1Q09

THE FSAG ADVISOR

Inside this issue:

Contact us:

Scott J. Munkvold, CFP, CTFA
773.714.1541
sjm@fsadvisorygroup.com

Scot A. Jurczyk, CFA
773.714.1543
saj@fsadvisorygroup.com

Mark C. Soehn
773.714.1542
mcs@fsadvisorygroup.com

Georgeanna Fischetti
312.464.8104
gf@fsadvisorygroup.com

Doug W. Bennington
773.632.4099
dwb@fsadvisorygroup.com

Market & Economic Update

The overall economy remains in difficult shape, a situation that will continue until the Fed and other policymakers can unfreeze the credit markets and help spark a return to a more normal lending environment. In retrospect, it seems clear that some policymakers erred when they focused too heavily on inflation in 2007 and into 2008 when, as it turned out, deflation was the real threat.

Additionally, many underestimated the ripple effect that would be caused by the Lehman Brothers bankruptcy filing, which resulted in a widespread collapse in confidence. Since mid-September, however, governments around the world have acted quickly to ease the pressures facing the credit markets. There are some signs that policy reflation is starting to work. Looking ahead, we will continue to closely watch credit spreads, as well as broader consumer and business confidence surveys and other economic indicators, as a key sign to determine when reflation has taken hold.

From an equity markets perspective, we maintain our view that the bottoming process that began on October 10th continues. We are now in the twelfth week of this process and, as we have been saying for some time, we believe we have at least a couple more months to go. The economic environment remains a challenging one and deflationary pressures present an ongoing risk to equities. Having said that, however, we would also point out that the approximately 50% drop in stock prices does represent a significant discount to that risk. Our view is that, at this point, we do not actually need to see outright signs of economic improvement. A belief among investors that things are no longer getting worse should be enough to spark a cyclical rally. Our sense is that we are getting close to such an environment, and could see such a rally develop in 2009 on the back of continued aggressive policy reflation.

Source: BlackRock (Bob Doll, Vice President and Director)

2008 Returns

DOW	*-31.92%*
S&P 500	*-37.03%*
NASDAQ	*-40.03%*
Russell 2000	*-33.79%*
Mid Cap	*-41.46%*
MSCI EAFE	*-43.38%*
Lehman US Agg	*5.65%*
Lehman Muni.	*-2.85%*
10 Year Treasury Yield	*2.25%*

How Bear Markets End

The last day of a bear market is always the first day of a bull market. Put another way, the day in the bear market when losses are most severe and despair is typically most extreme is also the day in the subsequent bull market when return opportunities are greatest. I don't know whether the November 20th equity market low will ultimately hold, but a new bull run entered the record books with a 21% rally in the S&P 500 as of December 8th.

The drivers: larger-than-expected interest rate cuts globally; the coming fiscal stimulus plan from the Obama administration; exceptionally low cash yields; and the hope that we're sufficiently far enough through the recession to allow a market bottom to form. Volatility diverged from the market recently, too, not breaking out to new highs as the market sold off into the November low … a possible sign of sellers' exhaustion.

Through the end of November, we experienced a very rare event, with the S&P 500 down 30% during three straight months of declines. Looking at the history of the market since its inception, there were only five prior cases where returns were this weak—four during the Great Depression. As you can see on the next page in "Market physics: rebounds have typically followed sharp drops," the market was higher during subsequent periods the vast majority of the time.

Markets have a tendency toward mean-reversion, or in other words, returning to their long-term average performance. Strong historical returns have typically been a signal of low future returns while low historical returns have tended to generate better subsequent returns. However, a plunging stock market has meant that investors who have naturally shied away from rebalancing (or have moved out of the market altogether) are now much less exposed to equities than they were at the market's top last year.

In fact, according to Hewitt Associates, the proportion of 401(k) plans invested in equities was at an all-time low of 53.8% as of October, compared with 74.2% at the market's high in 2000. Indeed, many investors were overexposed to stocks in early 2000 … and they may be underexposed today.

The November jobs report was

Continued on page 2

A Registered Investment Advisory Firm
Financial Solutions Advisory Group

How Bear Markets End *Continued from page 1*

Market Physics: Rebounds Have Typically Followed Sharp Drops

S&P 500 Loss of Greater Than 30% During a 3-Month Period							
		Cumulative Return in Months After a 3-Month Decline					
Date	3-Month Decline	3 Months	6 Months	9 Months	12 Months	18 Months	24 Months
11/30/29	–34.03%	11.3%	17.1%	2.2%	–20.8%	–37.8%	–54.6%
5/31/32	–46.08%	87.7%	46.5%	26.6%	115.7%	121.0%	115.0%
6/30/32	–39.40%	82.4%	55.5%	32.1%	146.3%	128.0%	121.4%
11/30/37	–30.74%	2.1%	–16.6%	8.6%	14.6%	4.4%	9.8%
11/30/87	–30.17%	16.3%	13.8%	13.6%	18.8%	39.2%	50.2%
	Average	39.9%	23.3%	16.6%	54.9%	51.0%	48.4%
	Median	16.3%	17.1%	13.6%	18.8%	39.2%	50.2%
	Percentage up[1]	100%	80%	100%	80%	80%	80%

Source: Ned Davis Research. Losses occurred over a three-month period with all months down.

horrendous—a drop in payrolls of 533,000. Much is being made of the fact that it was the single worst month since December 1974. But we should always look at economic statistics in percentage, not absolute terms. As shocking as a drop of a half-million jobs is for one single month, it's actually only the 41st-worst month for job losses in history based on percentage of the working population. Overall, 1.9 million jobs have been lost since the recession began, equal to 1.4% of the total payroll count. That's below four of the past five recessions—and all of them if the early 1980s back-to-back recessions are considered as one. During the 1973–1975 and 1981–1982 recessions, the peak was 2.7%.

It also may be instructive (or at least interesting) to discover that when the December 1974 jobs report was announced in January 1975 (three months before the recession ended), the market had already found its bear-market low (in October), from which it rose 53% during the following nine months.

Fast forward to the brutal 1981–1982 recession: The peak month for job losses was July 1982, which was reported in August (also three months before the recession ended). July was the month when the market bottomed, proceeding to enjoy a 62% bull run during the following 14 months.

Looking at the jobs data collectively, The Leuthold Group found that when nonfarm payrolls fell more than 0.9% year over year, there was a good chance the stock market was at or near its cyclical low (see below). This was the case in eight of the past nine recession-related bear markets. November 2008 payrolls have fallen 1.35% year over year.

Along with the extreme recent weakness in the stock market has come extreme strength in U.S. Treasury prices (as yields have plunged), thanks to the rampant risk-aversion prevalent among investors today.

But remember, at times of extreme investor pessimism like today, the public has historically proven wrong. Money market mutual funds relative to the total market value of all U.S. stocks hit a record high at the end of October (and will surely be higher once November's data is reported). When discounting this record liquidity for paltry yields, we see a compelling story of cash sitting on the sidelines. Once the mood shifts, we believe the flow back to equities could be dramatic.

It's already clear that investors have been doing a little bottom-fishing lately, with the most beaten-down, lowest-valuation names performing best from November 20th through December 7th, according to Bespoke Investment Group (B.I.G.). It's also noteworthy that the stocks with the highest institutional ownership were also the best performers, indicating that perhaps hedge funds, mutual funds and other institutions have been getting back into the market—a sign that the deleveraging process could finally be easing.

We've often noted that this bear market, with its wild swings, could bring sharp rallies at any time. So far, they haven't been of the sustainable variety, but we see new hope in a series of contrarian signals.

Dropping below the November 20th low would only exaggerate the unprecedented fact that 67% of the overall decline has occurred in the last quartile of this bear market (see "Bear markets are end-loaded" table below). But remember the market's tendency on the upside, too.

According to Leuthold, in the Dow's 22 bull markets since 1900, price gains in the first three months have averaged more than 18%, with a median gain of 14%. One year after a bear market low, the gains are 46% and 41%, respectively. Most telling: The median first-year gain is nearly half the 84% median total bull market gain since 1900.

I'm not one to try to call bottoms—and no one knows what the next weeks may hold—but it's useful to note how bear markets typically end. The economy is not healthy, but bull rallies have often come when the news seems most dire. That said, we should heed the warning of 1930s, when multiple bull rallies played out within a bear market. Still, even then, the average bull run saw a gain of nearly 62% for the S&P 500 during 177 days, according to B.I.G.

So, be mindful of complacency...but here's to a better 2009 ...we hope.

Source: Liz Ann Sonders, Senior Vice President, Chief Investment Strategist, Charles Schwab & Co., Inc..

Your Assets Are Safe

In the most recent bad news from Wall Street, Bernard Madoff, former NASDAQ Stock Market chairman and founder of Bernard L. Madoff Investment Securities LLC, was arrested and charged with securities fraud.

What did he do? He allegedly collected money to invest from clients, made up false statements to show they were doing well, and used new clients' money to pay interest and withdrawals to existing clients. This is known as a Ponzi scheme and is estimated to involve more than a $50 billion loss for his investors.

His clients didn't see this coming. Could they have? Let's look at some key safety tips that would have prevented this from happening.

Use an independent custodian.
Madoff held his client assets, managed them, and priced them, too. See the conflicts of interest? Investment performance can look better if the prices reported to clients are manipulated, which is allegedly how Madoff showed winning year after winning year despite market turmoil.

At our firm, our clients have an independent third party, Schwab Institutional, pricing each investment they own. We have no input on investment pricing, and that separation is a very good thing. Clients also get an independent statement directly from Schwab.

Check on insurance.
Our clients benefit from fraud insurance. The first part is Securities Investor Protection Corporation (SIPC) coverage for $500,000 per account. Then, at Schwab Institutional, there is an additional $149.5 million per account from London insurers. Fraud insurance does not protect against market declines; but it does protect against theft of securities and/or related fraudulent transactions.

One final thought—if an investment sounds too good to be true, it probably is. Reportedly, Madoff claimed consistent annual returns of 10-12% with little volatility and no annual losses. Can you name any legitimate investor who can make that claim in recent years?

This is one of several recent high-profile cases of advisors and/or managers absconding with funds entrusted to them by their clients. Due to the amount of publicity given to these stories, I recognize that some of you, and your friends and neighbors, may reasonably ask themselves: "I trust you, I trust my advisor, but what if I'm wrong? I don't want to be the victim statistic 20 years from now."

So how are our clients protected from their advisor stealing their funds? The primary line of protection is the fact that we use an independent custodian to hold client funds. It is the custodian's responsibility to keep client funds safe. The only power we have over those accounts is as follows:

- To make trades in the account
- To receive copies of monthly statements, tax documents and trade confirmations
- To deduct our fees directly from the account

Each client receives statements directly from Schwab Institutional, confirming the location and safety of the assets.

We have worked hard to build the trust and confidence of our clients. We have communicated time and again that this isn't something we take for granted. One of the ways that we can demonstrate this is to structure our relationships so that your assets are protected from theft.

Source: Bob Veres E-Column: Words of Reassurance

Charts of Interest: Long-Term Returns and Bear Market Cycles

20-Year Annualized Returns

Bear Market Cycles vs. Subsequent Bull Runs

Market Peak	Market Low	Bear Return	Length of Decline	Bull Run	Bull Run Length	Yrs to Reach Prev. Peak
5/29/46	5/19/47	-28.6%	12	257.6%	122	3.1 yrs
7/15/57	10/22/57	-20.7%	3	86.4%	50	0.9 yrs
12/12/61	6/26/62	-28.0%	6	79.8%	44	1.2 yrs
2/9/66	10/7/66	-22.2%	8	48.0%	26	0.6 yrs
11/29/68	5/26/70	-36.1%	18	74.2%	31	1.8 yrs
1/5/73	10/3/74	-48.4%	21	125.6%	74	5.8 yrs
11/28/80	8/12/82	-27.1%	20	228.8%	60	0.2 yrs
8/25/87	12/4/87	-33.5%	3	582.1%	148	1.6 yrs
3/24/00	10/9/02	-49.1%	31	101.5%	60**	4.6 yrs
Average:		**-32.6%**	**14 mo's**	**176.0%**	**68 mo's**	**2.2 yrs**

Source: Standard & Poor's, FTSE, MSCI Inc., Nymex, Barclays Capital Inc., NAR, EcoWin, JPMorgan Asset Management.

A Registered Investment Advisory Firm
Financial Solutions Advisory Group

ETF in the News: ProShares UltraShort Barclays 20+ Year Treasury Fund (TBT)

Key Statistics: TBT	
Price	*$39.00*
Expense Ratio	*0.95%*

The ProShares UltraShort Barclays 20+ Year Treasury Fund (TBT) seeks daily investment results, before fees and expenses and interest income earned on cash and financial instruments, that correspond to twice (200%) the inverse of the daily performance of the Barclays 20+ Year U.S. Treasury Index. That means that when the Barclays 20+ Year U.S. Treasury Index is down 10% for the day, this fund should be up 20%, and vice versa.

Bear Case

- We expect a period of deflation to last for the next several quarters. This could extend the rally in the Treasury bond market.
- As the recession deepens, investors appetite for risk could remain nonexistent.
- Because leveraged and short-sale funds exchange shares for cash instead of securities, they do not have the tax efficiency benefits of a normal ETF.

Bull Case

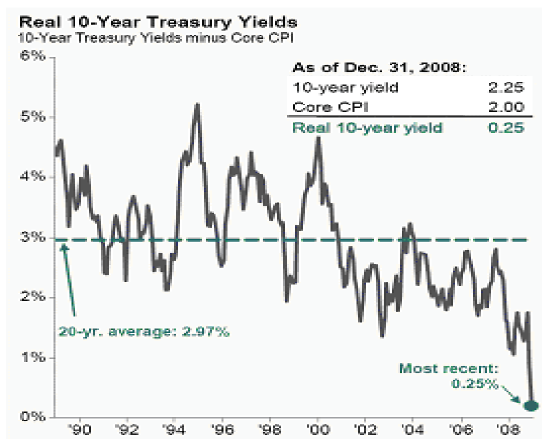
- Treasury rates are at 70-year lows right now, meaning that prices are at 70-year highs.
- This fund provides an easy way for investors to gain double-inverse exposure to the long-dated U.S. Treasury market.

We think the frenzied safe haven buying of treasuries has come to an end. And here's why:

1. A-grade corporate debt demand has jumped dramatically. At what is often talked about as the "October 10 lows," investors didn't just leave the stock market; they also left company debt. In fact, they left A-grade Wal-Mart and Procter & Gamble-like debt. At that time, the iShares Investment Grade Bond Fund (LQD) traded at 80. Ten weeks later, LQD is trading 20% higher. Of course, it isn't just the 20% capital appreciation in corporate debt that's impressive here. It's the fact that it is trading near the 100 price point that it historically traded at before the Lehman bankruptcy and Fannie/Freddie failure. What's more, the 5% annual yield paid monthly is going to keep pushing LQD up to the 110 level, as any yield above 4% will be seen as attractive. And that money will likely come out of treasuries.

2. In the past, any VIX spike above 30 was a sign of irrational fear. For the last 90 consecutive days, however, the VIX has traded between 30 and 89, breaking record highs and ushering in a new era of heightened "scared-to-death-ness." All that said, the VIX is well below its 50-day moving average. What's more, intra-day price swings have declined substantially each month since October. In other words, treasury overdrive may be wearing a bit thin.

3. The bear market itself may be getting long in the tooth. But stocks still have serious detractors. The possibility of a multi-year recession, as opposed to a "hoped-for" late 2009 recovery, may keep stocks in relative check. Some of the efforts of the central banks/governments around the world will take hold, encouraging a bit of risk taking activity. That means money will come out of treasuries and go somewhere. Whether it's A-grade debt, foreign bonds, emerging bonds, preferred debt, convertible debt. In other words, the money does not have to flow into stocks for the ProShares Ultra-Short Barclays 20+ Year Treasury Fund (TBT) to thrive; it just has to leave U.S. treasuries and we believe that it will.



Sources: ETFExpert.com, Morningstar, JP Morgan

2009 Required Minimum Distributions (RMDs)

Congress approved legislation that includes a one-year suspension of the required minimum distributions for 2009 for taxpayers who are 70 1/2 and older.

The legislation, H.R. 7327, the Worker, Retiree, and Employer Recovery Act of 2008, passed the Senate by unanimous consent on December 12, 2008, and is expected to be signed by the President.

Under the provision, no minimum distribution is required for calendar year 2009 from individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans. The next required minimum distribution would be for calendar year 2010. This relief applies to life-time distributions to employees and IRA owners and after-death distributions to beneficiaries.

Source: FPA Tax Advisory

At Financial Solutions Advisory Group, you'll find a fee-only Registered Investment Advisor (RIA) committed to putting your interests and your needs first, eliminating the commissions and self-serving incentives that get in the way of solid, successful financial planning and investment management.

Please contact us if you would like to receive this publication by e-mail.

8700 W. Bryn Mawr Ave.
Suite 410-N
Chicago, Illinois 60631
773.714.1540 *Main*
773.714.1550 *Facsimile*
fs@fsadvisorygroup.com
www.fsadvisorygroup.com