



Vigil Trust & Financial Advocacy

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Quick Tips

Tip #1

There are thousands of Americans who, after losing as much as 50% on mutual fund investments, will be stuck with an additional tax liability on top of that devaluation. If you end up paying income tax on an investment which lost you substantial amounts of money in 2008, it is high time for you to do something differently this year, such as hiring a professional who minimize the taxation of mutual funds in your portfolio.

Tip #2

Vigil Trust has unearthed and begun to conservatively implement a way for our clients to participate in the market more safely. With a slight adjustment to our investment strategy through the use of some recently developed investment tools, we are able to structure your portfolio to participate fully in the market and yet due so with less risk by leaving part of your funds that would otherwise be in the market in cash. Please call us for more information to talk about this strategy.



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VIGIL Strategies

First Quarter Newsletter 2009

Taking you where you want to be

So What Do We Do Now?



This question seems to be at the top of the mind for most investors right now. You feel like you should do something to address what has been going on in the markets, but you aren't exactly sure what. Well, know that you aren't alone in that

regard. Evidence is mounting that even many professional investors have been frozen by indecision into doing nothing during these crazy times.

Let's see if we can offer some ideas that will help you work your way through this situation to a point of deciding *whether* you need to do something right now and to give you some sense of *what* you might do if action is necessary.

Do you have the "right" amount in stocks for your situation?

For those of you that are regular readers of this publication, it should not be surprising to you that we start with that question because this is ALWAYS the first place to

start. All other decisions flow from the underlying question of "what is your desired asset allocation" – i.e., what percentage should you have invested in stocks?

So what is the "right" amount invested in stocks? The "right" amount would be the maximum amount possible that a severe market downturn does not affect your day-to-day lifestyle and does not cause you to become SO uncomfortable with your declining values that you feel compelled to sell out of stocks. Look, none of us likes it when the market goes down. We all feel a certain sense of anxiety at the notion that our paper wealth is declining. But if you are young, you are living comfortably off your earned income and the money you are investing is for retirement many years down the road, you can afford to be heavily invested in stocks; you are not affected at all today by the market decline and you can wait for a recovery. If you are older and distributions from your investments are an important part of the money you need to live every day, then you can't afford to have as much in stocks.

The other part – when do I have too much in stocks such that I will just become TOO uncomfortable with a big market decline – is a bit less objective to assess and difficult to grasp. Just as people tend to have the wrong instincts about their investments – they instinctively want to sell when the market goes down and buy when the market goes up – they have a tendency to understate their tolerance for risk when the market is declining and overstate it when the market is advancing. If you thought you had the right stock allocation for your risk tolerance (which is quite different from never having carefully looked at the question) but you now find yourself terribly uncomfortable and obsessing about

the current market, perhaps you have overstated your true tolerance for risk. In that case, there would be two suggestions:

- Selectively look for chances to decrease your market exposure.
- Remember 10 years from now when the market is roaring and you are wondering why you are stuck in a portfolio that seems to be going not very far very fast, that you made the decision to be more conservative to reduce the downside risk.

But what if you have carefully planned your stock exposure and you are comfortable that you have had the right amount in stocks for your situation? Then what? Well, let's consider the options:

Sell Out.

I'm sure that nearly every one of us has been tempted with this idea. Of course, if we knew with certainty what was going to happen, it would be much easier to decide what to do. There are many now, talking with the benefit of hindsight, who assert that it was "clear" we were going to have problems like this. Well, if we knew for sure that were going to be the case, then we definitely should have sold out.

The problem with such a "timing-based" approach is it is predicated on the assumption that someone can actually accurately and repeatedly predict short-term market movements. I believe it was Warren Buffet who said "the market timer's hall of fame is an empty room". In other words, even if someone happens to call a short term move or two correctly, no one has proven to be able to do so regularly and reliably over time. History is littered with investment people who got it right once or twice and then lost it all being wrong the next time.

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Take the situation right now. Without the benefit of hindsight that you will have next January, predict the market’s return for 2009. I will tell you this – Bloomberg News recently reported that the average economist they surveyed predicts the S&P 500 will have a gain of 17% for 2009. However, the comment was made during the introduction of an economist who was calling for the S&P to drop to below 600 (more than a 25% reduction from its current level). So who do you believe – the “average” economist or this thought “outlier”? And consider – Bloomberg surveys many economists who on average believe the market will have a substantial gain, and yet who does Bloomberg put on air and talk to you? Why is that? Because “mainstream” thought is boring and not good television. To get and keep your interest, they need to have programming that is bold and “on the edge”. That is fine; that’s their business. But is this good information, then, to use in formulating investment strategies for your life’s savings?

The problem with trying to “time” the market is that you might be wrong. And if you are wrong and instead of the market going down it goes up and you miss a major move because you are sitting on the sidelines, you have inflicted real long-term damage to the return prospects for your portfolio. On the other hand, if you are right and the market does indeed go down, if you remain in you will eventually recover so there is no permanent damage. If you have the “right” allocation of stocks (see above), you should be able to weather the storm and continue to live comfortably until the market recovers.

So long story short, the only way you should even think about selling out at this time is if it has become quite clear that you simply have too much investment risk in your portfolio for your risk tolerance. Even in that case, you’ve already paid a heavy price for your current misallocation, so adjust selectively. If you were working your way toward a more conservative portfolio over time, this is a time to temporarily suspend those plans. Look to reduce your equity allocations when the

market is strong, not when it is weak.

Do Nothing

As alluded to above, this option has been a *de facto* popular option with many professional managers. It is rationalized by a “let’s not throw ‘good’ money after ‘bad’” type of argument.

If your manager is doing nothing in this environment, my strong advice to you is “get a new manager”. If that manager who is frozen by uncertainty happens to be you, my advice is the same. You need to have a strong talk with yourself and ask yourself if you are truly up to the task of doing what needs to be done. The same managers who do nothing when the market is down and allocations to stocks should be increased do nothing when the market is up and allocations to stocks should be decreased. This is the “herd” mentality and is not the path to successful long term investing.

Just review the simple mathematics. If, for example, you invested \$10 in a stock that lost 75% of its value last year – and unfortunately there are some stocks that did that or worse – you have \$2.50 left. If you do nothing, what kind of return do you have to get on \$2.50 to get back your \$10 that you originally invested? 300%! If you have done nothing, a 75% positive return – which takes you back to zero in terms of your measured return on the stock – actually only takes you back to about \$4.40 in terms of your investment value. So there is a heavy price for inaction!

Buy More Stocks at Reduced Prices

In the above example, if you buy 3 times as many shares as you originally owned – that is, invest \$7.50 more at the reduced price of \$2.50 - you again have \$10 invested. If that \$10 investment experiences a 75% gain (in other words, a percentage gain equaling your loss), you now have \$17.50. You can sell the \$7.50 you invested when the market was low and your dollar return, like your percentage return, is back to even.

Believe me, I understand how emotionally difficult it is to make the tough decision to buy more stocks when most of the other people are selling. But *if your stock allocation is right for you* (again, see above), then your long-term investment success requires that you make the hard decisions and adjust your portfolio exposure to reflect what has happened in the market by buying more stocks.

In advising that this is a time to buy more stocks, bear in mind that we have no idea whether the average economist or the outlier discussed above are right in terms of what will happen to stock values in 2009. Obviously we HOPE the average economist is right, but we have no way of knowing over such a period of time. The reason we recommend you buy stocks now *if your allocation is right for your situation* is that even a further short-term deterioration in stock prices won’t harm you. On the other hand, history suggests that sometime in the next 10 years you will be delighted that you were able to buy stocks at today’s prices.

In Conclusion

So what do you do now? If you haven’t had an assessment of or given serious consideration to your stock allocations, that needs to be done. If you need help with that, seek it. Don’t be selling stocks unless your allocation is just way off base for your true risk appetite as we have come to learn about it in this market, and even in that case do so only selectively. If your manager – even if that manager is you – has been doing nothing in this period, that is not investment management. That is fate. Get someone who knows what they are doing and who will watch out for your best interests to help you. Be a selective buyer of stocks in this market and then wait like the rest of us for the certain recovery of unknown time frame. ✓



Tom Batterman
President
Vigil Trust & Financial Advocacy

Paying Capital Gains Taxes on Losses

Adding insult to injury.
Kicking a guy while he’s down.
Leveling capital gains distribution taxes on mutual fund owners this year.
They’re all peas in a hateful pod.

You’d think that the surest way of avoiding a capital gains tax liability would be not having any capital gains. Hey, that makes sense. Even the sneakiest IRS person can’t come up with a way to tax you for losing, right?

Not so fast. We’re talking about taxes. Your logic has no place here. There are thousands of Americans who, after losing as much as 50% on mutual fund investments, will be stuck with an additional tax liability on top of that devaluation.

How does that happen? It’s called a distribution. To summarize the situation:

Because investors are becoming discouraged about their losses, mutual fund managers are being forced to sell some of their best stocks to raise cash for the investors who are fleeing. That means the mutual fund incurs a capital gain on profitable sales of stock. Under federal law, those gains, plus dividends, must be passed on to the people who have money in the mutual funds. They are called “distributions,” and must be reported on tax returns.

Basically, if your fund bought one of its many stocks at \$5 years ago and sold it recently for \$15, you’re going to be on the hook for some of the capital gains tax liability associated with that sale. The fact that the stock was worth \$30 last year is a moot point. The fact that every other stock in the portfolio may have lost money this year? Also unimportant with respect to this particular element of the tax code.

This can translate into some serious coin, too. *Consumer Reports* explains how some of the biggest losers among mutual funds this year are still on the hook for big capital gains taxes:

But some funds will pay out huge. Vanguard Precious Metals and Mining (VGPMX), for instance, has lost 64 percent of its value so far this year, but will send out long-term capital gains distributions equal to about 15 percent of its share price. T. Rowe Price Spectrum Growth (PRSGX), which is down 43 percent year-to-date, is expected to pay out 9 percent of the fund in taxable distributions.

Most of us will shake our heads in dismay at the idea of taxing someone for capital gains after they barely survived the biggest stock market freefall we’ve seen since folks were living in Hoovervilles. If your mutual fund investments are in a 401k wrapper or are part of an IRA, you won’t have to worry about the distribution. You can be sickened by the dementedness of it all, but at least you won’t be compelled to pay capital gain taxes on positions that lost money.

Only those who have made mutual fund investments outside of the tax-protected account types will get stuck ponying up for the distributions. This is why it is so important to work with a planner that specialized in minimizing the way your investments are handled for tax purposes. If you will be paying distributions for accounts that lost a great deal of value, it might be time to talk with one of our advocates. There are better ways to handle the taxation of mutual funds than rubbing salt into open wounds. ✓

Vigil Trust & Financial Advocacy...

...conducts weekly calls on financial topics of interest.

If you would like to have access to the information we discuss, please contact us; we can make special arrangements for participation by friends and acquaintances of our firm.