SEC, an EIA is a special type of contract between you and an insurance company. During the accumulation period – when you make either a lump sum payment or a series of payments – the insurance company credits you with a return that is based on changes in an equity index, such as the S&P 500. The insurance company typically guarantees a minimum return. Guaranteed minimum return rates vary. After the accumulation period, the insurance company will make periodic payments to you under the terms of your contract, unless you choose to receive your contract value in a lump sum.

Tips to avoid being taken:

Don't let the promise of easy money lure you into an early retirement you weren't otherwise considering. Before you quit your day job (or night job) and invest your retirement savings, follow these tips:

- Be skeptical of "free lunch" seminars. Even if those events take place at or near the workplace, don't assume that your employer is behind the event.
- Be wary of early retirement pitches based on little-known loopholes. While IRS Section 72(t) is a "little-known loophole" that allows you to access your retirement funds early, there's a lot more to a successful early retirement than avoiding a 10 percent tax penalty.
- Determine your willingness to live with an unpredictable amount of retirement funds. Think hard before trading the relative certainty of a company pension—which may offer steady and predictable payments for as long as you live—for the uncertainty of investments whose value fluctuates.
- Know your current plan. Many employers allow former employees to leave their 401(k) assets in the company's plan. Before moving your assets, take time to understand your current plan. You may find that staying put is a sound and less costly option.
- Understand the tax bite. Before quitting and cashing in a 401(k), do a little math. Remember that even if you avoid the 10 percent early withdrawal tax penalty, you won't be able to spend every penny. Instead, you will have to pay ordinary income taxes on your withdrawals. Be sure to ask a tax professional about any other potential tax consequences of your decision.
- Figure out the unintended consequences of early retirement. You may also wish to consult an attorney about any other unintended consequences, especially if you are in debt or owe child support or alimony. Depending on the laws in your state, cashing out of your retirement plan may mean that your creditors can collect against that payment you receive—even if you're rolling the assets to a traditional IRA.
- Understand the total expenses of mutual fund shares and what better alternatives we recommend.
- Consider the costs associated with variable annuities. Be aware that most variable annuities have sales charges, including asset-based sales charges or surrender charges. In addition, variable annuities may impose a variety of fees and expenses when you invest in them, including mortality and expense fees, administrative costs, and investment advisory fees.
- Check the speaker's credentials. Find out whether the person offering you investments is registered with FINRA, which regulates brokers. Use FINRA BrokerCheck or call the FINRA Hotline at (800) 289-9999. If he or she is registered, be sure to check out any red flags raised by employment or disciplinary history. To check out an investment advisor, contact your state securities regulator or call (202) 737-0900.
- Get a second opinion. Before committing to an early retirement strategy, consult with a financial professional of your choosing before taking the advice of someone who "found you."

For 2010, the maximum contribution allowed for both Traditional and Roth IRAs is $5,000 if under age 50, or $6,000 if age 50 or older. You have until April 15th, 2010 to make your 2009 contribution. Talk to your children about the benefits of starting an IRA.

Protect Yourself From Early Retirement Scams (continued)

And continue to be skeptical if you hear any of the following:

- **Everyone can retire early!** The reality is that many employees simply do not have the resources to do so. Early retirement is not feasible for many people and is particularly risky for workers who haven't saved enough for an extended retirement and who have limited opportunities for other employment.
- **You can make as much in retirement as you can by continuing to work!** Promises like this usually hinge on unrealistically high returns on investments and unsustainably large yearly withdrawals.
- **You can expect returns of 12 percent or more!** First of all, no one can predict what an investment will do from one year to the next—and even if an investment performed well in the past, this is no guarantee it will do so in the future. Second, any return over 10.4 percent exceeds the historical long-term returns for the stock market (assuming all dividends were reinvested rather than spent), and greatly exceeds long-term returns for less risky investments such as bonds, for which the average annual return over the long term is less than 6 percent. Finally, the stock market is inherently volatile—it goes up, and it goes down. Over the past 80 years, there have been many short term periods that produced returns well below the historical average of 10.4 percent.
- **You can withdraw 7 percent or more and never run out of money!** While there is no perfect consensus on what this withdrawal rate should be, the uncertainty of return, market fluctuations and increased life expectancies among other factors argue for being conservative with your withdrawals, especially during the first years of retirement. Many experts recommend withdrawal rates between 3-5 percent per year, especially in the first years of retirement.

Source: www.sec.gov, www.finra.org

> "Don't let the promise of easy money lure you into an early retirement you weren't otherwise considering."

The Little Dutch Boy

There's a story of a little Dutch boy who walked past a dike and noticed a small leak. He considered putting his finger in the dike to protect the people from what could happen if it were to break. At that point, he remembered a teacher explaining moral hazard and started to think about the companies who built the dike and the poor job they did. The builders don't deserve the help; doing so would only encourage more shoddy construction in the future. Besides, the foolish people who live here should never have built their homes below sea level. So the little boy continued on his way home. Before he arrived home, the dike burst, and everyone for miles around drowned, including the little Dutch boy.

The Federal Reserve's version of this story may be more traditional, as the little Dutch boy was desperate to help and worried about the whole town. Thus he stuck his finger in the dike and held it there until help arrived. This decision was painful and not guaranteed to work, but he still did it and saved all of the people who lived behind the dike, including himself. The builders of the dike realized the errors of their ways and made changes so these occurrences would not happen in the future.

I'm sure this story sounds familiar but who would have thought that Fannie Mae and Freddy Mac needed former Treasury Secretary Hank Paulson to "put his finger in the dike." Like the little Dutch boy, I don't like how Fannie Mae and Freddy Mac got into the position that they did. I do, however, applaud Paulson and Federal Reserve Chairman Bernanke for their decisive action. What occurs from here is still to be written but we must keep vigilant to the long-term actions which caused the financial collapse and not forget those responsible.

Excerpts from: *House of Cards*

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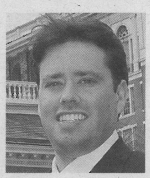
Understanding Capital Gains

I have always believed that tax planning, especially pertaining to capital gains and losses, is critical when making investment decisions. The unsettled markets of 2008, and early 2009, allowed most of us to avoid paying capital gains taxes. It also allowed us to realize capital losses, which can be carried over until totally extinguished. While we have always tried to do this over the years, 2009 may have been an especially good year to have carry forward capital losses. Don't be confused, we never try to lose money on an investment, however, if a loss exists, why not realize this loss if the investment we are selling can be replaced with an equally attractive idea?

There are two reasons why having carry forward losses may be valuable. The first is the almost certain possibility that taxes will be increased in the near future. The second reason is obvious to many investors - if we can postpone paying taxes (unless we pay those taxes during low tax periods) why not do it?

Over the years I have found confusion among some clients over how loss carry-forwards are used. Naturally, you should always check with your professional tax-preparer, but it is important to understand that capital losses offset capital gains (short or long-term) up to the total amount of the loss. This provides substantial tax planning opportunities. As usual, please call with any thoughts or questions you may have on this subject, but keep in mind your Schedule D tax losses are not indicative of your account performance, they simply allow you to manage the taxes you pay on capital gains.

Blue Bell PWM In The News



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INVESTORS MUST maintain a level head; many tend to become overly emotional in times of heightened volatility. Investors seeking the super safe or crash-proof portfolio typically don't have an inflation-proof portfolio. Many investors don't fully understand the risks to fixed income in an inflationary environment. Hedging must play an important role in any investors' portfolio, both the total fees to hedge as well as the opportunity cost, or what is given up in return for reduced risk must be understood. Some techniques we use to hedge are: maintaining a diversified portfolio, covered call writing, protective put buying, structured products, closed-end funds when they trade at relative discounts, ETFs, as well as purchasing investments we believe will be profitable in an inflationary environment.

"The premium is more conspicuous now because of the low-cost alternatives" J. Scott Miller, *Wall Street Journal*, referring to exchange-traded funds that focus on gold and silver.

"Absolutely, positively, it's about education, because the client needs to understand the risks." J. Scott Miller, *InvestmentNews*, speaking about the need for investor education.

"Make sure you understand exactly how they work. Some catches aren't evident in sales pitches. How is your profit calculated?" J. Scott Miller, *Bankrate.com,* speaking about equity-indexed CDs and that many are too complicated for average investors to understand.

"Structured Products are good for clients who want exposure to equities, but who are willing to give up some upside return potential for some downside protection." Scott Miller, Jr., *Registered Rep Magazine*, speaking about the evolution of Structured Products.

Thank you for your continued support of our business through referrals of family and friends!