Market Update - February 2009

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It's no secret that 2008 was one of the most challenging years anyone with any history in the stock or bond market – whether a long time or short – has ever experienced! But as difficult as it's been, it is not without precedent. We've been here before and, in the past, have always eventually recovered and enjoyed new periods of prosperity. Though no one can guarantee the future or a repeat of past performance, the U.S. and world economies have always shown resiliency, and that has not changed.

Many say, though, that this bear market feels different – that this crisis is different. In fact, every bear market, every crisis, is different. From the recession in 1937, the war in Europe in 1939 and the devastating attack on Pearl Harbor in 1941, to the Dow topping 200 in 1946 (market touted as "too high"), to the beginning of the Cold War, then the Dow topped 300 in 1954 (Way "too high"), the Suez Crisis of 1956, the recession of 1958, Castro seizing power in Cuba in 1959, the Kennedy assassination in 1963, the Viet Nam war escalating in 1966, money markets tightening and the market falling in 1969, the Watergate scandal in 1972, Nixon resigning in 1974, then New York City threatened bankruptcy in 1976, an energy crisis in 1977, President Reagan and the Pope are shot in 1981, and to the "worst recession we've had in 40 years in 1982.

It continued: In 1984 the Iran/Iraqi war was escalating, the U.S. bombed Libya in '86, bank failures peaked in 1988 followed by the junk bond debacle in 1989, followed by another U.S. recession in 1991, then the Feds raised interest rates six times in 1994 and the Dow topped 4,000, /then 5000, /in 1995 ("market too high"), the global economic turmoil of 1998, terrorist attack of 9/11/2001, and the hurricanes of 2005. We will one day look back and call this the "subprime" crisis. We believe this too shall eventually pass.

So as we begin this new year, it's important to know the rules you're playing by – and there are some new ones. These are some of the tax law changes that went into effect January 1st of this year.

Retirement plans:

There's good news if you're 70 1/2 or older. Required minimum distributions (RMD) have been suspended for the year 2009 so if you don't need the money, you don't have to take it. The same holds true for beneficiary IRAs - the RMD is waived for 2009.

Several key contribution ceilings affecting retirement plans are higher for 2009. The maximum 401k contribution increases to $16,500, up by $1,000. Individuals born before 1960 can add an extra $5,500 for a total contribution of $22,000. These contribution limitations also apply to 403b and 457 plans.

The ceiling on SIMPLE IRAs jumps to $11,500. People who are age 50 or older in '09 can put in $2,500 or more.

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There's no change in the pay-in limits for IRAs and Roth IRAs. These limits remain at $5,000 plus $1,000 more for anyone who was born in 1959 or earlier.

Changes on the income tax return:

Personal exemptions are $3,650 for filers and dependents. Basically, that means for anybody you claim in your household on your tax return, you are able to receive this deduction. That’s the good news. The bad news is that these exemptions are gradually reduced as your income increases, beginning with incomes over $250,200 for married filers or $166,800 for single filers. The standard deduction, which is the deduction you take if you don't have enough itemized deductions, also increased this year. Marrieds can claim $11,400 and singles can deduct $5,700. These figures are bumped higher if you're over age 65.

Estate taxes:

Far fewer estates will be subject to federal estate tax in 2009. The estate tax exemption jumps to $3.5 million, up from $2 million in 2008. Amounts above the exemption will continue to be taxed at a flat 45%. The big unknown is what will happen next year. These taxes are currently slated to be eliminated entirely for the year 2010. Under current law, the estate tax is slated to go back to the previous exclusion of $1 million. You can see why this law, when passed, was called the “Throw Momma from the Train Bill.” We believe you will see some action by Congress regarding this exact issue this year!

Medicare:

The basic Medicare Part B premium remains at $96.40 a month in 2009. However, upper-income seniors have to pay considerably larger premiums. This is based on a scale depending on your income in 2007. The amounts are much higher than the premiums for 2008 because the lawmakers phased in the premium hike over three years. The final phase is now fully in effect. So for upper income earners, their Social Security benefit wasn’t “lowered” but they are definitely receiving less money.

Social Security:

The Social Security wage base rises to $106,800 in 2009. This is a $4,800 increase, resulting in an extra $298 tax bill for higher-paid employees. For those of you currently collecting Social Security, your benefits increased 5.8% this year with the cost of living hike – but again, if you’re an upper income earner, you still got less.

Long-term Care Premiums:

These premiums continue to be deductible and at higher rates. Tax payers who are over age 71 can claim as much as $3,980 per person. These rates phase down for those who are younger - one more reason to consider long-term care insurance!

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Mileage Deduction:

The standard mileage rate for business driving is $0.55 a mile for 2009. For medical traveling and moving, it's $0.24 a mile. But, when you're driving for charity, it's $0.14 a mile. Hmmmmm.

A special message from our staff:

As you organize to go to your tax preparer this year, if you have an NPC brokerage account, please be sure to also take your December statement with you. It shows all the cost basis information for anything you may have sold during the year! Keeping a long-term perspective doesn't make it much easier to live through the current downturn, but it does reinforce our conviction that we will get through it. Almost daily we hear that our government and other world governments have committed to doing whatever it takes to get this system up and running smoothly again. Likely, it will take some time.

But a market slump like this can create opportunities. We will continue to work hard at finding the information and investments that could benefit you, our investors. Our goal is to bring sense and sensibility to the table and to help you avoid what are often referred to as bear market mistakes. To that end, we're attaching a chart from American Funds that we think you'll find very interesting. Again, past results are not predictive of results of future periods. Additionally, in a few weeks we will be attending a three day conference with our seasoned group of long-time financial planners and investment managers to discuss current markets and strategies. (It's being held at the Temecula Creek Inn – not the Kona Kai.) We'll tell you more about these meetings in our next letter.

And finally, a few words from Ronald Reagan (1986) ……

"Government's view of the economy could be summed up in a few short phrases. If it moves, tax it; if it keeps moving, regulate it; and if it stops moving, subsidize it."

And the beat goes on. . . . . . .

Happy New Year, Gloria and Barbara