



FINANCIAL IQ

Independent Advice. Intelligent Financial Solutions.

Volatility Returns in the 2nd Quarter

Volatility in financial markets increased during the second quarter. The Standard & Poor's 500 stock index posted its worst quarterly performance since the final three months of 2008, when the financial crisis was in full swing, falling about 12% during the quarter to 1030.71. The yield on the U.S. Treasury 10-year note finished the quarter at 2.96%, down from 3.84% at the end of March and making Treasuries one of the best-performing asset classes for the quarter. Although the 2nd quarter was tough on stock returns, 1 year returns were still mostly positive in double digits, as evidenced by the chart below.

	2nd Qtr.	YTD	1 Year
Large Cap Stocks S&P 500 Index	-11.4%	-6.7%	14.4%
Small Cap Stocks Russell 2000 Index	-9.9%	-2.0%	21.5%
International Stocks MSCI EAFE Index	-13.8%	-12.9%	6.4%
Emerging Markets MSCI Emerging Mkt. Index	-8.3%	-6.0%	23.5%

Investors responded to the quarter's market upheaval by selling U.S. stock funds. Redemptions exceeded purchases by an estimated \$21.8 billion, far exceeding the net \$3 billion that investors pumped into these funds in the first quarter, according to the Investment Company Institute (ICI) trade group. As in the first quarter, bond funds took the lead in attracting new investor cash. However, the \$62.1 billion net inflow was down from the first-quarter figure of \$91 billion, according to ICI estimates.

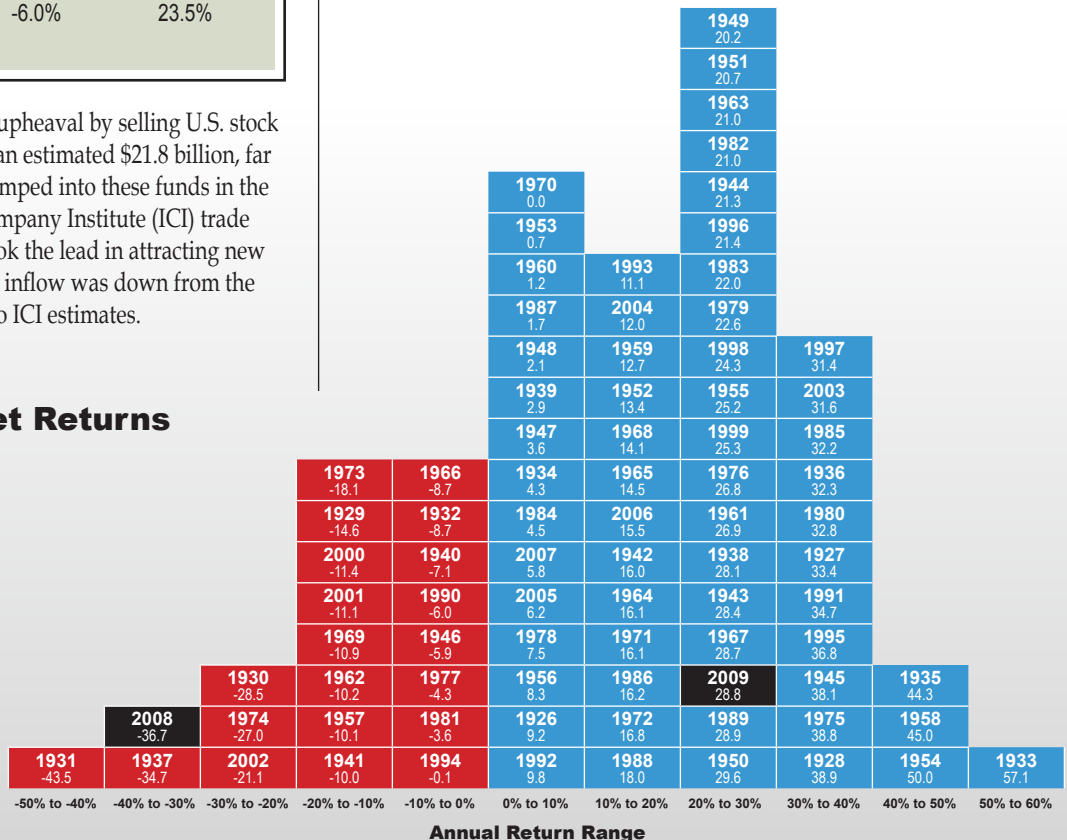
Distribution of US Market Returns

CRSP 1-10 Index Returns by Year
1926-2009

Positive Years: 62 (74%)

Negative Years: 22 (26%)

CRSP data provided by the Center for Research in Security Prices, University of Chicago. The CRSP 1-10 Index measures the performance of the total US stock market, which it defines as the aggregate capitalization of all securities listed on the NYSE, AMEX, and NASDAQ exchanges. Indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results.



It is important to keep in mind that in order to capture long-term capital market rates of return, one must remain exposed to the chosen equity allocation, instead of redeeming your equity funds during quarters such as these, as many investors do. As the most recent annual Dalbar study indicated, for the 20-year period ended December 31, 2009, the average equity fund investor averaged 3.17% compared to 8.20% for buy-and-hold fund investors (S&P 500).

Recent Market Volatility in Perspective

Volatility can be scary. What should we make of the global stock markets taking investors on a bumpy ride in recent years, as well as in the second quarter? Volatility indeed tests investor discipline and prompts some people to question their commitment to equities. While no one knows the future, looking at the past may help you gain a better view of long-term market performance and put the recent market volatility in perspective. And remember, Plancorp's view is that investors should always have a long-term investment horizon for the equity portion of their portfolio.

The chart on the previous page shows the historical distribution of US market returns since 1926. The performance years are stacked in ascending order by return range. This chart illustrates that:

- Market performance over the past two years has been extreme by historical standards. In 2008, US stocks experienced their second-worst calendar year in eighty-four years. Then, in 2009, stocks rebounded strongly to deliver a return in the top quartile of the historical distribution.
- Over the long term, the market's positive return years have outnumbered the negative return years. Since 1926, the market has experienced a positive return in almost three-quarters of the calendar years.
- Not only are the positive years more numerous, the chart shows a larger concentration of performance in the higher ranges of returns.
- The sequence of calendar-year returns appears random, suggesting that accurately predicting future performance is a difficult task for any investor or professional manager.

Over time, the market has rewarded investors who can bear the risk of stocks and stay committed through various periods of performance.

Reaching for the Stars

It is human nature for consumers to seek comfort in the idea that the products they are considering buying have been proven in the marketplace. Investors are no different, often seeking validation from many of the numerous research publications available today to ease their anxiety of putting their money at risk. For investors using Morningstar's mutual fund star rating system, however, there is no guarantee that a "five-star" rated fund will lead to a "five-star" investment experience.

The risks of this approach were highlighted in a survey by the US private wealth management firm Burns Advisory Group, which studied the 10-year performance of Morningstar's five-star funds through 2009.*

The survey found that of the 248 funds rated five-star by Morningstar on December 31, 1999, only four were still receiving that rating a decade later. Of the original sample, 87 had ceased to exist. Of those still in business, all had been downgraded to an average of just under three stars. Even worse, in all categories except international stocks, the average performance for five-star funds over this 10-year period was worse than the average for all funds.

At Plancorp, we believe that investors having their money managed in a responsible, consistent way using a well-grounded, structured investment strategy will provide for a much more successful investment experience than one where investors find themselves reaching for the "stars".

McGuigan, Tom and Courtenay, Tim, Star gazing: Five Star Funds Revisited, Burns Advisory Group, April 2010.

Tax Planning 2011

It is hard to believe that half of 2010 is already gone. Since tax-planning season is almost upon us, we want to make you aware of certain changes to individual income taxation due to the expiring Bush tax cuts and healthcare reform. Below are some of those changes:

- **Capital Gains:** Long-term capital gains rates will increase from the current rate of 15 percent to 20 percent for most taxpayers. Interestingly, the most drastic change would come for those with the lowest incomes. For taxpayers in the 15 percent tax bracket, capital gains would increase from 0 percent to 10 percent.
- **Dividends:** Qualified dividends no longer will be taxed the same as capital gains, but instead will be taxed as ordinary income. In fact, the word "qualified" will have no meaning and all dividends will be treated the same. For those in the highest brackets, the rate increases from 15 percent to 39.6 percent.
- **Ordinary income:** Tax rates on ordinary income will revert to pre-2001 levels. For a couple with taxable income in excess of \$375,000, the top marginal rate will increase from 35 percent to 39.6 percent. In addition, the following brackets also increase as follows: 33% bracket increases to 36%, 28% bracket increases to 31%, 25% bracket increases to 28%, and the 10% bracket increases to 15%.
- **Deductions:** The phase-out of itemized deductions and personal exemptions will return, limiting the benefits of these offsets for high-income taxpayers.

Further, the recently enacted health care reform package contains two new surtaxes beginning in 2013, of which we wanted to make you aware and will address as they get closer to their effective date:

- An additional 0.9 percent Medicare tax on wages and self-employment income for single taxpayers making more than \$200,000 and couples making more than \$250,000.
- A special 3.8 percent Medicare surtax on the lesser of unearned (investment) income or modified adjusted gross incomes above a certain threshold (\$200,000 for single taxpayers and \$250,000 for married taxpayers.) Investment income includes interest, dividends, capital gains, annuities, royalties and passive rental income.

There are some strategies that taxpayers may want to consider in light of the above increases, including the following:

- Accelerating taxable income into 2010 v. 2011. Paying taxes at lower rates may more than offset the present value cost.
- Pushing charitable donations, estimated tax payments and other discretionary deductions to 2011.

The above changes will occur in the absence of Congressional action. We will be monitoring the situation closely for you and will discuss these items at our upcoming planning meetings. If you have any questions in the meantime, please do not hesitate to call.