TAX AND INVESTMENT PLANS
THE LIBERTIES
33 BEDFORD STREET, SUITE 11
LEXINGTON, MASSACHUSETTS 02420-4488
Fax: (781) 861-9916
Telephone: (781) 861-9720

January 26, 2009

As calendar year 2008 came to a close, it clearly found its place in the history books. The historical significance which unfolded in 2008 was profound. It was a year marked by extreme volatility, bank failures, corporate bankruptcies, home foreclosures and fear. Our financial structure was shaken to its foundation. Our domestic equity markets finished with one of their worst performances in nearly a century. Week-end deal making under the guise of the Fed became the preferred alternative to bankruptcy for many corporate titans. The financial system we came to know over decades was dramatically transformed overnight.

During this period, money management skills were tested unlike other periods in our recent history. Mitigating risk and loss required pains taking research, appropriate timing, and good execution. There were no safe havens. Even cash proved vulnerable, witness the auction rate preferred market, Prime Reserve money markets breaking the buck and the Indy Mac bank failure losses.

With that said, our portfolios managed to sidestep the many gaping holes created by the problems above. Your portfolio returns for calendar year 2008, though disappointing from an absolute basis, weathered the storm on a comparative basis. Below you will find a comparative review of the major indices and your portfolio through the calendar year end 2008[1].

	4th Quarter Return	2008 Calendar Year Return
S&P 500	-22.6%	-38.5%
NASDAQ	-24.3%	-40.5%
DOW	-19.1%	-33.8%
EAFE	-20.3%	-45.1%

The Glass Half Full:

Intervention by the Federal and World central banks was equally dramatic; never before has there been such a coordinated worldwide attempt to fortify our financial system. The jury remains in deliberations as to if and when success will be achieved and the inflationary costs that may result. These fiscal and monetary objectives look to use *the infinite balance sheet of the Fed* to stimulate lending, rebuild confidence, retain and create jobs, and provide a catalyst for asset appreciation.

[1] Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index; and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.

What is known; however, is that some compelling investment opportunities have emerged as a result of the dislocations in our credit markets. High quality municipal and corporate bonds are appealing in regard to fixed income; as are some high income investments which have seen spreads widen to levels never before occasioned.

At some point, we believe, the tide will turn, risk appetite will grow, and equity markets will again be in favor. With certain treasuries yielding negative real returns, and the threat of inflation looming, that time should come prior to an economic recovery. As Warren Buffett has said in the past, “What is likely is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. If you wait for the robins, spring will be over.”

Historically, markets begin their recovery before the economy bottoms. The chart below reflects the depth of prior bear markets, and some of the ensuing rallies that followed.

S&P 500 Bear Markets Since 1937

Start	End	Months	Change
March 6, 1937	June 29, 1942	62	-60.0%
May 29, 1946	June 14, 1949	37	-29.6%
August 2, 1956	October 22, 1957	15	-21.5%
December 12, 1961	June 27, 1962	6	-28.0%
February 9, 1966	October 7, 1966	8	-22.2%
November 29, 1968	May 26, 1970	18	-36.1%
January 11, 1973	October 3, 1974	21	-48.2%
November 28, 1980	August 12, 1982	20	-27.1%
August 25, 1987	December 4, 1987	3	-33.5%
July 16, 1990	October 11, 1990	3	-19.9%
March 24, 2000	October 9, 2002	31	-49.1%
Average		20	31.0%
Source: Standard and Poore’s			

(October 10th 2007 – Novemeber 20th 2008 (52.3%)…continued?

S&P500 Returns Following Recent Bear Markets

Bear Market Ending	12 month Return/After	Months to Peak	Trough to Peak Returns
May 26, 1970	43.6%	32	73.5%
October 3, 1974	34.6%	74	125.6%
August 12, 1982	57.7%	61	222.8%
December 4, 1987	21.4%	32	64.8%
October 11, 1990	28.8%	113	417.0%
October 9, 2002	33.1%	90	101.5%
Average	36.5%	67	168.5%
Source: Yahoo Finance			
Past returns are not a guarantee of future results.			

CHANGE

Both of our Presidential candidates promised change. It's significantly impacting our economics, politics, history, and sociology. It's basic. It's a critical concept in today's financial vocabulary. Commenting on its impact a President of the Federal Reserve recently indicated that he was experiencing a new age where every issue –whether **stocks**, **bonds, real estate, commodities, human compensation,** or **cash** is calculating its value differently than in the recent past. That's every *element of capital wealth.*

Capital wealth is the product of human endeavor and capital joined in a business enterprise.

Business is said to abhor change, to favor predictable periods when planning can be accomplished with stable guideposts enabling one to better see and plan for the future. Similarly, financial planning is easier during such periods. The present, obviously, is not such a period. But, surely, it will best reward those who can clearly discern its outline.

A major impetus to this rapid financial change is **cash** or, rather the lack of it.

Cash facilitates exchange between countries, businesses, and individuals. It is valued not for what it is but for what it represents—gross national product for a country, the produce and wares of a business, the work product of the individual. When those measures are exceeded **cash** can be advanced based on the future expectation of production or loaned against accumulated capital wealth. The loans can continue *for awhile based on the lender's expectation.* Thereafter there is a move for payment.

A critically important element of wealth in today's marketplace is **real estate,** whether vacant land or improved, including the home. You've read that the home has been used as "an ATM machine", collateralized to such an extent that it was likened to a **cash** reserve or banking account. The practice was widespread. In the late nineties and again in this decade legislators encouraged banking institutions to lend to those who had little hope of paying their mortgages, explaining that no one should be denied the opportunity to own their own home. This quest for increased living standards beyond the ability to pay became endemic to our nation. Lenders, whether they be individuals, organizations, or other nations now look to collect.

When a number of these entities look to collect at the same time, the effect is like a *cascade*, seriously impacting each of the other *elements of capital wealth* until our value system is seriously often irrationally impacted in what is referred to as the deleveraging process. It is a time of financial fear. It is a time of financial opportunity. It is the time we are now experiencing.

It is important to recognize that this process is going on between individuals, organizations, and governments. The immediate concern is to pay debts now being satisfied by foreclosures or the *sale* of other capital assets. The debts are widespread and an interlocked process is involved. As one debtor defaults another is threatened unable to receive the cash he anticipated collecting to pay his or her bills. The lenders and borrowers are spread throughout the world. Looked at in its parts the process may appear irrational, the value system turned eschew. It is the resulting *cascade* of so many individuals, so many businesses having to sell their particular assets.

The whole process began in the United States and is one indication of our having become a debtor nation, one whose gross national product is overwhelmed by its gross national expenditures.

At such a time individuals hold onto cash, make do with what they have, avoid a number of business transactions. This puts the squeeze on business that requires **cash** exchange in order to pay its costs including those of its work force. Without that exchange the business dies and its work force is laid off. Without that exchange the nation loses both its national product and its revenue (tax) base. The nation, the business, the individual, all will take extraordinary measures to avoid the deleveraging process impacting them.

Like the homeowner who used his home as an ATM machine, the nation leveraged on its future by printing paper money beyond the capability of its gross national product to back. You have read the accounts of the enormous sums of our paper held by Asian nations, the reports of the attempted sale of the port of New York to Dubai investors, the sales of major American business enterprises to foreign investors.

Now with the deleveraging process in mid cycle, the government is accelerating the amount of paper it prints by buying out troubled enterprises, reducing interest rates, pumping liquidity into the system. This is done to reliquefy the system, avoid foreclosures and job loss, re-energize business. At the same time it hopes to protect our borders and regain respect for our currency. The efficacy of the government's actions is open to debate.

It's a complicated process. By issuing so much unbacked paper money, the government is practically promising us that in the not distant future the value of the dollar in purchasing power will be substantially reduced. It will cost us more for our necessities, for the food we eat, the energy we need, the metals we utilize. The commodity implosion of the past several months will reverse. Gold, too, may rise in value. Thus we see the cost reductions of today, the deflation, reversing with substantially increased future costs, *inflation.*

You, as individuals, should be maintaining sufficient cash to satisfy your needs for the immediate future, perhaps as long as two or three years. Beyond that, you should be considering the other elements of your wealth portfolio, both as to value in today's economy that may be skewed from its rational base and in tomorrow's economy. In so doing consider the impact that today's extraordinary government actions will have on an asset's future value and how the imbalances now apparent and occurring in today's society may influence its future value.

We have a dynamic new political leader who is calling for a fiscal program, a program that will put two point five million people to work on our infrastructure and educational systems. A call is made for a health system available to all. These are areas to which cash will be applied. What import will these programs have for your stock portfolio? A number of stocks are now paying dividends—cash—that exceeds the interest payments made by quality bonds. Can we find stocks with promise, with good balance sheets and dividend payouts that also look to future capital gains? Yes. We can.

Some good corporate bonds now selling at a discount are yielding interest rates in excess of ten percent. They look to a nice **cash** flow presently and full principal payment at maturity. There are closed end municipal bond funds discounted presently yielding seven even eight percent tax exempt. That computes to an after tax return of twelve or thirteen percent. Timing, limit trades, intense scrutiny is necessary to take advantage of these opportunities.

The financial planning business must take all of this into consideration. And more. Two thousand nine will be a pivotal year for our portfolio as we move from deflation to, hopefully, a period of reflation, quite possibly to inflation. It will be a pivotal year as we see the end of the Bush tax cuts and, perhaps, the institution of a new tax system. It's a year of opportunity for which one must be alert.

We are going through a hard period, the most difficult in generations in the industry. Change will be welcome. It's here. But determining when that change will turn advantageous is critical. Having the cash flow to weather the downturn and the capital position for the recovery is what we all want. I would welcome the opportunity to speak with each of you regarding your preparation for this period.

It will not be a pleasant period. People are losing jobs, money, homes. The country is ideologically split, at war and is threatened by a number of outside agents: terrorists, Russia, Iran. Our defense department has more than fifty percent of its planes and ships completely disabled for want of repairs. We have lost international respect. Our people expect a living standard three times that of Europe, nine times that of Latin America, twenty times that of Africa. How can we produce sufficiently to maintain that standard? The economy of the future may not mirror that of the past.

President Obama faces Herculean issues as he enters the Presidency. But he is young, well organized—witness his campaign--, a great communicator, a leader. And his initial appointments indicate that he wants to bring us together. His announced stimulus program for the infrastructure appears needed. His dynamism and energy can bring us together as a country and re-engage the economy. Let's pull together as a country. We can believe. Yes, we can.