



### Asset Allocation- Does it Still Work?

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The gyrations in financial markets over the past decade have, for many, created the sense that diversification as an investment concept is no longer useful. Had you invested \$1,000,000 in a diversified basket of stocks, like the S&P 500 at the beginning of 2000 and held for the ten years ending in 2009, you would have been left with \$908,832. The impact of inflation would have reduced the purchasing power to approximately \$726,000, or a real decline of almost 25%. This result is further devastating to the individual who might have been trying to live off of their investment portfolio. If annual distributions of \$50,000 had been taken from the original \$1,000,000 invested in the S&P 500, only \$377,882 would have remained by the end of the period! This very tumultuous decade drove many to abandon the idea of diversification and securities markets altogether in exchange for low yielding “safer” alternatives like CDs and government bonds. The problem with this way of thinking is that diversification isn’t simply owning a basket of different kinds of stocks, but rather different asset classes. By incorporating different types of assets like bonds, commodities, and stocks the end result would have been much better. For example, had you taken the same \$1,000,000 and invested it equally between bonds, commodities and stocks over the ten-year period beginning in 2000 and holding through 2009, you would have ended up with \$1,735,027.\* After the impact of inflation, you would have had the equivalent of \$1,388,021 in purchasing power or an increase of almost 40%. With annual distributions of \$50,000 you would have finished the decade with \$1,091,048 or \$92,048 more than the original principal. Thus, even in an environment that many consider to be the worst since the Great Depression, proper diversification still proved to be a successful tool in growing your assets and protecting your portfolio against the effects of inflation.

Although many experts and advisors understand the benefits of diversification, too many are quick to abandon this and other time-tested strategies when they see the potential for higher possible returns that riskier, more concentrated investment strategies can provide. The problem with these types of higher return strategies is that they invariably have lower probabilities of success and often have tragic results when they fail. Our research also indicates that even over long periods of time, the additional risk taken may only generate small, incremental units of return. At MutualWealth, we continue to focus on diversification as a valuable tool that can give our clients peace of mind during even the most challenging of financial environments. As always, we are appreciative of your confidence in our capabilities and look forward to serving you well into the future.



Shayne Nagy, CTF  
 Senior Vice President  
 Trust and Investments  
 574-273-7612  
 shayne.nagy@bankwithmutual.com

\* As represented by Barclays Aggregate Bond Index, Goldman Sachs Commodities Index and S&P 500.

## 2010 First Half Economic and Market Review

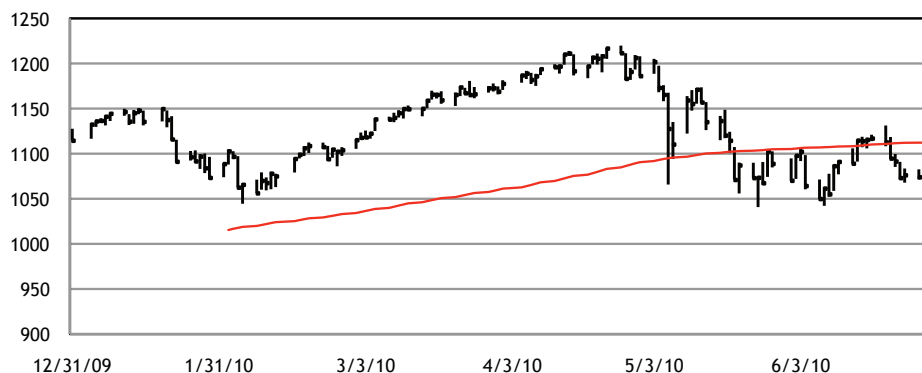
The increase in Gross Domestic Product (GDP) during the last quarter of 2009 was revised downward slightly, but remained at a robust level although the activity was largely due to businesses replenishing inventories. First quarter 2010 GDP growth initially reported at 3.2% and later revised to 2.7% showed more activity in the critical consumer spending category which makes up most of overall GDP.

Through most of the first half, other economic reports lent support to the notion that the economy was recovering at a slow but reasonable pace; however, disappointments continued to occur. Home sales stayed very weak, unemployment remained stubbornly high, and construction indicators, usually strong in the early stages of a recovery, dropped back in May.

Elsewhere in the world, the picture is even more cloudy. The government debt crisis centered in Greece and to a lesser extent in Portugal and Spain threatens to pour over into other European countries restraining global economic growth. The ensuing rush into U.S. Treasury issues has caused a rapid rise in the dollar relative to the Euro and other currencies. This makes U.S. exports more expensive and harms U.S. companies with significant overseas operations, which in turn could dampen GDP growth.

The stock market as measured by the S&P 500 Index started the new year continuing the strong uptrend of 2009, but stumbled early on into a nearly 10% decline by the beginning of February. Many investors simply decided to take some profits after becoming concerned about valuations following the market's 73% rebound from the March 2009 low. The European debt situation, uncertainty over the recovery, future government regulation and taxes added to the nervousness.

S&P 500 Index  
with 200 Day MA



These concerns were quickly eased with the Federal Reserve maintaining low, short-term interest rates and as mostly favorable first quarter corporate earnings were reported. The market resumed its uptrend until late April/early May when the problems in Greece and Europe came to a head, a mysterious trading event took the market down nearly 10% during one day and the oil spill in the Gulf of Mexico occurred. Since then, volatility has increased and the market has continued to weaken. The S&P 500 closed the first half at a new low for the year down -7.57%. Total return on the index which includes reinvested dividends was -6.65%.

All ten sectors of the market were down in the first half. The best performing sector was Industrials with a -1.94% return followed by Consumer Discretionary, -2.28% and Financials, -4.2%. The worst performing sectors were Materials, -13.69% and Energy, -13.16%. In overseas trading, the widely-followed MSCI Europe-Far East-Australian Index dropped 15.86%.

Other asset categories were mixed. Commodities as represented by the Powershares DB Commodity Index ETF fell 12.39%, light crude oil was off 8.36%, gold was up 13.25%, and the Dow Jones Equity Real Estate Total Return Index gained 5.41%.

Bonds are also up this year on average. The Barclays U.S. Bond Aggregate Index returned a positive 5.33% as money streamed into the safe haven of U.S. Treasuries. This action drove dollar denominated bond prices higher which pushed yields lower. The yield on the benchmark 10-year Treasury note dropped from 3.84% to 2.95% year to date.

AA-rated corporate bonds returned an average 4.89% in the first half of the year and municipal bonds 3.31%. GDP Growth will probably remain subdued in the second half due to reduced government stimulus and continuing weakness in the housing market and employment; but with low interest rates, and low inflation, many economists see the probability of a second recession or "double dip" in 2010 unlikely, but not impossible.

The recent volatility in the stock market along with technical indicators have resulted in our adopting a more defensive position in many of our investment models. We remain cautious given the number of macroeconomic and technical headwinds facing global capital markets at present.

David Riggs  
Vice President  
Trust Investment Officer  
765-213-2702  
david.riggs@bankwithmutual.com

## Estate Taxes

Three times in this nation's history a federal death tax has been imposed - only to be repealed shortly thereafter. In each instance, the tax was implemented to provide revenue on a short-term basis to finance military action (1797-1802, 1862-1870, and 1898-1902). With the advent of World War I, the estate tax was reintroduced in 1916 and has existed ever since.

As we reported here six months ago, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) raised the effective estate tax exemption (the value of your assets that can pass estate tax-free to heirs) incrementally from \$1,000,000 in 2002 to \$3.5 million in 2009, while dropping the top tax rate from 55% to 45%. The Act also called for the tax to be completely eliminated in 2010 and then to revert to 55% with a \$1 million exemption in 2011. Because Congress has yet to resolve the issue this year, we are still in limbo as to what estate tax, if any, will be due in 2010. Before year-end, Congress could, 1) Enact legislation retroactively to January 1, 2010 and either extend the 2009 tax rates or enact new rates and exemptions; 2) Enact legislation as of the date of enactment and either extend the 2009 tax rates or enact new rates and exemptions; or, 3) Enact no new legislation, so that we will have to muddle through 2010, and return to 2009 levels next year.

### What if no law is passed in 2010 and there truly is no estate tax?

To complicate matters, assuming the current law stands, there is a different way to calculate how estates will be impacted in 2010. You must start with an understanding of the stepped-up basis rule. Basically, the pre-2010 law increased (or stepped-up) the tax basis of inherited assets, effectively forgiving the tax on appreciation that occurred prior to the owner's death. If stock that someone bought for \$10 was

worth \$100 when he or she died, \$100 became the tax basis for the person who inherited the stock. Tax on the \$90 of appreciation was forgiven and the heir would only owe tax if he or she sold the stock for more than \$100.

As the law now stands for 2010, the stepped-up basis is replaced with carryover basis, but only for some assets. Assets can be stepped up a maximum of \$1.3 million (with an additional \$3 million for assets left to a surviving spouse), which means the tax cannot be forgiven on more than \$4.3 million of market appreciation. Any assets above that amount will pass to heirs with the original owner's tax basis. Using the example above, if you inherit that \$100 stock, your basis would be \$10 and you would owe capital-gains tax on the \$90 of appreciation when you sell it.

Who has to figure out the carryover-basis rules? The executor of your estate does. That individual or corporation will be responsible for deciding which assets get a stepped-up basis and which do not - potentially leading to conflict among heirs and between heirs and the executor. Additionally, the executor must know the basis of the decedent's assets. If you bought stock in 1994 and did not keep records on what you paid for it, the IRS may require your executor to assign a cost basis of ZERO to that asset. Your heirs will then be forced to pay capital gains on the entire value of the stock when they sell it.

### Unintended consequences of estate tax repeal...

As in most legislation, there are unintended consequences, and estate tax repeal is no exception. The elimination of the estate tax may result in confusing the intent of the creator of a trust. Many wills were redrafted in the last decade to take into account the increasing federal estate tax exemption.

Instead of rewriting legal documents every time the exclusion amount changed, or making the documents more specific, clauses were put in to reflect the rising exemption amount. Two commonly worded clauses for estates that leave money in trust could cause problems. If the clause in your document says you leave the applicable exclusion to your offspring in trust and the rest to a spouse, it could mean that you are leaving nothing to your children since there is no applicable exclusion in 2010. On the other hand, if the clause says that you leave the maximum amount in trust that could pass free of federal tax to your children and the rest to a spouse, then the children receive everything and your spouse is disinherited. Indiana has joined a handful of states to address this ambiguity by enacting Senate Bill 65, which applies 2009 Federal Estate Tax laws to wills and trusts that use formula clauses.



We recommend that you discuss documents containing trust language with your attorney and suggest keeping documents as flexible as possible until the final legislation is enacted. We will do our best to keep you informed of future developments concerning the estate tax in this publication.

Martha Wargo Oprea, CTFA  
Vice President  
Fiduciary Compliance  
574-273-7611  
martha.oprea@bankwithmutual.com

## Retirement: How Much Should I Save?

Even if you feel like every dollar is spoken for and you can't afford to put anything aside, investing a small amount of your pay can make a big difference at retirement. Use this worksheet to determine how much you may need to retire in the future. (This information is not intended to represent the return of any specific investment. Actual results will vary.)

### Your monthly retirement goal

	Example	YOU
1. Current gross monthly pay (before tax & deductions)	\$2,500	_____
2. Pay Increase Factor (Enter factor from Table 1.)	3.26	_____
3. Monthly pay at retirement (Multiply line 1 by line 2.)	\$8,150	_____
4. Your percent of pay needed at Retirement (60-100%)	85%	_____
5. Your monthly retirement goal (Multiply line 3 by line 4.)	\$6,928	_____

### Your retirement income sources

6. Current value of all retirement accounts	\$5,000	_____
7. Monthly income factor (Enter factor from Table 2.)	.1669	_____
8. Monthly income at retirement (Multiply line 6 by line 7.)	835	_____
9. Monthly income from Social Security (See Table 3.)	\$3,742	_____
10. Total expected monthly income at retirement (lines 8+9)	\$4,577	_____
(If line 11 is less than line 5, you are short of your goal. If it is zero or negative, congratulations!)		

### Amount you need to save

11. Subtract line 10 from line 5	\$2,351	_____
12. Monthly saving factor (Enter number from Table 4.)	.032	_____
13. Approximate monthly savings amount needed to meet goal (Multiply line 11 by line 12.)	\$75	_____

Table 1: Pay Increase Factor

Age	25	30	35	40	45	50	55	60
Factor	3.26	2.81	2.43	2.09	1.81	1.56	1.34	1.16

Table 2: Monthly Income from Retirement Account

Annual Return	25	30	35	40	45	50	55	60
3%	.0140	.0121	.0104	.0090	.0078	.0067	.0058	.0050
6%	.0546	.0408	.0305	.0228	.0170	.0127	.0095	.0071
9%	.1669	.1085	.0705	.0458	.0298	.0194	.0126	.0082

Table 3: Monthly Income from Social Security

Annual Pay	25	30	35	40	45	50	55	60
\$20,000	2939	2497	2119	1794	1516	1328	1161	979
\$30,000	3742	3185	2705	2293	1939	1700	1486	1254
\$40,000	4544	3872	3292	2792	2362	2070	1811	1528
\$50,000	5347	4560	3879	3291	2785	2442	2135	1802
\$60,000	5948	5040	4266	3606	3045	2665	2329	1964
\$70,000	6324	5363	4541	3840	3243	2838	2481	2090
\$80,000	6701	5686	4816	4074	3441	3012	2633	2211
\$90,000	7077	6007	5091	4308	3636	3183	2782	2323
\$100,000	7425	6283	5318	4485	3781	3310	2884	2391

Table 4: Monthly Savings Needed to Fund Monthly Retirement Income Shortage

Annual Return	25	30	35	40	45	50	55	60
3%	.151	.200	.271	.376	.546	.843	1.466	3.400
6%	.065	.094	.138	.208	.327	.546	1.025	2.560
9%	.032	.051	.083	.139	.238	.434	.884	2.384

If you are a business owner or involved in the management of employee benefit programs, we may be a valuable resource for you. Please contact Tom Mohler, Vice President, Retirement Plan Services. 877-289-0299 or [thomas.mohler@bankwithmutual.com](mailto:thomas.mohler@bankwithmutual.com).