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FINANCIAL IQ

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Rising from the Ashes

Just like the mythological phoenix, the immortal bird that, when it dies, bursts into flames and is reborn from its own ashes, so too the stock market has had a similar rebirth. It is now well into a year-long recovery that has left many investors smiling and others, unfortunately, still sitting on the sidelines…waiting for that perfect time to invest. Looking back on recent history, it truly has been an amazing two years in the stock market…a devastating bear market followed by a powerful, yet unexpected rebound. It was a rebound missed (as is so often the case) by many of the so-called experts of the day who, in the end, wanted no part of this market a year ago. How tragic it would have been had we listened to their advice, for we'd have missed most of the market rally and we'd still be sitting on mounds of cash with no place to go. Instead, our clients, to their credit, had the resolve to stay the course…and have been rewarded handsomely for doing so. The market today, while still short of its previous high, is now at least within striking distance. See following chart for current return data.

Performance thru 3/31/2010 (total return)

	March	1st Quarter	1 year.
Large Cap Stocks S&P 500 Index	6.0%	5.4%	49.8%
Small Cap Stocks Russell 2000 Index	8.1%	8.9%	62.8%
International Stocks MSCI EAFE Index	6.3%	0.9%	55.2%
Emerging Markets MSCI Emerging Mkt. Index	8.1%	2.5%	81.6%

In light of what's happened in the market's recent past, most investors have come to realize that, regardless of how well informed they are or how much confidence they have in a particular trading system or philosophy, the investing experience can still be a very difficult one. One of the main reasons for this is the unrealistic expectations of most investors. Beating the market consistently is tough to do, and in the end, few investors walk away winners. At Plancorp, we often refer to it as the "hope springs eternal trap"…the belief that markets can be outsmarted on a consistent basis…not by everyone, certainly, but surely by these Masters of the Universe! This attitude can get an investor in trouble, for, as many of us know all too well, the stock market is a very expensive place to get an education…although, the late humorist Will Rogers seems to have discovered one way to achieve a successful investing experience: "The way to make money in the stock market is to buy a stock. Then, when it goes up, sell it. If it's not going to go up, don't buy it!" Wow! Why didn't we think of that!

Truth is often stranger than fiction…

Here's an interesting story that will make you feel good, and one that probably takes the whole investment notion of "staying the course" to the extreme. Nevertheless, it holds some important lessons for all investors.

The Chicago Sun-Times reported that a long time resident of Lake Forest, Illinois, passed away recently at the age of 100, leaving a $7 million bequest to her alma mater, Lake Forest College. Although the woman lived in one of the wealthiest communities in the country, she hardly fit the profile of a trust-fund socialite. An orphan at age 12, she was cared for by neighbors and attended college, earning an English degree in 1931. She went to work as a secretary for nearby Abbott Laboratories in Chicago where she worked for 43 years. She never married, never owned a car and lived much of her life in an apartment before moving to a tiny one-bedroom house willed to her by a friend.

Her $7 million estate was the fortuitous result of a lifetime characterized by frugality, simplicity and a large dose of good luck. She had purchased 3 shares of Abbott stock for $60 each in 1935, reinvested the dividends, and never sold them. Over the subsequent 75 years, her three shares multiplied to well over 100,000, and her $180 initial investment grew over 38,000-fold to approximately $7 million.

The story brings a smile to almost everyone's face and offers a number of investment lessons as well.

- Compound interest is a wondrous thing over long periods of time. To turn $180 into $7 million over 75 years requires an annualized return of 15.13%. By comparison, a similar purchase in other investments would have done as follows: in one-month US Treasury Bills: $3,046 (3.84%), in the S&P 500: $389,669 (10.78%), and in US small cap value stocks: $10,435,007 (15.75%). Two things of note here: Remember, returns come from taking risk…US small value stocks are obviously much riskier than US T-Bills; and, check out the slight difference in percentage return between the Abbott stock and US small cap value stocks…and yet notice the huge difference in ending value. It's amazing how, over the long run, a little extra percentage return can have such a huge impact on the bottom line.
- Maintaining an investment strategy requires discipline, detachment, or some form of both. Our investor had ample reason over 75 years to question the wisdom of holding Abbott shares, and, by extension, equity

shares of any kind. The shares lost roughly one-third of their value in the bear market of 1937, and did not exceed the mid-$50 price range of March 1937 until March of 1944. She continued to hold her shares despite plunging stock prices in 1962, 1970, 1974, 1982, 1987, 1990, 2002 and 2008. Do we tend to pay too close attention to our investments?

- Does it make sense to try to emulate our investor's success by making a bet on a single company? We think not (don't forget Enron, Fannie Mae, etc.), particularly if we are seeking to use our portfolio to fund our retirement. The risk would just be too great. In addition, although we may admire her habit of thrift, most of us would have a hard time riding the bus for decades and wearing second hand clothes while maintaining a multi-million dollar portfolio. It just doesn't happen. Strangely though, if her investments had done poorly, the loser would have been Lake Forest College, not her lifestyle.
- Finally, a major factor in our investor's success is a happy accident of geography. She was raised in Lake Forest and went to work for a nearby firm in Chicago that turned out to be one of the biggest winners in the entire US equity universe. For the 50-year period ending in 2009, for example, only seven stocks had higher rates of return: Altria Group (formerly Philip Morris), Kansas City Southern, Loews, Walgreen, RadioShack, Dover and Johnson and Johnson. Had she chosen, instead, to work for one of the other industrial leaders of the time located in the same city, the outcome probably would have been sharply different.

John Keilman, *"A Hidden Millionaire's Gift," Los Angeles Times, March 6, 2010*
David Roeder, *"One Woman, Three Abbott Shares Equals $7 Million", Chicago Sun-Times, March 7, 2010*
Eugene Fama, *"The Behavior of Stock Market Prices"," Journal of Business 38, no.1 (Jan 1965): 34-105*
Center for Research in Security Prices, *University of Chicago*
Weston Wellington, *Vice-President Dimensional Fund Advisors, Down To The Wire, March 31, 2010*

Performance data shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Average annual total returns include reinvestment of dividends and capital gains.

Those pesky investing costs…

We never cease to be amazed what little time is spent by the average investor trying to get a handle on what his or her investing costs are. It's amazing because, aside from the fact that costs can have a major impact on portfolio returns, they are still the only thing that we, as investors, have control over. And, as John Bogle, founder of The Vanguard Group, and considered by many to be the father of the index fund, so cleverly put it some years ago: "When it comes to the costs of investing, you end up getting what you don't pay for!"

A recent article in the Wall Street Journal on the hidden costs of mutual funds brought to our attention the strong case that can be made for keeping an eye on your investment costs. The article listed the average annual expense ratio and the average trading costs (which are not included in the expense ratio) of the Morningstar universe of actively managed US equity funds. The combined numbers came to 2.75%. That's a significant number, and one that we're confident most people who invest in these funds are not aware of.

As a way of comparison, we checked the average expenses of holding a U.S. all-equity portfolio managed by Plancorp and using all DFA funds…a typical U.S. equity portfolio held by Plancorp clients. The difference was quite astonishing. To begin with, the average expense ratio of these DFA funds came to .27%, a number dramatically lower than the average actively managed mutual fund. More surprising, the trading costs of the DFA funds actually showed a slightly negative number (which means they actually make money on trading…a real benefit to the investor), reflecting DFA's expertise as a major player in the trading of small cap stocks. The combined average expenses would then come to something short of .27 basis points…a number quite a difference from the 275 basis points of the average actively managed mutual fund…and an amount which can easily account for the difference between an investor making money in the market or losing it. In actual dollars and cents, here's an example of what it would look like: On a $1,000,000 investment, the investor would be staring at a difference of somewhere close to $25,000 a year…just in annual investment expenses. And, even adding our maximum management fee of 1% to the mix, the investor is still ahead by an amount close to $15,000. That's a hurdle that few money managers can overcome with outperformance on a consistent basis.

GRAT Alert…

For some time, Plancorp has been concerned that Congress might curtail some popular estate planning tools. The House of Representatives took a giant step in that direction on March 24 when it passed H.R. 4849. If the Senate follows suit, the use of GRATs will be much less attractive for shifting wealth to future generations.

Presently, a GRAT allows someone to put assets into an irrevocable trust for the benefit of one or more beneficiaries while the grantor retains the right to receive annual distributions back over the trust term. The IRS assumes that the trust assets will produce a return equal to the Section 7520 rate (AFR) applicable to the month of transfer, which is 3.2% for April 2010. For transfer tax valuation purposes, the amount of the taxable gift is the fair market value of the property transferred minus the value of the grantor's retained annuity interest. For a "zeroed out" GRAT, the present value of the grantor's retained annuity interest is equal to fair market value of the property transferred to the trust, thereby allowing a gift tax free transfer. If the value of the trust assets increases by more than the AFR during the term of the GRAT, the GRAT will be economically successful, and the excess appreciation will go to family members (the remainder beneficiaries) or to trusts for their benefit…gift and estate tax free when the GRAT term ends.

The proposed legislation will:

1. require a GRAT to have a term of at least ten years, as opposed to two years presently, greatly increasing the risk that the GRAT will fail,
2. not allow the annuity payment to be reduced from one year to the next during the first ten years, and,
3. require that the taxable gift of the remainder interest at the time of the transfer have "a value greater than zero," although there is no clarity on the exact meaning of this provision at this time.

GRATs are not for everyone, and there is probably no reason why this pending legislation should encourage someone to create a GRAT who would not otherwise do so. However, for those for whom a GRAT makes sense or those who have a pattern of creating GRATs from time to time, one should consider acting sooner rather than later to finalize the creation and funding of this valuable estate planning tool.

Reminder…

Just a reminder to all our clients that we would like to have a copy of your completed 2009 tax returns for our files.