Review, Outlook and Opinion October, 2009

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Updated Web Site – If you're interested in learning more about investments and financial planning matters, check out our new updated web site www.walkerfinancial.com We have a lot of new articles, information and calculators to assist you in becoming more financially aware. In the future, we are planning to activate a new "Advisor Vault" which would be a password protected area where you would go to view your quarterly statement.

Investment & Market Analysis – Stocks, bonds, and gold all moved higher last quarter and we were fortunate to own all three in many accounts which lead to an above average net gain of 9.89% for the three months, and 16.20% year-to-date across all client accounts. Individual returns will vary based on risk tolerance and specific holdings. Moving forward, given the current low interest rate slow-growth environment, we are expecting more moderate returns with our conservative balanced approach. Stock markets worldwide continue to show strength, but future gains will hinge on earnings growth generated from top-line revenue gains, since costs have already been cut to the bone. The U.S. unemployment rate is now at 9.8% as manufacturing jobs have moved overseas, and technology has allowed companies to increase productivity with fewer workers. The emerging markets continue to be the big story, especially the BRIC countries of Brazil, Russia, India, and China. These markets are extremely volatile and have had a huge run, so we are patiently waiting for a pull back to increase our exposure. Our largest international position continues to be in the Matthews Asia Growth & Income Fund (MACSX) with over 50% invested in China/Hong Kong, Singapore, and South Korea. The Matthews organization specializes in the Southeast Asia region, and this fund buys dividend-paying equities and convertible securities to smooth out the ride.

A big positive for the domestic market is the Federal Open Market Committee has indicated they intend to keep short-term interest rates targeted at 0 – 0.25% and will continue to purchase mortgage-backed securities in an effort to assist financial institutions and stimulate economic activity. This has left money market and CD buyers wilting on the vine, while it has been party time for stock and bond holders. Bond funds have been experiencing record monthly inflows from yield starved investors who are still wary of stocks. Municipalities and corporations are taking advantage of the low interest rates and issuing new bonds to meet the voracious demand for interest-bearing securities. So far the credit markets have not choked on the torrent of new supply, as steady demand has pushed yields lower and prices of existing bonds higher. The Fed has a delicate balancing act between keeping the monetary spigot open and continuing to pump liquidity into the system, and timing their exit strategy correctly to avoid over stimulation with inflationary consequences.

Equities – We like to own dividend-paying blue chip stocks from different industries. These titans of American industry receive a significant portion of sales from outside the United States and represent a way to play the growing emerging market consumer demand for U.S. branded products, and a potentially weaker U.S. dollar. Historically, over one-half of the total return from stocks has come from their quarterly dividends. The best companies strive to increase their dividends each year as earnings grow, producing an inflation-adjusted income stream. We also like to see a company buying in their shares as opposed to issuing more.

Our largest holdings include Proctor & Gamble (PG) in consumer staples, 3.0% yield. Johnson & Johnson (JNJ) for diversified health care exposure, 3.2% yield. Chevron Corp. (CVX) as a global integrated energy play, 3.9% yield. These companies all have a significant foreign revenue component which will benefit from a weaker U.S. dollar. We are carefully watching the developments in the utility industry, as Exelon (EXC), 4.2% yield and FPL Group (FPL), 3.5% yield have been weak recently.

Beware of common stocks with dividend yields over twice the rate of the 10-year Treasury bond, current yield 3.2%. A dividend yield over 6% can be a red flag that a cut is coming. Dividend cuts are not well received in the marketplace, so after a cut is announced and the stock has been hammered we get interested. General Electric (GE), yield 2.5%, and the big money center banks would qualify as turnaround situations in this area.

We believe that prospects for the technology industry are very favorable, but that share prices are overextended at this time. Google (GOOG) continues to be the king of search, maps, and internet advertising. The company just announced that Verizon will join T-Mobile in carrying their Android smart phones. Qualcomm (QCOM) is our top wireless pick as they move forward with 4G products. 4G refers to the fourth generation of cellular wireless and is expected to provide voice, data, and streamed video at much higher data rates compared to previous generations.

Bonds – There's sunshine and blue skies in bond land these days, but there is danger lurking down the road for long maturity bonds due to the threat of higher interest rates a year or two down the road. This interest rate risk and potential principal erosion is most pronounced in bonds maturing in 15-30 years, so we are positioned mainly in the short to intermediate part of the yield curve. Deficit spending and a growing national debt are not a recipe for lower long-term interest rates.

We split our bond money between individual issues and bond funds for the best of both worlds. Individual bonds have a set maturity date when our principal is returned and we know for sure what our income will be from the bond coupon. We will buy new issue bonds and also find bargains on the secondary market. Bond funds provide more diversified exposure with monthly dividends and are easy to convert to cash at the prevailing share price. Our lowest risk bond fund is the Vanguard Short-Term Investment Grade Bond Fund (VFSTX), 3.5% yield. The lead manager has been at the helm since 1983, and after stumbling last year has rebounded strongly with top quartile performance this year. Another shorter maturity fund we have recently started purchasing is the Metropolitan West Low Duration Bond Fund (MWLDX), 4.5% yield. This fund has more mortgage-backed securities exposure where pricing is still more reasonable.

Market History – Stocks have now posted seven consecutive months of gains, and the S&P 500 is now 20% above its 200-day moving average for the first time since 1983, a staggering turnaround for a benchmark that just six months ago was slumping 20% below this same average. Such sharp swerves between extremes have been seen just three times before, in 1932, 1938, and 1975. Each time, the overbought market would pull back an average 12.2% three months later before recovering to notch one-year gains averaging 13.3%. History never repeats exactly, but given the recent oversized gains, we are cautious at this point and have recently taken some profits by selling some higher risk positions.

Golden Refinance Opportunity – We are now seeing a conforming (up to $417,000) mortgage rate for a 15-year fixed rate loan at 4.25%, with no points. Your interest rate will be higher with a 30-year note, but still below 5%. This is an excellent time to lock in a rate and refinance a loan, or leverage into real estate for those able to qualify for financing. We typically recommend paying extra principal each month to shorten the remaining term, thereby saving significant interest costs over the life of the loan.

Tax-Free Income – A Roth IRA account is something every young person should have, and is also appropriate for many of us middle-aged savers. IRA's come in two varieties, traditional and Roth. Many taxpayers would prefer to have a Roth, but they've been prevented by law from contributing to one. Restrictions on conversions will loosen up in January, when income caps are removed. Benefits of a Roth IRA include:

- Tax-free income. Once you've had a Roth IRA for five years, all distributions from it are tax-free as long as you are at least 59 ½ years old. Regular distributions from a traditional IRA are taxable, and vulnerable to any increase in tax rates.
- No required minimum distributions (RMDs). Regardless of age, you won't have to withdraw anything from your Roth IRA if you don't need the money.
- No income cap. Through 2009, you can't convert a traditional IRA to a Roth IRA if your modified adjusted gross income is more than $100,000. As of 2010, the income cap will be eliminated, so anyone will be allowed to convert.
- Special loophole. For conversions made in 2010 only, the resulting taxable income can be divided equally between 2011 and 2012. Alternatively, you can choose to report the full amount in 2010, when tax rates may be lower.

Who is a good candidate to convert to a Roth? Someone in a low tax bracket who is worried about steep future tax increases, and wants to prepay income tax now at the current rates. If you think you might benefit from a partial or full Roth conversion, please contact us and we would be happy to coordinate with your tax advisor for a more thorough analysis.

Statement Upgrades – Last quarter, we uploaded your cost basis information to Schwab which you will now find reflected on your monthly Schwab statement. In addition, we have modified your quarterly portfolio statement from our office to provide more user friendly data.

Thanks for your continued trust and confidence. We are working hard to continue to earn it.
October 8, 2009