Napa Wealth Management's

The Sensible Investor

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Economic Update – A Positive Approach to a Challenging Environment

By George McCuen, CFP®, President, Napa Wealth Management

The Treasury and the Federal Reserve are throwing trillions of dollars at financial firms to compel them to lend more. But even if those programs succeed, debt-laden families probably won't want to borrow like there's no tomorrow. In the March 15 article entitled "Are We Headed into a Depression?" Ron Sadoff, founder and investment adviser at Sadoff Investment Management in Milwaukee states, "Instead of spending, Americans boosted their savings rate in the last quarter (2008) to 2.9% of after-tax income, up from 1.2% in the third quarter". The savings rate in February hit 4.2%, near the highest levels of the past decade as tracked by the Commerce Department. "The irony is that spending less, saving more is good for the individual but horrible for the economy, especially when everyone is doing it".

Household net worth has dived by $12.8 trillion since the fourth quarter 2007. With Americans focused on repaying debt and rebuilding savings, demand for mortgage, credit card and other consumer loans will likely remain weak. Applications for mortgage loans have surged recently, but that's mostly due to refinancing activity. Meanwhile home prices continue to erode.

"It will take a decade or more for household wealth to recover," said Mark Vitner, an economist at Wachovia. That's bad news for an economy that relies heavily on consumers. "We're going to have a long and difficult road to recovery," Vitner continues.

The economy shrank in the fourth quarter of 2008 by the largest amount since 1982. Another big drop in growth is expected this quarter. The Treasury's plan to remove some $1 trillion of toxic assets from banks' books is also aimed at unlocking credit. But analysts doubt consumers will return to their profligate ways. "If they're not seeing money coming in the door, they're not really interested in taking on more debt," Vitner said.

Now the bad news … I'm kidding! Since the stock market low of early March, we are seeing some rays of sunshine burning through the economic clouds. Tim wrote on March 6th about the reduced production 'overreaction' by many industries with particular emphasis on the auto industry. In summary, demand is still higher than the reduced production which will result in the realignment of supply with demand and this, in turn, will help boost economic activity. Increased economic activity will begin to propel earnings and the stock market will begin to rise again.

As of the end of March, year-to-date the Dow - 13.3%, S&P500 -11.7%,and the NASDAQ -3.1%. To put it in perspective, on March 10th the Dow and S&P 500 were down 25% so as you see the market has had a nice rebound within the past three weeks.

In the short run our model suggests that the stock market will push the Dow into the 9,000 - 10,000 point range so it appears that we have some upside to look forward to. As always though, as things change, so can our outlook. We don't, therefore, suggest that this is a "done deal" and nothing but an easy or smooth ride up from here – prudence is still in order. Even though we believe that we have seen the stock market low for this year, based on the economic headwinds facing us (some of which have been pointed out in this article), we don't see a sustained economic recovery for a couple of years.

We still contend that the sensible approach is to invest in essential services industries that pay the lion's share of their earnings to the owners of the company - the shareholders. Our view from an investment point of view is rooted in the perspective that if we are in for a longer-term time frame for an economic recovery, we want to be paid while we wait. If the recovery comes sooner than later, we will be thrilled like every other American.

Steven Shepich, Chartered Financial Analyst and CPA with Ameriprise Financial wrote a research paper entitled "Dividend Investing" dated March 17, 2009. In it he writes, "It is not the Wall Street darling investments that create wealth over the long run; rather it is the boring, steady-growing, cash-generating firms that return cash to shareholders on a consistent basis". His paper focused on "toll road" types of investments that are structured to pay their income out to the share-

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Index Annuities—Financial Comfort Zones

By Jim Riley, CFP®, EA
Senior Financial Advisor

Nowadays, millions of investors are seeking safe haven for their finances – a niche formerly epitomized by local banks with FDIC insured accounts and personalized service. Okay, just the FDIC insured accounts then.

But scrutinizing the current puny interest rates, I pose the question: Is it necessary to sacrifice real growth and income in order to responsibly manage one's finances in these uncertain times? Let me introduce to you a viable alternative that may satisfy your desire to secure your money and to see it flourish.

The indexed annuity, as a financial vehicle, is a safe haven that still has growth potential.

Annuities come in different forms, but for our purposes I'll focus on one type of fixed annuity known as an Equity-Indexed Annuity (hereafter referred to as an EIA). Generically annuities are contracts made through insurance companies. EIA's specifically, unlike securities, will typically not decline in value, being viewed as preservation vehicles. EIA's credit interest to your account based on the performance of some form of equity index, such as the S&P 500.

For example, if over one year the S&P 500 increases by 10%, then an EIA might increase in value by 6 or 7%. However, if over one year the S&P 500 decreases by 10%, the EIA would simply incur a 0% return. In other words, during up market years EIA's typically increase in value, but if the stock market tanks your annuity loses nothing.

… one of the most attractive features of annuities is tax deferral.

Unlike deposits in the bank, your annuity interest is not taxed until you ultimately withdraw your earnings.

Consider these following pertinent facts to realize annuities as a financial comfort zone:

- One common concern is that annuities tie up your money. True. In general annuities do charge surrender fees for early withdrawals. But there are exceptions. Many annuities offer 10% free withdrawal annually, so if you need some of your money, it's available.
- Stick with the highly rated insurance companies. And always ask for an insurer's rating before purchasing an annuity. Your money is extremely safe with a highly rated insurer.
- To decrease the volatility of your overall portfolio, place 10 to 20% of your assets into EIA's. In general I recommend a maximum of 50% of your portfolio in annuities.

We at Napa Wealth Management have extensive experience in index annuities and will be happy to answer any questions that you may have.

Frankly speaking.

Jim

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holders. These types of investments, as Shepich describes, usually come from companies whose income is derived from exploration, development, mining, or production, processing, refining, transportation, or the marketing of any mineral or natural resource.

We continue to believe, as Shepich points out in his research paper, that this boring approach simply makes sense. In a tough economic environment, many of these companies produce consistent profits. Even though their share prices move with the market, their dividends are a nice way to be compensated while waiting for a recovery. This is good news and a positive approach in this challenging environment.

Keep looking up,

George

Napa Wealth Management in the news!

George was recently interviewed by the North Bay Business Journal for an *Investment Strategies* article published on March 23, 2009. See the full article at http://www.busjrnl.com/article/20090323/BUSINESSJOURNAL/903209883

How to Reach Us

1836 Second Street, Napa, CA 94559 ♦ 707.252.1343

Website: www.NapaWealth.com